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Insider Dealing and Corporate Governance: Understanding the Role of Directors

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Abstract
The separation of ownership and management of the company implicates the agency problem of insider dealing. And the practice of insider dealing has made it a target of judicial and statutory regulation due to its perceived breach of legal, equitable and ethical standards of conduct by self-interested company directors. However, the mandatory and penal force of statutory regulations has not successfully curbed the practice across various jurisdictions such as the US, the UK, and Nigeria. In this article, we probe the role of directors at the intersection between insider dealing and corporate governance. We determine how corporate governance processes may be implemented to prevent information asymmetry which breeds insider dealing. Our conclusion is instructive towards understanding the difficulty which arises from the incongruous role of directors who are potentially disposed to indulge in insider dealing while at the same time, have the responsibility to implement corporate governance processes relating to the prevention of insider dealing within the company.
Keywords: Insider dealing, corporate governance, information asymmetry, agency problem, company securities, corporate managers, company regulation
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INTRODUCTION

The foundational objective of an incorporated company with shareholding investors is to make profitable returns on investments for the shareholders. The nature of an incorporated company makes it susceptible to the control and management of persons who are not shareholders or owners of the company. In most cases, investors and shareholders of the company rarely play an active role in the management of the company. Directors are appointed to manage the business and conduct the affairs of the company on behalf of the shareholders and owners of the company.

However, the separation of ownership and management of the company almost always implicates agency problem which occurs when a person acts as an agent in the making of important decisions on behalf of another person who is the principal. The agency problem arises because sometimes the agent may be driven to act in his personal interest rather than that of his principal. As has been noted elsewhere[1], once investors have invested their funds in the company, the self-interested directors may be motivated to make decisions that expropriate the investors' funds.

According to the agency theory in corporate structure analysis, in the presence of information asymmetry directors and managers are able to satisfy their self-interest at the expense of the company's shareholders and investors[2]. One practice that studies have found as the manifestation of agency problem in the separation of ownership and management of a company is the phenomenon of insider dealing[3]. The definition or description of an ''insider''[4] captures directors and other management officials who, by virtue of their office and status in the company, have access to internal information that may be sensitive to the market price of the company's shares and securities.

Thus, it is insider dealing when directors in charge of the management of a company trade in the company's stocks and bonds based on internal information that is yet to be made available to the shareholders and the investing public. The motivation for insider dealing is either to make abnormal profit or avoid loss in the sale or

[1] Healy M. H and Palepu G. K. 2001. Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. Journal of Accounting and Economics 31 (2001) 405¨C440

[2] Jensen, M. C., and W.H. Meckling, 1976. Theory of the firm: managerial behaviour, agency costs and ownership structure, Journal of Financial Economics 3(4), 305–360

[3] While there is a plethora of literature on this point, see the relatively recent studies of Fidrmuc, J. P., A. Korczak, and P. Korczak, 2013. Why does shareholder protection matter for abnormal returns after reported insider purchases and sales? Journal of Banking & Finance 37(6), 1915-1935; Beekes, W., P. Brown, and Q. Zhang, 2015. Corporate governance and the informativeness of disclosures in Australia: A re-examination. Journal of Accounting and Finance 55(4), 931-963; Ali, U., and D. Hirshleifer, 2017. Opportunism as a firm and managerial trait: predicting insider trading profits and misconduct, Journal of Financial Economics 126, 490-515

[4] "Insider" has been defined to include current or former director (either executive or non-executive) of the company or a person discharging managerial responsibilities within the company. See Bebchuk, L. A., Y. Grinstein, and U. Peyer, 2010. Lucky CEOs and lucky directors, The Journal of Finance 65(6), 2363-2401

purchase of the company's shares by insiders. Studies have long associated insider dealing with higher cost of capital, lower market liquidity and increased litigation risk for the company[5]. Therefore, insider dealing works against the interests of shareholders, and exacerbates the agency problem in corporate ownership and management.

Originally, efforts towards addressing agency problem informed the concept of corporate governance, which involves rules and processes towards ensuring the protection of the interests of shareholders, investors and other stakeholders in the management of a company. Corporate Governance is when a company is controlled by focusing on its internal corporate structures with a view to monitoring the actions of its directors and management, and mitigating agency loss which may stem from the selfish interests of the corporate managers[6].

Accordingly, in order to minimise agency problem shareholders may prevail on board of directors to institute corporate governance processes towards protecting the interest of shareholders and limiting management ability to undertake self-centred practices. Through corporate governance the interests of shareholders and management are aligned with a view to resolving the inherent conflict of interests. Studies have confirmed that agency problem can significantly be addressed by good corporate governance[7]. As a form of agency problem, insider dealing may also be curtailed through appropriate corporate governance processes.

In this article, we probe the functional relationship between insider dealing and corporate governance. The objective of this article is to determine how corporate governance may prevent or mitigate insider dealing within the company. Whether in relation to insider dealing or corporate governance company directors inevitably play a key role. Therefore, we critically examine the role of directors in the relationship between insider dealing and corporate governance; we determine the role played by directors in the practice of insider dealing and the implementation of corporate governance processes. As its theoretical framework, this article proposes that the understanding of the role of directors is crucial to determining how corporate governance may address insider dealing in a company.

INSIDER DEALING: MEANING AND EFFECT

At the aftermath of the global financial crisis, public enquiries and criminal investigations in worst-hit countries such as the United States of America (US) revealed that insider dealing by directors and top management officials contributed to the bankruptcy and collapsed of big corporations like the Lehman Brothers, Bear Stearns and Washington Mutual[8]. In the debates on the pros and cons of insider dealing, the fate of such failed corporations underscores one of its consequences: the capacity of insider dealing in a company's shares to indicate abnormal profits and send wrong market signals to shareholders and investors about the financial status of the company[9]. Wrong market signals constitute mere bubbles that are bound to burst, leading to corporate bankruptcy and collapse.

In its relatively short history from the early twentieth century, the practice of insider dealing has attracted debates that cut across law, finance and economics relating to its utility and effect on the company, shareholders and the investing public. Following the first statutory regulation of insider dealing in the US in 1933[10], Professor Manne argued that insider dealing has positive effect as it is able to release private information to the market which increases market efficiency[11]. According to Manne's theoretical postulation, the agency problem in the separation of ownership and control of a company would be mitigated if corporate insiders like directors were allowed to trade and benefit from their activities as this would lead to improved corporate decision making, resulting in an overall increase in the market value of the company's shares[12].

Other scholars have pursued this line of argument that insider dealing increases the informational efficiency

[5] Lambert, R., C. Leuz, and R.E. Verrecchia, 2007. Accounting information, disclosure, and the cost of capital, Journal of Accounting Research 45(2), 385-420; Bhattacharya, U., and Daouk, H., 2002, "The world price of insider trading." The Journal of Finance, 57: 75–108; Fishe, R. P. H., and Robe, M. A., 2004, "The impact of illegal insider trading in dealer and specialist markets: evidence from a natural experiment," Journal
of Financial Economics, 71: 461–88

[6] Sifuna, Anazett Pacy 2012. "Disclose or Abstain: The Prohibition of Insider Trading on Trial". Journal of International Banking Law and Regulation 27, 9

[7] Shleifer A, Vishny R. W. (1997). A survey of corporate governance. Journal of Finance 52, 737-783; Berglöf E, and Claessens S. 2006. Enforcement and Good Corporate Governance in Developing Countries and Transition Economies. World Bank Research Observer. Volume 21, Issue 1 P. 123-150

[8] Layna Mosley and David Andrew Singer 2009. The Global Financial Crisis: Lessons and Opportunities for International Political Economy, International Interactions, 35:4, 420-429, DOI: 10.1080/03050620903328993

[9] Seyhun, N. (1986). Insiders' profits, costs of trading, and market efficiency. Journal of Financial Economics, 16(2), 189–212; Bettis, C., Coles, J., & Lemmon, M. 2000. Corporate policies restricting trades by insiders. Journal of Financial Economics, 57(2), 191–220; Ravina, E., & Sapienza, P. 2010. What do independent directors know? Evidence from their trading. Review of Financial Studies, 23(3), 962–1003

[10] The Securities and Exchange Commission Act 1933, which was subsequently replaced by the more comprehensive Securities and Exchange Act 1934

[11] Manne, H. G.,1966. "In Defense of Insider Trading", Harvard Business Review, 113–122

[12] De Groote, S., Bruynseels, L. and Gaeremynck, A. 2019. "Do companies care about insider trading behavior? Evidence from director turnover." KU Leuven Working Paper

of markets by contributing to the existing information set held by investors, and that corporate insiders use their trades as signals to confirm or contradict the information publicly available hence, investors view the signals as complimentary and thus act accordingly[13]. However, the nature of insider dealing has made it a target of judicial and statutory regulation due to its perceived breach of legal, equitable and ethical standards of conduct by corporate managers. Insider dealing involves trading of a company's shares by directors and managers based on privileged material information about the company that is not available to the public.

Corporate managers take advantage of the information asymmetry as they sell or purchase shares of the company based on imminent event that is likely to affect the company's shares price when news of the event is announced and made public. For instance, directors with inside information about imminent merger, takeover or acquisition relating to the company, including imminent changes in plans, policies, or operations of the company may decide to either sell or purchase the company shares in anticipation of making abnormal profit or avoiding any loss. Shareholders and other investors of the company like creditors and debenture holders are short-changed when the announcement of such event is eventually made public with resultant impact on the price of the company's shares in one way or another.

Therefore, insider dealing is considered as unfair to outsiders and the investing public who do not have access to such information, and who cannot make high profits or avoid loss like the insider dealers. The practice of insider dealing is thus associated with a public perception that corporate insiders such as directors unethically exploit shareholders and other investors for personal financial gains[14]. But beyond its ethical disapproval, insider dealing has been subject of legal containment due its negative financial and economic effects. Numerous studies have confirmed that insider dealing instigates higher cost of capital, reduces market liquidity, increases litigation risk, lowers the market value of shares of affected companies, and decreases overall economic growth and development[15]. These dire and far-reaching consequences of insider dealing have made its regulation imperative across jurisdictions.

Regulation of Insider Dealing

The US leads in the conceptualization and regulation of insider dealing. The first statute to comprehensively regulate insider dealing was the US Securities and Exchange Act 1934 which made it unlawful for any person to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device in contravention of such rules and regulations as the US Securities and Exchange Commission may prescribe[16]. The Act allowed injured parties to recover from insider traders short-swing profits, or profits made through the buying and then selling, or selling and then buying shares of a company within a period of six months[17]. But this provision of the Act was not breached where there was disclosure of the insider sale or purchase of shares of the company.

The US Securities and Exchange Commission (SEC) has made broad rules pursuant to the Act, including significant reforms made to the Act under the Sarbanes Oxley Act 2002. The result is that the SEC now vigorously enforces insider dealing regulations by bringing civil claims or referring criminal charges to the Justice Department for criminal prosecution. Persons or entities found guilty of insider dealing may be subject to civil penalty such as fines or suspension of professional licence while criminal sanction may involve restitution or imprisonment [18]. Prior to the enactment of these statutory regulations, there had been judicial conceptualization and sanction of insider dealing in the US. In the earliest case of *Strong v Repide*[19], the US Supreme Court ruled that a director who bought the company's shares with inside knowledge that the shares' price was about to go up committed fraud by buying without disclosure of the inside information. Arguably, this case laid the foundation for contemporary jurisprudence on insider dealing in the US and beyond.

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[13] Seyhun, N. 1986. Insiders' profits, costs of trading, and market efficiency, op.cit; Jensen, M.C. 1986, "Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers", American Economic Review 76(2): 323-329; John, K., and Lang, L., 1991. "Insider trading around dividend announcements: Theory and evidence." Journal of Finance 46(4): 61–89; Cui, J., Jo, H., and Li, Y., 2015. "Corporate Social Responsibility and Insider Trading," Journal of Business Ethics, 130:869–887

[14] McGee, R.W., 2008. "Applying Ethics to Insider Trading" Journal of Business Ethics, 77(2):205-217

[15] Bhattacharya, U., and Daouk, H., 2002. "The world price of insider trading." The Journal of Finance, 57: 75–108; Fishe, R. P. H., and Robe, M. A., 2004. "The impact of illegal insider trading in dealer and specialist markets: evidence from a natural experiment," Journal of Financial Economics, 71: 461–88; Bhattacharya, N., Desai, H., and Venkataraman, K., 2013. "Does Earnings Quality Affect Information Asymmetry? Evidence from Trading Costs." Contemporary Accounting Research, 30: 482-516; Billings, M; B., and Cedergren, M. C., 2015. "Strategic silence, insider selling and litigation risk", Journal of Accounting and Economics, 59: 119-142

[16] Section 10(b). The precursor to this Act was the Securities and Exchange Act of 1933 which contained prohibitions of fraud in the sale of securities under its section 15

[17] In addition, insiders could be forced to return any profits realized from round trip transactions that take place within 180 calendar days and have to report each transaction to the Securities and Exchange Commission (SEC). Note that since the reforms implemented in the Sarbanes Oxley Act 2002 insiders have to use form 4 to report their transactions to the SEC within 2 business days after they take place

[18] Cohen, Daniel A.; Dey Aiyesha; Thomas Z. Lys 2005. "Trends in Earnings Management and Informativeness of Earnings Announcements in the Pre- and Post-Sarbanes Oxley Periods". Kellogg School of Management: SSRN 65878

[19] 213 U.S. 419 (1909)

Since then, the US has tightened the noose on insider dealing in the form of stiffer penalty in subsequent statutes such as the Insider Trading Sanctions Act 1984; the Insider Trading and Securities Fraud Enforcement Act 1988; the Securities Enforcement Remedies Act 1990; and the Financial Disclosure Regulation Act 2000. Under these statutes it is illegal for insiders to trade in a company's shares while in possession of material non-public information. The combined effect of the provisions of these statutes covers derivatives trading, allows for both civil and criminal charges; increases the criminal fines and the maximum jail term for both the company and its employees; and prohibits selective disclosure of corporate information to large shareholders and capital market analysts[20].

Like the US, other countries have since applied legislations and administrative rules to restrict insider dealing. In the United Kingdom (UK), the Financial Conduct Authority has issued broad regulations on insider dealing, which limit the extent to which directors and other corporate managers can take advantage of insider information[21]. The regulations impose ''blackout'' or ''close period''[22] and prohibit corporate insiders from trading in the shares of their company at least sixty days prior to the release of any preliminary, interim, or annual earnings announcement[23]. The UK has also criminalized insider dealing under the Criminal Justice Act 1993. According to the Act, any person who has information as an insider is guilty of insider dealing if he deals in securities that are price-affected securities in relation to the information[24].

Within the UK regulations, insider dealing is defined by materiality of the information in that if the information is made public it would likely have a significant effect on the price of the company's shares. Thus, in the UK context insider dealing is where an individual or organisation buys or sells securities while knowingly in possession of some piece of insider information which is not generally available and which is likely, if made available to the general public, to materially affect the price of these securities[25]. And ''inside information'' is defined as the knowledge of a fact not publicly known relating to the issuers of insider securities and which fact is capable of substantially influencing the price of the insider securities in the event of it becoming publicly known[26].

The UK definition of an ''insider'' goes beyond persons under fiduciary relationship with the company or persons discharging managerial responsibilities to include any person in possession of non-public information from any source, such as persons who are tipped off on confidential information by a corporate insider. For persons tipped off on insider information that is likely to have an effect on the company's share price, the fiduciary duty the corporate insider owes the company is imputed to such persons if they trade in the company's shares based on the information. The UK definition of an insider is therefore wider than that of the US where an insider must have some formal or informal fiduciary relationship with the company[27]. It is the UK position that is replicated under the Nigerian legal framework on insider dealing[28].

The Nigerian Investments and Securities Act 2019 prohibits any person who is an insider of a company from buying, selling or otherwise dealing in the securities of a company which are offered to the public for sale or subscription if he has information which he knows is unpublished price sensitive information in relation to those securities[29]. The Act therefore prohibits insider dealing which it defines as where a person who, being in possession of some confidential and price sensitive information not generally available to the public, utilizes such information to buy or sell securities for the benefit of himself[30]. The definition of an ''insider'' under Nigerian statutory regulation encompasses persons who are or can be deemed to have any connection with the company or a member of the company, including persons who, in their professional capacity, obtained unpublished price sensitive information in relation to the securities of the company[31].

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[20] Iain Clacher, David Hillier and Suntharee Lhaopadchan, 2009. Corporate insider trading: A literature review, Revista Española De Financiación Y Contabilidad, Vol. 38; 143, pp. 373-397

[21] Established under the authority of the Financial Services Act 2012

[22] This is the period during which corporate insiders are not allowed to trade in their company's shares. Close period usually covers the period prior to such corporate events as; Declaration of Financial results; Declaration of dividends; Issue of securities; Any major expansion plans or execution of new projects; Acquisition, mergers, takeovers and buy-back; Disposal of whole or substantially whole of the undertaking; and any changes in policies, plans or operations of the company.

[23] See also Fidrmuc, J., Goergen, M., and Renneboog, L., 2006. "Insider trading, news releases and ownership concentration," The Journal of Finance, 6(1): 2931–2973

[24] See Part V of the

[25] Charlesworth's Company Law, 13th Edition, at page 474

[26] ibid

[27] (Tridimas, T. 1991. Insider trading: European harmonisation and national law reform. International and Comparative Law Quarterly 40: 919-937

[28] The Investments and Securities Act 2019; the Securities and Exchange Commission Rules 2013 made pursuant to the Act; and the Nigerian Stock Exchange Rule Book 2015 constitute what is considered in this article as Nigerian legal framework on insider dealing.

[29] See generally Parts XI-XII

[30] See the Interpretation section 314

[31] See Rule 400 of the Securities and Exchange Commission Rules 2013; The Nigerian Stock Exchange Rule Book 2015 comprehensively defines price sensitive information to include: Changes in the Directorate of the Issuer; the death, resignation, dismissal or appointment of a principal officer; change in the accounting year end; Annual and Interim Results or any recommendation or decision that dividends or scrip

Many other jurisdictions now have statutes regulating insider dealing in different ways[32]. But a common thread across the different regulations is that the definition of insider dealing centers on the use of asymmetric information by corporate insiders for their selfish interest and at the expense of the company, shareholders, investing public, and the economy at large. However, empirical studies on the effectiveness of insider dealing regulation and enforcement are mixed. In most jurisdictions, the studies have found that regulation is generally weak in preventing insider dealing[33].

The regulatory approach does not restrict insider dealing but only implements speedy and transparent reporting to shareholders and investors so that the private information advantage of corporate insiders is limited. Results from various studies show a statistically significant positive relationship between a company's restrictive share trading policy and overall corporate governance index score based on the independence of board of directors, audit committees, board chairmen, and the existence of codes of conduct for directors and other corporate insiders[34]. Accordingly, all these may play a common corporate governance role towards the prevention of insider dealing.

THE CONCEPT OF CORPORATE GOVERNANCE

Modern companies have been shaped by the market economy with the development of corporate professionals who direct and manage the companies independent of the shareholders and investors. While companies' directors are expected to serve the interests of the shareholders, the inherent agency problem has led to directors' self-serving practices such as insider dealing. From the corporate scandals in the year 2000 in the US involving the bankruptcy of Enron and WorldCom, followed by the global financial crisis in 2008, including the Nigerian banking sector crisis in 2009, it was evident that statutory regulations had failed to ensure corporate governance required to sustain a common alignment of the interests of shareholders and directors.

Reports showed how executive management officials were steeped in unethical and fraudulent practices for their own selfish interests without institutionalized checks and balances, or internal company policies for a fair, transparent and accountable conduct of the companies' businesses[35]. At the most fundamental level, corporate governance is to ensure that business and financial sectors function optimally for all stakeholders and the economy as a whole. Thus, corporate governance has been defined as the system by which companies are directed and controlled[36]. It involves the processes through which corporate objectives are set and pursued in the context of the social, regulatory and market environment. And these include monitoring the actions, policies, practices, and decisions of companies, their directors, shareholders and other stakeholders[37].

Corporate governance structures and principles identify the distribution of rights and responsibilities among different participants in the company, such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders. And includes the rules and procedures for making decisions relating to the business and affairs of the company to be fair, transparent and accountable[38]. The original concept of corporate governance focused on the interest of shareholders of the company, and sought to align the interests of the shareholders and those of directors in order to solve the agency problem. This shareholders model of corporate governance involved legal structure that defined the right of shareholders to regulate the company and make the board of directors and management solely responsible to the shareholders[39].

The board consists of a single tier system of both executive and non-executive directors, while the chief

issues will or will not be made; profit warnings or a change in the financial forecast or expectation; proposed capital raising or restructuring exercise or changes in the capital structure; giving or receiving a notice of intention to make a takeover or mergers, or acquisitions or tender offers or divestments; any proposed change in the business model of general character or nature of the business of the company or of the group; major new developments in the issuer's sphere of activities including major new products, contract awards and expansion plans; any change in voting control or in beneficial ownership of the securities carrying voting control; items of unusual or nonrecurrent nature; any proposed alteration of the Memorandum or Articles of Association; any other information necessary to enable shareholders to appraise the position of the company and to avoid the establishment of a false market in the shares of the company.

[32] See for example the European Union Criminal Sanctions for Market Abuse Directive 2014 which harmonised criminal sanctions for insider dealing across EU Member countries. All EU Member States committed to introduce maximum prison sentences of at least four years for serious cases of insider dealing, and at least two years for improper disclosure of insider information. See Hauck, P., 2019. Europe's commitment to countering insider dealing and market manipulation on the basis of Art. 83 para. 2 TFEU

[33] Bris, A., 2005. Do insider trading laws work? European Financial Management 11(3), 267-312; Bhattacharya, U., and Daouk, H., 2002. "The world price of insider trading." Op.cit; Iain Clacher, David Hillier and Suntharee Lhaopadchan, 2009. Corporate insider trading: A literature review, Op.cit

[34] Allan Hodgson, Michael Seamer & Katherine Uylangco, 2020. "Does Stronger Corporate Governance Constrain Insider Trading? Asymmetric Evidence from Australia" Accounting & Finance, Vol. 60, Issue 3, pp. 2665-2687

[35] See Bratton W. William, 2002. "Does Corporate Law Protect the Interests of Shareholders and Other Stakeholders? Enron and the Dark Side of Shareholder Value". Tulane Law Review (1275). SSRN 301475

[36] Adrian Cadbury, 1992. The Cadbury, p. 15

[37] Shailer, Greg, 2004. An Introduction to Corporate Governance in Australia, Pearson Education Australia, Sydney, p. 28

[38] Lee, Janet; Shailer, Greg, 2008. "The Effect of Board-Related Reforms on Investors' Confidence". Australian Accounting Review. 18 (2): 123–134

[39] La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. W. 1997. Legal determinants of external finance. The Journal of Finance, 52(3), 1131-1150. https://doi.org/10.1111/j.1540-6261.1997.tb02727.x

executive officer (CEO) functions as chairman of the board thereby creating a chairman/CEO duality. The stakeholder model, on the other hand, puts more emphasis on the interests of all stakeholders or capital market players such as the workers, suppliers and the public[40]. This model of corporate governance is known for having two-tier board system composed of two different boards working together. These are the supervisory board which represent the employee and shareholders, and the management board which is composed of the executives of the company.

In comparison to the shareholder model, employees play a major role in the stakeholder model[41]. The employee's participation happens is actualized through a legally mandated system of cooperation with management. There is also a managerial principle that employees are a significant company group among the stakeholders, and the management's duty is to reconcile the various interests amongst the shareholders, investors, employees and the rest of the stakeholders[42].

General Principles of Corporate Governance

Contemporary concept of corporate governance basically refers to the principles and procedures enunciated in the UK Cadbury Report 1992 and the Organisation for Economic Co-operation and Development (OECD) Principles of Corporate Governance 1999. Within the general Principles in these documents, the company is required to recognize that it has legal, contractual, social, and market driven obligations to not only its shareholders, but also to non-shareholders and stakeholders such as employees, investors, creditors, customers, suppliers, local communities, customers, and policy makers[43]. But the rights of shareholders need to be respected and they should be assisted to exercise those rights and be treated equitably through open and effective communication of information, and encouragement for them to participate in the company's general meetings[44]. The role and responsibilities of the board of directors are required to be enhanced with sufficient relevant skills and understanding to review and challenge management performance, and also deserves adequate size and appropriate levels of independence and commitment. The Principles of corporate governance emphasize integrity and ethical behaviour as a fundamental requirement in choosing corporate officers and board members, while the company is required to develop a code of conduct for its directors and executives that promotes ethical and responsible decision making. Disclosure and transparency are also promoted under the Principles as the company is expected to clarify and make publicly known the roles and responsibilities of board and management to provide stakeholders with a level of accountability[45].

As a corporate responsibility the company is required to implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Also, disclosure of material matters concerning the company needs to be timely and balanced to ensure that all investors have access to clear, factual information. These general Principles of corporate governance have been statutorily enacted in most countries, including the US and Nigeria. For instance, the US Sarbanes–Oxley Act 2002 incorporates most of these Principles by making provisions for corporate responsibility, enhanced financial disclosure by companies, corporate fraud accountability, companies' auditor independence, including the establishment of an oversight board for public accounting.

The Sarbanes–Oxley Act prescribes criminal penalties for certain corporate misconduct, and requires the boards to have independent directors to monitor the company for the benefit of shareholders and other stakeholders[46]. In Nigeria, the Financial Reporting Council[47] published the country's latest Code of Corporate Governance 2018. The Code prescribes the highest corporate standards and professional best practices in terms of corporate ethics and values intended to enhance the integrity, transparency, and accountability of Nigerian companies and their executive management. The Code incorporates the two models of corporate governance and

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[40] Hassan Ahmed Shirwa and Murat Onuk, 2020. Corporate Governance Models and the Possibility of Future Convergence. Journal of Corporate Governance Research, Vol. 4, 1: 3-9

[41] Bhasa, M. P. 2004. Global corporate governance: debates and challenges. Emerald group Publishing, 4(2), 5-17. https://doi.org/10.1108/14720700410534930

[42] Jacoby, S. M. 2001. Corporate Governance in Comparative Perspective: Prospects for Convergence. Comparative Labor Law & Policy Journal, 22(1), 1-29. https://doi.org/10.2139/ssrn.285949

[43] Cadbury, Adrian, 1992. Report of the Committee on the Financial service Aspects of Corporate Governance, London, Sections 3.4

[44] OECD Principles of Corporate Governance, 1990, Preamble and Article IV

[45] OECD Principles of Corporate Governance, 1990, Articles II and III

[46] Clarke, T. 2016. The continuing diversity of corporate governance: Theories of Convergence and variety. Ephemera: Theory & politics in organization, 16(1), 19-52

[47] Established and so empowered under the Financial Reporting Council of Nigeria Act 2011; Until this latest Code, there had been previous sundry codes of corporate governance in Nigeria such as the Code of Corporate Governance for Banks issued by the Central Bank of Nigeria in 2006; the Code of Corporate Governance for Licensed Pension Operators issued by the National Pension Commission in 2008; the Code of Good Corporate Governance for Insurance Companies issued by the National Insurance Commission in 2009; the Code of Corporate Governance issued by the Securities and Exchange Commission in 2011; and the different Codes of Corporate Governance for the Public Sector, Private Sector, and Not-for-Profit companies issued in 2016. The discussion of corporate governance in this article refers, without distinction, to both public and private registered companies.

strikes a balance between the interests of both shareholders and stakeholders of the companies in order to achieve overall standards of fairness and corporate responsibility.

For instance, the Code stipulates that; ''As a link between shareholders and the Company, the Board is to exercise oversight and control to ensure that management acts in the best interest of the shareholders and other stakeholders while sustaining the prosperity of the Company"[48]. Accordingly, the Code obligates board of directors to ensure that chief executive officers carry out their duties in a way that serves the best interests of shareholders and other stakeholders of the company. Thus, the board can be seen as a supervisory organ that functions to align the various interests within the company.

The Code recommends the separation of the role of the chairman and the CEO in order to prevent an all-powerful single executive that would be beyond the reins of the board and management. The Code also prescribes an independent board, a more influential role for non-executive directors, and free control of the company's accountants and auditors. The overall goal of the Nigerian Code is to institutionalize the core principles of corporate governance: fairness, transparency, accountability and responsibility in the way directors conduct the business and affairs of companies in Nigeria.

DIRECTORS, INSIDER DEALING AND CORPORATE GOVERNANCE

The ultimate aim of the principles of corporate governance adopted and enacted in different jurisdictions is to reduce the agency cost of insider dealing. As noted above, statutory regulations have not succeeded in curbing the practice of insider dealing in various jurisdictions because recorded cases of corporate bankruptcies due to the practice occurred in the face of extant legal regime. Instructively, some of the conduct of directors and chief executive officers which would amount to corporate abuse and detrimental to the interests of shareholders may not necessarily be illegal.

Similarly, humongous remuneration of directors which often attracts public opprobrium may not be illegal. For instance, equity compensation for directors may be perfectly within the bounds of law but it may provide the directors the leverage to get involved in round tripping such as off-loading and re-loading the equity[49]. Rather than functioning as a lawful device to align the interests between directors and shareholders, equity compensation may thus enable directors to earn abnormal profits from insider dealing. Studies have confirmed that the confidential and price-sensitive information available to directors by virtue of their office motivate them to take advantage of the benefit from such information for personal interest[50].

Studies have also shown that the profitability from insider dealing largely depends on the position of the insider within the company, otherwise referred to as informational hierarchy – the higher in the company's structure the more access to material and confidential information for personal benefits[51]. Directors are therefore well positioned to know and exploit any non-public information that impacts on their company's shares and other securities.

For the purpose of clarification, insider dealing is not illegal in itself provided there is full disclosure of the transaction. Illegal insider dealing is therefore the most appropriate term when directors buy or sell the securities of their company without disclosure in breach of their fiduciary duty to the company. It thus appears that insider dealing based on price-sensitive confidential information may be cured of illegality once there is disclosure of the transaction by the insider as required under various statutory regulations.

The US Securities and Exchange Commission first established the rule of ''abstain or disclose'' in relation to insider dealing[52]. According to the rule, originally enforced in the case of *SEC v Cady, Roberts & Co.*[53], an

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[48] See Principle of the Code

[49] For the purpose of resolving the agency problem between outside shareholders and directors, companies award their directors equity incentives to align their interests with those of the shareholders and outside investors. But the effectiveness of this form of compensation to achieve that objective is disputed. See Jensen, M. C., and Meckling, W. H., 1976. "Theory of the firm: managerial behavior, agency costs and ownership structure." Journal of Financial Economics 3(4):305–360; Bebchuk, L. A., and Fried, J. M. 2005. "Pay Without Performance: Overview of the Issues" Journal of Applied Corporate Finance 17(4):8-23; For an academic serious investigation of the association between directors' equity compensation and their likelihood of insider dealing, see De Groote, S., Bruynseels, L. and Gaeremynck, A. 2019. "Do companies care about insider trading behavior? Evidence from director turnover", op.cit

[50] Fidrmuc, J., Goergen, M., and Renneboog, L., 2006. "Insider trading, news releases and ownership concentration," The Journal of Finance, 6(1): 2931–2973; Betzer, André; Theissen, Erik 2007. Insider trading and corporate governance: The case of Germany, CFR Working Paper, No. 07-07

[51] Aboody, D., and Lev, B., 2000. "Information Asymmetry, R&D, and Insider Gains", The Journal of Finance, 55(6): 2747-2766; Ke, B., Huddart, S., and Petroni, K., 2003. "What insiders know about future
earnings and how they use it: evidence from insider trades." Journal of Accounting and Economics 35: 315–346; Piotroski, J. D., and Roulstone, D. T., 2005. "Do insider trades reflect both contrarian beliefs and superior knowledge about future cash flow realizations?", Journal of Accounting and Economics, 39(1): 55-81; Huddart, S., Ke, B., and Shi, C., 2007. "Jeopardy, non-public information, and insider trading around SEC 10-K and 10-Q filings." Journal of Accounting and Economics, 43(1): 3–36

[52] It evolved from Rule 10b-5 made by the Securities and Exchange Commission pursuant to the Securities and Exchange Act 1934. According to the Rule: "It 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

insider in possession of material non-public information must first disclose such information before trading in the company's shares or, if disclosure is impossible or improper, must abstain from trading. In the subsequent cases of *Chiarella v United States*[54] and *Dirks v SEC*[55], the US Supreme Court narrowed the scope of the "abstain or disclose" rule to only persons in positions like directors who have a duty to disclose due to fiduciary obligation.

However, undisclosed insider dealing is not illegal if the confidential non-public information is not a factor in the decision to trade in the company's shares such as pursuant to a pre-existing plan that was made in good faith[56]. This exception to the rule of "abstain or disclose", in addition to the requirement of a guilty knowledge[57], constitutes the major reason for the difficulty in proving insider dealing under the various statutory regulations. The difficulty arises from the incongruous position of directors who are opportune and potentially disposed to indulge in insider dealing while at the same time, have the responsibility to comply with statutory regulations and implement the company's internal policies relating to the prohibition of insider dealing.

Given their expertise in corporate practice and knowledge of their companies' affairs, including access to privilege information, directors can successfully have their way with insider dealing. For example, with directors' prerogative to make business judgment they may involve their companies in high-risk investments mainly for the purpose of obtaining benefits from either the increase or decrease in their companies' share value, whichever the outcome.

Consequently, the prevention of insider dealing depends not so much on statutory regulations than the prevailing culture of compliance and implementation within the company. The existing corporate culture is decisive with respect to directors' inclination or willingness to discharge their fiduciary duties to the company, such as the duty not to make secret profits, and to act honestly, in good faith and in the best interests of the company[58].

Instead of enforcement of statutory provisions against insider dealing, regulators have sometimes found it more effective to implement codes of best practice on insider dealing through voluntary corporate policies[59]. Significantly, the empirical study by Dai, et al[60] presents the following findings: codes of corporate governance restricts insider dealing; better-governed companies are more likely to adopt voluntary insider dealing restriction policies; better-governed companies enforce voluntary insider dealing restriction policies more effectively; and better-governed companies are more likely to discipline directors who engage in insider dealing.

Thus, the principles of corporate governance when adopted and implemented by companies have the force to prevent or restrict insider dealing. Though corporate governance processes and mechanisms lack the penal force of statutory regulations, they are however effective in compelling directors to act honestly and without recourse to illegal insider dealing for the overall interest of shareholders and other stakeholders of the company.

Prevention of Insider Dealing through Corporate Governance

The company loses a lot when insider dealing is a profitable business practice engaged in by the directors. The corporate reputation of the company is tarnished, investors' confidence eroded and prospects for access to capital dimmed, with the consequence of a fall in liquidity and a decrease in market efficiency. Insider dealing can also result to litigation against the company and the directors with possible civil penalty and criminal sanctions or prosecutions. Where its impact on the company's share price is significant it may lead to class actions, and if the conduct of the directors is in breach of their fiduciary duties, they can be held liable in their personal capacity[61].

In order to prevent insider dealing, relevant statutory regulations and the company's internal policies need to be fully understood, upheld and applied in the management and operations of the company. Implementation of the principles of corporate governance within the company introduces a culture of adherence to ethics and code of conduct for the board of directors, chief executive officers, accounting officers and auditors. Since access to the company's confidential information underlies insider dealing, the board, in particular, bears the ultimate

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."

[53] 40 S.E.C. 907 (1961)

[54] 445 U.S. 222 (1980)

[55] 463 U.S. 646 (1983)

[56] Utpal Bhattacharya 2014. Insider Trading Controversies: A Literature Review, vol.6:1

[57] From the US, UK and Nigerian definitions of material non-public information, there is the requirement that the insider was "knowingly" in possession of such information and traded based on the information.

[58] Directors have these duties both under common law and statutes. For an incisive discourse on director duties, see Babajide S. Shoroye, 2021. Analysis of Directors' Duty of Care and Skill Under Section 308 of the Nigerian Companies Act 2020: Any Lessons from the United Kingdom? 39 Irish Law Times 16: 225-240

[59] Iain Clacher, David Hillier and Suntharee Lhaopadchan, 2009. Corporate insider trading: A literature review, Op.cit

[60] Lili Dai, Renhui Fu, Jun-Koo Kang, Inmoo Lee, 2016. Corporate governance and the profitability of insider trading, Journal of Corporate Finance, vol. 40: 235-253

[61] see Babajide S. Shoroye, 2021. Analysis of Directors' Duty of Care and Skill Under Section 308 of the Nigerian Companies Act 2020: Any Lessons from the United Kingdom? Op.cit

responsibility to drive and monitor the flow of such information within the company. The board also needs to determine the process of flow of share price-sensitive information to the shareholders and the investing public in a timely and transparent manner so as to avoid information asymmetry which breeds insider dealing.

Board oversight of executive directors and management has been identified as a key principle of corporate governance towards ensuring transparency and accountability in the business and affairs of the company[62]. Therefore, the board must implement an effective system of oversight of the processes for information flow within and through the company before announcement or publication to the public. The implication of informational hierarchy requires probative inquiries to determine the effectiveness of processes and procedures for directorial supervision of employees in high-risk points of the information flow-chart of the company. Regular reviews of the processes and procedures are necessary to ascertain the levels to which the code of conduct has been voluntarily imbibed and practiced by employees across the company's hierarchy.

The fulcrum around which corporate governance revolves is employees' voluntariness in the practice of the company's code of conduct and compliance with statutory regulations, including compliance with the company's internal policies. Hence, in the UK the ''comply or explain'' method of corporate governance prescribes voluntary compliance with statutory regulations by directors and management, and for them to provide explanation for any failure to so comply[63]. According to their business judgments, directors are expected to inform regulators of their company's compliance with the prescribed principles of corporate governance or explain their non-compliance. In running the business and affairs of the company the directors are expected to cultivate a culture of values and ethics which reflect the general principles of good corporate governance.

In Nigeria, the current Code of Corporate Governance 2018 recommends the approach of ''apply and explain'', a variant of the UK ''comply or explain. Under the Nigerian approach the companies and directors are required to adopt ethical practices and the principles contained in the Code, or explain the application if different from the stipulated mode. Directors are charged with the responsibility of explaining how the company's operations apply the content of the Code towards achieving transparency and accountability in protecting the broad interests of shareholders and other stakeholders such as the employees, creditors and the larger society.

A common underpinning of the approach in both UK and Nigeria is that unlike statutory regulations where compliance is mandatory and non-compliance is visited with civil or penal sanctions, the company and management are expected to voluntarily imbibe the corporate culture of fairness, transparency and accountability. Thus, under corporate governance the approach towards curbing insider dealing allows for flexibility of the board and management to determine how best to achieve best practices in line with cultivated corporate culture of ethics, values and integrity. Directors may choose to comply with the prescribed principles of corporate governance or apply such principles in ways different from the stipulated mode, provided that the intended outcome as envisaged under the principles is achieved.

It has been noted that good corporate governance is ultimately measured by the quality of the individuals involved, their ability to take collective action and achieve a desired result, despite often different and conflicting interests, in a way that is appropriate to the regulatory and market environment, including the culture of norms and values of the company[64]. Like in insider dealing, directors are key to the practice of corporate governance. As an agency problem, their position and status in the company expose them to the practice of insider dealing. However, it is yet to be clear how, as individuals, they can play a decisive role in preventing insider dealing through corporate governance. What is clear, however, is that their role is indispensable in the implementation of the principles of corporate governance towards the prevention of insider dealing.

CONCLUSION

It has been pointed out elsewhere that well-defined corporate structures and processes help to promote good corporate governance but do not guarantee it. And that the socio-economic environment in which companies and their directors operate is dynamic, requiring corporate governance structures and processes to always evolve over time[65]. The structure and functioning of the board of directors need to respond to the demand of the moment and the environment in terms of role, duties, composition, processes and remuneration, including the evaluation and training of all corporate insiders to uphold the principles of corporate governance.[66] This implies that efforts towards the prevention of insider dealing through corporate governance lies beyond the position and role of company directors.

[62] Adungo, Brian Ikol, 2012. An Analysis of the View that the Corporate Governance Systems Worldwide are Inevitably Converging Towards a Model Based on Shareholder Primacy and Dispersed Ownership Structure. Available at SSRN: https://ssrn.com/abstract=2049764 or http://dx.doi.org/10.2139/ssrn.2049764

[63] Meier, H. H., & Meier, N. C. 2013. Corporate governance: An examination of US and European models. Corporate board: role, duties & composition, 9(2), 6-11. https://doi.org/10.22495/cbv9i2art1

[64] Stijn Claessens and B. Burcin Yurtoglu, 2013. "Corporate governance in emerging markets: A survey," Emerging Markets Review 15:1–3

[65] Stijn Claessens and B. Burcin Yurtoglu, 2013. "Corporate governance in emerging markets: A survey," op.cit

[66] IFC Family Business Governance Handbook (Washington, D.C.: International Finance Corporation, 2018)

Even the position and role of the company's general counsel has been considered as crucial to preventing insider dealing. In a study that examined the role of the general counsel in mitigating insider dealing, it was found that when given the authority, the general counsel may limit the extent to which directors and other corporate insiders use confidential information to trade in the company's shares for their personal benefits. But the study was inconclusive as to how effective the general counsel is able to discharge this function[67].

It is postulated that as a means of resolving information asymmetry which enables insider dealing, the company's corporate governance framework needs to reflect the twin-principle of transparency and accountability[68]: it needs to ensure that timely, accurate and transparent disclosure is made of all material information relating to the company ownership, performance, financial status, expansion or merger plans; information that inevitably impacts on the market value of the company's shares when it is made public. The corporate governance framework also needs to ensure a strategic board oversight of the company, the effective monitoring of management by the board, and director's accountability to the company, shareholders and other stakeholders.

[67] See Jagolinzer, A. D., Larcker, D. F., & Taylor, D. J. 2011. Corporate Governance and the Information Content of Insider Trades. Journal of Accounting Research, 49 (5), 1249-1274. According to the study, personal ethics and professional standards, including the risk of being disbarred, provide sufficient motivation for the general counsel to always take the necessary actions to maintain a high level of corporate governance. However, the study pointed out that the appointment and compensation of the general counsel are approved by the directors to whom the general counsel reports. Consequently, the study concluded that it was not clear whether the general counsel would always actively monitor and evaluate directors' conduct. The study cited the general counsel at Enron who ignored the conflict of interest posed by special-purpose-entity transactions in which the Chief Financial Officer had a vested financial interest. In addition, the study found that approximately 30% of the general counsel of companies where the US Securities and Exchange Commission filed civil and criminal charges had been terminated, with the implication that at least some general counsel had been either complicit or failed to institute appropriate internal controls.

[68] These principles of transparency and accountability most relate to the prevention of insider dealing. Other principles of corporate governance as enunciated by the OECD are fairness and responsibility. See G20/OECD Principles of Corporate Governance (Paris: OECD Publishing, 2015), p. 9