FAIR SHARES FOR ALL:
INSIDER TRADING IN AUSTRALIA

GOVERNMENT RESPONSE

TO
THE REPORT BY

THE HOUSE OF REPRESENTATIVES
STANDING COMMITTEE
ON LEGAL AND CONSTITUTIONAL AFFAIRS

Report tabled: 28 November 1989

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GOVERNMENT RESPONSE TO THE REPORT OF THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON LEGAL AND CONSTITUTIONAL AFFAIRS ENTITLED "FAIR SHARES FOR ALL: INSIDER TRADING IN AUSTRALIA"

The House of Representatives Standing Committee on Legal and Constitutional Affairs (the Committee) conducted an inquiry into insider trading and other forms of market manipulation following the request made by my predecessor, the Hon. Lionel Bowen, on 8 February 1989.

2. The Committee received 32 submissions and conducted hearings in Melbourne, Canberra and Sydney during April, May and August 1989. Written submissions were received from a variety of interested parties including lawyers, industry groups, the National Companies and Securities Commission, the Australian Stock Exchange Limited and the Australian Consumers' Association.

3. Public submissions were made available to other interested parties for comment and the Committee prepared a newsletter for the wider community. Many of those who made submissions also appeared before the Committee. The contributions of these individuals and groups are gratefully acknowledged by the Government.

4. The Government views with great concern the deterioration of public confidence in the securities markets over recent years. Insider trading, because it reserves the profits from investing on Australia's financial markets to the select few with inside information, is an especially insidious and damaging form of market manipulation.

5. The Government is therefore vitally concerned to stamp out this practice, both through tightening the relevant legislation and by reforming the regulatory framework within which the legislation is administered. In an historic

agreement reached in Alice Springs in June this year the States and the Northern Territory have agreed that the Commonwealth should assume principal responsibility for the regulation of companies, securities and the futures industry. The Government will be introducing and seeking the passage of legislation in these sittings to give effect to the new arrangements.

6. The Government would like to thank the Committee for the thoroughness of its report and its constructive suggestions for legislative amendment. It welcomes the thrust of the Committee's recommendations as a means of ensuring that public and investor confidence in the Australian securities markets is not undermined by fear of insider trading and so that the securities markets operate freely and fairly.

7. The Government accepts and is acting on the vast bulk of the Committee's recommendations. The Government has approved the preparation of amendments to the Corporations Act 1989 to give effect, to a substantial degree, to most of the recommendations contained in the Committee's report which require legislative action. It is planned that these provisions will be released as an exposure draft later this year. The Government considers that public consultation is desirable because of the widespread public interest in stamping out insider trading following the considerable media attention given to this issue in recent years.

8. The Government also supports the recommendations directed to other bodies - the Australian Stock Exchange, the National Companies and Securities Commission, the Australian Securities Commission and representative groups in the securities industry - and urges these bodies to examine and implement those recommendations at an early date.

9. However, the Government does have some reservations about the following recommendations - a summary of, and response to, the remaining recommendations is to be found in the attached schedule.

Penalties (Recommendation 11)

10. The Government agrees that the maximum penalty for insider trading should be increased to at least $100,000 for a natural person and $500,000 for a body corporate, as recommended by the Committee.

11. However, the Government has some reservations about the recommendation to include a penalty equivalent to double the profit realised or loss avoided, for two reasons. First, if a Court were to impose such a penalty, the ability of persons affected by the crime to seek damages from the offender could be severely impaired. The Corporations Act currently provides, in s.1005, that a person who has suffered loss or damage as a result of conduct that contravenes the insider trading prohibition may recover the amount of that loss from the offender or a person involved in the contravention. If an offender had already been required to pay as a penalty up to double the amount of profit he or she made, in many cases the offender would not have sufficient assets to meet damages claims from victims of the offence. The Courts may well take notice of the possibility of damages claims in deciding what penalty to impose, but if so they would be reluctant to impose the maximum penalty, which in part defeats the purpose of making available that penalty.

12. Secondly, there are existing avenues available to ensure that an offender is stripped of the profits of insider trading. Leaving aside civil actions for damages by aggrieved persons under s.1005, the body corporate which issued the securities in which the insider traded may recover the profit made by the offender under s.1013. If it is impossible to identify a person who has suffered a particular loss, and the relevant body corporate is unwilling or unable to take action for any reason, the profits may be stripped from the offender and paid into Consolidated Revenue under the Proceeds of Crime Act 1987.

13. Thus, the legislative framework is structured so that rights of action are given to victims of crime to recover their loss, and the Crown is entitled to confiscate the profits derived from a crime so that they can be channelled back to the general community through the Consolidated Revenue. The Proceeds of Crime Act 1987 provides a specific and comprehensive legislative mechanism for tracing, freezing and confiscating the proceeds of indictable offences committed against the laws of the Commonwealth and of the Territories. The offence of insider trading under the Corporations Act 1989 will fall within the ambit of that Act, pursuant to the agreement reached between the Commonwealth and the States and Northern Territory concerning the future of corporate regulation in Australia.

14. The Proceeds of Crime Act 1987 provides two avenues relevant to confiscating the profits of persons convicted of insider trading:

(a) forfeiture orders; and

(b) pecuniary penalties.

15. They are both referred to as confiscation orders. The Act also provides means of controlling property liable to confiscation through search and restraining orders and it confers effective powers on law enforcement officers to gain access to documents relevant to following a money trail and transferring tainted property.

16. The Director of Public Prosecutions may, where a person is convicted of an indictable offence, apply to the appropriate court for an order for the forfeiture of tainted property, or for a pecuniary penalty order in respect of benefits derived by the offender from the commission of the offence, or both. Confiscation orders may be sought at any time within 6 months after conviction. Alternatively, where sufficient evidence is available to bring confiscation proceedings at the time of conviction, the matter can be

expeditiously dealt with by the court as part of the sentencing process.

17. An application for a pecuniary penalty order requires the court to assess the benefit which the offender derived directly or indirectly from the commission of the offence, assigning a monetary value to that benefit and making a pecuniary penalty order equal to that amount. Once such an order has been made it can be enforced as a civil debt and is provable in bankruptcy.

18. The Act confers far-reaching powers on police officers to seize property which is tainted and to hold such property for 14 days pending the making of a restraining order over the property. Both search warrants and restraining orders may be sought immediately before charges are laid.

19. The legislation also contains provisions to enable the courts to look behind the legal ownership of property to determine whether that property is subject to the effective control of the defendant, having regard to shareholdings, or directorships of companies, any trust that has a relationship to the property, family, domestic and business relationships.

20. The Government is vitally aware of the need for the insider trading prohibition to be supported by stern penalties which represent both an effective deterrent for prospective offenders and a clear signal to the securities industry and the wider community that insider trading will not be tolerated. As noted above, the Government therefore will move to increase the maximum pecuniary penalty for insider trading under the Corporations Act 1989 to at least 5 times its current level (ie to $100,000 for a natural person or $500,000 for a body corporate).

21. However, with respect to that part of the Committee's recommendation concerning tying the amount of the penalty to the amount of profit gained or loss avoided, the Government considers that the same deterrent effect can be achieved by the combination of increased monetary fines and terms of

imprisonment under the Corporations Act 1989 and the availability of confiscation orders under the Proceeds of Crime Act 1987 and awards of damages to persons affected by insider trading under the Corporations Act 1989.

International Co-operation (Recommendations 18 and 19)

22. The Committee recommended that the Government pursue the development of Memoranda of Understanding (MOU's) with other countries which have securities markets. Such MOU's would provide the basis for co-operation in the detection and investigation of practices such as insider trading. The Committee further recommended that the NCSC/ASC be provided with sufficient powers for the purpose of co-operating with overseas regulatory agencies in the detection and investigation of practices such as insider trading.

23. The Government has recently agreed to develop a major new legislative proposal to enable Australian business regulatory agencies, including the ASC, to provide mutual assistance to corresponding overseas agencies in the investigation of corporate crime and improper business conduct. The proposed new legislation will enable Australian agencies to use their compulsory information gathering powers in aid of requests from overseas agencies with corresponding functions. The capacity to provide such assistance will also enable Australian agencies to obtain assistance in other countries in the investigation of breaches of Australian law. I am proposing to introduce legislation to give effect to these proposals later in the Budget sittings.

Conclusion

24. These matters aside, the Government is currently preparing amendments to the Corporations Act 1989 to implement the remaining recommendations of the Committee report directed to the legislation, and expects to release an exposure draft for public comment later this year. The Government thanks the Committee for its contribution to the process of law reform in this area.

SCHEDULE OF RECOMMENDATIONS AND RESPONSES

Re-drafting and simplification of insider trading and tipping provisions (Recommendation 1)

25. The Committee has recommended that the existing insider trading provision be re-drafted and simplified and suggests that clear and practical definitions of the offence are required.

26. The Government accepts this recommendation in principle.

27. Simplicity in the language of statutes is certainly the aim but when it is inconsistent with certainty, certainty has usually been preferred. The tension between simplicity and certainty in drafting is exacerbated when the subject matter is itself complex. Ultimately, it is for specialist draftspersons to decide on the most effective wording, but the Government welcomes the Committee's suggestions as to how the legislation can be simplified.

Definition of an insider (Recommendation 2)

28. The Committee has recommended:

(a) that the definition of insider should encompass corporations as well as natural persons;

(b) that the requirement that a person be connected with the corporation which is the subject of the information (in the case of insider trading) or that an association or arrangement be proved (as in the current requirement for tipping) should be deleted;

(c) that the prohibition should focus on the use (to trade in or subscribe for the securities of a company or an associate company) of inside information by a person who is in possession of it and who knows or

ought reasonably to know that it is inside information. An exception would be included for underwriters taking up securities as a result of an underwriting agreement.

29. The Government accepts this recommendation, but notes that the amendments will need to be carefully drafted to avoid imposing an unreasonable burden on the prosecution to prove that the person in possession of the inside information used it to trade in or subscribe for particular securities. The Government considers that, once the prosecution has proved that the person was in possession of the information and that the person traded in the relevant securities, it is reasonable to assume that the person was motivated to trade by possession of the information.

Definition of inside information (Recommendation 3)

30. The Government accepts the Committee's recommendation that inside information be defined in the legislation as information which is not generally available but, if it were, a reasonable person could expect it to have a material effect on the price or value of the securities issued by the company which is the subject of the information.

Availability of information (Recommendation 4)

31. The Government accepts the Committee's recommendation that information be defined as generally available where it is disclosed in a manner which would, or would be likely to, bring it to the attention of a reasonable investor, and where a reasonable period of time for the dissemination of the information has elapsed.

Guidelines - appropriate methods for disclosure of information (Recommendation 5)

32. The Government recognises that commercial certainty would be assisted by guidelines to help determine appropriate methods for disclosure of price-sensitive information.

33. The Government encourages the National Companies and Securities Commission and the Australian Securities Commission to develop such guidelines in consultation with interested parties.

Extension to prescribed interests, exchange traded options and convertible securities (Recommendation 6)

34. The Government accepts the Committee's recommendation that the insider trading provisions be amended to ensure that the prohibition extends to unit trusts and other prescribed interests, exchange - traded options and convertible securities.

Tippees be included in the definition of insider (Recommendation 7)

35. The Government accepts the Committee's recommendation that the insider trading provisions be amended to provide that tippees are included in the definition of an insider (see Recommendation 2).

The definition of tipping be re-drafted and simplified but continue to cover only listed securities (Recommendation 8)

36. The Government accepts the Committee's recommendation that the provision on tipping be re-drafted and simplified but continue to apply only to listed securities. The difficulty in achieving simplification has been referred to under Recommendation 1 above.

Availability of Chinese Walls defence to non-corporate dealers (Recommendation 9)

37. The Government accepts the Committee's recommendation that the insider trading provisions be amended to provide that the "Chinese Wall" defence be available to both corporate and non-corporate dealers.

Onus of Proof (Recommendation 10)

38. The Government accepts the Committee's recommendation that the onus of proof in relation to insider trading should remain on the prosecution.

Penalties (Recommendation 11)

39. The Government accepts that the maximum monetary fine for the offence of insider trading should be increased to $100,000 for a natural person and $500,000 for a body corporate. However, the Government rejects that part of the Committee's recommendation about tying the amount of the penalty to twice the amount of profit gained or loss avoided by the offender, having regard to the availability of action under the Proceeds of Crimes Act 1987 and damages actions under the Corporations Act 1989.

Review of all penalties in relation to corporations and securities offences (Recommendation 12)

40. The Government is vitally concerned that penalties in respect of white-collar offences, especially corporations and securities offences, should properly reflect the serious effect that those offences have on the integrity of, and public confidence in, Australia's financial markets. It acknowledges the concerns expressed by the Joint Select Committee on the Corporations Legislation and the House of Representatives Standing Committee on Legal and Constitutional Affairs concerning the adequacy of penalties for offences against the Corporations Act and the Trade Practices Act 1974.

41. The Government has commissioned a Review Committee chaired by the former Chief Justice of the High Court, Sir Harry Gibbs, to examine and report on the operation of Commonwealth criminal law in a broad range of areas. That review, which recently released a report which discussed in part the 'mens rea' or intention element in corporate offences, will also touch on the issue of penalties. However

given the degree of public concern I consider it an urgent priority to examine specifically the adequacy of penalties for Corporations Act offences. Therefore, I have instructed my Department to review urgently all penalties in relation to corporations and securities offences under the Corporations Act, with a view to ensuring the penalties are internally consistent and appropriate having regard to the nature of each offence.

Court orders (Recommendation 13)

42. The Government accepts the Commission's recommendation that the range of possible court orders be extended so that it is similar to those available where a person is found to have engaged in unacceptable conduct in the context of a takeover.

Conviction not a prerequisite to obtaining a civil remedy (Recommendation 14)

43. The Government agrees that a criminal conviction for insider trading is not a pre-requisite for exercise of a civil remedy, and is currently examining whether any legislative amendment is necessary to make this clear.

Detection, investigation and prosecution as a priority (Recommendation 15)

44. The Government notes and endorses the Committee's desire that detection, investigation and prosecution of insider trading should remain one of the priorities of the National Companies and Securities Commission and the Australian Securities Commission.

45. The Government firmly believes that preserving the integrity of Australia's financial markets is vital to the future viability of those markets and the business community generally. To meet that end, it is most important that Australia's corporate regulators vigorously pursue and eradicate illicit market behaviour.

Transitional arrangements (Recommendation 16)

46. The Committee recommended that, in the changeover from the NCSC to the ASC, appropriate transitional arrangements be implemented to ensure that any outstanding insider trading matters are given full and proper consideration by the ASC. As a result of the agreement reached with State and Territory Attorneys-General on the future of corporate regulation in Australia, the ASC is to assume responsibility from 1 January 1991 for all existing investigations and prosecutions under co-operative scheme law, including insider trading matters. Further, the ASC will be able to investigate and prosecute contraventions of co-operative scheme law which are detected after 1 January 1991 but in fact took place before the Corporations Act took effect. Finally, the full-time members of the ASC have also been appointed as the full-time members of the NCSC during the transition period. These arrangements are designed to ensure a smooth transition to the new administration.

Provision of resources sufficient to establish detailed computer systems for monitoring securities trading (Recommendation 17)

47. The Government shares the Committee's concern that the NCSC/ASC have adequate resources to fulfil their role.

48. NCSC funding is a matter for the Ministerial Council for Companies and Securities. The Report at para 5.4.9 notes a resolution by the Ministerial Council to increase the resources available to the NCSC. That additional funding was to be provided by increasing some of the fees charged to users of NCSC services. To implement the new fees structure legislative amendments were required in each Co-operative Scheme jurisdiction. Despite the fact that the Commonwealth Parliament passed the necessary changes to Commonwealth legislation within a short time of the Ministerial Council resolution, not all States have passed the necessary legislation and it seems that the increased fees will not take effect before 1 January 1991.

49. Nonetheless, the NCSC has been provided with significant additional funding for the period to 1 January 1991 to enable it to vigorously pursue a number of major investigations.

50. The ASC will certainly be funded to the level necessary to provide the effective corporate regulation needed in Australia.
The August 1990 Budget has confirmed the Government's commitment to ensuring that the ASC has at least sufficient resources to perform its functions.

Development of Memoranda of Understanding (Recommendation 18)
Powers to the NCSC/ASC to co-operate with overseas regulatory agencies (Recommendation 19)

51. The Government supports in principle the ideal that corporate regulatory authorities around the world should co-operate with and assist each other where possible in the interests of ensuring that illicit international conduct is eradicated. To this end, a proposal is currently being developed for a legislative scheme to enable Australian business regulatory agencies to use their powers in aid of corresponding overseas authorities. Such a scheme would be independent of any treaty basis, although memoranda of understanding might still be pursued to further underpin the Government's intentions in this area.

Market surveillance by the stock exchanges (Recommendation 20)

52. The Government supports the Committee's recommendation that the stock exchanges pursue a rigorous approach to market surveillance. I understand that the Australian Stock Exchange has established a Surveillance Department which examines aberrant market behaviour, and that the Exchange is looking to develop specialised computer software to enhance its surveillance activities. The Government supports and encourages the Exchange in its endeavours to upgrade its market surveillance capabilities.

Development of codes of conduct (Recommendation 21)

53. The Government believes that the primary focus for improving the reputation of the securities markets is better regulation and a vigorous well-funded regulator. However, the Government supports the Committee's recommendation that representative groups develop codes of conduct which particularly address the integrity of the securities markets. This will assist more generally in the restoration of corporate morality.

54. It is noted that the Australian Merchant Bankers Association issued a pamphlet earlier this year entitled "Avoiding Conflicts of Interest: a Guide for the Financial Services Industry" which sets out principles and guidelines for members. The pamphlet gives information about employees' obligations in order to avoid conflicts of interests, constructing Chinese walls and embargo lists.

55. The Government supports such attempts by industry associations to raise public awareness of the prohibition on insider trading and to give guidance on how to avoid engaging in prohibited activity.