INSIDER TRADING AND THE CULPABILITY OF CORPORATE OFFICERS UNDER NIGERIAN LAW

By

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Abstract

It is no gainsaying that the taking of advantage of information that the other party could not obtain, is as old as human nature; admittedly, man is naturally structured to think of protecting his interest first. Consequently, the regulation of insider dealing has and will no doubt continue to throw up a host of issues. The overall aim of this paper was to examine insider trading and culpability of corporate officers under Nigerian laws. The paper employed the doctrinal methodology. The findings revealed that both the Investment and Securities Act of 2007, the Securities and Exchange Commission Rules regard insider trading as a criminal offence and though Companies and Allied Matters Act, as amended in 2020 was silent about it, its sections 279,280 and 282 which deal with the fiducial duties of company directors could be relied upon when bringing charges of insider trading against anyone. However, the sad reality is that there have been no celebrated or known cases of conviction or punishment for the offence, since the introduction of the Investment and Securities Act. The paper concluded that suspicion amongst shareholders as to transparency of directors and officers of companies' vis-à-vis handling price sensitive information of companies has generated the upsurge of insider trading regulations. Thus, the paper recommended that adequate enforcement mechanism should be implemented by the Nigerian government because it will be futile having rules that are not enforced.

Keywords: *Trading, Culpability, Officers Nigeria Law*

Introduction

Insider trading is one of the corporate ills that have existed since the emergence of the abstract entity known as company.[1] Insider trading is regarded as the buying or selling of securities either by corporate or private insiders, employing non-public information to their own selfish advantage either to amass huge returns or to prevent large losses.[2] Incidentally, this corporate evil has existed unchecked for over a century of the development of company law. At common law no clear prohibition was imposed on the use of insider information except only in the case

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[1] Investment and Securities Act 2007 (ISA 2007), preamble; A Garba, 'Impediments to Effective Enforcement of Insider Trading Regulations in Nigeria' [2013] *IJM*, 13.

2. A Nadine, 'Insider Trading Liability and Enforcement Strategy' [1998] (17) Facilities Management Journal, 667

of industrial and trade secrets.[2] In other respects, the directors or other officers were free to hold and deal in the shares of the companies.[3] The lack of legislative check on the ills of insider trading was a feature of company law in most jurisdictions including Nigeria until recently.[4]

In the United Kingdom, it was not until the mid-80s, when Ivan Boesky, an American admitted to large scale dealings on the basis of insider information, and handed over some 100 million US Dollars of alleged profit to the Security and Exchange Commission and other instances of the practice involving ring of bankers, lawyers and others that issues of insider trading came to the front burner of company legislation in England, ultimately resulting in the passing of the Company Securities (Insider Dealing) Act 1985.

The United States of America has historically been the world leader in insider trading law. In 1909, the US. Supreme Court ruled in *Strong v Repids*[5] that because a company director could affect the value of his company's shares, keeping buyers ignorant of his expected actions while selling his own shares would be deceitful and therefore fraudulent. This case was the first major step in the foundation for insider trading in which an insider was obliged to disgorge his ill-gotten gains to the company or to the persons with whom he dealt.[6]

Insider trading was not treated as a statutory offence in Nigeria until 1990. The move towards a prohibition and the regulation of insider trading in Nigeria was introduced by the Nigerian Law Reform Commission which acknowledged that insider trading was a serious malpractice.[7] The recommendation of the commission led to the enactment of provisions on insider trading prohibition in sections 614-620 of the Companies and Allied Matters Act 2020. The provisions are pari material with those of the English Company Securities (Insider Dealing) Act 1985. However, the above provisions of the Companies and Allied Matters Act 2020 (CAMA)[8] turned out to be inadequate and ineffective for purpose of combating insider trading, because for almost ten years after its inception, no person was successfully prosecuted under the sections. Consequently, the provisions under CAMA were repealed and replaced by the Investment and securities Act 1999. The Investment and Securities Act (ISA) 1999 has been repealed and replaced by the ISA 2019. To the best of researcher's knowledge, the new provisions like its predecessors have its own flaws as no person is also yet to be reported to have been convicted of insider trading.

[3.] J O Orojo, *Company Law and Practice in Nigeria* (3rd edn, Lagos: Mbeyi and Associate 1990) 447; *British Industrial Phastic v Ferguson* 9 [1938] 4 ALL ER 504.
4 *Percial v Wright* (1902) 2 Ch. 421.
5 I J Essien, 'A Gritical Examination of the Statutory Bottleneck Against Insider Dealing' [2007] (2) *NSLJ*, 145.
[5] 213 US 419 [1909]
[6] Security Exchange Act 1934 of USA, s 166 and Rules 106 -5 made by US SEC.
[7] Report on the Reform of Nigerian Company Law of 1988, 30
[8] Cap C20 LFN 2004 (Repealed).

Regulatory Approaches to Insider Trading and the Culpability of Corporate Officers in Nigeria

There is no gain saying that insider trading is one of the corporate problems that have bedeviled the operations of companies.[9] By the way, this corporate problem remained unimpeded for over a century of the development of company law. At common law, no clear prohibition was imposed on the use of insider information except only in the case of industrial and trade secrets.[10] In other respects, the directors or other officers were free to hold and deal in the shares of the companies.[11] The lack of legislative check on the ills of insider trading was feature of company law in most jurisdictions including Nigeria until recently.[12]

Insider trading was not treated as a statutory offence in Nigeria until 1990. The move towards a prohibition and the regulation of insider trading in Nigeria was orchestrated by the Nigerian Law Reform Commission. They acknowledge that insider trading was a serious malpractice.[13] The recommendation of the commission led to the enactment of provisions on insider trading prohibition in the Companies and Allied Matters Act 2020, particularly sections 614 – 620. The provisions were copied from the English Company Securities (Insider Dealing) Act 1985. However, the above provisions of CAMA turned out to be inadequate and ineffective for purpose of combating insider trading, because for almost ten years after its inception, no person was successfully prosecuted under the sections. Consequently, the provisions under CAMA were repealed and replaced by the Investment and securities Act 1999. The ISA 1999 Act has been repealed and replaced by the Investment and Securities Act 2007. The new provisions like its predecessors have its own flaws as no person is also yet to be reported to have been convicted of insider trading. Albeit, this is still no record of corporate officers prosecuted for getting involved in insider trading.

There is no doubt that the unethical practice of insider trading in company law, particularly during merger and acquisition is a world-wide phenomenon. There is also global effort to stamp it out. The various efforts at eradicating it, which started under self-regulatory market codes, and the common law doctrine of disclosure have developed to the state where many countries including Nigeria have criminalized the practice in its various ramifications. Insider traders will not only pay fines, disgorge their unjust profits, they will also go to jail. It is generally true that the United States and Britain had been at the forefront of discouraging insider trading by putting in place appropriate legislation and machineries for detecting, investigating and prosecuting offenders. Their machineries had worked effectively and prominent people who ran foul of the law had been dealt with. In the United States, the Security and Exchange

[9] A Garba, 'Impediments to Effective Enforcement of Insider Trading Regulations in Nigeria' [2013] *IJM*, 13.
[10] J O Orojo, Company Law and Practice in Nigeria (3rd edn, Lagos: Mbeyi and Associate 1992) 447; *British Industrial Phastic v Ferguson* 9 [1938] 4 ALL ER 504.
[11] *Percial v Wright* (1902)2 Ch. 421.
[12] I J Essien, 'A Gritical Examination of the Statutory Bottleneck Against Insider Dealing' [2007] 2 NSLJ 145.
[13] Report on the Reform of Nigerian Company Law of 1988, 30

Commission (SEC) is the arrowhead of the fight against insider trading. They file at least sixty cases in court every year and the Commission has closely monitored activities in the market to be able to prosecute violators. Unlike the Nigerian SEC which is static, perceived and unresponsive. In Nigeria, the war against insider trading is at best pedestrian. The summation is that in spite of the existence of the self-regulating dealing rules of the Stock Exchange and the criminalization of the practice sunder two laws, not much has been done to address the issue in Nigeria. The general defence of the authorities is that the incidence of insider trading is not rampant. It will thus appears that the directors and employees of companies in Nigeria are not ready to blow the whistle on insider traders among themselves. Who will guard the guards?

Insider trading has also crept into merger and acquisition. The capital markets play a critical role in national and economic development. The capital market is the financial space that provides a platform for trading in company's securities and stocks.[14] Consequently, it is crucial that these markets and trading floors in the course of their operations are effectively regulated to enhance market efficiency, eliminate fraud and ensure uniformity, accountability and complete disclosure in their operations.[15] This hits an important nerve with regard to the latent dangers which are connected with insider trading. With regard to the harmful effects of insider trading, several economists and financial analysts have argued that insider trading is prejudicial and weakens foreign and local investors' confidence in the capital markets.[16]

Insider trading has captured the public imagination over the past decades owing primarily to a heightened occurrence of schemes that have afforded insiders several millions of dollars in illegal profits.[17] Meanwhile, the regulatory bodies within the Nigerian finance sector have remained closed off to the issue and have instead chosen to bury their heads in the sand, unwilling to discuss this heinous crime.[18] Non-public information is regarded as advantaged, price sensitive and material information which the rest of the public is not privy to. Material information refers to data, which has a high possibility of affecting to a large extent, the price at which securities will be issued in the capital markets. It also means information which is likely to be regarded as crucial and important by competent traders in making a decision on whether to trade a particular security or not.[19] More often than not, insider trading occurs owing to the compromising of company executives as well as company employees, together with the bankers of the company and its auditors, stockholders and shareholders, financial advisers and brokers, and a host of other related parties. The scope of related parties has been expanded to

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[14] J O Orojo, *Company Law and Practice in Nigeria*, (5th edn, South Africa: Lexis Nexis Butterworths 1992) 361.
[15] J Lorie and N Valerie, 'Predictive and Statistical Properties of Insider Trading' [2002] (11) *Journal of Law and Economics*, 35.
[16] N Arshadi and H Eyssell, 'Regulatory Deterrence and Registered Insider Trading: The Case of Tender Offers' [1999] (20) *Financial Management*, 23.
[17] J Jaffe, 'The Effects of Regulation Changes on Insider Trading' [2011] (3) *Bell Journal of Economics and Management Science*, 78.
[18] O Tayo, 'SEC, NSE, and the Menace of Insider Traders' <https://punchng.com/sec-nse-and-the-menace-of-insider-traders> accessed 5 June 2022.
[19] *Ibid.*

include the directors of listed companies alongside their spouses, children, relatives and close friends.[20]

The Nigerian Stock Exchange Rulebook gives the definition of "inside information" to mean information related to an issuer of a security or the issuer's securities, either directly or indirectly, which has not been published and whose disclosure may have a significant effect on the price of securities and stocks so listed and traded or derivative instruments which are linked to those securities.[21]

The portfolio of stocks bought by corporate insiders typically outperforms the stocks selected on non-privy information by a regular investor.[22] Moreover, the distributions which are made by "knowledgeable" sellers have, most of the time, come before substantial price declines.[23] At the core of the insider trading debate is the crucial question of whether or not it should be ruled as an offence, and whether it is good for the financial markets. In 1934, the United States Congress decided that it was a danger to the economy and in response to this decision the Securities and Exchange Commission (SEC) has since regulated the practice of insider trading in the United States.[24] In Nigeria, however, it was not until 1990 that insider trading was strictly regarded as an offence after written recommendation presented by the Nigerian Law Reform Commission (NLRC).[25] The justification or otherwise of insider trading have been discussed on two levels: One: is it just and fair to have trading on largely different levels of individual information and understanding? Two: is it an economically sound policy to allow the practice of insider trading without sanction? It is however important to note that the United States of America was the first, and for quite a while afterwards, the only country to make the act of making trading decisions on sensitive non-public information illegal.[26]

In Nigeria, both the Investment and Securities Act of 2007, The Securities and Exchange Commission Rules and the CAMA, as amended in 2020, regard insider trading as a criminal offence.[27] This is a pointer that the legislative arm of government is in agreement that clandestine insider dealing should not be considered as commonplace or legal.

Prohibition

By Section 111(1) of Nigeria's Investments and Securities Act 2007 ("ISA"), any person who is an insider of a company is prohibited from buying, selling or otherwise dealing in the securities of the company which are offered to the public for sale or subscription if he

[20] *SEC v Switzer W.D.* [1984] Okla 590.
[21] Nigerian Stock Exchange Rulebook, r.17(3).
[22] N Seyhun, 'Insiders Profits, Cost of Trading, and Market Efficiency' [2015] (16) *Journal of Financial Economics*, 69.
[23] S Seyhun, 'The Effectiveness of the Insider Trading Sanctions' [1992] (8) *Journal of Comparative Financial Studies.*
[24] *Peek v Gurney* [1873] L.R. 6 HL 377; [1861-1873] All E.R. Rep. 116.
[25] Nigerian Law Reform Commission Act (Laws of the Federation of Nigeria 2004), Cap. N118.
[26] S Daniel, 'Insider Trading Reforms Sweep Across Germany: Bracing for the Cold Winds of Change' [2017] (4) *Central North Law Review*, 36.
[27] A A Oluwabiyi, 'A Comparative Legal Appraisal of the Problem of Insider Trading in Mergers and Acquisitions' [2014] (7) *Frontiers of Legal Research Journal*, 78.

knowingly has knowledge of unpublished price sensitive information in relation to those securities. Upon a consideration of the foregoing provision, it may be right to conclude that for any person to contravene the provision of Section 111(1) of the ISA, the following conditions must be met:

a) The person in question must be an insider of a company;
b) The insider must have bought, sold and otherwise dealt in the securities of the company which are offered to the public for sale or subscription;
c) The insider must have had information which he knew was unpublished price sensitive information in relation to those securities which he bought, sold or otherwise dealt in, offered either to the public for sale or subscription.[28]

Notably, it has been argued that the two essential elements that make up a dealing offence are: (a) that an individual must have information as an insider; and (b) that the insider must deal in securities that are price-affected securities in relation to the information – the test is that the prices of price-affected securities will likely be significantly affected if information related to such securities is made public.[29] Furthermore, the ISA prohibits any person from buying, selling or otherwise dealing in the securities of the company which are offered to the public for sale or subscription where: (a) such a person has information which he knowingly obtains (directly or indirectly) from another person who is connected with a particular company, or was at any time within the six months preceding the obtaining of the information so connected; (b) where the former person knows or has reasonable cause to believe that, because of the latter's connection and position, it would be reasonable to expect him not to disclose the information except for the proper performance of the functions attached to that position.[30]

Furthermore, the ISA prohibits such a person who has information which he knowingly obtains (directly or indirectly) from another person who is connected with a particular company from dealing in securities of that company himself if he knows that the information is unpublished price sensitive information in relation to those securities and it relates to any transaction (actual or contemplated) involving the first company and the other company, or involving one of them and securities of the other, or to the fact that any such transaction is no longer contemplated.[31] The confusion however posed by section 111(3) of the ISA is the test for making a determination as to whether or not a person "knowingly" obtained unpublished price sensitive information. Relying on the concept of "*mens rea*" in criminal law, it may be rightly argued that the lawmakers had only in contemplation a person who intentionally obtained price sensitive information with the ultimate aim of dealing in the securities of such company as

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[28] O Orojo, *Company Law and Practice in Nigeria* (5th edn, LexisNexis Butterworths 2008) 390.
[29] B Rider and Others, *Market Abuse and Insider Dealing* (London: Butterworths 2000) 36; B Hannigan, *Insider Dealing* (London: Kluwer Law Publishers 1998) 1.
[30] ISA 2007, s 111(2).
[31] *Ibid,* s 111(3).

opposed to a person who "accidentally" had access to such price sensitive information. Nonetheless, the use of the word "knowingly" has not really helped much as it has created more confusion than expected. Thus, for any person to be made liable under section 113(1) ISA, cogent and compelling evidence must be led to establish that such person had knowledge of the fact that such unpublished information obtained was price sensitive.

In the same vein, Section 113(4) of the ISA stipulates that where a person is contemplating making (with or 19 without another person) a take-over offer for a company in a particular capacity, that person shall not deal in securities of that company in another capacity if he knows that the offer is contemplated or is no longer contemplated and the offer is unpublished price sensitive information in relation to those securities. Furthermore, ISA provides that where a person has knowingly obtained (directly or indirectly) from an individual contemplating making a take-over offer, information that a take-over offer is being contemplated or is no longer contemplated, such a person is prohibited himself from dealing in securities of that company if he knows that the information is unpublished price sensitive information in relation to those securities.[32] From the foregoing provision, it would appear that the draftsman only took into cognizance take-over which arguably includes acquisition,[33] but left out mergers. This clear omission becomes more disturbing as it leaves one wondering whether it is indeed the suggestion of the lawmakers that insider dealing is non-existent in mergers.

Additionally, the ISA prohibits an insider from dealing on an approved securities exchange or capital trade point in any securities and from counselling or procuring any other person to deal in those securities, knowing or having reasonable cause to believe that that person would deal in those securities.[34]

Offence and Punishment

By Section 115 of the ISA, any person who engages in insider dealing commits an offence and is liable on conviction – in the case of a person not being a body corporate, to a fine of not less than N500,000 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 to imprisonment for a term not exceeding seven years; or in the case of a person being a body corporate, to a fine not less than N1,000,000 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 relating to insider dealing.

As for the punishment for the breach of any provision of the Amendments to the Nigerian Stock Exchange (NSE) Rulebook, it is worth noting that the NSE may suspend trading in an instrument with effect from such time as it may determine, if there are reasonable grounds to

[32] ISA 2007, s 113(5)
[33] *Ibid,* ss 117 and 131(1).
[34] *Ibid,* s 111(6).

suspect the Issuer failed to comply with disclosure rules as stipulated under the NSE Rulebook.[35] The NSE may further impose such conditions on the procedure for lifting the suspension as it considers appropriate.[36]

However, given the requirement of proof beyond reasonable doubt in criminal cases, it is often difficult to prosecute persons for insider dealing. As noted by Garba, the difficulty with prosecution in insider dealing cases often arise because of the paucity of direct evidence and reliance on circumstantial evidence, which often prove to be inadequate to ground conviction for a crime of this nature.[37]

Compensation

In furtherance of the powers under Section 116 (1) ISA, the Securities and Exchange Commission (SEC) or the Investments and Securities Tribunal (IST) can order a person who is liable for insider dealing (trading) to pay compensation, as the case may be, to any aggrieved person who, in a transaction for the purchase or sale of securities entered into with the first-mentioned person or with a person acting for or on his behalf, suffers a loss by reason of the difference between the price at which the securities would have likely been dealt in such a transaction at the time when the first-mentioned transaction took place if the contravention had not occurred.

It should be noted that the amount of compensation for which a person is liable is the amount of the loss sustained by the person claiming the compensation or any other amount as may be determined by SEC or the IST.[38] However, by section 114 of the ISA, any transaction done in contravention of Section 112 and 111 of ISA is voidable at the instance SEC. Relatedly, SEC is empowered under Rule 601 of the SEC Rules 2013 to determine the quantum of compensation for insider dealing cases.

Conclusion

Capital realization is one of the factors accountable for economic growth; the availability and cost of capital is therefore a central theme in discussions of growth possibilities in developing countries. An efficient capital market of a country is of paramount importance as it is considered the bedrock of growth in modern economies. Based on the sensitive nature of capital market transactions, it is imperative that the operations are adequately regulated as this not only ensures that business is carried on smoothly in the market, but also has the propensity to attract more investors.

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[35] NSE Rulebook 2015, rule 21.1 – chap. 21
[36] *Ibid,* rule 21.1 - chap. 21
[37] A Garba, 'Impediments to Effective Enforcement of Insider Trading Regulations in Nigeria' [2013] (3)(1) *International Journal of Management*, 19.
[38] ISA 2007, s 116(2).

Suspicion amongst shareholders as to transparency of directors and officers of companies vis-à-vis handling price sensitive information of companies has generated the upsurge of insider trading regulations. Several countries have utilized the enactment of laws prohibiting insider trading as a mechanism to preserve the integrity of their capital markets as well as revive investor confidence. Some countries have recorded success in attempting to regulate the act of insider trading and at the top of the list are the UK and the US. They started with self-regulatory market codes and the common law doctrine of disclosure, which have been adopted by developing countries such as Nigeria. It is arguable that insider trading is practiced in the Nigerian capital market. Its effects are evident on the confidence of the public in the Nigerian capital market.

Recommendations

In order to strengthen the value of the exclusionary rule of insider trading in Nigeria and for SEC to live up to its statutory responsibility of protecting the security market from insider trading, it is recommended that the following steps be urgently taken:

i In the event of any uncertainty under the Nigerian law as to what the scope of the insider trading provisions under the ISA, the SEC Rules 2013 and the NSE Rulebook is in any transaction or better still, where there exists some doubt or confusion as to whether or not a situation would amount to insider trading, it is recommended that each situation should be tested against the relevant provisions of the ISA, the SEC Rules 2013 and the NSE Rulebook and judged on its own merit.

ii Adequate enforcement mechanism should be implemented by the Nigerian government because it will be futile having rules that are not enforced. Furthermore, in other to effectively enforce the rules regulating the capital market, there is the need for copious investigations. SEC should also be empowered to appoint specialist investigators that will inquire into any alleged infringement of the ISA generally and any suspected case of insider trading.

iii This paper proposes that the SEC align with the Ministry of Justice to generate a medium through which insider trading cases can be prosecuted by the provision of a specialist unit charged with prosecuting market abuse like insider dealing. This will go a long way in the fight against insiders. As a substitute to the foregoing, it is also recommended that the Nigerian government should statutorily empower the EFCC to carry out investigations and prosecute cases of market abuse such as insider trading.