



ISSN 2809-7572 (Online)

YURIS: Journal of Court and Justice

<https://journal.jfpublisher.com/index.php/icj>

Vol. 3 Issue. 3 (2024)

doi.org/10.56943/icj.v3i3.582

Legal Protection for Investors against Insider Trading Practices by Issuers on the Capital Market

Comparative Study between Indonesian and U.S. Capital Market

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ABSTRACT

Transparency of information in stock trading is concerned with all information about the business affairs of a company that is going to become more popular, which is owned by the company to the wider community. The efforts that can be conducted to realize the principle of information disclosure in the capital market are public companies must provide the correct prospectus, which is written information related to the public offering. Infringements of this principle can lead to abnormalities in the capital market, one of which is insider trading practices where insiders or corporate insiders conduct securities transactions by using exclusive information and the information is unavailable to the public or investors. In addition, this practice is also an unfair trading practice due to the inside trader's superior position (in information ownership) compared to other investors. This research uses normative juridical research methods that focuses on studies related to the implementation or application of rules or norms contained in positive law. There are several approaches commonly used in legal research such as statute approach, case approach, comparative approach. Data collection in this research will be conducted by library research on secondary data. This research will use a qualitative normative analysis method. The research indicated that controlling insider trading is quite difficult because it is impossible to know when it began, the number of transactions, and the amount of losses. Legal protection against insider trading can be preventive or repressive. Preventive protection aims to prevent violations through legislation, while repressive protection provides sanctions such as fines or additional penalties after a violation occurs. Law enforcement in capital market activities consists of administrative sanctions, criminal sanctions, and civil compensation claims.

Keywords: *Insider Trading, Investors, Legal Protection*

INTRODUCTION

The capital market is a non-bank financial institution that is crucial for the development of the national economy. On the other hand, capital markets have the same important role as banks in developed countries.¹ The development of the capital market has a significant impact on the economy, especially in the securities trading sector. According to Article 1 Paragraph 13 of Law No. 8/1995 on Capital Market (UUPM), the capital market consists of the activities of public offering and trading of securities, and related institutions and professions.²

The capital market connects fund owners with fund users for medium and long-term investments.³ These two parties buy and sell capital in securities, where the fund owner submits funds and the listed company submits proof of ownership of securities. According to Article 1 point (5) of the Capital Market Law, the securities consist of securities such as stocks, bonds, and other financial instruments.

Capital market activities are based on the principle of transparency. Article 1 point (25) of the Capital Market Law requires that every capital market participant must provide true and not misleading material information.⁴ Information disclosure is important so that investors know the company's activities and the direction of its development. Issuers and public companies are obliged to submit important information to the public in periodic reports and important event reports in accordance with Article 86 Paragraph (1) of the Capital Market Law.

Infringements of this principle can lead to abnormalities in the capital market, one of which is insider trading practices where insiders or corporate insiders conduct securities transactions by using exclusive information and the information is unavailable to the public or investors.⁵ This practice is unfair as insider traders have an information superiority over other investors. Although insider trading can be detected from insider transactions and unusual changes in price and trading volume, it is difficult to prove as it requires a high standard of proof.

Law enforcement against insider trading includes administrative, civil, and criminal sanctions. The Capital Market Law provides a basis for law enforcement,

¹ Reva Amalia, "Prosedur Penanganan Tindak Pidana Insider Trading Yang Dilakukan Oleh Korporasi," *Lex Renaissance* 4, no. 6 (2021): 664–676.

² Hamud M. Balfas, "Masalah-Masalah Aktual Di Pasar Modal," *Jurnal Hukum & Pembangunan* 29, no. 4 (May 29, 2017): 305, <http://jhp.ui.ac.id/index.php/home/article/view/562>.

³ United Nations Conference on Trade and Development, "Capital Markets and Sustainable Finance," in *World Investment Report*, 2023, 97–138, <https://www.un-ilibrary.org/content/books/9789210027847c009>.

⁴ Pemerintah Pusat Indonesia, *Undang-Undang Republik Indonesia Nomor 8 Tahun 1995 Tentang Pasar Modal*, 1995.

⁵ Attila Balogh, "Insider Trading," *Scientific Reports* 10, no. 237 (2023).

but the practice has not been optimized.⁶ Legal protection for investors is crucial to maintain the trust and integrity of the capital market. Efforts to counter insider trading require criminal law reform and a more effective approach in preventing and dealing with this practice.

Previous studies have demonstrated that Indonesia's capital market legal system has not been fully effective in managing insider trading. These studies examine existing regulations and suggest the application of new theories such as Misappropriation Theory to address legal gaps.⁷ Legal protection for investors is essential to create a fair and trustworthy market, but criminal law reform and better countermeasure policies are needed to protect investors from insider trading practices. This research is conducted to identify and analyze responses to insider trading practices in the Indonesian capital market from the perspective of criminal policy and legal protection for investors against insider trading practices in the Indonesian and US capital markets.

LITERATURE REVIEW

Definition and Concept of Insider Trading

Insider trading is the purchase or selling of securities by a person who has access to material non-public information about those securities.⁸ Meanwhile, according to Henry G. Manne, insider trading is securities transactions made by company insiders based on information that has not been published to the public.⁹ Each form of insider trading has different characteristics and methods of utilizing material non-public information for personal gain. Here are some forms of insider trading:

1. Classic Insider Trading means that securities transactions by individuals who have non-public material information about the company.¹⁰
2. Misappropriation Theory means that the person who unlawfully obtains confidential information from the company and uses the information for securities transactions.¹¹

⁶ Esther Natalia Gani and Victor Dragano, "Protection and Enforcement of Law Against Insider Trading Crimes in The Indonesian Capital Market," *Syntax Literate ; Jurnal Ilmiah Indonesia* 9, no. 5 (May 19, 2024): 3078–3089, <https://jurnal.syntaxliterate.co.id/index.php/syntax-literate/article/view/15385>.

⁷ Fariel Mandalanta Ginting and Budi Santoso, "Law Enforcement of Insider Trading in the Capital Market in Indonesia," *International Journal For Multidisciplinary Research* 6, no. 2 (March 9, 2024), <https://www.ijfmr.com/research-paper.php?id=14633>.

⁸ Stephen F. Diamond, "Insider Trading: A Clash Between Law and Economics," in *Oxford Research Encyclopedia of Economics and Finance* (Oxford University Press, 2020), <https://oxfordre.com/economics/view/10.1093/acrefore/9780190625979.001.0001/acrefore-9780190625979-e-372>.

⁹ Henry G. Manne, *Insider Trading and the Stock Market* (Free Press, 1966).

¹⁰ Andrew W. Marrero, "Insider Trading: Inside the Quagmire," *Berkeley Business Law Journal* 17 (2020).

¹¹ J. N. Carpenter and G. D'Avolio, "The Misappropriation Theory of Insider Trading: An Analysis," *Journal of Law and Economics* 47, no. 1 (2004): 1–35.

3. Tippee Trading means that transactions by individuals who receive material non-public information from an insider (tipper) and exploit the information.¹²
4. Front Running means that brokers or traders who use information about upcoming large transactions to execute trades before the transaction occurs.¹³
5. Information Leakage means that dissemination of material non-public information prior to the official announcement, which is used by individuals for self-profit.¹⁴
6. Trading Ahead of Research Reports means that analysts or employees of financial companies who use information from unpublished research reports to make transactions.¹⁵

Insider Trading Legal Regulations and Policies

In Indonesia, Law No. 8/1995 on Capital Market is the main basis that regulates insider trading. Whereas Article 97 of the Indonesian Capital Market Law expressly stipulates that any person in possession of inside information is prohibited from buying or selling securities issued by an Issuer or a public company, using such inside information before such information is disclosed to the public.¹⁶ The sanctions imposed can be imprisonment and high fines in accordance with Article 103 of the Capital Market Law. In addition, the Financial Services Authority (OJK) also has regulations and operational standards related to insider trading that must be complied with by all capital market players in Indonesia. In the United States, the Securities Exchange Act of 1934 is the main regulation governing capital markets, including insider trading. This law strictly regulates the prohibition of using non-public information to gain an advantage in the capital market. The Securities and Exchange Commission (SEC) acts as the regulatory body in charge of enforcing these regulations and imposing strict sanctions on violators.

Legal Policy Evaluation

An evaluation of legal policies implemented in Indonesia and the United States demonstrates different approaches in handling insider trading. In Indonesia, sanctions tend to be more severe with significant imprisonment, but the challenges in enforcement and the effectiveness of sanctions are still debatable. In the United States, the SEC is known to be active in investigating and prosecuting insider

¹² S. M. Bainbridge, "The Law and Economics of Insider Trading: A Comprehensive Primer," *Harvard Journal of Law and Public Policy* 33, no. 2 (2001): 1–74.

¹³ D. Easley and M. O'Hara, "Price, Trade Size, and Information in Securities Markets," *Journal of Financial Economics* 19, no. 1 (1987): 69–90.

¹⁴ A. S. Kyle, "Continuous Auctions and Insider Trading," in *Econometrica*, 1985, 1315–1335.

¹⁵ R. Michaely and K. L. Womack, "Conflict of Interest and the Credibility of Underwriter Analyst Recommendations," *Review of Financial Studies* 12, no. 4 (1999): 653–686.

¹⁶ Indonesia, *Undang-Undang Republik Indonesia Nomor 8 Tahun 1995 Tentang Pasar Modal*.

trading offenders, with a focus on early detection and prevention through strict regulation.¹⁷

Comparison of Regulatory Efficiency

A comparison of the effectiveness of legal regulations and policies between Indonesia and the United States shows that although both countries have strict regulations related to insider trading, their implementation and enforcement can differ. The United States, with the SEC as a strong supervisory institution, is able to provide early detection and prompt handling of insider trading cases. On the other hand, Indonesia still struggles with consistent and effective law enforcement against insider trading practices.

The Role of the Financial Services Authority (OJK) in Indonesia and the Securities and Exchange Commission (SEC) in the United States Overview

Capital market supervisory institutions such as the Financial Services Authority (OJK) in Indonesia and the Securities and Exchange Commission (SEC) in the United States have an important role in monitoring and prosecuting insider trading violations. OJK is tasked with regulating and supervising the financial services sector, including the capital market, based on Law No. 21/2011. OJK has the authority to conduct examinations, investigations, and apply administrative, civil, and criminal sanctions against violations in the capital market, including insider trading.

Meanwhile, the SEC in the United States is tasked with regulating securities markets and protecting investors from fraudulent practices, including insider trading. It was established in 1934, and has the authority to investigate, prosecute violations of securities laws, and impose severe sanctions on violators. The SEC also has a whistleblower program that encourages whistleblowers to report violations with financial rewards, which strengthens the SEC's ability to detect and prosecute insider trading.

Analysis of Weaknesses and Difficulties in Detecting and Prosecuting Insider Trading

Although the OJK and SEC have extensive authorities, there are some weaknesses and difficulties in detecting and prosecuting insider trading. One of the main difficulties is the complexity and confidentiality of information in the capital market, which makes insider trading practices difficult to detect. OJK often has difficulty in obtaining sufficient evidence to prosecute insider trading, especially when it involves extensive and hidden networks.

In addition, technological challenges are also an obstruction. Due to advances in information technology, insider traders can use more sophisticated

¹⁷ Made Cinthya Puspita Shara, "Studi Komparasi Pendekatan Hukum Pada Pengaturan Insider Trading Dalam Kaitannya Dengan Penegakan Di Dunia Pasar Modal," *LITIGASI* 22, no. 1 (April 19, 2021): 39–70, <https://journal.unpas.ac.id/index.php/litigasi/article/view/3856>.

methods to hide their tracks. OJK and SEC must continue to develop their technological capabilities to match these developments and improve supervisory effectiveness.

Another weakness is limited resources. Both the OJK and SEC have to manage many cases with limited resources. This may affect their ability to follow up on each case in depth and quickly. OJK, for example, has to handle various types of violations in the financial services sector, so the resources to handle insider trading cases may be shared with other cases.

RESEARCH METHODOLOGY

This research uses the normative juridical method to analyze legal protection for investors in the capital market against insider trading by issuers. This approach refers to positive law with a focus on the implementation of the norms contained in Law No. 8/1995 on the Capital Market in Indonesia and the Securities Exchange Act in the United States. In this context, the researcher will take a statutory and comparative law approach to compare the policies to counter insider trading in the two countries. This research is descriptive analytical which collects and describes data related to legal protection for investors against insider trading practices. Secondary data used includes primary legal materials such as the 1945 Constitution, Capital Market Law, and related regulations. In addition, secondary legal materials such as legal literature and articles are also used to support the analysis. Data collection techniques are conducted through literature studies with the stages of searching, collecting, inventorying, and systematizing data.¹⁸ The analysis is conducted in a normative qualitative approach to describe and connect the data with the formulation of the problems studied, using a deductive approach to formulate conclusions and recommendations from the results of this research.

RESULT AND DISCUSSION

Legal Protection for Investors against Insider Trading Practices in The Indonesian and U.S. Capital Markets

The capital market supervisory institution in Indonesia, regulated by Law No. 8/1995 on the Capital Market, aims to regulate the efficiency and protection of investors and the general public in trading securities such as stocks and obligations. Bapepam-LK, now known as OJK, is responsible for the supervision of stock exchanges, clearing houses, securities companies, and other capital market supporting institutions. Since 2011, OJK has acted as an independent institution overseeing the entire financial services sector, including capital markets, banking, insurance and non-bank financial institutions, with a focus on

¹⁸ Soerjono Soekanto & Sri Mamudji, *Penelitian Hukum Normatif: Suatu Tinjauan Singkat*, 17th ed. (Jakarta: Rajawali Pers, 2015).

transparency and legal protection for investors, including in regulating insider trading practices.

Bapepam regulates provisions to ensure the implementation of securities in an orderly and fair manner, which includes the disclosure of securities transaction information, record keeping, and reports, and securities over-rationing in those cases of oversubscription. Bapepam is led by a chairman who is in charge of leading and fostering the Bapepam apparatus and stipulating technical implementation provisions in the field of capital markets in accordance with government policy. The Financial Services Authority (OJK), established under Law No. 21/2011, is a state institution that regulates and supervises all activities in the financial services sector such as banking, capital markets, insurance, pension funds, and other financing institutions. Supervision of the non-bank financial industry and capital markets transitioned to the OJK in 2012, while supervision of the banking sector transitioned in 2013 and microfinance institutions in 2015.

The regulation of insider trading in Indonesia is regulated in Articles 95-98 of Law No. 8/1995 on the Capital Market. Article 95 prohibits insiders of issuers or public companies who have personal information to purchase or sell securities. Article 96 prohibits insiders from affecting other parties to buy or sell securities or providing inside information to other parties. Article 97 states that a party who unlawfully obtains inside information is subject to the same prohibition as an insider. Article 98 prohibits securities companies that have inside information from conducting transactions in the securities of the issuer or public company unless the transactions are conducted on the instructions of their customers and without providing recommendations.

The United States began informal capital market activities in New York as early as 1700 on the premises of present Wall Street, as a barrier to Indian incursions. In 1792, a formal exchange was established in New York by 24 brokers, which became the forerunner of the New York Stock and Exchange Board and the beginning of the capital market authority, the Securities and Exchange Commission (SEC). The US capital market has two main exchanges, the New York Stock Exchange (NYSE) and NASDAQ. Early regulation of capital markets was governed by state-level laws known as “Blue Sky Laws”, with Kansas being a pioneer in such regulation in 1911. The SEC, formed in 1934, became the national agency that oversees the capital markets to ensure transparency, investor protection, and enforcement, with a focus on preventing insider trading and addressing violations of the law. The two major capital markets in the US are the New York Stock Exchange (NYSE) and NASDAQ. NYSE is the world’s largest stock exchange by market capitalization, while NASDAQ is the second largest stock exchange with many technology companies listed.

The SEC has an important role in preventing and prosecuting insider trading through preventive and repressive measures. The SEC requires public companies to provide regular financial reports and make information available through the EDGAR online database. If suspected insider trading persists, the SEC may conduct investigations through its Enforcement Division, which works closely with law enforcement agencies in the US and internationally. SEC investigations are usually conducted under seal and may involve witness calls and document reviews to gather evidence of securities law violations.

Bapepam-LK has the authority stipulated in Articles 100 and 101 of the Capital Market Law to conduct examination and investigation of any violation or crime in the capital market. Article 100 authorizes Bapepam-LK to request information, examine documents, and impose conditions on parties suspected of violating capital market laws. Meanwhile, Article 101 allows Bapepam-LK to initiate an investigation if the capital market violation is deemed detrimental to the interests of the capital market or investors. Investigations are conducted by Bapepam-LK employees who have special authority as investigators, which also involves a reporting process to the public prosecutor.

Under Indonesian capital market law, Bapepam has an important role in investigating criminal offenses, such as insider trading, which is not handled by the police. The process of proving criminal offenses in the capital market refers to the Criminal Procedure Code and requires a high standard of proof, that is, beyond reasonable doubt. Valid evidence in the Indonesian legal system includes letters, testimonies, allegations, confessions, and oaths. In insider trading cases, further investigation and examination of written documents are required for proof as electronic transaction evidence is not sufficient.

The definition of legal protection in accordance with Indonesian terminology focuses on efforts to protect and provide legal certainty. Protection refers to actions to protect individuals or groups, while law is a normative system that regulates social behavior and relationships. In Indonesia, legal protection of the capital market is affirmed in Law No. 8/1995 on the Capital Market, which regulates securities transactions such as stocks and bonds. Investors, both domestic and foreign, have a crucial role in the dynamics of the capital market, with OJK responsible for preventive and repressive supervision, including in tackling insider trading. The Capital Market Law provides a legal foundation for the enforcement of capital market rules, however challenges remain especially regarding the interpretation of the fiduciary versus abuse theory. Legal protection for investors also includes administrative, civil and criminal sanctions, ensuring fairness and regulatory compliance.

Law No. 25/2007 on Capital Investment defines an investor as a domestic or foreign entity that invests in Indonesia. Law enforcement of insider trading includes administrative sanctions, criminal sanctions, and civil compensation claims as stipulated in the Capital Market Law. The Capital Markets Law is

considered to be less supportive of investor protection as it does not fully embrace the misappropriation theory, but rather the fiduciary duty theory. This creates a legal gaps that allow some insider trading perpetrators to avoid sanctions.

The Financial Services Authority (OJK) has preventive and repressive supervisory authority in accordance with Law No. 21/2011. Preventive aims to prevent disputes through rules, guidelines, and supervision, while repressive includes examination, investigation, and application of sanctions after violations. The Capital Market Law stipulates information disclosure obligations to protect investors, and OJK has the authority to impose sanctions on violators. Article 104 of the Capital Market Law threatens insider trading offenders with a prison sentence of one to ten years, emphasizing the importance of criminal sanctions as an *ultimum remedium* to enforce compliance in the capital market.

The Analysis of Insider Trading Practices in the Capital Market and Legal Protection for Investors against Insider Trading Practices in Indonesia and the United States

The preamble of the 1945 Constitution contains a basic description of social policy (social police), which includes policies for social welfare and social protection (social defense policy). In order to protect society from various threats, including new crimes that occur due to technological developments, a criminal policy is needed that is integrated into national development. Criminal policy is not only separable from legal and social politics, but also interrelated, where interference with legal and social politics can interfere with the effectiveness of criminal policy.

Criminal law enforcement, within the context of criminal policy, is one of the crucial aspects in tackling crime, including the practice of insider trading. Insider trading is a serious offense in the capital market that affects the transparency and welfare of investors. Law enforcement against insider trading involves various aspects, ranging from investigations, investigations, to the application of administrative, civil, and criminal sanctions in accordance with the Capital Market Law. However, the apparent difficulties in implementing insider trading law enforcement are the difficulty in collecting evidence and complying with the necessary evidentiary standards.

Criminal law reform that is more responsive to the dynamics of the capital market is needed to strengthen the legal protection of investors and issuers from insider trading practices. This includes improving law enforcement structures, supporting facilities, and public awareness of the importance of compliance with capital market regulations to create a fairer and more efficient capital market for all parties involved.

Insider trading is a securities trading practice that involves the use of confidential or important information that is not available to the public to make a profit in the capital market. This phenomenon is regulated by the Capital Market

Law and various related provisions to protect investors and ensure market equity. The Capital Market Law regulates the principle of information disclosure which includes the requirement of disclosing material information to all shareholders, both before and after a public offering. This protection aims to ensure that all investors have equal access to information that may affect share prices.

Sanctions against insider trading can be administrative, criminal or civil, depending on the offense committed. Administrative sanctions are imposed by the Financial Services Authority (OJK) to protect the capital markets from harmful practices. Criminal sanctions include prison sentences and fines imposed by courts for convicted insider traders. Meanwhile, civil sanctions allow aggrieved investors to file a civil lawsuit against insider trading offenders, with the aim of obtaining compensation for the losses suffered.

The application of legal sanctions against insider trading requires strong evidence and a fair trial. Nevertheless, this law enforcement has an important role in maintaining the integrity of the capital market and building investor confidence. Strict supervision by supervisory institutions such as OJK and the Capital Market Supervisory Agency (BAPEPAM) is crucial in preventing and overcoming insider trading cases.

The regulation of insider trading at the international level is also governed by the principles issued by the International Organization of Securities Commissions (IOSCO), which sets global standards for capital market regulation. These principles encourage member countries to develop strong and consistent regulations to protect investors and promote market integrity.

In general, legal protection against insider trading is not only important to maintain capital market stability and transparency, but also to provide equity to all stakeholders. The active role of regulators, the application of strict sanctions, and international cooperation are important in ensuring effectiveness in combating this illegal practice and building a healthy and sustainable capital market.

CONCLUSION AND SUGGESTION

Conclusion

The measure to tackle insider trading is very difficult, especially in identifying when this practice started in the capital market. It is also difficult to determine the number of transactions that actually took place and the extent of the losses. Legal protection against insider trading cases can be preventive or repressive. Preventive protection aims to prevent violations from occurring in the first place, regulated in legislation with the aim of setting limits on the performance of obligations. Meanwhile, repressive protection includes sanctions such as fines or additional penalties imposed after a violation has occurred. Law enforcement is carried out through administrative sanctions (Article 102 of the Capital Market Law), criminal sanctions (Articles 103-110 of the Capital Market

Law), and civil compensation claims (Article 111 of the Capital Market Law) to protect the integrity of the capital market from any violations.

Suggestion

Changes in the criminal law are needed to accommodate modern behaviors that develop in society, by making prevention and control efforts using legal and non-legal approaches. In addition, it is important to update the legal system by improving the substance of the law which is currently considered less effective in providing legal protection. The legal structure needs to be improved, which law enforcement officers as officials authorized to conduct investigations and inquiries must understand well. More optimal supervision is also needed, with the support of adequate facilities and infrastructure, as well as increased public legal awareness, especially regarding insider trading which is not widely understood. Reconstruction and reformulation, as and harmonization of laws between countries in regulating insider trading, are needed to ensure that the practice is treated consistently across countries. Insider trading is an extremely important economic crime to be addressed with legal certainty, fairness, and optimal benefits.

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