

# Research on Insider Trading and Legal Regulation Issues in China's Securities Market

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**Abstract.** The purpose of this paper is to conduct an in-depth study on insider trading in China's securities market and its legal regulation, and to propose strategies and recommendations for improving and enhancing the legal framework. Firstly, the paper provides an overview of the definition, harms, and elements of insider trading. Then, it analyzes the historical development and current status of the legal regulation of insider trading in China's securities market, and identifies the existing problems and challenges. Finally, it presents measures for improving and enhancing the legal regulation of insider trading, including drawing on domestic and international experiences, strengthening the functions and capabilities of regulatory agencies, improving monitoring and detection mechanisms, and enhancing enforcement effectiveness and penalties. By implementing these comprehensive measures, the paper aims to further enhance the effectiveness of combating insider trading and uphold fairness and healthy development in the securities market.

**Keywords:** Insider trading; Legal regulation; China's securities market.

## 1. Introduction

The origin of China's securities market can be traced back to the 1980s when China began implementing its reform and opening-up policies, gradually establishing a modern financial system. With the rapid growth of the Chinese economy and the deepening reform of the financial market, China's securities market has gradually developed into one of the largest emerging markets globally. It not only provides financing channels for domestic companies but also attracts a large number of domestic and foreign investors. The healthy development of the securities market is crucial for economic stability and the interests of investors. However, insider trading, as a violation of the principles of fair trading and detrimental to market integrity, has a significant impact on the normal operation of the securities market and investor confidence [1]. Therefore, studying insider trading and its legal regulation in China's securities market is of great practical significance and academic value. Firstly, it can help us better understand the definition, characteristics, and impact of insider trading. By conducting in-depth research on the essence and extension of insider trading, we can accurately grasp its nature. Secondly, it can evaluate the problems in the current regulatory framework. The China Securities Regulatory Commission and legislative bodies have issued a series of laws and regulations to combat insider trading, such as the "Securities Law of the People's Republic of China" and the "Criminal Law of the People's Republic of China." However, insider trading still exists, and the number has not significantly decreased. It is also constantly evolving, making research on countermeasures to address insider trading necessary.

This paper aims to conduct an in-depth study on insider trading and its legal regulation in China's securities market, providing theoretical support and practical recommendations for addressing insider trading issues. Through analysis of insider trading and discussions on legal regulation, it is expected to contribute to the healthy development of China's securities market and the protection of investors' rights. However, due to the author's limited understanding and grasp of knowledge, as well as academic research capabilities, this paper may have certain limitations in the process of discussion. Firstly, the research starts with the definition of insider trading, but there may be shortcomings in theoretical research depth and comprehensive description. Secondly, due to the limited reference materials obtained during the research, the study may lack precision and persuasive power, as there are relatively few case analyses. Lastly, the improvement suggestions for insider trading legal

regulation in China rely on the author's existing knowledge base, which may not deeply analyze the core issues and may have limitations in addressing the key problems with the proposed suggestions.

## **2. Overview of Insider Trading**

### **2.1. Meaning of Insider Trading**

Insider trading refers to the act of certain individuals using non-public information they possess to buy or sell stocks or assist others in doing so in the securities market [2]. These individuals are typically insiders of listed companies, such as executives, directors, shareholders, etc. By gaining access to undisclosed information, they gain a trading advantage, violating the equal right to information and property interests of the investing public. For example, an accountant of a listed company knows in advance that their company's performance will be better than expected, so they buy shares of the company before this positive news is publicly announced. After the company's performance is disclosed and the stock price sharply rises, the accountant sells the previously purchased company shares, thus making a profit.

### **2.2. Harms of Insider Trading**

Insider trading is explicitly prohibited in various countries worldwide. Although insider trading often follows the same operational procedures as normal transactions in the market, it involves a group of individuals who use insider information to react to the market in advance, giving them more opportunities for profit or reducing losses. This behavior possesses several harmful aspects: (1) Violation of market principles: insider trading violates the fundamental principles of "openness, fairness, and impartiality" in the securities market, thereby infringing upon the legitimate rights and interests of investors. Information plays a crucial role in investors' decision-making process, and insider trading allows a select group of individuals to gain an unfair advantage by utilizing privileged information. This advantage grants them greater opportunities for profit or minimizing losses, which significantly increases the risk of substantial losses for the majority of investors. Consequently, the majority of investors become the direct victims of insider trading [3]. (2) Detriment to listed companies' interests: insider trading undermines the interests of listed companies. As publicly traded entities, listed companies are required to disclose financial and operational information in a timely manner and establish a comprehensive system of information disclosure to foster public trust. However, individuals engaging in insider trading exploit privileged information, which undermines the fairness of information disclosure and erodes investors' confidence in listed companies [4]. Therefore, this negatively impacts the normal development of listed companies. (3) Disruption of market order: insider trading disrupts the order of the securities market and can even extend to the entire financial market. Insider traders often exploit insider information to artificially manipulate stock prices, thereby distorting the timely and objective process of price formation. Consequently, stock prices become the result of a few individuals speculating with privileged information rather than reflecting the comprehensive evaluation of a company's performance by the investing public. Ultimately, this undermines the securities market's role in optimizing resource allocation and serving as an economic indicator [5].

### **2.3. Elements of Insider Trading**

The elements of insider trading in China's securities market mainly include the following aspects:

Insider information: such as substantial modifications to a company's operational strategies and the extent of its business activities; major investment activities; significant contracts, guarantees, and related-party transactions; incurrence of significant debts or failure to repay them upon maturity; occurrence of significant losses.

Specific individuals: including issuers and their key personnel directors; companies controlled by issuer or actual controller; individuals who can obtain insider information about the company through their positions or business dealings; personnel of securities-related institutions.

Trading behavior: buying or selling securities, subscribing or redeeming securities investment funds, and other trading activities. The key point is that specific individuals use the insider information they possess for trading to gain unfair trading benefits.

The above are the main contents of the elements of insider trading in China's securities market. The existence and fulfillment of these elements determine whether insider trading has occurred and whether it violates relevant legal provisions. It should be noted that the legal regulations of the securities market have specific provisions on the elements of insider trading, and the specific application standards may vary depending on different laws and regulations.

### **3. Current Status and Problems of Legal Regulation of Insider Trading**

#### **3.1. Development History of Legal Regulation of Insider Trading**

The historical development of legal regulations on insider trading in China can be traced back to the "Provisions on the Administration of Securities Companies" issued by the People's Bank of China. These provisions established explicit rules prohibiting insider trading in the country. The 17th article of this administrative regulation initially stipulated the prohibition of insider trading and other illegal and irregular activities by securities companies, which affect the stability of the overall market and allow individuals to profit improperly. However, this regulation lacked legal significance as it did not define insider trading behavior or establish corresponding penalty systems [6]. Starting from April 1993, the China Securities Regulatory Commission successively issued major administrative regulations and rules such as the "Provisional Regulations on the Administration of Stock Issuance and Trading," marking the elevation of the regulatory system for insider trading to the legislative level [7]. In 1997, the "Criminal Law of the People's Republic of China," as a fundamental law, elevated some serious insider trading behaviors to criminal offenses, making certain insiders bear the most severe consequences. In 1998, China officially promulgated the "Securities Law of the People's Republic of China," which not only established the legislative guiding ideology and basic principles regarding insider trading but also included comprehensive provisions on the key elements of identifying insider trading, the penalty framework, and the establishment of regulatory institutions. As a result, China has established a robust and comprehensive legal framework to regulate insider trading in the securities market. With the continuous deepening of China's economic system reform, the third amendment to the "Securities Law of the People's Republic of China" was officially passed in 2019 to adapt to the new economic situation in securities regulation. Additionally, to better align the Criminal Law with the Securities Law and enhance its adaptability to the development of the securities market, the 11th amendment to the Criminal Law made modifications to relevant securities-related crimes. Although this amendment does not directly involve insider trading, it still holds significant and far-reaching implications for safeguarding the stable and healthy development of the securities market, demonstrating the country's firm determination to combat illegal activities in the securities market through legal means.

#### **3.2. Current Legal Regulation of Insider Trading**

Currently, the legal framework of China's securities market mainly includes the "Securities Law of the People's Republic of China," the "Criminal Law of the People's Republic of China," and related regulations, rules, and normative documents. The Securities Law is the fundamental law of China's securities market, providing explicit provisions and prohibitions on insider trading. The latest version of the Securities Law officially took effect on March 1st, 2020. The first article clearly states the legislative purpose: to regulate securities market transactions, protect the legitimate rights and interests of securities market investors and public interests. Compared to previous regulations, the Securities Law expands the scope of insider trading individuals and insider information. The provisions from Article 50 to 54 of the Securities Law specifically regulate insider trading. Article 50 stipulates that individuals who obtain insider information are prohibited from using it for related trading activities. Article 51 defines the scope of insider trading individuals. Article 52 clarifies the

concept of insider information. Article 53 prohibits insider trading individuals from trading securities related to the insider information they possess, advising others to trade securities of the company related to the information, or leaking the insider information. They should also bear liability for compensation for losses incurred by investors due to insider trading. Article 80 defines the scope of insider information [8].

In addition, a series of relevant laws and regulations further regulate insider trading, including the "Administrative Measures for the Disclosure of Information by Listed Companies," the "Trading Rules of Stock Exchanges," the "Guidelines for Internal Control of Securities Companies," and others. These laws and regulations together constitute the legal framework of China's securities market, providing the basis for prohibiting and regulating insider trading.

### **3.3. Problems and Challenges of Existing Legal Regulation**

Although China's securities market has established a relatively complete legal regulatory framework to combat insider trading, there are still some problems and challenges. Firstly, the covert and operational nature of insider trading makes regulatory and enforcement work extremely challenging. Insider traders often adopt hidden methods to conduct transactions, avoiding market attention and regulatory investigations. They may use methods such as nominee holdings, paired trading, or false transactions to conceal the traces of insider trading, increasing the difficulty of tracking and monitoring [9]. Secondly, the determination and evidence collection for insider trading also face certain difficulties. Determining insider trading requires proving that the trader had knowledge of undisclosed information and conducted transactions before the public disclosure of the information. Collecting and ensuring the credibility of evidence place high demands on law enforcement agencies, requiring cooperation and information sharing with relevant departments [10]. Additionally, the cross-border nature of insider trading poses challenges to regulation. With the opening of China's securities market and increased international exchanges, the risk of cross-border insider trading is also growing. It is necessary to strengthen cooperation with other countries, combat cross-border insider trading, and address this issue. Finally, the punishment for insider trading needs to be strengthened. Although current laws impose penalties on insider traders, there are still some issues, such as limitations on the amount of fines and the potential evasion of criminal liability. Increasing the punishment for offenders and raising the cost of violations are of significant importance in combating insider trading.

## **4. Improving and Enhancing Legal Regulation of Insider Trading**

### **4.1. Learning from Domestic and International Experiences**

Improving and enhancing the legal regulation of insider trading in China's securities market can draw on relevant domestic and international experiences and practices. Developed countries have accumulated rich experience in insider trading regulation, and lessons can be learned from the following aspects. Firstly, strengthen cooperation and information exchange. Strengthen cooperation with regulatory agencies in other countries, share information, and conduct joint law enforcement to combat cross-border insider trading. Establish international cooperation mechanisms, enhance timely information transmission and sharing, and improve the effectiveness of insider trading regulation. Secondly, learn from the legal systems and enforcement experiences of other countries. Lessons can be learned from the successful experiences of other countries in regulating insider trading, such as improving the accuracy of evidence collection and determination.

### **4.2. Strengthening the Functions and Capabilities of Regulatory Agencies**

To improve and enhance the legal regulation of insider trading, it is necessary to strengthen the functions and capabilities of regulatory agencies. Specifically, improvements can be made in the following aspects. Firstly, enhance the training and professional capacity building of regulatory agency personnel. Improve the professional competence and understanding of insider trading among

regulatory agency personnel, strengthening their ability to identify insider trading. Professional knowledge and skills can be enhanced through training, exchanges, and cooperation. Secondly, increase the allocation of resources to regulatory agencies. Increase the number of enforcement and professional personnel in regulatory agencies. Additionally, increase funding and technical support to regulatory agencies, improving the effectiveness and efficiency of regulation. Lastly, strengthen cross-departmental collaboration and information sharing among regulatory agencies. Strengthen cooperation with other relevant departments, such as public security agencies and judicial departments, establishing cross-departmental collaboration mechanisms.

### **4.3. Improving Monitoring and Detection Mechanisms for Insider Trading**

At the same time, it is vital to enhance the monitoring and detection mechanisms for insider trading, improving the ability to identify and track insider trading. Firstly, establish a sound insider trading monitoring system, utilizing advanced technologies such as big data analysis and artificial intelligence to monitor and analyze abnormal trading behaviors in real-time. By establishing warning mechanisms and risk notification systems, signs of insider trading can be promptly identified. Secondly, strengthen data collection and information disclosure supervision for insider trading. Enhance the supervision of information disclosure by listed companies, ensuring timely disclosure of important information. Simultaneously, strengthen the collection and analysis of trading data, establishing a comprehensive regulatory mechanism for trading data to enhance the monitoring capabilities for insider trading.

### **4.4. Enhancing Enforcement Effectiveness and Increasing Penalties**

It is also essential to enhance enforcement effectiveness and increase penalties to enhance deterrence and increase the cost of violations. Firstly, strengthen cooperation and coordination among law enforcement agencies. Strengthen cooperation with public security agencies, judicial departments, and other law enforcement agencies, forming a joint force to combat insider trading crimes. Strengthen information sharing and case transfers, improving law enforcement efficiency and effectiveness. Secondly, increase the severity of penalties for insider trading violations. Increase the amount of fines imposed on insider traders, raising the economic costs for violators. Simultaneously, strengthen criminal prosecution for insider trading, rigorously holding insider traders accountable for their actions, and increasing the legal risks for offenders. Lastly, strengthen the recovery and confiscation of illegal gains from insider trading. Increase efforts to recover the illegal gains from insider trading, returning them to the state. Additionally, increase the confiscation of illegal gains from insider trading, depriving offenders of their ill-gotten profits.

## **5. Conclusion**

In conclusion, this research paper has conducted an in-depth study on insider trading and its legal regulation in China's securities market. Through the analysis of insider trading and discussions on legal regulation, several key findings and implications have been identified. Firstly, insider trading poses significant harms to the securities market, investors, and listed companies. It violates the principles of fairness and impartiality, infringes upon the rights and interests of investors, undermines the integrity of the market, and disrupts the normal operation of the securities market. Secondly, the current legal regulation of insider trading in China has made significant progress, with a relatively complete legal framework in place. The "Securities Law of the People's Republic of China" and related regulations provide explicit provisions and prohibitions on insider trading. However, there are still challenges and problems that need to be addressed, including the covert nature of insider trading, difficulties in determination and evidence collection, cross-border regulation, and the need for stronger punishments.

To improve and enhance the legal regulation of insider trading, several measures and recommendations have been proposed. Drawing on domestic and international experiences,

strengthening the functions and capabilities of regulatory agencies, improving monitoring and detection mechanisms, and enhancing enforcement effectiveness and penalties are crucial steps. Cooperation and information sharing with other countries, training and professional capacity building for regulatory agency personnel, establishment of a comprehensive monitoring system, and increased penalties for offenders are among the key strategies to combat insider trading effectively.

Looking ahead, the future development of the legal regulation of insider trading in China's securities market is promising. With continuous efforts to strengthen the legal framework, enhance regulatory capabilities, and improve enforcement mechanisms, it is expected that the effectiveness of combating insider trading will be further enhanced. This will contribute to the fairness, integrity, and healthy development of the securities market, protecting the rights and interests of investors and promoting economic stability.

In summary, this research provides theoretical support and practical recommendations for addressing insider trading issues in China's securities market. While acknowledging the limitations of this study, it is hoped that the findings and suggestions presented here will contribute to ongoing efforts to combat insider trading and promote the healthy development of China's securities market.

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