CHARTERED SECRETARIES
AUSTRALIA

Keeping good companies

10 October 2001

Mr John Kluver
Executive Director
Companies and Securities Advisory Committee
GPO Box 3967
SYDNEY NSW 2001
BY EMAIL

Dear Mr Kluver,

INSIDER TRADING DISCUSSION PAPER

Chartered Secretaries Australia (CSA) welcomes this opportunity to comment on the above Discussion Paper.

CSA has been at the forefront of improved compliance and corporate governance for many years. With over 8,000 members throughout Australia, CSA has representatives in a wide cross section of Australian businesses, including in particular, listed companies.

Generally CSA endorses the Committee's support for the principles underlying the Australian insider trading legislation, and most of its existing provisions, as expressed in paragraph 0.17 of the Introduction to the Discussion Paper.

However, while also supporting adjustments in a number of areas, CSA is concerned that the Committee's views may not give adequate recognition to those persons who develop their own independent knowledge base. We make the following comments:

Chapter 1: Rationale and overview of insider trading regulation

Issue 1 - Are the current market fairness and market efficiency rationales for the Australian insider trading legislation appropriate?

Subject to the qualifications expressed in this response, yes.

Issue 2 - Is the current Australian broad approach to the definition of inside information appropriate? Should the legislation exclude information that relates only to securities generally or to issuers of securities generally?

CSA sees no difficulties in all the situations under 1.40 being caught. However, as expressed above, CSA is concerned by suggestions that the law should also seek to limit or restrict persons transacting on the basis of their own research or deduction, where the information on which that conduct is based is not derived from within the Company, its officers or advisors. It follows that as a minimum, CSA would support the legislation excluding information that only relates to securities generally or to issuers of securities generally.

Issue 3 - Should the current Australian definition of insider, which includes entities as well as natural persons, be maintained or be confined to natural persons?

CSA supports retention of the current Australian definition of insider.

Issue 4 - Should the Australian definition of insider continue to take an "information connection" approach only or require an additional "person connection" element?

The type of exemption envisaged by CSA under the above paragraphs would not alter the position discussed in footnote 85. However, it would require clarification of what is meant by "information" under 1.62. Provided "information" in that context was intended to mean "real" information as distinct from opinion or deduction, CSA would support the continuation of an "information connection" only approach, without any additional "person connection" element.

Issue 5 - Should the insider trading legislation:

- **prohibit any person holding insider information from disclosing that information without a lawful reason, even where the purpose or result of the disclosure is that the recipient does not trade:** Yes.

- **require a person lawfully disclosing inside information to inform the recipient that the information is inside information:** Yes.

- **impose liability on persons holding inside information if they "discourage or stop" another person from dealing in affected securities?** No, for the reasons expressed in 1.107.

Chapter 2: Details of regulation

Issue 6 - Should the test of generally available information:

- **give priority to the publishable information test**

- **expand the application of that test**

- **extend the circumstances where a reasonable dissemination period is required under that test?**

Issue 7 - Should the readily observable matter test be clarified? If so, in what manner?

The facts of R v Kruse and R v Firns are an excellent illustration of the concerns CSA has in this area. In the opinion of CSA, a distinction should be drawn between the defendants, who were both officers of the appellant company (and this should include their professional advisors), and those who had no connection with the company. With respect to the outcome, CSA is surprised that the Court appeared to accept as legitimate any delay in notifying the Australian Stock Exchange of the Court's decision. In CSA's opinion, there should have been a complete prohibition on any dealings by persons within or associated with the company until ASX had been notified of the outcome. In CSA's opinion, the ASX disclosure test, as amended under 2.32, should be paramount. This would also confirm that the requirement exists irrespective of the location of the event giving rise to the Continuous Disclosure obligation.

The wider question is whether a casual observer should be placed in the same position as the corporate officers or their advisors? Using the example quoted under 2.43, A should not be liable, particularly as in that event, B itself may not be aware of the deposit or its consequential value.

Issue 8 - Should the Australian legislation require that inside information must be specific or precise? No.

Issue 9 - Do the current insider trading and continuous disclosure provisions properly complement each other?

CSA supports both the Overseas law position as expressed in 2.65, and the Advisory Committee's view expressed in 2.66, that the insider trading provisions should be wider than the existing Listing Rule 3.1. To the extent that it is necessary, for the reasons expressed above, CSA also believes that the insider trading provisions should redress the decisions in R v Kruse and R v Firns.

Issue 10 - What, if any, amendments are necessary to take into account research and analysis?

CSA shares the Advisory Committee's view about Dirks v SEC. In CSA's opinion, as the source of that information was corporate employees, the defence should not have been allowed. CSA's concern is that research based upon sources external to the Company should not be penalised, even though the information upon which that research is based may not be regarded as being generally available (the 2.43 situation above).

Issue 11 - What, if any, amendments are necessary to take into account trading before release of one's own research?

CSA considers that in the context of professional advisors or researchers, the decisions reported in 2.79 and 2.80 should be regarded as correctly representing the law, and that the contrary argument expressed by the Committee in 2.82 should prevail. Private research where there is no obligation to publish should be treated differently, and should only be attached where all or part of the information has been made available by the Company or its officers.

Issue 12 - Should the range of financial products covered by the insider trading provisions of the Financial Services Reform Bill exclude indices, derivatives over commodities and/or any other financial products? No.

Issue 13 - Should the insider trading legislation apply to any trading or only transactions that are or can be carried out on a public market?

CSA supports the Advisory Committee's view set out in 2.96: at this stage it should not extend further as canvassed under 2.97.

Issue 14 - What, if any, amendments are needed to enable companies to issue their own securities without breaching the insider trading provisions, while properly protecting investors?

CSA supports the concern expressed under 2.101 that the reasoning in the Exicom case is questionable, and sees no justification in excluding new issues from the insider trading provisions.

Issue 15 - What, if any, amendments are needed to enable companies to buy back their own securities without breaching the insider trading provisions? Nil.

Issue 16 - What, if any, amendments are needed to enable informed persons (that is, persons who only receive inside information in the period between entry into and exercise of an option contract) to exercise their physical delivery of option rights without breaching the insider trading provisions?

CSA supports the concluding words under 2.126 that an exemption should only exist where the exercise price is fixed on entry into the original option contract.

Issue 17 - What, if any, amendments are necessary to enable uninformed counterparties to informed persons (that is, persons who only receive inside information in the period between entry into and exercise of an option contract) to exercise their physical delivery options?

CSA supports the respective positions expressed under 2.129 and 2.131.

Issue 18 - Should any amendments be made to the current awareness test? and Issue 19 - Should any amendments be made to the current knowledge test?

No. CSA supports the current Australian position under 2.134.

Issue 20 - Should the Australian legislation deal more specifically with the use requirement issue and, if so, in what manner?

CSA supports the recommendation of the Griffiths Report set out in 2.143 and stresses that in cases of criminal liability as distinct from civil liability, both tests should apply.

Issue 21 - Should the legislation permit an informed person to trade contrary to inside information?

CSA supports the retention of the current statutory prohibition on trading (2.154).

Issue 22 - Should the underwriting exemptions be reformulated and, if so, in what manner?

CSA supports the current law (2.161).

Issue 23 - Should the rules regulating transactions by external administrators be amended and, if so, in what manner?

CSA would support an amendment to the existing law so that administrators, scheme managers, receivers, and receivers and managers receive the same statutory protection as afforded under 2.168.

Issue 24 - Should persons with confidential price-sensitive information be liable when they instruct a broker to trade, when that broker places the offer on the

market, when that offer is accepted by a counterparty broker or at some other time?

As Stock Exchange systems become increasingly automated, offer and acceptance will become virtually instantaneous. CSA therefore supports the second bullet point under 2.180 - when an offer is placed on a stock exchange trading system.

Issue 25 - Should the legal position of intermediaries acting for clients who they know have inside information be clarified and if so, in what manner? and Issue 26 - Should intermediaries who have been informed by clients that they have inside information be restricted in acting for other clients?

CSA supports the Advisory Committee's view as expressed in 2.188 and 2.189.

Issue 27 - Should the Chinese Walls defence be amended and, if so, in what manner?

CSA agrees that protection should be afforded to the Bank in the example provided in footnote 265, and that the legal position should be as set out in 2.195.

Issue 28 - Should a derivative civil liability provision be included in the Australian legislation? Yes.

Issue 29 - How should the Australian legislation deal with consortium bidders?

As set out in 2.211.

Issue 30 - Do the Australian provisions need any modification for target company directors in the context of takeover bids?

CSA supports the two restrictions test proposed in 2.219.

Issue 31 - Should white knights be permitted to purchase issued shares when aware of a pending price-sensitive hostile bid not known to the market?

No, the law should remain as set out in 2.221.

Issue 32 - Should white knights be permitted to purchase issued shares when aware of any other inside information affecting those shares? No.

Chapter 3: Remedies

Issue 33 - Should the regulator be given any additional powers to deal with insider trading?

No, nor would CSA support a multiple factor at this time.

Issue 34 - In what circumstances, if any, should uninformed procured persons not be civilly liable for the profit made or loss avoided by an insider trading transaction?

In the circumstances, and to the extent provided in 3.16 and 3.17.

Issue 35 - Is any amendment to the equal information defence necessary?

While CSA believes a distinction should continue to be drawn between civil and criminal proceedings, it is supportive of the amendment proposed in 3.23.

Issue 36 - Should there be a right of compensation for insider trading? If so, who should be eligible claimants and how should compensation be assessed?

As evidenced by the breadth of matters discussed under these headings, these are most complex issues. In the absence of a more specific view expressed by the Committee, CSA is of the view that compensation rights should be left as is under 3.25, and that the suggestion included in 3.32 provides the most focused outcome.

Issue 37 - In what circumstances, if any, should companies whose securities are affected by insider trading be entitled to compensation?

CSA supports the retention of the existing Australian law as set out in 3.45 and 3.46. CSA would have no objection to a power similar to 3.49 being included in the Australian legislation, but remains opposed to any multiple of profit as envisaged under 3.48.

Chapter 4: Other provisions

Issue 38 - In what manner should the director notification requirements be amended?

CSA believes that these matters are adequately covered by the ASX Listing Rule amendments which became effective on 30 September 2001.

Issue 39 - Should the Australian legislation introduce controls over speculative trading by corporate decision makers in the securities of their companies?

As part of its submissions to ASX relating to Listing Rule amendments, CSA has supported the adoption by Listed Companies of policies governing dealings in the company's shares, with details of the policy to be set out in the Annual Report. In this respect, CSA would support a prohibition on conduct of the type covered by the Canadian legislation under 4.15.

Issue 40 - Should the Australian legislation include a "short swing profit" prohibition? If so, who should be subject to the prohibition?

CSA believes this prohibition should be addressed under Issue 39 as part of a wider control over speculative trading by both Directors and Executive Officers.

We would be happy to meet with members of your Committee to discuss these comments after you have had the opportunity to consider them.

Yours sincerely

Tim Sheehy
CHIEF EXECUTIVE