

**CORPORATE GOVERNANCE IN KENYA: A CASE FOR REVIEW OF THE LEGAL
FRAMEWORK ON INSIDER TRADING**

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DECLARATION

I, **ROSE MWIKALI KYALO**, do hereby declare that this is my original work and it has not been submitted to any other institution for any qualification.

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.....

DATE

This thesis has been submitted for examination with my knowledge and approval as the university supervisor.

.....

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.....

DATE

DEDICATION

To Jomo Kenyatta University of Agriculture & Technology, my family and my best friend,
Hillary Oyare Oloo.

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First and foremost, I thank the Almighty God for bringing me this far, keeping me in good health and for the gift of wisdom.

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ABSTRACT

Insider trading which involves the buying or selling of securities while in possession of material non-public information, is one of the weak corporate governance practices in Kenya.

Kenya's insider trading laws are inadequate. They are characterized by inadequacies, such as, limited scope of application, narrow and flawed definitions of insider trading terms, for example, 'insider', 'dealing' and 'inside information'. The study also found the disclosure obligations, insider trading offences and penalties in-exhaustive. On the other hand, the institutional framework is characterized by inadequacies, such as, poor surveillance and motoring techniques, weak whistleblowing system, the Capital Markets Authority's duty to supervise market players is narrow, lack of adequate support and co-operation from other agencies, poor investor education and lack of policy guidelines on insider trading regulation.

To draw lessons for Kenya, the study comparatively analyzed the legal frameworks on insider in the United Kingdom, the United States of America and South Africa. The findings of the study informed the final recommendations made herein that call for reforms.

LIST OF ABBREVIATIONS

ASAM	-	Auto Search And Match
CEO	-	Chief Executive Officer
CMA	-	Capital Markets Authority
CMFIU	-	Capital Markets Fraud Investigation Unit
CJA	-	Criminal Justice Act
DMA	-	Directorate of Market Abuse
DCI	-	Directorate of Criminal Investigations
DOJ	-	Department of Justice
DPP	-	Director of Public Prosecutions
EC	-	European Community
FBI	-	Federal Bureau of Investigation
FCA	-	Financial Conduct Authority
FSMA	-	Financial Services and Markets Act
FSA	-	Financial Services Authority
FSB	-	Financial Services Board
ISIS	-	Inter-market Surveillance Information Systems
JSE	-	Johannesburg Securities Exchange
KCC	-	Kenya Co-operative Creameries
LSE	-	London Stock Exchange
LTD	-	Limited
NYSE	-	New York Stock Exchange
NSE	-	Nairobi Securities Exchange
OECD	-	Organization for Economic Co-operation and Development
PCAOB	-	Public Company Accounting Oversight Board

RDC	-	Regulatory Decisions Committee
SEC	-	Securities Exchange Commission
STOCK Act	-	Stop Trading On Congressional Knowledge Act
UK	-	United Kingdom
USA	-	United States of America

LIST OF STATUTES

Kenya

1. Capital Markets Act, Cap. 485A, Laws of Kenya.
2. Capital Markets Authority Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya, 2002, Gazette Notice No. 3362.
3. Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.
4. Code of Corporate Governance for the Issuers of Securities to the Public, 2015, Gazette Notice No. 1420.
5. Companies Act, No. 17 of 2015, Laws of Kenya.
6. Companies Act, Cap. 486, Laws of Kenya.

South Africa

1. Companies Act, No. 71 of 2008.
2. Companies Act, No. 61 of 1973.
3. Financial Markets Act, No. 19 of 2012.
4. King III Report on Corporate Governance, 2009.
5. Insider Trading Act, No. 135 of 1998.
6. Securities Services Act, No. 36 of 2004.

United Kingdom

1. Cadbury Report, 1992.
2. Criminal Justice Act, 1993.
3. Financial Services and Markets Act, 2000.
4. Public Interest Disclosure Act, 1998.

United States of America

1. Insider Trading Sanctions Act, 1984.
2. Insider Trading and Securities Fraud Enforcement Act, 1988.
3. Sarbanes-Oxley Act, 2002.
4. Securities Act, 1933.
5. Securities Exchange Act, 1934.
6. Stop Trading on Congressional Knowledge Act.

LIST OF INTERNATIONAL INSTRUMENTS

1. EC Directive on Insider Dealing and Market Abuse (1989).
2. OECD Principles of Corporate Governance (2004).
3. OECD Principles of Corporate Governance (1999).

LIST OF CASES

1. *Capital Markets Authority v. Jeremiah Gitau Kiereini & another* (2014) eKLR; Civil Appeal No. 9 of 2014.
2. *Diamond v. Oreamuno* 248 N.E. 2d 910 (1969).
3. *Dirks v. SEC* 463 U.S. 646 (1983).
4. *Percival v. Wright* (1902) 2 Ch. 421.
5. *R. v. McQuoid* (2009) 4 All E.R. 388.
6. *Republic v. Bernard Mwangi Kibaru*, CMCC 1337 of 2008.
7. *Republic v. Terrence Davidson*, CMCC 1338 of 2008.
8. *SEC v. Materia* 745 F.2d 197 (1984).
9. *SEC v. Texas Gulf Sulphur Co.* 401 F. 2d 833 (2d Cir. 1968).
10. *Strong v. Repide* 213 US 419 (1909).
11. *United States v. Chiarella* 445 U.S. 222 (1980).

CHAPTER ONE

A BROAD OVERVIEW AND STRUCTURE OF THE STUDY

1.1 Introduction

In Kenya dealing in shares began in the 1920s when the country was still a British colony.¹ However, there was no formal market, rules and regulations to govern the trading activities, thus trading took place on a gentlemen's agreement with no physical trading floor.² Later on, the London Stock Exchange (LSE) officials recognized the need to set up a stock exchange in Kenya which led to the registration of the Nairobi Stock Exchange, today known as the Nairobi Securities Exchange (NSE) that became a formal and physical trading floor for securities. Trading in shares and other securities moved from being conducted over a cup of tea to a formal trading floor where there were rules and regulations.³ In as much as this transformation was good for Kenya's economy, it has over the years become a fertile ground for securities frauds and weak corporate governance practices such as market manipulation practices and insider trading, which is the focus of this study.

Insider trading occurs when someone makes an investment decision based on information that is not available to the general public.⁴ In most cases the information either allows the person to make a profit or avoid a loss. Like in most countries in the world, in Kenya insider trading is a securities fraud as well as a breach of good corporate governance.

¹ J. K. Gakeri, 'Enhancing Kenya's Securities Markets through Corporate Governance: Challenges and Opportunities' (2013) Vol. 3 No. 6 IJHSS, p. 6 <http://www.ijhssnet.com/journals/Vol_3_No_6_Special_Issue_March_2013/11.pdf> accessed 16 October 2015.

² NSE Website <www.nse.co.ke> accessed 16 October 2015.

³ Ibid.

⁴ G. Morse, *Company Law* (16th Edn, Sweet & Maxwell), p. 349.

Corporate governance was defined by the United Kingdom Cadbury Committee as “...the system by which companies are directed and controlled”.⁵

Good corporate governance is part and parcel of the Kenya’s long-term development blue-print Vision 2030, whose economic pillar calls for enhancement of leadership and governance skills in all sectors of the economy. For good corporate governance to prevail, weak corporate governance practices such as insider trading should be rooted out.

In Kenya insider trading is a crime under the Capital Markets Act.⁶ The Act contains provisions which expressly prohibit and criminalize insider trading. In 2013 the Capital Markets Act was amended with a view to introducing clearer regulatory provisions to tackle market manipulation and insider trading.⁷ This was in the aftermath of the Uchumi insider trading cases involving Mr. Terrence Davidson and Mr. Bernard Kibaru who were tried and acquitted on grounds of lack of enough evidence.⁸ Institutionally, in May 2009, the CMA in collaboration with the Kenya Police established a Unit known as the Capital Markets Fraud Investigation Unit (CMFIU) to detect and carry out investigations on securities frauds such as insider trading.⁹

Given that it will be impossible for Kenya to fully realize its Vision 2030 economic goals with weak corporate governance practices such as insider trading standing in the way of good corporate governance. This study sought to assess the adequacy of Kenya’s legal framework on insider trading, find out what lessons Kenya can learn from the experiences in other jurisdictions

⁵ Cadbury Committee Report (1992) Report on the financial Aspects of Corporate Governance, London: Gee Publishing, Introduction, para. 1.2.

⁶ Cap. 485A, Laws of Kenya.

⁷ CMA Annual Report 2013, p. 25 available at <http://www.cma.or.ke/index.php?view=download&alias=291-annual-report-2013&category_slug=annual-reports&option=com_docman&Itemid=581> accessed 31 October 2016.

⁸ P. Wanyama, ‘Kenya: Why Law on Insider Trading Needs Urgent Overhaul’, (Business Daily, 29 November 2010) available <<http://www.propertykenya.com/news/1391618-cobrand!>> accessed 16 November 2015.

⁹ J. K. Gakeri, ‘Regulating Kenya’s Securities Markets: An Assessment of the Capital Markets Authority’s Enforcement Jurisprudence’ (2012) Vol. 2 No. 20, IJHSS, p. 274 <www.ijhssnet.com> accessed 30 October 2016.

with more effective insider trading regimes and based on the overall findings, make recommendations for reforms.

1.2 Background to the Study

Transactions conducted by insiders such as directors based on material, non-public information amount to a breach of the fiduciary duties owed to the company, which stipulate that directors being the key decision makers, should act in the best interest of the company and not in their own interests.¹⁰ Fiduciary duties include the duty of good faith, the duty to avoid conflict of interests and the rule against managerial opportunism. The duty of good faith, requires directors to exercise their powers in the best interests of the company whereas, the duty to avoid conflict of interests requires them not to put themselves in a position where their interests may conflict with the interests of the company. The conflict of interest duty applies to the exploitation of any property, information as well as an opportunity of the company.¹¹

Moreover, even though internationally accepted corporate governance standards call for equal disclosure and equal treatment of shareholders, the fundamental characteristic of insider trading is that there is asymmetry of information with some stakeholders having an advantage of being privy to information which has not yet been disclosed to the public and other stakeholders.¹²

¹⁰ L. M. Musikali, *The Law affecting Corporate Governance in Kenya: A need for Review* (2008) Vol. 19 No. 7 ICCLR 213, p. 214 <<http://ssrn.com/abstract=1275308>> accessed 11 November 2015; A. Cabot and B. Preber, *Insider Trading* (Gaming Management, June 2008) <www.CasinoEnterpriseManagement.com> accessed 11 November 2015.

¹¹ A. Dignam, *Cases & Materials on Company Law* (7th Edn, Oxford University Press 2011), p. 395.

¹² P. Akivaga, *Corporate Governance Watch: Insider Trading* (VIP sight Archives Africa-Kenya, 22 May 2011) <<http://vipsight.eu/index.php/vip-aktuell?id=22&lang=en>> accessed 2 April 2016.

Insider trading is also harmful to a company's reputation putting the company at the risk of limited access to capital due to lack of investor confidence.¹³

In Kenya the principal legislation governing insider trading is the Capital Markets Act which prohibits and criminalizes insider trading. However, despite the fact that Kenya has had a legal framework on insider trading that is comprised of laws, regulations and institutions for decades now, insider trading is rampant and persistent causing companies, shareholders, stakeholders and the Kenyan economy enormous losses.¹⁴ Recent insider trading scandals include the Safaricom Ltd and Chase Bank Ltd scandals.¹⁵ It is quite unfortunate to note that in Kenya, many insider trading instances go undetected and investigations take too long to be finalized. Kenya has also had no successful prosecution of insider trading cases.

It is against this background that this study sought to assess the adequacy of Kenya's legal framework on insider trading, with a view to identifying flaws and gaps that hinder successful prosecution of the insider trading offence and make recommendations for reforms.

¹³ In *Diamond v. Oreamuno* 248 N.E. 2d 190 (1969) p. 193, the Court held that the prestige and goodwill of a corporation, so vital to its prosperity, may be undermined by the revelation that its chief officers had been making personal profits out of corporate events which they had not disclosed to the community of stockholders.

¹⁴ See Adili, 'Corruption and the Private Sector: The corporate governance crisis in Kenya's financial sector' (Global Corruption Report, 2009), p. 2 <<http://www.tikenya.org/phocadownload/adili113.pdf>> accessed 11 November 2015; B. Wambugu, 'Claims of Insider Trading Emerge at CMC Case Hearing' (Business Daily, 31 October 2011) <www.businessdailyafrica.com/Claims-of-insider-trading-emerge-at-CMC-case-hearing-/539552-1265234-15k9lxa/index.html> accessed 9 August 2016; J. Opiyo, 'Boardroom Wars at Co-op Bank' (Citizen Weekly, 23 November 2014) <<http://weeklycitizennewspaper.blogspot.co.ke/2014/11/boardroom-wars-at-co-op-bank.html>> accessed 2 April 2016; J. Opiyo, 'Boardroom Wars at Co-op Bank' (Citizen Weekly, 23 November 2014) available at <<http://weeklycitizennewspaper.blogspot.co.ke/2014/11/boardroom-wars-at-co-op-bank.html>> accessed 2 April 2016; Capital FM, 'Kenya Markets Regulator Cracks Whip' (9 March 2010) <<http://www.capitalfm.co.ke/business/2010/03/kenya-markets-regulator-cracks-whip/>> accessed 2 April 2016.

¹⁵ The allegations in the Chase Bank scandal were that a senior Safaricom executive who had insider knowledge fled the bank, two days before its collapse. Star Reporter, 'Safaricom director denies she fled Chase Bank ownership two days before collapse' (The Star, 15 April 2016) <www.the.star.co.ke/news/2016/04/15/safaricom-director-denies-she-fled-chase-bank-ownership-two-days_c1333131> accessed 4 August 2016.

1.3 Statement of the Problem

For Kenya to achieve the goals of the economic pillar enshrined in its Vision 2030, practices such as insider trading that violate good corporate governance should be rooted out.

As previously stated, the Capital Markets Act is the principal legislation on insider trading in Kenya. The Act contains provisions which expressly prohibit and criminalize insider trading.¹⁶ However, there are inadequacies in the Act such as limited scope of application, narrow and flawed definitions of insider trading terms, for example, ‘insider’, ‘dealing’ and ‘inside information’.¹⁷ The Act is characterized by in-exhaustive disclosure obligations, whose scope of application is limited to issuers of securities and lack penalties for non-compliance.¹⁸ The Act also contains in-exhaustive insider trading offences and the prescribed penalties are not severe enough to punish/deter insider trading.¹⁹

Further, the Companies Act, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations and the Code of Corporate Governance for the Issuers of Securities to the Public, lack adequate provisions on disclosure obligations and equal treatment of shareholders.

On the other hand, Kenya’s institutional framework on insider trading is characterized by inadequacies such as poor surveillance and monitoring techniques, weak whistleblowing system, lack/poor investor education and lack of an insider trading policy that can offer guidance on insider trading regulation. The CMA also lacks support and co-operation from other market intermediaries and stakeholders. Another shortcoming is brought about by the fact that, CMA’s

¹⁶ See pp. 2 and 4 (above).

¹⁷ Capital Markets Act, ss. 32A (1); 2; 32 B (1); 32C (1).

¹⁸ S. 30F (1).

¹⁹ Ss. 32B (1); 32E.

role to supervise and monitor market intermediaries and stakeholders, is limited to licensed/listed persons.

The effect of this, is that insider trading perpetrators will go scot free and insider trading instances will take place undetected. Therefore, this study examines the extent to which the aforementioned inadequacies hinder the successful prosecution of the insider trading offence and the lessons that Kenya can learn from jurisdictions with more effective legal frameworks on insider trading namely; the UK, USA and South Africa. Based on the findings, the study makes recommendations for reforms.

1.4 Theoretical Framework

The origin of the insider trading problem can be traced back to the introduction of limited liability companies and the opening up of corporate ownership to the general public through share ownership which had a remarkable impact on the way in which companies were controlled.²⁰ The outcome was that the owners who were principally the shareholders of the listed companies delegated the running of the companies to the management, hence a separation of ownership and control leading to the 'agency problem' also referred to as the 'corporate governance problem'.²¹

Different theories have been developed in an attempt to explain the corporate governance problem. These theories include the agency theory, transaction cost theory, stakeholder theory and the stewardship theory. However, the corporate governance theory that best explains insider

²⁰ J. Solomon and A. Solomon, *Corporate Governance and Accountability* (John Wiley & Sons Ltd, Cromwell Press 2004) p. 17; La Porta Rafeal, Lopez-De-Silanes Florenzio & Shleifer Andrei, 'Corporate Ownership around the World' (1999) Vol. LIV No. 2 Journal of Finance, 471, p. 472.

²¹ Ibid.

trading which manifests itself as conflict of interests between directors and shareholders, is the agency theory also known as the principal-agent theory.

The key proponents of the agency theory are the USA economists, Jensen and Meckling.²² The agency theory perceives the governance relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating decision making authority to the agent. In this relationship the shareholders are the principals and the directors are the agents. The theory sees both shareholders and directors as utility maximizers, hence the belief that the directors will not always act in the best interests of the shareholders.

The theory argues that the separation of ownership and control potentially leads to self-interest actions such as insider trading by the directors. The shareholders delegate day-to-day decision making to the directors, who by virtue of their knowledge and expertise, gain an advantage over the shareholders who do not have the actual control of the firm. The problem is that the agents do not necessarily make decisions in the best interest of the principals. One of the principal assumptions of the agency theory is that there is always a conflict between the agents' goals and the principals' goals. Since the directors are in charge of decision making, chances are that they will make decisions that favor them and not the shareholders.²³

The theory argues that even though the assumption is that the primary objective for companies is shareholder wealth maximization, in practice this is not necessarily the case. This is because it is likely that company directors prefer to pursue their own personal objectives aimed at maximizing

²² M. C. Jensen and W. H. Meckling 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) Vol. 3 No. 4 Journal of Financial Economics, p. 305 <<http://ssrn.com/abstract=94043>> accessed 11 November 2015.

²³ Ibid.

their interests.²⁴ According to this theory, the directors are always tempted to supplement their salaries with as many perquisites as possible leading to a reduction in shareholder value, known as ‘residual loss’ in the agency theory terminology. These perquisites may include self-interest practices such as insider trading where directors make investment decisions on the basis of material non-public information to which they gain access, by virtue of their positions as directors.

The theory further argues that the agency problem caused by the separation of ownership and control in listed and public companies, presents shareholders with a need to monitor and control the management. However, the theory assumes that, it is expensive and difficult for the shareholders to verify the decisions and actions of the directors. Even though there are ways in which shareholders’ and directors’ interests may be aligned, the theory perceives these ways as costly. The theory refers to the costs that arise from attempts by shareholders to monitor company management as ‘agency costs’.²⁵ Other agency costs arising from the agency relationship, are those incurred by directors. The theory argues that directors are keen to demonstrate to the shareholders that they are accountable and that they are following the shareholder wealth maximization objective. They therefore, incur costs in the accounting process and arranging meetings with primary shareholders among others. These costs in the agency theory terminology are known as *ex-ante* bonding costs. The agency theory, therefore, summarizes the total agency costs arising from the agency problem as comprising of; residual loss, principal’s monitoring expenditure and agent’s bonding expenditure.²⁶

The agency theory has been used in most scholarly research into corporate governance. One of its strongholds is simplicity as it focuses only on the relationship between the shareholders and

²⁴ Solomon, *supra* note 20, p. 17.

²⁵ Jensen and Meckling, *supra* note 22, pp. 306-310.

²⁶ *Ibid.*

directors. However, the theory has been criticized for its relatively narrow theoretical scope because it studies corporate governance in terms of contracts between principals and agents.²⁷ It has also been criticized for its philosophical moral assumption about the nature of man, because the theory assumes that people are always self-interested and are incapable of looking after the interests of others.²⁸

1.5 Conceptual Framework

This study is premised on two variables; corporate governance and insider trading. There is no agreed on definition of corporate governance, however, there are two approaches to defining corporate governance. One of the approaches adopts a narrow view where corporate governance is defined with strict reference to the relationship between a company and its shareholders. This is known as the shareholder-oriented approach. The other approach adopts a broad view where corporate governance is viewed as a web of relationships besides the one between a company and its shareholders. According to this approach, corporate governance is also inclusive of the relationships between a company and its stakeholders (employees, creditors, suppliers and customers). This is known as the stakeholder-oriented approach.²⁹

This study adopts the stakeholder-oriented approach to corporate governance. For purposes of this study, corporate governance is the system of checks and balances on directors' powers, whose aim is to ensure that companies discharge their accountability to the shareholders, stakeholders and the society at large.

²⁷ B. Tricker, *Corporate Governance: Principles, Policies & Practices* (2nd Edn, Oxford University Press), p. 62.

²⁸ Ibid.

²⁹ Solomon, supra note 20, p. 12.

Likewise, there is no agreed on definition of insider trading. Generally, insider trading involves the buying or selling of securities while in possession of material non-public information.

In an endeavor to make recommendations for reforms that Kenya should adopt in order to effectively curb insider trading, this study conceptualized a negative relationship between corporate governance and insider trading. It is argued that for good corporate governance to prevail, insider trading must be rooted out.

1.6 Literature Review

As stated by Bob Tricker, “corporate governance is a subject whose time has come.”³⁰ The exceptional growth of interest in corporate governance has equally been accompanied by an array of literature that seeks to achieve clarity on the subject and pave way for reforms of corporate governance practices. Even though corporate governance problems are well documented, insider trading as a corporate governance problem has received little attention both locally and internationally. The literature review commences with a discussion that seeks to show why insider trading is a weak corporate governance practice that should be curbed. This is then followed by a review of the literature on the insider trading laws and their enforcement in the UK, the USA and South Africa, to show how they have handled challenges in insider trading regulation. The literature review sums up with a discussion on Kenya’s literature on insider trading regulation whose aim is to expose a scarcity of literature on the adequacy of Kenya’s legal framework on insider trading which is the main focus of this study.

³⁰ Tricker, supra note 27, p. 61.

(a) Insider Trading as a Weak Corporate Governance Practice

Stephen Girvin, Sandra Frisby and Alastair Hudson in their text on Company Law³¹ state that one of the principal arenas for corporate governance relates to the management of a company by its directors. They assert that directors are agents through whom a company acts and it is for this reason that they are regarded as owing fiduciary duties to the company, to ensure the success of the company, to always act in the best interest of the shareholders and to avoid conflict of interests.³²

Bob Ticker in his text on corporate governance³³ states that the directors' duty of trust requires them to exercise a fiduciary responsibility to the company and its shareholders. He asserts that the duty demands that directors act with integrity, behave honestly and fairly for the benefit of the company and its stakeholders. He says that, acting honestly in good faith is the primary duty of a director and when acting honestly in good faith, a director should not treat a company as though it exists for his personal profit. According to him, a director should avoid conflict of interests and should not make a secret profit or acquire any unauthorized benefit by virtue of his position as a director.

Pamela Akivaga³⁴ a Kenyan writer on corporate governance matters, contends that insider trading is a blatant violation of corporate governance principles. She asserts that insider trading contravenes internationally accepted corporate governance standards that call for equal disclosure and equal treatment of stakeholders. Her argument is that insider trading presents a situation whereby there is asymmetry of information, with some stakeholders being privy to

³¹ S. Girvin et al., *Charlesworth's Company Law* (18th Edn, Sweet & Maxwell 2010).

³² *Ibid*, p. 601.

³³ Tricker, *supra* note 27.

³⁴ Akivaga, *supra* note 12.

information that has not yet been revealed to the public and other stakeholders. Those with the information use it to their advantage at the detriment of the less informed.

(b) Insider Trading Laws and Their Enforcement in Other Jurisdictions

The international literature on insider trading, mainly focuses on the formulation and enforcement of insider trading laws in the developed economies such as the UK, the USA, Canada and Australia among others. The authors and the commentators expound on the strengths and the challenges hindering the enforcement of the insider trading laws, critically examine the ways in which the challenges have been addressed, and above all identify areas in which there is room for improvement. This has to a greater extent contributed to the effectiveness and adequacy of the insider trading laws in the developed economies. This study will selectively review the literature on the UK, the USA and South Africa's legal frameworks on insider trading.

Stephen Girvin, Sandra Frisby and Alastair Hudson, note that the regulation of insider trading in the UK was necessitated by the widespread concern about the misuse of confidential information by officers of the company and their associates, their families and friends to whom information about the company had been relayed, and the misuse of such information by others outside the company such as accountants, auditors and bankers. The authors allude that the exhaustive definition of 'inside information' by the UK Criminal Justice Act is one of the strongholds of the UK insider dealing laws. The Act clearly specifies the requirements that must be met for any information to be regarded as inside information. They criticize the UK Criminal Justice Act is, for not defining when, for example, does a rumour cease to be rumour and become specific or precise? They also criticize the Act for not exhaustively stating when information is deemed to have been made public and is no longer inside information. One of the shortcomings of the UK

Criminal Justice Act and its predecessor the Companies Act identified by the authors is that the two legislations only provided for criminal proceedings against insider dealing offenders. This meant that the prosecution had to prove the offenders' guilt beyond any reasonable doubt, leading to lack of successful prosecution of insider dealing offenders. A shortcoming that Kenya's legal framework on insider trading can relate to. They assert that in response to this challenge the UK Parliament enacted the Financial Services and Markets Act of 2000 which introduced civil proceedings against insider dealing offenders under the umbrella of the market abuse offence.

According to the authors, another shortcoming of the insider trading provisions in the 1980 Companies Act was that no provision was made or mechanism included whereby alleged or suspected abuse of insider information could be investigated by a regulatory body other than the police. This challenge was addressed through the establishment of the FSA, now, the FCA, vested with wide powers to carry out investigations into insider trading allegations.

Stephen M. Bainbridge has written a series of articles on the USA insider trading laws and their enforcement. In one of his articles he observes that insider trading jurisprudence worldwide is skewed towards the USA insider trading laws.³⁵ He contends that the USA was the first country in the world to ban insider trading and up-to-date, the USA remains the jurisdiction in which insider trading law is most energetically enforced.

A comparative study conducted by Han Shen³⁶ between the USA and China's legal frameworks on insider trading examined the shortcomings in China's insider trading laws most of which are

³⁵ S. M. Bainbridge, 'An Overview of Insider Trading Law and Policy: An Introduction to the Insider Trading Research Handbook' (2012) No. 12-15 UCLA School of Law Law-Econ Research Paper Series pp. 1-37 <<http://ssrn.com/abstract=2141457>> accessed 16 November 2015.

³⁶ H. Shen, 'A Comparative Study of Insider Trading Regulation Enforcement in the U.S and China' (2008) Vol. 9 No.1 Journal of Business & Securities Law, SSRN: <<http://ssrn.com/abstract=964548>> accessed 16 November 2015.

identical to the shortcomings in Kenya and discussed how the USA has addressed some of the challenges. The study identified lessons for China which can also be helpful in the Kenyan context. Shen observes that in an attempt to ensure the successful prosecution of insider trading offenders, like the UK, the USA insider trading laws provide for both civil and criminal proceedings against insider trading offenders. He states that in the USA, civil proceedings brought by the US Securities Exchange Commission (SEC) have been proved a powerful tool against insider trading. Save to add that, in 1988 the USA Congress expressly authorized private actions against insider trading offenders.

With regard to detection of insider trading in the USA, Shen identifies three methods used both in the USA and China to detect insider trading; referrals from the stock exchanges, investigations by the regulators and informants. He notes that one of the important cornerstones of the effective enforcement of the USA insider trading laws is the commitment of the stock exchanges in monitoring market transactions. He states that in the USA, advanced technologies play an essential role in monitoring market transactions and detecting market frauds such as insider trading. He contends that the New York Stock Exchange (NYSE) also uses sophisticated technology and pattern recognition system to monitor volume and price movements of all publicly traded stocks on a real-time basis.

Furthermore, Shen asserts that USA stands in the front-line in fulfilling the deterrence objective of insider trading laws. The USA insider trading laws provide for severe insider trading sanctions which take three forms, administrative, criminal and civil. Shen contends that the USA SEC may seek disgorgement of up three times the profit made or loss avoided, injunctive order, bar or suspension of individuals from acting as corporate officers or directors. Shen observes that criminal sanctions have gradually been enhanced in the USA. The USA Insider Trading

Sanctions Act of 1984 increased the criminal penalty for insider trading from \$10,000 to \$100,000. He goes further to state that the Insider trading and Securities Fraud Enforcement Act of 1988 increased maximum prison sentences from five years to ten years, maximum individual fines from \$0.1 million to \$1 million and for corporations from \$0.5 million to \$2.5 million. In 2002 the USA Sarbanes-Oxley Act further increased the fines to \$5 million for individuals, \$25 million for corporations and raised the prison terms to 20 years.

The literature on South Africa's legal framework on insider trading can be traced back to the King Report that identified the shortcomings of the then law on insider trading; the Companies Act of 1973. The report found the insider trading provisions of the 1973 Act inadequate and recommended the enactment of an Insider Trading Act³⁷ as a separate piece of legislation on insider trading. Since then and up-to-date, numerous studies have been conducted to evaluate the adequacy of South Africa's insider trading framework. This has also been accompanied by numerous reforms of South Africa's insider trading laws, all in an effort to make its legal framework on insider trading more effective and to bring it at par with international standards in combating insider trading.

Five years after the enactment of South Africa's Insider Trading Act, G:enesis Analytics³⁸ prepared a report on the impact of South Africa's insider trading regime.³⁹ The survey was conducted with a view to assessing whether the Act had had any impact on the market. One of the key observations made was that the Insider Trading Act was a breakthrough in the regulation of insider trading in South Africa. The Act clarified the types of behaviours that amounted to

³⁷ No. 135 of 1998.

³⁸ G:enesis Analytics is an economics firm working in Africa and in other developing countries with its headquarters in Johannesburg, South Africa.

³⁹ A. Myburgh and B. Davis, *'The Impact of South Africa's Insider Trading Regime: A report for the Financial Services Board'* (G:enesis Analytics, 25 March 2004) <www.genesis-analytics.com> accessed 23 January 2016.

insider trading, it declared tipping illegal, it allowed for both civil and criminal proceedings against insider trading offenders, it made penalties upon conviction tougher and it introduced compensation schemes for insider trading victims. Genesis also observed that there was an increase in insider trading awareness in the markets and as a good corporate governance practice, majority of the companies had come up with internal policies on insider trading.

The Insider Trading Act was later found inadequate and was repealed by the Securities Services Act, No. 36 of 2004. Likewise, a study was conducted by Howard Chitimira on the adequacy of the Securities Services Act.⁴⁰ His contention was that the coming into force of the Act had no impact on the market because the gaps and flaws that existed in the repealed Insider Trading Act were carried over into the new Act. The Securities Services Act was in 2012 repealed by the Financial Markets Act which improved South Africa's legal framework on insider trading by introducing additional insider trading offences among other changes.

(c) Insider Trading Regulation in Kenya

In the Kenyan context, the literature on the adequacy of Kenya's legal framework on insider trading is scanty.

Peter Wanyama in an article published by Business Daily⁴¹ identified loopholes in the legislative provisions on insider trading. According to him the definition of insider trading was not clear, the elements that constitute the crime were ambiguous, lack provisions on how temporary insiders and tippees should be treated, lack of a clear guide on how the police should prove that

⁴⁰ H. Chitimira, *The Regulation of Insider Trading in South Africa: A Roadmap for Effective, Competitive and Adequate Regulatory Statutory Framework* (2008) LL.M Thesis, School of Law at University of Fort Hare <<http://hdl.handle.net/10353/230>> accessed 10 October 2015.

⁴¹ Wanyama, supra note 8.

an insider has communicated, concealed or procured price-sensitive information and narrow definition of ‘securities’.

A study by Anne Kotonya sought to examine the extent to which various provisions of the Capital Markets Act impede the successful prosecution of insider trading offenders in Kenya.⁴² The study found the provisions on inside information, material price-sensitive information, publication of information, possession of information and disclosure of information vaguely formulated and difficult to prove in court. Kotonya argued that this hindered the successful prosecution of insider trading offenders in Kenya hence the need for reform of the Capital Markets Act.

The literature review reveals that in Kenya insider trading is an area that has not been widely explored and nothing much has been written as far the adequacy of Kenya’s legal framework on insider trading is concerned. Therefore, to bridge the gap in literature, this study sought to assess the adequacy of Kenya’s legal framework on insider trading after the Capital Markets Act amendments of 2013, in the wake of a new Companies Act and a new CMA Code of Corporate Governance. The study also assesses the adequacy of the disclosure obligations prescribed in the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, and the adequacy of Kenya’s institutional framework on insider trading.

1.7 Objectives of the Study

The broad objective of this study was to assess the adequacy of Kenya’s legal framework on insider trading.

⁴² A. Kotonya, ‘*Combating Insider Trading in Kenya’s Capital Markets: Challenges and Opportunities for Reform*’ (2012) LL. M Thesis, University of Nairobi Digital Repository, College of Humanities and Social Sciences (CHSS) <<http://erepository.uonbi.ac.ke:8080/xmlui/handle/123456789/9404>> accessed 16 November 2015.

Specifically, the study sought:

- a) To assess the adequacy of the laws which govern insider trading in Kenya.
- b) To assess the adequacy of Kenya's institutional framework on insider trading.
- c) To draw comparative parallels on insider trading regulation from select jurisdictions namely; the UK, the USA and South Africa.
- d) To assess the need for review of Kenya's legal framework on insider trading.

1.8 Hypotheses

The study is premised on the two hypotheses, that;

- a) Kenya's legal framework on insider trading is inadequate.
- b) To effectively address the insider trading problem, the review of the legal framework on insider trading is of ultimate necessity.

1.9 Research Questions

The study sought to answer the following questions:

- a) Are the laws which govern insider trading in Kenya adequate?
- b) Is Kenya's institutional framework on insider trading adequate?
- c) What lessons can Kenya learn from the legal frameworks on insider trading in the UK, the USA and South Africa?
- d) Is there need for review of the legal framework on insider trading?

1.10 Justification of the Study

This study is justified on the basis that even though there exists an array of literature on insider trading, there is an apparent scarcity of literature on insider trading as a corporate governance

problem both locally and internationally. Moreover, in the Kenyan context the literature on the adequacy of the Kenya's legal framework on insider trading is scanty.

This study contributes to the existing literature and bridges the gap in literature by examining insider trading from a corporate governance perspective and assessing the adequacy of Kenya's legal framework on insider trading. The major output expected from this study is recommendations that call for reforms of Kenya's legal framework on insider trading in order to effectively curb the insider trading vice that undermines good corporate governance in the spirit of the country's Vision 2030.

1.11 Research Methodology

This study sought to assess the adequacy of Kenya's legal framework on insider trading and examine how select jurisdictions; the UK, the USA and South Africa deal with the insider trading vice. Due to the nature of the study and given the fact that in Kenya, insider trading regulation and enforcement is an area that is still in its embryonic stage, the desk-review design was used to gather information. International instruments, domestic and foreign statutes, case law, legal opinions, commentaries, policy documents and other writings on corporate governance and insider trading regulation were critically examined.

The study relied on both primary and secondary sources of data. In the Kenyan context, the study examined the Capital Markets Act, the Companies Act (the old and the new), the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, CMA Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya and the Code of Corporate Governance Practices by Issuers of Securities.

In carrying out the comparative analysis statutes such as the UK Criminal Justice Act, Financial Services and Markets Act and the Public Interest and Disclosure Act, the USA Securities Act, the Securities Exchange Act, the Insider Trading Sanctions Act, the Insider Trading and Securities Fraud Enforcement Act, the Sarbanes-Oxley Act and Stop Trading on Congressional Knowledge Act and the South Africa's Companies Act (1973 and 2008), the Insider Trading Act, the Securities Services Act, the King III Report on Corporate Governance and the Financial Markets Act, were examined.

An examination and analysis of relevant case law and judicial precedents was conducted. This included both local and international cases.

The process also involved visits to the library to access relevant text books, case law, journals, statutes and other relevant materials on the topic. There was extensive internet browsing which entailed reference to relevant blogs and websites for information such as the SEC, FCA, South FSB, CMA and NSE websites. Internet browsing also enabled the researcher to access online journals and the opinions of various authors and commentators on corporate governance and insider trading regulation. For purposes of proper referencing, the links and dates on which the blogs, websites, opinions and online journals were accessed are clearly stated.

1.12 Chapter Breakdown

This study has five Chapters:

This chapter has given a broad overview and structure of the study. It has set out the agenda for discussion by generally introducing the study, discussing the background to the study, statement

of the problem, theoretical framework, conceptual framework, literature review, and objectives of the study, hypotheses, and research questions, justification of the study and chapter breakdown.

Chapter two assesses the adequacy of the laws which govern insider trading in Kenya. It focuses on the formulation of the legislative provisions of the Capital Markets Act as the principal law on insider trading in Kenya. It focuses on issues such as scope of application, definition of insider trading terms, disclosure obligations, insider trading offences and penalties among others. This chapter also assesses the adequacy of the Companies Act, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations and the Code of Corporate Governance for the Issuers of Securities to the Public, in supplementing the Capital Markets Act in the fight against insider trading. It is established that there are gaps and flaws in the said insider trading laws that should be addressed.

Chapter three assesses the adequacy of Kenya's institutional framework on insider trading. It assesses the adequacy of the CMA in terms of its capacity to detect and investigate insider trading cases. It is established that there are serious inadequacies in the institutional framework that need addressing.

Chapter four conducts a comparative analysis of the legal frameworks on insider trading in select jurisdictions namely; the UK, the USA and South Africa, to draw lessons for Kenya. It focuses on how some of the inadequacies ailing Kenya's legal framework on insider trading have been handled in the said jurisdictions. It is noted that for Kenya to effectively curb insider trading and improve its corporate governance standards, it should learn from the experiences in the said jurisdictions.

Chapter five is the conclusion and recommendations. It summarizes the key findings of the study and makes recommendations for reforms. It is argued that to effectively address the inadequacies identified in chapters two and three of this study, Kenya's legal framework on insider trading should be reviewed.

CHAPTER TWO

THE ADEQUACY OF KENYA'S INSIDER TRADING LAWS

2.1 Introduction

The regulation of insider trading has been the subject of debate since the 1920s.⁴³ It has over the years been identified as one of the most controversial aspects of securities regulation even among the law and economics community. In one of his articles, Stephen M. Bainbridge said;⁴⁴

Insider trading likely is one of the most common forms of securities fraud, yet it remains one of the most controversial aspects of securities regulation among legal and economic scholars.

There are those who favor deregulation of insider trading and there are those who favor its regulation.

Scholars such as Henry G. Manne, Milton Friedman, Thomas Sowell, Daniel Fischel and Frank H. Easterbrook have argued that laws against insider trading are unfair and should therefore be removed. Milton Friedman, in favor of insider trading deregulation said;⁴⁵

You want more insider trading, not less. You want to give the people most likely to have knowledge about deficiencies of the company an incentive to make the public aware of that.

According to Henry G. Manne, insider trading is an effective way of compensating corporate innovators for their innovations.⁴⁶ He asserts that a corporate agent can recover the value of his

⁴³ Chitimira, supra note 40, p. 1.

⁴⁴ S. M. Bainbridge, *The Law and Economics of Insider Trading: A Comprehensive Primer* (2001) University of California, Los Angeles (UCLA) School of Law, p. 1 <http://papers.ssrn.com/paper.taf?abstract_id=261277> accessed 30 September 2015.

⁴⁵ Michelle Caruso-Cabrera, Interview with Milton Friedman, a laureate of the Nobel Memorial Prize in Economics, *Power Lunch: Trust Markets to Weed out Corporate Wrongdoers* (CNBC Television Broadcast, 12 March 2003), see J. Pahl, 'A Heart as Far From Fraud as Heaven From Earth: SEC v. Cuban and Fiduciary Duties Under Rule 10b5-2' (2012) *Northwestern University Law Review*, Vol. 106, No. 4, p. 1880, available at <<http://scholarlycommons.law.northwestern.edu/nurl/vol106/iss4/6>> accessed 29 October 2016.

discovery through buying the firm's securities prior to disclosure and selling them after the price rises which in turn makes it possible to pay a lower salary. His contention is that in the long run, insider trading acts as an incentive to corporate agents to produce information for the benefit of the corporation.⁴⁷ Manne's argument is strongly supported by Carlton and Fischel who believe that the salary that the corporate agents receive is not enough to compensate them for their innovations.⁴⁸ This argument has attracted several critics. S. M. Bainbridge argues that it is difficult to restrict trading to those who produced the information. Therefore, many corporate agents may trade on the information without having contributed to its production.⁴⁹ Another difficulty pointed out by Bainbridge is the limitation of trade to instances in which the insider actually produced valuable information to the corporation.⁵⁰

Proponents for deregulation also argue that insider trading is beneficial to the securities market as it helps in providing the correct price for securities. This according to them is beneficial to the economy and corporations. Manne argues that insider trading is an effective tool in maintaining accurate prices for securities.⁵¹ According to him, insider trading improves market efficiency by moving stock prices in the proper direction sooner than it would otherwise have occurred. Finally, it is argued that insider trading is a victimless crime where a willing buyer and a seller agree to trade property which the seller rightfully owns without any condition to refrain from trading if there is asymmetry of information. It is also difficult to identify those who have lost as

⁴⁶ Bainbridge, supra note 44, p. 68.

⁴⁷ Ibid.

⁴⁸ D. W. Carlton and D. R. Fischel, 'The Regulation of Insider Trading' (1983) 35 Stanford Law Review 857, pp. 869-871 <http://Chicagounbound.uchicago.edu/journal_articles> accessed 20 October 2015.

⁴⁹ Bainbridge, supra note 44, p. 69.

⁵⁰ Ibid.

⁵¹ Ibid.

a result of insider trading therefore, carrying out investigations and prosecuting insider trading perpetrators is not cost effective.⁵²

Likewise, arguments for insider trading regulation have also been put forth. The moral and ethical reason for prohibiting insider trading is that the use of inside information is unfair to those who deal with the insider.⁵³ Patricia Werhane in support of this argument said that insider trading gives the outsider an unfair comparative disadvantage that skews competition and with insider trading taking place in the markets, there can never be a level playing field.⁵⁴ One of the economic arguments for regulating insider trading is that it renders the market too dangerous for investors to enter, because they fear that they will not have an equal chance to earn profits.⁵⁵ They believe that they do not stand a chance against insiders who trade advantageously on inside information.⁵⁶ Further, in *R. v. McQuoid*⁵⁷ the court observed that;

Those who involve themselves in insider dealing are criminals: no more and no less. The principles of confidentiality and trust, which are essential to the operations of the commercial world, are betrayed by insider dealing and public confidence in the integrity of the system which is essential to its proper function is undermined by market abuse.

Insider trading is also viewed as an unethical conduct that ruins the reputation of both the company and the securities markets at large.⁵⁸ In *Diamond v. Oreamuno*⁵⁹ the Court held that the prestige and goodwill of a corporation, so vital to its prosperity, may be undermined by the revelation that its chief officers had been making personal profits out of corporate events which they had not disclosed to the community of stockholders. The court was of the view that insider

⁵² Ibid, p. 71.

⁵³ Morse, supra note 4, p. 350.

⁵⁴ P. H. Werhane, 'The Ethics of Insider Trading' (1989) Vol. 8 Journal of Business Ethics, p. 841 available at <<http://www.jstor.org/stable/25071973>> accessed 11 October 2015.

⁵⁵ L. K. Meulbroek, 'An Empirical Analysis of Illegal Insider Trading' (1992) Vol. XLVII, No. 5, The Journal of Finance, p. 1661 < <http://www.jstor.org/stable/2328992>> accessed 30 October 2016.

⁵⁶ Morse, supra note 4, p. 350.

⁵⁷ (2009) 4 All E.R. 388, p. 389.

⁵⁸ Morse, supra note 4, p. 350.

⁵⁹ 248 N.E. 2d 190 (1969) p. 193.

trading by corporate managers, casts a cloud on the corporation's name, injures stockholder relations and undermines public regard for the corporation's securities.

Again insider trading should be regulated because it reduces market liquidity which allows for quick and cheap disposal of their securities.⁶⁰ Insider trading also amounts to breach of fiduciary duties owed to the company and the shareholders. A relationship of trust and confidence exists between the shareholders of a company and the insiders who stumble upon inside information by virtue of their positions in the corporation. Therefore, by trading on the inside information the insiders are said to be in breach of the fiduciary duties. According to *Charlesworth & Morse*, from a company law point of view insider trading should be regulated because the insider with access to confidential information is in a potential conflict-of-interest situation.⁶¹ Finally, there is need to regulate insider trading because inside information is a property of the corporation and trading on it amounts to theft.⁶² By purchasing or selling securities while in possession of material non-public information the insider actually uses something (the inside information) that does not belong to him, to earn a profit or avoid a loss.

Even though the debate of whether to deregulate or regulate insider trading is unsettled, support for its prohibition has grown in almost every country around the world. Kenya is amongst the jurisdictions that support and in fact regulate insider trading.⁶³

This study sought to assess the adequacy of Kenya's legal framework on insider trading. The study divides the legal framework into two parts; insider trading laws and the institutions tasked

⁶⁰ M. J. Fishman and K. M. Hagerty, 'Insider trading and the efficiency of stock prices', (1992) Vol. 23, No. 1, pp. 106-122, RAND Journal of Economics, p. 106 <<http://www.jstor.org/stable/2555435>> accessed 30 October 2016.

⁶¹ Morse, supra note 4, p. 350.

⁶² Bainbridge, supra note 44, pp. 78-82.

⁶³ U. Bhattacharya and D. Hazem, 'The world price of insider trading' (2002) Vol. 57, No. 1, pp. 75-108, The Journal of Finance, p. 93.

with the enforcement of the insider trading laws. This chapter will assess the adequacy of the laws that govern insider trading in Kenya. The chapter will critically examine the provisions of the Capital Markets Act as the principal legislation on insider trading. It will also assess the adequacy of the Companies Act, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations and the Code of Corporate Governance Practices for Issuers of Securities to the Public in supplementing the Capital Markets Act in the fight against insider trading.

2.2 The Capital Markets Act, Cap. 485A, Laws of Kenya

The Capital Markets Act, Cap. 485A, is the principal legislative framework on securities in Kenya.⁶⁴ The Act first came into force as the ‘Capital Markets Authority Act’ in 1989 and in 2000 its title was changed to the ‘Capital Markets Act’. The Capital Markets Act, is an Act of Parliament to establish the Capital Markets Authority for the purpose of promoting, regulating and facilitating the development of an orderly, fair and efficient capital markets in Kenya.⁶⁵ In other words, the principal role of the Capital Markets Act is to enhance market integrity and investor confidence. In fulfilment of its objectives, the Act provides for the regulation of market abuses such as insider trading which is the focus of this study.

The Act criminalizes insider trading and prescribes penalties upon conviction.⁶⁶ Insider trading is specifically dealt with under Part VI of the Act. The provisions are broken down into various parts namely; application, insider trading, inside information, information made public and

⁶⁴ J. K. Gakeri, ‘*Enhancing Securities Markets in Sub-Saharan Africa: An Overview of the legal and Institutional Arrangements in Kenya*’ (2011) Vol. 1 No. 9, IJHSS, p. 140 <www.ijhssnet.com/journals/vol_1_9_SpecialIssue_july2011/18.p.d.f> accessed 29 October 2016.

⁶⁵ Capital Markets Act, Preamble.

⁶⁶ Ss. 32B and 32E.

penalty for insider trading.⁶⁷ This chapter systematically and critically examines these provisions with a view to assessing their adequacy as far as combating insider trading is concerned.

(a) Limited Scope of Application

Under the Capital Markets Act insider trading is a very limited offence. Section 32A (1) of the Act expressly states that the insider trading provisions apply to listed securities, their derivatives and derivatives traded on any market regulated by the CMA.

The scope is limited further by the narrow definition of ‘securities’ which does not include other forms of securities such as tenders and investment contracts.⁶⁸

(b) What is Insider Trading?

The Capital Markets Act adopts the American style whereby the term ‘insider trading’ is not expressly defined, but instead, the Capital Markets Act specifies three situations where a person might be said to have committed an insider trading offence.⁶⁹ The first situation is where a person deals in listed securities or their derivatives that are price-affected in relation to the information in his possession. The second situation is where a person encourages another person, whether or not that other person knows it, to deal in securities or their derivatives which are price-affected securities in relation to the information in the possession of the insider, who knows or has reasonable cause to believe that the trading would take place. The third situation is where a person discloses the information to another person, otherwise than in the proper performance of his employment, office or profession.

⁶⁷ Ss. 32A-32E.

⁶⁸ See s 2; Gakeri, *supra* note 64, p. 142; Wanyama, *supra* note 8.

⁶⁹ S. 32B (1).

In the absence of a definition, looking at the three situations specified in the Act it is difficult to grasp the meaning of insider trading and its elements. The situations are stated in a vague and ambiguous manner, making it impossible for one to understand the elements that constitute the insider trading offence. Normally, the elements that constitute the insider trading offence are, securities (price-affected/sensitive securities), dealing, insider and inside information.

With regard to the first element, ‘securities (price-affected/sensitive securities)’ Section 32A (2) (a) of the Capital Markets Act is clear. It provides that the securities or their derivatives must be those that are price-affected also referred to as price-sensitive securities. Therefore, the prosecution must prove that the securities or their derivatives that the insider dealt in, were price-affected or price-sensitive.

The second element that constitutes the insider trading offence is ‘dealing’ which is clearly stated in the first and second situations.⁷⁰ For purposes of the actual dealing and encouraging offences the Act defines ‘dealing’. It provides that a person deals in securities or their derivatives if, whether as principal or agent, sells, purchases, exchanges or subscribes for any listed securities or their derivatives or acquires or disposes of, or agrees to acquire or dispose of the right to sell, purchase, exchange or subscribe for any listed securities or their derivatives.⁷¹

However, the definition of ‘dealing’ by the Capital Markets Act is inadequate because, it seems to be referring to dealing in the context of the actual dealing offence and forgets about dealing in the context of the encouraging offence. This begs the question, is it not dealing for purposes of the Act if a person procures the acquisition or disposal of securities or their derivatives by another person?

⁷⁰ S. 32B (1) and (1) (a).

⁷¹ S. 32B (3).

Even though it is commendable that the definition of dealing covers an agreement to acquire or dispose of securities or their derivatives, it however, does not cover agreements to create securities or the termination of an agreement that created a security. This omission begs the question, is it not dealing for purposes of the Act, where a person agrees to create a security or where a person agrees to terminate an agreement that created a security? The impact of this, is that the scope/meaning of ‘dealing’ under the Capital Markets Act is narrow and non-exhaustive.

‘Insider’ is the third element that constitutes the insider trading offence. An internationally accepted norm on insider trading regulation is that the offence of insider trading can only be committed by individuals who are insiders. Therefore, the prosecution must prove that the person who dealt in the price-affected securities or their derivatives was an insider. The Capital Markets Act does not put enough emphasis on the fact that the insider trading offence can only be committed by an insider (an individual in possession of inside information). The Act vaguely and ambiguously uses the term ‘person’ in the three situations. For instance in the actual dealing offence the Act provides that a person who deals in listed securities or their derivatives that are price-affected in relation to the information in his possession commits an offence of insider trading.⁷² The Act completely disregards the use of the term ‘insider’ making the statement too general, vague and ambiguous.

The other element that constitutes the insider trading offence is ‘inside information’. The prosecution must prove beyond any reasonable doubt that the insider dealt in price-affected securities or their derivatives on the basis of inside information. Again the Act captures this element in a vague and ambiguous manner. The phrase ‘...in relation to the information in his possession...’ is too general and vague. The Act does not make use of the term ‘inside

⁷² S. 32B (1).

information' making the provision vague because usually a person's brain possesses too much information.

(c) Who is an Insider?

On the question of who an insider is, the Capital Markets Act adopts two approaches; the USA classical/traditional approach and the UK approach. It first defines an insider as any person who is or was connected with a company or is deemed to have been connected with a company and who is reasonably expected to have access, by virtue of such connection to unpublished information which if made generally available would be likely to materially affect the price or value of the securities of the company, or who has received or has had access to such unpublished information.⁷³ This is the USA classical/traditional approach. Secondly, an insider is defined as a person in possession of inside information.⁷⁴ This is the UK approach which is also adopted in South Africa.

First, it is a flaw in the formulation of the Act to adopt two different approaches to defining 'an insider'. The first definition under the USA classical approach is non-exhaustive and narrow because it places so much emphasis on the connection of an insider to the issuer of securities. This means that the prosecution besides proving that the person was an insider, it bears an additional burden of proving the connection between the insider and the issuer of securities. The Act in this definition fails to appreciate that the term 'insider' is a broad concept. Insider trading laws do not apply only to corporate insiders such as directors, officers and senior executives of

⁷³ S. 2.

⁷⁴ S. 32A (2).

companies but also to anyone with access to inside information whether connected or not connected to the company.⁷⁵

On the other hand, even in its second definition under the UK approach, the provisions of the Capital Markets Act are not substantive. Despite being broad enough to cover insiders who may be connected or not connected to the company, the definition is too brief, general and vague. For instance, it is difficult for one to understand the circumstances in which a person is deemed to be in possession of inside information. In the UK where this approach is applicable, a person is deemed to be an insider if the information he/she has is inside information and he/she knows that it is inside information and that they got it from an inside source.⁷⁶ The UK insider trading laws further specify the situations in which information is deemed to have come from an inside source. This shall be discussed in details in chapter four.

In light of the aforementioned, it is evident that the Capital Markets Act does not adequately cover the concept of ‘an insider’ which is paramount in the insider trading regulation.

(d) Inside Information

In a nutshell, inside information is material non-public information. Pursuant to the Capital Markets Act, inside information means information which relates to particular securities or to a particular issuer of securities but has not been made public, and if it were made public is likely to

⁷⁵ Tricker, *supra* note 27, p. 317.

⁷⁶ See Girvin, *supra* note 31, p. 599.

have a material effect on the price of the securities.⁷⁷ However, the Act does not define ‘material effect’.

Moreover, in as much as the Act makes remarkable efforts to highlight the elements of inside information, it lacks the requirement that inside information must be specific or precise which distinguishes inside information from a mere rumour.

(e) Insider Trading Offences

The Capital Markets Act provides for three insider trading offences only. The first offence is the actual dealing offence where a person deals in listed securities or their derivatives that are price-affected in relation to the information in his possession.⁷⁸ The second offence is the encouraging offence where a person encourages another person, whether or not that other person knows it, to deal in securities or their derivatives which are price-affected securities in relation to the information in the possession of the insider, who knows or has reasonable cause to believe that the trading would take place.⁷⁹ The third offence is the disclosure offence which occurs when a person discloses inside information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person.⁸⁰ However, the Act does not define ‘proper’ in the context of the disclosure offence.

The Capital Markets Act contains a limited number of insider trading offences. There are other insider trading offences that the Act does not provide for. For instance the Act does not provide for the tipping offence which occurs when insiders who do not wish to trade on inside

⁷⁷ Capital Markets Act s. 32C (1).

⁷⁸ S. 32B (1).

⁷⁹ S. 32B (1) (a).

⁸⁰ S. 32B (1) (b).

information themselves, tip others to do so.⁸¹ The person giving the tip is known as the ‘tipper’ and the person receiving the tip is known as the ‘tippee’. The tipping liability was elaborated in the USA *Dirks* case,⁸² where the court held:

...not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they also may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain.

This is a serious gap in the legislation that tippers and tippees of inside information are likely to utilize to their advantage.

Furthermore, in the upshot of the provisions, it may be understood that it is not an insider trading offence for an insider to deal in securities on behalf of another person. In the context of the actual dealing offence, the Act only refers to a situation whereby an insider deals in securities on his/her own account and fails to include a situation whereby an insider deals in securities on behalf of another person.

The provisions also imply that it is not an insider trading offence to deal in securities on behalf of an insider, knowing or having reasonable cause to believe that the person is an insider. For instance stockbrokers who transact in securities on behalf of investors. Due to this omission establishing insider trading liability on stockbrokers becomes a challenge. The Act defines a stockbroker as a person who carries on the business of buying or selling of securities as an agent for investors in return for commission.⁸³ This definition acknowledges that the relationship between an investor and a stockbroker is that of a principal and an agent. This begs the question,

⁸¹ H. J. Kaplan et al., ‘*The Lessons of the Raj Rajaratnam Trial: Be Careful Who’s Listening*’ (ABA Section of Litigation Annual Conference, 18 April 2012) <www.Americanbar.org/...the_law_of_insider_trading.pdf> accessed 2 October 2014.

⁸² 463 U.S. 646, 655 (1983) p. 657; M. V. Hristova, ‘*The Case for Insider Trading Criminalization and Sentencing Reform*’ (2012) Vol. 13, Transactions: The Tennessee Journal of Business Law, p. 270 available at <<http://trace.tennessee.edu/transactions/vol13/iss2/4>> accessed 29 October 2016.

⁸³ Capital Markets Act, s. 2.

what happens if a stockbroker trades in securities on behalf of his/her principal, knowing or having reasonable cause to believe that, the principal is in possession of inside information? This is a gap in the legislation that is likely to result in stockbrokers arguing that they were only following instructions despite knowing or having reasonable cause to believe that the investor is in possession of inside information.

(f) Insider Trading Penalties

Kenya's insider trading laws operate on the belief that the only way to combat insider trading is through deterrence. To that end, the Capital Markets Act prescribes civil penalties in the form of disgorgement of profits made or loss avoided, and criminal penalties such as fines and prison terms to be imposed upon insider trading convicts.

An individual on a first offence is liable to a fine not exceeding Kshs. 2,500,000 or to imprisonment for a term of two years and payment of the amount of the profit made or loss avoided.⁸⁴ A company on a first offence is liable to a fine of up to Kshs. 5,000,000 and payment of the amount of the profit made or loss avoided.⁸⁵ An individual on any subsequent offence is liable to a fine not exceeding Kshs 5,000,000 or to an imprisonment for seven years and payment of twice the amount of the profit made or loss avoided.⁸⁶ A company on any subsequent offence is liable to a fine not exceeding Kshs. 10,000,000 and payment of twice the amount of the profit made or loss avoided.⁸⁷

⁸⁴ Capital Markets Act, s. 32E (a) (i).

⁸⁵ S. 32E (a) (ii).

⁸⁶ S. 32E (b) (i).

⁸⁷ S. 32E (b) (ii).

These penalties as prescribed under the Capital Markets Act are not severe enough to punish and deter insider trading.⁸⁸ There are instances when insider trading offenders make more profits or avoid huge losses compared to the prescribed amount of fine.

Moreover, the prison terms prescribed in the Act are not harsh enough to deter insider trading with particular emphasis on the prison terms for the first offenders. A jail term of two years for an insider trading convict is not enough punishment but a mere slap on the wrist. Save to add that the prescribed seven year prison sentence for second time offenders is also not severe enough to achieve the punishment and deterrence goals.

The civil penalties in the form of disgorgement of the profit made or loss avoided is also not severe enough to meet the deterrence goal. For the first time offenders, the Act provides that the person or the company is only liable to the payment of the amount of the profit made or the loss avoided. This begs the question; how is the payment of the amount of the profit made or loss avoided a punishment? For the second time offenders, the Act prescribes the payment of twice the amount of the profit made or loss avoided for both individuals and companies. Again, this is not severe enough to deter insider trading, bearing in mind the fact that in the context of a subsequent offence, the person or the company is a second time insider trading offender. This again is a mere slap on the wrist.

Nevertheless, the provisions of the Capital Markets Act on the insider trading penalties seem to have been formulated under the assumption that 'one size fits all' which translates to rigidity in the imposition of the penalties.

⁸⁸ See Gakeri, *supra* note 64, p. 141.

(g) Inadequacy of the Disclosure Obligations

Disclosure is one of the fundamental facets of insider trading regulation, because whereas issuers need capital, investors require information about the issuer and the securities. Disclosure in the regulation of insider trading is designed to provide timely, accurate and complete information to the market.⁸⁹ It ensures that the market is fully informed about the securities and that the window within which an insider can trade on the basis of inside information is narrowed.⁹⁰

The Capital Markets Act acknowledges the importance of disclosure in insider trading regulation. Surprisingly though, is that the Act does not contain substantive provisions on disclosure. The Act only goes as far as requiring an issuer of securities to keep the CMA, members of the company and other holders of its securities, any listing exchange and the general public informed as soon as reasonably practicable of any information relating to the issuer and its subsidiaries which might be reasonably expected to materially affect market activity in the price of its securities.⁹¹ The issuer is expected to communicate such information preferably not later than the end of the next working day and a person who fails to disclose such information is deemed to have committed an offence.⁹² The Act does not prescribe the penalties for non-disclosure of such information.

Moreover, the disclosure obligation contained in the Act is narrow and limited because it only targets issuers of securities. This means that the Capital Markets Act does not impose a statutory duty on other insiders and affected parties to disclose their transactions pertaining to securities or

⁸⁹ J. K. Gakeri, 'Calibrating Regulatory Disclosure in Kenya's Securities Markets: Challenges and Opportunities for Investors' (2014) Vol. 4 No. 5, IJHSS, p. 134 <www.ijssnet.com> accessed 20 June 2016.

⁹⁰ Ibid.

⁹¹ Capital Markets Act, s. 30F (1).

⁹² S. 30F (3).

other instruments issued by their companies or other institutions and the inside information in their possession.

2.3 The Companies Act, No. 17 of 2015, Laws of Kenya

On 11 September, 2015 President Uhuru Kenyatta assented to the new Companies Act whose objective is to consolidate and reform the law relating to the incorporation, registration, operation, management and regulation of companies.⁹³ The Act repeals the 1948 Companies Act and borrows heavily from the UK Companies Act of 2006.

The former Companies Act was based on the disclosure principle. For instance, all registered companies were required to file annual returns with the Registrar of Companies and failure to do so, attracted a fine. In the case of public companies, the Act contained provisions to the effect that financial statements sent to members should give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries, if any.⁹⁴ Section 187 of the Act required directors to disclose their age to the company upon appointment or pending appointment, whereas, Section 194 provided for the directors' duty to disclose payment for the loss of office, made in connection with transfer of shares in the company. The Act imposed a duty on a director who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors.⁹⁵

Unfortunately, despite appreciating the materiality of disclosure, the former Companies Act did not contain any express provisions on the regulation of insider trading or other market abuses. Save to add that, the disclosure provisions contained in the Act were inadequate to the extent that

⁹³ Companies Act 2015, Preamble.

⁹⁴ Companies Act, Cap. 486, ss. 152 and 158.

⁹⁵ S. 200(1).

they offered no protection to the shareholders and other stakeholders in the context of insider trading.

The 1948 Companies Act which was the principal company law in Kenya for many decades was recently repealed by the Companies Act 2015 that brought numerous changes. For example, prior to the enactment of the new Companies Act, directors' duties were governed by the English common law. The duties included the duty of care, skill and diligence and directors' fiduciary duties to the company which require directors to act in utmost good faith and in the best interests of the company so as to promote the success of the company. The new Act now codifies the common law duties of a director.

The Act provides that a director owes the company a duty to act in accordance with the constitution of the company and to exercise the powers conferred upon him/her only for purposes for which they were conferred.⁹⁶ A director also owes the company a duty to promote its success by doing that which he/she considers in good faith, would promote the success of the company.⁹⁷ Under the Act a director owes the company a duty to exercise independent judgment.⁹⁸ The Act also provides for the director's common law duties of care, skill and diligence. According to the Act, a director owes the company a duty to exercise reasonable care, skill and diligence in performing his functions as a director.⁹⁹

The other common law duty of a director provided for in the Act is the duty to avoid conflict of interests. The Act expressly provides that a director owes to the company a duty to avoid conflicts of interest and in avoiding conflict of interests, a director should avoid a situation in

⁹⁶ Companies Act 2015, s. 142.

⁹⁷ S. 143 (1).

⁹⁸ S. 144 (1).

⁹⁹ S. 145.

which he/she has, or can have, a direct or indirect interest that conflicts, or may conflict with the interests of the company.¹⁰⁰ The Act goes further to provide that a director's duty to avoid conflict of interests applies in particular to the exploitation of any property, information or opportunity which belongs to the company, regardless of whether the company could have taken advantage of the property, information or opportunity.¹⁰¹ Finally, the Act provides that a director owes to the company a duty not to accept benefits from third parties.¹⁰²

The codification of the directors' common law duties is a huge contribution to the regulation of insider trading in Kenya. This is because unlike in the past, the law is now clear on the duties that a director owes to the company and there is also a statutory liability on a director who breaches any duty owed to the company. With the new company law in place the reality is that, it is not just a common law duty that a director should act in good faith, in the best interest of the company and avoid conflict of interests, but a statutory duty whose breach attracts certain liabilities. Therefore, a director who engages in insider trading, is not only committing a securities fraud but is also in breach of his/her statutory fiduciary duties to the company.

The new Companies Act like its predecessor is based on the disclosure principle. For example, the Act requires companies to lodge copies of all types of resolutions passed or agreement made with the registrar. In cases whereby, the resolutions or agreements are not in writing, the companies are required to lodge copies of a written memorandum setting out the terms of the resolutions or agreements.¹⁰³ Companies are also required to furnish the Registrar with up-to-date memorandum, articles of association and other documents such as the company's statement of nominal capital, register of members, register of directors, director's contract of service or

¹⁰⁰ S.146 (1).

¹⁰¹ S. 146 (2).

¹⁰² S. 147 (1).

¹⁰³ S. 27(1).

memorandum of terms and conditions, register of company secretaries, auditor's report and annual returns, annual financial statement and reports which are also open to public inspection. The Act requires a company to provide prescribed information on request to those with whom the company deals with in the course of its business.¹⁰⁴ A director who is in any way directly or indirectly, interested in a proposed or existing transaction or arrangement with the company is required to declare the nature and extent of that interest.¹⁰⁵ The Act places upon directors, a duty to prepare individual financial statements which should be a true and fair view of the assets, liabilities and profit or loss.¹⁰⁶ Directors are also required to include in notes to company's annual financial statement details of their benefits other than remuneration.¹⁰⁷ A director is liable to compensate the company for any loss suffered by it as a result of any untrue or misleading statement in its financial statement and reports.¹⁰⁸

Even though the Companies Act, 2015 is a remarkable improvement of company law in Kenya, a major shortcoming in the previous Act seems to have been carried over to the new Act. Like its predecessor, the new Act is silent on the regulation of insider trading and other market abuses. Moreover, despite the fact that the Companies Act 2015 is also based on the disclosure principle which plays a pivotal in the regulation of insider trading, the disclosure provisions contained in the Act are not stringent enough to safeguard shareholders' and stakeholders' interests from insider trading transactions.

¹⁰⁴ S. 67(1) (c).

¹⁰⁵ S. 151(1).

¹⁰⁶ Ss. 635 and 636.

¹⁰⁷ S. 650.

¹⁰⁸ S. 703.

2.4 The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002

The Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations issued by the CMA pursuant to Section 12 (1) of the Capital Markets Act, govern disclosure obligations by issuers of securities. Generally, this means that the scope of application of the disclosure obligations prescribed by the Regulations is limited to the issuers of securities only.

In relation to insider trading, the Regulations define material information and provide for equal treatment of shareholders. The Regulations state that an issuer of securities to the public must ensure equality of treatment for all holders of such securities of the same class in respect of all rights attaching to such securities.¹⁰⁹ The scope of this regulation is inadequate because it is only limited to holders of the same class of shares and does not extend to holders of different class of shares.

The Regulations provide for continuing disclosure obligations which require issuers of securities to make immediate public disclosure of information which might reasonably be expected to have material effect on market activity in the prices of its securities. The Regulations require such information to be disclosed within twenty-four hours of the event, to the CMA, securities exchange and to the public and failure to comply with the continuing obligation to disclose information attracts a fine.¹¹⁰ It is a serious gap in the continuing disclosure obligations to target the issuers of securities only, and leave out other insiders. Just like the Capital Markets Act, the Regulations do not place a duty on other insiders who may not necessarily be issuers of securities to disclose the inside information in their possession.

¹⁰⁹ Fourth Schedule, Reg. 1.

¹¹⁰ Reg. 19(2) & (3); Reg. 19(5); see Fifth Schedule to the Regulations.

Moreover, the enforcement of the disclosure obligations remains the primary problem in Kenya. The capacity of the CMA and other regulators to enforce compliance with the obligations is weak.

2.5 Code of Corporate Governance Practices for Issuers of Securities to the Public, 2015

The Code of Corporate Governance Practices for Issuers of Securities to the Public was issued by the CMA in exercise of the powers conferred by Sections 11(3) (v) of the Capital Markets Act. The Code applies to both listed and unlisted companies and supersedes the 2002 CMA Guidelines on Corporate Governance. The Code sets out the principles and specific recommendations on structures and processes, which companies should adopt in making good corporate governance an integral part of their business dealings and culture.¹¹¹ The Code adopts the “apply or explain” approach instead of the “comply or explain” approach adopted by the 2002 Guidelines. However, like the 2002 Guidelines the Code is principle-based rather than rule-based.¹¹²

The Code does not contain express principles on insider trading regulation. However, in its interpretation section, it defines conflict of interest as a situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person’s self- interest and professional interest or public interest. The Code defines material information in the same terms as the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations.

The Code promotes the disclosure principle. For example, during appointments to the Board, a director or potential director should disclose any potential area of conflict that may undermine

¹¹¹ The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015, Preliminary.

¹¹² Ibid.

their position or service as director.¹¹³ A director should declare any real or perceived conflict of interest with the company and to that end, the Board should put in place a policy to manage conflict of interest.¹¹⁴ To promote and protect shareholders, the Code recommends that all shareholders should receive relevant information on the company's performance through the distribution of annual reports and accounts, and half-yearly results as a matter of best practice. Likewise, these disclosure requirements are not adequate or stringent enough to protect stakeholders' interests from insider trading.

In relation to directors' fiduciary duties, the Code recommends that a director ought to act in the best interests of the company, act honestly at all times and must not place themselves in a situation where personal interests conflict with those of the company, promote and protect the image of the company. The Code also states that a director owes the company a duty to hold in confidence all information available to them by virtue of his position as a director.¹¹⁵

The Code contains a principle which requires all shareholders to be treated equitably. Under this principle, the recommendation is that equitable treatment should only be accorded to shareholders who hold the same class of shares.¹¹⁶ This renders the recommendation controversial, in that, on the one hand all shareholders should be treated equitably and on the other hand, equitable treatment is for shareholders who hold the same class of shares.

The Code also contains guidelines on the equitable treatment of majority and minority shareholders and the protection of minority shareholders from any adverse actions by the controlling shareholders, acting either directly or indirectly. In cases where a minority

¹¹³ The Code does not have sections or articles rather it contains principles, recommendations and guidelines. See Principle 2.1.

¹¹⁴ Recommendation 2.3.8.

¹¹⁵ Recommendation 2.3.1.

¹¹⁶ Principle 3.2 and Recommendation 3.2.1.

shareholder is affected by such actions, he/she shall have effective means of redress.¹¹⁷ These guideline are formulated in a vague manner and are non-exhaustive. For example they do not specify how, a company can ensure the equitable treatment of the majority and minority shareholder and how minority shareholders can be protected from the adverse actions by the majority shareholders. Save to add that, merely stating that a minority shareholder adversely affected by such actions shall have effective redress is not sufficient enough to protect minority shareholders' interests in cases where, the majority shareholder trades in securities while in possession of inside information.

2.6 Conclusion

There is indeed an overwhelming case for insider trading regulation. There are several pieces of legislations that govern insider trading in Kenya. However, the principal legislation on insider trading is the Capital Markets Act which prohibits and criminalizes the offence.

Regrettably, even though the insider trading law has been in place for decades now, Kenya has never had any successful prosecutions. Following the unsuccessful prosecution of the Uchumi cases, the Capital Markets Act was amended in 2013 in an attempt to address the flaws and gaps suspected to have led to the unsuccessful prosecution. However, a critical examination of the formulation of the legislative provisions on insider trading in the Capital Markets Act, has indeed showed that there are still gaps and flaws in the Act and without proper reforms, any enforcement actions brought under the Act cannot hold in court.

Moreover, it is puzzling to note that the Companies Act which governs both limited and unlimited companies in Kenya and is expected to supplement the Capital Markets Act in the

¹¹⁷ Guideline 3.2.1.

fight against insider trading, does not contain any express provisions on insider trading regulation. On the other hand, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations which govern disclosure obligations by issuers of securities has a limited scope of application, whereas the new Code of Corporate Governance that is principle-based rather than rule-based does not contain substantive best practices on insider trading.

This chapter has confirmed the first part of the hypotheses of this study that Kenya's legal framework on insider trading is inadequate by establishing that the laws that govern insider trading in Kenya are inadequate. The chapter has identified serious flaws and gaps in Kenya's insider trading laws that call for reforms. The subsequent chapter assesses the adequacy of the Kenya's institutional framework on insider trading to test the second part of the hypotheses.

CHAPTER THREE

THE ADEQUACY OF KENYA'S INSTITUTIONAL FRAMEWORK ON INSIDER TRADING

3.1 Introduction

The aim of this study is to assess the adequacy of Kenya's legal framework on insider trading. As previously stated, the study divides the framework into laws that govern insider trading and institutions tasked with the enforcement of the laws. Having assessed the adequacy of the insider trading laws in the previous chapter, this chapter assesses the adequacy of Kenya's institutional framework on insider trading. The adequacy of the Capital Markets Authority (CMA) as the principal regulatory body on insider trading is assessed in terms of its capacity to detect and investigate insider trading cases.

3.2 The Capital Markets Authority

The Capital Markets Authority (CMA) is an independent public agency established by the Capital Markets Act.¹¹⁸ The Authority became operational on 15th December, 1989 and derives its powers to regulate and supervise the capital markets industry from the Capital Markets Act and the Regulations issued there under.¹¹⁹

The Authority was established for the purpose of promoting, regulating and facilitating the development of an orderly, fair and efficient Capital Markets in Kenya, geared towards enhancing market integrity and investor confidence.¹²⁰ The Authority is tasked with the creation,

¹¹⁸ Cap. 485A, Laws of Kenya.

¹¹⁹ CMA website, <www.cma.or.ke> accessed 15 October 2015.

¹²⁰ Capital Markets Act, Preamble.

maintenance and regulation of a market in which securities can be issued and traded in an orderly, fair and efficient manner.¹²¹ It also bears a statutory duty to protect investor interests.¹²² As the principal government institution responsible for regulating securities markets, the CMA has primacy in enforcing the provisions of the Capital Markets Act and other Rules and Regulations that govern securities markets in Kenya.¹²³ In enforcing the securities laws, the CMA enjoys wide investigative powers which can only be invoked by the chief executive of the Authority.¹²⁴

In fulfilment of its duties, the Authority has in place an Investigation and Enforcement Department which pursues compliance with the Capital Markets Regulatory framework. This Department mainly deals with securities markets improprieties of a civil nature.¹²⁵ To carry out investigations on securities frauds of a criminal nature such as insider trading, theft, conversion of funds and employee pilferage, the CMA in collaboration with the Kenya Police established the Capital Markets Fraud Investigation Unit (CMFIU) in May, 2009.¹²⁶ The Unit was established with the aim of consolidating all investigations on securities fraud cases under one roof.

The Unit is manned by officers from the Directorate of Criminal Investigations with experience and expertise in investigating economic, cyber and other white collar crimes.¹²⁷ The prime role of the Unit is to investigate securities frauds, identify the perpetrators and gather evidence for

¹²¹ Capital Markets Act, s. 11(1) (c); see J. K. Gakeri, '*Regulating Kenya's Securities Markets: An Assessment of the Capital Markets Authority's Enforcement Jurisprudence*' (2012) Vol. 2 No. 20, IJHSS, p. 266 available at <http://www.ijhssnet.com/journals/Vol_2_No_20_Special_Issue_October_2012/25.pdf> accessed 23 July 2016.

¹²² S. 11(1) (d).

¹²³ Gakeri, supra note 121, p. 274.

¹²⁴ Capital Markets Act, s. 13A; Ibid, Gakeri, p. 278.

¹²⁵ CMA website, supra note 119.

¹²⁶ Ibid, CMA website; Ibid, Gakeri, supra note 121, p. 278.

¹²⁷ See B. Kathuri, '*The task ahead for market fraud unit*', (The Standard, 13 May 2009) p. 18; CMA's Annual Report and Statement of Account 2010, p. 20 <http://www.cma.or.ke/index.php?view=download&alias=289-annual-report-2010&category_slug=annual-reports&option=com_docman&Itemid=581> accessed 31 October 2016.

their prosecution.¹²⁸ The Unit manages the risk of fraud through prevention, detection and deterrence.¹²⁹

In carrying out its investigations on suspected securities fraud cases, the CMA besides its officers, has previously engaged professional firms such as accountants, auditors and lawyers to investigate specific incidences. For example, when Uchumi Supermarkets Ltd collapsed on 31st May 2006, the Authority engaged a group of advocates, auditors, receivers and capital market specialists to investigate the reasons why the company collapsed and in particular transactions involving the company's securities.¹³⁰ The taskforce notably uncovered instances of insider trading, leading to insider trading charges against Mr. Terrence Davidson and Mr. Bernard Kibaru.¹³¹

In the 2008-2009 financial year, the CMFIU received 36 complaints over fraudulent activities.¹³² However, the CMA did not specify in the report any insider trading enforcement action after the investigations and it's also not clear if any out of the 36 complaints received, touched on insider trading. In 2010, it was reported that the Unit had received a total of 390 cases for the period from 1st July, 2009 to 30th June, 2010. The Unit carried out investigations into a total of 66 cases out of the 390 cases meaning that there were 324 pending investigations.¹³³ In the course of investigation of the said cases, the Unit made recoveries totaling to Kshs 7.5 million, being the

¹²⁸ The prosecutorial powers lies with the office of Director of Public Prosecutions. This means that if the investigation is successful and there is compelling evidence to show that the perpetrator committed the fraud, the Unit passes the information in form of a recommendation to the office of the DPP to prosecute the matter.

¹²⁹ CMA website, supra note 119; Gakeri, supra note 121, p. 278.

¹³⁰ Ibid, Gakeri, p. 278.

¹³¹ Wanyama, supra note 8; The CMA also engaged Price Waterhouse Coopers (PwC) to perform a forensic audit on Francis Thuo and Partners Co. Ltd in 2009, following their collapse. See J. Anyanzwa, '*CMA to Investigate Troubled Broker*' (The Standard, 2 June 2009) p. 26.

¹³² CMA Annual Report and Statement of Accounts 2009, p. 27 <http://www.cma.or.ke/index.php?view=download&alias=147-annual-report-2009&category_slug=annual-reports&option=com_docman&Itemid=581> accessed 31 October 2016.

¹³³ CMA Annual Report and Statement of Account 2010, supra note 127, p. 20. There were 36 cases pending before court, 2 pending arrest of Known accused person, 2 settlements through court, 10 withdrawal by complainant after settlement, 13 recommendation for enforcement actions and 3 forwarded to director at the CID for further action. This is the highlight of the 66 cases per the 2010 CMA Annual Report.

values of monies paid to clients and the value of shares reinstated.¹³⁴ In the financial year 2011/2012, the Authority received and dealt with a total of 148 complaints.¹³⁵ Again none of the received complaints or enforcement actions was specified in the report as insider trading.

The CMA has statutory powers to sanction markets improprieties. The Authority can impose fines, censures and disqualifications of persons from holding positions in the industry. The power to suspend securities listings of a company suspected to have committed frauds such as insider trading was invoked by the CMA in Uchumi Supermarkets Ltd and CMC Holdings Ltd.¹³⁶ In 2012 seven directors of CMC Holdings Ltd were sanctioned by the Authority for breach of their fiduciary duties.¹³⁷

3.3 Inadequacies of the Institutional Framework on Insider Trading

This study identified the following as some of the inadequacies ailing Kenya's institutional framework on insider trading.

(a) Poor Surveillance and Monitoring Techniques

In Kenya, the technique used to detect insider trading instances is continuous market trading data surveillance, based on abnormal trading patterns whereby buying or selling of a large number of

¹³⁴ Ibid.

¹³⁵ CMA Annual Report and Statement of Account 2011, p. 27 <http://www.cma.or.ke/index.php?view=download&alias=543-annual-report-2012&category_slug=annual-reports&option=com_docman&Itemid=581> accessed 31 October 2016.

¹³⁶ On 16th September 2011, the CMA suspended the CMC Holdings Ltd from trading its shares on the Nairobi Stock Exchange, pending investigations. See *Capital Markets Authority v. Jeremiah Gitau Kiereini & another* (2014). eKLR; Civil Appeal No. 9 of 2014.

¹³⁷ CMA Annual Report and Statement of Account 2012, p. 24 <http://www.cma.or.ke/index.php?view=download&alias=543-annual-report-2012&category_slug=annual-reports&option=com_docman&Itemid=581> accessed 30 October 2016. The 7 directors were disqualified from being directors of any listed company or licensed or approved person, including a securities exchange in the capital markets in Kenya under Section 25A (1)(c) (i) of the Capital Markets Act. However, the CMC Holdings Ltd case is ongoing.

securities takes place before or after the announcement of information that boosts or negatively affects the price of securities. Insider trading instances are also detected through tip-offs.¹³⁸

Apart from market surveillance other methods used to detect insider trading instances include manual review of trading data and relevant records such as client purchase and sale orders as well as communications between traders/dealers and clients and insiders, which is slow and labour intensive.¹³⁹ This could perhaps be the reason why many insider trading instances go undetected.

Lack of timely detection of insider trading instances in Kenya is largely attributed to lack of appropriate technology and lack of qualified staff who can effectively run the market surveillance system. Reports show that one of the key reasons why the CMA has not dealt with the insider trading vice expansively, is due to lack of the proper tools to detect and investigate insider trading instances. The CMA's surveillance system that monitors trades, client accounts and access to the central depository system was in 2010 criticized for being inadequate.¹⁴⁰ The CMA's Annual Report and Statement of Account for the year 2010 also revealed that there were instances where the Automated Trading System at the NSE experienced technical hitches during the 2009/2010 financial year.¹⁴¹

Timely detection of insider trading instances is also hindered by the diverse communication media network in Kenya. Insiders and their accomplices use media such as social media to communicate, hence thwarting the investigators' ability to obtain evidence of conveyance of inside information. This is mainly aggravated by the intangible nature of the subject matter being

¹³⁸ See CMA Annual Report and Statement of Accounts 2009, supra note 132, p. 26.

¹³⁹ Ibid.

¹⁴⁰ See Capital Fm news, supra note 14.

¹⁴¹ CMA's Annual Report and Statement of Account 2010, supra note 127, p. 16.

regulated, that is, information. Information by its very nature is easily communicated to third parties.¹⁴²

In 2013 the Authority procured an online reporting system known as the Risk Based Supervision system (RBSS) which is an interactive online system that provides an efficient and timely interface between the Authority and its key stakeholders.¹⁴³ However, the adequacy of this system in detecting insider trading instances on time and on real time basis is yet to be reported on.

(b) Weak Whistleblowing System

A weak whistleblowing culture has also been a huge setback in the detection of insider trading instances in Kenya. Whistleblowers have proved to be a very effective tool in detecting insider trading instances in countries such as the USA and the UK. The USA in an attempt to promote the whistleblowing culture, has even gone to such lengths as to introduce bounty rewards for whistleblowers who provide information leading to successful insider trading cases.

The CMA operates an online Complaints Portal where complaints touching on securities trades can be reported. The Complaints program was established for purposes of ensuring investor protection. What the Authority did not realize is that a complaints program cannot be a reliable tool in whistleblowing because being a whistleblower or a complainant are two different things. This is a flaw that was went unnoticed for a long a time and it was only recently that the CMA recognized the gap and launched anonymous portal to enable whistleblowers to report malpractices in the capital markets. However, a major shortcoming of the program is that, the

¹⁴² K. Opoku, 'What is Really Wrong with Insider Trading?' LL.M Thesis, University of Cape Town School of Advanced Legal Studies, p. 64 <<http://hdl.handle.net/11427/4530>> accessed 29 October 2016.

¹⁴³ CMA Annual Report 2015, pp. 55-56 available at <http://www.cma.or.ke/index.php?view=download&alias=489-cma-2015-annual-report&category_slug=annual-reports&option=com_docman&Itemid=581> accessed 31 October 2016.

portal can only be accessed online through the Authority's website. Given that a majority of the Kenyan population is not computer literate, this requirement becomes a major drawback on the effectiveness of the program.

Moreover, the requirements that a whistleblower has to meet are too many to actually encourage them. For example the whistleblower is required indicate the nature of the malpractice or allegation, the place, date and time of its occurrence, information on key suspects and details of persons who can verify or provide further information and to attach supporting documentation to assist the investigations team at the Authority.¹⁴⁴ Therefore, to effectively encourage a strong whistleblowing culture especially one that is going to have an impact on insider trading regulation, the Authority has to realize that operating an anonymous online portal is neither adequate nor good enough and much needs to be done.

(c) Limited Supervisory Function

The CMA is charged with the prime responsibility of supervising, licensing and monitoring the activities of market intermediaries, the NSE, the central depository and all other persons licensed under the Capital Markets Act.¹⁴⁵ The upshot of this, is that the authority of the CMA to supervise and monitor market activities is only limited to persons licensed and companies listed under the Capital Markets Act. This renders detection of insider trading instances through market supervision and monitoring by the CMA unlikely. This is a serious gap in the institutional framework on insider trading that allows insider trading instances by unlicensed persons and unlisted companies to go undetected.

¹⁴⁴ CMA website, '*CMA Launches Anonymous Portal to Report Malpractices in Capital Markets*' <http://www.cma.or.ke/index.php?option=com_content&view=article&id=536:cma-launches-anonymous-portal-to-report-malpractices-in-the-capital-markets-2&catid=80:latest-newz&Itemid=574> accessed 10 August 2016.

¹⁴⁵ CMA website, supra note 119.

It is indeed a loophole that unlicensed persons and unlisted companies may utilize to get away with insider trading liability.

(d) Lack of Support and Co-operation from Other Agencies

Mostly, investigations on insider trading cases like majority of other fraud cases, requires the assistance and co-operation of a third party in sharing information.¹⁴⁶ The CMA relies on brokerage firms, investment banks, listed companies and the Nairobi Securities Exchange (NSE) for information. It also relies on other agents such as the National Registration Bureau, Registrar of Companies and document examiner.¹⁴⁷ The fact that there is insider trading taking place under the watch of these agencies, can only mean that they have not been vigilant in keeping the CMA informed about insider trading instances.

Unfortunately, no legal action can be brought against the agencies, because they are not statutorily obliged to assist the CMA in curbing insider trading in any way. Save to add that, stakeholders such as the banking sector is reluctant and sometimes uncooperative in sharing information related to suspicious transactions over confidentiality issues. This perhaps, could be one of the reasons why many insider trading instances go unnoticed and undetected. It could also be one of the reasons why only a small number of insider trading instances make headlines, whereas, majority of insider trading instances go unmentioned.

The NSE in particular, has not been very effective in assisting in insider trading regulation especially in enforcing disclosure obligations. The NSE's track record of enforcing disclosure obligations shows that it is only in one occasion that the Exchange imposed a financial penalty

¹⁴⁶ S. Akelola, 'Prosecuting Bank Fraud in Kenya: Challenges Faced by the Banking Sector' Journal of Finance and Management in Public Services, Vol. 14, No. 1, p. 13.

¹⁴⁷ CMA website, supra note 119.

on a company for late submission of its financial reports.¹⁴⁸ Moreover, the NSE does not have investigatory and prosecutorial powers, meaning that it cannot enforce the provisions of the Capital Markets Act, particularly the insider trading provisions, in any way.¹⁴⁹ Thus, the best the NSE can do to assist in the fight against insider trading is to be a vigilant informant, a role that it has not performed so well over the years.

(e) Lack of Proper Investor Education

Investor education has been identified as one of the most instrumental tools in the fight against fraud such as insider trading. Educated investors as opposed to illiterate investors, are less likely to be defrauded. However, a majority of investors in Kenya are illiterate on investment and finance matters.¹⁵⁰ The CMA reported that in the year 2009 and 2010, it had conducted investor education through seminars, workshops and exhibitions. It was reported that the Authority offered certification programs and conducted a media campaign to reach the rural areas.¹⁵¹ However, it is not clear from the Authority's reports if any of the investor education and public awareness programs were on securities frauds and corporate governance weak practices such as insider trading.

(f) Lack of Policy Guidelines on Insider Trading

It is puzzling to note that the CMA which charged with the enforcement of the insider trading laws, has not put in place any specific policy guidelines on insider trading regulation. Insider

¹⁴⁸ Gakeri, supra note 121, p. 271.

¹⁴⁹ Ibid.

¹⁵⁰ Gakeri, supra note 64, p. 143.

¹⁵¹ CMA Annual Report and Statement of Account 2009, supra note 132, pp. 28-29; CMA Annual Report and Statement of Account 2010, supra note 128, p. 21; See also CMA Annual Reports and Statements of Account 2011-2015 available at CMA website, supra note 121.

trading is thus dealt with under the CMA Market Surveillance policy, which is not exhaustive or comprehensive enough to handle insider trading.

There is lack of policy guidelines on insider trading investigation and prosecution, policy guidelines on the dissemination and disclosure of material non-public information, policy guidelines on the imposition of administrative and criminal sanctions and policy guidelines on whistleblowing among others.

3.5 Conclusion

For proper enforcement of insider trading laws, the need for an effective institutional framework cannot be over-emphasized. Laws alone cannot prohibit and effectively curb insider trading. Regulatory bodies that can effectively enforce the laws are equally important.

This chapter has assessed the adequacy of Kenya's institutional framework on insider trading with special emphasis on the capacity to detect, investigate and prosecute insider trading cases. It has been established that Kenya's institutional framework is not adequate enough to enforce the insider trading laws. Some of the shortcomings in the institutional framework include lack of sophisticated information technology systems for market surveillance and monitoring, a weak whistleblowing system, lack of proper investor education on investment and finance matters, lack of support and co-operation from other market agencies such as the NSE and lack of policy guidelines on insider trading among others.

These findings have indeed confirmed the second part of the hypotheses that Kenya's legal framework on insider is inadequate. To remedy the inadequacies, there is need for reforms.

CHAPTER FOUR

A COMPARATIVE ANALYSIS OF THE LEGAL FRAMEWORKS ON INSIDER TRADING IN THE UK, THE USA AND SOUTH AFRICA: LESSONS FOR KENYA

4.1 Introduction

This study sought to assess the adequacy of Kenya's legal framework on insider trading. Having identified the inadequacies in Kenya's legal and institutional frameworks on insider trading in the previous chapters, this chapter carries out an incisive comparative analysis of the legal frameworks on insider trading in the UK, the USA and South Africa, to draw lessons for Kenya.

The study has selected the above-mentioned countries for various reasons. First the UK is considered appropriate for this chapter because Kenya's legal system is founded on the common law of England and has numerous insider trading enforcement actions. The USA has been selected because it was the first country in the world to enact insider trading laws and up-to-date, the USA leads the world in the regulation of insider trading. South Africa is selected because it is closer to Kenya economy-wise. Further, South Africa is one of the pioneers in corporate governance having published its first corporate governance report in 1994. In the fight against insider trading, South Africa was the first country in the world to introduce a civil offence of insider trading.¹⁵²

4.2 The United Kingdom

Insider trading known as 'insider dealing' in the UK is regulated indirectly through common law and directly through legislation. Until 1980, there was no statutory regulation of insider dealing

¹⁵² South Africa's JSE Insider Trading Booklet, *'Insider Trading and other Market Abuses (Including the Effective Management of Price Sensitive Information'* (Rev. January 2015), p. 4.

in the UK following the court's decision in *Percival v. Wright*¹⁵³ that a director's fiduciary duties are owed only to the company and not to an individual member. In the late 1950's, it was considered unethical for directors to make a private profit at the expense of the shareholders, but no legislation was enacted to back this position. In the period between 1960 and 1970 insider dealing was spreading rapidly with no regulation at all. After several fruitless attempts to enact a legislation to curb insider trading, Sections 69-73 of the UK Companies Act of 1980 came into force as the principal law on insider trading.¹⁵⁴

The Sections were later re-enacted in the Company Securities (Insider Dealing) Act of 1985 following a clamor for a law that could regulate the UK securities industry. The 1985 Act was later repealed by the Financial Services Act of 1986. The next clamor for reform of the insider dealing law came in 1989 to comply with the European Community (EC) Directive on Insider Dealing,¹⁵⁵ leading to the enactment of the Criminal Justice Act of 1993 (CJA).¹⁵⁶ The CJA albeit remaining in force to-date, was criticized for restricting the enforcement of insider dealing to criminal proceedings only which was largely blamed for the lack of successful prosecutions. To address this gap and other gaps in the CJA, in 2000 the Financial Services and Markets Act (FSMA) came into force to supplement the insider dealing criminal regime in the CJA, by introducing the civil offence of market abuse which among other offences includes insider dealing.¹⁵⁷ Thus, the principal laws governing insider dealing in the UK are the Criminal Justice Act of 1993 and the Financial Services and Markets Act of 2000. The insider trading and market

¹⁵³ (1902) 2 Ch. 421.

¹⁵⁴ See Morse, supra note 4, p. 359.

¹⁵⁵ Directive 89/592/EC (1989) OJ L334/30.

¹⁵⁶ Morse, supra note 4, p. 361.

¹⁵⁷ See, s. 118 of the Financial Services and Markets Act.

abuse laws are enforced by a single regulatory body known as the Financial Conduct Authority (FCA) previously known as the Financial Services Authority (FSA).¹⁵⁸

This chapter focuses on the formulation of the legislative provisions in the CJA on ‘insider’, ‘inside information’, ‘dealing’, insider dealing offences, insider dealing defences and penalties. It examines the adequacy of the FCA in executing its enforcement function in terms of its capacity to detect, investigate and prosecute insider dealing cases and the powers vested in it by the FSMA. It also examines the policy guidelines on insider trading regulation put in place by FCA.

4.2.1 The Adequacy of the UK Insider Trading Laws

(a) Definition of Insider Trading Terms

The study explores the definition of insider trading terms such as ‘insider’, ‘inside information’ and ‘dealing’ as contained in the CJA. Generally speaking, the insider trading offence can only be committed by persons regarded as insiders and this is the case both in the UK and Kenya. However, the CJA contains more substantive provisions on insiders and casts a wider net compared to the Capital Markets Act. Moreover, the CJA uses the term insider with more precision and clarity compared to the Capital Markets Act. As mentioned earlier, the provisions of the Capital Markets Act repeatedly use the phrase ‘a person’ instead of ‘an insider’.¹⁵⁹

Under the CJA, an insider is person in possession of inside information. That is to say, the information that the person has is inside information and he/she knows that it is inside

¹⁵⁸ M. Filby, ‘*The Enforcement of Insider Dealing under the Financial Services and Markets Act 2000*’ (2003) 24(11) *Company Lawyer* 334, p. 2 <<http://ssrn.com/abstract=2087821>> accessed 23 August 2016.

¹⁵⁹ Morse, *supra* note 4, p. 361.

information and that they got it from an inside source.¹⁶⁰ The Act, goes further to specify the situations whereby information is deemed to have come from an inside source. First, information gained by the person by virtue of being a director, employee or a shareholder of the company which has issued the shares or debentures. Second, information gained by a person who has access to it through his employment, profession or office for example a lawyer. The proof of relationship between the person and the issuer of the securities is not required; all that is required is that the guilty party dealt or caused dealing while in possession of inside information. Third is information that a person has obtained directly or indirectly from a director, employee or a shareholder of the issuer of the securities or from a person who happens to access the information through his employment, profession or office. This last situation covers tipper and tippees of inside information.¹⁶¹

With regard to 'inside information', the CJA derives its definition from the EC Directive on Insider Dealing and Market Abuse. It sets forth four elements of inside information. First, the information must relate to particular securities or to a particular company or its business but not to securities generally or companies generally. Second, the information must be specific or precise. Third, the information must not have been made public. Fourth, the information must be such that if it were made public it would be likely to have a significant effect on the price or value of the price affected securities.¹⁶²

The provisions of the CJA and the Capital Markets Act in relation to the elements of inside information are similar, save for the fact that the CJA requires the information to be specific or precise. This requirement is aimed at distinguishing inside information from a rumour. The

¹⁶⁰ Ibid.

¹⁶¹ Criminal Justice Act s. 57; Morse, *supra* note 4, p. 363.

¹⁶² S. 56(1).

Capital Markets Act falls short by omitting the requirement that for information to be inside information it must be specific or precise. However, both legislations do not define ‘material effect’ and ‘significant effect’ in relation to inside information.

Sometimes an insider trading offence is committed if the dealing actually takes place, therefore, the definition of what amounts to dealing is essential. Both the Capital Markets Act and the CJA define ‘dealing’.¹⁶³ However, the meaning of dealing contained in the Capital Markets Act is narrow, whereas, the CJA offers a broad definition of dealing that covers dealing in the context of the encouraging offence and agreements to create a security and termination of an agreement that created a security.

(b) Utilization of Civil and Criminal Proceedings

Unlike in Kenya, insider trading is both a criminal and a civil offence in the UK. Insider trading is a criminal offence under Part V of the CJA and a civil offence in the form of market abuse under the FSMA.¹⁶⁴ The introduction of the civil offence of market abuse was as a result of the difficulties experienced in the enforcement of criminal insider trading under the CJA. Insider trading as a criminal offence requires proof beyond reasonable doubt whereas, as a civil offence the standard of proof is on a balance of probabilities which is achievable.¹⁶⁵

¹⁶³ Capital Markets Act, s. 33(B); CJA, s. 55(1).

¹⁶⁴ Market abuse is a civil offence consisting of insider dealing and market manipulation activities (misleading and distorting the market), created in the UK (as an EU member) following a requirement by the EC Directive 2003/6/EC of the European Parliament and Council of 28 January 2003; see The FSMA, s. 118.

¹⁶⁵ J. McNally, ‘*Briefing: Insider Trading Risks*’ (UK Shareholder Activism-London, August 2014) available at <http://www.SRZ_UK_Shareholder_Activism_Briefing_Insider_Trading_Risks.pdf> accessed 19 January 2016.

The provision for both criminal and civil proceedings in the UK ensures that the FCA has a choice of regime when instituting insider dealing actions.¹⁶⁶ Kenya's Capital Markets Act provides only for criminal action against insider trading offenders.

(c) Insider Trading Offences

The CJA and the Capital Markets Act provide for three insider trading offences; the actual dealing offence, the encouraging offence and the disclosure offence.¹⁶⁷ However, compared to the Capital Markets Act, the provisions of the CJA are clear and more straightforward. The CJA incorporates the elements of insider trading in its description of the offences and does use vague or general terms such as 'person' and 'information in the possession of the insider'. The Act is consistent in the use of precise and direct terms such 'price-sensitive securities', 'dealing', 'insider' and 'inside information' in describing the offences.

In relation to the disclosure offence which is committed when an insider discloses the inside information to another person otherwise than in the proper performance of the functions of his/her employment, office or profession, the legislations contain similar provisions. They both fall short by failing to define what is meant by 'proper'.¹⁶⁸

(d) Statutory Defences for Insider Trading

Whilst the Capital Markets Act does not contain any insider trading defences, the UK insider dealing laws go an extra mile to provide for insider trading defences that a defendant should prove on a balance of probabilities.¹⁶⁹ The essence of incorporating insider trading defences in an

¹⁶⁶ Ibid.

¹⁶⁷ Capital Markets Act, s. 32B; CJA, s. 52.

¹⁶⁸ Morse, *supra* note 4, 362.

¹⁶⁹ Ibid, p. 364.

insider trading legislation is to protect an innocent person from incurring liability.¹⁷⁰ The CJA provides for three defences to the actual dealing and encouraging offences.¹⁷¹ The first defence is that the person did not at the time expect the dealing, by himself/herself or another person, to result in a profit or avoidance of a loss. The second defence is that at the time, the person reasonably believed that the information was widely known so as not to prejudice the other parties. The third defence is that the person would have dealt or encouraged another person to deal in the securities even if he/she had not had the inside information.

The CJA provides for two defences to the disclosure offence. The first defence is that the person did not expect that any person would deal in securities as a result of the disclosure. The second defence is that, even if the person expected another person to deal in securities, he/she did not expect a profit or avoidance of a loss to arise from such dealing.¹⁷²

(e) Insider Dealing Penalties

Unlike the Capital Markets Acts, the CJA provides for tougher insider trading penalties. Insider trading offenders can be sentenced to a maximum of seven years imprisonment on conviction or six months on a summary conviction, together with a fine.¹⁷³ It is important to note that in enforcing the penalties, the UK courts adopt a “one size does not fit all” rule, therefore, penalties vary from one case to another based on the facts.

The Court of Appeal in the case of *R. v McQuoid*¹⁷⁴ gave the following guidance on sentencing:

These considerations seem to us to be relevant: the nature of the defendant’s employment or retainer, or involvement in the arrangements which enabled him to participate in the insider dealing of which he is guilty; the circumstances in which he came into possession of confidential information and the use he made

¹⁷⁰ See Chitimira, supra note 40, p. 65.

¹⁷¹ CJA ss. 53(1) and 53(2).

¹⁷² S. 53(3); Morse, supra note 4, p. 364.

¹⁷³ S. 61(1).

¹⁷⁴ (2009) 4 All E.R. 388, p. 389.

of it; whether he behaved recklessly or acted deliberately, and almost inevitably therefore, dishonestly; the level of planning and sophistication involved in his activity, as well as the period of trading and the number of individual trades; whether he acted alone or with others and, if so, his relative culpability; the amount of anticipated or intended financial benefit or loss avoided, as well as the actual benefit; although the absence of an identified victim is not normally a matter giving rise to mitigation, the impact, where proved, on any individual victim; the impact the offence on overall public confidence in the integrity of the market.

4.2.2 The Adequacy of the UK Institutional Framework on Insider Trading

Under this heading, the study identifies some of the factors that make the UK institutional framework on insider dealing more adequate than Kenya's.

(a) One-Tier Enforcement Structure

The UK adopts a one-tier enforcement structure, whereby a single regulatory body (the FCA) is responsible for enforcing the insider dealing and market abuse laws.¹⁷⁵ Under the FSMA, the FCA has a statutory objective to reduce financial crimes such as insider trading in the UK financial industry.¹⁷⁶ As the sole enforcer, the FCA enjoys a wide range of enforcement powers under the CJA and the FSMA. It has regulatory, civil and criminal powers to enforce the insider trading laws.¹⁷⁷

The one-tier structure ensures accountability and mitigates moral hazard risks associated with multiple/tiered structure. Since the FCA is the sole enforcer it feels the pressure to perform its functions effectively and it does this aware of the fact it is accountable for each and every action and decision it makes. Perhaps, this is one of the reasons why the FCA has been vigilant and aggressive in enforcing the insider dealing and market abuse laws in the UK.

¹⁷⁵ See Filby, *supra* note 158, p. 2.

¹⁷⁶ FSMA s. 2(2).

¹⁷⁷ FCA website <<https://www.the-fca.org.uk/about/enforcement>> accessed 23 July 2016.

(b) Detection of Insider Dealing

The FCA detects possible instances of insider dealing in the UK securities markets in three ways; supervision, surveillance and whistleblowing.¹⁷⁸ Through whistleblowers, the FCA receives information about a possible insider dealing or market abuse from an informant, other than a compliance officer carrying out his/her duty. The FCA's whistleblowing policy released in 2000 is based on the Public Interest Disclosure Act of 1998, whose objective is to protect employees who report matters of public interest from victimization by their employers. Apart from encouraging people to be whistleblowers in insider dealing and market abuse offences, the FCA has dedicated a telephone number for whistleblowers to use when reporting such matters.¹⁷⁹

However, like the CMA, the FCA's supervision and monitoring function is only limited to licensed persons and listed companies otherwise referred to as authorized persons in the UK. This is a gap in the UK institutional framework on insider trading as well, because any insider dealing or market abuse instances by unlicensed persons and unlisted companies is unlikely to be detected by the FCA.¹⁸⁰

Market surveillance in the UK, takes place in form of monitoring and supervising the stock exchanges mostly carried out by the market surveillance group at the London Stock Exchange (LSE). The LSE possesses real time and historical trading monitoring systems that detect insider dealing or market abuse instances. The LSE has also developed a computerized monitoring system, IMAS, which is based on the exchange computer systems used in the USA, namely; the Inter-market Surveillance Information Systems (ISIS) and the Auto Search And Match (ASAM). The LSE's IMAS system monitors every market transaction which takes place, and brings any

¹⁷⁸ Filby, supra note 158, p. 3.

¹⁷⁹ Filby, supra note 158, p. 5.

¹⁸⁰ Ibid, p. 2.

large or suspicious transactions to the attention of the market surveillance group staff. Suspicious transactions include for example instances whereby a large quantity of securities is purchased shortly before an announcement which increases share price is made and instances whereby, a large quantity of securities are sold before an announcement which negatively affects the share price. Once the LSE concludes that the transaction is indeed suspicious, the matter is referred to the FCA for investigation.¹⁸¹

(c) FCA's Capacity to Investigate Insider Trading Cases

The FSMA vests wide investigative powers on the FCA. The Act empowers the FCA to appoint one or more competent persons to conduct an investigation on its behalf.¹⁸² The investigators appointed by the FCA are empowered to summon any person they consider is or may be able to give information which is or may be relevant to the investigation.¹⁸³ The investigators are also empowered to require the person to produce any documents which appear to them to relate to any matter relevant to the investigation.¹⁸⁴ The power to summon and require production of documents is wide enough to cover persons such as financial journalists who may in certain circumstances be the actual insider dealing perpetrators.¹⁸⁵ Moreover, the investigators have the power to require the summoned individual to give them all assistance in connection with the investigation which the person is reasonably able to give.¹⁸⁶

The FSMA backs the FCA's investigatory powers by providing that non-compliance with the FCA or its investigators and committing certain acts of obstruction such as tampering with or falsifying documents, or giving false information are criminal offences, punishable with a

¹⁸¹ Ibid, p. 3.

¹⁸² FSMA, ss. 168(2) (a) and 168(3).

¹⁸³ S. 173(2).

¹⁸⁴ S. 173(3).

¹⁸⁵ See Girvin, supra note 31, p. 602.

¹⁸⁶ FSMA, s. 173(4).

custodial sentence, a fine, or both.¹⁸⁷ The investigators appointed by the FCA are further enabled under the FSMA to take a person to court for failure to comply without reasonable excuse, and if the court is satisfied it deals with the defaulter as if he/she were in contempt of the court and may require them to contribute to the costs of the inquiry.¹⁸⁸

(d) The FCA's Enforcement Powers

As previously stated, the FCA enjoys wide enforcement powers under the CJA and the FSMA. Its enforcement powers range from regulatory and civil to criminal prosecutorial powers. Upon completion of investigations on suspected insider dealing or market abuse instances, the FCA decides on whether to institute regulatory, civil actions or to criminally prosecute the perpetrator under the CJA.¹⁸⁹

If the FCA considers regulatory sanctions appropriate, it notifies the Regulatory Decisions Committee (RDC) which responds by issuing a warning notice to the perpetrator. The notice notifies the perpetrator about the nature of the allegation, the type of action that the FCA wishes to take and reasons thereof. The notice also gives the perpetrator a time period of 28 days to make representations (respond to the contents of the notice).¹⁹⁰ Informed by the representations, the FCA may issue penalties or decide not to.

The FCA is enabled to institute proceedings for criminal insider dealing under Part V of the CJA.¹⁹¹ To this end the FCA has published a detailed policy of instances when it can institute criminal proceedings and factors which influence its decision.

¹⁸⁷ S. 177.

¹⁸⁸ S. 177(2).

¹⁸⁹ Filby, *supra* note 158, p. 11.

¹⁹⁰ *Ibid*, pp. 11-12.

¹⁹¹ FSMA, s. 402.

(e) The FCA'S Power to Punish Insider Dealing

The FCA is given a wide range of powers to impose sanctions that aid it in its task of protecting the market and investors and eliminating insider dealing from the UK securities markets.¹⁹² For instance, the FCA is empowered to impose unlimited fines on insider trading offenders and in circumstances whereby the purpose of the fine is restitution, the FCA has the power to impose the fine itself or exercise the option of applying to the court to impose the fine on its behalf. The FCA is also empowered to apply to the court and request it to impose a penalty fine on the offender. Moreover, the FCA can request the court to serve an injunctive order to prevent the offender from dealing, or from disposing of any assets related to market abuse, or to require the offender to take steps necessary in order to effect restitution.¹⁹³

Finally like the CMA, FCA has the power to publicly censure, that is, to name and shame any market abusers such as insider dealing offenders, and to vary or cancel any permissions held by offenders who are also authorized/licensed parties.¹⁹⁴

4.2.3 Legislative, Institutional and Policy Lessons for Kenya

From the legal framework on insider trading in the UK, these are the lessons for Kenya;

There is need for precision and clarity when defining the insider trading terms. With regard to the definition of an insider, the Capital Markets Act should abandon the USA classical/traditional approach which limits the meaning of insiders to those connected to the issuer of securities. The Capital Markets Act should adopt the UK approach that casts a wider net to cover both primary and secondary insiders and tippees and tippers of inside information. The Act should incorporate

¹⁹² Filby *supra* note, 158, p. 13.

¹⁹³ See, s.123 of the Financial Services and Markets Act; Filby *supra* note 158, pp. 14-15; J. MacNally, *supra* note 165.

¹⁹⁴ FSMA s. 123.

substantive provisions which clearly identify the parties who may be deemed insiders and the circumstances in which a person becomes an insider. It should also introduce the concept of the inside source to bring clarity in the context of secondary insiders. With regard to the definition of 'inside information', the Capital Markets Act should include an additional requirement to the effect that inside information must be specific or precise, for purposes of distinguishing inside information from a mere rumour. Kenya should also emulate the UK and expand the scope of 'dealing' to cover dealing in the context of the encouraging offence and agreements to create a security and termination of an agreement that created a security.

With regard to the insider trading offences the need for clarity and precision to avoid confusion and conceptual difficulties, is a lesson that Kenya should learn for the UK. The Capital Markets Act should make use of the elements that constitute the insider trading offence in describing the insider trading offences and avoid the use of vague and ambiguous terms such as 'person' in place of 'insider' or 'information in the possession of the insider' in place of 'inside information'.

To avoid instances whereby innocent persons may incur insider trading liability, Kenya should emulate the UK and incorporate insider trading defences in the Capital Markets Act which is the principal legislation on insider trading.

To effectively punish insider trading and achieve the deterrence objective, Kenya should emulate the UK and enhance its insider trading penalties. Kenya should increase and make the insider trading penalties under the Capital Markets Act tougher. Moreover, just as the Financial Services and Markets Act vests the FCA with wide and adequate powers to punish insider trading, the Capital Markets Act should also vest the CMA with similar powers. Furthermore, Kenya should move away from the 'one size fits all' rule on imposition of insider trading penalties and put in

place a comprehensive policy containing guidelines on sentencing in insider trading cases to guide the courts.

To boost detection rates, Kenya should emulate the UK and put in place a firm policy on whistleblowing aimed at encouraging and promoting a whistleblowing culture and ensuring sufficient protection to whistleblowers who come forward or wish to report insider trading cases.

To enhance market surveillance and monitoring which have proved to be useful tools in insider trading detection, the CMA and the NSE should acquire a computerized monitoring system that is programed to detect suspicious trades on real-time basis. Moreover, the NSE and other relevant agencies should emulate the LSE and be more vigilant and aggressive in keeping the CMA informed of any suspicious trades in securities.

Finally, the Capital Markets Act like the FSMA should contain provisions on investigations on insider trading cases, clearly stating the investigative powers of the insider trading investigators. Further, the Capital Markets Act should make a direction for the formulation of a policy statement that outlines the investigation process.

4.3 The United States of America

As Kenya continues to experience unsuccessful prosecution of insider trading, the first insider trading case took place in the USA as early as 1909. This was the case of *Strong v. Repide*¹⁹⁵ which involved the sale of stock in the Philippine Sugar Estates Development Company to one of the directors of the company. The Court held that a corporate director who bought that

¹⁹⁵ 213 US 419 (1909).

company's stock when he knew it was about to increase in price, committed fraud by buying and not disclosing his inside information.¹⁹⁶

The prohibition of insider trading evolved in the USA as a way of protecting the statutory fiduciary duties of corporate directors and officers.¹⁹⁷ Following the collapse of its stock markets in 1929, the USA enacted two insider trading legislations; the Securities Act of 1933 and the Securities Exchange Act of 1934.¹⁹⁸

There is no statute that singularly establishes insider trading liability in the USA. The interpretation of the Securities Exchange Act and its principal implementing regulation (Rule 10b-5) has over the years, led to the enactment of multiple insider trading legislations. Other insider trading legislations in the USA include the Insider Trading Sanctions Act 1984, Insider Trading and Securities Fraud Enforcement Act 1988, the Sarbanes-Oxley Act and the Stop Trading On Congressional Knowledge Act (the STOCK Act). In the USA mail and wire fraud statutes which prohibit the use of mail, wire and radio or television communications to execute insider trading transactions are also utilized to aid in the fight against insider trading.¹⁹⁹

The USA adopts a tiered enforcement structure made up of multiple enforcers. The principal enforcers are the Securities Exchange Commission (SEC) and the Department of Justice (DOJ). The SEC is divided into four main divisions namely; the Corporate Finance, Market Regulation, Investment Management and Enforcement Divisions.

¹⁹⁶ This ruling was delivered in the USA during a time when insider trading was considered to be fraud against shareholders before the passing of insider trading laws.

¹⁹⁷ S. M. Bainbridge, 'An Overview of US Insider Trading Law: Lessons for the EU?' (2004) University of California, Los Angeles, School of Law, Law & Economics Research Paper Series 1, p. 2. <<http://ssrn.com/abstract=654703>> accessed 23 August 2015.

¹⁹⁸ S. M. Bainbridge, 'Insider Trading: An Overview' (2000) University of California, Los Angeles (UCLA)-School of Law, p. 1. <<http://ssrn.com/abstract=132529>> accessed 23 August 2015; Chitimira, supra note 40, p. 5.

¹⁹⁹ C. L. Garcia and B. M. Johnson, 'Defending Clients in Insider Trading Investigations and Enforcement Actions' Ch. 13, p. 5.

This chapter focuses on the scope of application of the USA insider trading laws, definition of insider trading terms particularly ‘insider’, utilization of civil and criminal actions, statutory right of action by private litigants, provisions on disclosure obligations and their enforcement, insider trading penalties and the adequacy of the USA institutional framework on insider trading in terms of capacity to detect, investigate and prosecute insider trading cases.

4.4.1 The Adequacy of the USA Insider Trading Laws

(a) Scope of Application

Whilst, the Capital Markets Act regulates insider trading in the context of listed securities only, the USA insider trading laws have a wider scope of application. The USA insider trading laws have defined securities to include tenders offers. Rule 14e-3 of the SEC Regulations governs insider trading in the context of tender offers, by making it illegal for anyone to trade on the basis of material non-public information regarding tender offers especially if the person knew that the information came from an insider.²⁰⁰

(b) Utilization of Civil and Criminal Proceedings

Unlike the Capital Markets Act which restricts the enforcement of insider trading to criminal proceedings only, the USA insider trading laws provide for both criminal and civil proceedings of insider trading cases. This lowers the burden on the prosecution to prove the elements of the offence beyond reasonable doubt and enables aggrieved parties to seek damages against those who illegally traded in securities on the basis of inside information or tipped others to trade on

²⁰⁰ Bainbridge, supra note 197, p. 2.

the basis of inside information.²⁰¹ Over the years, the civil proceedings brought by the SEC have proved to be a powerful tool against insider trading in the USA.²⁰²

(c) The Scope of an Insider

Compared to Kenya's insider trading laws, the USA insider trading laws are very strict in the sense that they affect not only corporate insiders but also constructive insiders, as well as outsiders who receive inside information from either corporate insiders or constructive insiders.²⁰³ This means that the term 'insider' in the USA context, covers both primary (corporate insiders) and secondary (constructive insiders) insiders and tippers and tippees of inside information.

Tippling liability for tippers and tippees of inside information was established in the case of *Dirks v. SEC*²⁰⁴ where the US Supreme Court ruled that tippees who receive inside information from corporate insiders or constructive insiders are liable for insider trading, if they had reason to believe that the tipper had breached a fiduciary duty in disclosing confidential information and the tipper received any personal benefit from the disclosure.

Moreover, the *Dirks* case defined constructive insiders to include lawyers, bankers and others who receive confidential information from a corporation while providing services to the corporation. Constructive insiders are liable for insider trading if the corporation expects the information to remain confidential. They are deemed to have acquired the fiduciary duties of a corporate insider.²⁰⁵

²⁰¹ Securities Exchange Act ss. 10(b) and 20A.

²⁰² See Shen, supra note 36, p. 42.

²⁰³ Bainbridge, supra note 198, p. 13.

²⁰⁴ 463 U.S. 646, 655 (1983).

²⁰⁵ Bainbridge, supra note 198, p. 13.

(d) Statutory Right of Action by Private Litigants

In the USA investors and issuers of securities are statutorily allowed to bring private lawsuits for damages against insiders who illegally trade on the basis of inside information.²⁰⁶ The maximum amount of civil recovery by an investor is equal to the difference between the price at which the investor sold or purchased the shares and the market price of the stock at reasonable time after the information was announced to the public.

(e) Adequacy of Disclosure Obligations

The USA legal framework on insider trading comprises various disclosure obligations which aid in the prevention of insider trading. For example the SEC Regulations contain a Rule on fair disclosure which requires that if a company intentionally discloses material non-public information to one person, it must simultaneously disclose that information to the general public.²⁰⁷ This Rule also stipulates that in the case of an unintentional disclosure of material non-public information to one person, the company must make a public disclosure promptly.

Disclosure obligations have further been enhanced through case law by the USA Courts. The ‘abstain or disclose’ rule also known as the ‘parity of information’ rule was developed in *SEC v. Texas Gulf Sulphur Co.*²⁰⁸ where the officers of the defendant company used inside information about the discovery of the Kidd Mine to make profits by buying shares. The Court held that anyone who possessed material nonpublic information was required either to disclose it before trading or abstain from trading in the affected securities.

²⁰⁶ See Shen, supra note 36, p. 54. The Insider Trading and Securities Fraud Enforcement Act of 1988 allows civil proceedings against insider trading offenders by private litigants.

²⁰⁷ Bainbridge, supra note 198, p. 2.

²⁰⁸ 401 F. 2d 833 (2d Cir. 1968).

The ‘disclose or abstain’ rule was again invoked in the 1980 case of *United States v. Chiarella*²⁰⁹ where the Supreme Court ruled that a corporate insider has a duty to disclose or abstain from trading which arises from the relationship of trust and confidence that exists between the shareholders of a company and those insiders who have obtained confidential information by reason of their position with that issuer.²¹⁰

The rule is expansive because it is not limited to true insiders otherwise known as corporate insiders, such as officers, directors, and controlling shareholders, but picks up corporate outsiders who themselves in possession of inside information from either true insiders or constructive insiders.²¹¹

(f) Insider Trading Penalties

Whilst the insider trading penalties prescribed by the Capital Markets Act have been criticized in the previous chapter as insufficient to deter insider trading, the violation of insider trading laws in the USA triggers a broad range of severe penalties. For instance, an insider who willfully violates securities laws is subject to criminal penalties which include a maximum of ten years imprisonment and a fine of 1 million dollars for individuals and 2.5 million dollars for companies.²¹² On the other hand, Section 16b of the Securities Exchange Act requires insiders to relinquish to the corporation all profits made as a result of insider trading. Moreover, in civil actions instituted by the SEC, the Securities Exchange Act empowers SEC to seek a permanent or temporary injunction if it appears to it that a person is engaged or is about to engage in insider

²⁰⁹ 445 U.S. 222 (1980).

²¹⁰ G. Kramer, ‘*Insider Trading: Examining Primary Theories of Liability*’ (2013) *New York Law Journal*, p. 7. <<http://www.newyorklawjournal.com/id=1202588045359/Insider-Trading-Examining-Primary-Theories-of-Liability>> accessed 12 January 2016.

²¹¹ See Bainbridge, *supra* note 198, p. 2.

²¹² The Insider Trading and Securities Fraud Enforcement Act of 1988 is the insider trading legislation that increased the jail term for insider trading convicts to 10 years.

trading practices. In addition to the injunctive orders, SEC is also empowered to seek disgorgement of profits and disclosure of material information.

The coming into force of the Insider Trading Sanctions Act in 1984 amended various Sections of the Securities Exchange Act by enhancing insider trading penalties. The Act empowers the SEC to seek the payment of up to three times the insider's illegal profits or loss avoided. The Act also increases criminal penalties, particularly, the amount of fine that an insider trading convict is liable to pay from \$10,000 to \$100,000. In 2012, the SEC amended its sentencing guidelines to increase insider trading penalties.²¹³

The USA severe penalties have been enforced in several cases. For example in 2009, Bernard L. Madoff was sentenced to 150 years in prison for committing securities fraud through his fraudulent Ponzi scheme that caused investors enormous financial losses. The sentence was pronounced by Federal District Judge Denny Chin who condemned Madoff's crimes as "extraordinarily evil".²¹⁴ Others cases include Matthew Martoma sentenced to nine years in prison for insider trading and Michael Steinberg, sentenced to three and a half years in the USA federal prison for insider trading and ordered to pay \$2 million fine for an insider trading scheme that allegedly earned him \$1.8 million in illegal profits.²¹⁵ Other convicts such as Matthew Kluger received a sentence of twelve years in prison for insider trading, Rajaratnam received eleven years and Zvi Goffer received ten years.²¹⁶

²¹³ Garcia and Johnson, *supra* note 199, p. 23.

²¹⁴ D. B. Henriques, 'Madoff is Sentenced to 150 Years for Ponzi Scheme' (New York Times, 30 June 2009) <www.nytimes.com> accessed 11 June 2016.

²¹⁵ Forbes, 'As Steve Cohen Roams Free, EX-SAC Trader Michael Steinberg Sentenced to 3-5 Years for Insider Trading' (Forbes, 16 May 2014) <<http://www.forbes.com/sites/afontevicchia/2014/05/16/as-steve-cohen-roams-free-ex-sac-trader-michael-steinberg-sentenced-to-3-5-years-for-insider-trading/>> accessed 11 November 2015; N. Vardi, 'Mathew Martoma Sentenced to Nine Years for Insider Trading' (Forbes, 8 September 2014) <www.forbes.com/sites/nathanvardi/2014/09/08/mathew-martoma-sentenced-to-nine-years-for-insider-trading/#2eec1f5622e5> accessed 11 November 2015.

²¹⁶ See Garcia and Johnson, *supra* note 199, p. 25; see also Hristova, *supra* note 82, p. 267.

Moreover, when it comes to sanctioning insider trading activities, the USA does not leave any stone unturned. The USA has in place a legislation, Stop Trading on Congressional Knowledge Act (Popularly known as the “STOCK Act”), which deals with the imposition of insider trading sanctions on members of the US Congress and other government officials who trade in securities while in possession of inside information which they acquire by virtue of their official duties.²¹⁷

4.3.1.1 The Sarbanes-Oxley Act 2000 and the Regulation of Insider Trading in the USA

The USA adopts a rule-based corporate governance system. Its corporate governance principles are codified in the Sarbanes-Oxley Act of 2002. The Act was passed by the USA Congress on 25th July, 2002 in reaction to corporate scandals such as Enron, Worldcom, Xerox, Sunbeam, Waste Management, Adelphia, Tyco, HealthSouth and Global Crossing among others. The Act was aimed at fixing poor auditing practices which were largely blamed for the scandals.²¹⁸

As a way of eliminating financial crimes from the USA securities markets, the Sarbanes-Oxley Act established the Public Company Accounting Oversight Board (PCAOB) to oversee and regulate auditing.²¹⁹ As part of its mandate, the Act requires the Board to enlist auditors and to enforce existing laws against theft and fraud by corporate officers such as insider trading.

Further, Sarbanes-Oxley Act prohibits directors and other corporate officers from trading in securities issued by their companies during what the Act refers to as ‘pension fund blackout periods’.²²⁰ The Act also makes it an offence for anyone to execute or attempt to execute a

²¹⁷ Ibid.

²¹⁸ J. C. Coates, ‘*The Goals and Promise of the Sarbanes-Oxley Act*’ (2007) Vol. 21 No. 1, *Journal of Economic Perspectives*, pp. 91-116, p. 116.

²¹⁹ Sarbanes-Oxley Act 2002 s. 101 (a).

²²⁰ See, s. 306 of the Sarbanes-Oxley Act.

scheme with the intention to defraud another person in connection to securities trade. Such trades are said to include among others insider trading schemes.

4.4.2 The Adequacy of the USA Institutional Framework on Insider Trading

(a) Tiered Enforcement Structure

There are multiple enforcers of the USA insider trading laws. The key enforcer of civil insider trading is the SEC through its Department of Enforcement.²²¹ Whereas, the enforcers of criminal insider trading include the DOJ through the United States Attorneys' Offices in various parts of the country.²²² As regards investigations on insider trading cases, the FBI is the lead investigative agency in criminal insider trading cases. Save to add that the United States Postal Inspection Service and investigators employed by the United States Attorneys' Offices also play a major role in the investigations and prosecution of insider trading cases.²²³ Private litigants who bring civil proceedings against offenders in pursuit of damages have also been instrumental in the enforcement of the insider trading laws in USA.²²⁴

(b) SEC's Enforcement Powers

The SEC is empowered to initiate two types of enforcement actions namely; administrative and civil actions. In its administrative actions, the SEC has wider powers to punish insider trading offenders compared to the CMA. The SEC is empowered to seek disgorgement, injunction and

²²¹ The SEC's Department of Enforcement is tasked with investigations into possible violations of the federal securities laws, and prosecutes the Commission's civil suits in the federal courts as well as its administrative proceedings. See SEC website <<http://www.sec.gov/enforce>> accessed 25 July 2016.

²²² The US DOJ also initiates criminal proceedings against insider trading offenders through its Fraud Section located in Washington, D.C.

²²³ Garcia and Johnson, *supra* note 199, p. 34.

²²⁴ M. I. Steinberg, *'Insider Trading: A Comparative Perspective'* (IMF Seminar on Current Developments in Monetary and Financial Law, Washington DC, 2002), p. 12.

bar or suspend individuals from acting as corporate officers or directors and to seek civil penalties.²²⁵

However, like the CMA, the USA SEC is not authorized to institute criminal proceedings against insider trading offenders. Instead, the SEC is authorized by the Securities Exchange Act to request the Justice Department to institute the criminal proceedings.²²⁶ Whereas, in the Kenyan context, the CMA through the CMFIU which is manned by officers from the Directorate of Central Investigations can investigate suspected insider trading cases but the prosecutorial power mainly, rests with the Director Public Prosecutions (DPP).

The SEC's Corporate Finance Division oversees compliance with the mandatory disclosure requirements as well as registration by public companies of transactions such as mergers. It also operates the Electronic Data Gathering Analysis and Retrieval system (EDGAR system) to ensure equal access to non-public information.²²⁷ This aids in the fight against insider trading by ensuring that market participants are equally informed.

(c) Strong Whistleblowing Culture

As pointed out in the previous chapter, a weak whistleblowing system is one of the inadequacies ailing Kenya's institutional framework on insider trading.²²⁸ Whistleblowers or informants is a very common method used in the USA to detect insider trading instances. In fact, the Insider Trading and Securities Fraud Enforcement Act of 1988 introduced a bounty program for insider

²²⁵ See Ibid, Steinberg, p.13; Shen, supra note 36, p. 68.

²²⁶ Securities Exchange Act 1934, s. 21(d) (1).

²²⁷ Chitimira, supra note 40, p. 115.

²²⁸ See chapter 3 (of this study) pp. 50-51.

trading informants of up to 10% of the insider's amount of profits made or loss avoided, at the discretion of the SEC.²²⁹

(d) Possession of Sophisticated Surveillance Techniques

Moreover, the USA is said to possess adequate and effective government personnel, resources, and surveillance that deter prospective insider trading violators. The SEC has the financial capability of employing competent staff and providing appropriate resources to conduct meaningful market surveillance and monitoring.²³⁰

Advanced technologies play an essential role in monitoring market transactions and detecting insider trading. The New York Stock Exchange (NYSE) uses sophisticated technology and pattern recognition system to monitor volume and price movements of all publicly traded stocks on a real-time basis.²³¹ Whereas in Kenya, one of the challenges hindering the proper enforcement of the insider trading law is lack of sophisticated information technology systems that can effectively detect suspicious trades.

It is also important to note that the SEC has in place a specialized unit that is devoted and committed to insider trading regulation. This unit has been innovative in its use of complex analytics to detect insider trading activities. In carrying out its duties, this unit also coordinates with its criminal counterparts.²³²

(e) The SEC's Investigatory Powers

The SEC's Enforcement Division is tasked to carry out the investigations on any violation of the laws and rules that govern insider trading and other related practices. The Division has extensive

²²⁹ Filby, supra note 158, p. 4; Shen, supra note 36, p. 75.

²³⁰ See Steinberg supra note 224, p. 30.

²³¹ Shen, supra note 36, p. 71.

²³² See, Garcia and Johnson, supra note 199, p. 26.

investigatory powers which include issuing subpoena for production of relevant evidence such as documents and compelling suspects and others to testify in the courts.

Save to add that, the Division has the powers to enforce the civil remedies, institute administrative orders, recover any illegally obtained profits from guilty persons (disgorgement of profits), impose punitive penalties on such persons and refer criminal matters to the Department of Justice.²³³

(f) Co-operation and Assistance from Other Agencies

The strategy of availing assistance from the official government investigative agencies in investigations into insider trading allegations has proved to be extremely successful and efficient in the USA. For example the FBI aids the SEC in investigating insider trading allegations in a more comprehensive and expeditious way.

Moreover, in the USA other relevant agencies such the NYSE are statutorily required to co-operate and assist the SEC in the fight against insider trading.

(g) Use of Wire-tapping Technique

The USA DOJ uses the wire-tapping technique to investigate insider trading by hedge fund professionals.²³⁴ This exercise has been pivotal to the US government's ability to uncover insider trading networks. Wire-tapping as a method of investigating insider trading was approved by the USA Courts in the Raj Rajaratnam, Fleishman and Goffer cases to secure successful prosecutions.²³⁵

²³³ Chitimira, supra note 40, p. 116.

²³⁴ Ibid.

²³⁵ See Garcia and Johnson, supra note 199, p. 26.

4.4.3 Legislative, Institutional and Policy Lessons for Kenya

From the legal framework on insider trading in the USA, these are the lessons for Kenya;

To increase the scope of application of its insider trading laws, Kenya should follow in the steps of the USA and move away from the perception that insider trading can only take place in the selling or buying of listed securities. Kenya should extend its insider trading regulations to other areas such as tender offers.

Kenya should emulate the USA and enhance the scope of ‘an insider’ to include corporate insiders, constructive insiders, tippees and tippers of inside information. This will ensure that no one escapes insider trading liability for lack of connection to the issuer of securities.

To enhance its disclosure obligations, Kenya should consider adopting the USA ‘disclose or abstain’ rule that goes beyond issuers of securities to target each and every person who is in possession of material non-public information. The CMA should also establish a department tasked with policing and overseeing compliance with the disclosure obligations.

To supplement the public enforcement of its insider trading laws, Kenya should emulate the USA and provide for statutory right of action to private litigants. This will act as a redress mechanism for issuers of securities and investors who suffer losses as a result of insider trading activities.

To ensure effective deterrence of the insider trading, Kenya should emulate the USA and make its insider trading penalties tougher by increasing the prison terms, the amount of fines and the number of times that a convict should disgorge the profits made or loss avoided. The Capital Markets Act should provide for a variety of insider trading penalties to include for example injunctive orders against insider trading perpetrators. In imposing the insider trading penalties

Kenya should move away from the ‘one size fits all’ rule and let the severity of the punishment be determined by the facts of the case in terms of the amount of profits made or loss avoided and the magnitude of the damage caused by the offence. This calls for policy guidelines in sentencing.

Kenya should also consider the enactment of a legislation or inclusion of a provision in the Capital Markets Act, which seeks to punish insider trading by governmental officials who trade on the basis of inside information that they acquire by virtue of their offices.

The CMA should explore ways in which it can enhance the whistleblowing culture to make it stronger. For instance it should consider introducing a reward program like the USA. The CMA should be well equipped in terms of qualified personnel, resources and sophisticated technology and pattern recognition systems to monitor trades on real-time basis. Furthermore, the CMA’s investigatory powers should be clearly and statutorily provided for. These institutions should also be allowed to explore other options during investigations such as wire-tapping.

Finally, Kenya should also explore and weigh the benefits of statutorily requiring agencies such as stockbrokers and the NSE to report suspicious insider trading instances to the CMA. The Code of Corporate Governance for Issuers of Securities albeit principle-based, should be reviewed to contain similar provisions as the Sarbanes-Oxley Act geared towards discouraging insider trading activities.

4.4 The Republic of South Africa

Insider trading is statutorily prohibited both in Kenya and South Africa. Insider trading was criminalized in South Africa in 1973 particularly under Section 233 of the Companies Act of 1973, which was later found inadequate and was replaced by its Section 440F. Like the previous

section, the provisions of Section 440F were found ineffective and incapable of combating insider trading following an increase in insider trading cases in the mid-1990s. In 1997, the King Task Group recommended the reform of the Companies Act, 1973. In 1998, following the King's recommendations, the provisions in the Companies Act were replaced by a separate piece of legislation on insider trading; the Insider Trading Act.²³⁶

The Insider Trading Act was enacted mainly to improve the efficiency of South Africa's financial markets and upgrade its corporate governance standards. The prime objective of the Act was to put the country in a position that would make it comparable to international best practices in combating insider trading. The breakthrough in insider trading regulation in South Africa was marked by the enactment of the Insider Trading Act which improved the country's legal framework on insider trading in various ways. For example it clarified the types of actions that amounted to insider trading and widened the scope of insider trading regulation by introducing civil proceedings in insider trading cases. It introduced tipping liability by declaring dealing in securities while in possession of inside information or tipping a person to trade on the basis of inside information illegal. Penalties upon conviction were also made tougher. Under the civil proceedings the Act provided that fines of up to four times the gains made from a trade could be levied together with the legal costs. Whereas, under the criminal proceedings it provided for a R2 million fine or imprisonment of up to 10 years, or both. The Act also increased the scope of the powers vested in South Africa's Financial Services Board (FSB) in pursuing insider trading cases. Notably, the FSB was empowered to bring civil claims against those who defied the provisions of the Act. The FSB was also empowered to compensate individuals who may have

²³⁶ No. 135 of 1998; Chitimira, *supra* note 40, p. 4; Myburgh and Davis, *supra* note 39, p. 13.

suffered losses as a result of insider trading transactions. The Act provided for the handing over of criminal investigations to the National Director of Public Prosecutions.²³⁷

In 2005, in yet another attempt to enhance the adequacy of South Africa's legal framework on insider trading, the Insider Trading Act of 1998 was repealed by the Securities Services Act of 2004.²³⁸ One of the objectives of the Securities Services Act was to increase confidence in the South African financial markets by requiring provision of securities services in a fair, efficient and transparent manner.²³⁹ However, the Securities Services Act did not have any significant impact on the country's legal framework on insider trading because the Act was a carbon copy of the Insider Trading Act.²⁴⁰

The Securities Services Act governed securities services in South Africa from 2005 to 2012 when it was repealed by the Financial Markets Act of 2012.²⁴¹ The Financial Markets Act was enacted to regulate the country's financial markets, to license and regulate exchanges, to regulate and control securities trading and to prohibit insider trading and other market abuses.²⁴²

The Financial Markets Act is currently the principal legislation on insider trading in South Africa. It refines the insider trading provisions contained in the previous Securities Services Act. Like its predecessor, the Financial Markets Act defines various terms and phrases connected to the insider trading offence namely; an insider, inside information, dealing. It also specifies the insider trading offences and their statutory defences, and prescribes insider trading penalties.

²³⁷ See, Myburgh and Davis, *supra* note 39, p. 14.

²³⁸ No. 36 of 2004.

²³⁹ The Securities Services Act, s 2(1) (a).

²⁴⁰ Chitimira, *supra* note 40, p. 8.

²⁴¹ No. 19 of 2012.

²⁴² Financial Markets Act, Preamble.

4.4.1 The Adequacy of South Africa's Insider Trading Laws

(a) Definition of Insider Trading Terms

Unlike the Capital Markets Act, the Financial Markets Act contains substantive provisions on 'an insider'. The Act defines an insider as a person who has inside information through being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates. An insider is also defined as a person who has inside information through having access to such information by virtue of his or her employment, office or profession.

Lastly, under the Financial Markets Act an insider means a person who has inside information obtained directly or indirectly from an inside source such a director, employee or a shareholder or obtained from a person who gained access to the information by virtue of his/her employment, office or profession.²⁴³

The term 'inside information' under the Financial Markets Act means 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.²⁴⁴ The elements of inside information under the Financial Markets Act are similar to the elements contained in the Capital Markets Act, save for the fact that the Capital Markets Act lacks a provision to the effect that inside information must be specific and precise. However, the legislations do not define the terms 'material effect'.

²⁴³ Financial Markets Act, s. 77.

²⁴⁴ S. 77.

(b) Utilization of Civil and Criminal Proceedings

The Financial Markets Act provides for both civil and criminal proceedings against insider trading offenders. The benefit of this is that the onus on the prosecution to prove the offence beyond reasonable doubt, is lowered to proof on a balance of probabilities that is achievable. Civil proceedings have been the main tool utilized in South Africa resulting in 17 settlements between 1999 and 2004.²⁴⁵

(c) Adequacy of Disclosure Obligations

In South Africa, listed companies are legally required to communicate with or rather disclose information to the market more quickly so that the window of opportunity to engage in insider trading is narrowed.²⁴⁶ The Financial Markets Act empowers the JSE to require an issuer of listed securities to disclose to it any information at the issuer's disposal about those securities, or about the affairs of that issuer. In addition to disclosing such information to the JSE, the issuer may also be required to disclose the information to the registered holders of the securities, within a period specified by the JSE. The Act further provides that if the issuer refuses to disclose the information to the JSE or the registered holders of the securities, JSE may suspend trading in those securities until such time as the required disclosure has been made to the satisfaction of JSE.²⁴⁷

²⁴⁵See, Myburgh and Davis, *supra* note 39, p. 16.

²⁴⁶*Ibid.*

²⁴⁷Financial Markets Act, s 14 (1) (a)-(c).

It is a condition on disclosure that when an issuer discloses information to the registered holders of securities that may influence the price of those securities, the issuer must at the same time make the information available to the public.²⁴⁸

(d) Insider Trading Offences

The Financial Markets Act provides for five insider trading offences,²⁴⁹ whereas, the Capital Markets Act of Kenya, caters only for three insider trading offences. The Financial Markets Act first provides for the actual dealing offence on one's account. It states that 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.²⁵⁰

The second offence relates to dealing on behalf of another person. The Act provides that an insider who knows that he or she has inside information and who deals, directly or indirectly, 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.²⁵¹

The third offence is the dealing offence on behalf of an insider. The Act provides that 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.²⁵²

²⁴⁸ S. 14(2).

²⁴⁹ This is an improvement of the Securities Services Act of 2005 that provided for four insider trading offences. The Financial Markets Act of 2012 expanded the regulation of insider trading in South Africa by introducing an additional insider trading offence.

²⁵⁰ Financial Markets Act, s. 78(1) (a).

²⁵¹ S. 78(2) (a).

²⁵² S. 78(3) (a).

Therefore, unlike Kenya's insider trading law which is silent on stockbrokers' liability, South Africa's insider trading laws provides for liability of retail brokers who trade on behalf of insiders. A retail broker firm is also guilty of insider trading if it is aware that a client on whose behalf it trades is in possession of inside information.²⁵³

The fourth offence is the disclosure offence. The Act provides that an insider who knows that he or she has inside information and who discloses the inside information to another person commits an offence.²⁵⁴

The fifth insider trading offence is the encouraging and discouraging offence also known as the tipping offence. The Act provides that an insider who knows that he 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.²⁵⁵

(e) Statutory Defences of Insider Trading

Whereas, Kenya's Capital Markets Act does not contain any statutory defences to the insider trading offences, the Financial Markets Act affords defences to certain persons who are suspected to have engaged in the actual dealing offence on one's account, dealing on another's account, disclosed inside information or dealt on behalf of an insider. The defendant is expected to prove the defences on a balance of probabilities.

For the actual dealing offence on one's account the defendant may argue that he only became an insider after he had given the instruction to deal to an authorized user and the instruction was not

²⁵³ See, Myburgh and Davis, *supra* note 39, p. 19.

²⁵⁴ Financial Markets Act s. 73(4) (a).

²⁵⁵ S. 73(5).

changed in any manner after he became an insider. The person may also argue that he was acting in pursuit of a transaction in respect of which all the parties to the transaction had possession of the same inside information, that trading was limited to the parties with the inside information and that 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.²⁵⁶

In relation to the offence of dealing on behalf of another person, the Act provides that the defendant may defend himself by arguing that he is an authorized user and was acting on specific instructions from a client, and did not know that the client was an insider at the time, that he only became an insider after he had given the instruction to deal to an authorized user and the instruction was not changed in any manner after he became an insider. The defendant may also argue that he was acting in pursuit of a transaction in respect of which all the parties to the transaction had possession of the same inside information, that trading was limited to the parties in possession of the inside information, and that 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.²⁵⁷

As regards the dealing offence on behalf of an insider, the person on whose behalf the dealing was done may argue that he only became an insider after he had given the instruction to deal to an authorized user and the instruction was not changed in any manner after he became an insider. Whereas the person who deals on his behalf may argue that he was acting in pursuit of a transaction in respect of which all the parties to the transaction had possession of the same inside information, that trading was limited to the parties in possession of the inside information, and

²⁵⁶ S. 78(1) (b).

²⁵⁷ S. 78(2) (b).

that 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.²⁵⁸

For the disclosure offence, the Act provides that the defendant may argue that he disclosed the inside information because it was necessary to do so for the purpose of the proper performance of the functions of his employment, office or profession in circumstances unrelated to dealing in any security listed on a regulated market and that he at the same time disclosed that the information was inside information.²⁵⁹

However, like its predecessor the Financial Markets Act does not contain any statutory defence for the tipping offence.

(f) Insider Trading Penalties

Under the Financial Markets Act, a person who is found guilty of the actual dealing offence on one's account, dealing on behalf of another person or dealing on behalf of an insider, is liable to pay an administrative sanction not exceeding the equivalent of the profit that the person, such other person or the insider, made or would have made if he had sold the securities or the loss avoided, through such dealing. The person is also liable to the payment of an amount of up to R1 million plus three times the amount of the profit made or would have made if the securities had been sold or the loss avoided, through such dealing. The person is also liable to the payment of interest and cost of suit, including investigation costs, on such scale as determined by the Enforcement Committee.²⁶⁰

²⁵⁸ S. 78(3) (b).

²⁵⁹ S. 78(4) (b).

²⁶⁰ S. 82(1) (a)-(d).

On the other hand a person who is guilty of the disclosure offence or the tipping offence is liable to the payment of an administrative sanction not exceeding the equivalent of the profit that such other person made or would have made if he had sold the securities, or the loss avoided, through such dealing. The person is also liable to the payment of an amount of up to R1 million, plus three times the amount of the profit made or would have been made or the loss avoided. The person is also liable to the payment of the interest, cost of suit, including investigation costs, on such scale as determined by the Enforcement Committee and the commission or consideration received for such disclosure, encouragement or discouragement

4.4.1.1 South Africa's Companies Act 71 of 2008 and the Regulation of Insider Trading

The South Africa's Companies Act of 1973 was repealed by the Companies Act of 2008²⁶¹ which among other objectives, seeks to provide for the incorporation, registration, organization and management of companies, to define the relationships between companies and their respective shareholders or members and directors and to provide for appropriate legal redress for investors and third parties with respect to companies.²⁶²

Like the Kenya's Companies Act 2015, South Africa's Companies Act 2008, has also codified the directors' common law duties. However, the two pieces of legislation differ to the extent that, the South Africa's Act requires a director to communicate to the board at the earliest practicable opportunity any information that comes to his attention, unless the director reasonably believes that the information is immaterial to the company or is generally available to the public, or known to the other directors.²⁶³

²⁶¹ No. 71 of 2008.

²⁶² South Africa's Companies Act 2008, Preamble.

²⁶³ S. 76(2) (b).

As far as directors' duties are concerned, the Companies Act 2008 provides that a director of a company, in his capacity as a director, must exercise the powers and perform the functions of a directors in good faith, in the best interests of the company and with the degree of care, skill and diligence reasonably expected of a person performing the same or similar duties of a director.²⁶⁴

A director is prohibited from using his position as a director, or any information obtained while acting in the capacity of a director to gain an advantage for himself or for another person other than the company.²⁶⁵

4.4.1.2 The King III Report on Corporate Governance and the Regulation of Insider Trading

South Africa's legal and institutional framework on insider trading is reinforced by corporate governance best practices which demand for controls on information dissemination within companies and financial markets.²⁶⁶ The King III Report on Corporate Governance of 2009 states that every listed company should have a practice of prohibiting dealing in its securities by directors, officers and other selected employees for designated period preceding the announcement of its financial results or in any other period considered sensitive.²⁶⁷

As far as conflict of interests between directors and stakeholders is concerned, the King III Report on Corporate Governance provides that directors personal interests should never at any one given time take precedence of the company's interests. The Report further provides that, in performing their duties as company directors, directors should at all times bear in mind that their

²⁶⁴ S. 76(3).

²⁶⁵ S. 76(2) (a).

²⁶⁶ See, Myburgh and Davis, *supra* note 39, p. 19.

²⁶⁷ Like Kenya's Code of Corporate Governance for Issuers of Securities, the King III Report on Corporate Governance does not contain sections or articles. It contains principles. See Principle 1.9, para. 39.

primary duty is to always act in the best interest of the company.²⁶⁸ Each director of a company has a fiduciary duty to act in good faith and in a manner that the director reasonably believes to be in the best interest of the company.²⁶⁹

As regards combating markets frauds such as insider trading, the King III Report promotes a culture of whistleblowing. It is the duty of the audit committee to review the arrangements made by the company to enable employees and outside whistleblowers for example customers and suppliers to report possible improprieties touching on compliance with laws and regulations. It is also the duty of the audit committee to ensure that the company has in place appropriate arrangements for proper and independent investigation of whistleblowing reports.²⁷⁰

In relation to equitable treatment of shareholders, the King III Report states that there must be equitable treatment of all holders of the same class of shares issued by a company as regards those shares, including minorities, and between holders of different classes of shares in the company. Whereas, the Code of Corporate Governance of Kenya principle on equitable treatment of shareholders is limited to holders of the same class of shares, the scope of the principle is broad in the King III Report. The Report extends principle to cover shareholders who do not hold the same class of shares.

However, like the Code of Corporate Governance of Kenya, the King III Report does not extensively address the protection of minority shareholders from abusive actions by or in the interests of the controlling shareholder.²⁷¹

²⁶⁸ Principle 1.9, para. 36 & 37.

²⁶⁹ Principle 1.8, para. 32.

²⁷⁰ Principle 3.8, para. 65 & 66.

²⁷¹ Principle 8.5, para. 24 & 25.

4.4.2 The Adequacy of the Institutional Framework on Insider Trading in South Africa

South Africa adopts a tiered enforcement structure. The FSB through the Directorate of Market Abuse (DMA), is empowered to initiate civil proceedings against insider trading offenders in the High Courts of South Africa.

Investigations on insider trading cases usually begin with tip-offs to the FSB which then conducts investigations. Mostly, it's the JSE which alerts the FSB because it has got sophisticated Information Technology systems for markets surveillance.

The FSB is tasked with investigations because it has the capacity to carry out thorough investigations. Once the FSB completes the investigations, the DMA committee decides on whether there is enough evidence to hold insider trading charges or not and what kind of proceedings to initiate (criminal, civil or administrative). The FSB is empowered to impose administrative sanctions of up to 24 million rand.²⁷²

The insider trading awareness rate is higher in South Africa than in Kenya. The FSB and JSE sensitize and educate the market participants on insider trading practices through presentations, conferences and seminars. This process began in South Africa in 1999 following the enactment of the Insider Trading Act and continues to-date. As part of the educating process, the JSE produced a guide to issues surrounding insider trading (the Insider Trading Booklet) in 2002.²⁷³

As part of good corporate governance, a large percentage of companies in South Africa have put in place formal internal policies on insider trading. For instance, the companies have implemented procedures aimed at stopping insiders from trading in possession of inside

²⁷² Administration, 'What Does Insider Trading Really Mean?' (CNBC Africa, 25 October 2013) available at <www.cnbc.com/news/southern-africa/2013/10/25/understanding-insider-trading-in-safrica/> accessed 29 July 2016.

²⁷³ See, Myburgh and Davis, supra note 39, p. 21.

information. Such procedures include policies requiring senior or relevant employees to get permission to trade in the company's shares. In an effort to control the flow of inside information, some companies in South Africa impose restrictions on who is allowed to speak to the company's financial analysts.²⁷⁴

To minimize instances where various service providers such as printers are used as conduit of inside information, the JSE requires companies to enter into confidentiality agreements with such service providers.²⁷⁵ This is to prevent inside information from leaking and ensure accountability by the responsible parties when such information leaks.

4.4.3 Legislative, Institutional and Policy Lessons for Kenya

From South Africa's legal framework on insider trading, below are the lessons for Kenya.

With regard to definition of insider trading terms, Kenya should follow the South Africa's example and incorporate substantive provisions on the meaning of 'an insider' in the Capital Markets Act. The provisions should be broad enough to cover corporate insiders such as directors, shareholders and employees, persons who gain access to inside information by virtue of their profession, employment or office and tippers and tippees of inside information. In relation to 'inside information' like the Financial Markets Act, the Capital Markets Act should include an additional element to the effect that inside information must be specific or precise information.

On disclosure obligations, like South Africa, Kenya should realize that it is not adequate for the Capital Markets Act to state that failure to disclose price-sensitive non-public information is an offence on the part of the issuer of securities, the penalty for failure to disclose should be

²⁷⁴ Ibid.

²⁷⁵ Ibid.

prescribed. The penalty should also be made harsh enough to deter such failures and achieve parity of information.

Like the Financial Markets Act, the Capital Markets Act should provide for more insider trading offences to increase the scope of insider trading liability. For example the Capital Markets Act should cover instances whereby an insider trades, directly or indirectly, in securities on the basis of inside information, on behalf of another person. It should cover an instance whereby, an insider discourages another person from trading in securities as result of which, the person avoids a loss. It should also cover an instance whereby, a person say a stockbroker, trades in securities on behalf of an insider, knowing or having reasonable cause to believe that the person is an insider.

As a way of ensuring that innocent parties do not incur insider trading liability, Kenya should emulate South Africa and incorporate insider trading defences in the Capital Markets Act to be proved on a balance of probabilities by persons facing insider trading charges.

To achieve the deterrence objective, Kenya should emulate South Africa and increase the insider trading penalties prescribed under the Capital Markets Act. The statutory prison term should be increased to at least ten years and the amount of fine payable should be increased. The number of times that a convict is supposed to disgorge the profit made or loss avoided should be increased to three or four times. The Act should also introduce more civil and administrative sanctions for insider trading perpetrators to complement the criminal penalties.

Like South Africa, Kenya should include a provision in its Companies Act on disclosure of information by directors, aimed at protecting stakeholders' interests from practices such as insider trading. Particularly, the Act should require a director to communicate to the board at the

earliest practicable opportunity any information that comes to his/her attention, unless the director reasonably believes that the information is immaterial to the company or is generally available to the public, or known to the other directors.

To ensure equitable treatment of all shareholders, Kenya should follow the South Africa's example and review the principle on equitable treatment of shareholders in the Code of Corporate Governance for Issuers of Securities, to cover all shareholders regardless of the class of shares they hold.

The CMA should be well and adequately equipped to detect insider trading instances in time and carry out meaningful investigations. For instance there is need for a sophisticated information technology system to assist in the detection of insider trading instances.

4.5 Conclusion

Insider trading is a global corporate governance problem. Insider trading laws have been passed and enforced in various jurisdictions across the world. The fact that attempts to successfully enforce insider trading laws in Kenya have for more than two decades now, borne no fruits, indeed shows that Kenya can learn from the experiences in other countries that have been successful in insider trading regulation or better still have made remarkable strides in the fight against insider trading. Moreover, the need to bring Kenya's legal framework on insider trading in line with international norms cannot be over-emphasized.

This chapter has conducted a comparative analysis of the legal frameworks on insider trading in the UK, the USA and South Africa. The chapter has identified legislative, institutional and policy lessons for Kenya which inform recommendations for reforms in the subsequent chapter.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

This study has interrogated four research questions. First, are the laws that govern insider trading in Kenya adequate? Second, is Kenya's institutional framework on insider trading adequate? Third, what lessons can Kenya learn from the legal frameworks on insider trading in the UK, the USA and South Africa? Fourth, to address the insider trading problem, is there need to review the legal framework on insider trading?²⁷⁶

In assessing the adequacy of Kenya's legal framework on insider trading and in an endeavor to make suitable recommendations for reforms, this study has tested two hypotheses; that Kenya's legal framework on insider trading is inadequate and that to effectively address the insider trading problem, the review of the legal framework on insider trading is of ultimate necessity.²⁷⁷

Several conclusions flow from this study.

Chapter two has assessed the adequacy of Kenya's insider trading laws and established that there are flaws and gaps that hinder successful prosecution. The chapter focused on the formulation of the Capital Markets Act as the principal legislation on insider trading in Kenya. It was concluded that insider trading is a very limited offence under the Act²⁷⁸ and that the Act is not clear on the elements that constitute the insider trading offence mainly attributed to the fact that it lacks a definition of insider trading.²⁷⁹ The definition of the terms relating to insider trading such as

²⁷⁶ See chapter 1, p. 18.

²⁷⁷ Ibid.

²⁷⁸ Chapter 2, p. 26.

²⁷⁹ Ibid, pp. 26-29.

‘dealing’, ‘insider’ and ‘inside information’ are faulty, narrow and ambiguous. Whereas, the Act lacks the definition of other key terms such as ‘material effect’.²⁸⁰ The Act only provides for three insider trading offences, hence a limited scope of insider trading liability.²⁸¹ Despite the fact that disclosure of information plays a pivotal role in insider trading regulation, the Act falls short in that it does not contain substantive provisions on disclosure obligations, and the disclosure obligation contained in the Act is narrow. Moreover, besides stating that failure to disclose information is an offence, the Act does not prescribe appropriate penalties.²⁸² Moreover, the insider trading penalties prescribed in the Act are not severe and tough enough to punish the offence and achieve the deterrence goal.²⁸³

Similarly, the adequacy of the Companies Act, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations and the Code of Corporate Governance Practices for Issuers of Securities to the Public in supplementing the Capital Markets Act has been assessed. It was concluded that the codification of directors’ common law duties in the new Companies Act is a remarkable improvement in insider trading regulation.²⁸⁴ However, the Companies Act falls short in various aspects. For example, like its predecessor (the 1948 Companies Act) the new Act is silent on insider trading regulation and its provisions on disclosure obligations are inadequate and cannot sufficiently protect stakeholders’ interests against insider trading.²⁸⁵

With regard to the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, it was concluded that the disclosure obligations are insufficient because the scope of application of the Regulations is only limited to issuers of securities who may not necessarily

²⁸⁰ Pp. 26-31.

²⁸¹ Pp. 31-33.

²⁸² Pp. 35-36.

²⁸³ Pp. 33-35.

²⁸⁴ Pp. 37.

²⁸⁵ P. 40.

and always be the insiders. The Regulation on equitable treatment of shareholders is flawed for restricting the equitable treatment to holders of the same class of shares only, making the Regulation inadequate as far as protecting shareholders' interests from insider trading is concerned.²⁸⁶

The new issued CMA Code of Corporate Governance Practices for Issuers of Securities to the Public, is characterized by inadequacies such as lack of principles that directly touch on insider trading regulation and narrow principle on equitable treatment of shareholders that is only limited to holders of the same class of shares. The Code also lacks substantive provisions on the protection of minority shareholders from the majority shareholders especially in insider trading instances.²⁸⁷

Chapter three has assessed the adequacy of Kenya's institutional framework on insider trading in terms of capacity to detect, investigate and prosecute insider trading cases. Shortcomings such as lack of sophisticated information technology systems for market surveillance and monitoring, weak whistleblowing system, lack of proper investor education, lack of co-operation from other agencies such as the NSE and lack of policy guidelines on insider trading regulation such as whistleblowing policy, investigation policy, enforcement policy and sentencing policy were identified as the key inadequacies that ail Kenya's institutional framework on insider trading. It was also concluded that the CMA's supervision and monitoring roles are too limited for proper or timely detection of insider trading transactions.²⁸⁸

Chapter four has conducted a comparative analysis of the legal frameworks on insider trading in the UK, USA and South Africa, to draw lessons for Kenya. This chapter examined how some of

²⁸⁶ Pp. 40-41.

²⁸⁷ See pp. 41-43

²⁸⁸ Pp. 48-54.

the inadequacies ailing Kenya's legal framework on insider trading identified in chapters two and three have been handled in the said jurisdictions. For example, the UK and South Africa in order to avoid conceptual difficulties associated with the insider trading offence have incorporated very clear, broad and straightforward definitions of the insider trading terms such as 'insider', 'dealing' and 'inside information' in their insider trading legislations.²⁸⁹ On the other hand, the USA has dealt with the problem of limited scope of insider trading laws by regulating insider trading in tender offers.²⁹⁰ To widen the scope of insider trading liability South Africa's insider trading law provides for five insider trading offences.²⁹¹ To ensure timely detection of insider trading instances, these countries have put in place sophisticated information technology systems for market surveillance and monitoring.²⁹² The countries also have strong whistleblowing systems, the USA in particular, has a bounty reward program for its informants.²⁹³ Lastly, to effectively punish the offenders and deter insider trading the UK, the USA and South Africa have over the years increased their insider trading penalties.²⁹⁴

These findings have indeed confirmed that Kenya's legal framework on insider trading is inadequate and to effectively curb insider trading there is need for reforms. As pointed out at the onset of this study, good corporate governance is an essential tool for sustainable economic growth and an integral part of Kenya's long-term development blue-print, Vision 2030. For Kenya to fully realize its economic goals by the year 2030, good corporate governance practices

²⁸⁹ Chapter 4, pp. 57-59 (UK); pp. 70-71 (USA); pp. 83-84 (South Africa).

²⁹⁰ Ibid, p. 70

²⁹¹ Pp. 85-86.

²⁹² P. 63 (UK); pp. 77-78 (USA); p. 92 (South Africa).

²⁹³ See p. 77.

²⁹⁴ Pp. 61 (UK); pp. 73-74 (USA); pp. 88-89 (South Africa).

should be prioritized and challenges that stand in the way of this, such as insider trading should be rooted out.²⁹⁵

5.2 Recommendations

Ideally, based on the findings and conclusion made in this study, Kenya should enact a separate piece of legislation on insider trading; an Insider Trading Act, which will comprehensively address the inadequacies identified in this study and establish an effective enforcement mechanism. But in the meantime, this study makes several recommendations that Kenya should adopt to effectively curb insider trading.

The recommendations of this study are categorized into legislative, institutional, policy and other reforms.

5.2.1 Legislative Reforms

The study makes recommendations for specific amendments to the Capital Markets Act, the Companies Act, the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations and the Code of Corporate Governance Practices for Issuers of Securities to the Public.

(a) Amendments to the Capital Markets Act

With regard to the inadequacy of limited scope of application, the Capital Markets Act should be amended to expand the scope of the insider trading offence.²⁹⁶ Expanding the scope of insider trading liability will be a positive development because business practices change and promoting

²⁹⁵ Chapter 1, Introduction, p. 2.

²⁹⁶ See chapter 2, p. 26.

public safety requires the law to be flexible.²⁹⁷ The Act should move from the misconception that insider trading is an offence that can only take place in the securities markets, its perpetrators are licensed or listed companies and the subject matter is always securities, particularly, shares. The scope should be expanded by reviewing the meaning of ‘securities’ to include tender offers and investment contracts.²⁹⁸

To improve the understanding of what insider trading is and its elements, the Capital Markets Act should be amended to provide for a concise definition of insider trading. The definition should be formulated in clear and precise terms that bring out the elements that constitute the insider trading offence namely, securities which are price-affected/sensitive, dealing, insider and inside information. To avoid a repeat of some of conceptual difficulties experienced in the Uchumi cases, the flawed definitions of the insider trading terms such as ‘insider’, ‘dealing’ and ‘inside information’ should be rectified. The Act should also incorporate definition of ‘material effect’ which is currently lacking in the legislation.

With regard to the concept of an insider, the Capital Markets Act should be amended to contain a harmonized definition.²⁹⁹ The study recommends the adoption of UK approach which casts a wider net to cover all persons in possession of inside information regardless of their connection to the company. The Capital Markets Act should move away from the narrow USA classic/traditional approach that emphasizes on the connection of an insider to the company. The scope of the meaning of an insider should be widened to cover tippers and tippees of inside information. The Act should specify persons who are deemed primary insiders and those that fall under the category of secondary insiders. The ways in which a person may be deemed to have

²⁹⁷ Hristova, *supra* note 82, p. 275.

²⁹⁸ Capital Markets Act, s 2.

²⁹⁹ Chapter 2, pp. 29-31.

acquired inside information should also be specified and this calls for the introduction of the concept of ‘inside source’ in the Capital Markets Act.³⁰⁰

In relation to inside information, the Capital Markets Act should be amended to include an additional element that requires information to be specific or precise for it to be deemed inside information.³⁰¹ This element will avoid instances whereby rumours are mistaken for inside information. The Capital Markets Act should also offer as earlier on stated, a concise definition of ‘material effect’ with regard to inside information.³⁰²

To further expand the scope of insider trading liability, the Capital Markets Act should be amended to provide for more insider trading offences besides the actual dealing offence on one’s own account, encouraging and disclosure offences.³⁰³ The Capital Markets Act should move away from the misconception that, an insider can only deal in securities, directly, on the basis of inside information on his/her own account. The scope should be expanded to cover a situation whereby an insider, directly or indirectly, deals in securities on the basis of inside information, on his/her account or on behalf of another person. The scope of the encouraging offence should be expanded to cover a situation whereby an insider discourages a person from dealing in price-sensitive securities, as a result of which, the person does not deal and avoids a loss. The Capital Markets Act should also declare an insider trading offence a situation whereby, a person for example a stockbroker deals in securities on behalf of an insider, knowing or having reasonable cause to believe that the person is an insider. This will ensure that stockbrokers do not escape insider trading liability on the technicalities of the principal-agent relationship.³⁰⁴

³⁰⁰ Chapter 4, p.

³⁰¹ Chapter 2, p. 31.

³⁰² Ibid.

³⁰³ Pp. 31-33.

³⁰⁴ P. 33.

Since disclosure is an important facet in insider trading regulation, the Capital Markets Act as the principal legislation on insider trading should be amended to contain substantive provisions on disclosure obligations with a broader scope of application to cover other insiders other than the issuers of securities.³⁰⁵ The Act should also be amended to impose a duty on insiders and other affected parties to disclose their transactions pertaining to securities or other instruments issued by their companies or other institutions. Legal consequences for failure to disclose information should also be provided for and should be severe enough, because it is not sufficient for the Act to provide that failure to disclose information is an offence.

In relation to insider trading penalties, the study recommends the enhancement of the penalties by increasing them. As discussed in chapter two, the insider trading penalties contained in Capital Markets Act are too low and limited to effectively punish and deter insider trading.³⁰⁶ Normally, where the probability of detention is low, insiders have little incentive to abide by the law.³⁰⁷ There is therefore, need to increase the current prison terms, amounts of fine and the number of times that a convict should disgorge the profits made or loss avoided should be increased to three or four times depending on the circumstances on the case. The Act should further be amended to provide for more civil remedies, for purposes of providing incentives for investors and company stakeholders to detect and assist in the apprehension and prosecution of insider trading offenders. The CMA's administrative sanctions should be enhanced to enable the Authority to seek injunctive orders against persons who engage or are about to engage in insider trading in cases pending the completion of an insider trading transaction. The Capital Markets Act should move away from the 'one size fits all' rule with regard to imposition of the insider trading penalties. The penalties to be imposed on an insider trading convict should not

³⁰⁵ Pp. 35-36.

³⁰⁶ Pp. 33-35.

³⁰⁷ See Chitimira, *supra* note 40, p. 60.

necessarily be those that a legislation prescribes, flexibility should be exercised guided by the magnitude of the offence to avoid instances whereby some insider trading convicts end up getting a mere slap on wrist.³⁰⁸

Since the incorporation of insider trading defences has become an international norm in the fight against insider trading, the study recommends the amendment of the Capital Markets Act to provide for insider trading defences. The defences will protect insiders who find themselves facing insider trading charges due to circumstances, from incurring unnecessary insider trading liability.³⁰⁹

(b) Amendments to the Companies Act

The study observed that it is a serious gap in Kenya's legal framework on insider trading that, the Companies Act lacked provisions on the regulation of insider trading and other market abuses.³¹⁰ Insider trading is a broad offence that affects both listed and unlisted companies. Furthermore, insider trading perpetrators may not necessarily be licensed persons under the Capital Markets Act. For these reasons, the Companies Act which governs both listed and unlisted companies should be amended to expressly provide for insider trading regulation. This way the Companies Act will adequately supplement the Capital Markets Act in the fight against insider trading. More so because, unlike the Capital Markets Act whose jurisdiction is limited to licensed persons or listed companies, the Companies Act has a wider scope of application that covers all companies, listed or unlisted.

³⁰⁸ The UK case of *R vs. McQuid* (2009) 4 All E.R. 388, p. 389, the court gave guidelines that should the courts in imposing penalties in insider trading cases; see chapter 4, p. 61.

³⁰⁹ See chapter 4, pp. 60-61 (UK); pp. 86-89 (South Africa).

³¹⁰ Chapter 2, p. 40.

The disclosure obligations provided for in the Companies Act are in-exhaustive and cannot protect stakeholders' interests from insider trading,³¹¹ thus the Act should be amended to provide for substantive disclosure obligations that can protect stakeholders' interests from insider trading. For instance following the South Africa's example, the Companies Act should be amended to incorporate a provision that requires a director to communicate to the board at the earliest practicable opportunity any information that comes to his/her attention, unless the director reasonably believes that the information is immaterial to the company or is generally available to the public, or known to the other directors.³¹² This will go a long way in reducing the insider trading window.

(c) Amendments to the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations

The scope of application of the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations is limited.³¹³ There is therefore need to expand the scope to cover companies and institutions that may not fall under the class of issuers of securities.

The fact that the disclosure obligations only target issuers of securities is a major drawback in the regulation of insider trading.³¹⁴ The Regulations should be amended to incorporate a regulation to the effect that issuers of securities, other insiders and affected parties should disclose their transactions pertaining to securities or other instruments issued by their companies or other institutions. This will go a long way in ensuring parity of information in the markets.

³¹¹ Ibid.

³¹² Chapter 4, p. 89.

³¹³ Chapter 2, p. 40

³¹⁴ Ibid, p. 41.

With regard to the inadequacy of the Regulation on equal treatment of all shareholders,³¹⁵ in order to narrow the gap of asymmetry of information the Regulation on equitable treatment of all shareholders should be amended to accord equitable treatment to all shareholders regardless of the class of shares they hold, especially in relation to access to information. This will go a long way in minimizing asymmetry of information which is a major conduit for insider trading.

Ideally though, there is need for new disclosure regulations that target a wide range of market players and contain more disclosure obligations geared towards preventing insider trading.

(d) Amendments to the Code of Corporate Governance for Issuers of Securities to the Public

Even though the application of the new CMA Code on Corporate Governance is still in its early stages, some changes need to be effected. One of the inadequacies in the Code is that it lacks principles that expressly discourage companies and its stakeholders from engaging in weak corporate governance practices such as insider trading. Regardless of the fact that the Code is principle-based rather than rule-based, there should be included in the Code, principles that discourage directors, other corporate officers, shareholders and other stakeholders from engaging in insider trading practices.

Further, the Code does not contain substantive principles on disclosure obligations that can protect a company and its stakeholders' interests in insider trading incidences.³¹⁶ The Code should be amended to incorporate disclosure principles that have a direct impact on insider trading regulation for example principles that provide guidance on dissemination of sensitive information within and outside the corporate setting.

³¹⁵ P. 40.

³¹⁶ P. 42.

The study also found the principle on equitable treatment of all shareholders inadequate.³¹⁷ To counter asymmetry of information difficulties which to a large extent hinder effective regulation of insider trading, the principle on equitable treatment of all shareholders should be amended by expanding it to cover equitable treatment of shareholders who hold different class of shares, especially in relation to access to information.

5.2.2 Institutional Reforms

The study identified poor surveillance and monitoring techniques as one of inadequacies in Kenya's institutional framework on insider. This inadequacy makes timely detection of insider trading transactions impossible.³¹⁸ There is therefore need for Kenya to step up its market surveillance and monitoring techniques to aid in the detection of insider trading. For example, the CMA should be well equipped in terms adequate, qualified and competent staff and should be provided with a computerized monitoring system that is programed to monitor trades on real-time basis and is able to detect suspicious trades such as instances whereby many securities are sold before an announcement that negatively affects their prices is made or instances whereby, many securities are bought before an announcement that increases their price is made.

Another inadequacy in the institutional framework is a weak whistleblowing system which is also a serious drawback in the detection of insider trading incidences.³¹⁹ To further assist in insider trading detection, the CMA should create and promote a strong whistleblowing system. The reporting facilities or forum should be accessible by all members of the public. The CMA should also explore and weigh the benefits of initiating a reward program for whistleblowers

³¹⁷ P. 43.

³¹⁸ Chapter 3, pp. 48-50.

³¹⁹ Ibid, pp. 50-51.

whose information materialize to successful insider trading prosecutions.³²⁰ A program like that will go a long way in motivating whistleblowers or other informants to come forward and report insider trading cases.

To ensure meaningful and successful investigations on insider trading as well as successful prosecution, the CMA should be equipped with qualified personnel who have the competence and expertise to carry out proper and thorough investigations on suspected insider trading cases and pursue successful prosecution. When conducting investigations on suspected insider trading cases, the CMA should perhaps be allowed to use the wire-tapping technique and support should be encouraged from service providers such as telecommunications companies.

Another inadequacy identified in this study that ails Kenya's institutional framework on insider trading is lack of assistance and co-operation from other agencies.³²¹ The CMA should work closely with the NSE and other market intermediaries, likewise the market intermediaries and stakeholders should be urged to work together with the CMA to eradicate frauds such as insider trading. The NSE and other market intermediaries such as stockbroker firms should be the frontline detectors of unusual or suspicious trades.

5.2.3 Policy Reforms

Lack of policy guidelines on insider trading regulation is also a serious inadequacy in Kenya's legal framework on insider trading.³²² The study recommends the formulation of a comprehensive insider trading policy that will provide guidance on matters touching on insider trading regulation such as concepts of 'insider', 'dealing', 'material information' and 'inside

³²⁰ As is the case in the USA; see chapter 4, p. 77.

³²¹ Chapter 3, pp. 52-53.

³²² Ibid, pp. 53-54.

information'. The policy should also point out the behaviors that amount to insider trading and the legal consequences for such behaviors. The policy should contain guidelines that should guide the courts on the imposition of insider trading penalties.

To further strengthen whistleblowing, the CMA should consult with market intermediaries and other stakeholders in coming up with a substantive whistleblowing policy statement to appeal to market players as well as employees of the issuers of securities, who may be privy to insider trading and other market abuse schemes to come forward and report the same. The policy should promote whistleblower safety and call for arrangements that call for independent, expeditious and thorough investigations of whistleblower reports.

5.2.4 Other Reforms

Companies should be encouraged to put in place internal policies on insider trading which among other things will restrict access to sensitive information. Such policies should also place a duty on companies to sign confidentiality agreements with service providers such as lawyers. Companies should be required to put in place enforcement mechanisms for such policies.

There is also need for periodic training of company directors and employees on insider trading regulation, disclosure obligations, on what time is suitable to talk to financial analysts/journalists and who should do the talking. The training courses should be a collective project by the CMA, market intermediaries and other stakeholders inclusive of unlisted persons.

Lack of proper investor education on investment and finance matters is also a weakness in insider trading regulation.³²³ It is puzzling and indeed disappointing to note that, a majority of the Kenyan population do not know what the offence of insider trading that has been a crime in

³²³ See chapter 3, p. 53.

Kenya for more than two decades, entails. There is therefore, need to create insider trading awareness, more so because investor protection calls for investor education too. This can be achieved by conducting seminars, workshops, presentations and conferences on insider trading practices, targeting both listed and unlisted companies, investors, financial journalists and other stakeholders. This will create a forum whereby the said groups can be educated on issues surrounding insider trading regulation, for example the dangers that insider trading poses to good corporate governance, securities markets, companies, investors and the overall economy, the elements that constitute the offence, actions that amount to insider trading and penalties among others. Such interactions will also enhance and boost co-operation between the stakeholders and the CMA in the fight against trading and other market abuses. The CMA as part of the educating process should emulate South Africa's JSE and come up with an insider trading booklet that touches on insider trading regulation.³²⁴

³²⁴ See chapter 4, p. 92.

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