

THE REGULATION OF INSIDER TRADING IN SOUTH AFRICA

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SUMMARY

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LIST OF ABBREVIATIONS

DMA	Directorate of Market Abuse
JSE	Johannesburg Stock Exchange
SENS	Stock Exchange News Service

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Chapter 1:

1.1 Introduction

Since the late 1990s, South Africa had legislation in place to combat some insider trading and market abuse activities. Given the inherent complexities and flaws in detecting, prosecuting and preventing insider trading, it comes to no surprise that there have been various changes to the legislation regulating insider trading since it was made illegal. The enforcement and prosecuting of such legislation remains problematic.

Before insider trading became illegal worldwide, there was a long debate as to why it is important to have preventative measures in place to prevent insider trading within the marketplace. Public companies¹ can raise capital by offering their shares to the general public for trading on a regulated market², for example the Johannesburg Stock Exchange. The shareholders of these public companies can then freely trade with their shares by purchasing or selling existing shares on a stock market such as the Johannesburg Stock Exchange.

Any price changes of the shares acquired by shareholder are important, because it will have an effect (increase or decrease) on the value of their shares. Therefore accurately priced shares provide valuable information to investors or shareholders, who is dealing for their own account and benefit on stock markets. The importance of accurately priced shares, lies in the stimulation of supply and demand for those shares for example: a high demand triggered by the recent success or popularity of a listed company will increase the price of the shares. However, the opposite will also affect the share price negatively, for example: if there is financial strain or reported fraud within the company the shareholders will prefer to sell their shares as soon as possible, before the value of their

¹ The Companies Act 71 of 2008 defines a "Public company" as a profit company that is not a state-owned company, a private company or a personal liability company.

² The Financial Markets Act 19 of 2012 defines regulated market as any market, domestic or foreign, which is regulated in terms of the laws of the country in which the market conducts business as a market for dealing in securities listed on that market.

shares decreases. The potential capital gain and loss in share prices of listed companies can be distributed between current shareholders, wishing to sell their shares, and new shareholders buying the shares on a regulated stock exchange market. Shareholders will gain an unfair advantage over other shareholders if they have access to price sensitive information³, which they know that it can have an impact on the values of their shares, and deals accordingly to their own benefit, before publication of the information to the rest of the public. The abuse of inside information⁴, by an insider, for the purpose of personal gain, or avoiding a loss to the expense and disadvantage of other shareholders, became a very common malpractice over the past few decades. The importance in regulating market abuse and insider trading activities lies in the encouragement of potential investors to invest in these markets and to increase the public's confidence in regulated markets. Buyers and sellers of shares relies on management to create a sustainable company with secure cash flows and prosperous asset growth, which will create a higher demand for the shares and effectively increase the value of the shares.

South Africa passed various laws to combat the abuse of inside information and regulatory bodies are statutorily tasked to oversee the regulation of insider trading. The Financial Markets Act, 19 of 2012⁵ came into force on 3 June 2013 and is currently regulating the abuse of inside information in South Africa and will be discussed in Chapter 3 and Chapter 2 will discuss previous legislation attempts to combat insider trading.

³ The Johannesburg Stock Exchange Listing Requirements defines price sensitive information as unpublished information that, if it were made public, would reasonably be likely to have an effect on the price of a listed company's securities.

⁴ The Financial Markets Act 19 of 2012 defines "inside information" as specific or precise information, which has not been made public and which - (a) is obtained or learned as an insider; and (b) if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market.

⁵ Hereafter the Financial Markets Act of 2012.

1.2 The research problem

The object is to analyse and reveal the flaws in the previous legislation which was intended to prevent insider trading. This dissertation will firstly investigate former legislation which regulated insider trading in South Africa; secondly, present and evaluate the development of the legislation preventing insider trading in South Africa; and lastly, present and evaluate the capacities of the current regulating bodies of insider trading in South Africa. This research is intended to provide an updated review of the current legislation and provides a broad description on the roles which the regulating bodies plays in combating insider trading. The current functions of these regulating bodies will be considered to conclude if enough is being done from a legislative and corporate governance point of view to prevent insider trading in South Africa and why the enforcement and prosecuting of such legislation remains problematic.

1.3 The overview of the study

Chapter 1: Introduction of insider trading and highlights the importance of regulating inside information in a trading environment.

Chapter 2: Provides the historical background of legislative developments regulating insider trading.

Chapter 3: Provides an overview of the current legislation and regulating bodies regulating insider trading in South Africa.

Chapter 4: Concludes the dissertation and highlights the changes required to reduce market abuse offences.

Chapter 2: The statutory development of insider trading in South Africa

2.1 Introduction

Over the last few decades South Africa followed suit with various other leading investing countries to develop a legal framework for prohibiting insider trading activities. South Africa has a rich history of trial and error statutory changes to prevent these insider trading offences. Insider trading was never considered as a statutory offence in South Africa until the enactment of the Companies Act 61 of 1973. This chapter will provide a historical and chronological overview of the development of legislation which object is to identify and penalise unlawful acts of insider trading in South Africa. The various laws prohibiting insider trading will not be discussed in detail, however, the focus will be on the changes of the definitions of insider trading, defences on insider trading and a comparison of the extent of the penalties for such offences.

2.2 The Companies Amendment Act 46 of 1952

The first piece of legislation which can indirectly relate to restricting insider trading can be traced back to 1952, when section 70 was introduced in the Companies Act 46 of 1926.⁶ Section 70 dealt indirectly with insider trading but did not condemn insider trading at all. Section 70 provided that every company should keep a register of shares. This register should record the number, description and amount of shares or debentures held by all directors, and record any changes of such holdings together with the date and price or other considerations.⁷ This provision only required that the company records the trading of shares by the directors, however, it did not place any fiduciary duties⁸ on potential

⁶ By the Companies Amendment Act 46 of 1952.

⁷ Contemporary Company Law, 937.

⁸ The common law prescribed that once a person accepts appointment as a director, he becomes a fiduciary in relation to the company and is obliged to display the utmost good faith towards the company and in his dealings on its behalf. Section 76 of the Companies Act 71 of 2008 partially codified the

insiders like certain officers and staff who might have had access to the records of the company. The amendment was ineffective and on the recommendation of the Van Wyk de Vries Commission new provisions were enacted in the Companies Act 61 of 1973.

The State President of the Republic of South Africa appointed a Commission of Enquiry on 14 October 1968 under the chairmanship of Justice Jan van Wyk de Vries to evaluate and recommend any statutory amendments required in the laws regulating companies.⁹ The 1973 Companies Act (and the current 2008 Companies Act which we continue to use today) emerged from the Van Wyk de Vries Report. The Van Wyk de Vries Report was of the belief that a company suffers no harm itself as a result of insider trading but that sellers and buyers of shares of that company might be impacted negatively and can suffer harm. In *Percival vs Wright*¹⁰ it was held that a director of a company has no general fiduciary duty to a shareholder, however a duty of disclosure is required under the general law of contract. The Van Wyk de Vries Report pointed out that in the case of listed shares, the parties (the buyers or sellers) to the transaction are mostly anonymous and it is deemed impossible to identify the parties and therefore concluded that insider trading in the case of listed shares should be made an offence with a substantial penalty for offenders.¹¹ The Van Wyk de Vries Report recommended that directors should be prohibited in dealing in listed shares of the company to which it holds office or its associated companies.¹² The recommendations of the Van Wyk de Vries Report were adopted in the Companies Act 61 of 1973, making this the first legislation prohibiting

common law fiduciary duties of directors which requires that directors exercise and perform their duties in good faith and for proper purpose in the best interests of the company, and with the degree of care, skill and diligence that may be reasonably expected of a person in carrying out the same function in relation to a company as carried out by a director, and having the general knowledge, skill and experience of that director, which is an objective test.

⁹ Commission of Enquiry into the Companies Act Main Report (RP 45 of 1970), hereinafter referred to as the "Van Wyk de Vries Report".

¹⁰ (1902) 2 Ch 421 (ChD).

¹¹ Van Wyk de Vries Report Paragraph 44.54.

¹² Van Wyk de Vries Report Paragraph 44.43.

insider trading in South Africa directly, however, it did not prohibit directors from dealing in the shares of their company in its entirety, only if they had access to price sensitive information.

2.3 Companies Act 61 of 1973

Section 233 of the Companies Act 61 of 1973 read in conjunction with sections 224¹³, 229¹⁴, 230¹⁵, 231¹⁶, 232¹⁷, and 441¹⁸ was the first statutory attempt to prevent insider trading in South Africa.

Section 233 of the Companies Act 61 of 1973 made insider dealing in all shares (and not only listed shares as per the recommendation of the Van Wyk de Vries Report) an offence.¹⁹

The Companies Act 61 of 1973 only provided for a criminal sanction, which burden of proof requires that guilt should be proved beyond reasonable doubt. It lacked civil and administrative sanctions which requires a lesser burden of proof, for example proving that the defendant violated the relevant provisions on a balance of probabilities.

¹³ Section 224, prohibited directors from dealing in options in respect of listed shares and debentures of the company or its subsidiary or holding company or a subsidiary of its holding company.

¹⁴ Section 229 defined interest, officer, past director, person, shares and debentures of the company.

¹⁵ Section 230, required that every public company having a share capital to keep a register of interests of directors and others in shares and debentures of the company.

¹⁶ Section 231, required the directors of a company to determine by resolution which officers of the company, whose names had not already been entered in the register under section 230, and are to be considered to have access to inside information to be entered into the register.

¹⁷ Section 232, inter alia, obliged directors, past directors, officers and certain persons to lodge written notice with the company within a specified period regarding changes in any material interest in their shareholding in the company concerned.

¹⁸ Section 441(1)(b) provided that the criminal penalties for contravening Section 233 was a maximum fine of R8 000.00 or two years' imprisonment, or both such fine and imprisonment.

¹⁹ Section 233 provided that every director, past director, officer or person who has knowledge of any information concerning a transaction or proposed transaction of the company or of the affairs of the company which, if it becomes publicly known, may be expected materially to affect the price of the shares or debentures of the company and who deals in any way to his advantage, directly or indirectly, in such shares or debentures while such information has not been publicly announced on a stock exchange or in a newspaper or through the medium of the radio or television, shall be guilty of an offence.

Section 233 was considered ineffective to combat insider trading efficiently in many ways. For example, it did not require the expiring of a reasonable period after the publication of the price-sensitive information before an insider may trade. This still gave the insider the privilege to trade immediately after the announcement of price-sensitive information, but before the information can have an effect on share prices. The price-sensitive information concerned was only limited to certain events²⁰ and only a limited category of persons were considered as insiders, no provisions were made for scenarios where individuals were tipped off or know that they were in possession of inside information.

The Companies Act 61 of 1973 did not result in any prosecution and it was soon realised that new provisions would have to be adopted to combat insider trading. In a further attempt section 224 and sections 229-233 were repealed by section 6 of the Companies Amendment Act 78 of 1989 which became effective from 1 February 1991²¹.

2.4 Companies Amendment Act 78 of 1989

In 1989 the Securities Regulation Panel was established and mandated to issue legislation regulating insider trading. Subsequently sections 229-233 of the Companies Act 61 of 1973 was repealed and replaced by new provisions in terms of section 6 of the Companies Amendment Act 78 of 1989.

The new provisions regulating insider trading prevailed in the Companies Amendment Act 78 of 1989 and the Companies Second Amendment Act 69 of 1990. Section 440F of the Companies Amendment Act 78 of 1989 provided that:

- “(1) any person who, directly or indirectly, in connection with the purchase or sale of any security –
- (a) employs any device, scheme or artifice to defraud any person;
 - (b) makes any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or
 - (c) engages in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, shall be guilty of an offence.

²⁰ A transaction or proposed transaction of the company or of the affairs of the company.

²¹ In terms of Government Notice R10 Government Gazette 12997.

- (2) Any action specified in paragraph (a), (b) or (c) of subsection (1) includes –
- (a) any director, past director or officer of a company or any person connected with a company having knowledge of any information likely, when published, to affect the price of securities of that company, dealing, except for the proper performance of the functions attaching to his position with that company, in such securities before the expiration of a period of not less than 24 hours after such information has been publicly announced for the first time on a stock exchange or in a newspaper or through the medium of the radio or television or by any other means;
 - (b) any other person, having directly or indirectly received from any person mentioned in paragraph (a) such information, so dealing, on the basis of such information, in such securities at a time when the said person mentioned in paragraph (a) may in terms of that subsection not so deal in such securities.
- (3) Any person who contravenes subsection (1), or subsection (2) as applied by subsection (1), shall, subject to any defence that may be available to him, be liable to any person for any loss or damage suffered by him as a result of such contravention.
- (4) The provisions of this section shall not apply to dealings in members' interests in close corporations."

This section of the Companies Amendment Act 78 of 1989 was based on American legislation.²² It was subject to substantial criticism and was never enforced due to the fact that it still had the same limitations of the former legislation²³ and it adopted American legal principles and concepts with limited relevance to South Africa. Securing convictions for insider trading under the Companies Amendment Act 78 of 1989 remained challenging evidenced by the minimal success in prosecuting insider trading cases.

2.5 King Task Group

The Policy Board for Financial Services and Regulation, on request from the Minister of Finance, mandated the King Task Group in September 1995 to review the existing insider trading legislation contained in the Companies Act, 61 of 1973, under the chairmanship of Mr Mervin King. Members of the Task Group included representatives of the

²² Rule 10b-5 promulgated by the Securities Exchange Commission and section 10 (b) of the Securities Exchange Act of 1934.

²³ It also did not provide a comprehensive description of an insider or insider trading.

Johannesburg Stock Exchange, the South African Futures Exchange, and the Bond Exchange of South Africa, the Financial Services Board, the Securities Regulation Panel, the South African Reserve Bank, the Department of Finance, the Life Office's Association, the South African Institute of Chartered Accountants and the Council of South African Banks.²⁴ In May 1997 the King Task Group released their draft report with a summary of their work and the proposed draft of legislative changes as suggested by the majority of the Task Group.²⁵ In their report the King Task Group suggested the incorporation of a complete separate act to specifically govern insider trading practices. They also recommended the introduction of civil penalties for insider trading, in addition to possible criminal sanctions. They stated the following in their report:

“It was well known that there has not been one prosecution for alleged insider trading in the RSA since prohibition against insider trading was first introduced into our law in 1973 by the Companies Act, 61 of 1973;

In the context of the RSA's re-integration into the international financial markets and the Government's desire to create an environment conducive to foreign investment, there was justified concern over the adequacy of the existing insider trading regulations in the RSA;”

Subsequently the Insider Trading Act 135 of 1998 was incorporated and will be discussed next.

2.6 The Insider Trading Act 135 of 1998

The Insider Trading Act 135 of 1998²⁶ came into effect on 17 January 1999. The Insider Trading Act revealed a new sanctions regime based on criminal and civil liability for insider trading. The Insider Trading Act established the a regulating body called the Insider Trading Directorate²⁷ consisting of senior lawyers and market professionals. The Insider Trading Directorate were mandated to institute any civil proceedings of insider

²⁴ Memorandum on the objects of the Insider Trading Bill, 1998

²⁵ The King Task Group reviewed the feedback and responses received at another meeting on 30 July 1997 and submitted the final report and draft legislation at the Task Group meeting held on 23 September 1997 and published their final report on 21 October 1997.

²⁶ The Insider Trading Act.

²⁷ See Section 12 of the Insider Trading Act.

trading cases and enforced actions on behalf of the Financial Services Board. The Insider Trading Directorate operated between 1999 and 2005 and was substituted by the Directorate of Market Abuse thereafter. The Insider Trading Directorate utilised civil enforcement actions extensively to pursue insider trading activities and was reasonably effective in adjudicating insider trading cases.

As per the recommendation of the King Task Group, the Insider Trading Act made provision for civil liability and provided for a penalties payable by the guilty insiders.²⁸ The Insider Trading Act provided that any individual who knew that he or she had inside information, and deals directly or indirectly for his or her own account in the securities, and made a profit or avoided a loss through dealing and fails to prove, on a balance of probabilities, any one of the defences²⁹ available, was liable to pay to the Financial Services Board the following penalties:

- a) The amount by which the individual profited, or the loss which he or she avoided as a result of such dealing;
- b) A penalty, for compensatory or punitive purposes, in a sum determined in the discretion of the court but not exceeding three times the amount of the profit gained or the loss avoided as a result of such dealing;
- c) Interest; and
- d) Costs of suit on such scale as may be determined by the court.

The Insider Trading Act definition of an insider was not extensive enough to include information obtained from other external sources or juristic persons. The Insider Trading Act defined an 'insider' as:

- a) an individual who has inside information through being a director, employee or shareholder of an issuer of securities or financial instruments to which the inside information relates; or
- b) who has access to such information by virtue of his employment, office or profession; or

²⁸ See Section 6 of the Insider Trading Act.

²⁹ See Section 4(1) of the Insider Trading Act.

- c) who knew that the direct or indirect source of the inside information was a director, employee or shareholder of an issuer of securities.³⁰

This definition is ambiguous because the source of information was limited to employees, officers and directors directly linked and employed by the company. Disclosures originating from other external sources for example price-sensitive information which was leaked unintentionally by insiders were excluded in this definition. The Final King Report of 1997 deliberated that both criminal and civil offences of insider trading should be limited to individual persons only and not to juristic persons.³¹ Inside information was defined as specific or precise information which has not been made public and which is obtained or learned as an insider; and if it were made public would be likely to have a material effect on the price or value of any securities or financial instrument.³² Neither of the terms 'specific' or 'precise' was defined in the Insider Trading Act leaving it to the courts to interpret.

Knowledge that they knew that they were in possession of inside information was a requirement for criminal liability under the Insider Trading Act, therefore individuals were only liable if they knew that they had inside information.³³ To prove beyond reasonable doubt that an accused was aware and had knowledge, that he or she was in possession of inside information could be very challenging to prove. However, the Insider Trading Act provided for civil liability which requires a lessor burden of proof than criminal liability.

³⁰ Section 1 of the Insider Trading Act.

³¹ The 1997 Final King Report in par 3.1.2.

³² Section 1 of the Insider Trading Act.

³³ Section 2 of the Insider Trading Act 135 of 1998 stated that any individual who knows that he or she has inside information and who deals directly or indirectly, for his or her own account or for any other person, in the securities or financial instruments to which such information relates or which are likely to be affected by it or encourages or causes another person to deal or discourages or stops another person from dealing in the securities or financial instruments to which such information relates or which are likely to be affected by it or any individual who knows that he or she has inside information and who discloses that information to another person, shall be guilty of an offence.

The Insider Trading Act provided the following offences which alleged insiders could use to prove themselves not guilty of insider trading:

1. An individual was not regarded as guilty if such individual can prove on a balance of probability that he or she was acting on specific instructions from a client, save where the inside information was disclosed to him or her by that client, would have acted in the same manner even without the inside information or if the individual was acting on behalf of a public-sector body and if the individual was acting in pursuit of the completion or implementation of an affected transaction;
2. If an individual believed on reasonable grounds that no person would deal in the securities or financial instruments as a result of such disclosure;
3. If the individual disclosed the inside information in the proper performance of the functioning of his or her employment, office or profession and at the same time disclosed that the information was inside information.³⁴

Based on the Insider Trading Act's provisions, an individual convicted of an insider trading offence could be penalised to pay the Financial Services Board a fine up to (but not exceeding) R2 million, or be sentenced to imprisoned for a period not exceeding ten years, or both a fine and imprisonment.³⁵ The accused could be held responsible for the payment of the amount by which the person profited from the insider trading, or the loss which he or she avoided as a result of such dealings and furthermore, pay a discretionary penalty determined by the court.³⁶ The Financial Services Board was entitled to prosecute by way of civil proceedings in any court with competent jurisdiction.

2.7 Securities Services Act 36 of 2004

The Insider Trading Act was replaced by the Securities Services Act 36 of 2004³⁷ which came into operation on 1 February 2005. The Securities Services Act repealed various

³⁴ Section 4 of the Insider Trading Act.

³⁵ Section 5 of the Insider Trading Act.

³⁶ Not exceeding three times the amount of the profit gained or the loss avoided as a result of such dealing.

³⁷ Hereinafter refer to as 'The Security Services Act'.

other Acts³⁸ and consolidated them into one act. The Securities Service Act aimed to increase the confidence in the South African financial markets by delivering securities services³⁹ in a fair, efficient and transparent manner to promote the protection of regulated persons and establish a stable and favourable environment.⁴⁰ The provisions of the Security Services Act broadened the scope of offences relating to insider trading by prohibiting three kinds of offences namely dealing, encouraging or discouraging dealing in securities, and the improper disclosure of insider information. Another step in the right direction for the Security Services Act was to extend criminal and civil liability to juristic persons, partnerships and trusts by defining an insider as a person who has insider information and not just an individual.⁴¹ Section 2 of the Interpretation Act 33 of 1957 defines a 'person' as:

- a) "any divisional council, municipal council, village management board, or like authority;
- b) any company incorporated or registered as such under any law; and
- c) any body of persons incorporated or unincorporated."

Section 72 of the Securities Services Act defined an insider as:

- a) "A person who has inside information –
- b) Through being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates; or
- c) having access to such information by virtue of employment, office or profession; or

³⁸ The Security Services Act repealed the Stock Exchanges Control Act of 1985, the Financial Markets Control Act of 1989, the Custody and Administration of Securities Act of 1992 and the Insider Trading Act of 1998.

³⁹ In terms of s 1 of the Security Services Act, securities services are services provided in respect of –

- (a) the buying and selling of securities;
- (b) the custody and administration of securities;
- (c) the management of securities by an authorised user;
- (d) the clearing of transactions in listed securities; and
- (e) the settlement of transactions in listed securities.

⁴⁰ See Section 2 of the Security Services Act.

⁴¹ The Insider Trading Act defined an Insider as an 'individual who has inside information' which limited the application only to natural persons.

d) where such person knows that the direct or indirect source of the information was a person contemplated in paragraph (a).”

Therefore, an insider is a person holding a specific office or position who has insider information and has acquired that information through his or her position, or who has acquired the information from a person whom he or she knows is an insider.

The Securities Services Act defined inside information as specific or precise information, which has not been made public and which is obtained or learned as an insider and if it were made public would be likely to have a material effect on the price or value of any security listed on a regulated market.⁴² This definition removes the requirement that the inside information originated from a contractual relationship which increased the ambit of an insider, however it does not make provision for information obtained through espionage, theft, bribery or fraud like section 440F(1) of the 1973 Companies Act did. The Securities Services Act also did not provide a definition of what might be regarded as specific or precise information. Proving insider trading offences were even more difficult, as it should be proved that the information which the alleged insider received was specific or precise with regards to the trading of the securities. If a company pursues the acquisition of a competitor, it can be regarded that the information is specific; however, it will not be regarded as precise because the name of the competitor or exact date of the acquisition is unknown. If the exact date and identification of the competitor was also known, it could be considered as specific and precise information. However, the alleged insider should understand the specifics and materiality of the insider information when he deals with the securities, and knows that the information has not yet been made public. Unlike its predecessors both the Insider Trading Act⁴³ and Securities Services Act⁴⁴ attempted to clarify when the price-sensitive information can be regarded as been made public.

⁴² See Section 72 of Security Services Act.

⁴³ See Section 3 of the Insider Trading Act.

⁴⁴ See Section 74 of the Securities Services Act.

The Securities Services Act introduced the following four circumstances where the information shall be considered as been made public:

- 1) “when the information is published in accordance with the rules of the relevant regulated market⁴⁵ for the purpose of informing clients and their professional advisers;
- 2) when the information is contained in records which by virtue of any enactment are open to inspection by the public;
- 3) when the information can be readily acquired by those likely to deal in any listed securities –
 - a) to which the information relates; or
 - b) of an issuer to which the information relates; or
 - c) when the information is derived from information which has been made public.”

It was however noted that it was not limited to the above-mentioned events. Section 74(1)(a) allows for dealing in securities the moment when the information is published, therefore the market does not have to respond to the information after publication before trading may proceed.

Section 74(2) provided an even wider definition of the publication of information:

- a) “It can be acquired only by persons exercising diligence or observation, or having expertise;
- b) It is communicated only on a payment of a fee; or
- c) It is only published outside the Republic.”

Section 74(2) implies that information does not need to be freely available to the public in South Africa; it will be regarded as having been made public even though it was only published to persons paying certain subscription fees for the information or living abroad of South Africa.

As mentioned earlier the Security and Services Act prohibited three kinds of offences⁴⁶ namely dealing, encouraging or discouraging dealing in securities, and improper

⁴⁵ Section 72 defines regulated market as ‘any market, whether domestic or foreign, which is regulated in terms of the laws of the country in which the market conducts business as a market for dealing in securities listed on that market’.

⁴⁶ See Sections 73 of the Security Services Act.

disclosure of insider information. It also made it an offence for any person who knew that he or she has inside information, to encourage or cause another person to deal, or to discourage or stop a person from dealing in securities or financial instruments to which the information relates or which are likely to be affected by it. Furthermore, it was also considered an offence for any person who knew that he or she has inside information to encourage or cause another person to deal, or to discourage or stop a person from dealing in securities or financial instruments, to which the information relates, or which are likely to be affected by it.

The Securities Services Act provided for the following two defences for alleged insiders⁴⁷:

1. If the accused was acting in pursuit of the completion of an affected transaction as defined in section 440A of the Companies Act of 1973 liability can be avoided if he can prove it on a balance of probability; or
2. If an accused can prove that he or she only became an insider after he or she had been given the instruction to deal, and the instruction was not changed in any manner after he or she became an insider.

The Insider Trading Act provided a wider defence than the above, whereas it was a defence that he or she would have acted in the same manner even without the inside information.⁴⁸ Therefore, a person in financial distress, who has price-sensitive information, and is actually motivated to sell his securities in order to pay demanding creditors, would have been covered by the Insider Trading Act offence, but not by the Securities Services Act offences.

The penalties for offences of the Security Services Act were excessively higher than those of the Insider Trading Act. A person who commits an offence of the Securities Services Act is liable on conviction for a fine not exceeding R50 million or imprisonment for a period

⁴⁷ See Section 73(1)(b) of the Securities Services Act.

⁴⁸ Section 4(1)(b) of the Insider Trading Act of 1998

not exceeding 10 years, or both, whereas the Insider Trading Act provided for a fine not exceeding R2 million or imprisonment for a period not exceeding 10 years, or both. As a result, only the High Court or a Regional Court had jurisdiction to adjudicate any of the offences of the Securities Services Act.

In *Pather and Another v Financial Services Board*⁴⁹ the Enforcement Committee found that Pather and AH-Vest contravened section 76(1) of the Securities Services Act by making false, deceptive and misleading statements and imposed an administrative penalty. Pather and AH-Vest challenged the constitutionality of the Enforcement Committee proceedings and argued that because the finding of the Enforcement Committee is similar to a finding of criminal guilt, the standard of proof should be beyond reasonable doubt, rather than the civil standard, which is proof on a balance of probabilities. The Supreme Court of Appeal dismissed their argument.

⁴⁹ 2018 (1) SA 161 (SCA); [2017] 4 All SA 666 (SCA)

Chapter 3: Overview of current legislation and bodies regulating insider trading

3.1 The Financial Markets Act

The Financial Markets Act was approved by the President on 30 January 2013 and came into effect on 3 June 2013.⁵⁰ The Financial Markets Act repealed the Securities Services Act entirety. The object of the Financial Markets Act is essentially to ensure that the trading in South African financial markets are fair, efficient and transparent which will produce more confidence in the South African financial markets. If the Financial Markets Act can reduce systemic risk⁵¹ in the trading of securities on a regulated market, it will succeed in gaining confidence in the South African financial markets and securities.⁵²

In terms of the Financial Markets Act, insider trading occurs where a person who knows that he or she is in possession of inside information and deals in that security directly or indirectly.⁵³ The definition of securities⁵⁴ of the Financial Markets Act are similar to the

⁵⁰ In terms of Government Gazette number 36485 of 31 May 2013.

⁵¹ The risk of collapse of an entire financial system or entire market.

⁵² See Section 2 of the Financial Markets Act.

⁵³ See Section 78 of the Financial Markets Act.

⁵⁴ In terms of the Financial Markets Act securities means -

“(a) listed and unlisted-

- (i) shares, depository receipts and other equivalent equities in public companies, other than shares in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980);
- (ii) debentures, and bonds issued by public companies, public state-owned enterprises, the South African Reserve Bank and the Government of the Republic of South Africa;
- (iii) derivative instruments;
- (iv) notes;
- (v) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), and units or any other form of participation in a foreign collective investment scheme approved by the Registrar of Collective Investment Schemes in terms of section 65 of that Act; and

definition of the Security Services Act, however the Financial Markets Act went further and expanded the definition of securities to include listed and unlisted shares, depository receipts and other equivalent equities in public companies.

The Financial Markets Act defined an 'insider'⁵⁵ as a person who has inside information as a result of his or her role as director, officer, employee or shareholder of an issuer of securities listed on a regulated market, or who has access to such information by virtue of employment, office or profession, or where such person knows that the direct or indirect source of the information was an insider.

The potential insiders is not only limited to directors, officers, employees and advisers, but they can also include companies indirectly involved with the company. Therefore media and publication companies employed to compile and produce confidential information, annual reports, newspaper advertisements announcing company results, cautionary announcements and other price-sensitive notices can also be considered as insiders.

In terms of the Financial Markets Act⁵⁶ inside information is specific or precise information that has not been made public and which is obtained or learned as an insider, and if it were made public would be likely to have a material effect on the price or value of any security listed on a regulated market. Like its predecessors, the Financial Markets Act also does not define what constitutes specific or precise information. The High Court of South Africa deliberated in detail on what constitutes specific and precise information during the hearing of the *Zietsman v Directorate of Market Abuse*.⁵⁷ It was noted that the Financial Services and Markets Act 2000⁵⁸ of the United Kingdom, which regulates the

(vi) instruments based on an index;

⁵⁵ Section 77 of the Financial Markets Act

⁵⁶ Section 77 of the Financial Markets Act

⁵⁷ *Zietsman and Another v Directorate of Market Abuse and Another* (A679/14) (2015) ZAGPPHC 651; 2016 (1) SA 218 (GP) hereinafter refer to as *Zietsman v Directorate of Market Abuse*.

⁵⁸ Section 118C(5)

misuse of non-public price sensitive information suggested that "precise" information must:

- (i) indicate that circumstances exist or that an event has occurred (or may reasonably be expected to come into existence or occur); and
- (ii) be specific enough to enable a conclusion to be drawn as to the "possible effect" of those circumstances, or that event on the price of the relevant investments.

However, in the Upper Tribunal case of *David Massey v the Financial Services Authority*⁵⁹ the tribunal held that the second element of the definition "specific enough" introduces a strong note of definiteness, which is far removed from the second part of the definition (as to the possible effect on the price). It does not require a conclusion as to the actual or probable effect on the price, but only as to the possible effect, and does not stipulate on how precise the conclusion needs to be. This was also found in the case of *Ian Charles Hannam v The Financial Conduct Authority*.⁶⁰ In this case the Upper Tribunal held that, for information to meet the second part of the precise test mentioned above, one would need to be able to draw a conclusion to the possible direction of the price movement, up or down. It can be argued that to draw a conclusion that there will be a movement in price, cannot be considered precise enough, because it is still not certain if the direction will be for the better or for the worse. The Europe court held in the *Jean-Bernard Lafonta v Autorité des Marchés Financiers*⁶¹ that in order for information to be regarded as being of a precise nature for the purpose of those provisions, it need not be possible to infer from that information, with a sufficient degree of probability, that, once it is made public, its potential effect on the prices of the financial instruments concerned will be in a particular direction. In the Singaporean matter of *Public Prosecutor v G Choudhury*, the term "specific information", as referred to in its insider trading legislation, was held to refer to information which has an existence of its own which is quite apart from the operation of any process of deduction. The "specific information" must be capable of being pointed

⁵⁹ *David Massey v Financial Services Authority*. (2011) UKUT 49 (TCC).

⁶⁰ *Ian Charles Hannam v The Financial Conduct Authority* [2014] UKUT 0233 (TCC).

⁶¹ Case C-628/143

to and identified, and had to be capable of being expressed clearly.⁶² In the *Zietsman v Directorate of Market Abuse* case it was noted that one must be sensitive to the differences in wording of provisions in foreign case laws when comparing them with South African Law because the principles emerging from foreign case law confirms universally accepted propositions regarding insider trading and should be determined by South African courts on a case-by-case basis. The appellants contended that the information alleged to be insider information was not specific or precise as the loan agreement had not yet been finalised and signed at the time of the alleged dealing in the securities. Given the comparison of the various foreign cases, the court held that for information to be specific or precise, it does not require the circumstances or event to which it relates to be in its final form. Information relating to circumstances or an event in an intermediate phase could still be regarded as specific and precise and constitute inside information. The Court held that sufficient information of the approval of the loan had been communicated to render the information as specific and precise.

The Financial Markets Act did not include such an extensive list of circumstances where information shall be considered as been made public like its predecessor, the Security Services Act.⁶³ Information is regarded as been made public in the following circumstances:⁶⁴

1. when the information is published in accordance with the rules of the relevant regulated market. It did not repeat the second part of the Security Services Act (“for the purpose of informing clients and their professional advisers) which limited the intension of the publication only clients and their advisors;

⁶² This was determined in the *Zietsman v Directorate of Market Abuse* 2016 1 SA 218 (GP) 1, herein after referred to as *Zietsman v Directorate of Market Abuse*. See also Morajane “What constitutes inside information for purposes of insider trading? *Zietsman v Directorate of Market Abuse* 2016 1 SA 218 (GP)” 2017 *THRHR* 506.

⁶³ Section 74 of the Securities Services Act.

⁶⁴ Section 79 of the Financial Markets Act.

2. when the information is contained in records which by virtue of any enactment are open to inspection by the public;⁶⁵
3. when the information can be readily acquired by those likely to deal in any listed securities—
 - a) to which the information relates; or
 - b) of an issuer to which the information relates; or
4. when the information is derived from information which has been made public.

Section 74(2) of the Securities Service Act was not repeated in the Financial Markets Act.⁶⁶ The emphasis is thus placed on the fact that information need to be freely available and open for inspection and readily acquirable by any person. If expertise and diligence in obtaining and accessing the published information is required, then the information is not regarded as been made public.

The Financial Markets Act retained the offences of the Securities Services Act, however the Financial Markets Act extended the ambit of the offences by adding the trading on behalf of a third party, while suspecting that the third party was an insider, as a fifth offence. The Financial Markets Act⁶⁷ provides for the following five offences⁶⁸ of insider trading:

- “1. An insider who knows that he or she has inside information and who deals directly or indirectly or through an agent for his or her own account in securities listed on a regulated market to which the inside information relates or which are likely to be affected by it, commits an offence. However the person is not guilty if he or she—

⁶⁵ See Jooste “The regulation of insider trading in South Africa – Another attempt” 2000 *SA Merc LJ* 284 for discussion on meaning of “by virtue test”.

⁶⁶ Information can be considered as made public if it can be acquired only by persons exercising diligence or observation, or having expertise it is communicated only on a payment of a fee; or if it is only published outside the Republic.

⁶⁷ Section 78 of the Financial Markets Act.

⁶⁸ All the defences of Section 78 of the Financial Markets Act requires to be proved on a balance of probability.

- (i) only became an insider after they had given the instruction to deal to an authorised user and the instruction was not changed in any manner after he or she became an insider; or
 - (ii) was acting in pursuit of a transaction in respect of which—
 - (aa) all the parties to the transaction had possession of the same inside information;
 - (bb) trading was limited to the parties referred to in subparagraph (aa); and
 - (cc) the transaction was not aimed at securing a benefit from exposure to movement in the price of the security, or a related security, resulting from the inside information.
1. An insider who knows that he or she has inside information and who deals, directly or indirectly or through an agent for any other person in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it, commits an offence. However the person is not guilty if it can be proved that he or she—
- (i) is an authorised user and was acting on specific instructions from a client, and did not know that the client was an insider at the time;
 - (ii) only became an insider after he or she had given the instruction to deal to an authorised user and the instruction was not changed in any manner after he or she became an insider; or
 - (iii) was acting in pursuit of a transaction in respect of which—
 - (aa) all the parties to the transaction had possession of the same inside information;
 - (bb) trading was limited to the parties referred to in subparagraph (aa); and
 - (cc) the transaction was not aimed at securing a benefit from exposure to movement in the price of the security, or a related security, resulting from the inside information.
3. Any person who deals for an insider directly or indirectly or through an agent in the securities listed on a regulated market to which the inside information possessed by the insider relates or which are likely to be affected by it, who knew that such person is an insider, commits an offence. However a person is not guilty if the person on whose behalf the dealing was done had any of the defences available to him or her as set out in subsection (2)(b)(ii) and (iii).
4. An insider who knows that he or she has inside information and who discloses the inside information to another person, commits an offence. However the person is not guilty if such insider proves on a balance of probabilities that he or she disclosed the inside information because it was necessary to do so for the purpose of the proper performance of the functions of his or her employment, office or profession in circumstances unrelated to dealing in any

security listed on a regulated market and that he or she at the same time disclosed that the information was inside information.

5. An insider who knows that he or she has inside information and who encourages or causes another person to deal or discourages or stops another person from dealing in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it, commits an offence.”

Both the Security Services Act and Financial Markets Act placed emphases that insiders are both criminally⁶⁹ and civilly liable if they deal “directly, indirectly or through an agent”. The Insider Trading Act only referred to dealing directly or indirectly.⁷⁰ It can be argued that the dealing through an agent will also fall under the ambit of dealing indirectly, leaving a question mark to why dealing “through an agent” was actually added to the Financial Markets Act, and why dealings through an agent cannot fall under the ambit of indirect dealing. The Financial Markets Act also lacks the definition of what constitutes the action of “dealing”. The Security Services Act provided that “deal” includes conveying or giving an instruction to deal.⁷¹ The Securities and Exchange Board of India⁷² defines dealing in securities as an act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person either as principal or agent. This definition is ambiguous, as the objective of the definition (“or deal in any securities”) is included in the definition, however it does give a direction that agreeing to the subscription, buying or selling also fall under the ambit of dealing. In the above definition, the transaction does not need to be concluded or finalised in order to qualify as dealing, just the application or agreeing to the transaction can therefore be considered is unlawful if one is dealing on inside information.

The Financial Markets Act provides for penalties and judiciary mechanisms pertaining to insider trading. Despite a fine not exceeding R50 million, or imprisonment not exceeding

⁷⁰ Section 2(1) of the Insider Trading Act.

⁷¹ Section 2 of the Securities Services Act.

⁷² Prohibition of Insider Trading Regulations, 1992.

10 years, or both,⁷³ the Financial Markets Act also introduced a new administrative sanction. As mentioned earlier, criminal sanctions against offenders requires that guilt should be proven beyond reasonable doubt. The Criminal Procedure Act⁷⁴ provides for prosecution of corporations for any act or omission with or without particular intent performed by a director or servant of the corporate body, however with the higher burden of proof required for a criminal sanction, a civil sanction will most likely have more success in all cases. The new administration sanction entitles the Financial Services Board to take civil action against any person who contravenes the relevant provisions of insider trading in the Financial Markets Act. This civil action is however, limited to only certain market abuse offences, because it does not provide for civil actions against market manipulation offenders.⁷⁵ The administration sanction empowers the Financial Services Board to prosecute reported incidents of insider trading. The administrative sanction provides that any person contravening the Financial Markets Act, can be liable to pay an administrative penalty equivalent to the profit made or the loss avoided through such dealing or a penalty up to R1 million plus three times the profit made or loss avoided.⁷⁶ The administrative mechanism is adjudicated, retained and controlled by the Financial Services Board, and by doing so it removes pressure from the existing civil juristic system which may lack the necessary expertise in adjudicating financial matters. Civil cases relating to insider trading is determined by the Enforcement Committee.

The statutory bodies regulating the administration penalties and the success rate of the administration mechanism will be considered next.

3.2 The Financial Service Board

The Financial Services Board was first established in 1990 by the Financial Services Board Act ⁷⁷ as an independent body to supervise and regulate the non-banking financial services industry. The Financial Services Board is now mandated by the South African

⁷³ Section 109 of the Financial Markets Act.

⁷⁴ Section 332 of the Criminal Procedure Act 51 of 1977.

⁷⁵ Section 80 & 81 of the Financial Markets Act.

⁷⁶ Section 82 of the Financial Markets Act.

⁷⁷ The Financial Services Board Act 97 of 1990.

government to supervise and enforce compliance with specific laws regulating financial institutions and to promote financial education and awareness on related legislation. The Financial Services Board is empowered to investigate all cases of suspected market abuse offences committed before the repeal of the Securities Services Act and the Insider Trading Act, however the Financial Services Board is not required to investigate insider trading offences committed before the repeal of section 440F of the Companies Act 61 of 1973. Any strange trading behaviour on the stock markets are brought to the attention of the Financial Services Board. The Financial Services Board has an enormous task in combating market abuse offences.⁷⁸ It is only evident that the Financial Services Board does not operate in a individually; it is assisted by other enforcement bodies namely the JSE, the Board of Appeal, the Directorate of Market Abuse, the Enforcement Committee and the courts. The Financial Services Board is self-sustainable as it is fully funded by the fees and levies imposed by this industry. The mandate of the Financial Services Board is to ensure the integrity of South African financial markets and to protect consumers by ensuring that financial services are treated fairly by all financial services providers. The Financial Services Board administers a network of financial regulations and Acts of which the Financial Markets Act is one.⁷⁹

The Financial Markets Act provides the Financial Services Board with several powers and rights⁸⁰ to pursue reported alleged insider trading activities. These powers include the

⁷⁸ The offences entail insider trading (prohibited in section 78 of the Financial Markets Act), market manipulation (prohibited in section 80 of the Financial Markets Act), and false reporting (prohibited in section 81 of the Financial Markets Act).

⁷⁹ The Financial Services Board also administers the following Acts: Collective Investment Schemes Control Act 45 of 2002; Credit Rating Services Act 24 of 2012; Financial Advisory and Intermediaries Services Act 37 of 2002 (FAIS Act); Financial Institutions (Protection of Funds) Act 28 of 2001; Financial Intelligence Centre Act 38 of 2001; Financial Services Board Act 97 of 1990; Financial Services Ombud Schemes Act 37 of 2004; Financial supervision of the Road Accident Fund Act 8 of 1993; Friendly Societies Act 25 of 1956; Inspection of Financial Institutions Act 80 of 1998; Long-term Insurance Act 52 of 1998; Pension Funds Act 24 of 1956; Securities Services Act 36 of 2000; and Short-term Insurance Act 53 of 1998.

⁸⁰ Section 84 of the Financial Services Act.

interrogation of any person believed to have information relating to an ongoing investigation, to search any person or premises in order to seize documents suspected to have information relating to an ongoing investigation, to refer matters to the National Prosecuting Authority for criminal prosecution and to apply for a court interdict or attachment order. The Directorate of Market Abuse is appointed by the Minister of Finance and is mandated to conduct investigations on any reported matters of market abuse offences. The Directorate of Market Abuse may on behalf of the Financial Services Board, decide whether to proceed with civil action or to refer a matter to the Enforcement Committee or the Director of Public Prosecutions. Proceedings before the Enforcement Committee do not lie within the criminal sphere because there is no formal charge for the breach of the criminal law. The proceedings of the Enforcement Committee are initiated by way of a complaint by the Directorate of Market Abuse to the Enforcement Committee. The Directorate of Market Abuse will always institute civil proceedings in the name of the Financial Services Board because it does not function as an independent regulatory body.⁸¹ The Directorate of Market Abuse consists of the chairperson, and other members and representatives, from the Financial Services Board, JSE, legal and accounting professions, insurance industry, fund management industry, banking industries, Association for Savings and Investments South Africa and South African Reserve Bank appointed by the Minister of Finance. The Directorate of Market Abuse has the power to confiscate records, interrogate offenders or institute legal actions against alleged offenders. The Directorate of Market Abuse may also refer a case to the Enforcement Committee for administrative penalties. Any offender can be tried on the basis of a criminal sanction, a civil sanction or an administrative sanction depending on the merits of the offence.

The Financial Services Board has managed to investigate a fair number of suspected market abuse offences to date. In order for the Financial Services Board to function efficiently the Financial Services Board established an administrative body called the Enforcement Committee, and was established in terms of the Financial Services Board

⁸¹ Section 85(1)(c) of the Financial Markets Act.

Act.⁸² Infringement of any provision of the Acts administered by the Financial Services Board can be adjudicated by either the Enforcement Committee or the Directorate of Market Abuse, however the Directorate of Market Abuse and Enforcement Committee does not have dual jurisdiction over these cases. The Enforcement Committee is responsible for adjudicating and considering all cases of alleged contraventions of market abuse referred to it by the Directorate of Market Abuse or the Registrar of Securities Services. The Financial Services Board appoints the members of the Enforcement Committee. The Enforcement Committee is entitled to enforce penalties, compensation orders and cost orders. Such orders are enforceable as if it was a judgment of the High Court of South Africa. Therefore, if the Directorate of Market Abuse is of the opinion that any provision of any Acts administered by the Financial Services Board has been contravened, it may refer the case to the Enforcement Committee.

3.3 The Enforcement Committee Referral process

The market abuse department of the Financial Services Board will investigate reported cases of insider trading and submit cases to the Directorate of Market Abuse for consideration. The Directorate of Market Abuse may consider closing the case or referring the case to the enforcement department for further action by the Enforcement Committee for civil cases. The proceedings of the Enforcement Committee is administered by the Financial Institutions (Protection of Funds) Act, 2001.⁸³ A matter is referred by an applicant to the Enforcement Committee by the serving of a notice. Any referral by an applicant to the Enforcement Committee should be supported by an affidavit, a notice enclosing the details and nature of the alleged contravention, as well as the proposed administrative sanction and other supporting documents. A copy of these documents should be delivered to the respondent's residential address, registered office or principal place of business. The correspondence between the applicant and respondent is limited to two events. The respondent has 30 days to respond to the applicant with an answering affidavit, and the respondent should state whether he or she admits to, or deny any of the

⁸² Section 10(3) of the Financial Services Board Act, 1990

⁸³ Act 20. 28 of 2001.

allegations mentioned in the notice. The applicant may deliver a replying affidavit to the answering affidavit of the respondent within 30 days, however no further affidavits may be filed by the parties without first obtaining the permission of the Enforcement Committee. If any of the parties requires more time to file an answering- or replying affidavit, the party may request, in writing, an extension from the chairperson on or before the expiry date for the filling of the relevant affidavit. However, the party seeking an extension of time must first approach the other party to agree to the extension. Once a matter has been referred to the the Enforcement Committee, the applicant may still at any time withdraw the referral, and may also at any time, either prior to the referral of the matter to the Enforcement Committee, or during, or after the Enforcement Committee proceedings, enter into a written settlement agreement with the respondent. However, the agreement must be filed with the Chairperson or Deputy Chairperson of the Enforcement Committee to be made an order of the Enforcement Committee.

3.4 Hearing by the Enforcement Committee:

The chairperson of the Enforcement Committee will appoint a panel to deal with each specific case. The Enforcement Committee must inform the applicant and respondent within a period of not less than 30 days of the date, time and place of the hearing. Where a matter cannot properly be decided on, based on the affidavits received from the parties (in exceptional circumstances and only when it is necessary to come to a just decision) the Enforcement Committee may order any person to appear before the panel to be examined and cross-examined as a witness and to produce the required documents as indicated in the summons.

Based on the merits of the stated case, the Chairperson may order inspection of the supporting documents and allow for legal representation of the parties. The Chairman may rule that a matter be presented to the Enforcement Committee by way of a stated case, abbreviated pleadings or any other procedure which will expedite the matter.

3.5 Determination by the Enforcement Committee

The *Zietsman v Directorate of Market Abuse* case was the first case in which anyone who was found guilty by the Enforcement Committee for insider trading appealed the case to

the High Court. The High Court confirmed that the Enforcement Committee was indeed entitled to make such rulings and impose such penalties as an administrative tribunal. The Enforcement Committee will have to determine on a balance of probability if there was a contravention of the law. The Enforcement Committee may impose a penalty on the respondent or order the respondent to pay any person who suffered patrimonial loss or damage as a result of the contravention of the law. The extent of the compensation amount will be determined by the Enforcement Committee. If the respondent contravened section 78 of the Financial Markets Act, the Enforcement Committee may order the respondent to pay to the board an amount calculated in accordance with section 82 of the Financial Markets Act.

The Enforcement Committee will consider the following factors when determining an appropriate administrative sanction:

- 1) The nature, duration, seriousness and extent of the contravention;
- 2) Any loss or damage suffered by any person as a result of the contravention;
- 3) The extent of the profit derived or loss avoided by the respondent from the contravention;
- 4) The impact which the respondent's conduct may have on the relevant sector of the financial services industry;
- 5) Whether the respondent has previously failed to comply with a fiduciary duty or law,
- 6) Any previous fine imposed or compensation paid for the contravention based on the same set of facts,
- 7) The deterrent effect of the administrative sanction;
- 8) The degree to which the respondent co-operated with the applicant and the Enforcement Committee.

The Enforcement Committee may make any such order of costs as it may deem suitable and fair, including cost of constituting the Enforcement Committee panel and all expenses reasonably incurred by the applicant. In the *Zietsman v Directorate of Market Abuse* case the Enforcement Committee determined that information relating to the loan amount received from the Industrial Development Corporation, constituted inside information, and

subsequently found the two parties guilty of insider trading on the basis that they had price sensitive information which was not yet made public in that African Cellular Towers Limited would obtain a R99 million loan from the Industrial Development Corporation. The Enforcement Committee fined the appellants a sum of R1 million and ordered the appellants to pay the costs of the case. African Cellular Towers Limited went into liquidation in the middle of 2012. The appellants still held the shares in question at the time of the ruling, as a result they lost the entire value of their holding, therefore they never realised a profit from the trade. The penalty imposed was based on, but not equal to, the potential profit arising from the insider trading, as evidenced by the increase in the share price of 54.5% on 11 March 2011. The judge's approach was to treat the relevant profits made on the date when the information was made public, as already gained by the insider, whether it realised or not. His approach was based on the case of *The Insider dealing Tribunal v Shek Mei Ling (1992) 2 HKCFAR 205* where this approach was explained by Lord Nichols of Birkenhead as follows:

"The approach is to treat the relevant profit as that gained by the insider dealer when the information was made public and the market had had a reasonable opportunity to digest the information. The gain is to be measured by reference to the market value of the shares at that date. At that date, the amount of the inside dealer's profit, whether realized or not, was fixed once and for all. Subsequent changes in market prices are irrelevant."

A determination of the Enforcement Committee may be objected to and taken on appeal to the High Court. The submission of appeal proceedings does not suspend the operation or execution of the ruling of the Enforcement Committee, unless the chairperson of the Enforcement Committee directs otherwise. Any determination of the Enforcement Committee must be made public by the registrar or directorate in any medium deemed appropriate by them. A tabled summary and copies of the order of all the enforcement actions by the Enforcement Committee can be found on the Financial Services Board Website.⁸⁴

⁸⁴ <https://www.fsb.co.za/enforcementCommittee/Pages/enforcementActions.aspx>

Given all the responsibilities included in the framework of the Financial Services Board, it is only evident that the Financial Services Board requires assistance from a third party to monitor, identify and flag cases of possible market abuse offences. The JSE which regulates listed shares and acts as a link between various investors and the listed companies, seem to be best solution to the problem. The JSE however has no civil or criminal jurisdiction or administrative actions for cases where legislation has been contravened, except for cases which falls under the ambit of its regulation, for example, the JSE Listing Requirements.⁸⁵ The Financial Services Board supervises the JSE in the directive of its regulatory duties which will be reviewed next.

3.6 Detecting and monitoring market abuse offences by the JSE

The Financial Services Board receives allot of support from the JSE and it depends heavily on the JSE's Surveillance Division to detect market abuse practices in the South African Financial markets because it does not have its own surveillance systems. The Financial Services Board finances itself through the money recovered from the market abuse offenders, it does not receive finances from the government.⁸⁶ The regulatory framework which governs the JSE's role, as a market regulator, and the compliance obligations of authorised JSE members, comprises the Financial Markets Act, 2012, the JSE Rules and Directives and the Financial Intelligence Centre Act, 2001. The regulatory activities undertaken by the JSE Surveillance Division includes the monitoring of trading in the various JSE markets to identify possible market abuse and oversight of JSE members' compliance with their regulatory obligations. The JSE requires that all the issuers of listed securities disclose any activities that might have a material effect on the price of such securities as timeously as possible. The JSE currently acts as the frontline regulator, setting listings requirements and enforcing trading rules. South Africa was ranked third in the world in terms of the regulation of securities exchanges in the World Economic Forum's Global Competitiveness Survey for 2016-2017. This gives the

⁸⁶ Section 82(4)(a) and Section 86 of the Financial Markets Act.

impression that both the JSE and its regulators works successfully together in their combat against market abuse offences.

The JSE connects buyers and sellers in a variety of financial markets such as equities, financial derivatives, commodity derivatives, currency derivatives and interest rate instruments.⁸⁷ The JSE is the holder of an exchange license in terms of the provisions of the Securities Services Act. A company wishing to trade its securities on the JSE can submit an application for the listing and would only be accepted if the company complies with the JSE Listing Requirements. Therefore, all listed companies must comply with the JSE Listings Requirements on a continuous basis and application to list includes a contractual obligation of the company to be bound to the JSE Listing Requirements. Directors of a company is also obliged to sign a schedule 13 declaration where they agree to comply with the JSE Listing Requirements and that noncompliance can result in sanction of the company and its directors. The JSE may grant a listing subject to any additional conditions that it considers appropriate. An integral function of the JSE is to provide facilities for the listing of securities (including securities issued by companies, domestic or foreign) and to provide the JSE's users with an orderly market place for trading in such securities and to regulate the market accordingly.⁸⁸ The supervisory activities undertaken by the JSE Market Regulation division includes the monitoring of trading in various JSE markets to identify possible market abuse offences and ensure that the JSE members comply with regulatory obligations. The JSE Securities Exchange functions as both a primary and secondary capital market. As a primary market, a listed public company issue new shares and debentures to raise capital, whereas the earnings will go directly to the company. Therefore, when a company issues shares for the first time and sells those securities directly to investors, that transaction occurs on the primary market. The shares may be issued to new shareholders or existing ones. As a secondary market in capital, the Securities Exchange facilitates the buying and selling of securities by existing shareholders or investors of a particular company. The South African Market

⁸⁷ <http://www.jsereporting.co.za/ar2013/overview/who-we-are.asp>

⁸⁸ JSE Listings Requirements

has three separate secondary markets namely: Development Capital, Venture Capital and Alternative Exchange.

The JSE's general principles of business are set out in the JSE Listing Requirements as follows:

- “(i) to ensure the existence of a market for the raising of primary capital, an efficient mechanism for the trading of securities in the secondary market, and to protect investors;
- (ii) to ensure that securities will be admitted to the List only if the JSE is satisfied that it is appropriate for those securities to be listed;
- (iii) to ensure that full, equal and timeous public disclosure is made to all holders of securities and the general public at large regarding the activities of an issuer that are price sensitive;
- (iv) to ensure that holders of relevant securities are given full information and are afforded adequate opportunity to consider in advance and vote upon any of the following:
 - (1) substantial changes in an issuer's business operations; and
 - (2) other matters affecting a listed company's constitution or the rights of holders of securities;
- (v) to ensure that all parties involved in the dissemination of information into the market place, whether directly to holders of relevant securities or to the public, observe the highest standards of care in doing so;
- (vi) to ensure that all holders of the same class of securities of an issuer are accorded fair and equal treatment in respect of their securities; and
- (vii) to ensure that the Listings Requirements, and in particular the continuing obligations, promote investor confidence in standards of disclosure and corporate governance in the conduct of applicant issuers' affairs and in the market as a whole.”

Prevention of market abuse offences is one of the primary objectives of the JSE's market surveillance division. The JSE has various market surveillance capabilities through which it can continuously identify suspicious trading volumes and price movements, which can be indicative of insider trading or market manipulation. The JSE can report alleged matters of insider trading to the Financial Services Board Enforcement Committee for investigation. The Directorate of Market Abuse investigators and JSE surveillance staff meet bi-weekly to consider surveillance results and the progress of cases under investigation. Surveillance Officers in the Market Practices Department of the Market

Regulation Division are responsible for detecting any signs of market abuse using this proprietary technology, which refreshes the trading information every half hour.⁸⁹

Throughout each trading day the JSE surveillance systems will identify any shares trading in an abnormal manner of price and/or volume. When unusual activities are detected, and there appears to be no noticeable cause for the trading activity, and it cannot be explained from information recently released to the market, the surveillance officers will contact the sponsors or designated advisors⁹⁰ of the listed company and request that they ask the directors if they know of any price-sensitive information that is due to be released.

On a weekly basis the JSE surveillance department will review and identify persons whom traded before the price sensitive information was released by the listed companies. Where the trading patterns suggest that there might have been trading on inside information, a report is prepared and submitted to the Directorate of Market Abuse of the Financial Services Board. The JSE only has jurisdiction over its members, their employees and to a limited extent over listed companies. As mentioned earlier, the Directorate of Market Abuse of the Financial Services Board is the statutory body responsible for exercising the powers of the Financial Services Board to investigate reports on market abuse. The Directorate of Market Abuse may refer cases involving persons believed to have committed an offence to the Enforcement Committee of the Financial Services Board. If suspicious trading or any contravention of the JSE Listing Requirements are being investigated the JSE will request issuer to publish a cautionary announcement via their Stock Exchange News Service (SENS). The JSE is also allowed to suspend the trading of company's shares until the announcement has been made or the matter has been resolved.

Companies listed on the JSE have a general obligation to disclose any information as timeously as possible in order to curb the leakage of any price sensitive information,

⁸⁹ Insider Trading Booklet 2016 page 23

companies are urged to disclose any price-sensitive information as soon as possible via SENS announcements. With the exception of trading statements, an issuer must, without delay, unless the information is kept confidential for a limited period of time, release an announcement providing details of any developments of the company's activities which are not public knowledge and which may, by virtue of its/their effect(s), lead to material movements of the reference price of such issuer's listed securities.

Immediately after a company acquires knowledge of any material price sensitive information, and the necessary degree of confidentiality of such information cannot be maintained, or if the issuer suspects that confidentiality has or may have been breached, an issuer must publish a cautionary announcement on SENS. A company that has published a cautionary announcement must provide updates thereon in the required manner and within the time limits⁹¹. When a listed company suspects that confidentiality has, or may have been breached, the company must immediately inform the JSE and ensure that such information is announced accordingly. Cautionary announcements generally only relate to information during the price sensitive information window⁹², during a period of negotiations prior to agreement of terms on a corporate action where information constitutes price sensitive information, and only to the extent that confidentiality cannot be maintained or breach suspected.

3.7 Director's dealings

Directors of companies can be classified as an executive, non-executive or independent non-executive director. Directors must act with independence of mind, some directors are classified as 'independent' directors based on the level of their association with or interest in the company. Directors have a fiduciary duty⁹³ to perform their functions in good faith and to always act in the best interest of the company. Directors may not use their position or any information obtained as a director, to gain an advantage for

⁹¹ JSE Listing Requirements number 3.9.

⁹² A period where the information of an issuer does constitute price sensitive information, however the issuer does not have certainty in respect of the information, then this period of time is afforded to the issuer to obtain that certainty provided the information is kept confidential during that period.

⁹³ Section 76 of the Companies Act 71 of 2008.

themselves or persons related to them, other than the company itself. Directors have a statutory duty to disclose any conflict of interest. If a director's personal interest conflicts with those of the company, the director should disclose the conflict of interest to the shareholders or the board of directors of the company, unless the director reasonably believes that the information is immaterial to the company, generally available to the public or known to the other directors.⁹⁴ Directors are required to apply an independent state of mind and objective judgement and their judgement should never be clouded by any personal interest.

The King Committee published the King IV Report on Corporate Governance for South Africa 2016 (King IV) on 1 November 2016. King IV recommends that the governing body⁹⁵ should comprise of a majority of non-executive directors most of whom should be independent directors.⁹⁶ This will reduce the possibility of conflicts of interest.

It is recommended practice⁹⁷ that the board of directors should consider the following and other indicators holistically, and on a substance-over-form basis, when assessing the independence of a member of the governing body for purposes of categorisation:

The director:

1. is a significant provider of financial capital, or ongoing funding to the organisation; or is an officer, employee or a representative of such provider of financial capital or funding;
2. if the organisation is a company, participates in a share based incentive scheme offered by the company;
3. if the organisation is a company, owns securities in the company the value of which is material to the personal wealth of the director;
4. has been in the employ of the organisation as an executive

⁹⁴ Section 75 of the Companies Act 71 of 2008.

⁹⁵ A governing body is a structure that has primary accountability for the governance and performance of the organisation. Depending on context, it includes, among others, the board of directors of a company, the board of a retirement fund, the accounting authority of a state-owned entity and a municipal council.

⁹⁶ Principle 7 of the King IV Report.

⁹⁷ Principle 7 of the King IV Report, recommended practice number 28.

5. manager during the preceding three financial years, or is a related party to such executive manager;
6. has been the designated external auditor responsible for performing the statutory audit for the organisation, or a key member of the audit team of the external audit firm, during
7. the preceding three financial years;
8. is a significant or ongoing professional adviser to the organisation, other than as a member of the governing body;
9. is a member of the governing body or the executive management of a significant customer of, or supplier to, the organisation;
10. is a member of the governing body or the executive management of another organisation which is a related party; or
11. is entitled to remuneration contingent on the performance of the organisation.

The board of directors is required to disclose their reasons for classifying a director as independent and should also consider the statutory requirements of independence. The Companies Act 71 of 2008 considers a director as independent if:⁹⁸

1. The director was not involved in the day-to-day management of the business for the previous financial year.
2. The director was not a full time employee or prescribed officer of the company or a related company during the previous three financial years.
3. The director is not a material supplier or customer of the company such that a reasonable and informed third party would conclude in the circumstances that the integrity, impartiality or objectivity of that director is compromised by that relationship.
4. The director is not related to anybody who falls within the above criteria.

It can be argued that executive directors should avoid or be restricted in trading in securities of the company in which they hold office, due to the fact that directors always

⁹⁸ Section 94 of the Companies Act 71 of 2008.

have more information than the investing public and that regular dealings by directors would attract suspicion. To prevent this extreme measurement King III⁹⁹ and King IV¹⁰⁰ recommends that it is the board of directors' responsibility to manage conflicts of interests. It is further recommended that every listed company should have a policy prohibiting dealing in its securities by directors, officers and other selected employees for a designated period preceding the announcement of its financial results or in any other period considered sensitive, and should have regard to the listing requirements of the JSE in respect of dealings of directors. As mentioned earlier, the JSE has implemented additional requirements of the Listing Requirements regarding dealings by directors. A company must, either via its sponsor or designated advisor, announce the details of all dealings in securities by a director or company secretary in relating to the company. Such announcement should contain the name of the director, the name of the company of which he or she is a director, the date on which the transaction was effected, the price, number, total value and class of securities concerned. In the case of options or any other similar right or obligation, the announcement should include the option strike price, strike dates and periods of exercise and/or vesting, the nature of the transaction, the nature and the extent of the director's interest in the transaction. In the case of dealings by associates, the announcement must disclose the name of the associate and the relationship with the director, confirmation as to whether the trades were done on- market or off-market and whether clearance has been given.

A director is not allowed to deal in any securities relating to the issuer of which he is a director of, without first advising and receiving clearance from the chairman of the board (or other appropriate directors designated for this purpose) in advance.¹⁰¹

A director may not receive clearance to trade during a prohibited period. A prohibited period is a closed period and any period where there exists a matter that constitutes unpublished price-sensitive information in relation to the issued securities.

⁹⁹ Principle 1.9

¹⁰⁰ Principle 1.1

¹⁰¹ JSE Listing Requirements number 3.66.

The JSE has identified high risk periods in which price-sensitive information is most likely to result in insider trading, and implemented the following closed periods in which trading is prohibited in a further attempt to reduce insider trading:

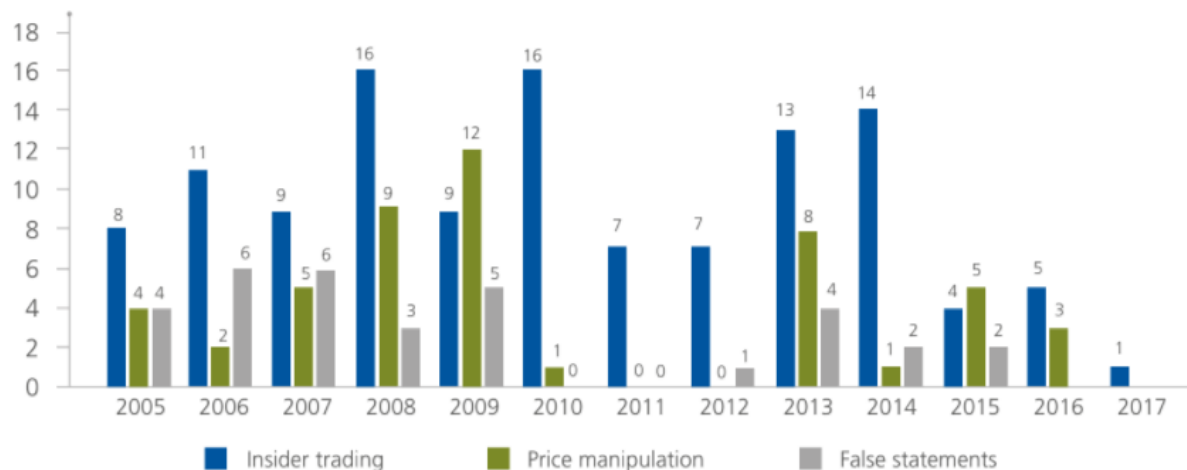
- 1) the date from the financial year end up to the date of earliest publication of the preliminary report, abridged report or provisional report;
- 2) the date from the expiration of the first six month period of a financial year up to the date of publication of the interim results;
- 3) the date from the expiration of the second six month period of a financial year up to the date of publication of the second interim results, in cases where the financial period covers more than 12 months;
- 4) in the case of reporting on a quarterly basis, the date from the end of the quarter up to the date of the publication of the quarterly results; and
- 5) any period when an issuer is trading under a cautionary announcement.

It is a recommended practice by the JSE that all issuers should have internal written policies for handling confidential price sensitive information. Therefore, the majority of firms have procedures to control inside information. Ensuring that inside information is not passed between the trading division and the non-trading divisions of a company may require a physical separation of employees with insider information from those without. This separation is known as the Chinese Walls technique and is intended to control the flow of inside information. This technique is used to prevent insider trading and to manage conflict of interest which can arise when the operations of a business is carried out by a multi-functioning organisation. A Chinese Wall cannot prevent intentional disclosure of inside information; however, it may limit the accidental flow of information between departments of a company. Ultimately the effectiveness of a Chinese Wall would depend on the firmness of management in applying the Chinese Walls and up keeping of high values and ethical standard practices within the company. Implementing Chinese Wall policies and procedures can be a strenuous task. To overcome this burden a company should enter into confidentiality and non-disclosure agreements internally with employees as well as externally with any of their service providers and not entertain any abuse of inside information by employees or management.

Chapter 4: Concluding Remarks

Significant legislative progress was made in combating market abuse offences. The Security Services Act and the Financial Markets Act extended the insider offender to juristic persons and the offence to include dealings in listed and unlisted shares, depository receipts and other equivalent equities in public companies. Since the inception of the Directorate of Market Abuse, a total of 381 cases were registered for investigation, however giving the difficulty of proving insider trading or due to insufficient evidence, not all of them were found to be market abuse offences. The majority of the registered cases were for insider trading and price manipulation offences. In the last few years, there have been a steady decline in the number of prescutions and reported cases of market abuse offences in South Africa. The following graph gives an indication that there has been a decrease in the number of registered cases per financial year.¹⁰²

Market-abuse incidents since 2005 below.



The prima facie explanation for the reduction may be that there are now a decrease of market abuse offences occurring in South Africa and that the surveillance technologies and legislation in place is succeeding in its task to prevent these offences, as only one case of insider trading was registered in the 2017 year. However, realistically it seems almost impossible that there were so little offences. The significant reduction in registered

¹⁰² The Financial Services Board Annual Report.

cases and prosecutions could be caused by the fact that the occurrence of market abuse offences is extremely difficult to prove and that some of the market abuse offences is going by unnoticed by the surveillance teams. Leaving the question as to how sufficient the detecting and prosecuting systems really are.

The table below¹⁰³ sets out new cases registered per financial year, and investigations completed since the inception of the Directorate of Market Abuse in 2005 (This table excludes investigations completed by the Insider Trading Directorate).

Year	Opening Balance	New Cases	Completed Cases	Closing Balance	% of cases completed per year
2005	12	11	-1	22	4.3%
2006	22	20	-28	14	66.7%
2007	14	16	-15	15	50.0%
2008	15	19	-21	13	61.8%
2009	13	21	-12	22	35.3%
2010	22	23	-20	25	44.4%
2011	25	16	-21	20	51.2%
2012	20	9	-15	14	51.7%
2013	14	25	-21	18	53.8%
2014	18	17	-18	17	51.4%
2015	17	11	-17	11	60.7%
2016	11	16	-17	10	63.0%
2017	10	3	-2	11	15.4%
Total		207	-208		

The percentage of cases closed per year raises a red flag. On an average the Directorate of Market Abuse and the Enforcement Committee succeeded in completing only 50% of the cases per year questioning the sufficiency and productivity of these regulating bodies to finalise cases under investigation. Inevitably, it remains an enormous task to gather sufficient evidence to warrant action in terms of the Financial Markets Act, but with enough capable and equipped resources it can be settled quicker and more efficient, leaving no excuse for so little movement in the closing balances of settled cases per year.

¹⁰³ The 2017 Financial Services Board Annual Report.

It seems that even with all the surveillance technologies and legislation in place, it remains an enormous task to prevent and pursue all market abuse practices. Substantial progress has been made with regards to the regulating of these market abuse offences, however, the enforcement and prosecution of these cases remains problematic in South Africa. The regulation of these offences will remain significantly important to increase public investors' confidence in the trading markets of South Africa.

The key mitigation actions companies can apply to prevent insider trading, is to restrict the amount of people involved in generating price sensitive information, ensure that there are proper company policies and procedures in place to restrict insider trading, educate the employees and service providers on insider trading, and most importantly publish any sensitive information to the public as soon as possible. From a legislative perspective, the difficulty in identifying cases with sufficient evidence, and prosecution of all the cases of market abuse offences prevails. The Financial Markets Act should look at other anti-market abuse enforcement measurements. Currently the Financial Market Act does not provide for private civil action measures whereas a prejudiced person can personally take legal action against an insider. It also does not provide for other enforcement measurements such as arbitration and alternative dispute resolution or bounty rewards for insider trading offences. With the wide description of the insider trading offences, the proving of criminal liability under the Financial Markets Act remains problematic.

Even with the implementation of more surveillance systems and alternative legal enforcement actions, it will still require that companies adopt a strong anti-market abuse culture and implement strict company policies to ensure that price sensitive information is managed efficiently within the company to prevent these offences.

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