

HOW TO MONITOR THE INSIDER TRADING

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Abstract

It is widely acknowledged that financial trading should be sured public, equal and fair. Nevertheless, some people working for financial industry make full use of its special status or opportunity disclosing some inside information to achieve the purpose of avoiding loss or in other words, gaining profit. We call this kind of behavior insider trading. It will infringe upon the investor's rights to know and property rights. What's worse, insider trading will make the forming process of stock price index lose effectiveness and objectivity, even disappoint the investors so that the stock market would fail to be the barometer of the national economy and optimize the allocation of resources. Hence, how to monitor the insider trading effectively has become a shared concern between countries all over the world. This paper will discuss from four aspects in detail: In Part One, I will introduce the component elements and the influence of insider dealing; In Part two, I will concentrate on analyzing current supervision of insider trading from three perspectives ;next, the measure will be told in detail in the third part. Based on all the discussion above, I will give the conclusion at last.

Keywords: Insider trading, Insider information, Regulatory and monitoring arrangements, Stock market

INTRODUCTION

Insider trading

The Insider

The insider is the person who holds the stock of the issuer, or in the position of a director, supervisor, or senior management personnel in the company that has a close relationship with the issuer, even the company of the issuer itself. Also, if the person can obtain or get in touch with some critical information due to its membership, management, the regulatory and

occupation status, or as the issuer's employees and professional consultants, we can call them the insider.

Specifically, the following categories of people can be called (Securities Law of the People's Republic of China in 2014 Amendment, Order No. 14 of the President of the People's Republic of China.):

- 1) The directors, supervisors, senior management personnel, a secretary, a typist, and other who obtain or get in touch with the critical information by performing their duties;
- 2) The issuer's lawyer, accountants, asset appraisal personnel, investment advisers and other professionals;
- 3) The person who can use their certain management power upon the issuer according to the laws and regulations[Article 74th of Securities Law of the People's Republic of China (2014 Amendment), Order No. 14 of the President of the People's Republic of China], including the supervision department of the stock and Stock Exchange staff, the competent department of the issuer and the examination and approval authority, industry and commerce, taxation and other relevant economic administrative organ staff etc.;
- 4) Some jobs and occupations that may obtain the insider information because the connection status, occupation personnel, including journalists, editors, radio host and arranging printing personnel etc.

Thus, constitute insider, its essence lies in whether or not one can obtain or get in touch with some critical information through legal means, not limited to the internal staff. Non-company internal personnel including the relatives, friends or other who can get the insider information through trading staff can be defined as the insider as well.

Insider information

Insider information is the premise for the existence of insider trading; it is also a key factor for insider trading. Therefore, how to define the insider information has become the key of monitoring insider trading. During the activities of securities trading, the non-public information relating to a company's operations, financial or have a significant impact on the company's securities market price is insider information[Article 75th of Securities Law of the People's Republic of China (2014 Amendment), Order No. 14 of the President of the People's Republic of China].Accordingly, the insider information should have four characteristics: (1) it must be non - public information, which is yet to be known by the investors, also did not enter the public domain; (2) the content must be exact, i.e., the information must be with the real basis, rather than rumors; (3) it must be price-sensitive information which could have a significant impact on

the price of the stock market or the decisions of investors; (4) it must be relevant with a particular issuer's securities or a certain securities.

Although the law is very clear, there are still a lot of difficulties in confirming whether the information is insider or not. So the specific analysis will be made in Current Situation part below.

Insider trading behavior

Insider trading can be divided into three categories [Article 76th of Securities Law of the People's Republic of China (2014 Amendment), Order No. 14 of the President of the People's Republic of China]:

- 1) The trade using insider information, including the insider directly using insider information to trade, or sale stocks by borrowing other's name and account.
- 2) The trade happened because of disclosed insider information. That means the insider divulge the insider information to the third person, helping him with trade or telling information to the public.
- 3) Insider use inside information to suggest others to buy or sell securities, such as providing advice or recommendations to the third person.

The influence of insider trading

Insider trading scandal would scare off many investors and exert serious influence on the function of securities market. At the same time, the forming process of stock price index will lose effectiveness and objectivity and insider trading makes it become one of the results of few people's speculation, instead of the one that made by public based on company performance evaluation. Thus, the insider trading will eventually cause the stock market losing the function to optimize the allocation of resources and fail to be the barometer of the national economy (Csrc.gov.cn, 2009).

CURRENT SUPERVISION OF INSIDER TRADING

Lack of insider trading investigation

As we know, the clues of insider trading case derived from two aspects: one is the news media reports and the masses reports; the other is the abnormal trading condition reported by securities exchange. Here the abnormal trading situation refers to first, stock prices have a large amplitude wave in a short term. Second, the particular transaction subject buys or sells a certain stock in the short term. In reality, the stock market has a lot of abnormal transaction every day, if

there is someone suspected insider trading of a particular stock, these will react to China Securities Regulatory Commission[CSRC].

However, because of limited manpower, the CSRC cannot investigate many practical cases. Even some cases have been investigated, few of them would be convicted. In this environment, the tremendous gains of insider trading give insiders the courage to defy the existing law.

Liability regulation is unspecific

Although the revision of Securities Law which first regulates civil liability and the victim can require civil claims could be regarded as a big breakthrough, it only says that losses caused by insider trading should be liable for compensation. This kind of regulations is not specific enough to carry out.

Due to the leakage of Securities Law in civil liability system, Securities Law is not able to adequately exert the protection the legitimate rights and interests of small investors, deter violations, standard the aim and function of securities market development. As a result, our stock market is lack of a self-development, self-improvement system.

Weak punishment

Since Article 202nd of the revised Securities Law of the People's Republic of China (2014 Amendment) [Order No. 14 of the President of the People's Republic of China] prescribes insider trading punishment, the problem is: first, the civil fine of insider trading is based on the illegal income, not including the avoidance of loss. That has weakened the punishment; second, for non-illegal income situation of administrative fine, the maximum amount is only 600 thousand Yuan, which shows the illegal cost is too low, the lack of proper deterrent. Third. The provisions of the Securities Law are not applicable to the specific provisions of Criminal Law of the People's Republic of China. On the one hand, it is the problem of two departments of law, that is some insider trading behavior, which is in Securities Law, is not available or has no specific rules in Criminal Law. On the other hand, the Criminal Law itself is lack of quantitative standard so that it is difficult to operate in the criminal lawsuit practice.

MEASURES

As I have said in the front part, the insider trading has a lot of harmful influence, however, the measures to monitor it are extremely absence. How to monitor the insider trading must be the most significant part I have to focus on. In my part, the following measures should be taken:

External environment

Improve public supervision

Strengthening the supervision consciousness of public investors. First of all, improve the public investors' professional knowledge of securities, correct their education of investment philosophy and cultivate them to supervise market behavior, driving them actively to safeguard their own rights and interests of the master. Secondly, further perfect the securities civil lawsuit system, in order to facilitate the investors through various legal channels to correct behavior that damaged their interests in securities market. Third, pay attention to complaints that people report, the establishment and operation of civil rights groups should be consciously encouraged, strengthen the legal aid work of this kind of proceedings for the minority investors. Some experts suggest that we can learn from foreign experience (News.xinhuanet.com, 2013), try to reward system. For a mature market, rewarding the reporters played an important role in the fight against stock market irregularities in these years. In 2010 the United States raised the reward prize from 10% of the total fine to 30% of that to strengthen the reporting system, which have got a good effect.

Perfect the system of Securities Law

1) Set up specialized investigation institution

We can learn from the British system, establish specialized agencies to investigate abnormal transaction in stock market. The UK obeys the separation principle of investigation and punishment that the specific investigation of insider trading cases is the executive department of Financial Service Authority (FSA), then throughout the investigations, FSA will propose punishment suggestions to the Committee. FSA is considered to be the most powerful financial regulators in the world. In spite of the nature of FSA is private association, its operating funds comes from membership's fee, but in fact it completely does not belong to the self-discipline organization, directors of FSA are appointed directly by the British Ministry of finance, so the internal management has obvious administrative nature. The FSA has a quasi reconnaissance right, which can require or order the relevant personnel to submit information in different stages of the survey.

2) More perfect laws and regulations should be published

Although in 2014, the latest revised Securities Law of the People's Republic of China [Order No. 14 of the President of the People's Republic of China] has substantial changes and further developments to adapt the actual China's stock market on the basis of the one published in 1998 [Securities Law of the People's Republic of China,(Adopted at the 6th Meeting of the Standing Committee of the Ninth National People's Congress on December 29, 1998)] in the

prevention of insider trading and market manipulation, it still exists a lot of shortage. For instance, the definition of the subject of insider trading is not comprehensive enough, such as insider's relatives or retired insiders should be included in the scope of the subject as well. A new authorization clause about the insider that 'other people regulated by Securities Regulatory Authority under the State Council' has been added, but no other explanation about what kind of staff it actually refers to.

Therefore, it is necessary to learn the advanced theories and methods of supervision on the insider dealing and the judicial practice from developed countries actively based on the existing legal system in China. As what I have analyzed before, the insider should be defined as a more open and generalized range while for insider trading and market manipulation and other securities violations, we can borrow inversion of burden of proof system (Cnstock.com, 2007) by the United States, namely, the burden of proof is shifted for defense etc. In addition, the legislative process of related laws such as Insider Trading Law, the Minority Investor Protection Law should accelerate. Regardless of fighting against insider trading, maintaining the rights and interests of investors or improving the efficiency of stock market regulatory action, the judicial discretion needs a solid legal basis for support.

3) Increase the intensity of punishment

We can draw lessons from the related system in America. On the one hand, increase the administrative punishment of insider trading; on the other hand, continue to amend the Criminal Law. Criminal Law, coordinated with Securities Law, plays an important role in criminal punishment of insider trading. In addition, from the aspects of legal interpretation, make a clear quantitative standard of 'serious criminal' in Article 180th of Criminal Law of the People's Republic of China, increasing the intensity of enforcement. The following aspects can make a reference: first, the illegal transaction reaches a certain amount, generally about the 200 thousand Yuan; second, the perpetrator conducted insider trading more than once; third, the case causes an abnormal wave of trading price; fourth, the one with adverse social impact; fifth, using multiple users or aliases in insider trading in order to evade supervision. Finally, detail the sentencing to enhance the applicability of the provisions of the criminal law.

Strengthen the management of listed corporation

1) Establish basic criterion for the management of listed corporation and regulate the operation of the general meeting of shareholders, board of directors and the board of supervisors. To guide and urge the listed corporation to improve the governance structure, strengthen its internal control system. Especially we should optimize the quality of large state-

owned listed corporation, changing its current ownership structure through the ways of reducing state-owned shares, dispersing of ownership reasonably.

2) Strict information disclosure system. Article 63rd of Securities Law of the People's Republic of China (2014 Amendment) [Order No. 14 of the President of the People's Republic of China] expanded the scope of the information disclosure to 'in accordance with the law, disclosure of information' based on the original Article 59th [Securities Law of the People's Republic of China, Order No. 43 (2005)]. Also, a content of 'the company's actual controller should be disclosed in the annual report of the listed corporation' was added in 66th. These rules of information disclosure all contributes to strictly regulate the behavior of issuers and listed corporation, easing information asymmetry of the stock market and enhancing its transparency.

3) Improve the provisions of the sponsor system. Article 11st and 49th [Securities Law of the People's Republic of China (2014 Amendment)] respectively stipulated that if publisher issue convertible bond or issue the stock taking the way of underwriting for listed transactions, he should hire an institution with the qualification of recommendation as sponsors, submitting listing recommendation to the stock exchange by sponsors, and at the same time, the sponsor should obey the duties of honesty and trustworthy, diligence and responsibility. The system ensures the listing Corporation quality from the source and safeguards the public interest of investors.

4) Enhance the independent director system of the company. First of all, the qualification of independent directors should be examined by social feedback information of CSRC and confirmed in a unified way. Finally, the listed company shall vote for a most suitable candidate for their own development needs. This process is fair, effective and open to ensure the maximum independence of directors. Secondly, strengthen the legal responsibility of independent directors to urge them conscientiousness.

Internal supervision system

Build effective supervision for CSRC

We suggest that the China Securities Regulatory Commission (CSRC) be responsible to the National People's Congress directly, and accept regular assessment and supervision of the relevant functional departments, such as Finance Committee, the Legislation Committee. In addition, we may establish the 'complaint center of law enforcement', to ensure the complaint and feedback information transparent.

Establish the scientific supervision concept

International organization of Securities Commissions (IOSCO) points out that, to protect investors, to ensure a fair, effective and transparent market and to reduce system risk are three

major goals of securities industry regulation. Our securities supervision should also be treaded as a strategic goal: respect regulation of the market mechanism, prevent daily operation from redundant administrative power interfere, pay attention to the legitimacy of the regulation on market behavior, be committed to creating and maintaining a fair, efficient and transparent investment environment, and protect the interest of investors.

Exert the advantage of self-regulatory supervision institution

Stock exchange is the closest institution to the stock market, which can carry out real-time monitoring of securities trading and has a low cost of supervision with strong flexibility and high efficiency. The effect of self-discipline organization in securities industry is an association not only in the internal industry but also between the industry and the society. It has obvious advantages of preventing vicious competition and improving industry norms and the social reputation degree.

Reflect functions of the securities intermediary institutions

Securities intermediary is actually the first barrier to protect the authenticity, accuracy and integrity of information disclosure, in other words, it is "night watchman" to protect the interests of investors, who plays an important role in promoting the healthy development of the capital market. Strengthening the management of intermediary service agencies in accordance with the law and the education of professional ethics for its employees, requiring diligence and integrity to fulfill its duties, is the effective way to impel it to play the supervisory role of the securities market.

CONCLUSION

Since the appearance of securities market, insider trading exists everywhere. With the development of securities market, due to the immaturity of supervision system, the number of insider trading cases has been growing rapidly, thus insider trading has become a common problem that every stock market need to face. In this paper, through exploring how the insider trading is defined, analyzing the practical situation of our country's current law supervision, it propose several suggestions to perfect regulation of insider trading in securities market. For external environment, public awareness should be increased, not only the media, but also everyone who witnesses the case. The most critical aspect of supervision is the soundness of securities law system so that a solid foundation of justice could be laid. Another effective method is to strengthen the management of listed companies. As for internal part, all kinds of institutions such as CSRC, self-regulatory supervision institutions and even intermediary

institutions should exert different advantages, providing help to ensure the development of capital market healthy and fast.

To summarize, only when the government strengthen and improve the market supervision, timely prevent and defuse financial risks and optimize the traditional innovation mechanism, the rights and interest of investors would be protected while the market would be public and fair as well. In the future, the possible research could contain the related topics in the area of trading, securities market, while more and more supervision will be talked about.

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