INDIVIDUAL

Insider trading

Directors should be aware of, and informed about, the *Corporations Act 2001* (Cth) (the Act) provisions prohibiting insider trading – Part 7.10, Division 3. Insider trading is the trading of securities or a wider set of financial products while in possession of information:

- which is not generally available; and
- if it were, would be likely to have a material effect on the price or value of the security.

Insiders can be anyone and they do not have to be directly related to the company. However, because of the nature of their roles, directors are more likely to be in possession of 'inside information' so they need to exercise great care in their use and disclosure of that information. There are very severe penalties if found liable for insider trading.

What activities are prohibited?

There are three specific prohibitions on persons with inside information. It is prohibited to:

1. trade securities or financial products or enter into agreements to trade;
2. get another person to trade or enter into agreements to trade; and
3. directly or indirectly communicate the information to someone who they think might trade, enter into agreements to trade or get another person to trade.

What is the meaning of 'inside information' and other definitions?

Important definitions associated with insider trading of which all directors should be aware include:

- **Insiders** – can be either natural persons or corporations;
- **Financial products** – refers to securities, derivatives, interests in managed funds, debentures, government-issued stocks or bonds, some superannuation products and other financial products able to be traded on financial markets (s 1042A);
- **Generally available** – consists of readily observable matters (for example, media reports) or has been made known in a way likely to bring it to the attention of those who commonly invest and a reasonable period for dissemination has elapsed, or it can be deducted, concluded or inferred from the previous points (s 1042C);
- **Inside information** – information not generally available and, if it were so, a reasonable person would expect it to have a material effect on the price or value of financial products (s 1042A); and
- **Material effect** – a reasonable person would expect it to influence a person who commonly invests to decide whether to buy or sell financial products (s 1042D).

Are there any exceptions?

Numerous exceptions exist for insider trading. They are covered in ss 1043B to 1043K of the Act and include withdrawing from registered schemes, underwriters, acquisitions, information barriers, bodies corporate and holders of Australian Financial Services Licenses. For example, some exceptions apply to specific types of financial products and can include exceptions for insurance underwriters and the revealing of information under legal obligation. These exceptions can be used as a defence in court. It is incumbent on the prosecution to prove that these defences do not apply.

Can there be insider trading where information is false?

The High Court, in *Mansfield v The Queen* (2012) HCA 49, held that a person can be guilty of insider trading even where the information on which the trading was based is false. At the original trial, the prosecution did not lead any evidence as to the truth of the relevant information and the defendants argued that the prosecution had failed to show that they had received 'information'. The trial judge held that the information which was acted upon had to be a 'factual reality'. On appeal, the High Court rejected this finding, saying that the ordinary meaning of 'information' is not confined to "knowledge communicated which constitutes or concerns objective truths". 'Information' can include knowledge which is false. Heydon J summarised that "the insider trading provisions, read as a whole, catch conduct by those who trade on the basis of untruths".

The High Court also noted that the prohibition of the use of false information was consistent with the objectives of the insider trading legislation.

What are the penalties for insider trading?

There are serious penalties for insider trading. The potential penalty for an individual for insider trading is up to 15 years imprisonment and/or the greater of $1.05 million or three times the profit gained or loss avoided. For companies, the maximum penalty is the greater of $10.5 million, three times the profit gained or loss avoided or 10 per cent of the body corporate's annual turnover in the relevant period.[1]

In a speech to the 2010 Supreme Court of Victoria Law Conference on insider trading and market manipulation,[2] the then ASIC chair Tony D'Aloisio noted the following on sentencing in this area:

> *A recent review of insider trading cases (Juliette Overland) has shown that courts had most commonly taken into account 17 criteria:*
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> - *amount of profit made*
> - *character of the offender*
> - *any expression of remorse or contrition*
> - *any extra-curial punishment*
> - *general deterrence*
> - *manner in which the information was acquired*
> - *personal circumstances of the offender*
> - *any breach of confidence*
> - *manner in which the trial was conducted and guilty plea*
> - *relationship with the relevant company*
> - *any delay in prosecution*
> - *prospects of rehabilitation*
> - *relationship with the securities industry*
> - *specific deterrence*
> - *acceptance of pecuniary penalty order*
> - *amount of money wagered*
> - *any hardship to the offender's family.*

Under s 1043L of the Act, persons affected can sue for compensation for damages suffered. ASIC can also institute an action on behalf of the issuer of the financial product.

1. S Linwood, 2019, "Stronger corporate penalties are here", *Membership Update*, Australian Institute of Company Directors, 26 February, **https://aicd.companydirectors.com.au/membership/membership-update/stronger-corporate-penalties-are-here**, (accessed on 26 April 2019).
2. T D'Aloisio, 2010, *Insider trading and market manipulation*, Australian Securities & Investments Commission , 13 August, **https://download.asic.gov.au/media/1347296/speech-insider-trading-market-manipulation-August-2010.pdf**, (accessed 2 April 2019).

Are companies required to have a trading policy?

The ASX Listing Rules require that a listed entity must have a trading policy that complies with those Listing Rules. Rule 12.12 provides that, at a minimum, a trading policy will have to include:

- the entity's closed periods (fixed periods specified in the trading policy when an entity's key management personnel are prohibited from trading in the entity's securities);
- the restrictions on trading that apply to the entity's key management personnel;
- any trading which is not subject to the entity's trading policy;
- any exceptional circumstances in which the entity's key management personnel may be permitted to trade during a prohibited period with prior written clearance; and
- the procedures for obtaining prior written clearance for trading.

Further, where an entity makes a material change to their trading policy, the entity must give the amended trading policy to the company announcements office for release to the market within five business days of the material change taking effect.

Other measures that companies should take

In addition to a trading policy, all entities should also establish a whistleblowing policy to ensure individuals can report suspicious or potentially illegal trading activities, as well as any other alleged misconduct and wrongdoings of company officers and employees, in a confidential manner. The ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* suggests every listed entity establish and disclose a whistleblower policy which is consistent with their organisation's values and culture.[3] Any reported incidents and the investigation/follow up should be reported to the board promptly.

In March 2019, the Federal Government passed the *Treasury Laws Amendment (Enhancing Whistleblower Protections) Act 2019*. These new provisions provide an expansion of whistleblower protections and remedies for corporate and financial sector whistleblowers.[4] They also require public companies and large proprietary companies to establish a whistleblowing policy. New provisions regarding whistleblower protection and the mandatory whistleblower policy commenced in July 2019 and require public and large proprietary companies to have a compliant whistleblowing policy in place as soon as possible but by no later than January 2020.

3. ASX Corporate Governance Council, 2019, *Corporate Governance Principles and Recommendations*, 4th edition, February, Recommendation 3.3, **https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf**, (accessed 8 May 2019).
4. S Linwood, 2018, "Whistleblower legislation passes Senate", *The Boardroom Report*, vol 16, issue 12, 19 December, Australian Institute of Company Directors, **http://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-16-issue-12/whistleblower-legislation-passes-senate**, (accessed on 4 April 2019).

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07236-5-11