



Insider Trading

Position and Consultation Paper

March 2007

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FOREWORD

Confidence in the fairness of the financial market and its efficiency in determining prices is important in encouraging Australians to invest. This is the basis of the prohibition on insider trading in Australia – market fairness and market efficiency.

The Corporations and Markets Advisory Committee has undertaken substantial work on insider trading and published a final report which made 38 recommendations. Some of the recommendations were for no change, some for technical improvements and several for significant change.

The purpose of this paper is to set out the Government's position on many of those recommendations and to seek further views and information on the issues raised by some. Of particular significance is the appropriate ambit of the prohibition in the light of the changes made to the relevant provisions by the *Financial Services Reform Act 2001*.

These are significant issues and the Government needs your views and experience to reach an appropriate conclusion. I therefore encourage all with an interest in this issue to respond to the issues raised in this paper.

After the consultation period, I shall assess the views expressed in the submissions and make decisions in the light of my concern to achieve simpler and more efficient regulation.

A handwritten signature in black ink, appearing to read 'C Pearce', is positioned to the left of a vertical red line.

The Hon Chris Pearce MP
Parliamentary Secretary to the Treasurer

ABBREVIATIONS

ASX	Australian Stock Exchange
CAMAC	Corporations and Markets Advisory Committee (previously the Companies and Securities Advisory Committee)
CASAC	Companies and Securities Advisory Committee
Corporations Act	<i>Corporations Act 2001</i>
OTC	over-the-counter
FSR Act	<i>Financial Services Reform Act 2001</i> , which inserted a new Chapter 7 into the Corporations Act

EXECUTIVE SUMMARY

The Corporations and Markets Advisory Committee (CAMAC) published its *Insider Trading Report* on 20 November 2003. The Report followed a discussion paper issued in June 2001 by the then Companies and Securities Advisory Committee (CASAC) and a proposals paper issued in September 2002 by CAMAC on insider trading laws.

The Report made 38 recommendations on a broad range of issues. CAMAC's Discussion Paper, Proposals Paper and Report are available from the CAMAC website: <http://www.camac.gov.au>.

The Government proposes to accept most of the recommendations of the CAMAC report. However, as discussed in this paper, there are a number of recommendations on which the Government seeks further input from the market.

Appendix A to this paper lists those recommendations that the Government proposes to accept.

The remaining recommendations on which comment is sought are:

- Recommendation 2: Restrict the on-selling exemption for underwriters
- Recommendation 3: Repeal the exemption for external administrators
- Recommendation 10: Amend the test of generally available information
- Recommendation 11: Informed party exercising option rights
- Recommendation 14: Entity making an individual securities placement
- Recommendation 15: Share buy-backs (as it applies to issuers buying back securities)
- Recommendation 38: Focus the prohibition

On several of these recommendations CAMAC was split on the recommended course of action. In some cases the initial government reaction to these recommendations has been indicated. Even so, further input from the market and interested parties is invited to assist the Government's consideration of these issues.

1. INTRODUCTION

WHAT IS INSIDER TRADING?

'Insider trading' is the trading of securities or some wider set of financial products while in possession of information that is not generally available and would be likely to have a material effect on their price or value if it were. The prohibition against insider trading extends to procuring trading, or communicating that information where trading in the relevant financial products is likely to take place.

The insider trading provisions are now found in Part 7.10, Division 3 of the *Corporations Act 2001* (the Corporations Act).

Contravention of the insider trading prohibition may result in significant penalties.¹

RATIONALE FOR THE PROHIBITION AGAINST INSIDER TRADING

While some overseas markets prohibit insider trading upon a number of different grounds (for instance, fiduciary duty and a theory of misappropriation), in Australia the fundamental basis is to promote market fairness and enhance market efficiency.

The 1989 Parliamentary Committee Report on insider trading (the Griffiths Report)² referred to the importance of a clear policy basis for regulating insider trading. The Griffiths Report:

- emphasised the need to guarantee investor confidence in the integrity of the securities markets;
- rejected the notion that the scope of the insider trading regime should be limited to some concept of fiduciary duty or a theory of misappropriation; and
- confirmed the following principles adopted in the 1981 Report of the Committee of Inquiry into the Australian Financial System (the Campbell Committee) as a basis for prohibiting insider trading:

'The object of restrictions on insider trading is to ensure that the securities market operates freely and fairly, with all participants having equal access to relevant information. Investor confidence, and thus the ability of the market to mobilise

1 Breach of the prohibition is:

- . a criminal offence with a maximum penalty of:
 - 2,000 penalty units (\$220,000) or imprisonment for 5 years, or both, for individuals;
 - 10,000 penalty units (\$1.1m) for bodies corporate; and
- . a civil penalty provision with a maximum penalty of:
 - \$200,000 for an individual; and
 - \$1 million for a body corporate.

2 Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, *Fair Shares for All: Insider Trading in Australia* (11 October 1990).

savings, depends importantly on the prevention of the improper use of confidential information.’³

The Explanatory Memorandum to the 1991 amendments to the *Corporations Act 1989* summarised the views expressed in the Griffiths Report:

‘[I]t is necessary to control insider trading to protect investors and make it attractive for them to provide funds to the issuers of securities, for the greater and more efficient development of Australia’s resources.’⁴

THE CURRENT PROHIBITION

While earlier legislation addressed insider trading, the current provisions date from amendments made to the *Corporations Act 1989* in 1991.

In response to concern in the late 1980s that insider trading was widespread and that the existing legislation was ineffective to address the practice, the Attorney-General requested on 8 February 1989 that the House of Representatives Standing Committee on Legal and Constitutional Affairs conduct an inquiry into insider trading and other forms of market manipulation. The Committee’s report, known as the Griffiths Report, was tabled on 28 November 1989 and contained 14 recommendations on insider trading.

The Government accepted a majority of the report’s recommendations, which were reflected in amendments made to the *Corporations Act 1989* by the *Corporations Legislation Amendment Act 1991*.

With some minor amendments in 1998, these provisions remained essentially unchanged and were re-enacted in 2001 in the *Corporations Act 2001*.

FINANCIAL SERVICES REFORM ACT 2001 — EXTENSION OF THE PROHIBITION

Prior to 11 March 2002, the insider trading prohibition was confined to transactions involving a relatively limited range of financial products (shares; options over, and units in, shares; debentures; interests in managed investment schemes; and futures contracts ‘concerning a body corporate’).

The *Financial Services Reform Act 2001* (FSR Act) amended the Corporations Act by inserting harmonised regimes for the licensing and conduct of financial services providers, the licensing of financial market operators and the operators of clearing and settlement facilities, disclosure in relation to certain financial products and market misconduct. It replaced Chapters 7 and 8 of the Corporations Act with a new Chapter 7.

The FSR Act extended the application of the insider trading prohibition to transactions involving a broader range of financial products, including derivatives and financial products able to be traded on a financial market (section 1042A (definition of ‘Division 3 financial products’) of the Corporations Act). These changes, which took effect on 11 March 2002, reflected the general objective behind the financial services reforms of harmonising the regulatory treatment of financial markets and of financial products.

3 Ibid, paragraph 3.3.6.

4 Explanatory Memorandum, Corporations Legislation Amendment Bill 1991, paragraph 307.

FINANCIAL SERVICES REFORM (CONSEQUENTIAL PROVISIONS) ACT 2002 — THE 'OWN INTENTIONS' EXCEPTION

Prior to the commencement of the FSR Act, the Government was made aware of concerns about the potential impact of the extended ambit of the insider trading provisions by a number of 'over-the-counter' (OTC) market participants and their representatives.

Concerns were expressed, for example, that the drafting of sections 1043H to 1043J of the Corporations Act might limit the capacity of OTC market makers to manage risk through the use of derivatives if 'order flow information', which is inevitably obtained in the ordinary course of OTC market participants' activities (both in relation to their own activities/intentions and those of their direct counterparties), amounted to inside information.

The concerns raised were addressed via amendments to the 'own intentions exceptions' in sections 1043H to 1043J by Schedule 2 of the *Financial Services Reform (Consequential Provisions) Act 2002*.

These amendments can be found at <http://www.comlaw.gov.au>, either separately or as a current consolidation of the Corporations Act. Commentary on the amendments is included in the Supplementary Explanatory Memorandum for the Bill. This is at http://parlinfoweb.aph.gov.au/piweb/view_document.aspx?ID=1125&TABLE=OLDEMS

REPORT BY THE CORPORATIONS AND MARKETS ADVISORY COMMITTEE ON INSIDER TRADING

In June 2001, the then Companies and Securities Advisory Committee (CASAC) published on its own initiative its Insider Trading Discussion Paper, which reviewed the insider trading laws in place since the 1991 amendments and raised 40 issues for further consideration.

With effect from 11 March 2002, CASAC was re-named the Corporations and Markets Advisory Committee (CAMAC).

In September 2002, CAMAC published an Insider Trading Proposals Paper. The Proposals Paper outlined CAMAC's policy options on the matters raised in the Discussion Paper, discussed the implications of the 2002 FSR amendments and sought comments on CAMAC's policy options and other matters raised by respondents.

CAMAC published its *Insider Trading Report* on 20 November 2003. The Report responded to all the substantial matters and policy options raised in the Discussion Paper and Proposals Paper. It also reflected the comments of various respondents and a number of overseas regulators who made submissions on those papers.

The Report made 38 recommendations on a broad range of issues. CAMAC's Discussion Paper, Proposals Paper and Final Report are available from the CAMAC website: <http://www.camac.gov.au>.

PURPOSE AND OUTLINE OF THIS PAPER

The Government agrees with the vast majority of the Report's recommendations. The number and title of each of these recommendations is listed in Part 2 of this paper (with the text of these recommendations reproduced in Appendix A). It is not the purpose of this paper to reopen these issues.

The purpose of this paper is to seek information and views in relation to issues raised in the remaining recommendations, in relation to which further consultation is required before a final position is formulated. They include the recommendations relating to the concept of 'inside information' and what is 'generally available', and to the application of the prohibition to underwriters, external administrators and issuers conducting a buy back or a placement. These recommendations are discussed in Part 3 of this paper, which also includes issues in relation to these recommendations on which public comment is sought. These issues are reproduced together in Appendix B.

2. RECOMMENDATIONS THAT ARE ACCEPTED

This part lists those recommendations made by CAMAC with which the Government agrees. Public consultation will be undertaken on the draft amendments to the Corporations Act that are necessary to implement these recommendations.

The full text of the recommendations referred to in this part is reproduced in Appendix A.

CHAPTER 1 OF CAMAC'S REPORT

Recommendations for miscellaneous changes to Australia's insider trading regime with which the Government agrees:

Recommendation 1: Strengthen the reporting requirements for directors

Recommendation 4: Clarify the relevant time for liability when trading through an intermediary

Recommendation 5: Extend the Chinese Walls defence to procuring

Recommendation 6: Permit bid consortium members to acquire for the consortium

Recommendation 7: Protect uninformed procured persons from civil liability

Recommendation 8: Extend the equal information defence to civil proceedings

Recommendation 9: Permit courts to extend the range of civil claimants

Recommendation 12: Uninformed party requiring the exercise of option rights

CHAPTER 2 OF CAMAC'S REPORT

The Government agrees with the following Chapter 2 recommendations that focus on the application of the insider trading provisions in various circumstances:

Recommendation 13: Entity making a general securities issue (majority position) – as it applies to issuers and offerees

Recommendation 15: Share buy-backs – as it applies to offerees⁵

Recommendation 16: Transactions under non-discretionary trading plans (majority position)

⁵ There are two aspects to recommendations 13, 14 and 15 – application of the prohibition to issuers and its application to offerees. Recommendation 14 and recommendation 15 as it relates to issuers are discussed in Part 3 of this paper.

CHAPTER 3 OF CAMAC'S REPORT

The Government agrees with the Chapter 3 recommendations (recommendations 17 to 37) that certain aspects of Australia's insider trading regime not change, as indicated below.

Recommendation 17: Regulate entities as well as natural persons

Recommendation 18: Maintain 'information connection' only approach

Recommendation 19: Not introduce rebuttable presumptions

Recommendation 20: No extension to decisions not to trade

Recommendation 21: No requirement to inform recipients that they are receiving inside information

Recommendation 22: Inside information need not be specific or precise

Recommendation 23: No use requirement

Recommendation 24: No exemption for trading contrary to inside information

Recommendation 25: Retain the communication and subscription exemptions for underwriters

Recommendation 26: Intermediaries to remain subject to aiding and abetting laws

Recommendation 27: No exemption for informed intermediaries acting for uninformed clients

Recommendation 28: No derivative civil liability for controllers

Recommendation 29: No exemption for directors of takeover targets

Recommendation 30: No exemption for white knights of takeover targets

Recommendation 31: No obligation on exchanges to publish their insider trading referrals

Recommendation 32: No differing criminal and civil insider trading regimes

Recommendation 34: No change to compensation assessment rules

Recommendation 35: Retain civil remedies for companies whose securities are traded

Recommendation 36: No speculative trading provision

Recommendation 37: No short swing profit provision

In relation to recommendation 33 (no immediate reform of Australian Securities and Investment Commission's enforcement powers), the Government does not intend extending the infringement notice scheme to insider trading at this time.⁶

6 Recommendation 33 states that the Advisory Committee does not put forward a formal recommendation on whether ASIC should have a power to impose administrative penalties for insider trading and goes on to state that any further consideration of this issue should take into account the recommendations in the Australian Law Reform Commission (ALRC) report, *Principled Regulation: Federal Civil & Administrative Penalties in Australia*, that deal with procedural fairness and review of administrative decision making.

3. ISSUES ON WHICH COMMENTS ARE SOUGHT

This part refers to those recommendations made by CAMAC on which comments are sought on the issues raised below.

They are:

Recommendation 2: Restrict the on-selling exemption for underwriters

Recommendation 3: Repeal the exemption for external administrators

Recommendation 10: Amend the test of generally available information

Recommendation 11: Informed party exercising option rights

Recommendation 14: Entity making an individual securities placement

Recommendation 15: Share buy-backs (as it applies to issuers buying back securities)

Recommendation 38: Focus the prohibition

They can be grouped as follows:

- A Whether the prohibition should apply to particular roles and in particular situations (recommendations 2, 3, 11, 14 and 15).
- B To what information the prohibition should apply and when is it generally available (recommendations 38 and 10).

The balance of this part addresses each of these recommendations in the order indicated immediately above; providing the current law, the text of the recommendation, a brief discussion and issues on which public comment is sought.

Appendix B reproduces in one place the issues included in this section on which comments are sought.

A. WHETHER THE PROHIBITION SHOULD APPLY TO PARTICULAR ROLES AND IN PARTICULAR SITUATIONS

Recommendation 2: Restrict the on-selling exemption for underwriters

Current insider trading law

Section 1043C of the Corporations Act currently provides that the prohibition against insider trading in section 1043A does not apply in relation to on-selling securities and interests in managed investment scheme interests under an underwriting agreement or a sub-underwriting agreement.

The recommendation

CAMAC recommends:

The exemption permitting the on-selling of securities and managed investment products under an underwriting agreement should be confined to sales to other underwriters/sub-underwriters.

CAMAC considers this issue at Discussion Paper 2.159-2.166; Proposals Paper 3.34 3.37; Final Report 1.3.

Discussion

CAMAC acknowledges the arguments of some submissions that implementing this recommendation may result in higher underwriting risk and fees, and reduced availability of underwriters. Omitting the exemption is therefore likely to reduce the efficiency in the market for underwriters and financial markets generally.

In the light of the apparent conflict between fairness to counterparties and market efficiency that this issue raises, further evidence is required in relation to this recommendation.

Issue 1A: Is there evidence that underwriters are disadvantaging counterparties by using this exemption?

Issue 1B: Is adopting recommendation 2 likely to result in less underwriting capacity, increased costs or otherwise impact on issuers' ability to raise funds? Can you make any quantitative estimate of the impact?

Recommendation 3: Repeal the exemption for external administrators

Current insider trading law

Paragraph 9.12.01(d) of the Corporations Regulations 2001 currently provides that the trading and procuring offence in section 1043A does not apply to transactions entered into by liquidators, personal representatives of deceased persons and trustees in bankruptcy in good faith to perform their official powers.

The recommendation

CAMAC recommends:

There should be no exemption for any class of external administrators.

While the relevant regulation relates to liquidators, personal representatives of deceased persons and trustees in bankruptcy, the recommendation appears to relate also to external administrators (as the term is understood in the corporations legislation) who are not liquidators.

In the remainder of this discussion, this paper uses the phrase 'external administrator' to describe the persons referred to in paragraph 9.12.01(d).

CAMAC considers this issue at Discussion Paper 2.167-2.171; Proposals Paper 3.38-3.41; Final Report 1.4.

Discussion

As in the case of recommendation 2, consideration of this recommendation would appear to involve weighing up the disadvantages of removing the exemption against the perceived increase in market efficiency and fairness for counterparties. CAMAC acknowledges that the submissions on this issue were divided.

It is desirable that people in such capacities be able to complete their tasks, even if they have come into possession of insider information while performing them. It is undesirable that estates not be wound up or liquidations completed because the trustee or liquidator has received inside information.

Currently, the exemption would allow this if the trading while in the possession of inside information were in good faith (that is, acting honestly, without fraud, collusion or participation in wrongdoing).

Although the exception in paragraph 9.12.01(d) is contrary to the generally stated market efficiency rationale for the insider trading prohibition, it could be seen as promoting efficiency in the way that external administrators complete their tasks.

According to the CAMAC majority recommendation, in circumstances where the external administrator is not in a position to disclose the inside information before entering into the transaction, he or she would be able to seek a court direction under section 424 or 447D to sell the affected financial products.

Issue 2A	What would be the effect of adopting recommendation 3 on the willingness and ability of external administrators to perform their roles, and cost of external administrators?
Issue 2B	What is the evidence of external administrators disadvantaging counterparties by using this exemption?
Issue 2C	If the exemption is to be retained, should it be subject to conditions or limitations other than, or as well as, the current requirement that the transaction be in good faith to exercise their official powers?

Recommendation 11: Exercising options with inside information

Current insider trading law

Since options fall within the class of financial products to which the insider trading legislation applies (section 1042A, definition of 'Division 3 financial products'), persons who possess inside information are prohibited from exercising their option rights for physical delivery.

The recommendation

The CAMAC majority recommends:

Persons who, in good faith, enter into fixed exercise price physical delivery option contracts when they are not aware of inside information should be entitled to exercise their physical delivery rights, even where they hold inside information at the time of exercise.

The CAMAC minority does not support this recommendation.

CAMAC considers this issue at Discussion Paper 2.117-2.132; Proposals Paper 3.47 3.57; Final Report 1.12.

Discussion

Adopting the majority recommendation may, as CAMAC indicates some respondents have already acknowledged, give informed persons an advantage over uninformed persons, which is contrary to the market fairness rationale for prohibiting insider trading.

However, the CAMAC majority was of the view that the insider trading provisions should not seek to deal with this advantage, given that the informed person only obtained the material price-sensitive information after entry into the fixed exercise price option contract. The Committee also referred to the fact that, in some instances, informed persons may have a fiduciary duty not to publicly release the inside information at the time they must choose whether to exercise or forgo their option rights.

A person with inside information is undeniably in a better position to assess the value of exercising the option than an uninformed person. The insider trading prohibition thus applies at two crucial points: entering into the option and any decision to exercise it. There would therefore appear to be strong arguments for retaining the present position – that is, not permitting informed parties to exercise their physical delivery option rights.

In connection with the availability of option schemes for directors and senior management, it should be noted that CAMAC majority recommendation 16 which addresses transactions under non-discretionary trading plans has been accepted.

Issue 3A: Are there any circumstances in which permitting informed persons to exercise their physical delivery option rights (as proposed by majority recommendation 11) should be allowed?

Recommendation 14: Entity making an individual securities placement; and

Recommendation 15: Share buy-backs — as it relates to issuers

Recommendations 13 to 15 are related. They address the situation of the issuer and investor/offeree in three situations: a general issue, a wholesale placement, and buy-backs.

To provide a framework for the following discussion, the views of the CAMAC majority and minority, and the Government position are summarised below:

CAMAC recommendation	Should the insider trading prohibition apply?					
	Issuer			Investor/offeree		
	Majority	Minority	Govt	Majority	Minority	Govt
13 (entity making a general securities issue)	No	Yes	No	Yes	N/A	Yes
14 (Entity making an individual securities placement)	No	Yes	For discussion	No	Yes	For discussion
15 (Share buy-backs)	Yes – unless full disclosure	Yes	For discussion	Yes†	N/A	Yes

† Represents the Advisory Committee's unanimous view.

Current insider trading law

By virtue of section 761E and paragraph 1043A(1)(c) of the Corporations Act, the insider trading provisions currently apply to issuers of new financial products (including under a general issue and under a private placement).

The insider trading provisions also currently apply to buy-back entities, although section 1043B of the Corporations Act exempts buy-backs by registered managed investment schemes.

The recommendations

CAMAC deals with three situations separately:

- Recommendation 13: general offer;

The *majority* considers that issuers making a general issue of securities should not be subject to the insider trading provisions.

The *minority* does not support this exemption.

All members of the Committee consider that offerees who subscribe for new issues when aware of inside information not known to the issuer should remain subject to the insider trading provisions.

- Recommendation 14: placement;

The *majority* considers that neither issuers making placements to wholesale investors, nor any places in an individual placement, should be subject to the insider trading provisions.

The *minority* considers that the insider trading provisions should continue to apply to all issuers and places.

- Recommendation 15: buy-back.

The *majority* considers that the insider trading provisions should apply to an entity buying back its own shares, except where the buy-back legislation requires that the entity make full prior disclosure of material information to shareholders.

The *minority* considers that the insider trading provisions should apply to a buy-back entity in all circumstances.

All members of the Committee consider that the insider trading provisions should continue to apply to offerees under share buy-backs.

CAMAC considers these issues at Discussion Paper 2.99-2.116; Proposals Paper 2.10-2.27; Final Report 2.3-2.4.

Discussion

Relationship to disclosure provisions

At the centre of the rationale for the prohibition on insider trading is the effect of one party having price-sensitive information which the other party to the transaction does not have.

Some submissions to CAMAC argued that the insider trading provisions should continue to apply to general issues, placements and buy-backs to complement the statutory disclosure obligations and, in certain circumstances, to make up for any deficiencies in them.

If the arguments raised by those submissions are valid (and there are deficiencies in the existing statutory disclosure requirements), then it would be preferable for them to be addressed directly. It is inappropriate for insider trading legislation to remedy any perceived deficiencies in statutory disclosure requirements.

General issue — recommendation 13

The majority accepts this as it relates to issuers making a general issue. It also recommends that the insider trading prohibition continue to apply to those who subscribe for new issues when aware of inside information (recommendation 13).

The Government accepts the majority position in recommendation 13

Placements — recommendation 14

The majority recommends that neither issuers making placements to wholesale investors nor any of these investors who subscribe should be subject to the insider trading provisions.

This is not because each side is in possession of all relevant price-sensitive information (the implication is that the issuer has not provided all relevant information) but appears to be

influenced by the majority's views as to the appropriateness of the insider trading prohibition to over-the-counter (OTC) situations (see recommendation 38 below).

The response to recommendation 14 needs to be considered in the context of recommendation 38 – just what is the appropriate ambit of the insider trading prohibition?

Buy-backs — recommendation 15

The majority recommends that the insider trading provisions should apply to any entity buying back its own shares, except where the buy-back legislation requires that the entity make full prior disclosure of material information to shareholders.

This appears to rest on the ground that adequate disclosure by the issuer means that the issuer should not be subject to the insider trading prohibition. It would also appear to be influenced by the view that the current disclosure regime is not comprehensive in relation to buy-backs and should not be relied on in the same way as in a general issue.

Acceptance of the majority recommendation 15 is consistent with a number of overseas jurisdictions and the position in Australia as previously understood.

There are five classes of buy-backs in Part 2J.1, Division 2 of the Corporations Act:

- minimum holding;
- employee share schemes;
- on market buy-backs;
- equal access schemes; and
- selective buy-backs.

Companies buying back their shares under an equal access scheme or a selective buy back are required to include with the offer, a statement setting out all information known to the company that is material to the decision whether to accept the offer (section 257G). This implies the conclusion that the disclosure requirement in these cases offers adequate investor protection. The Government accepts that the insider trading prohibition would not be appropriate in these circumstances. This is consistent with majority recommendation 15.

Companies buying back their shares under the other procedures – minimum holding, employee share schemes and on-market buy-backs – are not required to make such a statement. Implementing majority recommendation 15 would therefore mean that the insider trading prohibition would apply in these cases.

This is consistent with the equal information rationale referred to above. Note, however, that:

- the following disclosure requirements would apply to all buy backs:
 - the continuous disclosure regime (Chapter 6CA);
 - contractual disclosure requirements; and
 - Division 2 of Part 7.10 – for example, the prohibition on false or misleading statements likely to induce persons to apply for financial products (section 1041E).

- there is an efficiency argument for exempting minimum holding buy-backs from the insider trading provisions as companies undertake such buy-backs to reduce the administrative costs incurred in servicing shareholders with relatively small holdings. As the Advisory Committee points out in its Discussion Paper, the prohibition should not impede the overall liquidity and fundraising functions of markets.

The questions below in relation to majority recommendation 15 therefore focus on minimum holding buy-backs and the effect that the prohibition on insider trading has in this context.

Issue 4A	Should issuers and wholesale offerees, in the case of placements, be exempt from the insider trading prohibition, as recommended in majority recommendation 14?
Issue 4B	What is the evidence of the insider trading prohibition discouraging companies from undertaking minimum holding buy-backs, employee share schemes and on-market buy-backs (recommendation 15)?
Issue 4C	What would be the effect of adopting recommendation 15 on the willingness of companies to undertake minimum holding buy-backs, employee share schemes and on-market buy-backs?

B. TO WHAT INFORMATION THE PROHIBITION SHOULD APPLY AND WHEN IS IT GENERALLY AVAILABLE

Recommendation 38: Focus the prohibition

Current insider trading law

The insider trading legislation currently applies:

- to all persons who communicate, or deal in Division 3 financial products (including financial products able to be traded on a financial market) while possessing inside information; and
- in all cases, whether or not market rules require disclosure of the inside information.

Inside information is defined as information that is not generally available but if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of the particular financial products (section 1042A). The concept of 'generally available' is elaborated in section 1042C.

The recommendation

The Advisory Committee supports the application of the insider trading legislation to all currently regulated financial markets and financial products. However, there is a difference of view within the Committee on whether there should be any consequential amendments to meet the circumstances of different financial markets.

Majority proposal

Section 1043A should be amended by adding new paragraphs (1)(ba) and (2)(ba) as follows:

‘(ba) the inside information is disclosable information or announceable information;’.

The following definitions should be added to s 1042A:

‘**disclosable information**’ means information that:

- (a) has to be disclosed either now or in the future pursuant to any legal or regulatory requirement (other than a requirement for disclosure only to a counterparty), whether or not that obligation is complied with, or
- (b) would come within paragraph (a) were any person subject to the legal or regulatory requirement to be aware of the information, or
- (c) would come within paragraph (a) or paragraph (b) if the subject matter of the information came to fruition (whether or not it does so).

‘**announceable information**’ means information, other than disclosable information, that:

- (a) will become the subject of a public announcement, or
- (b) would come within paragraph (a) if the subject matter of the information came to fruition (whether or not it does so).

Minority position

The minority opposes the Proposal. Any particular problems that arise in specialist OTC markets and the like should be addressed by the introduction of defences and/or carve-outs that are justified by, and tailored to, the circumstances of the case.

CAMAC considers recommendation 38 at Chapter 4 of the Final Report. Previous consideration of transactions in unlisted entities is at Discussion Paper 2.93-2.98 and Proposals Paper 2.44-2.51.

CAMAC’s stated basis for seeking to narrow the scope of the insider trading provisions via recommendation 38 (and 10) is the impact these provisions currently have in specialist OTC markets.

Discussion

In its Final Report, CAMAC maintains that there is an ‘in principle’ difficulty with applying insider trading laws to directly negotiated transactions involving financial products, particularly transactions on OTC markets and transactions in the securities of unlisted entities. CAMAC notes that parties to such transactions typically negotiate their own disclosure terms and covenants to deal with any information asymmetry, and have legal remedies for any misrepresentation by counterparties.

CAMAC’s Final Report also asserts that the 2002 amendments to the ‘own intentions’ defence did not solve the inherent problem of applying the current insider trading provisions to the range of financial product transactions on OTC and other financial markets.

Notwithstanding the views expressed by CAMAC in its Final Report, majority recommendation 38 involves significant difficulties. These are described below. However, submissions are sought about the problems created by the current insider trading provision for certain OTC markets, as discussed in the CAMAC report, and suggestions as to how these problems could be addressed if recommendation 38 is not adopted.

1. *Commonwealth criminal law policy — retrospectivity*

The proposed definitions of ‘disclosable information’ and ‘announceable information’ in recommendation 38 risk applying the insider trading provisions retrospectively. In particular, the person with information may not be able to determine, at the time of trading, procuring or tipping, that the information was ‘inside information’. (Further, no one else may be in a position to do so at that time.)

For example, in relation to the ‘disclosable information’ limb, information is not required to be disclosed under the continuous disclosure requirements (sections 674 and 675) if:

- (a) a reasonable person would not expect the information to be disclosed;
- (b) the information is confidential; and
- (c) at least one of a series of criteria applies – the first and last, by way of example, are:
 - the disclosure of the information would contravene a law;
 - the information is a trade secret.

(Australian Stock Exchange (ASX) Listing Rule 3.1A and Corporations Regulation 6CA.1.01.)

This means that if information, which satisfies these requirements initially, ceases to be confidential (or, in the case of a listed entity, the ASX forms the view that it is no longer confidential), then the exception no longer applies. At the time of the trading, when all limbs of the exception were satisfied such information was not ‘disclosable information’, but retrospectively it has become ‘disclosable information’ and the trading has become insider trading.

In relation to the ‘announceable information’ limb, companies and governmental agencies make numerous, non-periodic announcements and decisions. They are not required to be made, or they would fall into the ‘disclosable information’ category. While some will inevitably be publicly announced (such as a Reserve Bank board decision to alter the interest rate), there is no certainty about many others some of which will be publicly announced, while others may not.

For example, assume a listed entity and a non-disclosing entity have adjoining leases. The non-disclosing entity announces that it has found significant uranium deposits on its lease, with obvious potential implications for the adjoining lease owned by the listed entity. The non-disclosing entity did not inform the listed entity and none of the officers or directors of the listed entity were aware of the find. The company making the find had no obligation to make the announcement or to tell the listed entity. Trading on that information prior to an announcement may seem legitimate under the proposed test but from the time of any public announcement, the earlier trading would become insider trading.

Retrospective criminal law undermines the certainty and predictability of the justice system in that it contradicts the notion that the content of the law should be accessible to the public.

It also means that an individual cannot ascertain whether they will commit a crime by engaging in certain conduct. There is clear potential for unfairness to a person who is exposed to criminal sanction for something that was not an offence at the time of the conduct.

The Commonwealth Parliament and successive Australian Governments have only endorsed retrospective criminal offences in very limited circumstances.

2. *Commonwealth criminal law policy — clarity; certainty; complexity*

The Attorney-General's Department has advised that the proposed definitions of 'disclosable information' and 'announceable information' in recommendation 38 are not sufficiently clear or certain to justify being an element of a criminal offence. Criminal law should be certain, so that all regulators, enforcers and those subject to the law are able to readily understand their rights and obligations arising from its operation.

A particular problem with recommendation 38 in this context relates to the paragraph (a) definition of 'disclosable information', which refers to information that must be disclosed pursuant to any legal or regulatory requirement. ASX Listing Rules are a regulatory requirement, which are afforded legal force by the Corporations Act (see, for example, subsection 674(1) of the Act in relation to continuous disclosure). However, ASX can waive compliance with a Listing Rule or part of a Rule. ASX also has discretion, apart from waiving the Rules, whether to require compliance with the Listing Rules in a particular case.

Adopting majority recommendation 38 would also increase the complexity of the insider trading provisions, resulting in greater uncertainty for market participants. What must be assessed is not only whether a reasonable person would expect it to have a material effect on the price or value of the securities, but also whether it is disclosable or announceable information.

3. *Appropriateness in relation to criminal offences*

The 'disclosable information' and 'announceable information' elements that are integral to recommendation 38 resemble paragraph 1.4.4E(4) (Information which a regular user would reasonably expect to be disclosed to other users of the market) of the United Kingdom (UK) Financial Services Authority Handbook, Code of Market Conduct (the Code). The following discussion outlines why the 'disclosable information' and 'announceable information' concepts may be inappropriate in relation to criminal offences.

Section 119 of the *Financial Services and Markets Act 2000* (UK) (the Financial Services and Markets Act), an Act that allows the Financial Services Authority to deal with and enforce via civil penalties any market abuse behaviour, requires the Financial Services Authority to produce a code providing guidance on what behaviour amounts to market abuse.

The Code, however, applies only to the market abuse provisions found in the Financial Services and Markets Act. While the 'misuse of information' category of market abuse behaviour in the Financial Services and Markets Act is similar to insider trading, the Code does not apply to the criminal offence of insider dealing, which is found in Part V of the *Criminal Justice Act 1993* (UK).

It may be appropriate for a regulator to provide guidance to market participants by offering its own interpretations of the meaning of 'disclosable information' and 'announceable information' (on a case-by-case basis or otherwise) in relation to a civil code of conduct (as in the UK). However, it is less clear that such concepts are appropriate in relation to provisions that constitute a serious criminal offence (for which the UK has a separate regime).

CAMAC recommended that there should not be different criminal and civil insider trading regimes (recommendation 32).

4. *Enforcement*

Implementing the majority recommendation 38 would require that the prosecution prove that the information is disclosable information or announceable information, as well as being not generally available, and materially price-sensitive.

Adding a further physical element for the prosecution to prove would make the prohibition more difficult to establish and to enforce, and may reduce the effectiveness of the insider trading regime generally.

5. *Inconsistency with harmonised treatment of markets and products*

It could be argued that majority recommendation 38:

- is inconsistent with the tenor of the FSR Act, which involves harmonised treatment across financial markets, and across financial products, unless there is a good reason to differentiate them; and
- would reduce the ambit of the provisions compared to the pre-FSR Act position.

In relation to the first dot point under 5 above, this does not mean that all financial markets and all financial products must be treated in the same way. It does mean that the onus is on those arguing for different treatment of a particular market or product to bring forward their difficulties. Clarifying such problems may help to identify previously misunderstood issues.

When this has been done it may mean, as the minority suggests, that any particular problems in OTC (and other) markets would be best addressed by a tailored and justified response (as was the case with amendments to the 'own intentions exceptions' prior to the commencement of the FSR Act – see above section 1).

6. *Transparency and community standards*

Transparency is fundamental to market integrity and investor protection. Greater transparency is more likely to enhance confident and informed participation by investors in secondary securities markets, which in turn can be expected to improve the depth, liquidity and efficiency of these markets. A lack of market transparency can deter liquidity, hinder the development of financial products and markets, and increase the risk of market inefficiency.

Any amendments to the insider trading regime must pay due regard to the importance of financial market transparency and to the expectations of the wider financial industry and community's expectations as to what constitutes inside information.

Issue 5A What are the specific, post-FSR problems with applying the insider trading legislation to particular financial markets and products?

Issue 5B How can these problems be addressed legislatively other than via majority recommendation 38?

Recommendation 10: Amend the test of generally available information

Current insider trading law

One of the elements of the insider trading prohibition is that information not be generally available. Section 1042C of the Corporations Act currently defines information as generally available if it satisfies either the 'readily observable matter' limb in paragraph 1042C(1)(a) or the 'published information' limb in paragraph 1042C(1)(b).

Currently, section 1042C reads:

- (1) For the purposes of this Division, information is generally available if:
 - (a) it consists of readily observable matter; or
 - (b) both of the following subparagraphs apply:
 - (i) it has been made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in Division 3 financial products of a kind whose price might be affected by the information; and
 - (ii) since it was made known, a reasonable period for it to be disseminated among such persons has elapsed; or
 - (c) it consists of deductions, conclusions or inferences made or drawn from either or both of the following:
 - (i) information referred to in paragraph (a);
 - (ii) information made known as mentioned in subparagraph (b)(i).
- (2) None of the paragraphs of subsection (1) limits the generality of any of the other paragraphs of that subsection.

The recommendation

Majority proposal (as part of recommendation 38)

The current s 1042C(1) should be replaced with the following provisions:

1042C(1) For the purposes of this Division, information 'is generally available' only if it:

- (a) is accessible to most persons who commonly invest in Division 3 financial products of a kind whose price or value might be affected by the information, or
- (b) consists of deductions, conclusions or inferences made or drawn from any information referred to in paragraph (a).

1042C(1A) Information is deemed to satisfy paragraph (1)(a) if it is disclosed pursuant to any prescribed disclosure procedure.

The defence in s 1043M(2)(a), which is part of the published information test, should be repealed.

Minority proposal

The minority considers that the current published information and readily observable matter tests of when information is generally available should remain, but the 'readily observable matter' test should be modified so that the matter must be observable:

- by a cross-section of Australian investors;
- without resort to technical assistance beyond that likely to be used by a cross-section of investors; and
- for a reasonable period of time.

CAMAC considers generally available information (recommendation 10) at Discussion Paper 2.1-2.50; Proposals Paper 3.8-3.24; Final Report 1.11.

Discussion

Accepting majority recommendation 10 depends on accepting majority recommendation 38. The arguments put forward by majority recommendation 38 are not convincing for the reasons outlined above. However, whether or not recommendation 38 is accepted, it is desirable to examine whether any change is needed to the definition of 'generally available'.

CAMAC argues that the published information test can create considerable uncertainty about when persons may lawfully trade and that the ambit of the readily observable matter test is even more uncertain. Options for addressing the claimed uncertainty in interpreting this definition include:

- (1) Clarifying the 'readily observable matter' test as recommended by the minority.
- (2) Leaving the question of interpretation to the courts, with the assistance of notes included in section 1042C providing examples of what fits within paragraphs 1042C(1)(a) and (b);

For instance, suggesting that:

- paragraph (a) (readily observable matter) would apply where an observation is based on something which accrues over time – for example, the value of a block of land owned by the disclosing entity appreciating; and
- paragraph (b) would apply in the case of information (say, a court judgment) where an opportunity to digest the information is needed before the information can be said to be generally available.

That 'generally available information' will apply to a broad range of possible fact scenarios suggests that the interpretation of its definition is an issue properly left for judicial and jury consideration, with minimal legislative guidance.

- (3) Amending the provisions (as suggested in the second approach in CAMAC's Proposals Paper paras 3.11-3.20) so that matter is readily observable:
 - if it either is disclosed in a public area or can be observed by the public without infringing rights of privacy, property or confidentiality;
 - even if other users of the market cannot obtain it because of limitations on their resources, expertise or competence or only on payment of a fee;

- even if it is only available overseas.

(This option would involve no change to the current law on dissemination period; that is, persons can trade immediately upon becoming aware of a readily observable matter.)

Given the varied circumstances in which the provision could operate, a highly prescriptive definition may not be desirable in this context as it could result in unintended consequences or application.

Issue 6A Do the definitions of 'inside information' or 'generally available' need to be amended?

Issue 6B In particular, if the notion of 'generally available' is to be retained, are any of the options outlined above appropriate?

APPENDIX A: RECOMMENDATIONS THAT ARE ACCEPTED

This Appendix lists those recommendations made by CAMAC with which the Government agrees and in relation to which the Government considers that no further consultation is necessary now.

Public consultation will be undertaken on the draft amendments to the Corporations Act that are necessary to implement the recommendations.

CHAPTER 1 OF CAMAC'S REPORT

The Government agrees with the following Chapter 1 recommendations for miscellaneous change to Australia's insider trading regime:

Recommendation 1: Strengthen the reporting requirements for directors

- Section 205G should be amended as follows:
 - the provision should apply to all listed entities. However, exempt foreign entities should be taken to have complied with the provision if the directors of those foreign entities have complied with the disclosure requirements of their incorporating jurisdiction;
 - the disclosure obligation should apply to all directors and senior executives including the chief executive officer. The disclosure obligation on these persons should cover any direct trading and any trading through related parties;
 - directors and senior executives of any entity that substantially manages the affairs of a listed entity should disclose any trading by them in the securities of that listed entity;
 - where a director or senior executive has resigned from that position, the disclosure obligation should cover any relevant transactions that occurred before that resignation and within one month thereafter;
 - with off-market transactions, a copy of the contract should also be disclosed;
 - the obligation should be to disclose the closest approximate number of securities whenever it is not reasonably possible to know the exact number;
 - the disclosure period should be reduced from 14 days to 2 business days, except for changes arising under dividend (distribution) re-investment plans, where the period should remain at 14 days;
 - the information to be disclosed under this provision should not include changes that have arisen from transactions that have applied equally to all shareholders, and without individual shareholder election, such as capital reconstructions or bonus issues. These pari passu changes should only be subject to any applicable periodic or annual disclosure obligations.

- The Advisory Committee does not support a materiality threshold that would permit senior executives to deal in small quantities without disclosure.

Recommendation 4: Clarify the relevant time for liability when trading through an intermediary

- The relevant time should be when instructions are given to the intermediary and the instructor does not contravene the provision unless a transaction takes place.

Recommendation 5: Extend the Chinese Walls defence to procuring

- The Chinese Walls defence should cover the procuring offence.

Recommendation 6: Permit bid consortium members to acquire for the consortium

- The 'own intentions' exemption should be amended to make clear that members of a prospective bid consortium can acquire on behalf of that consortium prior to the market becoming aware of the intended bid. However, these persons should not be entitled to trade on their own behalf before the market becomes aware of the bid, even with the consent of other bid consortium members.

Recommendation 7: Protect uninformed procured persons from civil liability

- An uninformed procured person should not be required to return any profit made or loss avoided by that person from a transaction if that person establishes that the insider who procured that person did not receive any direct or indirect benefit from that transaction.

Recommendation 8: Extend the equal information defence to civil proceedings

- The insider trading legislation should provide an equal information defence in civil proceedings similar to the defence that applies in criminal proceedings, namely that the counterparty to the transaction 'knew or ought reasonably to have known' of the inside information.

Recommendation 9: Permit courts to extend the range of civil claimants

- The legislation should enable a court to extend the range of civil claimants who have traded in the market beyond the insider's immediate market counterparty, using the concept of 'aggrieved persons'.

Recommendation 12: Uninformed party requiring the exercise of option rights

- Uninformed parties to any option contracts, whether or not fixed price, should be entitled to require their informed counterparties (that is, anyone who holds inside information at the time of exercise) to honour their physical delivery obligations.

CHAPTER 2 OF CAMAC'S REPORT

The Government agrees with the following Chapter 2 recommendations that the insider trading provisions not apply in various circumstances:

Recommendation 13: Entity making a general securities issue

Issuers

- The Majority considers that issuers making a general issue should not be subject to the insider trading provisions.
- The Minority does not support this exemption.

Offerees

- The Advisory Committee considers that offerees who subscribe for new issues when aware of inside information not known to the issuer should remain subject to the insider trading provisions.

Recommendation 15: Share buy-backs (Offerees)

- The Advisory Committee considers that the insider trading provisions should continue to apply to offerees under share buy backs.

Recommendation 16: Transactions under non-discretionary trading plans (majority position)

- The majority considers that there should be an exemption from the insider trading provisions for trading under non-discretionary plans where:
 - the trading takes place in accordance with a plan entered into when either the person was not aware of any inside information or any information of which the person was then aware was no longer inside information when any trading under the plan took place;
 - there are no discretions under the plan, other than to terminate it; and
 - the plan was entered into in good faith and not as part of a scheme to evade the insider trading prohibitions.
- The person seeking to rely on the exemption should have the legal onus of establishing the above elements, rather than merely an evidential onus to raise them.
- (The minority does not support any exemption.)

CHAPTER 3 OF CAMAC'S REPORT

The Government agrees with all of the Chapter 3 recommendations (Recommendations 17 to 37) that certain aspects of Australia's insider trading regime not change.

Recommendation 17: Regulate entities as well as natural persons

- The definition of insider should continue to include entities as well as natural persons.

Recommendation 18: Maintain ‘information connection’ only approach

- The ‘information connection’ approach, without any additional ‘person connection’ test, should be retained.

Recommendation 19: Not introduce rebuttable presumptions

- There should be no rebuttable presumptions.

Recommendation 20: No extension to decisions not to trade

- Decisions not to trade, disclosing inside information for that purpose and procuring another person not to trade, should continue to be excluded from the insider trading legislation.

Recommendation 21: No requirement to inform recipients that they are receiving inside information

- There should be no obligation to inform recipients that information is inside information.

Recommendation 22: Inside information need not be specific or precise

- There should be no requirement that inside information be specific or precise.

Recommendation 23: No use requirement

- The Advisory Committee elsewhere recommends an exemption for informed persons trading pursuant to a pre-existing non-discretionary trading plan (recommendation 16). Subject to this limited exception, the insider trading legislation should not have a use requirement or a defence of non-use.

Recommendation 24: No exemption for trading contrary to inside information

- There should be no defence that an informed person traded contrary to inside information.

Recommendation 25: Retain the communication and subscription exemptions for underwriters

- The communication and subscription exemptions for underwriting should be retained.

Recommendation 26: Intermediaries to remain subject to aiding and abetting laws

- An intermediary who is aware that a client holds inside information should remain liable for aiding and abetting by trading in affected financial products for that client.

Recommendation 27: No exemption for informed intermediaries acting for uninformed clients

- There should be no exemption for informed intermediaries acting for uninformed clients.

Recommendation 28: No derivative civil liability for controllers

- There should be no derivative civil liability provision.

Recommendation 29: No exemption for directors of takeover targets

- There should be no specific exemption for target company directors in communicating inside information to white knights.

Recommendation 30: No exemption for white knights of takeover targets

- There should be no statutory exemption for white knights of takeover target companies.

Recommendation 31: No obligation on exchanges to publish their insider trading referrals

- Exchanges should not be obliged to publish any details of their referrals to ASIC of suspected insider trading.

Recommendation 32: No differing criminal and civil insider trading regimes

- There should not be different criminal and civil insider trading regimes.

Recommendation 33: No immediate reform of ASIC's enforcement powers

- The Advisory Committee does not put forward a formal recommendation on whether ASIC should have a power to impose administrative penalties for insider trading. However, any further consideration of whether ASIC should have this power should take into account the recommendations in the ALRC Report, Principled Regulation: Federal Civil and Administrative Penalties in Australia, that deal with procedural fairness and review of administrative decision making.

Recommendation 34: No change to compensation assessment rules

- The existing rules for assessing the profit made or loss avoided should remain.

Recommendation 35: Retain civil remedies for companies whose securities are traded

- The existing law, under which companies whose financial products are traded are entitled to compensation, should remain, even where those companies have suffered no loss or damage.

Recommendation 36: No speculative trading provision

- There should be no new statutory prohibition on speculative trading.

Recommendation 37: No short swing profit provision

- There should be no specific statutory prohibition on short swing profits.

APPENDIX B: ISSUES

Recommendation 2: Restrict the on-selling exemption for underwriters

- Issue 1A: Is there evidence that underwriters are disadvantaging counterparties by using this exemption?
- Issue 1B: Is adopting recommendation 2 likely to result in less underwriting capacity, increased costs or otherwise impact on issuers' ability to raise funds? Can you make any quantitative estimate of the impact?

Recommendation 3: Repeal the exemption for external administrators

- Issue 2A What would be the effect of adopting recommendation 3 on the willingness and ability of external administrators to perform their roles, and cost of external administrators?
- Issue 2B What is the evidence of external administrators disadvantaging counterparties by using this exemption?
- Issue 2C If the exemption is to be retained, should it be subject to conditions or limitations other than, or as well as, the current requirement that the transaction be in good faith to exercise their official powers?

Recommendation 11: Exercising options with inside information

- Issue 3A: Are there any circumstances in which permitting informed persons to exercise their physical delivery option rights (as proposed by majority recommendation 11) should be allowed?

Recommendation 14: Entity making an individual securities placement

Recommendation 15: Share buy-backs — as it relates to issuers

- Issue 4A Should issuers and wholesale offerees, in the case of placements, be exempt from the insider trading prohibition, as recommended in majority recommendation 14?
- Issue 4B What is the evidence of the insider trading prohibition discouraging companies from undertaking minimum holding buy-backs, employee share schemes and on-market buy-backs (recommendation 15)?
- Issue 4C What would be the effect of adopting recommendation 15 on the willingness of companies to undertake minimum holding buy-backs, employee share schemes and on-market buy-backs?

Recommendation 38: Focus the prohibition

Issue 5A What are the specific, post-FSR problems with applying the insider trading legislation to particular financial markets and products?

Issue 5B How can these problems be addressed legislatively other than via majority recommendation 38?

Recommendation 10: amend the test of generally available information

Issue 6A Do the definitions of ‘inside information’ or ‘generally available’ need to be amended?

Issue 6B In particular, if the notion of ‘generally available’ is to be retained, are any of the options outlined in the text above appropriate?