Corporate Finance & Capital Market
21st December 2023



Ufuoma Eferha

UNDERSTANDING INSIDER TRADING AND ITS CONSEQUENCES IN BUSINESS[1]

1. INTRODUCTION

The Investments and Securities Act 2007 ("ISA 2007") defines insider trading or dealing thus: "Insider dealing includes insider trading and occurs when a person or group of persons who being in possession of some confidential and price sensitive information not generally available to the public, utilizes such information to buy or sell securities for the benefit of himself, itself or any person."[2]

The United States Securities and Exchange Commission also defines that term as follows: "illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, non-public information about the security. Insider trading violations may also include "tipping" such information, securities trading by the person "tipped", and securities trading by those who misappropriate such information."[3]

Individuals who exploit confidential, non-public information to gain an unfair advantage in the financial markets pose significant ethical, legal, and financial challenges in the realm of business. Understanding the intricacies of insider trading and its consequences is crucial to maintaining fairness, integrity, and trust within the business landscape.

---

1 **Ufuoma Eferha, Associate, Corporate Finance & Capital Markets, S.P.A. Ajibade & Co., Lagos, Nigeria**.
2 See, Section 315 of the Investments and Securities Act 2007.
3 See, U.S. Securities and Exchange Commission https://www.investor.gov/introduction-investing/investing-basics/glossary/insider-trading accessed on 11th May 2023.

In this article, we will delve into who an insider is, the issues related to insider trading, explore its implications for companies and investors and discuss measures that can be undertaken to address this unethical behaviour. By shedding light on this complex issue, we aim to foster awareness and facilitate informed discussions on insider trading and its impact on the business world.

2. WHO IS AN INSIDER?

Simply put, an insider is a person who has knowledge of the inside dealings of the company and uses that information to deal in buying and selling of securities to their advantage.

3. LAWS GUIDING INSIDER TRADING IN NIGERIA

The primary law regulating insider trading in Nigeria is the Investment and Securities Act 2007, which empowers the Securities and Exchange Commission ("SEC") to enforce rules and regulations to prevent insider trading. Section 111 (1) of the ISA 2007 provides on the prohibition of insider trading in Nigeria as follows:

> *Subject to section 104 of this Act, a person who is an insider of a company shall not buy or sell, or otherwise deal in the securities of the company which are offered to the public for sale or subscription if he has information which he knows is unpublished price sensitive information in relation to those securities.*

Section 115 of the ISA 2007 also provides the penalty for insider trading and other criminal offences as follows:

> *"Any person who contravenes any of the provisions of this part of this Act commits an offence and is liable on conviction —*
>
> *(a) in the case of a person not being a body corporate, to-*
>
> *(i) a fine of not less than x500,000 or an amount equivalent to double the amount of profit derived by him or loss averted by the use of the information obtained in contravention of any of the provisions of this part; or*
>
> *(ii) to imprisonment for a term not exceeding seven years; or*
>
> *(b) in the case of a person being a body corporate, to a fine not less than x1,000,000 or an amount equivalent to twice the amount of profit derived by it or loss averted by the use of the information obtained in contravention of any of the provisions of this part."*

The SEC issued several guidelines and rules to prevent insider trading in Nigeria. It established Codes of Conduct for Capital Market Operators (Institutions) and Employees of Capital Market Institutions (Operators) in the Securities and Exchange Commission Rules and Regulations 2013.[4] The Codes of Conduct set out the rules and procedures for handling confidential information, trading in the company's securities, and reporting any violations of the code.

4. ISSUES RELATED TO INSIDER TRADING IN BUSINESS

4.1 Market Manipulation[5]

When insiders use privileged information to buy or sell securities, they can distort market prices and create an uneven playing field for other investors who do not have access to the same information. This can erode investor confidence and lead to a loss of trust in the fairness and integrity of financial markets.

4.2 Legal and Ethical Implications[6]

Another issue is the legal and ethical implications of insider trading. It is illegal in many jurisdictions and can result in severe penalties, including fines, imprisonment, and the loss of professional licenses. Additionally, it can damage the reputation of the company and the individuals involved, leading to a loss of trust from stakeholders and customers. An example of such a damaged reputation is that of Martha Stewart in the insider trading scandal of 2003.[7]

4.3 Company Performance

When insiders trade on confidential information, it can lead to suboptimal decisions and ultimately hurt the company's financial performance. Furthermore, it can create a toxic culture within the organization that prioritizes personal gain over the best interests of the company and its stakeholders.

Overall, the issues related to insider trading in business are numerous and far-reaching, affecting not only the individuals involved profit, but also the broader financial

---

4 See, Schedule IX 1&2 of the Securities and Exchange Commission Rules and Regulations 2013.

5 See, Andrew Sebastian "Argument For and Against Insider Trading" Investopedia (30 January 2022) https://www.investopedia.com/articles/markets-economy/092216/why-insider-trading-bad-financial-markets.asp#:~:text=The%20main%20argument%20against%20insider,material%20nonpublic%20information%20is%20illegal. accessed on 26th May 2023.

6 See, "Insider Trading and Business Ethics", Law Teacher (31 August 2021) https://www.lawteacher.net/free-law-essays/business-law/insider-trading-and-business-ethics-business-law-essay.php accessed on 26th May 2023.

7 See, "SEC Charges Martha Stewart, Broker Peter Bacanovic with Illegal Insider Trading" (4 June 2003) https://www.sec.gov/news/press/2003-69.htm accessed on 26th May 2023.

system and society as a whole. It is important for companies to establish clear policies and procedures to prevent and detect insider trading and for regulators to enforce strict penalties for those who engage in this illegal and unethical behaviour.

5. IMPLICATIONS OF INSIDER TRADING FOR BUSINESSES AND INVESTORS

Insider trading carries far-reaching implications that can significantly affect businesses and investors. These consequences arise from the unfair advantages gained by insiders and the erosion of trust and integrity in the market.

5.1 Lack of Fairness and Transparency

When insiders engage in trading based on non-public information, it can undermine the principles of fairness and transparency that are vital for a well-functioning market. This unethical practice can damage a company's reputation, leading to decreased investor confidence and potential legal repercussions. Moreover, insider trading can create a toxic corporate culture, where personal gain takes precedence over the best interests of the company and its stakeholders.

5.2 Uneven Playing Field

Insider trading directly affects investors who do not have access to privileged information. It creates an uneven playing field, where insiders can profit at the expense of other market participants.[8] This disparity erodes investor confidence and undermines the integrity of the financial markets. Investors may become hesitant to participate in the market, fearing that their investments are compromised by insider trading activities. As a result, overall market liquidity may be impacted, hindering efficient capital allocation and impeding economic growth.

6. MEASURES THAT CAN BE UNDERTAKEN TO ADDRESS THIS UNETHICAL BEHAVIOUR

Addressing the implications of insider trading requires a multi-faceted approach. Regulatory bodies play a crucial role in enforcing stringent laws and regulations, imposing penalties, and promoting transparency and disclosure. Companies should establish robust internal controls, codes of conduct, and compliance programs to deter insider trading and foster a culture of integrity. Here are some recommendations of measures that can be undertaken to tackle insider trading in Nigeria:

6.1 Strengthening Legal Framework

---

[8] See, Babajide Shoroye, "Insider Dealing and Corporate Governance: Understanding the Legal Position of Directors" *African Journals OnLine*, pp. 92-93 https://www.ajol.info/index.php/naujilj/article/view/225875/213146 accessed on 31st May 2023.

Enhance existing laws to explicitly define insider trading, broaden the scope of prohibited activities, and increase penalties for offenders. This would act as a strong deterrent and increase the effectiveness of enforcement.

6.2 **Enforcement and Surveillance**

Strengthen the capacity and resources of regulatory bodies like the SEC and the Nigerian Stock Exchange ("NSE") to effectively monitor and investigate instances of insider trading. Implement sophisticated surveillance systems to detect suspicious trading patterns and identify potential insider trading activities promptly.

6.3 **Insider Trading Policies and Education**

Encourage listed companies to establish clear insider trading policies and codes of conduct. These policies should outline the responsibilities and obligations of insiders, restrict trading during sensitive periods, and establish mechanisms for reporting and addressing potential violations.

6.4 **Whistle-blower Protection**

Establish robust whistle-blower protection mechanisms to encourage individuals to come forward with information regarding insider trading. Provide incentives and safeguards for whistle-blowers, such as confidentiality, non-retaliation provisions, and potential rewards.

6.5 **Collaboration and Information Sharing**

Foster cooperation between regulatory bodies, law enforcement agencies, and exchanges to facilitate information sharing and coordination in investigating and prosecuting cases of insider trading. Promote international collaboration to combat cross-border insider trading activities effectively.

6.6 **Strict Penalties and Prosecution**

Ensure that penalties for insider trading are severe and commensurate with the gravity of the offence. Actively prosecute offenders, including company insiders and accomplices, to send a strong message that insider trading will not be tolerated.

6.7 **Investor Education and Protection**

Educate investors about the risks of insider trading, the red flags, and the importance of conducting thorough due diligence before making investment decisions. Enhance investor protection mechanisms and avenues for legal recourse in cases of insider trading-related losses.

6.8 **Continuous Monitoring and Adaptation**

Regularly review and update regulations and enforcement practices to keep pace with evolving market dynamics and sophisticated trading practices. Stay vigilant to emerging trends and technologies that may be exploited for insider trading, such as algorithmic trading and blockchain/distributed ledgers that power cryptocurrencies.

7. CONCLUSION

Insider trading presents significant implications for businesses, investors, and the overall financial system. Recognising and addressing these implications is essential to promote fairness, transparency, and trust within the business environment and maintain the integrity of financial markets.

There are laws and regulations in place to prevent and deter insider trading. It is important for individuals and companies to be aware of these laws and regulations and to comply with them to avoid severe penalties.

Measures should collectively be implemented to curb insider trading, foster market integrity, and enhance investor confidence in Nigeria's financial markets. It will require close collaboration between regulators, companies, investors, and other stakeholders to create a robust and ethical business environment.

For further information on this article and area of law,
please contact **Ufuoma Eferha** at:
S. P. A. Ajibade & Co., Lagos by
Telephone (+234 1 472 9890), Fax (+234 1 4605092)
Mobile (+234 80 9488 6972) or (+234.815.979.4218)
Email: ueferha@spaajibade.com
www.spaajibade.com