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INSIDER TRADING IN AUSTRALIA

PART 4

SUMMARY AND RECOMMENDATIONS

DR ROMAN TOMASIC

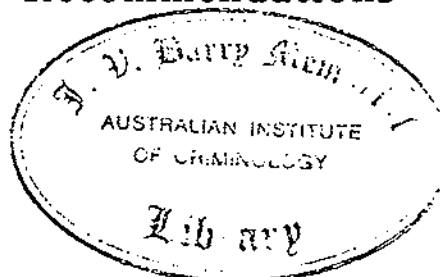
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**Insider Trading in Australia
Summary and Recommendations**



This is the final report from a project financed by a grant from the Criminology Research Council. The research on which this report is based was carried out by

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1 Introduction

This paper is the final stage of a study of insider trading in Australia which has sought to raise the level of debate on this subject. The study arose in the context of increasing concerns in Australia regarding the incidence and implications of insider trading and its possible impact upon the market for securities and for law enforcement. Following the publication of the *Anisman Report*, Insider Trading Legislation for Australia: An Outline of the Issues and Alternatives by the National Companies and Securities Commission (NCSC) in 1986 there was a widespread reaction that more evidence about the nature and extent of insider trading as a problem in Australia was called for. The publicity surrounding the enforcement of insider trading laws in the United States and, to a lesser extent, in Britain no doubt led many to wonder whether insider trading might also be a problem that faced the securities markets in this country. With the support of the Criminology Research Council and of members of the Ministerial Council on Companies and Securities we decided that it was timely to seek to inject some more concrete evidence into the Australian insider trading debate, particularly as there has not been a successful prosecution of such conduct in Australia.

This paper summarises the basic data drawn from the research project. Three earlier papers have been prepared and made public during the period August to December 1988. The first paper was concerned with the regulation and enforcement of insider trading laws in Australia. The second paper dealt with the extent to which insider trading occurs in Australia and the effect of insider trading on the market, on individuals and on Australia's international reputation. The third paper discussed the ethical dimension of insider trading and the attitudes to insider trading within the Australian commercial world.¹

Acknowledgments

We acknowledge with thanks the courtesies paid to us by the ninety nine interviewees who gave us their time for the interviews on which this project was based. We express our considerable thanks to Ms Robyn Dickson and the staff of the Computer Centre at the CCAE and to

¹ These three papers entitled:
 Insider Trading in Australia Part 1 Regulation and Enforcement
 Insider Trading in Australia Part 2 Extent and Effect
 Insider Trading and Business Ethics in Australia

are available from the University Co-Operative Bookshop at the Canberra College of Advanced Education P.O. Box 1 Belconnen 2616 (062 522207).

the staff of the CCAE printery. We also acknowledge the critical role played by the Criminology Research Council in funding the project.

2.1 The Research Project

The study sought to explore why the criminal law seems to have failed in Australia in respect of insider trading.(there have been six unsuccessful prosecutions since 1975) and how it might be improved at a time when deregulation of the financial markets is well under way. The research sought to examine the deterrent effects of the criminal law in this area, problems of detecting insider trading conduct and the obstacles to achieving the successful prosecution of those cases of insider trading which are detected. The objective of the study was to offer insights as to the criteria for the success and failure of prosecutions in this area and to contribute to the development of surveillance systems for the detection of insider trading.

2.2 Methodology

The lack of Australian case law on this topic meant that at least one of the traditional responses available to legal researchers was not available to us. Such case analysis that we did undertake was limited to overseas cases and to the few unsuccessful prosecutions which have been launched in this country. This was not a very promising approach to take with a view to obtaining a better understanding of insider trading in Australia. The other traditional approach to legal research was to engage in the fairly abstract and sterile debate concerning the policy issues surrounding the enforcement of insider trading which has particularly characterized the North American law review literature. We surveyed this arid jurisprudence but we did not feel that it would be productive to seek to add to it without some more tangible evidence. For these reasons we decided to undertake an empirical study of the attitudes and experiences of key players in the securities industry with a view to systematically collecting more reliable evidence than the largely impressionistic material that, up until now, has served as the basis for policy debates on insider trading in Australia.

The study is based upon interviews with officials and professionals in four Australian cities. These were Canberra, Melbourne, Perth and Sydney. We also obtained mail responses from officials in other capital cities. Our research was assisted greatly by the support which we received from the relevant Attorney's General and Commissioners for Corporate Affairs and their staff in each jurisdiction (other than Queensland), as well as from the Australian Stock Exchange (ASX) branches throughout the country. The staff of the NCSC were also most helpful during the course of this research. We were also able to interview principals and staff in twenty broking houses, as well as partners undertaking corporate law work in the largest law firms in each of the cities that we visited. The study also included merchant

bankers, financial advisers, representatives of industry groups and financial journalists. Our interviews often took up to two hours and, in some cases, even longer. We found in many cases that the person we had arranged to interview was also accompanied by one or more colleagues and that enriched the study. It is a minor point in the context of the study, but worth noting, that not one of the people we interviewed was a woman.

TABLE 1: Insider Trading Interviewees in four Australian cities

(A) Occupational Group	Number of Interviews or Questionnaires	Persons Interviewed
Brokers	20	21
Lawyers	13	17
Financial Advisers*	13	17
Market Observers**	10	10
ASX Officials	6	9
Regulatory Officials	17	25
TOTAL	79	99

(B) Geographical spread of Interviewees	Number of Interviews or Questionnaires	Persons Interviewed
Perth	17	23
Sydney	21	27
Melbourne	27	33
Canberra	10	12
Mail Questionnaires	4	4
TOTAL	79	99

*This category included merchant bankers, fund managers, accountants and investment advisers.

**The market observer group was made up of representatives of industry groups associated with the market and financial journalists.

The data on which this report is based came from the almost 2000 pages of questionnaire responses which we collected in personal interviews. The questionnaire contained 66 questions and was open ended in design to allow us to explore related issues as they arose

during the course of the interview. We had a core group of 30 questions that all interviewees were asked to answer and the remaining questions were designed for particular groups, such as brokers, lawyers and enforcement officials. The questionnaire was pre-tested with interviews in Canberra in late 1987. The main body of interviews took place in Perth during the first week of February 1988 and in Melbourne and Sydney during two weeks in May 1988. A number of other interviews of regulatory officials took place in Canberra, Melbourne and Sydney during the first half of 1988. Library research of legal issues is certainly much to be preferred over this kind of arduous field work.

One of us also interviewed enforcement and stock exchange officials as well as insider trading researchers in London, Toronto and Washington to obtain comparative insights for the Australian study. To our knowledge, this is the largest study of its kind undertaken to-date in Australia at least. The study demonstrated that empirical research can provide invaluable insights from the marketplace into the operation and meaning of corporate and securities law in Australia, and in that way, adds a dimension which is simply not available from the limited body of case law and literature in this broad area.

3.1 The History of Insider Trading Regulation in Australia

Prior to 1970 there was no law generally prohibiting insider trading in Australia. Before then, there was a provision in the Uniform Companies Act which prevented company officers from taking advantage of their position. This was section 124 of the Companies Act which was first enacted in Victoria and then followed in other States. Section 124 was an important development in that it was designed to overcome the very dubious decision in *Percival v Wright* [1902] Chancery Reports 421 which clouded the issue of whether a company director owed a fiduciary duty to shareholders. This section was later supplemented by section 124A which was more specific as to the prohibition of insider trading. Sections 124 and 124A were however limited to the officers of companies. Stock brokers were not within the reach of either section and the only form of regulation governing them was that provided by the rules of the stock exchanges in each of the States. Persons who were not company directors or stockbrokers were not subject to any regulation.

During the unprecedented investment boom of the late 1960s disquiet about the conduct of certain mining companies (especially) and those associated with them led to the establishment of the Senate Select Committee on Securities and Exchange (known as the Rae Committee). The Committee found that insider trading involving directors, investors and brokers was a feature of the Australian stock market and that it was taking place without any restraint - certainly no legal restraint. The Rae Committee also demonstrated that the system of self regulation within the Stock Exchanges was, to say the least, ineffective.

An early reaction to what the Rae Committee had uncovered was the introduction of the Securities Industry Act 1970 in New South Wales. This Act, amended in 1971, included section 75A which prohibited direct or indirect insider trading by any person who obtained information "through his association with a corporation".

The Corporations and Securities Industry Bill (Cth) 1974 included clause 123 which prohibited insider trading. This bill did not survive the change of government in 1975 but clause 123 formed the basis for section 112 of the Securities Industry Act 1975 which was uniformly adopted by the States participating in the Interstate Corporate Affairs Commission scheme (NSW, Victoria and Queensland).

The development of the current Co -Operative Companies and Securities Scheme brought with it the Securities Industry Act 1980 (Cth) which, under the scheme, applies in each State as the Securities Industry Code.

The prohibition of insider trading is to be found in section 128 which repeats the provisions of section 112 of the 1975 legislation. A related section which provides a variation of the prohibition of insider trading is to be found in section 229 (3) of the Companies Act / Codes. Sections 128, 129 which imposes penalties, 130 which provides a form of relief for persons who have suffered as a result of insider trading and section 229 (3) are set out in the Appendix to this report.

There were very few prosecutions for insider trading as at the end of 1988 and none of them was successful. The six reported cases are listed in the Appendix.

4.1 The Extent of Insider Trading in Australia

The necessary first step in this study was to attempt to gauge the extent to which insider trading occurs in Australia. A criticism of the Anisman report was that it was long on theory but short on facts about the Australian market. A salutary warning in this process was the comment that "the people who do it do not talk about it". Nevertheless, we asked a series of questions with a view to clarifying perceptions of market participants concerning the incidence of insider trading. We were, of course, aware that gossip and rumours, of themselves, do not amount to insider trading and that there is a populist usage of the term which perhaps embraces all forms of sharp practice in the stock market. It was emphasised to participants in the study that the survey was about insider trading as described by section 128 of the Securities Industry Code.

4.2 The Prevalence of Insider Trading

Perhaps no one issue was more fundamental to this study than that of the extent to which insider trading takes place in Australia. As mentioned earlier, we were at pains to emphasise that we were asking about insider trading in the sense referred to in section 128 of the Securities Industry Code. Our first question was whether the participants in the study agreed with the commonly expressed view that insider trading is widespread.

Answers ranged from insider trading being rare to it being rife but nobody said that it did not occur. Not surprisingly, the brokers tended to say that the prevalence of insider trading is blown out of proportion. Those respondents not so close to the centre of activity tended to give a higher estimate of the incidence of insider trading. The range of estimates made it clear that the precise incidence of insider trading is impossible to measure. The very nature of the phenomenon makes this almost inevitable. The few cases which most industry respondents were prepared to acknowledge represent the tip of the iceberg. Terminological confusions help to further obscure the issue. The legal use of price sensitive information is not far removed from the illegal use of such information, and many in the industry either cannot or are unwilling to distinguish the two. For some it was easier to blur the issue or simply to pretend that insider trading is not a problem. There is also a natural hesitancy of professionals to make accusations of others, or at least to publicly make disparaging remarks about those that one does business with. Notwithstanding, there were sufficient persons from across all sectors of the industry who provided enough information to lead us to conclude that insider trading is far more widespread than many are prepared to acknowledge. Moreover, the practice of many

Australian companies of selectively briefing brokers and institutional investors seems to stray into the realms of proscribed insider trading in the sense that the brokers and institutions might at least be categorized as tippers. Insider trading activity in Australia does not approach the scale of that perpetrated by the Boesky-Levine ring in the United States but it is widespread enough to be of concern.

4.3 Is Insider Trading More Common Now?

We attempted to get some idea of the level of insider trading by asking whether, in recent years, it has become more, or less, common. In this respect it was interesting to note how the benchmark was taken as the mining boom of the late 60s.

The brokers were generally defensive about the present level of insider trading although some would not have had the historical perspective to accurately make this kind of comparison. Many other brokers who had been through the late 1960s and early 1970s period seemed to be primarily concerned with improving the reputation of the broking profession and few were prepared to admit that the "bad old days" had returned.

We were also frequently told that the laws and regulatory structures which were introduced in the early 70s were of little concern to many in the industry. The bull run of the mid 1980s increased market activity to such an extent that many believe that there has been a corresponding increase in the level of insider trading. Merchant bankers were more prepared to acknowledge this than were the brokers. Though the cruder examples of insider trading covered in the Rae Committee Report seem to have decreased, many believe that this is due to contemporary inside traders simply becoming more sophisticated rather than having been deterred from such conduct. The public and the media have also become increasingly aware of insider trading as a issue of concern and it appears that these concerns are not unfounded because a number of observers suggested that the level of insider trading has at least remained constant.

4.4 Situations In Which Insider Trading Is More Likely

In trying to establish impressions about the extent of insider trading we first enquired about the circumstances under which it is likely to occur. We began by asking whether insider trading is more likely to occur in relation to particular types or classes of securities or markets.

There is no doubt from what we were told that insider trading occurs throughout the whole of the Australian securities market. It is more

apparent, however, in certain specific areas. At different times, insider trading seems to be more prevalent in some areas of the market than others. This is largely a matter of opportunity and the market situation affecting particular securities. For example, during the boom of the late 1960s and early 1970s insider trading took place in mining and exploration stock while during the early 1980s, it was common in high technology and takeover stocks. Market conditions were also said to have an impact on the incidence of insider trading - there was an almost unanimous view that it is more likely to occur in a bull market. The volatility of the stock in question and the degree to which the ownership of securities is tightly held by a relatively narrow group of shareholders were also identified as factors. This is not to suggest that insider trading does not occur in relation to the blue chip securities but it is more likely to be successful in moving market prices at the other end of the market and hence it is probably more likely to occur in lower quality stocks. However, as even some large Australian public companies tend to have large parcels of their stock tightly held in a relatively few hands, the likelihood of insider trading occurring in this sector should not be discounted, especially in takeover situations.

4.5 Takeovers and Insider Trading

It has often been said, and other research tends to show, that there is a distinct relationship between takeover activity and the level of insider trading. We asked the interviewees whether they could think of takeovers where they suspected that insider trading had taken place.

According to a considerable majority of those surveyed, a connection exists between insider trading activity and takeovers. Those closest to the market, such as brokers and merchant bankers, were particularly certain of this relationship and other groups also saw a link. Only the ASX officials seemed to question the existence of this linkage but their views were very much in the minority. Takeovers were described as ideal insider trading situations because of the profits which could be made by buying shares ahead of a takeover and the long chain of advisers and others involved in preparing the takeover. It has almost become a commonplace of the industry for many leaks to occur prior to a takeover and for prices to rise prior to a takeover being announced.

4.6 Who Are The Likely Insider Traders?

We then asked whether there are particular groups of investors and/or traders who are more likely to be involved in insider trading

Identifying insider traders by reference to occupational categories is by no means an easy matter. Some groups in the industry might have a greater opportunity to insider trade than others but opportunity alone is an insufficient indicator. Some groups such as directors of large public companies are seen as having too much to lose and as being too readily detectable to be likely to, themselves, directly engage in insider trading. It is possible, however, that directors and corporate executives are likely to pass on information to tippees.

It seems that other factors apart from the opportunity to insider trade need to be considered in pin-pointing those likely to insider trade. Critical factors are the personal integrity and the level of professionalism of a person faced with the opportunity to insider trade. The low risk of apprehension is another factor which is likely to be exploited by the more sophisticated market operators. Although it is not necessary to go offshore to insider trade, this is seen as an effective means of minimizing even further the low risk of apprehension. Perhaps brokers and merchant bankers are in the best positions to act in this way. In fact, these groups are generally seen as being most likely to engage in insider trading. They are in positions which give them considerable opportunity to so act. Linked to this is the relatively lower degree of professionalism amongst these groups when compared, for example, with accountants and lawyers. Insider trading cuts across occupational boundaries through well developed networks for the transmission and exploitation of price sensitive information found in some sectors of the securities industry and in some locations. Perth was singled out as one such location, although this does not mean that similarly oriented networks do not exist in other Australian cities. Those at the entrepreneurial end of the industry and peripheral members of the industry, such as geologists and tippees, were also frequently identified as common insider traders.

4.7 Opportunities for Insider Trading

Insider trading has been described as an opportunistic crime. It is carried out when an opportunity presents itself and by persons who take advantage of the opportunity. The difficulties of quantifying the extent of insider trading and perhaps, in detecting it might be due to the opportunistic, random nature of the practice. We were, therefore, interested to find out what opportunities existed for insider trading.

The first of our questions on this topic asked the interviewees about the frequency of conflicts of interest arising from access to price sensitive information which is referred to later in this paper. We followed that line of enquiry by asking whether traders build up their holdings in order to obtain access to price sensitive information and also whether

success on the stock market is possible without price sensitive information.

It emerged from our discussions with brokers that a significant opportunity for insider trading arises from the readiness of corporations, for a variety of reasons, to selectively divulge price sensitive information to brokers, institutions and large shareholders. This practice was described as merely good research and there is clearly room for greater control of the release of corporate information to ensure that all investors are given an equal opportunity to take advantage of the market opportunities which this information creates. Indeed it was frequently drawn to our attention that the process of bringing information to the market leaves much to be desired. More direct means of obtaining price sensitive information such as through the purchase of large holdings in corporations which might lead to board membership was described as an expensive and risky means of obtaining price sensitive information but one that is not unknown.

The market participants, especially the brokers, maintained the view that success is possible provided that the analysis of the market is correct or that fundamentals are relied on. This method was prescribed as the one most likely to bring success in the longer term, particularly with blue chip stock but most interviewees acknowledged that resort to inside information is superior to reliance upon fundamentals, particularly in the shorter term. In an over-analysed and competitive market, the temptation for financial intermediaries to obtain inside information is enormously attractive.

4.8 The Seriousness of Insider Trading

Another way of measuring the extent of insider trading was to find out how seriously it was regarded in comparison to other forms of market abuse.

There were some brokers who dismissed insider trading as a creature of the media but there is little doubt that insider trading is perceived as a problem in the Australian securities industry. Although it was said that it is not as serious as price rigging and warehousing it is unrealistic to isolate these forms of market abuse as they are often related and undertaken in the same operation. Insider trading was seen to have a far more corrosive effect on the market and was also seen as having the potential to affect more people than other forms of securities market abuse. One view was that insider trading was perhaps a small problem, but it could nevertheless destroy the market.

4.9 Conclusions

At the start of this project we did not expect to be able to quantify the extent of insider trading. This was confirmed by the responses to our questions. We must reach the obvious conclusion that nobody in Australia can say, with any precision, how extensively insider trading is carried on.

We did not expect brokers to say anything different to what they told us. It would have been impossible for any of them to nominate with any certainty the extent of insider trading. It is no reflection on their truthfulness and candour to say that we would have expected them to paint the industry in its best light. We regard it as significant that none of them was prepared to deny that insider trading goes on. That fact is a inescapable conclusion in our view. Given the opportunities that are available and, even if we accept the argument that there are always bad apples in any profession, it is clear that the temptation to make substantial profits through insider trading is ever present and would be very difficult for some to resist.

An interesting feature of the information which we gathered was that the further we moved from the centre of the market the more often insider trading was said to be widespread. The brokers said that it was not widespread and it was not surprising that the exchange officials said the same. The financial advisers thought that it was widespread as did the lawyers and the market observers. The regulators were inclined to say that it was very widespread. We found that most of the participants regarded insider trading in takeovers as commonplace and this confirms, to a degree beyond what we had expected, the widely held views about the link between takeovers and insider trading.

It appears, from what we were told that the level of insider trading is probably slightly lower than in the pre-prohibition period and that the main difference is that it is now less blatant. This is not altogether surprising in view of the widely held view that the legislation is moribund. It also reflects the reality of human nature that where there is a chance to make money it will be taken by some despite the law and despite the ethics of the matter. It was interesting to be told that insider trading is not a major problem. What made it so significant was that other forms of market abuse were quite readily identified. We were struck by the number of times that participants in the study referred to warehousing and, in particular, to price rigging which seems to be so commonly practised as to be almost legitimate by default. While we recognise that there could be an element of envy about "entrepreneurs" we could not fail but to note the strength of the disapproval of their activities. There was considerable variation in the opinions as to who engaged in insider trading and in which stocks this

occurred. The weight of opinion leans strongly towards persons associated with companies and there was a discernible pattern in the responses that showed that brokers and other marketplace professionals were also engaged in it to varying degrees.

Our impression is that insider trading is done on two levels - as an opportunity arises and in a calculated way. We also believe that it is conducted on two scales. At one end of the spectrum is petty insider trading, usually conducted by lower level staff and smaller investors. At the other extreme is trading which involves considerably larger sums. The key to the difference in scale is the amount of money required to make the investments. In the course of our discussions we learned that for a large player a profit of \$100,000 is regarded as unexceptional. We were shown figures that indicated that over a two day period an apparent insider trading operation yielded a profit of \$890,000 and there have been allegations of a profit of \$23 million from an off-shore insider trading operation. We think that these represent an unusual level of insider trading. We do not think that there is insider trading on a "Boesky" scale. The Australian market is too small to sustain such an operation and none of our respondents even hinted at the existence of such a person in Australia.

The sector of the market in which insider trading is most likely to take place is the market for shares. There was some reference to options as a possible vehicle for insider trading. The general view of the participants in the study was that insider trading is more likely to occur in lower quality stock such as mining, resources, high technology and speculative stock generally. We think that this is a plausible assessment. This type of stock is more likely to react to good news and more likely to yield better profits through the more spectacular movement of its price. There were, however, many respondents who told us that insider trading is not confined to a particular type of share.

In the course of the project much of what we came across was logical, plausible or predictable. We were, however, surprised by two particular matters. The first of these was the ease of carrying out an insider trading operation. It seems that this can be done quite simply either by using a false name or through a nominee or tippee. Persons wishing to do so can rest easy in the knowledge that the risk of challenge, detection and ultimate prosecution is so low as to be virtually non-existent. Even if one is suspected of insider trading there will be a minimum of professional opprobrium. For the more determined insider trader the use of an off-shore medium is seen as a riskless way of operation. The places mentioned in this context were London, New Zealand, Luxembourg and Monaco. Nobody was able to say how common this mode of insider trading is.

The second surprise was the level of ignorance among many of the participants, especially brokers, about what constitutes insider trading. There is evidence that when a broking firm discovers non-public price sensitive information in the course of visits to a company, it is common for the firm to use that information to trade on its own account before it is passed on to selected clients or to institutions that the firm would like to have as clients. When this matter was discussed with brokers we were surprised that many of them did not consider the possibility that what they did, as a matter of course, might bring them into conflict with the prohibition on insider trading. This matter further emphasised the point made by most interviewees that there must be something done to improve the disclosure practices of listed companies.

The level of ignorance which we detected is, perhaps, understandable given that section 128 is very complex and that there is no guidance about it from decisions of superior courts. It might also be explained by the reference to a lack of ethical training in the broking industry. We do not wish to have this observation interpreted as a denunciation of the ethical standards of all brokers. Nor do we wish to understate the pressure to make money that brokers must feel.

In respect of the extent of insider trading in Australia we can conclude with the following observations:

- the populist impression of insider trading which embraces rumours, gossip, guesses and uninformed tips is not necessarily always the type of insider trading that is referred to in section 128 of the Securities Industry Code. The impressions of the degree of insider trading are exaggerated by that factor.
- our study was undertaken after the 1987 crash and the responses to our questions about the extent of insider trading represent the base level of insider trading, that is, it is not enlarged by the higher level that could be expected during a bull market.
- insider trading occurs mainly, but not exclusively, in the lower level stocks.
- the persons most likely to engage in insider trading are those associated with the company but that does not mean that others more actively engaged in the market do not do it.
- while it is not amenable to precise measurement, it would be a reasonable estimate that the extent of insider trading ranges from "not uncommon" to "widespread". It is certainly not an occasional aberration.

5.1 The Effects of Insider Trading

If insider trading is, as we were told by informed observers, fairly widespread, an obvious question is what is the effect of this practice. A more definitive study of insider trading might have drawn upon data which reflected the views and experiences of ordinary investors and traders, rather than just those of the industry professionals. However, as these professionals occupy key vantage points from which to make authoritative judgments, it is not unreasonable to expect that they would be able to give us a fairly good idea of the likely effects of insider trading.

5.2 Harmful Effects of Insider Trading

In considering the impact of insider trading an obvious enquiry is whether it has any beneficial or detrimental effects. We first asked whether it has any harmful effects.

It seems clear from the observations of the respondents that insider trading is not the victimless crime it is often made out to be. The majority of them saw harm caused either to an individual or the corporation or to the market. Small investors and shareholders are widely seen as those who suffer most as a result of such conduct. Even where the protection of small investors did not evoke much sympathy, unfairness and the fraudulent nature of insider trading were seen as undesirable effects. There was a strong feeling that the market itself is harmed by insider trading if only because of the need to create the image of an honest and informed market. Insider trading was, in this sense, seen as corrupting or debasing the market. Among those we interviewed there were some who did not feel strongly about the issue but not one of them was prepared to say that there were no harmful effects associated with insider trading.

5.3 Beneficial Effects of Insider Trading

In looking to see the beneficial effects of insider trading we naturally asked respondents to exclude the direct benefit to the insider trader as a consequence of the trade. With this question we also sought to test the acceptability of Professor Henry Manne's argument in defence of insider trading. In brief, Manne's argument is that insider trading is can be beneficial because it acts as a price accelerator and helps to bring the price of securities to their proper level more quickly than would be the case without the insider trading taking place. This argument was once popularized by Graeme Samuel in Australia, although he seems lately to have begun to distance himself from it (BRW 15 July 1988 at p.62).

Another aspect of the Manne argument is that insider trading is beneficial in that allowing management to insider trade in their company stock provides an additional incentive to them to be more entrepreneurial in respect to the companies that they control.

The reactions to these questions were significant. They demonstrated quite clearly that the brokers have an aversion to insider trading, at least in principle, but, of even more significance is the commentary that these answers provide on the market. The brokers' responses suggest that insider trading does harm the market but there were a number of respondents who said that insider trading is beneficial in bringing information to the market faster than would otherwise be the case.

The consistent view of almost all the respondents was that there were no beneficial effects of insider trading. The only beneficiary was the person who makes the profit or avoids the loss by engaging in insider trading. Attempts to justify insider trading were strained and advanced without much conviction.

The respondents, especially those in the market place, were critical of the arguments associated with Manne. These arguments were regarded as academic, somewhat unsubtle and certainly not in accord with the realities of the Australian financial markets experienced by professionals closely involved in those markets. The reaction against arguments in favour of insider trading revealed a feeling that there is a need for companies to improve their mechanisms for disclosing price sensitive information to the market. Particular scorn was reserved for the executive incentives argument mainly reflecting the view that the interests of shareholders need considerably more attention than they currently attract.

5.4 Insider Trading and Market Confidence

Having looked at arguments regarding the possible harmful and beneficial effects of insider trading in general terms we turned to test the view often put that insider trading undermines the confidence of investors and others in stock markets. We asked the respondents whether, and to what extent, this is so.

It was reassuring to learn that insider trading has not adversely impacted on confidence in the market place but that feeling was dispelled when we heard that a significant reason for this is that investors tend to regard the stock market as something of a gamble. It was not within the scope of this study, but we had hoped to survey the level of public confidence in the stock market. We understand that the Australian Stock Exchanges Ltd has commissioned a study on that

matter and the results might be a useful starting point in developing a higher stock market participation rate amongst the Australian public.

We took the theme of market confidence further by asking about the likely effect on market confidence of the repeal of section 128.

Although the issue of market confidence is a complex question, it seems that the existence of insider trading laws does at least have some effect upon the level of market confidence. This is so even though the market is generally perceived to be manipulated to a certain degree anyhow and despite the widely held view that the laws are ineffective. It is not possible to know how many of the investing public are aware that section 128 exists. Perhaps they know that something is there and it reinforces the view that the law currently serves a function as a form of symbolic reassurance. The overwhelming view was that the law should not be repealed and if it were to do so, Australia would be ignoring the international trend of introducing or strengthening laws against insider trading. This suggests that the prohibition of insider trading must remain a feature of the Australian marketplace and its regulation.

We then looked at the effect on individuals. We asked the interviewees to what extent a market participant would be damaged by being known as an insider trader.

To our surprise we found that to be known as an insider trader was not a debilitating condition. There was a certain distaste for persons who engaged in this conduct but it would not be too much to say that the prospect of making a profit by following an insider trader overcomes the scruples of many within the market. It appears from what we were told that the informal system of social control in the business community does not work well to drive out insider traders. The reputation for insider trading is different to being convicted for it. The penalty for anyone who is convicted will be certain career destruction.

5.5 The Place of the Small Investor

It has often been said that insider trading laws are important because they were intended to protect the small investor or small shareholder and this lead us to ask whether it was important that the small investor remain in the market for securities. This matter was also of interest because it has been advocated by some that the small investor should leave the market to the big players. None of our respondents adopted this view directly although many of them did not have much to do with small investors as such and the stock affirmative response to this question suggested a hint of motherhood.

The reasons given in support of the place of the small investor in the stock market were diverse. The small investors were seen as providing substance and stability to the market, assisting in the role of capital raising, acting as watchdogs in public companies, and serving a useful social purpose in being active participants in the capitalist process. Many respondents lamented the low rate of direct participation in the stock market by the Australian public.

5.6 The Fairness of the Market

Following from our question on the place of small investors we went on to ask whether the market was unfair to any particular groups of investors or traders.

Very few of those interviewed felt that the market was unfair to any particular group but it was clear that advantages were enjoyed by larger investors and institutions as a result of their market power. The small investor is unable to take advantage of the economies of scale which are available to larger investors and though this was not seen to be an issue of fairness, there were allusions to shabby treatment of small investors by some brokers. This was so at least up until the crash of 1987. Brokers claimed in their defence that the transactions costs of dealing with small investors are inordinately high due in part to the inefficiencies of the Stock Exchange systems.

5.7 Conclusions

There is no doubt that insider trading is a practice that the market can do without. The overwhelming view of the participants in the study was that not only is insider trading harmful but that it brings no benefits.

Insider trading is said to be harmful to the market for a number of reasons. It is said to have the potential to erode confidence; to inhibit the capital raising process and to damage the efficiency of the market. According to a substantial proportion of the interviewees, it also directly harms investors who lose money to those who are engaged in insider trading. One view, which was mentioned by some, is that insider trading is a victimless crime. Whatever this term means, it ignores the fact that in an insider trading transaction there is a party who loses value from the securities involved or is forced to take a loss. Perhaps it might be more accurate to say that insider trading is a crime with an unknowing victim.

The discussion of the impact of insider trading on market confidence was rich in irony. On the one hand we were told that insider trading erodes confidence. On the other we were told that it has not affected confidence but yet it was asserted that if section 128 were to be repealed confidence would suffer. Another element of the confidence issue is that the impact of insider trading cannot be measured because confidence could already be at a very low level and, in any event, investors expect that insider trading does occur. Whether the generally perceived low rate of participation in the market by individuals is attributable to the effect of insider trading or to a general lack of faith in the market does not emerge clearly from the study. The issue of market confidence is a complex one and requires further research and the recently announced survey on the matter to be undertaken by the Stock Exchange is a welcome development. More empirical research in this area is badly needed.

It was significant that there was no pressure from the interviewees for the removal of the prohibition on insider trading. It was also significant that the arguments in favour of insider trading, by those such as Henry Manne, received very scant support. This reaction suggests that no matter how rigorous an academic theory might be its value can only be tested in the market place and that some of the legal and economic arguments should be reassessed in the light of market reality, particularly the realities of small markets such as in Australia. The references to the usefulness of insider trading in bringing news to the market reflect poorly on the efficiency of the market and it is clear that the performance of listed companies in disclosing price sensitive information needs to be improved. There seems to be a powerful case for the Stock Exchange to improve the enforcement of its listing rules in this regard. Finally, there is no doubt, from what we were told, that the small investor has an important part to play in the market. There seems to be no evidence that the market is unfair to small investors but there is a strong feeling that they are not treated as well as the large institutional investors.

6.1 INSIDER TRADING - REGULATION AND ENFORCEMENT

The problems of regulation and enforcement are of course central to an adequate understanding of insider trading in Australia. To a large degree it seems to be just as true in Australia as it is in the United States that there are major limits to the extent to which the law applies to the area of corporate behaviour. As Christopher D. Stone put it over a decade ago in regard to the US, this is an area "where the law ends...." Prior to undertaking the study we suspected that, despite the existence of uncompromising language in section 128 of the Securities Industry Code, this body of law has not penetrated very deeply into the consciousness of securities industry actors in Australia and that it had only a limited impact upon them. The fact that the law has remained largely unenforced added to our belief that for most practical purposes there is no law in force in regard to insider trading in Australia.

In forty three different questions we explored a variety of issues concerning the nature of regulatory problems and experiences, problems facing the enforcement of insider trading laws, the assessment of the effectiveness of different remedies for insider trading and the prospects for greater resort to self regulatory strategies in responding to insider trading conduct.

6.2 Should Insider Trading be Prohibited?

We began by asking what the interviewees believed were the policy justifications for the regulation of insider trading regulation. There has been considerable debate in USA about the policy basis for the prohibition of insider trading. In the literature, several views exist. These include arguments based upon market efficiency, the fiduciary principle, general notions of fairness and the concept that price sensitive information is the property of the corporation and that insider trading amounts to misappropriation of that property.

The general reaction was a fairly uniform expression of hostility to insider trading and a shared belief that such conduct should be prevented. Although the policy justifications varied, the most common feeling was that insider trading was at least unfair and a significant number of respondents said that it was likely to harm market efficiency. The fiduciary principle was only occasionally recognised and then, mainly by lawyers. The policy of continuing to outlaw insider trading as a market practice is almost universally accepted as an essential device for ensuring the integrity of the securities market

6.3 Regulatory Goals

Pursuing the policy objectives of insider trading regulation further we sought to distinguish exhortative or aspirational statements of policy objectives from more realistic assessments. We asked respondents to select from three particular policy goals, the goal which they thought to be the most realistic. The three goals which we put to them were "punishment, orderly marketing or symbolic reassurance".

Most felt that the provision of a system of orderly marketing is the most realistic goal of regulation. To a slightly lesser extent, this was linked to symbolic reassurance which came a close second as the most realistic goal. Very few interviewees saw punishment as being a purpose behind insider trading regulation.

6.4 The Role of the Criminal Law

Any discussion of the enforcement of insider trading prohibitions must ask what are likely to be the most appropriate legal means to achieve control of insider trading. We therefore asked if the criminal law was seen as an appropriate mechanism for dealing with insider trading.

Despite some reservations about the problems of actually seeking to apply the criminal law against insider traders, we were left in no doubt that for one reason or another it was essential that the criminal sanction continues to be available in this area. This view was enhanced by the strong criticism of the illusory nature of civil remedies as a sole means of response. Fines especially at the current level were generally regarded as being of little significance but imprisonment was seen as a real deterrent. However, in view of the practical difficulties involved in resorting to criminal sanctions there was a genuine basis for ambivalence about their effectiveness as a sole device. Most agreed that the criminal sanction had to be coupled with stronger civil remedies. There is also a case for greater resort to negotiated settlements and quasi-criminal sanctions either to get actors to leave the industry or to undo transactions. So long as the problems of proof continue to present such considerable obstacles these alternatives need to be looked at more seriously.

6.5 The adequacy of current penalties

We then asked whether the current criminal penalties of \$20,000 and/or five years imprisonment were appropriate for insider trading. The fact that there have not been any convictions for insider trading in Australia made this question appear somewhat academic.

The current criminal penalties of five years imprisonment and/or a maximum fine of \$20,000 are not perceived as credible deterrents for inside trading. The main reason for this is the lack of enforcement of section 128. Were this law to be enforced it is clear that the fear of imprisonment would constitute a serious deterrent, although it may be desirable to think about introducing a statutory minimum period of imprisonment. The fine of \$20,000 is however a different matter. This was all too frequently described as a joke or, at least, quite unrealistic in terms of the likely gains to be made, especially by the big players. What emerged from our enquiries is that we now have the worst of possible situations in respect to penalties for insider trading. There was a strongly expressed opinion that the courts are most unlikely to impose prison sentences on insider traders but, in the unlikely event of fines ever being imposed, these are seen as constituting trivial imposts upon the insider traders. The current approach to penalties seems to be unrealistic and has served to further undermine the effectiveness of the regulatory institutions. At the very least, it has undermined the confidence of these institutions in the value of insider trading laws.

Based on the comments from the marketplace there seems to be a compelling case for an increase of fines up to at least \$100,000 for each offence. Such an increase is in line with international developments, however, even this higher fine would be irrelevant if it were not to be applied. It is clear that money reputation and freedom of movement are highly regarded values in the securities industry. If insider trading penalties are to be seen as serious, then they must impact upon these values. To date this has not occurred and is all too widely perceived as not having occurred.

6.6 Civil Penalties

Would an alternative or supplementary scheme of civil penalties such as treble damages and the disgorgement of profits constitute a more credible deterrent than the existing criminal sanctions?

Greater use of civil remedies such as the disgorgement of profits and the use of multiple damages received widespread support but most felt strongly that civil remedies of this type should only supplement the criminal sanction and not replace it. Disgorgement of profits was especially approved of although most felt that it should be accompanied by additional pain if disgorgement were to be a deterrent. This applies especially to multiple offenders who may be detected on only one or a few of these occasions. There were frequent reservations about the introduction of treble damages but the notion of multiple damages was not rejected. Double damages seemed to be acceptable. It was also widely argued that disgorged profits from insider trading should not go

into general revenue. A common suggestion was that these be used to support insider trading regulation enforcement. Several of the respondents referred to the problem of inadvertent insider trading faced by company directors and executives who trade in their company's shares. The existing window of opportunity approach whereby trading is restricted to short periods after the annual report was described as unsatisfactory.

6.7 A Criminological Debate?

As stated earlier, one of the goals of this study was to make a contribution to the level of informed debate concerning insider trading in Australia. We were therefore interested to learn about the kind of debates that were currently taking place in relation to this issue. There seems to be very little debate or discussion amongst professionals in different fields about insider trading. Although it may be too strong to say that insider trading is seen as a taboo topic, there has not been much enthusiasm about public discussions on this subject. Even in organizations having a professional concern with this area, the level of debate has been disappointing

For example, we asked the regulators how much discussion has taken place amongst regulators regarding the relative merits of different types of penalties. Most reported that there had been none or not much debate. The subject of penalties is apparently discussed in a general manner, for example, to see if these need to be reviewed from time to time but this is not solely directed to insider trading as such.

There appears to be a need to improve significantly both the extent and the level of criminological debate on questions of investigation, detection and enforcement of insider trading in Australia if only to heighten public and political awareness of the issue.

6.8 The enforcement of the current law

A feature of the insider trading debate in Australia has been the frequent reference to the paucity of cases and the lack of convictions for insider trading. This could be explained by several factors such as a very low level of insider trading, inadequate enforcement and inadequate deterrence. All of these were mentioned in responses. The overwhelming attitude, particularly of the lawyers, was that insider trading laws were not adequately enforced, although some thought that these laws were enforced as well as they could be.

Apart from the naturally defensive answers of the regulators, and, even they were ambivalent, the vast majority of respondents showed little confidence in the adequacy of insider trading law enforcement. It is

clear that the CAC's and the NCSC face real problems in the areas of staffing and market surveillance as well as lacking sufficient political support to give difficult areas of prosecution the priority that they deserve. Although some respondents saw a need to reform or streamline the law in this area, this was seen as being of lesser importance than the need to prosecute these offences far more vigorously. Most people in the industry were of the view that the current level of enforcement of insider trading laws was quite inadequate and felt that, for most practical purposes, there was no law against insider trading, for all the impact which section 128 had. The picture presented by the reactions of our respondents does not show the enforcement effort in a very good light. It is perhaps significant that there was little direct criticism of the agencies. Indeed, there were some comments that suggested that the agencies were labouring under a heavy burden given their lack of resources and the law they had to enforce.

6.9 Regulatory Priorities

We were told that the agencies decide their own priorities and we asked about the priority given to dealing with insider trading. On a day to day basis, most regulatory agencies give a low priority to dealing with insider trading. One major exception to this is the NCSC where insider trading is given as high a priority as resources allow, although 40% of all matters investigated are said to involve some element of insider trading. It seems to be the case that insider trading is given a low priority because it is resource intensive.

6.10 The effectiveness of the agencies

We examined attitudes to the regulatory agencies to cross check the generally negative answers which we initially received. The subsequent responses served only to confirm our original picture.

It is quite clear that the regulatory authorities are not highly thought of by professional advisors and traders in the securities industry. Perhaps this is undeserved in view of their serious resource constraints. The CAC's in particular seem to inspire very little confidence. The agencies are described as lacking teeth, competent staff and sufficient resources to adequately do the job that is being asked of them. Many respondents also pointed to the lack of market sense of the regulators, although the courts are also criticised for failing to take commercial realities into account. There was a frequently made call for a more market oriented court comprising industry experts, although ultimately the retention of the full sanction of the criminal law was seen as essential.

6.11 Have there been insider trading cases where no action was taken?

As a further check on the operation of the agencies we asked whether there had been cases which the authorities had detected insider trading but had not proceeded with a prosecution. Some said that they were aware of such cases and either guessed that the evidence was not strong enough or wondered whatever happened. There was no suggestion of any corruption. The responses of the agencies on this issue are probably most instructive - they seem to receive many referrals, some of which are said to be motivated by spite, but each of them it was said is taken seriously and is investigated but, usually on legal advice, it is not taken to the prosecution stage. In terms of the public relations aspect of their work, it would help the agencies if they were to advise informants of the outcome of these enquiries but perhaps there is an element of confidentiality to be considered. It might be helpful for the agencies to tell likely informants such as the stock exchange what quality evidence is required before the cases can go further. Better still, if there was closer co-operation in this phase the prosecution record might improve.

The reaction of the agencies gave us some idea of their approach to prosecutions. The chances of success obviously weighed heavily in decisions to proceed to prosecution and as one regulator explained

"[we] have an obligation to investigate every complaint. There needs to be at least a 50:50 chance of success before prosecuting. Prosecutors have a natural hesitancy in running cases where there is no precedent"

When this feeling is added to the problem of resource constraints and the perceived lack of political support for insider trading prosecution, the reason for the lack of more prosecutions is fairly plain to see. More often than not, there was a preference amongst the regulators to proceed in relation to other offences arising under some other provisions of the Code as these were seen as being easier to substantiate

6.12 The paucity of prosecutions

The second most important question in this study was why there has been such a lack of insider trading prosecutions in Australia. Since insider trading was prohibited, almost twenty years ago, there have been only six reported cases. The record of insider trading prosecution in

Australia is deplorable in view of the strong evidence of the continuing existence of insider trading over many years.

The regulatory authorities should of course take some of the blame for this. However, the evidence of their lack of will or incentive to proceed vigorously against insider traders has to be matched with the obstacles facing them. The reluctance of the market community to lend support to substantiate complaints or to act as witnesses has served to increase the problems facing enforcement of a law that most acknowledge needs to be more vigorously enforced. The problem of getting persons to come forward to complain about insider trading is compounded by difficulties of gathering sufficient evidence especially to the effect that the information was "material" within the terms of section 128.

6.13 The detection of insider trading

A key issue confronting the enforcement of insider trading revolves around the detection of insider trading by regulatory agencies. Detection is of course a threshold issue and we were especially interested in the mechanisms used by the CAC's to detect the existence of insider trading.

It was quite clear from the outset that, as one regulator explained, "there is not much pro-active enforcement" of insider trading. There is little to no computer surveillance by the CAC's in respect of market transactions and reliance has tended to be placed upon the stock exchange and the NCSC in this regard. It became apparent that the regulatory style of the CAC's is almost completely reactive in nature. They seem to rely on tips, the press and references from the NCSC. This was also confirmed when we asked regulators how frequently they undertook random audits of stock trading for the purpose of detecting insider trading. The answer to this question was singularly striking and simple. All regulators who answered this question told us that such audits did not take place at all, indicating the complete resort to reactive strategies of enforcement of insider trading. There was not even a hint of pro-active enforcement carried on from time to time. The brokers and merchant bankers confirmed the lack of random audits but there were many references to a considerable volume of NCSC enquiries though these were not necessarily related to insider trading.

When we looked at the problems facing the agencies in detection we learned that the central issue arising is the difficulty of obtaining complaints or information about insider trading activity. The CAC's and NCSC's reactive strategy is related to the difficulties which a rigorous proactive enforcement strategy would create. These difficulties are mainly the resource constraints being faced by these agencies.

However, for insider trading detection and enforcement to be effective, we were repeatedly told that there was a need for reliable informers who were prepared to come forward with complaints or information. The lack of these presents serious and possibly insurmountable problems and also reflects upon the morality or ethics of the marketplace. A special detection problem is that the information trail gets cold very quickly and it becomes very difficult to deal with cases that arose beyond the immediate past.

6.14 Problems of Proof

Even if insider trading has been detected the agencies must be able to prove the offence according to the criminal standard - beyond reasonable doubt - if they are to prosecute successfully. We asked whether there were specific problems associated with proving insider trading. Two particular problems were identified. One was that of being able to find witnesses and the other, flowing from section 128, was to establish that the information was price sensitive and material.

The witness problem manifests itself in several forms. First there is the need to overcome the "no ratting" culture prevalent in the industry which makes it difficult to obtain expert evidence. Another practical consideration is to find witnesses who do not change their story. A further complication is that, by its very nature, insider trading is conspiratorial and the prospects of finding a witness are very poor.

The issue of expert witnesses is linked to the second of the key issues of proof, namely, establishing the element of materiality required by section 128. It seems that the strictness of this requirement is a serious defect in the current legislation and that it may actually be necessary either to spell out more precisely what is meant by the phrase "likely materially to affect the price of those securities" in section 128. In its present form the materiality requirement is a serious obstacle for the agencies.

6.15 The Standard of Proof

The problems of proof which section 128 itself creates are compounded by the fact that the criminal nature of the offence involves the criminal standard of proof i e beyond reasonable doubt. We asked the regulators whether a different standard of proof would make prosecution easier.

Although some thought that the prosecution would clearly become easier, many had doubts about taking this approach. If the civil standard of proof - on the balance of probabilities - was introduced it was felt that the penalties would necessarily have to be changed and as

a result the main deterrent of imprisonment would cease to exist. Others pointed out that even if this change was made the prosecution would still need to provide the evidence and satisfy the section. A common suggestion offered at this point was that rather than lowering the standard of proof, a more effective strategy might be to reverse the onus of proof so that the accused would be required to prove that his or her conduct did not fall within terms of section 128. This might be seen as politically undesirable but it might well be the only realistic solution to adopt short of a re-write of the current legislative provisions.

6.16 Resource problems

The issue of resource constraints imposed on public sector agencies is a commonly raised matter and was frequently mentioned in the course of this study. We pursued this matter by asking about the main resource constraints upon the CAC's affecting the detection and prosecution of insider trading. We were told repeatedly that there was not so much a resource restraint as a question of emphasis. It was explained that the government decides what resources are put into CAC's. Priorities are then internally determined depending on the level of complaints.

Resources constraints are no doubt a problem facing the regulatory agencies in dealing with insider trading. Frequent references were made to the problems of maintaining quality staff against competition from the private sector where salaries were considerably higher. Likewise, there appear to be severe deficiencies in the capacity of agencies to undertake appropriate levels of market surveillance.

6.17 Disincentives to Investigation

In reviewing the enforcement performance of the agencies we also asked about the factors that act as disincentives to investigation and, ultimately, prosecutions. What emerged was a picture of almost unrelieved demoralisation within the agencies. Apart from the problems of detection and proof referred to earlier the regulators were concerned about the lack of experience in handling insider trading cases, the absence of any authoritative guidance from the courts about what is involved in section 128, the perception that the courts would be too conservative in any event, the time involved in mounting a case and, generally, the low likelihood of success.

Against this background it is hardly surprising that there have been so few insider trading prosecutions over the last two decades.

6.18 The Prospects for Regulatory Co-operation

As regulatory resources appear so thinly stretched it seemed to us that there might be room for considerable co-operation between CAC's and the ASX in relation to insider trading investigations. The closer relationship to the industry enjoyed by the ASX might assist the CAC's in becoming better informed and being able to overcome their lack of market know how when dealing with insider trading cases or complaints. There were mixed feelings among the brokers about this idea but there nevertheless appears to be a considerable degree of goodwill for the governmental agencies.

The CAC's said that there were already good working relations between both organizations. Apparently there has been an improvement and earlier differences have been solved. The ASX was seen, however, as primarily dealing with the NCSC and not with the CAC offices. Both organizations were facing resource constraints but the NCSC-ASX relationship is said to be excellent.

6.19 Conclusions

Our initial suspicions, that the law against insider trading is practically non-existent, were confirmed during the course of this study.

There is no doubt that insider trading occurs and that is encouraged by the opportunities that have existed over the past few years. These opportunities have been supplemented by several factors. The law itself is extremely complex, largely untested and it presents significant problems of proof. There is also no doubt that despite a stated attitude of opposition to insider trading a sizable proportion of market participants feels unrestrained by legal or ethical considerations from engaging in it. The single most important factor is, however, the deplorable performance of the agencies who are responsible for the control of insider trading. We can accept that the agencies have severe problems with the detection and proof phases of a prosecution but we are not convinced that these factors of themselves explain such a poor record. It appears to us that, quite simply, the task has been consigned to the too hard basket and that resources have been deployed to other less demanding, more glamorous or more lucrative areas of responsibility. This judgment might appear to be harsh and in making it we do not excuse governments from criticism. In our view there has been a serious failure at the political level to ensure that the securities industry is adequately policed. The rhetoric of successive governments about the need for an efficient securities market has not been matched by any tangible commitment to the principles of efficient markets. Without the necessary political leadership and encouragement it is little wonder that the agencies have performed so poorly.

In the same vein we are critical of the Stock Exchanges and the broking community. The Exchanges are undoubtedly better than they were in the period reviewed by the Rae Committee. We were left with the distinct impression, however, that they are concerned more with administrative and public image issues. They appear to have paid insufficient attention to enforcing their own Listing Rules and, to this extent, they have also failed to support the principle of informed markets and thereby, if only indirectly, they have created the conditions where insider trading can flourish.

We acknowledge that the broking community includes persons whose ethical standards are exemplary, but we cannot avoid the conclusion that in other parts of that community a double standard operates. Despite their stated abhorrence of insider trading they tolerate it and have not been prepared to provide assistance for prosecutions. It might be that the existence of section 128 and the regulatory agencies has led many to believe that the industry has been absolved from any responsibility to eliminate insider trading.

7.1 Self Regulation

If regulation by the existing regulatory agencies is regarded as being wanting, it might be asked if self regulation is likely to be a more effective response to insider trading in the Australian context. This is an option that must always be considered particularly in a climate of deregulation. The developments in the United Kingdom including the emergence of "people's capitalism" or a stronger sense of "shareholder democracy" also place this option on the agenda of any possible reform. Is there a case then for a more extensive system of self regulation to deal with insider trading such as the model of the regulation of financial markets found in the City of London as a result of the Financial Services Act of 1986? In approaching this issue we looked at several aspects of the capacity for self regulation.

7.2 Attitudes to self regulation

It appeared that many of the brokers were not aware of the system in the United Kingdom and their comments largely reflected views about self regulation based on the stock exchange as the regulating body. There was little support from any of the groups we interviewed for the introduction of self regulatory structures in this country similar to those found in the United Kingdom. This was largely due to the significant differences which exist between the two countries geographically, and between the culture of their financial markets and practitioners. An important difference is the influence in the United Kingdom of the Bank of England.

7.3 Professional Attitudes to Insider Trading

The values of participants in the market provide a useful measure of whether self regulation would work and with this in mind we asked about their attitudes to insider trading. It appears that within the broking industry insider trading is not a topic much discussed but we were told by many brokers that it is regarded as improper and that there is opposition to it. There were however, several brokers who took a different view saying that insider trading is tolerated and this was confirmed by the non broker respondents. It would be going too far to dismiss completely the stated opposition to insider trading and it is more likely the case that it occurs at varying degrees within the broking sector. The apparent level of tolerance towards insider traders was however at odds with a culture of high ethical standards.

We explored this issue further by asking our lawyer and accountant respondents about their perceptions of the ethical standards of fellow professionals regarding insider trading. As we spoke only to partners in

large law firms, there is a possibility that we obtained a one sided view of the profession, as the social organization of legal work (e.g. clientele, division of labour and types of work handled) differ markedly in these firms from those in smaller firms. However, as these large law firm lawyers specialize in securities market work, something that is less common in smaller firms, they are likely to be in a position to give us a good picture of other lawyers working in this area. Virtually all of the lawyers told us that they thought that lawyers in other firms like their own had very high ethical standards regarding insider trading.

The accounting profession has a range of firms and division of work not unlike the legal profession. The presence and influence of international firms is, however, much more pronounced in the accounting profession. We were told that standards vary but that most accountants are strongly opposed to insider trading. Those firms with strong U.S. links are said to be particularly concerned about it. Our accountant respondents did, however, leave us room to wonder whether the same high standards applied throughout their profession.

7.4 Conflicts of Interests

If self regulation is to be considered, an important consideration is the likely behaviour of those who are self regulating. We therefore asked all of the participants about the frequency and management of conflicts of interest arising from access to price sensitive information. Lawyers had little trouble identifying the intent of this question, but many of the non-lawyer respondents we spoke to experienced some difficulties in coming to terms with the notion of conflict of interest. This could not be because conflicts of interest only arise in relation to legal work.

It appears that the everybody we spoke to was aware of the possibility of conflicts and the need to protect sensitive information. All of them told us that, where appropriate, they have procedures to guard against the misuse of sensitive information. We were not, however, in a position to assess the effectiveness of these procedures. In the case of government agencies, if overseas experiences are any guide, the security of information may be just as much at risk as it is in the offices of private sector professionals.

7.5 Chinese Walls

In relation to the management of conflicts we asked about attitudes and experiences with Chinese Walls as a means of preventing insider trading. Section 128(7) (b) of the Securities Industry Code provides that it is a partial defence to an insider trading charge if a body corporate "had in operation .. arrangements to ensure that the

information [in the possession of an officer of that body corporate] was not communicated to that person and that no advice with respect to the transaction was given to him by the person in possession of the information."

There was support for the concept of Chinese Walls but most of the participants in the study expressed severe qualifications about their practical value. The main reservation was that they break down too easily and that, to be effective, Chinese Walls required an organisational culture of integrity which was not always in existence.

7.6 The Monitoring of Trading

We were interested to know whether as part of their self regulating practice brokers (especially) monitored trading for evidence of insider trading. What monitoring that is undertaken is either to check on staff or to keep abreast of trading patterns or at the request of clients. It appears that brokers do not concern themselves about whether clients are insider trading.

7.7 Insider Trading and Risk Taking

The degree to which market participants perceive a risk of detection and prosecution associated with illegal conduct provides some idea of whether self regulation would work in practice. The answers we received on this subject were mixed. The general impression was that insider traders regard the risk of detection as very low but some of those who engage in it in a calculated way do so making some effort to avoid detection. Insider trading from offshore was described as risk free but it is not necessary to resort to this style of trading because the risk of being caught in Australia is seen as very low. An interesting observation from several respondents was that many people engage in insider trading not knowing that it is illegal.

7.8 The Stock Exchanges as Regulators

As a further test of the effectiveness of self regulation we asked those who are close to the market for their opinions about the adequacy of the Stock Exchanges' regulation of insider trading among their members.

The responses to this question were mixed. There was almost equally divided opinion as to whether the exchanges were adequate. There was not necessarily criticism implied in the negative answers. It was often pointed out that the exchanges can reach only the brokers and their contribution is best made through close co - operation with the NCSC.

Another factor was that the exchanges are also subject to resource limitations especially in terms of technology. Our own observations were that the exchanges were limited and that their capacity seems to be directed more towards accounting matters than to stamping out market place abuses.

7.9 Conclusions

The Rae Committee reported unfavourably on the performance of the Stock Exchanges as self regulators. Despite the subsequent improvement in that regard, there is little doubt that self regulation is not currently a realistic option. The major reason is that the members of the industry are not themselves committed to the concept. The Exchanges are also limited in that their power is restricted to members and, though it might be arguable that they can control the activities of persons associated with listed companies, there would be a gap in the coverage of the market. Another factor is that the Exchanges are said to be subject to resource constraints and their physical ability to undertake the task is doubtful.

We do not believe that it would be appropriate to leave the matter of insider trading to the individual members of the industry. Some would no doubt have the necessary ethical standards to do so but we are not confident that the industry as a whole would meet those standards.

Having dismissed self regulation as a realistic option, we believe that there is some ground for considering a further development of co-regulation. There seems to be a fair degree of goodwill to the agencies and, as it was pointed out more than once, the exchanges and the agencies are working to much the same goal. There is also some pressure from within the broking community for a system of co-regulation. On the debit side is the natural antipathy of Australians to regulators and it would be romantic to imagine that everybody would be happy to see the external enforcement agencies coming closer into their community. A more serious practical obstacle is that neither the exchanges nor the agencies seem to be well endowed with resources.

A system of co-regulation has the advantage of overcoming the common criticism by the industry that the agencies lack market skills. Co-regulation could allow for the harnessing of the abundant market skills within the industry and could therefore be expected to lead to an improvement in the enforcement effort. However, it is clear that neither industry bodies like the ASX or regulatory agencies such as the NCSC or CAC's can deal with insider trading regulation and law enforcement alone. Nevertheless, there is overwhelming evidence that the latter agencies must take the lead in these matters and encourage

the industry bodies to provide them with more effective back-up than presently occurs.

8.1 Insider Trading Law Reform

Several aspects of the legislation were considered in the range of our questions where we tested the reaction to possible changes in the law and, in one respect, the legal process itself.

8.2 Tippee liability

A perennial problem with section 128 and one which has particularly worried brokers, has been the extent to which it is applicable. In other words, it is necessary to ask who is caught by it and how far the law should go in defining tippees. The Anisman report dealt in some length with tippee liability and on this issue attracted considerable criticism. We found a predictable tension between casting the net too wide and so giving regulators a considerable discretion as to which cases to pursue, and on the other hand, codifying the classes of tippees more precisely. There were mixed feelings about these choices. There was not a great deal of support for a precise legislative definition of tippees. There were, however several suggestions that the NCSC could usefully prepare guidelines to assist the industry.

8.3 The Issue of Materiality

One of the elements of section 128 that must be proved is that the information "would be likely materially to affect the price" of the securities in question. We asked the brokers, financial advisers and stock exchange officials how they would measure materiality and we tested the US approach to materiality, namely, whether a reasonable person would consider information material.

Brokers were almost unanimous in stating that it is a complex matter. Most felt that a flat percentage formula would not be appropriate, and that market conditions, the particular share, price and volume movements and the established trading patterns must be considered. There was support for the use of a percentage movement but not by itself because it would move the price up to the legislated rate. The techniques and the data for examining trading patterns appear to exist within the broking industry. There was almost complete accord among the exchange officials about the unsuitability of a simple equation as a means of measuring what is material. Rather surprisingly some financial advisers suggested a simple percentage but those who were closer to the market rejected this approach.

There was widespread acceptance of the reasonably informed person test as the basis for determining whether the information was material.

8.4 Changing the standard of proof

The regulators were asked whether a change from the criminal standard of proof would make the task of prosecution easier. As discussed earlier, there was not a high level of support for this change, the major reason being that the existing range of penalties would need to be altered as a consequence and that the deterrent value of prison would be lost. Changing the standard would not alter the need to gather evidence and to prove the case in court. An alternative that emerged was that of reversing the onus of proof so that the accused would need to prove that the conduct was not within the range of section 128.

8.5 Conclusions

The complexity of the provisions of section 128 creates problems for those who are regulated by the section and for those who are required to enforce it. It would be a welcome development to have the section re-written in a comprehensible form and with clarification of the concepts that are embedded in the section. In this respect there appears to be considerable support for following the U.S. approach of defining "materiality" with reference to the reasonably informed person test. On the other hand the question of tippee liability remains a problem as there is little support for a legislative definition. The appropriate step would be to follow the suggestion that the NCSC prepare guidelines to assist in the interpretation of this concept.

There is a not strong case for changing the standard of proof from the criminal to the civil standard. There is, however, a case for reversing the onus of proof so that the prosecution would be required to make out a *prima facie* case and the accused would then be required to prove that the conduct would not fall within the scope of section 128.

There is a case also for providing some protection for those company directors and executives who trade in their company's shares and in this respect believe that a version of the U.S. section 16(b) approach should be adopted. This provides that profit from short swing trades should be repaid to the company.

9.1 The Ethical Dimension of Insider Trading

In the course of this study a number of questions were asked, the answers to which provide insights into the ethical climate of the industry. The failure to enforce the insider trading laws has created the situation where a great deal of the responsibility for obeying the law falls on to the individual and in this respect much is left to the ethical standards of the industry.

Insider trading and prevailing patterns of business ethics within the securities industry are clearly closely related. This is not just a question of greed, although greed is obviously a key underlying motivation for many within the industry. The real issues concern the culture of tolerance of insider trading, peer-group support for insider traders and the largely symbolic role of law and regulation in this area. There are obviously different ethical values at play within the industry. Some professionals, such as lawyers, accountants and many older and more established brokers clearly espouse and practise very high ethical standards, although we found that even they were reluctant to come forward and complain about insider traders or be prepared to give evidence against them. Many others in the industry are however much more relaxed about their commitment to ethical standards. Often this was seen to be due to ignorance of the law or a lack of interest in it. For those who know of the law's existence the widespread knowledge that the law has not been enforced very well, if at all, has contributed to a cavalier approach to the criminal law.

At the same time, the existence of criminal laws and regulatory structures which theoretically deal with insider trading has led many to see insider trading as a matter for the agencies and not for the industry itself. This partly explains the almost non-existent emphasis upon improving ethical standards by those working in the industry. The most common response to this problem is to say that the law had not failed in this area, but that it had not been enforced. It is however, unlikely to be able to be enforced without support from industry itself. In critical areas this is simply not forthcoming, although there may be some small change beginning to occur in this regard, such as with the likely provision of expert witnesses by Stock Exchanges to assist in prosecutions. This is very limited and the continued effect of peer group pressure against assisting policing authorities and the traditional Australian "Ned Kelly" attitude to authority is such that the enforcement agencies are unlikely to be able to be much more effective.

It is clear that insider trading laws exist to create confidence in orderly marketing arrangements and to this extent they have goals of symbolic reassurance. Their function is certainly not to punish or to deter insider

traders. At best, they serve to moderate the more extreme examples of insider trading, although it is well known that large insider trading transactions can be readily made off-shore. More realistically the laws create an illusion. To the uninformed the market is being controlled but, to those who know - the market participants - the laws pose no threat at all. In relation to insider trading both the formal and informal legal controls are weak or ineffective and private and peer group controls are sporadic and unreliable. Prevailing patterns of ethics have served to entrench and perpetuate this situation. This is despite a widespread recognition that insider trading is described as fraudulent, dishonest, or criminal, and that it is unfair to those who trade with the insider trader. It is also despite the recognition by those who profess concern for market efficiency that insider trading has an especially damaging effect on the market's efficiency. These factors are clearly not the decisive ones, and the compelling conclusion is that there must be some other factor at work such as the values embedded in the prevailing business culture of the Australian securities industry.

1 0 Recommendations

There are a number of matters in regard to which action should be taken. We should stress that some of these matters do not lend themselves to "quick fix" solutions. The responsibility for implementing these recommendations will lie with the stock broking community, the stock exchanges and government. In making these recommendations we should stress that they reflect the concerns and views of many participants in the market place.

10.1. In the listing of company shares on stock exchanges greater control should be exercised in relation to those who are associated with companies, in relation to the allotment of shares in such companies and in monitoring the trading patterns of such shares. This greater degree of control appears to be especially necessary in respect of second board companies and those on the main board which might be described as speculative stock.

10.2. Greater awareness should be developed amongst the investing public, directors and companies of the illegality of insider trading. The development over recent years of a community sense of outrage towards tax avoidance offers a useful parallel. It is necessary for insider trading (and other forms of market abuse) to be seen as a form of moral turpitude if control of corporate crime is to be achieved. Directors should be made aware of the risks that they run by trading and in this respect we believe that a body such as the Institute of Directors could usefully prepare material on directors' duties and responsibilities in relation to insider trading. Flowing from greater awareness amongst directors would be a higher degree of consciousness within companies of the need to protect the security of price sensitive information.

10.3. Much greater emphasis should be paid to training in ethics. We consider that the Securities Institute of Australia could make a signal contribution in this regard by incorporating a business ethics element into the courses it conducts. The same need for training in ethics exists in business courses in tertiary institutions throughout Australia. There is currently an international movement in this direction and also a growing concern about ethical standards in business.

10.4. In view of the economic significance of the stock market both in Australia and internationally, there should be further research into the issue of investor confidence in the market.

10.5. Related to investor confidence is the issue of the participation rate in the stock market. There is no doubt that there is a place for small investors in the market for securities. Equally, there is no doubt that there is a perception that small investors are not as well treated as other investors. There is no doubt that the broking industry could contribute to an improvement in this regard and that the encouragement of small investors could result in a healthier level of participation.

10.6. As a matter of priority, the disclosure practices of listed companies must be improved. The flow of information is critical to the efficiency of the market. Without accurate and timely information the market is prey to insider trading and to other forms of manipulation and abuse. The Stock Exchanges have an obligation to enforce actively their Listing Rules in relation to informing the market as a whole. It might also be necessary to consider some form of statutory regulation to ensure that there is timely disclosure and, in this respect, attention is drawn to the terms of the Formal Agreement establishing the present co-operative scheme on companies and securities, which provides the philosophical base to the Australian system of company regulation.

10.7. As the securities market takes on a more international dimension, it becomes more important for Australia to participate to the fullest extent in the regulation of that market. There is evidence to suggest that offshore based insider trading takes place and it appears that Australia should seek more vigorously and systematically to develop the necessary arrangements with foreign jurisdictions to control such activity. Although the Cash Transactions Reports Act will provide some means of control of international cash flows it is important that Australia should have arrangements with other countries, including the secrecy jurisdictions, in order to detect and to prosecute international securities offences.

10.8. The enforcement effort in relation to insider trading leaves much to be desired. The effective immunity from prosecution and the impunity with which insider trading can be carried on reflects the poor level of performance of the enforcement agencies. It is necessary that, if insider trading is to be curbed, the agencies must be given the resources and political commitment necessary to enforce the law.

10.9. Enforcement agencies, including the Stock Exchanges, should pay more attention to other forms of market conduct. The findings from this body of research suggest that market manipulation and rigging, however they are described, are quite common. It also appears that warehousing is a frequent practice. There are grounds for believing that these practices also involve an element of insider trading.

This suggests that a more wide-ranging strategy of dealing with securities market abuse is called for.

10.10. It is clear that there is an urgent need for more research and scrutiny in regard to securities market conduct in Australia. This needs to go hand in hand with improved mechanisms of market surveillance which need to be backed up by a greater governmental and private sector commitment to the introduction of appropriate computer technologies to facilitate research and oversight in the area of market abuse.

10.11. The lack of any successful prosecutions in this area over many years has led to the perception that there is no effective insider trading prohibition in existence in Australia at this time. Section 128 of the Securities Industry Act and the similar draft section 1002 of the Corporations Bill 1988 is an extremely complex provision. This complexity creates almost insurmountable problems both to the industry and to those charged with its enforcement. It is our view that the provision needs to be entirely rewritten and, in so doing, simplified.

10.12. It is clear that the criminal law must remain the principal mechanism for the enforcement of this section and that there is little if any support for self regulation as the primary basis for law enforcement in this area. There is however strong support within the industry for the introduction of new and improved civil remedies to supplement the criminal law.

10.13. As it is likely that the Australian courts will continue to interpret corporate legislation narrowly it is important that various concepts within the existing (and proposed) law be clarified. This should be done both to assist corporate law enforcers and those who are likely to be subject to the law. We refer here particularly to the concept of "materiality" which is in need of a clear definition. Some concern has also been expressed about tippee liability and the appropriateness of Chinese Walls as a defence.

10.14. On the question of the definition of "materiality", we consider that it should be statutorily defined and not left to the courts to do so. There is considerable industry support for the introduction of such a statutory definition. Specifically, this definition of materiality should mean that price sensitive information is material where two reasonably informed persons regard the information as material. As has been argued, there is no justification for reliance upon a percentage based price change formula of materiality and the industry regards such a formula as entirely inappropriate.

10.15. In regard to tippee liability there is not sufficient justification for a change in the current approach, although the NCSC or ASC should be encouraged to develop guidelines to assist the industry in dealing with this sometimes difficult problem.

10.16. There are also procedural and evidentiary dimensions of the prosecution process which are in urgent need of reform. In particular, there is a very strong case for the reversal of the onus of proof once a prima facie case of insider trading has been established. Such a change in this area would be likely to fall within the guidelines for the reversal of the onus of proof laid down by the Senate Standing Committee for the Scrutiny of Bills. It also seems to us to be essential that in the revised legislation the Federal Court of Australia be given jurisdiction to hear insider trading cases.

10.17. At the level of prosecution, it is highly desirable that a single national prosecutorial agency be given responsibility in this area. In view of the successes of the Federal Director of Public Prosecutions in the area of taxation fraud prosecution in recent years, we feel confident that this is the appropriate agency to undertake the prosecution of cases of insider trading.

10.18. In regard to penalties (s.129/s.1311) it is desirable to depart from the formula which currently applies. In particular, the upper limit for fines of \$20,000 is highly unrealistic in regard to insider trading. It is clear that this figure needs to be raised at least to \$100,000 for each offence. This view is widely held in all sectors of the industry. In the case of the associated penalty of five years imprisonment, we do not see that there is as urgent a need for change although other jurisdictions (such as the UK) have also seen fit to raise the maximum term of imprisonment.

10.19. It is clear that there is also an urgent need to introduce civil penalties, particularly the disgorgement of profits and at least double damages. Furthermore the present section 130 (s.1013 of the Bill) needs to be made more credible. There is a widespread view amongst lawyers that this section needs to be completely rewritten to make it an effective remedy. In particular, the introduction of class or group actions to shareholders damaged by insider trading conduct, seems to us to be essential.

10.20. In the context of the phrase, used in the legislation, of "persons connected with a body corporate in the preceding six months" we would urge the introduction of a defence to insider trading in circumstances where all short swing profits derived during that period are returned to the corporation whose securities were traded. This

defence should only be available provided the payment was made within thirty days of the profit being made.

10.21. In the revision of the current provisions dealing with insider trading, it is desirable to clarify the present uncertainty as to whether off-market transactions are covered by the section. They obviously should be covered and this needs to be more emphatically stated in clear and unambiguous words.

10.22. Similarly, it is clear that insider trading can be undertaken by a corporation. However, judicial interpretation of section 128 has read the word "person" narrowly so as only to cover natural persons. Such an interpretation, even if it is correct, would provide a major means of avoiding the insider trading prohibition. This would be contrary to the spirit of the legislation.

APPENDIX

LegislationSECURITIES INDUSTRY ACT 1980**Prohibition of dealings in securities by insiders**

128. (1) A person who is, or at any time in the preceding 6 months has been, connected with a body corporate shall not deal in any securities of that body corporate if by reason of his so being, or having been, connected with that body corporate he is in possession of information that is not generally available but, if it were, would be likely materially to affect the price of those securities.

(2) A person who is, or at any time in the preceding 6 months has been, connected with a body corporate shall not deal in any securities of any body corporate if by reason of his so being, or having been, connected with the first-mentioned body corporate he is in possession of information that-

(a) is not generally available but, if it were, would be likely materially to affect the price of those securities; and

(b) relates to any transaction (actual or expected) involving both those bodies corporate or involving one of them and securities of the other.

(3) Where a person is in possession of any such information as is mentioned in sub-section (1) or (2) that if generally available would be likely materially to affect the price of securities but is not precluded by either of those sub-sections from dealing in those securities, he shall not deal in those securities if-

(a) he has obtained the information, directly or indirectly, from another person and is aware, or ought reasonably to be aware, of facts or circumstances by virtue of which that other person is then himself precluded by sub-section (1) or (2) from dealing in those securities; and

(b) when the information was so obtained, he was associated with that other person or had with him an arrangement for the communication of information of a kind to which those sub-sections apply with a view to dealing in securities by himself and that other person or either of them.

(4) A person shall not, at any time when he is precluded by sub-section (1), (2) or (3) from dealing in any securities, cause or procure any other person to deal in those securities.

(5) A person shall not, at any time when he is precluded by sub-section (1), (2) or (3) from dealing in any securities by reason of his being in possession of any information, communicate that information to any other person if-

(a) trading in those securities is permitted on a stock market, whether within or outside the Territory; and

(b) he knows, or ought reasonably to know, that the other person will make use of the information for the purpose of dealing, or causing or procuring another person to deal, in those securities.

(6) Without prejudice to sub-section (3) but subject to sub-sections (7) and (7A), a body corporate shall not deal in any securities at a time when any officer of that body corporate is precluded by sub-section (1), (2) or (3) from dealing in those securities.

(7) A body corporate is not precluded by sub-section (6) from entering into a transaction at any time by reason only of information in the possession of an officer of that body corporate if-

(a) the decision to enter into the transaction was taken on its behalf by a person other than the officer;

(b) it had in operation at that time arrangements to ensure that the information was not communicated to that person and that no advice with respect to the transaction was given to him by a person in possession of the information; and

(c) the information was not so communicated and such advice was not so given.

(7A) A body corporate is not precluded by sub-section (6) from dealing in securities of another body corporate at any time by reason only of information in the possession of an officer of that first-mentioned body corporate, being information that was obtained by the officer in the course of the performance of his duties as an officer of that first-mentioned body corporate and that relates only to proposed dealings by that first-mentioned body corporate in securities of that other body corporate.

(8) For the purposes of this section, a person is connected with a body corporate if, being a natural person-

(a) he is an officer of that body corporate or of a related body corporate;

(b) he is a substantial shareholder within the meaning of Division 4 of Part IV of the *Companies Act 1981* in that body corporate or in a related body corporate; or

(c) he occupies a position that may reasonably be expected to give him access to information of a kind to which sub-sections (1) and (2) apply by virtue of-

(i) any professional or business relationship existing between himself (or his employer or a body corporate of which he is an officer) and that body corporate or a related body corporate; or

(ii) his being an officer of a substantial shareholder within the meaning of Division 4 of Part IV of the *Companies Act 1981* in that body corporate or in a related body corporate.

(9) This section does not preclude the holder of a dealers licence from dealing in securities, or rights or interests in securities, of a body corporate, being securities or rights or interests that are permitted by a securities exchange to be traded on the stock market of that securities exchange, if-

(a) the holder of the licence enters into the transaction concerned as agent for another person pursuant to a specific instruction by that other person to effect that transaction;

(b) the holder of the licence has not given any advice to the other person in relation to dealing in securities, or rights or interests in securities, of that body corporate that are included in the same class as the first-mentioned securities; and

(c) the other person is not associated with the holder of the licence.

(10) Where a prosecution is instituted against a person for an offence by reason that the person was in possession of certain information and entered into a transaction in contravention of this section, it is a defence if the person satisfies the court that the other party to the transaction knew, or ought reasonably to have known, of the information before entering into the transaction.

(11) For the purpose of sub-section (8), "officer", in relation to a body corporate, includes-

(a) a director, secretary, executive officer or employee of the body corporate;

(b) a receiver, or a receiver or manager, of property of the body corporate;

(c) an official manager or a deputy official manager of the body corporate;

(d) a liquidator of the body corporate; and

- (e) a trustee or other person administering a compromise or arrangement made between the body corporate and another person or other persons.

Penalties

129. A person who contravenes section 123, 124, 125, 126, 127 or 128 is guilty of an offence.

Penalty-

- (a) in the case of a person not being a body corporate - \$20,000 or imprisonment for 5 years, or both; or
 (b) in the case of a person being a body corporate - \$50,000.

Compensation for loss, &c.

130. (1) Where-

- (a) a person who is in possession of any such information as is mentioned in sub-section 128 (1) or (2) in respect of any securities deals in those securities in contravention of sub-section 128 (1), (2) or (3) or causes or procures another person to deal in those securities in contravention of sub-section 128 (4); or
 (b) a person being a body corporate deals in securities in contravention of sub-section 128 (6) at a time when an officer of the body corporate was in possession of any such information as is mentioned in sub-section 128 (1) or (2), that person is liable (whether he has been convicted of an offence in respect of the contravention or not)-
 (c) to compensate any other party to the transaction who was not in possession of that information for any loss sustained by that party by reason of any difference between the price at which the securities were dealt in in that transaction and the price at which they would have been likely to have been dealt in in such a transaction at the time when the first-mentioned transaction took place if that information had been generally available; and
 (d) to account to the body corporate that issued or made available those securities for any profit accruing to the first-mentioned person from dealing in those securities.

(2) A person who contravenes section 123, 124, 125, 126 or 127 (whether he has been convicted of an offence in respect of the contravention or not) is liable to pay compensation to any other person who, in a transaction for the sale or purchase of securities entered into with the first-mentioned person or with a person acting for or on behalf of the first-mentioned person, suffers loss by reason of the difference between the price at which the securities were dealt in in that transaction and the price at which they would have been likely to have been dealt in in such a transaction at the time when the first-mentioned transaction took place if the contravention had not occurred.

(3) The amount of compensation for which a person is liable under sub-section (1) or (2) or the amount of the profit for which a person is liable to account under sub-section (1) is-

- (a) in a case to which paragraph (b) does not apply - the amount of the loss sustained by the person claiming the compensation or the amount of the profit referred to in paragraph (1) (d), as the case may be; or
 (b) if the first-mentioned person has been found by a court to be liable, or has been ordered by a court, to pay an amount or amounts to any other person or persons under this Part or under sub-section 229 (6) of the *Companies Act 1981* or under a corresponding provision of a previous law of the Territory by reason of the same act or transaction - the amount of that loss or profit less the amount or the sum of the amounts that the first-mentioned person has been so found to be liable, or has been so ordered, to pay.

(4) For the purpose of sub-section (3), the onus of proving that the liability of a person to pay an amount to another person arose from the same act or transaction from which another liability arose lies on the person liable to pay the amount.

(5) An action under this section for recovery of a loss or profit shall not be commenced after the expiration of 2 years after the date of completion of the transaction in which the loss or profit occurred.

(6) The commission may, if the commission considers it to be in the public interest to do so, bring an action in the name of and for the benefit of the body corporate or other person for recovery of a loss or profit referred to in sub-section (1) or (2).

(7) Nothing in sub-section (1) or (2) affects any liability that a person may incur under any other law.

(8) For the purposes of paragraph (1) (b), "officer", in relation to a body corporate, includes-

- (a) a director, secretary, executive officer or employee of the body corporate;
- (b) a receiver, or a receiver and manager, of the property or any part of the property of the body corporate;
- (c) an official manager or a deputy official manager of the body corporate;
- (d) a liquidator of the body corporate; and
- (e) a trustee or other person administering a compromise or arrangement made between the body corporate and another person or other persons.

COMPANIES ACT 1981

Extract from section 229-

(3) An officer or employee of a corporation, or a former officer or employee of a corporation, shall not make improper use of information acquired by virtue of his position as such an officer or employee to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Penalty: \$20,000 or imprisonment for 5 years, or both.

Cases on insider trading

Es-Me Pty Ltd v. Parker [1972] WAR 52

Ryan v. Triguboff [1976] 1 NSWLR 588

Commissioner for Corporate Affairs v. Green [1978] VR 505

Kinwat Holdings Pty Ltd v. Platform Pty Ltd (1982) 1 ACLC194

Van Doussa v. Owens (1983) 30 SASR 367

Hooker Investments Pty Ltd v. Baring Bros Halkerston and Partners Securities Ltd (1986) 4 ACLC243

An unreported decision from a committal proceeding in Western Australia was *R v. Wise and Goldberg* (The Blackhills case). This did not proceed to trial.