

1. Introduction

- 1.1. Market abuse is a reality that every financial market in the world has to deal with. South Africa has legislated to prohibit three major forms of market abuse, namely insider trading, prohibited trading practices (market manipulation) and the publication of false, misleading or deceptive statements relating to listed companies (false reporting). These prohibitions are contained in sections 73, 75 and 76 of the Securities Services Act, 36 of 2004.

2. Insider trading (section 73 of the Securities Services Act)

- 2.1. Insider trading occurs when a person, who has price sensitive information relating to a security, deals in that security before the information is known to the rest of the market.
- 2.2. Security has been widely defined and includes shares, stocks, options, future contracts, bonds, collective investment scheme units, etc. In other words, in South Africa irregular trading in single-stock futures could typically be the subject of a market abuse investigation. However, the legislation relates only to **listed** securities.
- 2.3. Unpublished news regarding unexpected changes (good or bad) in financial results, restructuring, mergers, takeovers, material fraud, etc., are examples of what might be price sensitive information.
- 2.4. Insider trading is prohibited because, if an investor has price sensitive information that his counterparty does not have, the playing fields are not level. This is tantamount to fraud by non-disclosure. Insider trading has the effect of discouraging overseas and local investors. This inhibits economic growth.
- 2.5. There are certain periods (called closed periods) during companies financial years when senior management is likely to be in possession of price sensitive information. For this reason the Johannesburg Stock Exchange (JSE) prohibits dealings by directors in the shares of their companies from financial year-end until the results are published (see the continuing obligations of the JSE). This not only decreases the likelihood of insider trading, but protects the reputations of listed companies and the stock exchange. In addition, the JSE prohibits dealings by directors (and senior management) while price sensitive information other than year-end results, exists within the company.
- 2.6. Directors must obtain written authorisation from their chairperson or other designated person before they trade in their company's shares. Such authorisation must be in writing and must not be granted if the company is in a closed period, or the requesting director is likely to be in possession of price sensitive information.
- 2.7. All directors' dealings must be published on the official news wire service of the stock exchange (the Stock Exchange News Service or "SENS"). If

directors have funds under management with an external party, they must inform their asset managers of their directorships and closed trading periods so that prohibited investments are not made on their behalf by accident. (For more information on directors' dealings and companies' obligations, see the JSE booklet.)

2.8. The Securities Services Act provides several statutory defences against allegations of insider trading. A trader may proceed with a share transaction, while in possession of price sensitive information, if he is executing an affected transaction in terms of the Companies Act. An affected transaction refers to the range of transactions that will cause a buyer of shares to gain legal or factual control over a company, and who will therefore have to make an offer to minority shareholders in terms of section 440 of the Companies Act, and the Merger and Takeover Code of the Securities Regulation Panel.

2.8.1. Also, an insider (a person in possession of price sensitive information) may proceed with a transaction if he received the price sensitive information after he communicated his instruction to deal to his stockbroker or dealer, and does not amend the instruction in any manner afterwards. In such a case it is clear that the price sensitive information had no impact on his investment decision.

2.8.2. An authorised user (stockbroker or dealer), in possession of price sensitive information, may deal if he is acting on specific instructions from a client. In such a case the client is deemed to have made the investment decision and not the stockbroker.

2.8.3. Insiders acting on behalf of a public sector body in pursuit of fiscal policies may also deal notwithstanding the fact that they are in possession of price sensitive information.

2.9. The Securities Services Act prohibits the disclosure by an insider of price sensitive information to another person. However, an insider may disclose inside information if it is necessary for the proper performance of his employment, office or profession, in circumstances unrelated to dealing. In such a case he must inform the recipient of the information that he or she is now in possession of price sensitive information.

2.10. An insider may not encourage another person to deal, or discourage him from dealing.

3. Prohibited trading practices (section 75 of the Securities Services Act)

3.1. The prohibition against prohibited trading practices (market manipulation) reads as follows:

"No person may – either for such person's own account or on behalf of another person, directly or indirectly use or knowingly participate in the use of any manipulative, improper, false or deceptive practice of trading in a security listed on the regulated market which practice creates or might create –

- (i) *A false or deceptive appearance of the trading activity in connection with; or*
- (ii) *An artificial price for that security ...”*

3.2. It is therefore against the law not only to manipulate the share price (up or down), but also to create a false impression of the volumes traded in any security.

3.3. Typical examples of activities that are deemed to be manipulative are:

3.3.1. Executing a securities transaction which does not result in a change of beneficial ownership.

3.3.2. Entering an order into the market whilst knowing of a similar but opposite order that has been entered, or will be entered, with the intention of creating a deceptive appearance or price.

3.3.3. Entering orders into the market at successively higher or lower prices for the purpose of improperly influencing the market price of the security concerned.

3.3.4. Entering orders into the market near the close of the market or during the auctioning process for the purpose of creating a deceptive appearance.

3.3.5. Affecting a market corner, or maintaining an artificial price for a security.

3.4. The prohibition against market manipulation does not impact on the lawfulness of price stabilising mechanisms. This is the process of allowing oversubscription for shares during an initial public offer by a company. The short position created by the oversubscription may be utilised to purchase shares in the market after listing. This creates a demand for the share that in turn supports the price. This is only permitted for 30 days after the initial public offering and the oversubscription may not exceed 15% of the issued share capital of the company.

4. False, misleading or deceptive statements, promises and forecasts (section 76 of the Securities Services Act)

4.1. In the past, this practice was illegal because of the prohibition against market manipulation. In terms of the Securities Services Act, it is now a separate offence. The prohibition reads as follows:

“... No person may directly or indirectly make or publish in respect of listed securities, or in respect of the past or future performance of a public company –

- (a) *Any statement, promise or forecast which is, at the time and in the light of the circumstances in which it is made, false or misleading or deceptive in respect of any material fact and which the person knows, or ought reasonably to know, is false, misleading or deceptive; or*
- (b) *Any statement, promise or forecast which is, by the reason of the omission of a material fact, rendered false, misleading or deceptive and which the person*

knows, or ought reasonably to know, is rendered false, misleading or deceptive by reason of the omission of that fact ...”

- 4.2. The publication of false or misleading information is thus now an offence if the information is released negligently. False information can distort market prices of securities and cause direct or indirect prejudice to market participants. (Apart from participants trading at the wrong price, investment portfolios are mispriced as a result of this.)

5. Conclusion

- 5.1. People are sometimes placed in situations where they have access to price sensitive information, or where they have pressing inducements to manipulate the price of a security. In some instances, they give in to these temptations.
- 5.2. History has confirmed the old adage that the game is not worth the candle. Persons who transgress securities legislation put at risk their financial wellbeing, their career, their reputations, and in some cases, their personal freedom.

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