The use of confidential information in the trading game

The issue of using confidential information in the trading game (insider trading) is an important issue concerning the development of stock exchange trading. It is widely accepted that the use of information asymmetry is detrimental to business transactions because it causes the outflow of investors, offended by an unfair advantage of people who have the information unavailable to the general market, and it also causes other negative effects such as an increase in the cost of capital and agency costs.

In the past, the catalyst for the introduction of the institution of the ban on insider trading was the Great Depression of 1929. At that time, there was a collapse of stock exchange trading and an unprecedented outflow of investors from the stock exchange. In 1934, as a flagship method of fighting market pathology, the ban on insider trading was introduced, which led investors to returning to the stock market and improved the condition of the American capital market.
It was, however, a placebo effect, because the regulations regarding the ban on insider trading for the next twenty years were dead due to the failure in introducing executive acts to them and the level of security remained at an unchanged low level. In the second half of the 1980s, there was another very serious stock market crash. US law enforcement agencies broke up the financial group that derived income from insider trading. It was revealed that information asymmetry was used in hundreds of US stock exchange operations. The investors' reaction was adversarial to the theory of classical economics. There has been a collapse and outflow of investors, although according to the theoretical concept behind the prohibition of insider trading, market participants should become more involved in investing in a safer market. Investors returned to the market only after the amendment of the law which was to ensure the improvement of security, although similarly to the situation from nearly 60 years before, these regulations did not improve the level of security, still they have become an incentive for investors to return.

Economic phenomena almost always have a complex structure but the above-described events perfectly fit into the trend of behavioral economics which describes the use of confidential information in the stock market game in a different way than the classical economy on which the legal structure of the insider trading ban is based.

This paper shows the development of the history of a legal institution prohibiting the use of confidential information in a stock market game in its theoretical and practical aspect, including the latest research in the field of economics and law, basing on the example of American, Chinese and Polish regulations.

The first part of the work is a review of the theory on which the institution of insider trading is based. Firstly, a methodological framework concerning the subject under discussion is introduced, followed by a conceptual framework in the field of economics and law. Secondly, a review of the breakdowns and pathological phenomena present in the stock exchange trading in the world over the last 400 years is carried out in order to examine what impact the insider trading had and with what frequency it played a decisive role in these phenomena. Finally, the benefits and risks associated with insider trading were discussed.

In the dogmatic part, three systems were presented, namely: the American system as an unsurpassed pattern of fighting with insider trading, the European example of Poland, and the Chinese one as an example of a system functioning in the state, which is a pretender to owning the most powerful capital market in the world, and currently has the most dynamically developing market.

The finale of the work is the conclusion that the stock market trading has never been and will never be safe and the use of confidential information in a stock market game has only a negligible impact on the development of stock market trading. What is the real factor influencing the development of stock exchange trading in the context of insider trading in a stock market game is how its participants perceive the security of the market in a very subjective manner – the postulate of behavioral economics.

The current regulations of the insider trading are practically ineffective in virtually every system in the world. The basic remedy is to create a multicentric protection system, in which the most active role should be played by market participants, by providing them with the possibility of signaling the use of confidential information in the stock market game and motivating them through appropriate financial gratification. Due to the poor effectiveness in detecting and proving the insider trading, the injured parties should be enabled to submit a civil claim, which should be clearly and clearly regulated in the statutory regulations, and it should be made possible for them to accuse with a private indictment the perpetrator of

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insider trading. The key agencies for the protection system should be to increase the criminal sanctions against the perpetrator and to extend the competence of the employees of the Polish Financial Supervision Authority.

Only a change of the paradigm of the institution of insider trading from seeing it through the prism of classical economics to perceiving it also through behavioral economic concepts will allow to create a regulation that will protect the interests of trading participants as fully as possible and will be a factor conducive to its development. For this purpose, however, it is necessary, due to the inefficiency of regulation, to extend the protection system to market participants, give them additional competences, and increase their prerogatives. These actions, in the context of behavioral economics, will improve both the objective and subjective level of security of capital market participants, thus encouraging the wider part of the society to locate their investments within the stock exchange trading, which will allow to increase the prosperity of the national economy.

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