Manne's approach to Insider Trading in the Information Technology Age

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Abstract. This study delves into the phenomenon of insider trading within the contemporary financial market, with a particular focus on the contrasting viewpoints of Henry G. Manne and the prevailing regulatory framework. Employing a deductive-analytical approach, the research is underpinned by an extensive examination of various bibliographic resources encompassing dissertations, theses, articles, books, legislation, and jurisprudence. The methodology employed is qualitative in nature, emphasizing empirical analysis and the contextualization of theories considering the present circumstances.

Keywords. Insider Trading, Financial Market, Regulation, Henry G. Manne, Information Control, Market Fairness, Information Inequality, Regulatory Agencies, Global Jurisdictions, Securities Exchange Act, Market Abuse Directive, Misappropriation Theory, Information Technology, Information Exchange, Internet Era, Market Efficiency, Compensation Strategies.

1. Introduction

This study investigates insider trading in the financial market in this technological era, focusing on Henry G. Manne's view in counterpoint to the regulatory implications currently applied. This is a deductive-analytical analysis, supported by a comprehensive search of bibliographic resources, including dissertations, theses, articles, books, legislation, and jurisprudence. This approach is qualitative in nature, highlighting factual analysis and understanding the historical context of theories in relation to the current scenario.

Additionally, it employs a comparative framework to assess the effectiveness of contemporary regulatory measures in addressing insider trading concerns in the context of rapidly evolving financial technologies. This study aims to provide valuable insights into the ongoing debate surrounding insider trading and its regulation, shedding light on whether traditional theories such as Manne's still hold relevance and applicability in today's technologically advanced financial landscape.

2. Insider Trading

2.1 Insider Trading Definition

Insider trading involves the act of purchasing or selling securities (like stocks or bonds) utilizing non-public data concerning a company's financial results, business activities, or other significant details. This specific information is labeled as "inside information" and is usually accessible exclusively to individuals within the company's inner circle, including executives, staff, and those with access to confidential data.

Insider trading is generally regarded as illegal in many jurisdictions and is subject to strict regulations and penalties aimed at maintaining fairness and transparency in financial markets. These regulations are designed to prevent unfair advantages for those with privileged information, protect the interests of all investors, and uphold the integrity of the financial system.

Penalties for insider trading can include substantial fines, imprisonment, disgorgement of ill-gotten gains, and civil lawsuits. The severity of these penalties underscores the commitment of regulatory authorities to deter and punish individuals who engage in this unethical and illicit practice, promoting trust and confidence in the integrity of financial markets.

2.2 How insider trading is perceived

Insider trading is negatively perceived due to the arguments of information inequality, which would compromise market fairness. Furthermore, it would impact market integrity by distorting stock prices and potentially causing systemic risks, eroding trust in the financial system. Based on this, countries typically implement stringent measures to combat insider trading through regulatory agencies.

These measures may include enacting laws that prohibit insider trading, conducting thorough investigations to identify and penalize offenders, enhancing transparency in financial markets, and promoting ethical conduct among market participants.

Additionally, regulatory agencies often collaborate with law enforcement to ensure the enforcement of these measures and to maintain the credibility and stability of their financial systems.

3. Information control

3.1 Laws related to insider trading

Historical jurisdictions that have played a significant role in shaping global insider trading regulation include:

Comparative Experiences			
Country	Year of Establishment of Main Stock Exchange	Year Insider Trading Law Enacted	Year of First Enforcement of Insider
United States	1792	1934	1961
France	1826	1967	1975
Canada	1878	1966	1976
Singapore	1930	1973	1978
Kingdom	1773	1980	1981
Japan	1878	1988	1990
Norway	1819	1985	1990
Swalen	1863	1971	1990
Finland	1912	1989	1993
Belgium	1801	1990	1994
Hong Kong	1891	1991	1994
Netherlands	1600s	1989	1994
Gerrnany	1585	1994	1995
Switzerland	1938	1988	1995
Australia	1859	1991	1996
Denmark	1919	1991	1996
Italy	1806	1991	1996
Spain	1831	1994	1998
New Zealand	1870	1988	No
Austria	1771	1993	None
reland	1793	1990	None
Luxembourg	1929	1991	None

(Bhattacharya and Daouk, supra note 3, at 80-84)

United States (1934), the United States took a pioneering step in regulating insider trading with the enactment of the Securities Exchange Act of 1934. This landmark legislation established the Securities and Exchange Commission (SEC) and laid the foundation for a comprehensive regulatory framework governing securities market. The SEC was tasked with enforcing securities laws, including those related to insider trading, and ensuring transparency and fairness in the financial markets.

United Kingdom (1980s), In the United Kingdom, the Financial Services Act of 1986 introduced crucial provisions aimed at addressing market abuse, including insider trading. This legislation marked a significant step in aligning the UK with international standards for regulating financial markets and protecting investors from unfair practices.

Japan (2000), Japan introduced significant changes to its financial regulatory framework with the enactment of the Financial Instruments and Exchange Act in 2000. This law addressed various market practices, including insider trading, and aimed to enhance market integrity and investor protection in Japan's financial markets.

European Union (2003), The European Union recognized the importance of combatting market abuse, including insider trading, on a broader scale. In 2003, the EU adopted the Market Abuse Directive, which harmonized rules and regulations across EU member states to combat market abuse more effectively. This directive established a framework for identifying and sanctioning insider trading and other forms of market misconduct within the European Union.

These historical milestones in the regulation of insider trading in the United States, the United Kingdom, Japan, and the European Union have influenced and inspired the development of insider trading laws and regulations in many other jurisdictions around the world. The global effort to address insider trading reflects the shared commitment to maintaining the integrity and fairness of financial markets on an international scale.

3.2 Experience and Theories on Insider Trading in the USA

Securities and Exchange Act de 1934: A Securities and Exchange Act of 1934 was a significant legislation in the USA aimed at regulating securities markets and protecting investors. It established the Securities and Exchange Commission (SEC) and introduced provisions to ensure transparency and fairness in financial markets. The law contributed to the creation of a more robust regulatory environment and influenced the development of specific regulations related to insider trading.

In re Cady, Roberts & Co (SEC 1961) and SEC vs Texas Gulf Sulphur Co. (2d. Cir. 1968): These cases marked a significant advancement in insider trading regulation. In the "In re Cady, Roberts & Co." case, the SEC concluded that a fiduciary duty was violated when company directors shared non-public information with friends and family. In the "SEC vs Texas Gulf Sulphur Co." case, the court established the "disclosure or abstain" duty, highlighting insiders' obligation to disclose relevant information or refrain from trading. These decisions were crucial in shaping the disclosure duty in insider trading cases.

United States vs Chiarella (SCOTUS 1980): Classic Theory: In this case, the U.S. Supreme Court adopted a restrictive approach to insider trading. It ruled that liability for insider trading cannot be imposed unless the insider has a fiduciary duty to disclose privileged information. This led to the development of the classic insider trading theory, based on the premise that the disclosure obligation must be established through a fiduciary duty.

Dirks vs. SEC (SCOTUS 1983): Primary, Secondary Insiders, and the Beginning of Misappropriation Theory: The "Dirks vs. SEC" case marked a turning point in insider trading jurisprudence. The Supreme Court recognized the importance of "secondary insiders," such as financial analysts, who receive privileged information from primary insiders and disclose it to the public. The Supreme Court introduced the "Misappropriation Theory," which deems the use of insider information by third parties who do not have a fiduciary duty but use the information for personal gain as illegal.

United States vs. O'Hagan (SCOTUS 1997): consolidated the misappropriation theory as a valid approach to combat insider trading. The decision stated that individuals who obtain privileged information through their connections with the company, even if they are not employees, can still be considered insiders and therefore subject to insider trading laws. The decision also highlighted the importance of addressing the use of privileged information in transactions that do not involve securities of the company in question, but rather of other companies involved in the transaction. The consolidation of the misappropriation theory expanded the scope of insider trading laws in the United States.

In summary, the topics discussed reflect the evolution of insider trading jurisprudence in the United States. From the inception of legislation to the development of theories like the Misappropriation Theory, the legal approach to insider trading has evolved to address increasingly complex situations that are crucial for maintaining the integrity of financial markets and safeguarding investor protection.

3.3 Controlling confidential information in the technological age

The analysis of changes resulting from the evolution of the internet and communications is a complex undertaking, owing to the global interconnectedness and the rapid pace at which these transformations occur. While attributing specific causes to all the changes is challenging, several key shifts in the digital era are discernible.

The ascent of the internet has ushered in greater speed and technological advancements in communication. Email, instant messaging, and social media platforms have become ubiquitous, enabling near-instantaneous global communication. This transformation has revolutionized information sharing, both in personal and professional contexts.

Moreover, the digital era has witnessed the emergence of new communication mediums, including blogs, podcasts, streaming platforms, and social networks. These platforms have democratized content creation, allowing individuals and organizations to reach global audiences with their messages and content.

In tandem with these changes, businesses and organizations have leveraged digital technologies to streamline their operations. Automation, data analytics, and cloud computing have led to more efficient processes, cost savings, and improved decision-making.

However, alongside these benefits, the digital age has presented regulatory and economic challenges, some of which could potentially favor practices like insider trading.

The decentralization of information is a notable consequence of the internet. While this empowers individuals with greater access to information, it also makes it more challenging to detect privileged or non-public information that could be exploited for insider trading. Online forums, social media, and dark web channels can facilitate the dissemination of such information.

Additionally, the internet has made financial transactions and trading more accessible. While this expands investment opportunities, it also adds complexity to monitoring and regulating financial markets. Detecting suspicious trading patterns associated with insider trading becomes more challenging in this digital landscape.

Anonymity and privacy concerns have also arisen in the digital era. Online anonymity can be exploited by individuals engaged in insider trading to evade detection. Cryptocurrencies, due to their pseudonymous nature, have raised particular concerns about their potential use in illegal activities.

4. Insider trading: A different approach

4.1 Manne's approach

Henry G. Manne was a pioneering figure in the analysis of insider trading, advocating that trading with privileged information benefitted investors and improved market efficiency by swiftly adjusting asset prices through limited insider transactions. He identified flaws in theories like "market stability theoryos" and "unfair advantage theory," emphasizing market efficiency and effective incentives for innovative entrepreneurs. Manne viewed insider trading as a substitute for public information disclosure, maintaining market gains with accurate prices while affording corporations non-disclosure advantages. He also explored how privileged information could stimulate innovation within firms, addressing compensation strategies to encourage competitiveness.

They are comparing the real, imperfect world of insider trading to a never, never-land of perfect solutions to all problems, especially enforcement. They assume that a rule Against Insider trading is the equivalent of a full and timely disclosure rule perfectly enforced (Henry G. Manne)

Manne categorized corporate information into two types: "financial sophistication," encompassing knowledge of capital markets and global events, and context-based information with the potential to impact various sectors of a company. He established criteria for privileged information, requiring "physical exploitation" capability and direct influence on a company's stock price. Despite these criteria, he questioned how such information would be utilized and the unattainability of complete informational symmetry. He contended that allowing those with privileged information to trade could enhance market efficiency, yet he cautioned against a partial prohibition approach that might overlook the broader implications of insider non-trading and perpetuate substantial informational asymmetry.

4.2 Manne's pioneering work now

In the midst of the Information Age, interconnected networks, and the escalating significance of information as the driving force behind innovation, negotiation, and corporate dynamism, Manne's approach undergoes a fresh evaluation based on its applicability. In an era where information reigns supreme, his perspective on leveraging information for market advantage gains heightened relevance. The swiftness of information acquisition now holds the power to significantly alter the trajectories of companies and their actions, while also impacting political and economic scenarios.

Manne's pioneering stance on arguing that strategic information use can benefit the market aligns more strongly with the current landscape of rapid information exchange. Amidst various incentive mechanisms spanning from the popular to the effective, the utilization of insider trading as a means to motivate administrators and innovative entrepreneurs through compensation and adaptation to a competitive market garners attention, reflecting a facet he had already explored since the 1960s.

With the advent of the internet, the discourse around information control has taken center stage, shedding light on the complexity of maintaining such control without incurring exorbitant costs or violating other societal pillars. A fresh perspective on issues like insider trading, which has been a subject of regulatory debate for years, could provide valuable insights to address diverse contemporary problems, offering solutions that were previously less apparent.

5. Conclusion

This study explores insider trading in the financial market, considering Henry G. Manne's perspective in contrast to current regulatory frameworks. It employs a qualitative and deductive analytical approach based on an extensive review of academic and legal sources. Insider trading involves trading securities based on non-public information and is typically considered illegal due to concerns about information inequality.

Historical jurisdictions like the United States and the United Kingdom have played significant roles in shaping global insider trading regulations. In the US, the evolution of insider trading jurisprudence has led to the development of theories such as the Misappropriation Theory.

In the technological age, the rapid evolution of the internet and communication has introduced both opportunities and challenges, including the difficulty of detecting privileged information and concerns about privacy. Manne's perspective, emphasizing potential benefits of insider trading for market efficiency and innovation, gains relevance in the Information Age.

Reassessing issues like insider trading through a fresh perspective can offer valuable insights to address contemporary challenges while balancing information control and market fairness.

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