67%

NWU BUSINESS SCHOOL

Assignment Cover Page

MODULE NAME	Corporate Governance
MODULE CODE	MBAA 811
TOPIC:	Market Abuse: Insider Trading
FACILITATOR NAME	Mr Pieter Greyling

Name: (Members contributing to project) (Invictus)	**Student number**
Makintane, Seiso	33329443
Monethi, Leballo	25799959
Katz, Tshepisho	22436863
Malaku, Bangane	29778069
Flint, Dorothy	22224920
Nkosi, Thabang	33467919
Ramonyadioa, Lebohang	28167279

CONTENTS

1. HISTORY AND OBJECTIVES OF THE ACT IN SOUTH AFRICA

The history of this Act, the Financial Market Act, is to expose the errors that were previously bounded in the South African market abuse regulations prior to 2004. The intention of this was to promote awareness of the situation on part of relevant stakeholders and also if there had to be any errors that it would be effectively resolved and subsequently reintroduced under the Securities Service Act and Financial Market Act.

The cause for the unsuccessful execution of the ITA was that the resources and approvals where inadequate, and the fundamentally difficult nature of investing and prosecuting the case of market abuse.

That is why the Securities Services Act was enacted to repeal and replace all the flawed requirements of the ITA and improve the regulation and enforcement of the ban on market abuse. There are three forms of market abuse, inside trading, prohibited trading practices such as trade base market manipulation, and misleading or false statements relating to listed companies, therefore the disclosure-based market manipulation where banned.

Both the ITA and SSA was seen as a valuable solution to improve the general regulation of the market abuse, but due to the outcome of these Acts there were still convictions and settlements involved that lead to market abuse.

2. FORMS OF MARKET ABUSE, THE ELEMENTS THEREOF AND DEFENCES

Market abuse damages the integrity of financial markets by distorting prices, impairing the ability of markets to be used for hedging and creating a false appearance of market activity. Ideally, regulatory authorities around the world should have suitable data and systems in place to detect, investigate and prosecute market manipulation.

South African legislation prohibits three major forms of market abuse:

2.1.1 Insider trading

Insider trading occurs when a person who has inside information about the financial standing of a company or bid, or potential financial impact relating to a company takes advantage of such privileged inside information to make a transaction or dealing for their own benefit, before such information is made public. This behaviour can also be seen in take over transactional environments. Cases involving insider trading include companies such as Phumelela Gaming and Leisure Ltd, Basil Read, Micromedia Holdings, Times Media Limited and Randgold.

2.1.2 Prohibited trading practices (market manipulation)

Potential market manipulation by use of improper, prohibited trading practices. The stock markets are a free market; therefore, the price of a security should reflect its true value. Any interference with the manner that prices are determined is regarded as market manipulation. This is normally done to bring or maintain a price of a security to an artificial level, consequently investors are misled into buying shares with no value that are disguised as highly valuable or selling their valuable shares at a value lower than the true value due to false information fed into the markets. The market manipulation is done in three ways namely:

2.1.3 Disclosure-based market Manipulation

The whereby a person spreads wrong, false, misleading or deceptive rumours about the demand, supply, price or value of a security. This attracts investors into purchasing shares in that company, causing a high, artificial demand for the shares and increased share price, usually afterwards the manipulators sell their shares on the market to make a huge profit for themselves. It is also referred to as “pump and dump” method, and it is the commonly used price manipulation method. An example of this method involves Vox Telecom where an individual was fined R2 million for manipulating their price, as well as two individuals from African Dawn Capital Limited, each fined R1.75 million for price manipulation. Other cases that are still under investigation include Miranda Minerals and the Sunflower Futures Contract.

2.1.3.1 Wash sales

occurs when the buyer and seller of securities is the same person for that particular transaction. This creates false trading activity and affects the value of that security in question.

2.1.3.2 A matched order

Whereby the sell and buy activity of the security is done in a manner that intentionally create a false appearance of active trading for that particular security.

2.1.3.3 False reporting

Through publicizing of information/statements that are false, deceptive or misleading regarding listed companies, thereby giving false or misleading signals. An example is the Bre-X Minerals scandal where a prospecting geologist Mr. Micheal de Guzman spiked thousands of core samples to reflect false gold grades. This increased the share price of Bre-X minerals from 30 cents a share to more than $250 a share, their market value went from nothing to $6 billion as unsuspecting investors flocked to buy a piece of what they thought was a gold mine. Harmony Gold was also investigated by the FSB for false or misleading reporting in their quarterly results for April 2007 period. Another mining company scandal includes Wesizwe Platinum for publishing a statement that was false and misleading, they were fined R65 000.

2.2 Elements of Market abuse

Section 78 classifies the term insider into three elements, namely

a) the person should be a natural person or legal entity

b) he should be connected person or a deemed to be connected person and

c) acquisition of unpublished price sensitive information should be by virtue of such connection.

In the section below, we are going to expand and elaborate on each element, also providing its respective defence.

2.2.1 Insider trading for your own account

Section 78 (1) of the act defines insider trading for your own account as “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 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.”

2.2.2 An insider who deals for another person (section 78(2))

Section 78 (2)(a) of the act defined an insider who deals for another person as an insider who has inside information and deals (directly or indirectly) 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.”

2.2.3 A person who knowingly deals for an insider (section 78 (3))

Section 78(3)(a) of the act defines the insider as any person who deals for an insider deals (directly or indirectly) through an agent in the securities listed on a regulated market in which the insider possesses the information which relates or which are likely to be affected by it, who knew that such person is an insider, commits an offence.”

2.2.4 An insider who discloses inside information (section 78(4))

According to section 74(4)(a) of the act states that an insider who knows that they have inside information and discloses the inside information to another person commits an offence.

2.2.5 An insider who encourages or discourages another person to trade

In terms of section 78(5) of the Act: "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."

2.3 Defences against market abuse

Due to the complexities of financial markets, there are always a change that some market party will act in a manner that is unusual from the acts.

The Financial Sector Conduct Authority is restricted from imposing sanctions against individual for market abuse, where it has been provided with information that there are reasonable grounds for it to be satisfied that:

I. The individual concerned had reasonable grounds to believe that his behaviour did not, in any way, amount to market abuse; or
II. The person in question took all reasonable precautions and took the necessary steps to avoid behaving in a way that would leave him vulnerable to an allegation for being involved (in any way) with market abuse.

Additionally, JSE introduced additional listing requirements which prohibits the directors of the companies from dealing in any securities relating to issuer without obtaining the clearance issued by chairperson or other designated director; for a period from where there exists any matter that constitutes unpublished price-sensitive information in relation to the issued securities (whether or not a director has knowledge of such matter).

2.4 Examples of Market abuses in South Africa

In the past 5 years, the financial services board and Johannesburg Stock Exchange investigated the following cases, probing for misconduct against market abuse relating to inside trading.

2.4.1 Coal of Africa COO: Michiel Jakobus Bronn

In 2015, the Financial Service Board enforcement committee fined Mr Michiel Jakobus Brownn a fine of R350 000 for insider trading after he was found to have bought shares three days from the company he had inside information that it was to be granted the mining rights by Department of Mineral Resources.

2.4.2 Steinhoff, Brait share movements

Financial Sector Conduct Authority (FSCA) was investing the probing the possibilities of insider trading at Steinhoff, into seven accounts that sold their shares off between November and December 2017. There were suspicions that parties involved may have been in possession of inside information relating to some internal irregulars of their CEO. The accounts where the trading transactions took place belonged to individuals, trusts and corporate entities. It was suspected that the parties

2.4.3 JSE to investigate MTN for possible insider trading

When Nigerian Communications Commission fined MTN $5.2 billion relating to the timing of the disconnection of 5.1 million MTN Nigeria subscribers, The Johannesburg Stock Exchange (JSE) started an investigation to determine if there was any element of insider trading given the timing of their announcement. The investigation was to look at their trading before and after the announcement to determine whether any listing regulations had been breached.

3. THE MANNER IN WHICH THE PROVISIONS AGAINST MARKET ABUSE ARE ENFORCED AND THE INVOLVEMENT OF OTHER ROLE PLAYERS

Market abuse practices may directly or indirectly give rise to several difficulties such as inaccurate stock market prices, low public investor confidence, reduced market integrity and poor competence in the affected financial markets.

This thesis reveals that three major forms of market abuse, namely insider trading, prohibited trading practices (trade-based market manipulation) and the making or publication of false, misleading or deceptive statements, promises and forecasts relating to listed securities (disclosure-based market manipulation) are prohibited in South Africa.

3.1. The Role of the Financial Services Board

This is an independent board that exists to oversee and enforce the prohibited market abuse in South Africa, amongst other things. The FSB has ostensibly wide powers to ensure the proper supervision and enforcement of the South African market abuse prohibition in terms of the Securities Services Act.

The FSB relies on the Surveillance Division from the JSE to discover suspicious trading patterns and volumes. They then further rely on the accounts system of the broker-dealer for information from other market participants by investigating their trading history in order to detect any market abuse practices.

They also make use of an auction process system to prevent and avoid market manipulation. They can also investigate all the JSE transactions by analysing trade volumes of traded securities. These transactions are then kept in a database in order to easily identify illicit trading activities.

3.2. The Role of the Directorate of Market Abuse

This committee of the FSB is established in order to perform some of the FSB's functions. They are empowered to institute any civil proceedings as contemplated in the Securities Services Act and to investigate any matter relating to market abuse (REF).

With the appropriate warrant, they have the powers to interrogate, summon, and to search and seize any documents in possession of suspected abusers. Inversely, the Securities Services Act allows the committee to withdraw, abandon or compromise any civil proceedings instituted.

The Directorate of Market Abuse may also refer matters to the Director of Public Prosecutions, to institute derivative civil proceedings and to also refer matters to the Enforcement Committee.

3.3. The Role of the Enforcement Committee

This is another committee of the FSB that adjudicates and administrates on all forms of market abuse referred to it by the Registrar of Securities Services or the Directorate of Market. The Enforcement Committee's jurisdiction was expanded to all the industries that it regulates under the Securities Services Act by the FSB.

In cases where market abuse offenders are linked between the unlawful conduct and calculable damages suffered by the affected party or the applicant, the Committee may impose compensatory orders. The preparation and investigation costs of the FSB can also be imposed by the committee as cost orders on the market abuse offenders.

Market-abuse offenders may also be required to pay the remuneration costs of Committee panel members. It's important to note that orders made by the Committee have legal force as if it was made by the High Court and may be enforced by the FSB in cases of non-payment.

3.4. The Role of the Board of Appeal

This is an independent body where any decisions of the Registrar of Securities Services, the Enforcement Committee or the Financial Services Board regarding market abusers can be lodged and appealed. These hearings are held publicly more so if an appeal is against the above-mentioned.

3.5. The Role of the JSE Limited

The JSE through its Market Practices Department in its Surveillance Division has a responsibility to detect, investige, and prevent of market abuse. The JSE requires non-public price-sensitive information relating to any securities of the listed companies to be disclosed.

Certain other requirements by the JSE include releasing an announcement that provides details of any developments of material movements. The JSE's Surveillance Division usually examines the trading activity prior to the announcements to investigate whether there is evidence of possible market abuse.

3.6. The Role of the Courts

Market abuse cases referred by the FSB are the responsibility of competent courts (High Courts or Regional courts) who can/will ensue civil and criminal prosecution. The Director of Public Prosecutions may only exercise its prosecutorial powers on a referral basis.

3.7. Provisions

South Africa has had market manipulation legislation in place for about three decades, and has accomplished to improve market integrity by combating market abuse practices. These propositions suggest that the market abuse might have been intensified among other effects such as several gaps, errors and/or inconsistent application and enforcement of the market abuse legislation in South Africa. The anti-market abuse enforcement framework under the Securities Services Act 36 of 2004 is analysed to investigate its adequacy.

The competence of the awareness and preventative procedures in place to limit market abuse practices is also investigated to determine whether such procedures are strong enough to dominate other new challenges that were posed by the 2007 to 2009 global financial crisis.
A theory-based approach from all the selected role players for the market abuse recommends a practical anti-market abuse model and policy outline. This can be used to strengthen some of the market abuse provisions in South Africa.

4. BASIC FACTS PERTAINING TO THE CASE AND CRITICALLY EVALUATE THE CONCLUSION REACHED BY THE ENFORCEMENT COMMITTEE

MASLAMONY THEEGARAJAN PATHER	- FIRST APPELLANT
AH-VEST LIMITED	- SECOND APPELLANT
and	
FINANCIAL SERVICES BOARD	- FIRST RESPONDENT
THE ENFORCEMENT COMMITTEE	- SECOND RESPONDENT
THE MINISTER OF FINANCE (RSA)	- THIRD RESPONDENT

Neutral citation: *Pather v Financial Services Board* (866/2016) [2017] ZASCA 125 (28 September 2017)

Bench: Ponnan, Cachalia and Tshiqi JJA and Lamont and Rogers AJJA

Heard: 24 August 2017

Delivered: 28 September 2017

Summary: Securities Services Act 36 of 2004 – proceedings before enforcement committee – not in the nature of criminal proceedings – civil standard of proof applies – administrative penalties imposed by enforcement committee – not in the nature of a penal sanction.

Count 1

During April 2005, for the purpose of the audit of the company's accounting records in preparation of its financial statements for the year ending 28 February 2005, the appellants, through the records, represented to the auditors that portion of the recorded credit sales transactions to the value of R830 486 were genuine transactions concluded in the normal course of business when they knew or ought reasonably to have known that the representation was false, misleading or deceptive in that these were fictitious transactions which resulted in credit sales and accounts receivable being overstated by the sum in question.

Count 2

On 31 May 2005 the appellants caused the financial statements for the 2005 year to be published on the Stock Exchange News Service (SENS) which they knew or ought to have known were false, misleading or deceptive in overstating

1. Trade and other receivables by R1 633 377,
2. Capital and reserves after tax by R1 007 023 and
3. Profit after tax by R295 747.'

The Supreme Court of Appeal handed down judgment on 28 September 2017, in the matter of *Pather vs Financial Services Board*. The decision concerns a challenge to the jurisdiction of the Enforcement Committee of the Financial Services Board ("**FSB**") to deal with market abuse, specifically in this case publishing false statements that resulted in an overstatement of the performance of their company. The two appellants were Maslamony Pather and Ah-Vest Ltd (formerly All Joy Foods Ltd). The company took part in the market abuse type that can be referred to as insider trading and prohibited trading practices which was prohibited by the Financial Market Act 19, 2012.

The financial Market Act 19, 2012 aims to ensure that the South African financial markets are fair, efficient and transparent. The company presented wrong information to the auditors knowing exactly that the transactions were wrong. This promotes the manipulation of insider information.

The prohibition on the making or publication of false, misleading or deceptive statements, promises and forecasts was welcomed because it was believed that such information often distorts the market price of securities, giving rise to direct or indirect prejudice to innocent market participants but the same practices were prohibited in the amendment of Security Services Act 17 to establish Financial Markets Bill 2012 and the Financial Markets Act 19, 2012.

Insider trading was prohibited in the Securities Services Act which is the predecessor of Financial Market Act 19, 2012. It confirmed that the purpose of the Securities Services Act (which applied at the time and was subsequently replaced by the Financial Markets Act, 2012) is to protect the public and promote confidence in the market. The FSB's Department of Market Abuse investigates contraventions of the Act, and refers them to the Enforcement Committee for decision. The purpose of the legislative scheme is (i) to ensure that financial services are provided in a fair, efficient and transparent manner; and (ii) to maintain a stable financial market environment. So the company had to be charged under these conditions. Even though they did not contend that the factual findings of the Enforcement Committee of the FSB were wrong. Rather, the appellants argued that a hearing by the Enforcement Committee on charges of market abuse (such as insider trading, market manipulation, and false statements) that results in the imposition of an administrative penalty is similar to a criminal prosecution, and hence 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. It confirmed that the purpose of the Securities Services Act (which applied at the time and was subsequently replaced by the Financial Markets Act, 2012) is to protect the public and promote confidence in the market. The FSB's Department of Market Abuse investigated contraventions of the Act, and referred appellants to the Enforcement Committee for decision. The purpose of the legislative scheme is (i) to ensure that financial services are provided in a fair, efficient and transparent manner; and (ii) to maintain a stable financial market environment.

The Enforcement Committee imposed administrative penalties and did not make proceedings before it criminal proceedings. In fact, an administrative penalty, if unpaid, may be converted into a civil judgment in favour of the FSB. An administrative penalty does not constitute a previous conviction either.

In other words, although the regulatory provisions are punitive and intended as a deterrent, they are not criminal or quasi-criminal in nature. The administrative penalties are, furthermore, only monetary and there is no provision for the imposition of imprisonment.

All this supports the analysis, the SCA found, that these are administrative and not criminal proceedings. The same analysis is adopted in foreign jurisdictions where similar regimes exist. This is consistent with the approach adopted in regard to administrative penalties that are imposed under the Competition Act, the Income Tax Act, and the Employment Equity Act. The fact that very large monetary penalties may be imposed does not alter the position. The result is that a person aggrieved by the outcome of proceedings before the Enforcement Committee can only review the decision on grounds of unlawfulness, procedural unfairness or unreasonableness. The protections in section 35(3) of the Constitution, which deals with the right to a fair trial of an accused in a criminal prosecution, do not apply. The decision will no doubt please the FSB. Its ability to deal with market abuse via its Enforcement Committee is an efficient, informal and inexpensive process, relative to a ponderous criminal prosecution, and enables the FSB to be more agile and adroit in policing market abuse.

5. SUITABLE ETHICAL APPROACH

5.1. Consequentialism

This is a theory about whether or not something is right by the resultant of its consequences. This would be related to a lie, where we have characterised lies into being both a white lie and a normal lie. One lie has less effect than the other because of the consequences thereof.

This theory is difficult to use because of its unpredictability and difficulty of knowing what the result of an action will be ahead of time. Also, in certain situations, consequentialism can lead to decisions that are objectionable, even though the consequences are arguably good.

5.2. Virtue Ethics

This is an ancient Greek theory that was created by Aristotle to understand the moral character of a person.

So, virtue ethics helps us understand what it means to be a virtuous human being. And, it gives us a guide for living life without giving us specific rules for resolving ethical dilemmas.

5.3. Deontology

This theory is one that uses a binary way of thinking, promotes the adherence to rules in order to highlight what's right from wrong. The application of this theory/approach is one that requires people to just follow the rules and do their what they need to do. It doesn't need any special management in that it's based on natural intuition of the right and wrong.

So, following the rules makes deontology easy to apply. But it also means disregarding the possible consequences of our actions when determining what is right and what is wrong.

5.4. Rights-Based Approach

This theory highlights how we all have certain rights by mere fact that we are human. These rights are considered both negative and positive and can also be conventional or natural.

This would include as examples the following: The right to life, the right to liberty, The right to a lawyer, The right to religion of choice, The right to personal privacy, The right to own property. The right to be free from slavery, the right to not be tortured. These are amongst hundreds of other rights.

5.5. Provisions

Insider trading can be both legal and illegal. Although the crux of the insider trading concept centres around 'access to knowledge', the use of that knowledge either within the closed period or not can still yield 'benefit' to the one who holds that information.

Insider trading can also be consequential to my interests as an individual. As an example, I am a member of the management committee and I get corridor talk that a huge lawsuit is coming for the company I work for, which also happens to have over a million rand of my savings in stock, I would quickly liquidate those shares in order to preserve my savings. This can be seen as both right and wrong.

The consequentialism approach to insider trading can compare the benefits and consequences of insider trading with respect to its influence on public utility. Consequentialism arguments with insider trading causes an incorrect value of establishment within securities, this reflects to the fact that it can degrade market efficiency, it weakens the confidence in the investment market, it decreases liquidity, can cause harm with the non-informed counterpart of the insider.

Compare the shared gains that come with informational efficient capital markets. The more prices reflect information accurately, the better prices guide capital investment in the economy. This gives management a way to communicate a complex update in a trustworthy way. The confidence of stockholders is not likely to decline, researched and records have showed limited market liquidity and the non-informed part of the insider was not affected.

Consequentialism is likely to produce more social wealth rather than less. Another benefit from insider trading is the market-based reimbursement structure, which makes it also likely to reward the innovative and entrepreneurial inputs of corporate insiders. In terms of ethical approach on consequentialism limited ethical sources for banning insider trading.

Although in argument against consequentialism is that inside trading can be seen as biased to what is right, referring to it to be unfair or not being truthful. It gives the outsider a one-sided comparative difficulty that skews competition. Honoured corporate information can be seen as a valuable, insubstantial property right. Critical advantage of insider trading it is that this secure information can have has value with decision making.

Determine who holds the ownership rights over the material non-public information. Then the association between the trader and the owner has to be determined. If the trader is also the rightful owner of the information, then there is no 'theft' problem. If he is not, then one has to determine whether he has the actual or implied authority of the owner to use the information. Only in the case where he has not, there will be a violation of property rights.

Consequentialism approach is ideal in that in any event, all other approaches make reference to the universal rules and laws of concisions. Consequentialism however as state in my above example, will study the reason behind the action 'breaking the rule'.

6. REFERENCES

1. Parliamentary Monitoring Group (PMG), 2016. Overview: Protected disclosures amendment bill [B40-2015].
2. http://pmg-assets.s3-website-eu-west-1.amazonaws.com/160301Overview.pdf Date of Access: 09 March 2019
3. Chitimira, H. 2012. A comparative analysis of the enforcement of market abuse provisions. Nelson Mandela Metropolitan University. (Thesis – PhD)
4. McGee, R.W. 2008. Applying Ethics to Inside Trading. Journal of Business Ethics.77: 205-217 https://www.jstor.org/stable/25075554