

INSIDER TRADING LAWS IN SRI LANKA: IDENTIFYING THE 'INSIDER' TO COMBAT WHITE COLLAR CRIMES

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Introduction

Insider Trading has been the subject of a widespread debate which continues to remain unsettled and inconclusive. One set of scholars favour deregulation of insider trading on the basis that insider trading promotes market efficiency and provides an efficient way to compensate entrepreneurs (Manne 1966, Edmund 1980) while the other set of scholars emphasize the importance of regulating insider trading on the basis of fairness and property rights in information (Kraakman 1991, Schotland 1967).

Insider trading can be defined as trading in securities on the basis of material non-public information (Teal 2013, Bagley & Savage 2012). Despite the debates, most countries with stock exchanges regulate trade on confidential price sensitive information by corporate insiders (Beny 2006). In Sri Lanka, Insider Trading is basically regulated by the Securities and Exchange Commission of Sri Lanka Act (SEC Act) No. 36 of 1987 as amended by Acts No. 26 of 1991, 18 of 2003 and No. 47 of 2009 and Companies Act No. 7 of 2007.

Since the end of civil war in 2009, the growth of the stock market in Sri Lanka has accelerated, achieving a growth unrivaled by most other economies. If Sri Lanka wants to attain long term market efficiency, customer confidence and market integrity are essential. Regulation of insider trading will have a positive impact on market efficiency and customer confidence as insider trading can undermine the public's expectations of honest and fair securities markets. Notwithstanding the debated benefits of deregulation of insider dealings, Sri Lanka will lose investor confidence and market integrity if insider dealings are left unregulated reversing the growth achieved in the stock market.

In regulating insider dealings the definition of the 'insider' raises a question of significant importance. Traditionally this definition was confined to the corporate insiders, basically to the directors. However, now it is believed and has been proven that anyone connected with the

company either directly or indirectly and has the access to material confidential information can engage in insider dealings without necessarily being a director or a corporate insider of the particular company.

Since the offence of insider trading derives from the legislations in Sri Lanka it is important to analyze the comprehensiveness of the definition of the 'insider' under such legislations to effectively regulate insider dealings. The research problem which is sought to be answered in this study is whether Insider Trading legislations in Sri Lanka contain a comprehensive definition of the 'insider'. The study has four basic objectives; to analyze the legal definition of the insider under the existing laws in Sri Lanka, find out the loopholes in such definition, compare that definition with that of the United Kingdom; and to suggest necessary amendments.

Methodology

This research is conducted using the black letter approach of research and comparative analysis method of research based on Securities and Exchange Commission of Sri Lanka Act No. 36 of 1987 (as amended) and Companies Act No. 7 of 2007 in Sri Lanka, and Financial Services and Markets Act (FSMA) of 2000 and Criminal Justice Act of 1993 in the United Kingdom as primary sources; and journal articles, conference proceedings and commentaries as secondary sources. The basic limitation of this method is that it does not satisfactorily take into account the actual insider trading practices and the implementation of the existing legal framework.

Results and Discussion

The application of the provisions contained in the Companies Act No. 7 of 2007 with regard to the use of company information is restricted and applies only to 'directors'. According to Section 197 of the Companies Act, a director of a company who has obtained information in his capacity as a director or employee is prohibited from disclosing, making use of or acting on the information except for the company's purpose, when he is authorized to do so by the Board or the company or as required by law. Section 197(3) provides that the Board may authorize the director to disclose, use or act on the information if it is not likely to be prejudice the company. Thus it excludes other possible parties connected with the company in other capacities than a director, who may in different events disclose confidential information of such company to the outsiders.

By contrast the definition in the Securities and Exchange Commission of Sri Lanka Act (SEC Act) is broad and covers a wider range of individuals. However, unlike the Companies Act that applies to all the companies, the application of the SEC Act is limited only to the listed companies thereby excludes non-listed companies. In the United Kingdom, FSMA Act of 2000 and the Criminal Justice Act of 1993 covers the offence of insider trading, thereby covers all the companies in the country.

According to section 32 of the SEC Act, the individual must hold the information by virtue of being connected with the company. He shall respect the confidentiality of the information which he possesses and shall not disclose such information except for the proper performance of the functions attached to that position. Section 34 of the same Act defines the term 'individual connected with the company' to include director of that company or a related company or an officer (other than director) or an employee of that company or a related company or a person holding a position involving a professional or business relationship. The term professional or business relationship used in section 34 covers a wide range of individuals including auditors, lawyers, bankers and insurance agents. Such a wider definition is important since in practice the insider dealings by directors are relatively rare compared to the insider dealings by other individuals connected with the company.

However, since the term 'individual' is used instead of 'person', artificial persons such as corporate entities as well as companies are excluded. This is a weakness in the definition of the 'insider' since the offenders can use a company as a shield to exclude their liability. By contrast United Kingdom uses the term 'any person' in section 118 B of the Financial Services and Markets Act in 2000 which covers both Legal Persons and Natural Persons thus providing a very progressive interpretation to the 'insider'.

Further according to the definition given in the SEC Act of Sri Lanka, a shareholder can hardly be regarded as an insider. This is particularly disadvantageous to the minority shareholders since under the controlling shareholder regime that exists in Sri Lanka there is a high possibility of inside information being abused by the majority shareholders for their own benefit. In UK shareholders are recognized as insiders by virtue of section 118 B of FSMA Act and section 57 of Criminal Justice Act, thus preventing shareholders from engaging in insider dealings.

Conclusion

The above discussion shows that the 'insider' as defined by the legislations in Sri Lanka is not comprehensive and is thus in need of improvements. The definition in the Companies Act No. 7 of 2007 should be widened to include the parties who are connected with the company in capacities other than the capacity of a director and has access to confidential material information. Securities and Exchange Commission of Sri Lanka Act should widen its definition of 'insider' to include legal persons and shareholders as well.

References

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