TOWARDS INVESTOR CONFIDENCE: INSIDER TRADING LAWS AND ITS IMPLICATIONS ON MARKET EFFICIENCY*

*Karla Regina D. Valera***
*Francesca Marie Velasco-Lao****

INTRODUCTION

> *An investor's informational disadvantage vis-à-vis a misappropriator with material, nonpublic information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill.*[1]
>
> \- *Justice Ginsburg*

Throughout the years, history has witnessed the evolution of an increasingly complex securities network and its attendant effects on the economy. Fiscal policies and regulation have taken center-stage in ensuring economic development. Investor confidence and market performance have played a significant role in sustaining or stifling expansion. Manipulations in an otherwise fair market have however, caused distortions in the financial system. Such practices led to the simultaneous decline of credit security and investor confidence. Effective regulation, therefore, has been considered essential to the maintenance of a highly sound and reliable securities industry.[2]

Insider trading as a precursor of such distortions has been proscribed in most jurisdictions. In the Philippines, Republic Act 8799 or the Securities Regulation Code serves as the blueprint for prohibiting insider trading. It provides that "it shall be unlawful for an insider to sell or buy a

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** J.D. University of the Philippines College of Law (2009); B.S. Psychology, University of the Philippines, Diliman (2005). Research Associate, Institute of Government and Law Reform (2006- 2008).

*** Editor, PHILIPPINE LAW JOURNAL (2008); J.D., University of the Philippines (2009); A.B. Development Studies, minor in Economics, Ateneo de Manila University (2004).

[1] United States v. O' Hagan, 521 U.S. 642 (1997).

[2] INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (hereinafter "IOSCO"), OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION, 5-6 (2003), *available at* http://www.iosco.org/about/**or** http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf.

security of the issuer, while in possession of material information with respect to the issuer or the security that is not generally available to the public".[3] The same Code likewise imposes additional regulations, exemptions, and liabilities thereto.[4] While the current Philippine Law has been generally regarded as adequate in prohibiting insider trading, its enforcement is not quite as satisfactory. In a country assessment conducted by the World Bank, it was noted that the implementation of insider trading laws in the country was only partially observed.[5] This becomes more manifest given the dearth of Philippine jurisprudence involving the said subject. Consequently, the imperative nature of insider trading prohibition demands an examination of the law's adequacy and execution.

Recognizing that the study of the law should not be done in a vacuum, this paper will explicate on the legal and judicial antecedents of insider trading not only locally but also abroad. The evolution of both statute and case law in select foreign jurisdictions would be given due emphasis. The Philippine prohibition on insider trading would then be contextualized amidst contemporary legal developments around the world. Accordingly, this paper would address the insider trading quandaries that multi-service providers, cross-border transactions, and technology present.

A discourse on the said law however, cannot be divorced from the fiscal and economic market that supports it and vice-versa. As the stock market is continually utilized not only as a capital raising venture but likewise as a source for liquidity, a plunge in its confidence levels poses a threat to investor security. This results in an incessant decline in trade activity which ultimately reflects negatively on a country's market performance.[6] An economic milieu for an analysis of insider trading laws and its dynamics on investor confidence is consequently inevitable. The paper will therefore utilize the economic framework of efficient markets as a framework for the thesis of insider trading prohibition and enforcement as a vehicle for investor confidence and market security.

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[3] SEC. REG. CODE, § 27(1).

[4] *See infra.*

[5] WORLD BANK, REPORT ON THE OBSERVANCE OF STANDARDS AND CODES, CORPORATE GOVERNANCE COUNTRY ASSESSMENT: PHILIPPINES 23 (2006), *available at* http://www.worldbank.org/ifa/rosc_cg_phl_07.pdf.

[6] Interview with Edwin Shea Pineda, Senior Economist, University of Asia and the Pacific, Ortigas Center (Jan. 21, 2009).

The objectives of this paper rest on a three-fold dimension:

1.) To determine the ramifications of insider trading laws and enforcement on market efficiency;
2.) To present an analysis of insider trading laws and jurisprudence amidst a backdrop of an internationally converging market; and
3.) To address the contemporary issues plaguing the prohibition against insider trading.

To tackle such objectives, this paper will draw sources from both local and foreign laws, jurisprudence, commentaries, and data. Consultations from experts on the economic and financial disciplines would likewise be integrated. Finally, surveys would be conducted on the investing and non-investing public. As financial markets continually impinge on the economy, it is crucial that the predicament of insider trading be tackled. While the threat of recession ceaselessly bares its venom, it is with vigilance that every aspect of market stability or the lack thereof be immediately resolved.

I. STATEMENT OF FACTS

In the Philippines, jurisdiction over the enforcement of insider trading laws is lodged with the Securities and Exchange Commission (SEC). This is evident from Section 4.1 of the Securities and Regulation Code which provides that "this Code shall be administered by the Securities and Exchange Commission…"[7] as well as with Section 5.1(f) thereof which states that the SEC can "impose sanctions for violations of laws, rules, regulations and orders issued pursuant thereto."[8] In line with its mandate, the Commission has monitored and fined a significant number of corporations in the year of 2007 for violation of reportorial requirements. The licenses of a number of corporations were likewise revoked, while others had an order of revocation lifted in their favor as evident from the following graph:

[7] SEC. REG. CODE, § 4.1.
[8] SEC. REG. CODE, § 5.1(f).

Company Monitoring, 2007[9]

Number of corporations monitored	13,142
Number of certificates of incorporation revoked	1,156
Number of corporations fined	4,759
Number of corporations whose Orders of Revocation were lifted	217

The Compliance Department meanwhile acted on complaints initiated chiefly by the general public. A number of complaints likewise were referred from the various departments of the SEC and other government agencies:

Breakdown of Complaints Acted Upon[10]

NATURE	FREQUENCY	PERCENTAGE
Complaints from		
• the public	230	65.34%
• local/foreign law enforcement agencies	51	14.49%
• SEC Departments/ Officers	71	20.17%
TOTAL	352	100%

Despite these however, it is uncertain whether or not the laws on insider trading are actually rigorously enforced. In 2007, only "17 investigation reports were evaluated by the Department."[11] Most of these pertained only to unregistered securities and misrepresentation cases, viz:

[9] Securities and Exchange Commission (hereinafter "SEC"), *Observing Best International Practices and Standards for Monitoring Regulatory Compliance,* 2007 SEC Annual Report 25, *available at* http://203.167.80.132/revoked/SEC%20Annual%20Report%202007.pdf.

[10] *Id.* at 30.

[11] *Id.*

Results of Investigation[12]

Category	Description	No.
	Investigation Report Evaluated	
Complaint Affidavits	- Unregistered securities - Falsification	1 2
Administrative Petition for Revocation of Certificate of Registration	- Serious misrepresentation - Fraud in the procurement of certificate of registration	1 3
	- Fraud in the procurement of certificate of registration* - Non-submission of reportorial requirements	1 1
Penalties Settlement Offer Accepted	- Unregistered securities	7
Cease and Desist Order	- Offering of unregistered securities	1
Total		17

*description repeated in the Securities and Exchange Commission 2007 Annual Report

Though these numbers are not conclusive, it is evident that no investigation for insider trading was commenced during the said year. This is in marked contrast with the United States Securities and Exchange Commission which in 2007 alone prosecuted seven cases in insider trading:

Performance Measure[13]

Distribution of Cases across Core Enforcement Areas (Target met)

DESCRIPTION: Effective deterrence of securities fraud requires that the cases filed by the SEC have adequate reach across all core enforcement program areas. The mix and types of cases vary from year to year based upon the conditions of the markets and changes in financial instruments being used. The SEC's enforcement program seeks to maintain a presence and depth so that no single area dominates its case mix, nor is underrepresented. This measure evaluates whether the Commission maintains an effective distribution of cases so that no category exceeds 40 percent of the total.

	PERCENTAGE OF CASES					
CORE ENFORCEMENT PROGRAM AREAS	FY03	FY04	FY05	FY06	FY07 PLAN	FY07 ACTUAL
Financial Disclosure	29%	28%	29%	24%	<40%	33%
Investment Advisers/ Investment Companies	11	14	16	16	<40	12
Broker-Dealers	20	22	15	13	<40	14
Securities Offerings	16	15	9	11	<40	10
Insider Trading	7	7	8	8	<40	7
Market Manipulation	5	6	7	5	<40	5
Other	12	8	16	23	<40	19
Total	100%	100%	100%	100%	100%	100%

ANALYSIS OF RESULTS: The agency will continue to maintain a presence in all program areas with no category exceeding 40 percent of the total amount of cases brought in any one year. The exact percentage may vary depending on the circumstances and priorities unique to that year.

While these figures can be taken as a sign that cases of insider trading have been completely suppressed in the Philippines, reality is more in accord with the conclusion that the law is not effectively imposed. Studies undertaken by both the World Bank[14] and the International Monetary Fund (IMF) reveal that the enforcement thereof is only partially implemented.[15] It is likewise stressed that "the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program."[16] Despite these however, little improvement, years after the conduct of the studies, seem to have been effected. Consequently, the adequateness of the law and its enforcement mechanisms demand to be addressed.

II. STATEMENT OF ISSUES

This paper will analyze the importance of the effectual implementation of insider trading laws on market efficiency. The effectivity of the law and the enforcement thereof will likewise be tackled. Thus, in the course of exploring these concepts, the following issues will be resolved:

1. Whether or not insider trading laws promote market efficiency?;
2. Whether or not the contemporary security market demands further developments in insider trading laws?; and
3. Whether or not both a local and global perspective for insider trading enforcement is necessary?

III. THE STOCK MARKET AND INVESTOR CONFIDENCE: ENSURING INFORMATION SYMMETRY AND MARKET EFFICIENCY

An investigation of insider trading laws and its enforcement would be effectively facilitated through the knowledge of the market wherein it is predominantly traded. Thus, an integrated history of the various stock markets around the world would greatly enhance the understanding of the ramifications of insider trading in an otherwise efficient market. The consequences of the exploitation of material information on the pricing mechanism of shares likewise cannot be ignored. The fragile yet fundamental relationship between these precepts underscores the

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[14] *See supra* note 5.

[15] INTERNATIONAL MONETARY FUND & THE WORLD BANK, FINANCIAL SECTOR ASSESSMENT PROGRAM: PHILIPPINES, IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION 25 (2002), *available at* http://www.imf.org/external/pubs/ft/scr/2004/cr0462.pdf.

[16] *Id.* at 24.

significance of insider trading laws and its enforcement on the stock market industry.

A. Historical Antecedents of the Stock Market

The genesis of the contemporary stock market can be attributed to the English joint-stock companies of the sixteenth century together with the gradual increase of national debt.[17] Numerous shipping and trade companies pooled together massive amounts of assets to finance their expeditions. Transactions involving shares of stock surfaced as a means to raise capital. By 1688, fifteen joint-stock companies were actively involved in trading their shares of stock.[18] Meanwhile, the English monarchy engaged in large-scale borrowing to ensure liquidity. Instruments called "tallies" were issued by the Crown to represent their loans. These debentures were traded by "tally-brokers" who simultaneously dealt with shares issued by various joint-stock companies.[19] Fraud and manipulation however were far from being unheard of during the 1690s. "The line between commendable self-interest and arrant fraud was frequently crossed: sham companies were launched for the enrichment of projectors, share prices were manipulated, and false rumors were circulated."[20] The term stockjobbing emerged, which was "synonymous with speculation as well as the trade in shares… [in addition to] the act of blowing up shares above their true value while simultaneously running down a company's prospects."[21] Such transactions led to the enactment of "An Act to Restrain the Number and Ill-Practice of Brokers and Stockjobbers in 1697."[22] The purpose of the said law can be easily gleamed from its preamble which provides that:

> …Whereas Brokers and Stock-Jobbers, or pretended brokers, have lately set up and carried on most unjust Practices and designs, in selling and discounting , of Talleys, Bank Stock, Bank Bills, Shares, and Interests in Joint Stocks, and other Matters and Things, and have and do, unlawfully combined and confederated themselves together, to raise or fall from time to time the value of such Talleys, Bank Stocks and Bank Bills, as may be most convenient for their private interest and advantage: which is a very great abuse of the said Ancient Trade and Employment, and is extremely prejudicial to the private

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[17] EDWARD MORGAN & WILLIAM ARTHUR THOMAS, THE STOCK EXCHANGE: ITS HISTORY AND FUNCTIONS 11 (1962).

[18] *Id.* at 16.

[19] *Id.* at 19.

[20] EDWARD CHANCELLOR, DEVIL TAKE THE HINDMOST: A HISTORY OF FINANCIAL SPECULATION 48 (2000).

[21] *Id.*

[22] MORGAN & THOMAS, *supra* note 17.

> credit of this Kingdom and to the Trade and Commerce thereof, and if not timely prevented, may Ruin the Credit of the Nation and endanger the Government itself.[23]

To facilitate its objective, the law similarly restricted the number of brokers to one hundred. The law also mandated that brokers be registered at the Royal Exchange and at Guildhall with all their respective transactions recorded therein.[24] A year later, brokers began congregating in Jonathan's Coffee Shop in London. Stock and commodity prices were circulated inside the area and trading activity began in earnest. The traders eventually constructed their own building which they dubbed as "The New Jonathan's". This was later renamed as the "Stock Exchange", the forerunner of the current London Stock Exchange.[25]

Decades later, in 1973, regional exchanges in Britain and Ireland were incorporated with the Stock Exchange. Reforms were soon undertaken and firms were allowed to operate dually. [26] Via the Companies Act of 1985, the exchange was converted into a private limited company. In 1991, it was officially christened the London Stock Exchange with the shareholders eventually selecting to be a public limited company. The EDX London emerged in 2003 in order to engage in the "international equity derivative business."[27] A merger in 2007 was finally concluded between the London Stock Exchange and Borsa Italiana.[28]

In the United States, the financial market has its origin in the national debt incurred in behalf of the revolutionary war of the 1790's. This prompted the government to release eighty million dollars in bonds which signaled the beginning of the United States financial market.[29] After a lapse of two years, twenty-four stockbrokers signed the Buttonwood Agreement. Ratified under a buttonwood tree located in Wall Street, the agreement marked the alliance of its signatories into an investment community.[30] In 1817, traders officially organized the New York Stock and Exchange Board.

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[23] *Id.*, *quoting* An Act to Restrain the Number and Ill-Practice of Brokers and Stockjobbers, preamble.

[24] *Id.* at 24.

[25] London Stock Exchange, *Our History, at* http://www.londonstockexchange.com/about-the-exchange/company-overview/our-history/our-history.htm (last visited Dec. 29, 2009).

[26] *Id.*

[27] *Id.*

[28] *Id.*

[29] New York Stock Exchange Euronext (hereinafter "NYSE Euronext"), *American Stock Exchange Historical Timeline, available at* http://www.nyse.com/about/history/1089312755484.html **or** http://www.nyse.com/pdfs/AmexTimeline.pdf (last visited Dec. 29, 2009).

[30] Daily Stocks, *Definition of Buttonwood Agreement, at* http://www.dailystocks.com/glossary_words/BUTTONWOOD%20AGREEMENT.htm (last visited Dec. 29, 2009).

They commenced holding office in Wall Street and eventually adopted their own Constitution.[31] In 1863, the New York Stock and Exchange Board became known as the New York Stock Exchange.[32]

Meanwhile, other traders chose to do business on the streets. Such brokers became known as the "curbstone traders" who transacted on oil, railroad, and turnpikes shares. On 1911, the New York Curb Market was inaugurated with a marked increase in the volume of foreign shares traded. The New York Curb Market was ultimately renamed the American Stock Exchange.[33]

In 1923, the New York Stock Exchange established the anti-fraud bureau. A bull market reigned for six years only to be followed by the historic October 24 market crash indicating the beginning of the great depression. This prompted the enactment of the Securities Act of 1933 and the establishment of the Securities and Exchange Commission a year later.[34] Another bull run heralded the end of the great depression while the New York Stock Exchange adopted in 1959 a policy discouraging trade transactions between listed companies and their directors and officers.[35] These reforms yielded higher trading volumes throughout the years while the New York Stock Exchange continued to restructure its internal policies and technical equipment.[36] In 2007, a merger was concluded between the New York Stock Exchange and Euronext NV, from which the New York Stock Exchange Euronext was born.[37] In 2008, the American Stock Exchange joined the New York Stock Exchange Euronext group.[38]

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[31] NYSE Euronext, *Timeline: 1653-1859*, *at* http://www.nyse.com/about/history/timeline_chronology_index.html (last visited December 29, 2009).

[32] NYSE Euronext, *Timeline: 1860-1899, at* http://www.nyse.com/about/history/timeline_1860_1899_index.html (last visited December 29, 2009).

[33] *See supra* note 29.

[34] NYSE Euronext, *Timeline: 1920-1939, at* http://www.nyse.com/about/history/timeline_1920_1939_index.html (last visited December 29, 2009).

[35] NYSE Euronext, *Timeline: 1940-1959, at* http://www.nyse.com/about/history/timeline_1940_1959_index.html (last visited December 29, 2009).

[36] *See* NYSE Euronext, *Timeline: 1980-1999, at* http://www.nyse.com/about/history/timeline_1980_1999_index.html (last visited December 29, 2009). Changes include number of trading hours, voting rights policies, circuit breakers, off-trading sessions and technological upgrades ie. fiber-optics, wireless data systems, 3-D trading floor.

[37] NYSE Euronext, *Timeline: 2000-Today, at* http://www.nyse.com/about/history/timeline_2000_Today_index.html (last visited December 29, 2009).

[38] *See supra* note 29.

As for the Philippines, the history of its stock market can be traced to "W. Eric Little, Gordon W. Mackay, John J. Russell, Frank W. Wakefield, and W.P.G. Elliot,"[39] five businessmen who on August 8, 1927 organized the Manila Stock Exchange with the purpose of increasing trade activity. The Exchange was first established in Manila, moved to Binondo and eventually settled in the City of Pasig. Meanwhile, the Makati Stock Exchange was instituted on May 27, 1963 by Miguel Campos, Bernard Gaberman, Aristeo Lat, Eduardo Ortigas, and Hermenegildo B. Reyes. These two exchanges operated simultaneously for a period of about thirty years.[40]

The presence of two exchanges however caused some degree of uncertainty between existing and prospective investors. Conflicting investment procedures as well as different prices for the same shares of stock generated confusion. This paved the way for the consolidation of the Makati Stock Exchange and Manila Stock Exchange into the Philippine Stock Exchange (the Exchange) in 1992. Two years later, the Securities and Exchange Commission issued a license to the Philippine Stock Exchange to operate as a securities exchange.[41]

During 1998, the Exchange was granted by the Commission self-regulatory status, enabling the former to promulgate its own regulations with the authority to impose corresponding sanctions thereon.[42] This empowered it to take an active role in the prevention of market irregularities and distortions. Through the surveillance and regulation databases of the MakTrade system, the Exchange was able to monitor asymmetrical and dubious transactions. An online disclosure system was likewise established to ensure that all information from listed companies is promptly and accurately transmitted.[43]

To stimulate the competitiveness of the market, the Philippine Stock Exchange created the Floor Trading and Arbitration Committee as well as the Compliance and Surveillance Group. The former recommends "appropriate trading and settlement rules"[44] in addition to monitoring the transactions in the Exchange. Trading personnel are regulated and trade

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[39] Philippine Stock Exchange Inc. (hereinafter "PSE"), Knowing the Philippine Stock Exchange, A Guide for Investors, Investor's Primer 2: The Philippine Stock Exchange Inc., *at* http://fglinc.tripod.com/knowstockex.htm (last visited Dec. 29, 2009).

[40] *Id.*

[41] *Id.*

[42] PSE, *Corporate Overview, at* http://www.pse.org.ph/ (last visited December 29, 2009).

[43] *Id.*

[44] PSE, *FAQ's, at* http://www.pse.org.ph/ (last visited December 29, 2009).

activities scrutinized via a surveillance terminal.[45] On the other hand, compliance with the imposed regulations is supervised by the Compliance and Surveillance Group.[46]

From an examination of the history of various exchanges, it is readily apparent that the performances of stock markets are undeniably related to the availability of capital. Investors on the other hand, rely on timely and appropriate disclosures to determine the volume and position of their investments. Insider trading however distorts the availability of information so crucial to the investing public.

B. Insider Trading and the Theory of Efficient Markets

In the seminal case of *Strong v. Repide*, the Supreme Court of the United States recognized the legal duty of an insider to disclose information which would ultimately affect the price of shares of stock.[47] In the said case, the defendant owned majority of the shares of what was then known as the "friar lands". Knowing that a sale of such lands to the Philippine Government was imminent, he undertook to purchase the shares of stock held by the plaintiff through an agent. The shares in question were sold by the plaintiff to the defendant's agent, unaware that an agreement with the Government was about to be concluded. In view of the circumstances mentioned, the Supreme Court held that the defendant had the duty to disclose the information pertaining to the sale of lands, it being material to the value of such shares. The Court furthermore acknowledged that had the information been timely revealed, the plaintiff would have sold the shares at a much higher price.[48]

Even as far back as 1909, the *Strong v. Repide* case illustrates the importance of the timely revelation of material information. Such a disclosure ensures that the current and probable price of the shares of stock sufficiently reflects the performance of the corporation to which it is attributed. As such, investor confidence in the market is cemented, there being an assurance that the pricing mechanism is sufficiently accurate. Insider trading however encourages the prevalence of asymmetrical information as insiders exploit their privileged positions to earn huge profits. As the theory of efficient markets would illustrate, such a practice most

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[45] *Id.*
[46] *Id.*
[47] Strong v. Repide, 41 Phil 947 (1909); 213 U.S. 419 (1909).
[48] *Id.*

assuredly wreaks havoc on the performance of an otherwise proficient market.

The theory of efficient markets mandates that the prices in a given market must "fully reflect all available information."[49] Efficient markets are vital as they "allow firms to make appropriate decisions regarding the allocation of resources and assure the investors that the prices they are paying for assets are meaningful indications of the assets' actual value."[50] Thus, prices which are not fully reflective of all available information distort the efficiency of a specified market.

Applied to the contemporary stock market, the efficient market theory delves on three forms of hypotheses: the weak-form, the semistrong-form, and the strong-form.[51] The weak form hypothesis suggests that "stock prices already reflect information that can be derived by examining market trading data such as history of past prices, trading volume, or short interest."[52] The semistrong-form version asserts that the stock price must absorb all public information including a corporation's prospects.[53] Information on "past prices, fundamental data on the firm's product line, quality of management, balance sheet composition, patents held, earning forecasts and accounting practices"[54] must therefore be included. The last form of hypothesis provides that "stock prices reflect all information relevant to the firm, even including information available only to company insiders"[55] It is this last form of hypothesis against which insider trading laws are anchored on. As company insiders together with their cohorts undoubtedly have material information, insider trading laws seek to prevent the former from exploiting such information and unjustifiably profiting from them.

The efficient market theory, as applied to the stock market, finds its basis on the nature of stock prices as mirroring a random walk.[56] Predictions on favorable future stock performance almost instantaneously result to current positive performance.[57] The figure presented below illustrates[58] how the market reacts on takeover attempts:

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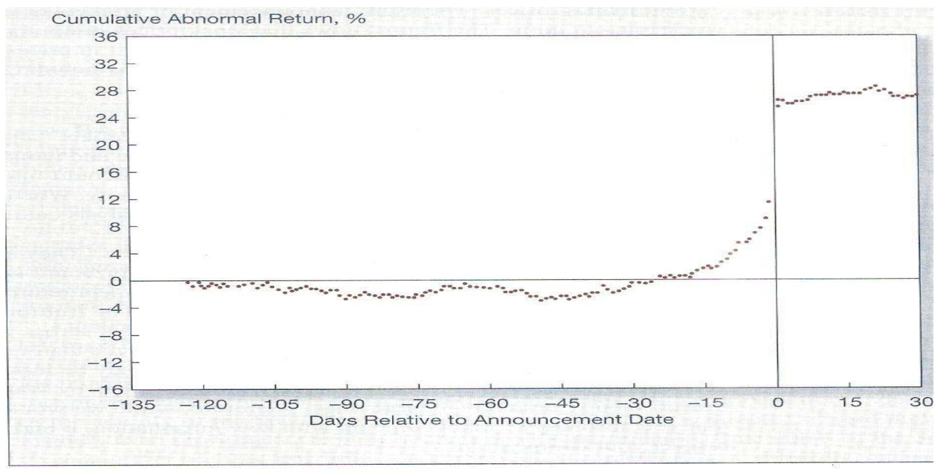
[49] STEVEN LANDSBURG, PRICE THEORY AND APPLICATIONS 293 (7th ed. 2008).
[50] *Id.*
[51] ZVI BODIE, ET AL., INVESTMENTS 373 (6th ed. 2005).
[52] *Id.*
[53] *Id.*
[54] *Id.*
[55] *Id.*
[56] *Id.* at 371.
[57] *Id.* at 370.



Source: Arthur Keown and John Pinkerton, "Merger Announcements and Insider Trading Activity," *Journal of Finance* 36 (September 1981).

The share prices of the 194 firms with takeover attempts patently jumped on the very day that the information on the takeover became public, in anticipation of the takeover premium to be paid. No remarkable change in prices however occurred after the announcement date which clearly indicates that the current price visibly reflects the disclosed information.[59] Consequently, if majority of the investors predicted that stock prices were likely to go up in a couple of days, immediate buy orders would drive the prices of shares upwards even prior to the assumed date.[60] This occurrence results in the randomness of stock prices. New information must therefore "be unpredictable; if it could be predicted, then the prediction would be part of today's information. Thus stock prices that change in response to new unpredictable information also must move unpredictably."[61] As such, market inefficiency results from the capability to predict information beyond that already at hand as this is not reflected in the stock's current price.[62] Information available only to insiders and the concomitant stock transactions utilizing such data therefore leads to market inefficiency as only a number profits from the undisclosed information.

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[58] *Id.* at 371, *quoting* Arthur Keown & John Pinkerton, *Merger Announcements and Insider Trading Activity: An Empirical Investigation*, 36 J. FIN. 855 (1981).
[59] *Id.* at 372.
[60] *Id.* at 370.
[61] *Id.*
[62] *Id.* at 371.

Realizing the adverse impact that asymmetrical information creates on an otherwise efficient market, states around the world sought to regulate the securities market. Governments devised various mechanisms to ensure that the interests of firms and the investing public would be protected. Thus, apart from enacting a myriad of securities law, regulators were established with the task of enforcing such laws.

C. Regulators and Restoring Market Integrity

Regulators emerged to guarantee the integrity of security markets. In the United Kingdom, the Financial Services Authority (the Authority) was organized to monitor and oversee the financial market. Its key objectives are summarized into "promoting efficient, orderly and fair markets; helping retail consumers achieve a fair deal; and improving business capability and effectiveness." [63] The Authority adopts a risk-based strategy in identifying potential issues in the market, allowing it to identify and assess perceived threats.[64] It has a broad array of powers which include rule-making authority,[65] ability to issue prohibition orders,[66] and ability to impose penalties in cases of market abuse.[67] The Financial Services Authority likewise has investigation powers over suspected Financial Services Act violators.[68]

In the United States, the Securities and Exchange Commission seeks "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[69] Timely disclosure of material information is given a central emphasis as security laws in the country are anchored on the notion that "all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it."[70] The United States Securities and Exchange Commission has rule making powers[71] in order to implement legislation enacted by the United States Congress. It furthermore has the powers to suspend unlisted trading privileges,[72] suspend trading itself,[73] and issue

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[63] Financial Services Authority, *What We Do, at* http://www.fsa.gov.uk/Pages/About/What/index.shtml (last visited Dec. 29, 2009).

[64] COLIN CHAPMAN, HOW THE STOCK MARKETS WORK 207 (2005).

[65] U. K. Financial Services and Markets Act of 2000, part X, § 138.

[66] part V, § 56.

[67] part VIII, § 123.

[68] CHAPMAN, *supra* note 64, at 208.

[69] US SEC, *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, at* http://www.sec.gov/about/whatwedo.shtml (last visited Dec. 29, 2009).

[70] *Id.*

[71] U.S. Securities Exchange Act of 1934, 48 Stat. 881, § 12(e)-(f-D) among others.

[72] § 12(f-2A).

emergency orders.[74] Enforcement of security laws and issuances are exercised through the Division of Enforcement which is authorized to collect evidence, conduct investigations, and institute suits against violators.[75]

For its part, financial markets in the Philippines are regulated by the Philippine Securities and Exchange Commission (the SEC/ the Commission). It seeks to "strengthen the corporate and capital market infrastructure of the Philippines, and to maintain a regulatory system based on international best standards and practices that promotes the interests of investors in a free, fair and competitive business environment."[76] The SEC is authorized by the Securities and Regulation Code to exercise a multitude of powers including that of formulating policies[77] and issuing opinions[78] for the securities market; approving, revoking, or suspending licensing applications;[79] monitoring, suspending and taking over exchanges;[80] regulating compliance with security laws and imposing the corresponding sanctions thereon;[81] and issuing subpoena duces tecum and ordering the seizure of documents under investigation.[82] To further strengthen the SEC and give it the much needed flexibility in its enforcement function, a catch-all provision is provided by the law, viz:

> (n) Exercise such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to the carrying out of, the express powers granted the Commission to achieve the objectives and purposes of these laws.[83]

As regulators strive to maintain an efficient and competitive financial market, the prevalence of insider trading continues to pose a threat to its integrity. The increasing sophistication and interdependence of markets around the world likewise present additional problems for regulators. The evolution of laws and jurisprudence in various countries and how the Philippines respond to the call for insider trading prohibition will be discussed in the succeeding sections.

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[73] § 12(k-1).
[74] § 12(k-2).
[75] *See supra* note 69.
[76] SEC, *Mission, at* http://www.sec.gov.ph/ (last visited Dec. 29, 2009).
[77] SEC. REG. CODE, § 5(b).
[78] § 5(g).
[79] § 5(c).
[80] § 5(e).
[81] § 5(d)-(f).
[82] § 5(l).
[83] § 5(n).

IV. COMBATING INSIDER TRADING: LAWS AND JURISPRUDENCE

A. Historical Antecedents of the Stock Market

1. United States

The foundation of insider trading liability which is the duty to "disclose or abstain," is based on the common law tradition of England.[84] Insider trading was prohibited as it frustrated "the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information."[85] In the United States, the Supreme Court in the 1909 case of *Strong v. Repide*[86], found a director of a Philippine corporation liable for trading while failing to disclose information affecting the value of the corporation's shares. This was decided by the said Court while the Philippines was still under the United States regime. Oddly though, this is the only case in the Philippines wherein a person was held liable by the Supreme Court for insider trading. Notably, this case preceded the enactment of the United States Securities Act of 1933 and the Securities Exchange Act of 1934. As a result of the United States stock market crash of 1929, the United States Congress enacted the abovementioned laws to curtail the abuses in the financial market.[87]

In the Matter of Cady, Roberts & Co.[88] discussed exhaustively the duty to disclose or abstain. The Securities and Exchange Commission of the United States not only extended the notion of an insider but likewise applied the obligation of disclosure to existing stockholders and the buying public. The obligation of disclosure was held to include those individuals who were privy to the internal affairs of a company due to the extraordinary relationships that they enjoy with the corporation.[89] The later case of *SEC v. Texas Gulf Sulphur Co.*,[90] cemented the principle that the duty to disclose embraces persons other than directors, officers, and controlling shareholders of the corporation. The Court of Appeals pronounced that anyone

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[84] STUART J. BASKIN, INSIDER TRADING, 1992 UNITED STATES SECURITIES AND INVESTMENTS REGULATION HANDBOOK 375 (1992).

[85] Securities and Exchange Commission (S.E.C.) v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), 394 U.S. 976 (1969).

[86] 213 US 419 (1909).

[87] Thomas Newkirk & Melissa Robertson, Speech by SEC Staff: Insider Trading – A U.S. Perspective at the 16th International Symposium on Economic Crime, Jesus College, Cambridge, England (Sep. 19, 1998) *available at* http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm.

[88] Fed. Sec. L. Rep. (CCH) ¶ 76,803, 81,015 (Nov 8, 1961).

[89] *Id.*

[90] 401 F.2d 833 (2d Cir. 1968).

possessing material, nonpublic information should reveal the information or otherwise restrain from trading.

This principle was however, abandoned in the subsequent case of *Chiarella v. United States,*[91] which was the first criminal prosecution under the laws on insider trading.[92] The defendant Chiarella was employed in a financial printer commissioned for printing deal announcements. Chiarella used the information in these announcements to determine the names of the target companies and purchased their shares before the publication would increase their prices.[93] The lower court convicted him based on his failure to either 1) disclose the information to the share holders of the companies or to 2) abstain from trading. In effect, the lower court imposed an all encompassing obligation to "disclose or abstain" on everyone holding inside information.[94] Chiarella was convicted even though "he was neither an insider nor a recipient of information from the target company".[95] The Supreme Court of the United States however reversed the decision and held that the possession of nonpublic information did not make trading illegal per se. It was noted that to amount to insider trading, it is required that the trader either owe a fiduciary obligation or derivatively assume the responsibility of his tipper. The actuality that a trader was in a favourable position would not ipso facto translate into a fraudulent transaction.[96]

Three years after the *Chiarella* decision, *Dirks v. SEC*[97] was decided wherein the Court made it clear that the government's enforcement powers were limited as the duty to disclose or abstain was restricted to those who have a fiduciary duty.[98] The *Dirks* case was considered significant as it referred to the issue of the liability of "tippees".[99] Tipping is defined as "the passing on of information by an insider to a second party, the tippee, so that the tippee can trade"[100]. This was prohibited under Section 10(b) to the same extent as direct trading. In the *Dirks* case, the Court held that the duty of tippees to disclose or abstain from trading depends on whether the tipper has himself breached a fiduciary duty to the corporation's shareholders by divulging the information to the tippee. In this case, Dirks, a broker, was told by a former officer of a corporation about a massive fraud involving the

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[91] 445 U.S. 222 (1980).
[92] *See* BASKIN, *supra* note 84, at 376.
[93] *See* Chiarella v. United States, 445 U.S. at 224.
[94] U.S. v. Chiarella, 588 F.2d 1358, 1364 (2d Cir. 1978), judgment *reversed by Chiarella*, 445 U.S. 222.
[95] BASKIN, *supra* note 84, at 377.
[96] *See* Chiarella v. United States, 445 U.S. at 235.
[97] 463 U.S. 646 (1983).
[98] *See* BASKIN; *supra* note 84, at 377.
[99] *See* Newkirk & Robertson, *supra* note 87.
[100] BASKIN; *supra* note 84, at 377.

same corporation which Dirks then revealed to his clients. While the SEC concluded that Dirks abetted securities fraud by conveying the information to his clients without public disclosure, the Supreme Court held otherwise. The Court compared this to *Chiarella* noting that the theory of the present case was of little differentiation from the access-to-market-information test in *Chiarella*.[101] In the same case, Justice Powell created the concept of "constructive insiders" in what eventually was to be referred to as "*Dirks* footnote 14". He defined them as "outside lawyers, consultants, investment bankers or others – who legitimately receive confidential information from a corporation in the course of providing services to the corporation". [102] In effect, the fiduciary obligation of an insider is imposed on these individuals as long as there is a necessity to keep the information classified.

As highlighted by *Chiarella* and *Dirks*, the classical insider trading theory failed to consider the possibility whereby an individual may misappropriate confidential information and illegally employ it to his benefit. The provisions of the law failed to take account of those situations wherein the trader owed no duty at all to the corporation. A need to develop a different approach became necessary, which eventually came to be known as the misappropriation theory.[103] While this was touched on in *Chiarella*, the theory was ultimately not utilized in the ruling of the said case. This instead became the focal point in the case of *United States v. Carpenter*.[104] This case differed from the previous ones as the information was traced from a newspaper which neither traded nor received information from the corporations involved. The case revolved around a conspiracy between a *The Wall Street Journal* reporter and a broker. The reporter tipped information to be published in his financial column "Heard on the Street" in advance to the broker and shared in the profits the latter gained. While there was no inside information included in the columns, the government still argued that the disclosure violated the newspaper's conflict of interest policy amounting to a breach of duty.[105] The Second Circuit affirmed the convictions of the reporter and his associates on the presumption that the reporter had indeed misappropriated material, nonpublic information in violation of an employer-imposed fiduciary duty of confidentiality.[106] The Supreme Court however deadlocked on this phase rendering the theory's validity uncertain.

[101] *Id.*

[102] *See* Newkirk & Robertson, *supra* note 87.

[103] Linda Thomsen, Speech delivered by SEC Staff: Opening Remarks to the Securities Industry and Financial Markets Association Regulatory Symposium on Insider Trading, at New York (May 19, 2008) *available at* http://www.sec.gov/news/speech/2008/spch051908lct.htm.

[104] 484 U.S. 19 (1987).

[105] *See* BASKIN; *supra* note 84, at 378.

[106] United States v. Carpenter, 791 F.2d 1024, 1031 (2d Cir. 1986).

While the Court unanimously agreed that Carpenter, the reporter, engaged in fraud, they were divided as to whether he indeed engaged in securities fraud.

Generally, the misappropriation theory has gained acceptance in the courts of the United States. However, in 1995 and 1996, two federal district city courts rejected the theory.[107] In 1997, the Supreme Court reversed one of the decisions abovementioned and adopted unanimously the misappropriation theory in *United States v. O' Hagan.*[108] O' Hagan was a partner in a law firm which was retained to represent Grant Met Corporation in an impending tender offer for Pillsbury Company's common stock. O' Hagan, upon discovering the deal, began acquiring these options which he sold for over $4 million after the tender offer. O' Hagan's contention was that because neither he nor his firm owed any fiduciary duty to Pillsbury, no fraud was committed in the acquisition of Pillsbury's stock.[109]

The Supreme Court found against O' Hagan and upheld his conviction due to the misappropriation theory, thus:

> The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of the information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information…[110]

Additionally, the Court also elucidated the two reasons for prohibiting insider trading as embodied in Rule 10b-5. First, the Court emphasized that prohibiting insider trading is "well-tuned to an animating purpose of the Exchange Act" which is "to insure, honest securities markets and thereby promote investor confidence".[111] While the informational

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[107] *See* United States v. Bryan, 58 F.3d 933, 944 (4th Cir. 1995); United States v. O'Hagan, 92 F.3d 612 (8th Cir. 1996).
[108] 117 S. Ct. 2199 (1997).
[109] *See* Newkirk & Robertson, *supra* note 87.
[110] United States v. O' Hagan, *supra* note 108, at 2207.
[111] *Id.* at 2210.

disparity in securities was unavoidable, the Court ratiocinated that investors would probably "hesitate to venture their capital in a market where trading based on misappropriated nonpublic information was unchecked by law."[112] Second, the Court recognized the "information as property" rationale expressing that the confidential information of a company constitutes property which it has the right to exclusively enjoy.[113]

SEC v. Falbo[114] delved on a case of an electric contractor who was employed to renovate the executive offices of a corporation and who at the same time is married to its executive secretary. It was proven that he utilized information from his wife and those gathered in the course of his employment to purchase the shares of the said corporation which was about to engage in a tender offer. He likewise passed substantial material information to an associate. He, together with his friend, was subsequently found liable for insider trading.[115]

One of the most high-profile cases in the United States is that of Michael Milken, a director at Drexel Burnham and Lambert. He was indicted on 98 counts of racketeering and securities fraud and eventually pleaded guilty to six securities and reporting violations.[116] He however, neither pleaded guilty nor was ever convicted of insider trading. He was later sentenced to 10 years of imprisonment but was able to only serve for a reduced period of two years.

2. Europe

While the United States had laws and jurisprudence on insider trading as early as the 1930s, Europe began efforts to ban insider trading only in the late 1970s. The European Community Directive Coordinating Regulations on Insider Trading ("EC Directive") was adopted in 1989 although deliberations for such were instituted a decade before. After the New York scandal involving Milliken and Boesky as well as in Europe

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[112] *Id.*
[113] *Id.* at 2208.
[114] (S.D.N.Y.) Fed. Sec. L. Rep. (CCH), Issue No. 1837, (Sep. 2, 1998).
[115] Anne Flannery & Rachelle Barstow, Insider Trading Cases: Settlement Criteria and Recent Developments, at the Fourth Annual Securities Litigation and Regulatory Practice Seminar, Institute of Continuing Legal Education in Georgia, at 11, (Oct. 8, 1998), *available at* http://www.morganlewis.com/pubs/58F01D62-AC6F-4C41-A5FBF15306E0FBBF_Publication.pdf.
[116] Kurt Eichenwald, *Milken Defends 'Junk Bonds' As He Enters His Guilty Plea*, NEW YORK TIMES BUSINESS SECTION, Apr. 25, 1990, a*vailable at* http://query.nytimes.com/gst/fullpage.html?res=9C0CEFD71E3DF936A15757C0A966958260.

involving the Guinness brewing group, Europe recognized the importance of a European-wide prohibition against insider trading.[117]

Jurisprudentially, it is difficult to trace the developments of insider trading in Europe. First, the insider trading laws of each country which were written along the lines of the Directive, still require further development. Second, either the member countries of the EC have no insider trading legislation or they have clearly divergent statutes. Third, the statutes are far from self-enforcing. Several countries, like Germany and Italy, have difficulty integrating the laws into their culture which have "traditionally viewed insider trading as an acceptable practice."[118] This predicament is perfectly illustrated in France wherein there has only been a single Frenchman who was sentenced to jail for committing insider trading.[119]

3. Japan

In Asia, specifically Japan, it was not until 1988 that the ministry announced that it would consider enacting a law that would define and prohibit insider trading. This can be attributed to the fact that insider trading had never been a cause for punishment or censure in the country. It was observed that the relationship between investment houses and corporate clients has grown extraordinarily close during the 1980s.[120]

The Japanese Securities and Exchange Act was patterned from the US Securities Act of 1933 and the Securities Exchange Act of 1934. Article 58 of the Japanese Securities and Exchange Act was established with a similar rationale to that of Article 10(b) of the US Insider Trading Regulations. As a consequence of insider trading regulations being strengthened in foreign jurisdictions, the Securities and Exchange Act was amended in Japan. Under the amended Act, material facts constituting insider trading were defined in material terms. [121]

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[117] *See* Newkirk & Robertson, *supra* note 87, at 34.

[118] *Id.* at 37-38.

[119] Peter Gumbel, *Europeans Get Serious About Insider Trading,* FORTUNE MAGAZINE, Jul. 2, 2008, a*vailable at* http://money.cnn.com/2008/07/01/news/international/Europe_insider_trading_Gumbel.fortune/index.htm?postversion=2008070208.

[120] MARTIN MAYER, MARKETS: WHO PLAYS, WHO RISKS, WHO GAINS, WHO LOSES 157-58 (1988).

[121] TOSHIHIKO KATO, *Japanese Securities Markets and Global Harmonization, in* 1992 REGULATING INTERNATIONAL FINANCIAL MARKETS: ISSUES AND POLICIES 132-33 (1992).

Under this law, only a number of legal actions have been filed in Japan. This can be ascribed to several factors, one of which is the different culture of Japan as far as legal proceedings are concerned. The Japanese Act is also notably dissimilar from its United States counterpart which does not provide for the definition of insider trading but instead utilizes judicial precedents. The distinctive feature of the Japanese law on insider trading which seeks to prevent illegal trading prior to completion likewise decreases the possibilities of prosecution. [122]

In 2006 however, the country has adopted a new law known as the Financial Instruments and Exchange Act which abolished the Securities and Exchange Act. In the two years that the law has taken effect, there have been a substantial number of cases instituted against persons for violating the said law. In 2006, Yoshiaki Murakami, one of Japan's best-known fund managers was arrested for an insider trading case. Murakami denied liability and insisted that he was not aware that his actions amounted to insider trading.[123] In November of 2008, an employee of Nomura Securities Co. and his associate both pleaded guilty at the Tokyo District Court after being charged with violating the Financial Instruments and Exchange Law.[124]

4. Philippines

In the Philippines, the 1909 *Strong* case, as previously discussed, is the pre-eminent case on insider trading. The more recent BW scam however illustrates perfectly how insider trading and stock manipulation can occur in Philippine shores. Regarded as the "most devastating of all scams that left the Philippine Stock Exchange on the brink of collapse,"[125] the case of BW Resources Corporation is the most infamous example of insider trading in the country. In the said case, investor Dante Tan heavily traded on BW shares throughout the 5, 250% rise in its value. He however failed to disclose to the Philippine Stock Exchange that he is a majority stockholder of the said corporation and thus, an insider. A series of around 130 buy and sell transactions were made by Tan which earned him a hefty profit of twenty million dollars in a span of six months.[126] At present, there has been

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[122] *Id.*

[123] The Associated Press, *Japan Fund Manager Admits Insider Trading*, WCCO BUSINESS SECTION, Jun. 5, 2006, *available at* http://wcco.com/business/Japan.Insider.Trading.2.268564.html.

[124] Kyodo News, *Pair Plead Guilty to Insider Ttrading*, THE JAPAN TIMES, Nov. 12, 2008, *available at* http://search.japantimes.co.jp/cgi-bin/nn20081112f2.html.

[125] M. Calderon, *Government Seeks to Reopen Case versus Dante Tan, at* http://www.yehey.com/finance/level3.aspx?id=53287.

[126] Cesar Bacani & Antonio Lopez, *Manila Struggles to Get Over the BW Fiasco,* ASIAWEEK, Mar. 3, 2000, *available at* http://www-cgi.cnn.com/ASIANOW/asiaweek/magazine/2000/0303/biz.bw.htmlAsiaweek.

no case decided on by the High Court finding a person liable of insider trading. Despite this, the Court has touched on a number of relevant concepts connected to it in jurisprudence.

In the case of *Philippine Stock Exchange v. Court of Appeals,*[127] the Supreme Court adopted the Securities and Exchange Commission (SEC)'s definition of materiality. In addition to this, the Court likewise confirmed that the SEC is the body primarily tasked to determine whether or not securities, including a corporation's shares of stock, may be traded or not in the stock exchange. The Court explained that this power is in line with the "SEC's mission to ensure proper compliance with the laws, such as the Revised Securities Act and to regulate the sale and disposition of securities in the country", citing *Securities and Exchange Commission v. Court of Appeals.*[128]

More recently, in 2008, the Court discussed extensively certain concepts related to insider trading. The suit of *SEC v. Interport Resources Corporation* is a case in point.[129] Interport Resources Corporation (IRC) acquired 100% of the entire capital stock of Ganda Energy Holdings, Inc. (GEHI) through a Memorandum of Agreement executed between IRC and Ganda Holdings Berhad (GHB). The SEC contended that it had received reports that IRC was unable to make timely public disclosures of its negotiations with GHB and that some of its directors heavily traded on shares utilizing insider information. After notice to the IRC, the Chairman of the SEC issued an order holding that indeed the IRC violated the Rules on Disclosure of Material Facts. The respondents filed an Omnibus Motion contending that the SEC had no authority to investigate the subject matter as under Section 8 of Presidential Decree No. 902-A, the Prosecution and Enforcement Division (PED) of the SEC was given jurisdiction for such matters. An Order was then issued prohibiting the SEC from instituting any civil, criminal or administrative action against the respondents. The SEC appealed this decision.[130]

The Supreme Court held for the SEC. It clarified that while the case was pending in the Court, the Securities and Regulation Code (SRC) took effect. Section 76 of the SRC expressly repealed Section 8 of PD 902-A. This, in effect, abolished the PED. Respondents argued also that Sections 8, 30 and 36 of the Revised Securities Act, the precursor of the SRC, required

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[127] G.R. No. 125469, 281 SCRA 232, Oct. 27, 1997.

[128] G.R. No. 106425, 246 SCRA 738, Jul. 21, 1995.

[129] Securities and Exchange Commission v. Interport Resources Corp., G. R. No. 135808, 567 SCRA 354, Oct. 6, 2008.

[130] *Id.* at 3-11.

implementing rules and regulations in order to be effective. The Court disagreed with this contention.[131] The Court also dispelled respondents' argument that the SRC repealed the abovementioned sections of the Revised Securities Act, thus:

> While the absolute repeal of a law generally deprives a court of its authority to penalize the person charged with the violation of the old law prior to its appeal, an exception to this rule comes about when the repealing law punishes the act previously penalized under the old law.[132]

The Court ultimately held that a criminal case may still be filed against the respondents since the sections contained in the old law are substantially contained in the provisions of the new law, the Securities and Regulation Code.[133]

B. Laws on Insider Trading

1. United States

The primeval rule on insider trading in the United States is contained in Sec. 10-b of The Securities Act of 1934, as amended which provides:

> [I]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[134]

Observably, the provision was too broad a prohibition that would be vulnerable to misinterpretation. The United States Securities and Exchange Commission endeavored to respond to this indistinct definition

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[131] *Id.* at 20-28.
[132] *Id.* at 66.
[133] *Id.* at 67.
[134] U.S. Securities Exchange Act of 1934, 48 Stat. 881, § 10(b).

through the SEC Rule 10b-5: Employment of Manipulative and Deceptive Practices which reads:

> [I]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> > (a) To employ any device, scheme, or artifice to defraud,
> >
> > (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> >
> > (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[135]

In the year of 2000, the SEC issued Rule 10b5-1 which aimed to define what constitutes illegal insider trading for implementing SEC enforcement actions. As evident in jurisprudence, the interpretation as to what constitutes insider trading has been indefinite. The dichotomy between what was actually prohibited between actual use vis-à-vis mere possession of inside information rendered the law vague. This was addressed by the rule as an individual could now be liable by the mere possession of inside information as opposed to the previous actual use requirement.[136]

2. Europe

As previously stated, the EC Directive was adopted only in 1989. The law defines inside information as "information of a precise nature about the security or issuer which has not been made public which, if it were made public would have a significant effect on the security's price."[137] It prohibits insiders from doing certain acts such as taking advantage of insider information[138] and tipping or using others to take advantage of inside information.[139] It likewise requires the issuers to inform the public immediately if there are significant circumstances that may affect the price of

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[135] US SEC Implementing Rule 10b-5.

[136] Allan Horwich & Andrew Klein, *A Primer on SEC Rule 10b5-1: Affirmative Defenses For Insider Trading*, at 25 (Nov. 10, 2003), a*vailable at* http://www.schiffhardin.com/binary/klein-primer_sec10b5-1.pdf.

[137] Council Directive 89/592 Coordinating Regulations on Insider Trading, 1 Common Mkt. Rep. (CCH) ¶ 1761, art. 1.

[138] art. 2.

[139] art. 3.

the securities.[140] The member countries of the Directive are required to apply the prohibitions to actions taken within its territory with regard to securities traded on any members' market,[141] to designate an enforcement authority with appropriate powers,[142] to coordinate with one other in the investigation efforts by the exchange of information,[143] and to enact legislation complying with the Directive. Each member country would have the discretion to decide on penalties for insider trading.[144]

After the latest controversy in Europe pertaining to the EADS investigations, a number of Paris lawmakers have articulated the need for stricter sanctions in the law, particularly increasing the maximum period of the sentence to three years. Britain has likewise intimated adopting measures that were successful in the United States such as giving adequate security for whistleblowers and providing a mechanism of plea-bargaining for the defendants.[145] It is to be emphasized that the concerns sought to be addressed by these jurisdictions centered on the prosecution of violators and the concomitant appropriate penalties prescribed for each.

3. Japan

As previously discussed, the Financial Instruments and Exchange Act amended Japan's earlier law, the Securities and Exchange Act. The new law was directed at "establishing a cross-sectional framework of a wide range of financial instruments and services,"[146] enhancing requirements for disclosure, increasing the maximum criminal penalties against market frauds, expanding its scope, and "providing organizational structures for self-regulatory functions of exchanges in the form of stock corporations".[147] The penalties for insider trading were manifestly increased. Penalty for imprisonment was increased from three to five years while the fine was increased from ¥3 million to ¥5 million for individuals and from ¥300 million to ¥500 million for corporations.[148]

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[140] art. 7.
[141] art. 6.
[142] arts. 8, 9.
[143] art. 10.
[144] art. 13.
[145] *See supra* note 119.
[146] Financial Services Agency, Japan, *New Legislative Framework for Investor Protection - "Financial Instruments and Exchange Act"*, at 2 (Jun 21, 2006), *available at* http://www.fsa.go.jp/en/policy/fiel/20060621.pdf.
[147] *Id.*
[148] *Id.* at 21.

4. Philippines

As early as 1916, the Philippines already passed a statute to regulate the issuance and sale of securities. This was Act No. 2581 (An Act to Regulate the Sale of Certain Corporation Shares, Stocks, Bonds and Other Securities) or what was commonly known as the "Blue Sky Law". As Act No. 2581 was insufficient, Commonwealth Act No. 83 (An Act to Regulate the Sale of Securities, To Create A Securities and Exchange Commission, To Enforce the Provisions of the Same, and To Appropriate Funds Therefore) was promulgated. As the law was likewise regarded as inadequate, the Batasang Pambansa enacted Batas Pambansa Blg. 178 (the Revised Securities Act of the Philippines).[149]

Due to the prevalence of various speculative schemes concocted by investors and promoters, the Securities Regulation Code (SRC) was passed on September of 2000.[150] It was observed that the two recent laws have short titles as opposed to their predecessors. The rationale attributed for such is to "signalize the main objective of the legislation".[151]

Noticeably, the SRC aims in its declaration of state policy to "minimize if not totally eliminate insider trading and other fraudulent or manipulative devices and practices which create distortions in the free market".[152] In contrast, the Revised Securities Act did not contain any declaration of state policy and proceeded to the definition of terms.[153] This signifies that the SRC was drafted to target and solve specific quandaries in securities law. It reflects the aim of the SRC to protect the investing public. In fact, the provisions of the SRC as a whole are directed towards such a goal. The main thrust therefore of the law, is to generate and establish investor confidence and with it, "the state policy of promoting capital market development could be achieved".[154]

The main provision on insider trading contained in the Philippines' Securities Regulation Code is Section 27 which defines the unlawful acts that would constitute insider trading[155] as well as concepts relevant to its

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[149] Anna Leah Fidelis Castaneda, *From Merit to Disclosure Regulation: The Shifting Bases of Philippines Securities Law*, XLII ATENEO L.J. 290, 296 (1998).
[150] MARY ANN OJEDA, SECURITIES REGULATION CODE (REPUBLIC ACT NO. 8799) WITH ANNOTATIONS 1 (2002).
[151] RAFAEL MORALES, THE PHILIPPINE SECURITIES REGULATION CODE (ANNOTATED) 1 (3rd ed. 2005), *citing* JUAN RIVERA, THE CONGRESS OF THE PHILIPPINES 491-496 (1962).
[152] SEC. REG. CODE, § 2.
[153] *See* Batas Blg. 178, 78 OG 6437 (Nov. 1982).
[154] MORALES, *supra* note 151, at 9.
[155] SEC. REG. CODE, §§ 27.1, 27.

definition such as "material non-public information"[156] and "securities of the issuer sought or to be sought by such tender offer".[157] As a general rule, the law provides "that it is unlawful for an insider to sell or buy a security of the issuer while in possession of material information with respect to the issuer or security that is not generally available to the public."[158] It then enumerates the exceptions, thus:

> (a) The insider proves that the information was not gained from such relationship; or (b) If the other party selling to or buying from the insider (or his agent) is identified, the insider proves: (i) that he disclosed the information to the other party, or (ii) that he had reason to believe that the other party otherwise is also in possession of the information.[159]

It should be noted that in this definition, the law makes mention of "material non-public" information which it defines in the subsequent subsection, viz:

> (a) It has not been generally disclosed to the public and would likely affect the market price of the security after being disseminated to the public and the lapse of a reasonable time for the market to absorb the information; or (b) would be considered by a reasonable person important under the circumstances in determining his course of action whether to buy, sell or hold a security.[160]

The problem lies in the second circumstance given in the section as what would be considered by a reasonable person important carries an element of subjectivity.[161] What may be important to consider for one person may be irrelevant to another. The SEC, in its Implementing Rules and Regulations (IRR), addresses this predicament in SRC Rule 14 – Amendments to the Registration Statement and Prospectus, thus:

> 1. "(F)or purposes of this Rule, material information shall include, but not limited to, the following:
>
>> A. Any event or transaction which increases or creates a risk on the investments or on the securities covered by the registration;

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[156] § 27.2.
[157] § 27.4(b).
[158] § 27.1.
[159] § 27.1.
[160] § 27.2
[161] *See* MORALES, *supra* note 151, at 201-02.

> B. Increase/decrease in the volume of the securities being offered at an issue price higher/lower than the range set and disclosed in the registration statement and which results to a derogation of the rights of existing security holders, as may be determined by the Commission;
>
> C. Major change in the primary business of the registrant;
>
> D. Reorganization of the company;
>
> E. Change in the work program or use of proceeds;
>
> F. Loss, deterioration of substitution of the property underlying the securities;
>
> G. Significant or ten percent (10%) or more change in the financial condition or results of operation of the registrant unless a report to that effect is filed with the Commission and furnished the prospective purchaser;
>
> H. Classification, de-classification or re-classification of securities which results to derogation of rights of existing security holders, as may be determined by the Commission."[162]

In the same IRR, however, the SEC cautioned that the enumeration is not exclusive.[163] While it attempts to assist the public in understanding the concept of nonpublic material information, the non-exclusivity of the list also presents certain difficulties. Further, the IRR while providing this list of what may constitute material information, defines material information in a separate Rule as "any fact/information that could result in a change in the market price or value of any of the issuer's securities, or would potentially affect the investment decision of an investor".[164]

The subsequent subsection deals with the tipper-tippee relationship and reads:

> [I]t shall be unlawful for any insider to communicate material non-public information about the issuer or the security to any person who, by virtue of the communication, becomes an insider as defined in Subsection 3.8, where the insider communicating the information

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[162] SEC. REG. CODE Amended Implementing Rules and Regulations (2004), Rule 14.
[163] Rule 3(1)(I).
[164] Rule 3(1)(I).

> knows or has reason to believe that such person will likely buy or sell a security of the issuer while in possession of such information.[165]

As quoted, the person who receives the material non-public information or the "tippee" from an insider or the "tipper" becomes an insider himself as he falls under the subsection 3.8 of the SRC which enumerates who are insiders. A tippee, in the enumeration, would most likely qualify as a "person who learns such information by a communication from any of the foregoing insiders."[166] This provision is a new one which was not contained in the Revised Securities Act. While the Securities Regulation Code removed the requirement that the tippee has knowledge that the tipper is an insider, it is still inherent in the new definition as the tipper would have to impress upon the tippee that he is an insider in order to induce the latter to deal with such security.[167] Seemingly, the provision, in order to hold a tippee liable, only necessitates that 1) the tippee obtains the information from an insider; 2) the information is material and non-public and 3) the tippee actually buys or sell such securities. Oddly, the laws of the United States make it more stringent for a tippee to be liable as they entail that the (1) tipper possessed material, non-public information concerning the issuer, (2) tipper divulged this information to tippees, (3) tippees obtained the corporation's stock while in possession of the information disclosed by the tipper, (4) tippees knew or should have known that tipper violated a relationship of trust by communicating information, and (5) tipper obtained advantage from the disclosure.[168] Curiously, despite these stringent standards, prosecution of insider trading cases in the United States has not been substantially mired. In fact, in that jurisdiction, tippers are liable solidarily for the profits obtained or losses avoided by their tippees.[169]

Finally, the Securities and Regulation Code likewise deals on instances wherein a tender offer has commenced or is about to commence for:

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[165] SEC. REG. CODE, § 27.3.

[166] *See* MORALES, *supra* note 151, at 203.

[167] *Id.* at 204.

[168] United States Securities Exchange Commission v. Blackwell, 477 F. Supp. 2d 891, Fed. Sec. L. Rep. (CCH) ¶ 94189 (S.D. Ohio 2007).

[169] Elizabeth Williams, *Recipients of Corporate Information Other than Directors, Officers, Substantial Shareholders, or Associated Professionals as Subject to Liability for Trading on Material, Nonpublic Information, Sometimes Referred to as "Insider Trading," Within § 10(b) of the US Securities Exchange Act of 1934 (15 U.S.C.A. § 78j(b))—and SEC Rule 10b-5 Promulgated Thereunder—Making Unlawful Corporate Insider's Nondisclosure or Manipulation of Information to Seller or Purchaser of Corporation's Stock*, 14 A.L.R. Fed. 2d 401).

> (i) Any person (other than the tender offeror) who is in possession of material non-public information relating to such tender offer, to buy or sell the securities of the issuer that are sought or to be sought by such tender offer if such person knows or has reason to believe that the information is non-public and has been acquired directly or indirectly from the tender offeror, those acting on its behalf, the issuer of the securities sought or to be sought by such tender offer, or any insider of such issuer; and
>
> (ii) Any tender offeror, those acting on its behalf, the issuer of the securities sought or to be sought by such tender offer, and any insider of such issuer to communicate material non-public information relating to the tender offer to any other person where such communication is likely to result in a violation of Subsection 27.4 (a)(i).[170]

In consideration of the SRC, there have been several changes in the provision on insider trading as opposed to the Revised Securities Act in order to strengthen its prosecution. This is evident from a reading of the old provision, viz:

> [I]t shall be unlawful for an insider to sell or buy a security of the issuer, if he knows a fact of special significance with respect to the issuer or the security that is not generally available, unless (1) the insider proves that the fact is generally available or (2) if the other party to the transaction (or his agent) is identified, (a) the insider proves that the other party knows it, or (b) that other party in fact knows it from an insider or otherwise.[171]

As can be gleaned from the aforesaid provision, the old law requires that the insider has knowledge of the material nonpublic information or that the other party obtained the information from a known insider. This created much difficulty as knowledge is a state of the mind which would be difficult to prove in an actual case enforcing the provision.[172] In the SRC, the provision does away with the knowledge predicament and instead creates a presumption of insider trading, thus:

> A purchase or sale of a security of the issuer made by an insider defined in Subsection 3.8 or such insider's spouse or relatives by affinity or consanguinity within the second degree, legitimate or common-law, shall be presumed to have been effected while in possession of material nonpublic information if transacted after such

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[170] SEC. REG. CODE, § 27.4(a)(i)(ii).
[171] Batas Blg. 178, 78 OG 6437 (Nov. 1982), § 30.
[172] Interview with Atty. Francis Lim, President, PSE, Ortigas City, Jan. 8, 2009.

> information came into existence but prior to dissemination of such information to the public and the lapse of a reasonable time for the market to absorb such information.[173]

Consequently, the prosecution would only need to prove two things for the presumption to apply: First, that the person is an insider or a relative of the insider in the degrees specified by the law. Second, that there was a purchase or a sale transacted after material nonpublic information came into existence but prior to dissemination of the information to the public.[174] The burden of proof is therefore shifted to the purchaser or seller to establish that "he was not aware of the material nonpublic information at the time of the purchase or sale."[175]

C. Comparative Discourse

As previously discussed, there are two theories available on insider trading. These are the classical theory, which limited the application of the provision to those who are strictly insiders and the misappropriation theory, which extends the ambit of the law to trading by outsiders. The latter theory provides that the law is violated when a person:

> (1) misappropriates material, nonpublic information, (2) by breaching a duty arising out of a relationship of trust and confidence, and (3) uses that information in a securities transaction, (4) regardless of whether he owed any duty to the shareholders of the traded stock.[176]

It would seem that based on the current laws of the Philippines, it follows the misappropriation theory as it includes outsiders as those who are liable under the law.

It must likewise be noted that the laws of the Philippines and Japan are largely based on the United States' Securities and Exchange Act. It is evident that the basis of liability for insider trading in these countries today is possession and not use. The mere showing that an insider had knowledge of particular information and that he or she traded before public disclosure would hold him liable for insider trading. On the other hand, the EC Directive of Europe, does not require that the insider trader breach a fiduciary duty to the source of information for him to be held liable. In

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[173] SEC. REG. CODE, § 27.1.
[174] Lim, s*upra* note 172, explaining Sec. 27.
[175] *Id.*
[176] United States Securities Exchange Commission v. Clark, 915 F2d 439, (CCH) Fed Sec. L Rep ¶95501 (CA9 Wash. 1990).

effect, it is analogous to the United States' prohibition against transacting on the basis of nonpublic information pertaining to a tender offer as provided for in Section 14(e) of the Securities Exchange Act of 1934.[177]

As may be gathered, it is apparent that the insider trading laws of different countries are somewhat similar to each other. In fact, some countries culled their laws from existing regulations of other countries as in the case of the Philippines which based its laws on that of the United States'. It may however be said that while the differences in enforcement may be blamed on the laws' inadequacy or the lack thereof, it may likewise be attributed to other contributing factors.

V. INTEGRATING THEORY WITH PRACTICE: DATA ANALYSIS

While theory and the law provide the necessary framework for understanding the debacle of insider trading, an analysis thereof cannot be detached from the actual financial market which it seeks to regulate. As such, it is necessary to contextualize the law as written with its concrete application in the capital industry today. An integration of theory and practice would reveal that the conundrum of insider trading necessitates not just responsive laws but effectual enforcement as well.

A. Methodology

To comprehend the mechanism governing the financial industry, a study using the multiple method approach was utilized. Such a technique employs methodological pluralism wherein "more than one method of research [is used] in order to build up a fuller and more comprehensive picture of social life."[178] The quantitative and qualitative methods were combined in order to "produce extracts of verbatim conversation that gives life to the 'why' and 'how' of the patterns and trends revealed by the statistics produced by official reports or questionnaires."[179] Thus the logic for combining both methods is "to capitalize on the strengths of the two approaches and to compensate for the weakness of each approach."[180]

For the quantitative aspect, a survey was conducted on both the investing and non-investing public. A sample size of thirty was chosen for

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[177] *See* Newkirk & Robertson, *supra* note 87.
[178] STEVE CHAPMAN& PATRICK MCNEILL, RESEARCH METHODS 22 (3rd ed. 2005).
[179] *Id.* at 22-23.
[180] KEITH PUNCH, INTRODUCTION TO SOCIAL RESEARCH QUANTITATIVE AND QUALITATIVE APPROACHES, 240 (2nd ed. 2004).

each category as thirty cases have been considered the minimum for data analysis.[181] Respondents were selected from an age bracket of above twenty-five years while economic backgrounds range from the middle class to the upper middle class strata of society. Categorization was made to limit the sample to those who have the capacity and/or impetuous to invest in the stock market industry.

As for the qualitative phase, unstructured interviews were utilized due to the sensitive nature of insider trading as a topic. The method is centered on the interviewee to "provide an opportunity for respondents to say what they want rather than what the interviewer might expect thus, this type of interviewing may be more likely to get at sensitive information difficult to reach using other methods."[182] To ensure a comprehensive outlook on the subject, interviewees were chosen from the various fields of economics, securities, and enforcement in the country specifically:

a.) Dr. Peter Lee U, Dean of the University of Asia and the Pacific, School of Economics;
b.) Mr. Edwin Shea Pineda, Senior Economist of the University of Asia and the Pacific;
c.) Atty. Francis Lim, President of the Philippine Stock Exchange Inc;
d.) Atty. Carol Lerma-Kant, Assistant Director of the Broker Dealer Division of the Market Regulation Department of the Securities and Exchange Commission;
e.) Mr. Vicente Graciano Felizmenio, Officer-in-Charge of the Market Regulation Department of the Securities and Exchange Commission;
f.) Atty. Oliver Leonardo, Chief Counsel-Broker of the Dealer Division of the Market Regulatory Division of the Securities and Exchange Commission.

While the data might have certain limitations due to the small number of respondents, it nevertheless presents a cross-sectional analysis on the subject. Accuracy is likewise maintained through the multiple method approach wherein results are compared and checked with the others. Thus, the study can be of further use for subsequent research on the topic.

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[181] DEAN CHAMPION, BASIC STATISTICS FOR SOCIAL RESEARCH 89 (1970).
[182] CHAPMAN & MCNEILL, *supra* note 178, at 58.

B. Results

1. Interviews

Chosen from diverse fields in the financial and economic industries, the respondents gave varied perceptions on the topic of insider trading laws and their concomitant enforcement. For a structured analysis on the subject, the presentation of data will first begin with the economists, followed by the Philippine Stock Exchange Management, and the regulators.

The economists emphasized on the need for an efficient market. Mr. Edwin Pineda, senior economist from the University of Asia and the Pacific stated that to produce a mature capital market, three things are essential: "1) a thriving stock exchange market, 2) a thriving bond market, and 3) a thriving commercial banking sector."[183] He stated that in the Philippine context, only the third exists due to the indifference of the common Filipino to the stock and bond industry.[184] Dr. Peter Lee U, the Dean of Economics from the same University added that the financial landscape in the country is highly concentrated. Only a handful of firms dominate the industry while only a few players regularly invest. [185] Because of these factors, both of the economists were in agreement that investor confidence should further be strengthened in the country. While they doubt that the laws on insider trading are completely implemented, they note that the current administration of the Philippine Stock Exchange and the Securities and Exchange Commission have been quite firm in mandating company disclosures. Nevertheless, they recommended that the laws be further improved and its provisions more severely enforced. They emphasized that as insider trading treads on the issue of fairness, it is imperative that investors perceive that the Philippine market is competitive and efficiently valued.[186]

The management of the Philippine Stock Exchange Inc. (the Exchange) accentuated on the current disclosure and enforcement mechanism of the Exchange against insider trading. Atty. Francis Lim, President of the Philippine Stock Exchange Inc., emphasized on the Exchange's internal disclosure rules and stated that listed companies are

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[183] Pineda, *supra* note 6.
[184] *Id.*
[185] Interview with Dr. Peter Lee U, Dean of Economics, University of Asia and the Pacific, Ortigas City, Jan. 21, 2009.
[186] Pineda, *supra* note 6; Lee U, *supra* note 185.

required to timely reveal material information.[187] Regulations preventing key corporate officials from selling shares of stock prior to disclosure were similarly established to prevent insider trading. Atty. Lim likewise stated that the modern surveillance and monitoring equipment of the Exchange deter the commission of insider trading. Radical price and volume movements are spotted by the said apparatus and unusual trading activity are immediately recorded in the system. Corporations and brokerage firms are then required to instantly disclose the reason for such occurrences. Violators, if any, are penalized and referred to the Securities and Exchange Commission for appropriate action.[188]

The Securities and Exchange Commission highlighted the role of the Commission in protecting the common investor. Atty. Carol Lerma-Kant, Assistant Director of the Broker Dealer Division of the Market Regulation Department stressed that in developing markets, regulation is essential to guard the general public from the manipulative practices of crooked individuals. As such the Commission has continually upgraded its standards to comply with international best practice methods to ensure efficient regulation.[189] However, it was also conceded that the Commission lacks several enforcement powers granted to regulators in foreign jurisdictions. Legislation has yet to provide disgorgement powers to the Commission as well as the authority to institute civil proceedings against violators.[190] Also it was stated that the Philippine Stock Exchange must continue to work with the Commission in enforcing the prohibition against insider trading. As such the Commission stressed that continuous improvement in the Exchange's monitoring system must likewise be made.[191]

2. Survey of Investors[192] (see Annex A)

There were 30 investors who responded to the survey. Most of them have been investing in the stock market for 1-6 months[193] while majority of them only invest in 10-25 stocks monthly.[194] It was also discovered that

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[187] Lim, *supra* note 172.
[188] *Id.*
[189] Interview with Atty. Carol Lerma-Kant, Assistant Director of the Broker Dealer Division of the Market Regulation Department, SEC, Mandaluyong City, Jan. 20, 2009.
[190] Interview with Atty. Oliver Leonardo, Chief Counsel-Broker of the Dealer Division of the Market Regulatory Division, SEC, Mandaluyong City, Jan. 20, 2009.
[191] Interview with Mr. Vicente Graciano Felizmenio, Officer-in-Charge of the Market Regulation Department, SEC, Mandaluyong City, Jan. 20, 2009.
[192] *See* Annex C Survey for Investors.
[193] *Id.* at Table 1.
[194] *Id.* at Table 2.

majority of the respondents invest only less than 10,000 pesos per month on the stock market.[195]

The investors perceive stocks as a long-term investment rather than a mechanism for quick profit.[196] More than half of the respondents invest only in Philippine stocks[197] and prefer such stocks over foreign ones[198] citing various reasons such as "better knowledge of market dynamics"[199], "access to available information"[200] and familiarity "with the companies and the demographics hue."[201] Surprisingly, a few respondents expressed concern for the country as a reason for investing as they see this as a way "to help the economy"[202] and "encourage more market movements in the Philippines."[203] Those who showed inclination towards foreign stocks expressed that these offer "more choices, greater profit potential"[204] and "are more transparent with their company's portfolio".[205] The stability of the foreign market as opposed to the Philippine market was also cited as a reason.[206]

Most of the investors were convinced by friends, family, and financial experts to participate in the stock market.[207] Information on the stocks they invested in was mostly retrieved from friends, other brokers, financial experts and the news.[208]

As to the query when the investors obtained the information regarding the stocks they would invest on, the results were relatively close. While most of them received the information after media reports, the answers of "before it is made public" and "after company disclosures were not far from behind.[209]

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[195] *Id.* at Table 3.
[196] *Id.* at Table 4.
[197] *Id.* at Table 5-a.
[198] *Id.* at Table 8-a.
[199] *Id.* at Table 8-b.
[200] *Id.*
[201] *Id.*
[202] *Id.*
[203] *Id.*
[204] *Id.*
[205] *Id.*
[206] *Id.*
[207] *Id.* at Table 9.
[208] *Id.* at Table 11.
[209] *Id.* at Table 12.

Majority of the respondents alleged that they were familiar with the concept of insider trading[210] and their definitions mostly approximated that of the law's.[211] Only a few respondents believed that insider trading was not prevalent in the Philippines.[212] Reasons cited for the incidence of insider trading in the Philippines were mostly based on reports, stories from friends, the cultural phenomenon in the Philippines, and the fact that the stock market is controlled by only a few individuals.[213] This was likewise cited as the case for the incidence of insider trading all over the world.[214] A number of the investors, however, believed that the occurrence of insider trading abroad is lesser as opposed to that of the Philippines.[215]

The answers to the question as to whether the respondents would still invest in the stock market if insider trading was not prohibited were divided.[216] Those who would still invest ratiocinated that they had "enough information to survive even without the law",[217] "believed in survival of the fittest"[218] and one qualified his or her statement that he or she would still do so if he or she is engaged in insider trading as well.[219] Those who did not want to invest considered the value of fairness and the resulting "lack of integrity in the system"[220] which would pose more risks to the investors and subject the stock market to more manipulation.[221]

Only one respondent believed that the laws on insider trading are being enforced effectively.[222] Most attributed the inefficiency of enforcement to the "lack of will and implementation"[223] as well as the lack of public knowledge and awareness that the act is prohibited. Many of the respondents expressed pessimism by stating that very few laws are properly enforced in the country and a lot of people get away with doing prohibited acts.[224]

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[210] *Id.* at Table 14-a.
[211] *Id.* at Table 14-b.
[212] *Id.* at Table 15-a.
[213] *Id.* at Table 15-b.
[214] *Id.* at Table 16-a.
[215] *Id.* at Table 16-b.
[216] *Id.* at Table 17-a.
[217] *Id.*
[218] *Id.*
[219] *Id.*
[220] *Id.*
[221] *Id.*
[222] *See Id.* at Table 18-a.
[223] *Id.* at Table 18-b.
[224] *Id.*

3. Survey of Non-investors[225] (See Annex B)

There were 30 non-investors who responded to the survey. Majority of those who participated did not have plans of investing in the stock market[226] mentioning several reasons such as lack of funds and lack of interest.[227] Those interested in investing cited the good or reasonable return that the stock market would bring.[228] Most of those inclined to invest however, allotted only less than P10, 000[229] and less than 10 stocks to invest in monthly.[230] As with the investors, most of the non-investors cited long-term investment as their reason for trading in the stock market.[231] The respondents also did not have plans on investing in the foreign stock market[232] citing lack of knowledge and lack of funds as their reasons.[233]

Majority of those who wished to participate in the stock market were convinced by friends, relatives and financial experts.[234] Some were likewise motivated by the media.[235] Most of the respondents admit, however, that their information regarding the stocks to invest on were inadequate[236] as there is a lack of materials that could guide a layman in understanding where to infuse their funds in.[237] Information regarding the stocks they would probably invest in were mostly obtained from friends, relatives, and the news.[238]

As to when they got the information for such stocks, a good number of the respondents replied that they had access to information after media reports. None of the respondents answered that they had information regarding the stocks before they were made public.[239]

Majority of the respondents answered that they knew what insider trading is,[240] yet only a few provided explanations.[241] Out of those who

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[225] *See* Annex D Survey for Non-investors.
[226] *Id.* at Table 1-a.
[227] *Id.* at Table 1-b.
[228] *Id.*
[229] *See Id.* at Table 3.
[230] *Id.* at Table 2.
[231] *Id.* at Table 4.
[232] *See Id.* at Table 5-a.
[233] *Id.* at Table 5-b.
[234] *Id.* at Table 9.
[235] *Id.*
[236] *See Id.* at Table 10-a.
[237] *Id.* at Table 10-b.
[238] *Id.* at Table 11.
[239] *Id.* at Table 12.
[240] *Id.* at Table 14-a.
[241] *Id.* at Table 14-b.

defined insider trading, several respondents expressed uncertainty as to the meaning of the term.

Despite the number of respondents who were not aware of insider trading, majority of the respondents felt that insider trading was prevalent in the Philippines and around the world.[242] A number of the non-investors who believed it was rampant in the Philippines heard or knew of instances of insider trading.[243] A lot surmised that it was based on the Filipino culture and fast money that could be obtained through this prohibited practice.[244] As to its incidence around the world, many expressed that insider trading may be limited to only a number of countries and that its prevalence abroad is a lot less compared to the Philippines.[245] Those who believed it was common around the world said that there are many high-profile cases on insider trading.[246] Some also expressed the opinion that the existence of a law prohibiting such act proves the widespread practice of insider trading.[247]

Finally, a large number of non-investors would not trade in the stock market[248] if insider trading were not prohibited citing fairness considerations.[249] Many were also not interested in stocks and as such did not care whether the act was made legal or not.[250] Only two respondents believed that the laws on insider trading are being enforced effectively.[251] Those who believed otherwise blamed the high incidence of corruption in the country and a weak enforcement body.[252] Despite its illegality, some believed that a lot of people still practice insider trading. Many believed that the laws in general are not being enforced effectively in the Philippines.[253]

C. Discussion of Results

Information threshed out from the interview and the survey concurred in several points. The interviewees expressed the lack of interest of Filipinos in general to the stock market which could explain the lack of interest in enforcing the law against insider trading. This was likewise

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[242] *See Id.* at Table 15-a, Table 16-a.
[243] *Id.* at Table 15-b.
[244] *Id.*
[245] *See Id.* at Table 16-b.
[246] *Id.*
[247] *Id.*
[248] *See Id.* at Table 17-a.
[249] *Id.* at Table 17-b.
[250] *Id.*
[251] *See Id.* at Table 18-a.
[252] *Id.* at Table 18-b.
[253] *Id.*