

The Difficulties of ASIC in Enforcing Insider Trading Laws and the Probable Solutions

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Abstract—ASIC is the most important of Australia's corporate regulator. It is empowered to enforce Australia's market misconduct laws with various powers. Insider trading is serious market misconduct in the capital market and it is crucial to enforce insider trading laws properly. In practice, the ASIC faces enforcement problems in the investigation, proving and division of supervision. The probable solutions may include giving ASIC the power to apply for telephone interception warrants and encouraging it to use reg-tech in investigations. And the ASIC should pay more attention to civil procedures and civil penalty proceedings. As for the division of supervision problems, introducing a joint body of ASIC and ASX could be a possible way.

Keywords—*corporate regulator; enforcement; insider trading; Australia security law*

I. INTRODUCTION

The financial market is highly complex and changeable, in order to protect the market integrity and confidence, a powerful regulator which is able to deal with market misconducts professionally and swiftly is necessary. The Australian Securities and Investments Commission (ASIC) plays the role as the regulator of Australia's integrated corporate, markets and financial services. As mentioned in cl 301 of the Corporations Agreement 2002, it is solely responsible for the general administration of the national law. As the most important Australia's corporate regulator, ASIC is empowered to enforce Australia's market misconduct laws by the Corporations Act 2001 and Australian Securities and Investments Commission Act 2001(ASICA).

Insider trading is the trading by a trader possessing "material" information, which is not already known to other traders[1]. Insider trading may be one of the most serious misconducts in the capital market. If the insider trading laws cannot be enforced well, the transparency and fairness of the market will be destroyed. The problem is whether ASIC is adequately empowered to enforce insider trading laws. This article will analyze this question in three parts. The first part is a summary of the powers and enforcement tools ASIC has. In the second part, the problems of enforcing insider trading laws in the practice will be analyzed. In the third part, there will be a discussion about the probable solutions to improve the position.

II. ASIC'S POWERS AND ENFORCEMENT ROLE

ASIC has various powers to enforce the Corporations Act. Among these powers, the most relative and important powers

may be the investigations and information-gathering powers. According to s 13 of the ASICA, ASIC can initiate an investigation where it has reasons to suspect there are certain contraventions, including insider trading. For the aim of the investigation, ASIC can examine persons and require the person to give reasonable assistance (s 19), inspect books (s 30) and notice to produce documents in person's possession (s 33). There are also some limitations on ASIC's investigation powers. In INFO 145, ASIC states that "it must use its powers for a proper purpose, and responsibly". As for the search warrant, it was held in *Williams v Keelty* that the warrant can not be used for ulterior purposes in legal proceedings other than the criminal proceedings, which is covered by the application for the search warrant. Also, in *ASIC v Rich*, it was held that the materials and information obtained using the search warrant for a specific criminal investigation, can not be used for civil proceedings unless the owner consents.

Also, ASIC has a range of enforcement tools where there is insider trading. Although it seems like ASIC has many options and powers for enforcement, there are also some limitations. In criminal prosecutions, generally, ASIC can only investigate and refer to the matters the Commonwealth Director of Public Prosecutions(CDPP) under s 1315 of the Corporations Act. It is the CDPP who decides whether to lay criminal charges. As for the civil proceedings, ASIC can bring or intervene in civil proceedings and apply to the court for various orders, but it is required to obey the rules of procedure and evidence. In the civil penalty regime, ASIC's role is to make an application to the court for a declaration of contravention firstly, and the order that the person pays a civil penalty may be accompanied by the declaration of contravention. ASIC has the obligation to act fairly and it is required to provide evidence that is not discounting. ASIC also has powers to take administrative actions, which are quite useful and efficient. But these actions can only be used to solve a problem for the short term. To settle the issue completely, ASIC still needs to bring the case to the criminal, civil proceeding or civil penalty proceedings.

III. ASIC'S ENFORCEMENT DILEMMA

Although ASIC is empowered with many powers and enforcement tools, there still remain some difficulties in practice. Firstly, without the power to intercept telecommunication, it is difficult to investigate insider trading timely. Secondly, the rules of evidence and procedure are too strict that sometimes ASIC fails to enforce those laws because it doesn't have sufficient evidence. Besides, the division of

supervision between the ASIC and ASX may make the enforcement less efficient.

A. ASIC's dilemma in investigation

ASIC has the power to obtain stored telecommunications data by seeking the issue of warrants. But ASIC doesn't have the power to apply for warrants to intercept telecommunications. According to Pt 2.5 of the Telecommunications (Interception and Access) Act 1979 (Cth) (TI Act), only a few agencies can apply for warrants to intercept telecommunications, and ASIC is not one of them. Although ASIC is able to access the information with the help of AFP, it can't get it directly. On the one hand, the co-work process may cause delays and inefficiency. In the enforcement of insider trading laws, efficiency is so important. Even ASIC and AFP can work together well, it is impossible to investigate as efficient as one body. With different organizations and different aims, ASIC can't get what they really want for the first time. On the other hand, with the limitation of "serious offenses", the telephone taps are only available for insider trading in criminal prosecutions, not the civil penalty proceedings or civil proceedings. Maybe only the insider trading involving multiple counts or particularly significant profits could provide a justified reason for the availability of intercepting telecommunications[2].

B. ASIC's dilemma in proving

Although ASIC has various administrative options, these actions can only be used to solve immediate problems. To solve the issues completely and make the wrongdoers fully pay for what they have done, it has to bring the case into criminal, civil or civil penalty proceedings. And here comes the problems of proving. It is quite difficult for an average jury "to make finding of guilt beyond reasonable doubt" in insider trading cases[3].

Perhaps one of the most important reasons for the proving difficulties is that ASIC concentrates too much on the criminal prosecutions. According to the summary of ASIC's enforcement outcomes (2019), there are 386 criminal charges laid in summary prosecutions for strict liability offenses, but only 132 banning orders, 5 infringement notices, and 125 investigations. And there were only 2 cases of insider trading from January to June 2019, both are in criminal proceedings. It is true that the prohibited conduct penal provisions provide for fines and terms of imprisonment for up to 10 years, which might be the most useful deterrence and the most efficient and adequate option to punish the wrongdoers in insider trading. But the rules of evidence in criminal proceedings are the strictest and the standard of proof is the highest. If it is too hard to prove, maybe it is not the best option. Another problem is that the proceedings in a criminal prosecution are always slow and costly. As the securities market is changing quickly, it's perhaps not so good both for the damaged investors and the regulator.

C. Problems in the division of supervision

As the regulator of the financial market, the ASIC is highly professional. But its status is the external regulatory agency of the government[4], not a market participant. The information

asymmetry between the market participants and the regulator leads to the inherent deficiency of the ASIC's regulation and enforcement. The securities exchange, as a special market participant, also has the functions of supervision and monitoring. It is more familiar with what is actually happening in the securities market and it also has the motivation to ensure the market is fair, transparent and efficient. Around the world, it is quite common that the stock exchange has the role as a co-regulator, and the Australian Securities Exchange (ASX) also takes responsibility. According to the ASX Operating Rules Section 05, ASX has regulatory responsibilities of investigating the activities of the market participant which may violate ASX rules as well as the related laws ([5010]). And it also has powers to take enforcement actions for breaches of its rules and related laws ([5100]). According to s 792B(2)(c) and 821B(2)(c) of the Corporations Act, if ASX has reasons to suspect an individual committing a significant contravention of the ASX Operating Rules or the Corporations Act, it is required to give written notice to ASIC as soon as possible. And ASIC will review these referrals and decide whether or not to take enforcement action or administrative action under the Memorandum of Understanding between ASIC and ASX. Before sending the referral, ASX should complete the investigation itself. After analyzing the broker records, trading data, and other related information, ASX is supposed to make its decision about whether there is prima facie evidence of insider trading. All these analyses, relevant data and details should be written in the referral to help the ASIC to make its decision of whether to commence further investigations[5].

With the assistance of ASX, the ASIC's regulatory gap problems in the stock market can be solved well. Especially in the supervision and investigation of insider trading, which is quite hard to detect. But the deficiencies of this division of supervision are also obvious. The first one is the efficiency problem. The investigations of insider trading are quite complicated, which may take a long time. To finish the detailed referral, the ASX would spend a lot of time and resources. After several months of investigation, when the cases are finally referred to the ASIC, the regulator may have lost the best chance to make further investigations and enforcement actions. The second problem is that ASIC can only take a handful of further enforcement actions for these referrals. In fact, the ASX gives ASIC a number of referrals of suspicious trading instances, but only a few are brought into actions by ASIC. For example, for the financial year ended on June 30, 2008, there were 92 instances of suspicious trading referred by the ASX to ASIC, but only 4 of them were taken further actions by ASIC[6]. This result would frustrate the ASX, because it has spent a lot of time and resources in order to investigate these instances. It is a kind of wasting resources. And the third problem is that, with different aims and concerns, there may be a divergence between the ASIC and ASX in how to deal with the instances. They may "blame shifting", which would aggravate the regulatory gap issues.

IV. PROBABLE WAYS TO IMPROVE THE POSITION

To solve the investigation, proving and division of supervision problems, we need to consider the existing laws

and practices in Australia, as well as the experiences of other countries.

A. Probable solutions for the investigation dilemma

For the dilemma in ASIC's investigations, maybe it is a probable solution to modify the TI Act and give ASIC the ability to apply for telephone interception warrants. On the one hand, with the ability to apply for the warrants, ASIC can detect more efficiently, making it possible to prevent insider trading at the inception. On the other hand, compared with the AFP, ASIC is more professional and experienced in the financial market misconduct investigation. Therefore, it can use the power better than the AFP.

As for the question that whether the evidence obtained by phone tapping should be used in civil and civil penalty proceedings, maybe it is not the right time to modify the laws right now. Although we do need a powerful regulator, it is not a good idea to make ASIC too powerful. It is true that the prevention of systemic collapse and prohibiting market abuse are two of the main objectives of financial market regulation, but we can't forget the third one is fostering market efficiency[7]. A too powerful regulator may be good for the market to maintain stable, but it may be detrimental to the efficiency of the free market.

Perhaps "reg-tech" is another way to solve the investigation difficulties. The Assistant Treasurer has made a review with some suggestions for ASIC on 24 July 2015. And one of the recommendations is to invest in big data "reg-tech" analytics and build required staff skills[8]. To respond to the recommendations, the Government has indicated it is progressing the suggestions[9]. With the development of technology, various tools of technology might be used in insider trading, which might be more difficult to discover. ASIC might be not able to detect insider trading well even with the ability to apply for telephone interception warrants. It is necessary to improve "reg-tech" for ASIC in future investigations.

B. Probable solutions for the proving dilemma

Apparently, there is no need to modify the whole rules of evidence just for insider trading problems. But it may be solved by changing ASIC's strategy and giving it more administrative power.

On the one hand, ASIC can pay more attention to civil and civil penalty proceedings rather than criminal prosecutions. The SEC may be one of the most efficient financial market regulators with an enviable reputation around the world. Its strategy in dealing with enforcement issues is quite different compared with ASIC. It concentrates on civil powers more, and its use of the civil remedies is quite effective both statutorily and at common law. Not like the ASIC, the SEC only brings the most serious cases into criminal prosecutions[10]. The standards of proving in civil and civil penalty proceedings are lower. As a result, each year, the SEC brings a few hundred actions and the alleged wrongdoer is "either found liable or consents to a judgment being entered against him without admitting or denying the allegations"[11] in almost every case. Although the punishment is not so severe

and the cost is not so much for the wrongdoer, the high efficiency and the high rate of the regulators' success in cases are sufficient to deter the wrongdoers. In Australia, one of the most important reasons for the introduction of the civil penalty regime is to overcome ASIC's dilemma in enforcing the Corporations Act. The major cause of the difficulties is that with the strict criminal evidence rules, it was too hard for ASIC to prove and win the cases. As an alternative enforcement mechanism, ASIC has been successful in its use of the civil penalty provisions. But it seems ASIC still doesn't issue many civil penalty applications[12]. Maybe it's time to change its strategy and make use of civil penalty mechanisms and civil proceedings more to overcome the difficulties in proving.

On the other hand, maybe ASIC should get more administrative powers. Since ASIC's enforcement function in the securities market is so important, it needs to be feared and respected. In order to achieve this goal, ASIC should have sufficient resources and enforcement tools. Right now, although ASIC has some administrative actions, these powers are used mainly for civil and criminal proceedings. To punish the individuals or bodies, ASIC has to wait for the decisions of the courts. In order to prosper the securities market and protect the investors, maybe there should be some proper changes. For example, the China Securities Regulations Commission (CSRC) has the power to take administrative penalties directly to the wrongdoers. With such power, the CSRC can take enforcement actions quickly and efficiently. If the bodies or individuals who are penalized think the decisions of the CSRC are unfair, they can appeal to the court, which can protect their rights and give them justice as well. But the CSRC has also been criticized that it is too powerful. And sometimes it just doesn't have enough resources and manpower to utilize these powers. There is no perfect mechanism and regime. The question is to find a better one, which is fittest for the financial environment of Australia. And giving the ASIC some administrative powers to punish the wronger directly may be a possible solution.

C. Probable solutions for the division of supervision problems

Although the division of supervision can reduce the regulation and enforcement burdens of the ASIC, the existing regime may not be the best way to enforce insider trading laws. Making a joint body of the ASIC and ASX, with the functions of surveillance and investigation may be a probable solution for this problem[13].

This solution is beneficial in two aspects. On the one hand, the ASX will still take an important role in the joint body and can provide its knowledge in dealing with insider trading cases. Compared with the ASIC, the role of the ASX is not solely a regulatory one. It is also a commercial entity and plays a commercial role[14]. Therefore, it is more familiar with what the market participants think and do. In other words, the information asymmetry problem between the ASIC and the market participants is less severe for the ASX. The joint body can still utilize these advantages of the ASX in insider trading investigation. Where there arising problems in investigation or enforcement of insider trading, the ASIC and ASX can discuss together face to face immediately, which can reduce the cost of communication. Working as a single body rather than two

organizations working together can also solve the problems of delay, waste of resources and blame-shifting.

On the other hand, it can also limit the powers of the ASX, whose status is quite complicated. The reason for ASX to spend so many resources for supervision is that doing so is in its own interest. In order to maintain the reputation of ASX, it has to take such responsibilities to ensure the market is fair and transparent. But once doing that has less value than what it has spent, the ASX may abandon its co-regulator role for the interest of its shareholders. Some research has pointed out that because there existing interest group rent-seeking within the exchange membership, the exchanges may provide suboptimal investor protections and enforcement[15]. Another view is that the stock exchanges have strong incentives to take actions on market misconduct, but one of the most important reasons is that there are intensified competitions among the exchanges. However, ASX is famous for its monopoly in the Australian securities market. It would not be faced with active competitions[16]. Therefore, it may be not proper to divide so many supervision responsibilities to the ASX. After all, it is the ASIC who is supposed to gather evidence to support a prosecution. With a joint body, the ASIC can take part in the investigations of insider trading early and control the process. In that way, the inherent deficiency of the ASX's supervision can be overcome, too.

V. CONCLUSION

Although the ASIC has been empowered with various enforcement powers, there are still many problems in the practice. The reasons for these problems are quite complicated and that ASIC not being adequately empowered to enforce insider trading laws is just one of them. There are mainly 3 kinds of enforcement difficulties with different reasons and probable solutions. The first one is the investigation dilemma, and the reason is that the ASIC doesn't have the power to apply for warrants to intercept telecommunications directly. The solution is to give the ASIC such power and develop "reg-tech". The second one is the proving dilemma, and the main reason is that the ASIC pays too much attention to the criminal prosecutions, whose standards of evidence are much higher. ASIC can focus on civil and civil penalty proceedings more. And more administrative powers should be given to the

regulator. The third problem is the efficiency problems arising from the division of supervision between the ASIC and ASX. Setting up a joint body is likely to be a good solution.

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