Inside story: regulators get real

Two recent Professional Development seminars provided industry professionals with insights on innovations in policing market misconduct and responding to current economic influences on investment funds.

Insider trading will become more easily detected and more severely punished under changes to corporate law embodied in provisions of the Federal government's new Criminal Code. Legal loopholes and ambiguities that often made prosecution of insider trading only a theoretical possibility have long frustrated regulators. A new regime removes many uncertainties, provides accurate definitions, and prescribes a penalty structure that gives regulators new options about how to approach enforcement.

The changes were explained to a Securities Institute's professional development seminar on market manipulation addressed by Joe Longo, a Freehills regulatory and compliance lawyer and former enforcement executive with the Australian Securities and Investments Commission (ASIC), and John Kluver, director of the Companies and Securities Advisory Committee.

Longo, describing the Government's Financial Services Reform Act as "a majestic piece of legislation", said the new act was not intended to change the existing approach to the law, but to introduce new concepts and simplify the code. It introduced a new vocabulary to define market manipulation and clarify concepts such as "fault elements" including intention, knowledge, recklessness and negligence.

The legislation covers market misconduct involving securities, derivatives and superannuation—a clearer specification than had existed formerly—and is directed against activities intended to create artificial prices in markets. Insider trading is one of these activities.

A significant feature is the provision of civil penalties, according to Longo. These enabled the imposition of pecuniary punishment for infringements without the need for criminal procedures, he said. The availability of monetary penalties up to $200,000 would have an impact on choices for regulators. There was a greater likelihood of court actions rather than "shaming actions" with limited effect.

Civil penalties were the "remedy of choice" for ASIC, offering significant new opportunities and enabling effective responses to practices such as poor disclosure, Longo said. A consequence for corporate responsibility was that company directors should be more concerned about their exposure.

John Kluver told the seminar that an important improvement in the new legislation was a redefinition of "insider trading". The term was formerly held to apply to persons connected with the company whose securities were being traded. This was no longer the case; an insider was now defined as anyone who holds inside information, regardless of how it is acquired. This definition would be incorporated in the Corporations Law, placing Australia ahead of other countries.

Another clarification under discussion by the Companies and Securities Advisory Committee is the meaning of "inside information". Kluver said the committee was not satisfied with the common, narrow definition that the information must be derived from within the relevant company. A broader and, in the committee's view, better definition was any price-sensitive information from any source, including activities such as "scalping", "front-running" and "piggy-backing".

Other continuing problems with inside information were the treatment of "white knights" in takeover attempts and "tainted brokers". The market activities of the former may involve buying stocks from uninformed holders while in possession of special knowledge about the target company which could later affect its share price. In the case of "tainted" brokers who have inside information, the committee believed it might be unfair to prohibit them from trading for innocent clients as third parties.

Funds outlook

Speakers at another PD seminar analysed the implications in 2002 for investment funds in the light of economic trends and political events. Shane Oliver, of AMP Henderson, Stephen Roberts, of Frank Russell, Andrew Fay, of Deutsche Asset Management, and Hans Kunnen, of Colonial First State, showed a diversity of perspectives in making several points:

Global growth could be expected to improve in the June quarter of the year, with Australia performing better than most economies despite rising unemployment. The United States' fortunes were crucial, although many of the negative signs that prevailed 18 months ago had been reversed. The $A continued as a source of embarrassment for most economists, although it was dramatically undervalued and would eventually recover.

An international focus on statistics ignored the realities of the "real world". The synchronised slowdown in the US, Japan and Europe was a "contagion effect" indicating a policy over-response to economic signals.

In existing economic conditions, timing markets was a "difficult game" leading some fund managers to favour strategic, rather than tactical, asset allocation. This required a long-term investment focus—at least three years —with the flexibility to acknowledge stresses in the market and top up with defensive and cyclical stocks as appropriate.

Audio tapes are available by emailing audiotapes@securities.edu.au