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Insider Dealing in Kuwait: A Comparative Study with United Kingdom and the United States

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Abstract:

Insider dealing involves the use of information that is not disclosed to the public. Insider dealing has a long and controversial history with regard to securities laws, because some people believe that insider dealing should not be banned by law. However, nearly every country bans insider dealing, although it is done in different ways. This article considers insider dealing as an example of fraud on the stock exchange. It examines protection of individual investors form insider dealing under the Kuwait Capital Markets Act of 2010 (the Act) and suggests recommendations that have the potential to provide more protection to such investors. In order to achieve this aim, this article discusses the existing legal framework for the regulation of insider dealing in the Kuwait and the UK stock markets. It also looks at American law, because the United States has a long history and extensive experience in this regard.

Keywords: Insider dealing, Securities laws,Kuwait Capital Markets

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1. Introduction

Professor Stephen M Bainbridge has described the issue of insider dealing as 'one of the most controversial aspects of securities regulation, even among the law and economics community'.(1)

There is no doubt that information is very important when buying or selling in the stock market, because information can materially affect the value of the securities. But, if access to information is limited to a group according to their positions, without which they cannot obtain the information, other investors will lose the opportunity to make a profit. Insider dealing adversely affects the opportunity that should be available to everyone in the market to have open access to information. This 'principle of equality' of having simultaneous information will be diminished.(2) Since investors depend on information to make good decisions at the right and appropriate time, it is clear that a problem arises when only some investors know the positive or negative information, which can lead to shortcomings in the principle of equal access.

Decisions on whether to buy or sell are based on information collected from the market. The problem arises, however, when the information comes from confidential sources, and only a few people have access to it. This leads to the violation and derogation of the fairness of the market because of the inequality created by their position or their relationship to the source of the information.

Promoting investor confidence in the securities markets and in particular ensuring that those participating in the markets do so on the same

(1) Stephen Bainbridge, 'Insider Trading', in Stephen Bainbridge (ed) *Insider Trading* (Edward Elgar 2011) 700.

(2) Article 3 of Executive Regulations of Kuwaiti Law No. 7 of 2010 provides that 'The Authority aims to:
1. Organise the securities business in line with the principles of equity, efficiency, competitiveness and transparency…'

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informational footing is one of the goals of the capital market in Kuwait. This goal cannot be achieved without regulating insider dealing. The existing legal framework for the regulation of insider dealing in Kuwait stock markets will be discussed in this article.

1.1 The aims of the Article

The primary aim of this research article is to seek a detailed understanding of the concept of insider dealing under the 2010 Act. It will focus on whether it offers an appropriate framework and, if applicable, will suggest amendments to the 2010 Act.

Apart from the main aim as set out above, the paper aims to improve the knowledge of the Kuwaiti people about insider dealing. It is also hoped that the research will be a useful addition to the body of literature in this field and will open a new avenue of research for other Kuwaiti scholars to follow for the improvement and development of the national economy.

1.2 The benefits of the Article

There are two potential benefits of this research article. First, it highlights any weaknesses of the Kuwaiti 2010 Act in terms of insider dealing so that the Act may be improved. Secondly, it provides original research which will be of interest and benefit to scholars, policy makers, government officials, law enforcement and others with an interest in this area in Kuwait.

1.3 The Methodology of the Article

There are a number of legal research methodologies, and one tries to select a methodology to suit a particular article. A comparison with more developed countries is beneficial in order to learn from their experience. Solving legal problems and finding the best way to apply special laws can be highlighted by using a comparative legal analysis. This type of methodology helps scholars to look outside of a country's laws to understand how other jurisdictions deal with similar problems and how they developed their laws and rules.

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This research article will compare similar legislation in the developed market in the USA and the UK in order to evaluate its potential effectiveness in averting future problems and come up with a better understanding of this subject.

The United States (US) and the United Kingdom (UK), have legislation to prevent insider dealing. This legislation has evolved over the years in an effort to increase the effectiveness of stopping insider dealing. As a result, the use of a comparative law approach in this article will help determine which laws and regulations are the most effective.

Extensive use will be made of primary sources, such as legislation and regulatory rules, to achieve the objectives of this article. Textbooks, journals and relevant websites published by legal experts and other scholars relating to the subject of this article will also be discussed to enrich the paper.

1.4 The Scope of the Article

The scope of the study is to understand the existing legal frameworks applicable to the Kuwaiti 2010 Act and analyze the insider dealing crime. This paper also intends to make a comparative analysis of insider dealing across the US, the UK and Kuwait to gain insight into the Kuwaiti system and to propose recommendations accordingly.

1.5 The Organization of the Article

To achieve the aims of this study, this article is divided into eight sections, including the introduction and the conclusion. Section two, three and four in this article will discuss the background to and the debate surrounding insider dealing. Section five and six will look at the experience of the US and the UK in this field with a comparison between the American and the British regimes. The existing legal framework for the regulation of insider dealing in the Kuwait stock market will also be discussed in section seven of this paper. Section eight will conclude the article.

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2. Definition of insider dealing

Generally, insider dealing involves trading (selling or buying) in a specific company's securities by a person linked to that company, who, by virtue of that link, has inside information that would change the securities' price if this information were made public knowledge.(1) Such a person who possesses inside information could not achieve any profit from the trade if he or she did not have the link to the company.

Bainbridge defines insider dealing, generally speaking, as 'trading in securities while in possession of material non-public information'.(2) This can be illustrated by the following example. A director of a company, who learns of good or bad news during a board meeting, buys or sells the company's shares to profit from the undisclosed information before the information is disclosed to the public. Under such circumstances, the director is involved in insider dealing. In this example, the director is seeking to take advantage of his position inside a company. This is also an example of the misuse of confidential data. Insider dealing also includes the situation where a person with confidential information persuades another person to trade in the securities. Insider dealing also occurs when a person avoids a loss or gains a profit by misusing confidential information gained through the person's position within the company.(3)

It should be underlined that the key to passing effective legislation against insider dealing is to define it properly. The definition has to cover the following four areas: who is an insider? What is the inside information? How is the inside information transferred? and what action is banned?

(1) Gill Brazier, *Insider Dealing: Law & Regulation* (Cavendish Publishing Limited 1996) 76.

(2) Stephen Bainbridge, *Insider*, *supra* note 1 at 701.

(3) Barry Rider, Kern Alexander, Lisa Linklater, *Market Abuse and Insider Dealing* (Butterworths Compliance Series LexisNexis 2002) 4.

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Who is an insider? In the past, 'insiders' were divided into two categories: primary insiders and secondary insiders. Primary insiders may hold such positions as members of the board of directors, managers, in-house accountants and in-house lawyers, among others. These people hold positions that enable them to obtain information through the company's management or supervision. Alternatively, secondary insiders are those who receive information directly or indirectly with full knowledge of the importance of the inside information through primary insiders.(1) This includes people who work with the company through their profession, such as external accountants and lawyers.

Some people argue that no distinction should be made between primary and secondary insiders. They offer several reasons to support their position. Firstly, they contend that the distinction is unnecessarily complicated, because it forces prosecutors and regulators to show not only that a person was in possession of inside information relating to a particular security, but that she or he obtained it in a particular manner. Secondly, the distinction fails to take into account how insider dealing is carried out. For example, few insider dealers deal themselves. Since there is nearly always a primary insider and a secondary accomplice, the distinction is not important. Finally, they argue that there is no justification for saying that a secondary insider (tippee) is less guilty than a primary insider.(2)

Nowadays, much of the legislation defines insiders differently in that it does not distinguish between primary and secondary insiders. For example, the UK defines an insider as any person who has inside information (he knows it is inside information) from an inside source (he knows that he has obtained it from an inside source) according to section 57 of the Criminal Justice Act (CJA) 1993.

(1) Ahmed Almelhem, 'The prohibition of company director from buying or selling the shares of the company during the term of his office' (2011) 35 Journal of Law, University of Kuwait 461.

(2) R C H Alexander, *Insider dealing and money laundering in the EU: Law and regulation* (Ashgate 2007) 230.

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What is inside information? Before defining inside information, the value of information in the financial market should be appreciated in order to understand insider dealing. Inside information includes the factors that determine the price of securities in the market.(1)

Some define inside information as unpublished correct information that may substantially affect the price of securities and that relates to such securities or to the source of information. The definition has four elements. First, the information must not have been previously published. This includes non-published information described as secret information, even if a number of people know this information, as long as they know that the information is confidential. It is not necessary that all people are familiar with the information in order for it to be published. It is enough if it becomes known by one or more persons who are interested in the information. Statistics and the analysis of the published data are not necessarily confidential information, even though they are unpublished. Secondly, the information should be precise in that it is comprised of correct data rather than mere rumours. The disclosure of rumours does not constitute insider dealing. The third element is that the information be material, which requires that its publication will affect the price of the securities to which it relates. Finally, the information must relate to securities or to their issuing company. Such information can be internal in nature, such as information that discloses the occurrence of high profits and rewards, or it can be external information, which discloses that another company has agreed to a merger with the issuing company.(2)

How is the information transferred? A person could obtain inside information from an inside source directly, suchas being a directororthrough family relationship, for example, or indirectly via a family member to another person. In this respect, some laws require that, to be charged with insider dealing, the person should have obtained the information from

(1) Brenda Hannigan, *Insider dealing* (2nd edn, Longman Group Ltd 1994) 2.

(2) Ahmed Almelhem*supra* note 14 at 460

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inside sources. If the person has not received the information from inside sources, he or she will not be charged.(1)

What actions are banned? There are two important points here: the first is the type of prohibited act, such as dealing with inside information, disclosing inside information or encouraging other persons to trade. The type of ban will depend on the legislation and will be discussed later. The second important point is the scope of prohibition in terms of who is banned. For example, the Kuwaiti legislature omits any mention of criminal responsibility for the third party (a tippee) because he is not considered an insider.(2)

Before considering Kuwait, it is useful to look at the experience of the USA and the UK in this field.

3. Developments in the United States against insider dealing(3)

The following section discusses the Pre-Securities Exchange Commission (SEC) rules, the SEC Era, the Disclose or Abstain Rule, Rule 14e-3, Misappropriation and Tipping.

3.1Pre-Securities Exchange Commission (SEC)

Before the introduction of specific laws to regulate insider dealing in 1933-34, attempts were made to apply the common law of fraud in all circumstances, although this did not always work because of the special nature of securities fraud. Three theories were used by the state courts.

(1) Barry Rider, Kern Alexander, Lisa Linklater, *supra* note 13 at 6.

(2) Adel Almane, 'Criminalization of insider dealing in capital market: Comparative study between Kuwaiti and French laws' (2012) Journal of Law, University of Kuwait.

(3) The phrase 'insider dealing' is referred to in the United States as 'insider trading'.

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The 'Minority Rule' was adopted by a minority of states. According to this rule, an insider had to disclose inside information to selling shareholders before dealing with them. The majority of states adopted the 'Majority Rule,' whereby insiders did not have a fiduciary duty to shareholders, because, unlike trust law, they were not strictly trustees of the company. Although an insider had a duty of good faith and undivided loyalty to the company, the courts held that it was illogical to treat an insider as a trustee.(1) The Majority Rule does not stop an action from being brought for misrepresentation or concealment of facts material to the purchase.(2) The third theory came about as an exception to the Majority Rule and was known as the 'special circumstances rule'. It means that the insider has to disclose to selling shareholders before dealing with them the special facts that he knows about a company's activities that may or will soon have a material effect and that are not available in books or financial reports about the company. This rule is similar to the Minority Rule.(3) An attempt to conceal the purchaser's identity was also classified as special circumstances.

3.2The SEC Era

Under American Federal law, four rules have evolved over the years in an effort to combat insider dealing. Two of these rules were created by courts according to section 10(b) of the Securities Exchange Act 1934 and Rule 10b-5.Neither section 10(b) nor Rule 10b-5 expressly mentions insider dealing. The third rule was developed pursuant to the rule-making authority granted by Congress to the SEC under section 14(e) of the 1934 Act. The fourth rule deals with tippee liability. Until the late 1960s, federal law did not pay much attention to insider trading, although the federal government took responsibility for securities regulation by passing the Securities Act

(1) Michael Conant, 'Duties of Disclosure of Corporate Insider Who Purchases Shares' in Stephen Bainbridge (ed), *Insider Trading* (Edward Elgar 2011) 5.

(2) <http://www.sechistorical.org/museum/galleries/it/index.php>accessed 1 December 2018.

(3) Michael Conant, *supra* note 46 at 9.

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1933 and the 1934 Act.(1) In 1961, the SEC brought its first enforcement action against insider trading in the case of *Re Cady, Robert & Co.*(2)

3.2.1 The Disclose or Abstain Rule

The Disclose or Abstain Rule states that 'the people who have access to material non-public information should either disclose the information or abstain from trading that security'.(3) This rule is also known as the 'equal access theory'.

The United States Supreme Court rejected the policy of equality of access to information in two cases, Chiarella v United States(4) and Dirks v SEC.(5) According to these decisions, there can be no liability unless and until a person has a duty to disclose material information to a person with whom he or she is trading. These cases narrowed the scope of the Disclose or Abstain Rule by requiring a fiduciary duty that excludes the outsider. In the two cases the Supreme Court would not apply the Disclose or Abstain Rule due to the fact that the people in the case did not have a fiduciary duty to the shareholders. These rules still work with insiders, in appropriate ways, such as with directors and officers. However, there are two essential

(1) Stephen Bainbridge, *An Overview of Insider Trading*, *supra* note 8 at 3.

(2) 40 SEC 907 (1961).

(3) Henry Cheeseman, *Business Law: Legal Environment, Online Commerce, Business Ethics and International Issues* (8th edn, Pearson Education 2013) 701.

(4) 445 US 222 (1980), Vincent Chiarella got the names of the tender offer target companies from his job in a printing company. The information was in documents that had been given to him for printing. Based on this information, he made transactions.

(5) 463 US 646 (1983), some facts in *Dirks v SEC* include fraud by a firm that was discovered by a financial analyst, who then informed *The Wall Street Journal*. When the *Journal* disregarded the information, the analyst passed the information to his clients to sell their stocks.

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ways in which the theory could cover the outsiders of a company. In these situations, a breach of fiduciary duty must also be found in order to apply thistheory.(1)

The first group of nominal outsiders to whom this rule can be applied are those who have a sufficiently close relationship to account for their role as insiders with the issuer of the affected securities, such as a 'constructive insider'(2) with the three following conditions. The first occurs when the issuer gives the material non-public information to the outsider. The second occurs when the outsider is expected by the issuer to keep the information confidential. Finally, the relationship between the parties must be implied by such a duty. If any of these three conditions is not met, the theory does not apply. The second group of outsiders to whom this rule can be applied are those who obtain the information from a true or constructive insider.

It can be clearly seen from these facts that the American law has some shortcomings that should be filled. This gap is covered by Rule14e-3 and the misappropriation theory.(3)

3.2.2 Rule 14e-3

The application of this rule does not require a breach of the fiduciary duty. According to Rule 14e-3, any person who is in possession of non-public information about a tender offer that the person knows has come from an insider is banned from revealing the non-public information to any person who can trade based on this information. However, the scope of the ban's application is very narrow in that it is limited to tender offers. Another consideration that may limit the scope of the application of this rule is the extent to which the offeror has started or has taken substantial steps toward the commencement of the offer.

(1) Stephen Bainbridge, *Insider*, supra note 1 at 702.

(2) *Ibid*.

(3) *Ibid*.

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Rule 14e-3 combats the improper use of inside information related to a tender offer. There remain gaps in the extent of the protection of inside information for which additional rules are required.

3.2.3 Misappropriation

The misappropriation theory is another part of American law governing insider dealing. It means simply that any person who deals in any shares on the basis of his or her employer's information will be guilty of insider trading.

In the *Chiarella* case, the Supreme Court with Chief Justice Burger dissenting, refused to find liability according to the misappropriation theory, because the trial record revealed that the argument of 'misappropriation' was not presented to the jury. The origins of the misappropriation theory are commonly attributed to Burger's dissent.(1) In *US v Newman*,(2) the Second Circuit adopted insider dealing liability based on the misappropriation theory.

The United States Supreme Court accepted the theory as legally binding in *US v O'Hagan*(3) after the previous two attempts to apply the theory. In July 1988, James O'Hagan worked as a partner in the Minneapolis law firm Dorsey & Whitney, which was retained by Grand Metropolitan PLC (Grand Met) relating to its plan to take over the Pillsbury Company. Through his position at the firm, O'Hagan obtained non-public material information upon which he relied in buying Pillsbury shares and call options. The most important point here was that O'Hagan did not work with any of the parties to the tender offer and, as a result, did not breach a fiduciary duty. After approximately four months, Grand Met declared its tender offer, at which time O'Hagan made a huge profit of more than $4.3 million, which resulted from an approximately $60 per share price increase in Pillsbury's stock.

(1) *Ibid* 704.

(2) 664 F 2d 12 (2nd Cir 1981).

(3) 117 S Ct 2199, 2211 (1997).

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The Supreme Court applied the theory of misappropriation to protect the integrity of the stock exchange from abuse by an outsider, who owed no duty to the company's shareholders or fiduciary duty to the company. The Court affirmed O'Hagan's conviction on the charge that he violated section 10(b) of the 1934 Act and Rule 14e-3 by dealing with misappropriated non-public information and on the charge that he violated Rule 14e-3 by trading while in possession of non-public information relating to a tender offer.(1)

The misappropriation theory means that a person who uses confidential information belonging to his employer to buy or sell securities breaches the duty owed to the source of the data. Such a person infringes a duty of confidentiality and loyalty. Generally, the theory relates to using the information belonging to his principal regardless of the fact that the person has no fiduciary duty regarding with whom he trades. The misappropriation theory says that insider dealing is part of a 'deceptive device or contrivance' (included in Section 10b). That is, the misappropriation theory is linked to insider dealing by section 10(b).(2)

3.2.4 Tipping

According to *Dirks v SEC*, two important conditions must be met to hold liable someone who receives confidential information (tippee). The first condition, relating to insiders (tippers), is that insiders breach a fiduciary duty by giving a tip to a tippee. The second condition, relating to a tippee, is that a tippee must know or have reason to know about the breach of a fiduciary duty (the first condition).(3)

In the *Dirks* case, simply breaching a duty was not sufficient; the duty of loyalty had to be breached by profiting from information entrusted to the tipper. In addition, some scholars said that the directors or other insiders

(1) Stephen Bainbridge, *Insider*, *supra* note 1 at 704.

(2) Stephen Bainbridge, *An Overview, supra* note 8 at 11.

(3) *Ibid* 9.

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had to benefit from the disclosure.(1) Consequently, while it may be careless to discuss business in a public place, it does not constitute a breach of loyalty.(2)

As an example of illegal tipping, Gen Tek Inc CEO, William E Redmond tipped his close friend, Stefano Signorastri the manager of Manhattan restaurant, with confidential information about the company which enabled the latter to make $164,000 in illicit trading profits. Both agreed to pay more than $324,000 to settle the ESC's charges related to dealing in Gen Tek Inc shares. The CEO also agreed to be barred from acting as an officer or director of a public company for five years.(3)

3.2.5 Rule 10b5-1 and rule 10b5-2 in 2000

Despite the courts' adoption of the misappropriation theory, there still remained unresolved issues. In a number of cases the Supreme Court described the insider violation as trading 'on the basis of material non-public information' but it did not address the issue of use versus possession. Three Court of Appeal cases reached different conclusions. In *United States v Teicher*(4) it ruled that 'knowing possession' is sufficient, in *SEC v Adler*(5) it ruled 'use is required, but proof of possession provides strong inference of use and in *United States v Smith*(6) it required that 'use' be proven in a criminal case.(7)Another unresolved issue that came to light in *United States*

(1) *Ibid*.

(2) *Ibid* 16.

(3) <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543516329#.VONAwNIcTIU> accessed 7 January 2019.

(4) 987 F 2d 112, 120-21 (2d Cir) cert denied, 510 US 976 (1993).

(5) 137 F 3d 1325, 1337 (11th Cir 1998).

(6) 155 F 3d 1051, 1069 & n 27 (9th Cir 1998), cert denied, 525 US 1071 (1999).

(7) <http://www.sec.gov/rules/final/33-7881.htm#P233_90511>accessed 1 January 2019.

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v Chessman(1) concerned the duty of trust or confidence in non-business relationships such as family and other personal relationships.

This was unsatisfactory from the SEC's point of view. One of the major responsibilities of the SEC is to promulgate regulations and rules that have the force of law and that help to achieve the aim of the Federal Securities Act.(2) Pursuant to that responsibility, the SEC promulgated rules 10b5-1 and 10b5-2to attempt to resolve the two issues mentioned above.(3)Part (A) of the former rule consisted of a general rule formalising the decision in *O'Hagan* while (b) introduced a definition of 'on the basis of' material non-public information as being aware of material non-public information when making a purchase or sale. In addition, the rule adds affirmative defences, which means that insiders can in certain circumstances be exempt from liability for insider trading, such as when the insiders had had a commitment contractfor tradingor awrittentradingplan before being aware of the inside information. Rule 10b5-2 provides three non-exclusive situations in which a person is deemed to have a trust or confidence duty.

In the United States, three sources of law have developed the insider trading regime: the 1934 Act (statute), the courts (common law), and the rules promulgated by the SEC. Each of the three sources has affected the insider trading regime over time, starting in 1934 and most recently in 2000.

4. Developments in the United Kingdom against insider dealing

It is difficult to compare the insider dealing laws of the United States and the United Kingdom, because the situation in the United States is and has been complicated by the evolution of many theories over time and by the complicated manner in which the American legal system addresses

(1) 947 F 2d 551 (2d Cir 1991); the Second Circuit said that 'marriage does not, without more, create a fiduciary duty'.

(2) Henry Chessman, *supra* note 53.

(3) <http://www.sec.gov/rules/final/33-7881.htm>accessed 12 January 2019.

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insider dealing (common law, statutes and SEC rules). However, in the United Kingdom, a fiduciary duty does not have to be breached, and insider dealing is defined more clearly than in the United States.The following discusses the evolution of financial regulation related to insider dealing.

4.1Pre-Financial Services Authority (now FCA)

Before 1980, prohibiting insider dealing was limited to requiring company directors and their families to report their trading in shares of their own companies.(1) According to Clarke, insider dealing first became a crime in the UK in 1980 in limited circumstances under the Companies Act1980.(2)

Legislation to regulate insider dealing in a wider way in the UK was first introduced in 1993 with the promulgation of the Criminal Justice Act (CJA), which made insider dealing a criminal offence punishable with an unlimited fine or imprisonment not exceeding seven years or both.(3)

4.2The FSA (now FCA) Era

The government felt that the 1993 Act, particularly relating to insider dealing, did not adequately address all forms of abusive conduct. Thus, it introduced the Financial Services and Markets Act 2000 (FSMA) in order to extend the scope of the law and to make it possible to take civil action to complement the criminal law, because the latter required a standard of proof which made it difficult to effectively police the UK markets. In 2005, the Act adopted secondary legislation that implemented the European Union Market Abuse Directive, section 118, which extended the types of market abuse to seven from the original three, including insider dealing. These will

(1) Kern Alexander, 'UK Insider and Market Abuse Law: Strengthening Regulatory Law to Combat Market Misconduct' in Stephen Bainbridge (ed), *Research Handbook on Insider Trading* (Edward Elgar 2013) 410.

(2) Sarah Clarke, *Insider Dealing: Law and Practice* (OUP 2013) 22.

(3) CJA 1993 s61.

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be described later.

In the United Kingdom, criminal lawsuits and civil sanctions for insider dealing offences are brought by the Financial Services Authority (FSA) (now FCA). Few criminal prosecutions have been pursued, because the standard of proof required to convict is higher than in civil actions. The criminal standard must show culpability beyond reasonable doubt, which is not easy to do with the type of evidence in such cases, because 'insiders' have many ways of concealing their tracks, including the use of nominees, offshore companies and the like. Even if the evidence is uncovered, it must be corroborated, which is also difficult. The prosecution needs to establish that:

- An individual possessed inside information.
- He or she knew that such information was inside information.
- An individual traded in such inside information.
- The individual traded knowing that such information had come from an inside source.

In the majority of cases, there will be no direct evidence that a person possessed inside information. In the case of *R v Holyoak, Hill and Morl* (unreported),(1) the prosecution failed to prove that when the defendants traded in the shares of a takeover target, the information that the defendants held was price-sensitive inside information. The defendants effectively disputed the charge by establishing that they thought that the information upon which they relied in their dealings had been publicly disclosed.

On the other hand, in the case of R v (1) McQuoid (2) Melbourne,(2)the

(1) An account of the case is given by Jane Mayfield in an article entitled 'The FSA's approach to insider dealing' [2009] 159 NLJ 7373.

(2) (2009) Southwark Crown Court. After the buying process on 1 June, the price jumped to 45 pence per share after the takeover offer was announced. Melbourne earned approximately £48,900. Three months later, he gave half

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prosecution was successful. The jury found that Melbourne had received inside information from McQuoid, in reliance upon which Melbourne made a profit. The court ordered the FSA (now FCA) to freeze the profit and sentenced each defendant to eight months in prison.

The 2008 financial crisis in the UK has led the FSA (now FCA) to prosecute more criminal cases in an effort to deter insiders. This policy of 'credible deterrence' has paid dividends with six successful prosecutions between 2009 and 2011.(1) The FSA (now FCA) uses its power of investigation provided by the FSMA 2000 to achieve this success, present evidence and prosecute insider dealing as defined in the CJA 1993. It is beyond the scope of this article to study methods of proof and investigation.

4.3Insider dealing under market abuse rules

Undeniably, insider dealing is a form of market abuse. How the legislation defines market abuse depends on the jurisdiction. For example, in Kuwait there is no legal definition of market abuse. On the other hand, in the UK the FSMA 2000(2) defines seven types of market abuse and is probably the most comprehensive definition of this activity. This is in addition to the definition of insider dealing in the 1993 Act.

In the UK, if a person commits any forms of market abuse, there is no threat of jail; however, there are administrative (civil) sanctions which do not involve court (including unlimited fines).(3) Thus, the FCA has two

of the money that he had made from the deal to McQuoid.

(1) Iain Macneil, *An Introduction to The Law on Financial Investment* (2nd edn, Hart Publishing Ltd, 2012)414.

(2) The seven types of behaviour that constitute a form of market abuse fall within 'market abuse' as that term is defined by the British Parliament in direction-driven amendments to the Financial Services and Markets Act 2000 (FSMA), Section 118 changed the statutory definition of market abuse in Part VII Control of Business Transfers:s118 Market abuse.

(3) Marten Hopper, 'Overview of Market Conduct Regulation in the UK' in

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options to follow. First, under the CJA it may prosecute an insider dealer through the courts. This can lead to prison. The second option is under the market abuse regime, which can lead to an unlimited fine. This is effected without going to court, through the FCA discipline committee.

The first three forms of market abuse are considered to be types of insider dealing.[1]These three types of market abuse are defined in the 2000 Act as follows:

The first type is defined as follows: '(2) The first type of behaviour is where an insider deals, or attempts to deal, in a qualifying investment or related investment on the basis of inside information relating to the investment in question'. This type of abuse can be described as insider dealing.

The second type of market abuse is defined as follows: '(3) the second is where an insider discloses inside information to another person otherwise than in the proper course of the exercise of his employment, profession or duties'. This type of abuse can be described as the wrongful disclosure of inside information.

The third type of behaviour is defined as follows:

(4) The third is where the behaviour (not falling within subsection (2) or (3) (a) is based on information, which is not generally available to those using the market, but which, if available to a regular user of the market, would be, or would be likely to be, regarded by him as relevant when deciding the terms on which transactions in qualifying investments should be effected, and (b)is likely to be regarded by a regular user of the market as a failure on the part of the person concerned to observe the standard of behaviour reasonably expected of a person in his position in relation to the market.

Martin Hopper and others (eds) *A Practitioner's Guide to the Law and Regulation of Market Abuse* (Sweet & Maxwell 2013) 10 -11.

(1) *Ibid* 11.

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This type of abuse can be described as the wrongful use of inside information.

As can be seen from the foregoing, market abuse is defined very broadly to cover market and off-market behaviour.(1) Market abuse can be committed by one person or more and according to the 2000 Act it is likely to be flexible.(2)

Market abuse has a destructive influence on the securities market and damages its integrity. An example of market abuse action can be seen from the FSA (now FCA) enforcement decision against Andrew Osborne, who worked as a broker. He engaged in serious market abuse and was fined £350,000 because he failed in his duty not to disclose inside information to one of his customers. The customer avoided losses of around £5.8 million as a result of having inside information. The former FSA (now FCA) Director of Enforcement and Financial Crime, Tracey McDermott, stated: 'There should be no doubt about the FSA's commitment to take tough action where approved persons fail in their responsibilities'.(3)

5. Insider dealing under Kuwaiti laws

The following section explains the regulations in Kuwait.

5.1 Regulation

Kuwaiti lawseems to be less effective in the campaign against insider dealing. No framework of exact laws regulating insider dealing exists in Kuwait, although the Kuwait Capital Markets Act 2010 was passed to regulate the administration of the Stock Exchange and the trading of securities. The main advantage of the 2010 Act is that it provides criminal

(1) Barry Rider and Kern Alexander, *Market Abuse and Insider Dealing* (2nd edn, Tottole 2009) 78.

(2) Edward Swan and John Virgo, *Market Abuse Regulation* (2nd edn, OUP 2010) 215.

(3) FSA/PN/104/2012 an enforcement decision was taken by the FSA.

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protection through provisions set out in Chapter 11, which make insider dealing a crime.

Before the 2010 Act, it could be clearly seen from the Kuwaiti Law of Commercial Companies Article No. 140that the article banned members of the board of directors from buying or selling shares of the company upon whose board they served. Some commentators describe this as a unique action in comparison with other laws.(1) Article 164 of the new Act provides: 'This law is a special law, its provisions are also special provisions, and this law shall repeal all laws in public or private law that are contrary to its provisions.' Consequently, the Act regulates the nature of the work of a member of the board of directors, because each such member is an insider according to Article 118 of the Act. Based on the authority of Articles 164s and 118 of the 2010 Act, Article 140 of the Kuwaiti Law of Commercial Company is consequently repealed.

It should be underlined that the perception of insider dealing is still not clear, although it was criminalised in Kuwait. As a result, there is much room for improvement; it is nonetheless a major step in the right direction. Combating insider dealing would be more effective if a new law were passed or if market rules were issued. In other words, the regulation of insider dealing in Kuwait must be improved in some way. Currently, the definition of insider dealing and the liability of the third party are not clear.

Article (118) is amended pursuant to Law No. 22 of 2015, amending certain Provisions of Law No. 7 of 2010 regarding the Establishment of the Capital Markets Authority & Regulating Securities Activities, by adding the following "…..The same penalty shall be applied to any person who purchased or sold a security based on insider information obtained from an insider, while being aware of the nature of such information, for the purpose of realizing any benefit for himself/herself or for others".

Despite the amendment of the text of the article, the purpose of the criminalization of the actions of the person receiving the inside information

(1) Ahmed Almehem,*supra* note 14 at 437.

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was not achieved. The article stipulates that information must be obtained directly from the insider, but does not include the person who obtained the information from a non-insider.

5.2. Definition

The Kuwaiti legislature has not clearly defined the offence of insider dealing. Some define the offence as an action by an insider, who personally benefits from inside information or who benefits others before the information becomes public in breach of the rules of justice, transparency and equality between dealers and outsiders.(1)

The Kuwaiti legislature provides in Article 1 of the Kuwait Capital Markets Act 2010 that an 'insider is any person who, due to his position, is informed of fundamental information or data regarding a listed company, which was not available to the public'. This definition presents four conditions that must be met for a person to be classed as an insider. 1) Due to his position: the Kuwaiti legislator does not define 'position' in terms of the person's relationship with the employer or with the shareholders with whom they deal. As a result, the extent to which a tippee, an outsider or a third party is included within this definition is uncertain. 2) Fundamental information or data: While fundamental information or data consists of material information, this definition does not set out the boundaries of such information or data; nor does it identify the standard by which information or data are determined to be material. 3) Listed company: The same Article of the 2010 Act defines the listed company as any shareholding company listed on the stock exchange market. 4) Non-public information: While it is important to describe a person as an insider when the information is not public knowledge, how can one determine whether information is public or not?

Consequently, the issues set out above identify shortcomings in the definition of an insider in the 2010 Act. Therefore, the definition should

(1) Adel Almane, *supra* note 19 at 19.

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be improved by reference to English law, which has a fixed definition of insiders. Section 57 of the Criminal Justice Act 1993 provides: 'Insiders: (1) for the purposes of this part, a person has information as an insider if and only if: (a) it is, and he knows that it is, insider information; (b) he has it, and knows that he has it, from an inside source.' Part (1) (b) above is sometimes referred to as 'tippee liability' in the situation in which the insider gives a tip to another person, who trades on the basis of the tip.(1)

According to Article 118 of the 2010 Act, Kuwaiti law only bans the insider from doing one of the following actions:

1. Benefitting from inside information. The Legislature assumes that an insider can benefit from inside information if he knows the nature of the information when buying or selling securities. The insider can refute this simple presumption through proof that he or she did not trade on the basis of this information in Kuwait.(2)
2. Taking advantage of inside information.
3. Disclosing the inside information.
4. Giving advice on the basis of inside information.Kuwaiti law limits the application of this article to the insider, which leaves unanswered the question of the outsider, especially the tippee.

In the United Kingdom, there are three independent offences according to the 1993 Act section 52:

1. Dealing based on inside information.
2. Disclosing inside information.
3. Encouraging another person to trade.

It would be beneficial for Kuwait to adopt a similar provision because

(1) Iain MacNeil, *supra* note 82 at 413.

(2) Ahmed Almelhem, *supra* note 14 at 462.

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the position is not clear in Kuwait.

Despite the fact that insider dealing has been criminalised in Kuwait, the need for such laws is still not taken seriously in all developing countries, including Kuwait.

4. Conclusion

This last section completes the article. The following is a summary of the main findings and recommendations.

6.1 Summary

This article has dealt with the protection of investors in Kuwait from insider dealing under the 2010 Act. The laws on insider dealing have a long and controversial history, because some people believe that insider dealing should not be illegal. Nevertheless, nearly every country bans insider dealing.

Insider dealing has been defined in terms of what constitutes an insider and inside information and the manner in which the latter is transferred. Moreover, the article has examined the ways in which it is combated in various countries. By comparing the UK and the US legislation, it has found that Kuwaiti law has not properly defined insider dealing. For example, a tippee is not considered an insider.

Insider dealing is a complicated crime that is not easy to combat. It is particularly difficult to bring a criminal prosecution because of the high burden of proof that is required. For example, in the UK, even though insider dealing was criminalised in 1993, the first case did not come to court until 2009. In the US, the law against insider dealing has been developed over the last eighteen years. In Kuwait, no case involving insider dealing has ever been brought. Because of the complexity of insider dealing, passing laws to regulate it and establishing appropriate authorities to enforce it takes a long time; furthermore, it needs to be accompanied by a change the financial culture.

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In conclusion, to answer the article question in terms of insider dealing, the 2010 Act only partly succeeds in protecting investors by banning insider dealing. However, the Act does not define insider dealing properly, and there are some problems in enforcing insider dealing, as mentioned above.

6.2 Recommendations on insider dealing

6.2.1 Definition of insider dealing

This article offers a number of recommendations related to the crime of insider dealing, the regulation of which must be improved in Kuwait. In Kuwait, there are several shortcomings in the definition of insider dealing. It is important to have a clear definition of insider dealing. The optimum definition must cover the following four areas: who is an insider; what is inside information; how is inside information transferred; and what type of activity is banned. The UK's Criminal Justice Act 1993 (CJA) is a good illustration of this point. Therefore, the definition should be improved by reference to English law, which has a fixed definition. It would be beneficial for Kuwait to adopt a provision that is similar to the UK's laws.

6.2.2 Fines

Although article 146 of the Kuwaiti Act 2010 provides that the disciplinary board may impose any of seventeen different kinds of penalties, including a caution or warning, it does not include any financial penalty. It would be beneficial to give the Kuwait Capital Market Authority (KCMA) the power to impose fines. Law No. 22 of 2015[1] included provisions relating to the imposition of fines, but this was limited to amounts below fifty thousand KD. However, these provisions do not constitute enough of a deterrent to stop insider dealing. The fines imposed should not be limited in the amount so that the (KCMA) has sufficient power to stop these unlawful transactions.

(1) Law No. 22 of 2015, amending certain Provisions of Law No. 7 of 2010 regarding the Establishment of the Capital Markets Authority & Regulating Securities Activities,

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6.2.3 Liability of third parties

One of the major shortcomings in Kuwaiti legislation is that no mention is made of criminal responsibility on the part of third parties (tippees), because they are not considered to be insiders. It would be better if Kuwaiti law considered a tippee to be an insider. There is no logical reason for treating a tippee differently from an insider and this has been recognised by countries such as the UK and the US.

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التعامل الداخلي في التشريع الكويتي: دراسة مقارنة مع التشريع البريطاني والأمريكي

عبدالله الشبلي

أكاديمية سعد العبدالله للعلوم الأمنية

معسكرات وكليات المباركية - الكويت

ملخص البحث:

يتناول البحث إحدى المسائل الهامة المتعلقة في سوق الأوراق المالية، وهي التعامل بالمعلومة الداخلية دون الإفصاح بها للعامة. والمعلومة الداخلية هي معلومة مهمة جوهرية تؤثر في سعر الورقة المالية في حال نشرها. حيث صدر في الكويت عام 2010 قانون الأوراق المالية ليجرم التعامل الداخلي في سوق الأوراق المالية. إلا أن كثيراً من المتعاملين في سوق الأوراق المالية يرى أنه لا معنى لهذا التجريم، وأن التعامل الداخلي أمر مشروع، ولا يصح تجريمه.

ونظراً لما تتسم به هذه الجريمة من أهمية، وما لها من حساسية تجاه كافة المتغيرات الاقتصادية والاجتماعية والسياسية، أثار البحث عدداً من التساؤلات منها: ما هو التعامل الداخلي؟ وهل هذا التعامل مجرم في التشريعات المتطورة؟ وكيف نستفيد من التجارب التشريعية في كل من بريطانيا والولايات المتحدة الأمريكية؟ وعليه يكون هدف البحث هو الإجابة عن التساؤلات السابقة، واستجلاء الملامح والجوانب المختلفة بأسلوب علمي منطقي من خلال اتباع المنهج الوصفي التحليلي للنصوص القانونية في التشريع الكويتي ومقارنتها مع التشريع البريطاني والأمريكي.

الكلمات دالة: التعامل الداخلي، سوق الأوراق المالية، المعلومة الداخلية.

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