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### ASIC's uphill fight to keep 'em honest

By Ian Ramsay  
August 8, 2005



Illustration: *Frank Maiorana*

#### **Enforcement headaches abound, but insider trading laws still matter.**

Australian insider trading law and enforcement is an anomaly. We have what may be the broadest insider trading laws in the world. Many transactions are caught by our insider trading laws but would not be under the laws of other countries.

Yet we have little enforcement. In the past 20 years, the Australian Securities and Investments Commission has brought only about 30 criminal cases for insider trading and has been successful in about one third of these. By comparison, in its most recent annual report, ASIC claims a success rate for all its litigation of 93 per cent.

Is the low rate of enforcement because there is virtually no insider trading in Australia?

Although accurate evidence on the extent of insider trading is impossible to obtain because it is an illegal activity, this would seem an unlikely explanation.

It is more likely that the low level of enforcement is due to a number of challenges that confront ASIC.

It can be difficult and resource-intensive to investigate insider trading as it may be well hidden, with the share transactions conducted offshore through several different companies.

Witnesses may be reluctant to give evidence.

Under the law, many separate elements must be established in order to prove that insider trading occurred.

Finally, the laws are not only complex (they are about 10 pages in length) but also they can be imprecise and uncertain in their application to some situations, and courts have criticised parts of the law for their ambiguity.

Of course, a low success rate in enforcement is no reason to reduce enforcement activity or to consider abolishing insider trading laws. There are many powerful reasons for the existence of the laws, such as promoting investor confidence and maintaining the integrity of the capital markets. These reasons become even more important because, according to Australian Stock Exchange data, Australia has one of the highest rates of share ownership in the world and compulsory superannuation means that almost all adults have a stake in the sharemarket.

Economic evidence is mounting on the value of insider trading laws. Research by Laura Beny (available at [www.ssrn.com](http://www.ssrn.com)), who examined insider trading laws in 33 countries, found that countries with strong laws generally have more widespread share ownership, more accurate share prices and more liquid sharemarkets.

There is also research on the economic value of enforcing insider trading laws. Beny found that greater public enforcement of the laws (especially criminal enforcement) is associated with more liquid sharemarkets.

Research by Uptal Bhattacharya and Hazem Daouk (available at [www.ssrn.com](http://www.ssrn.com)), who examined insider trading laws and their enforcement in 87 countries, found that it is actual enforcement of the laws that has the positive effect of reducing the cost of equity and increasing liquidity of the sharemarkets.

Interestingly, they found that insider trading laws had been enforced in only one out of three of these countries, with developed countries having a better enforcement record than emerging markets (82 per cent of developed countries and 25 per cent of emerging markets).

So what are some of the conclusions and lessons from this research? First, it is not just Australia that appears to have a low enforcement rate.

Second, enforcement of insider trading laws, particularly criminal enforcement, matters. It was no doubt desirable that the Australian law was changed in 2001 to give ASIC the option of bringing civil proceedings for breaches, rather than only for criminal proceedings. Civil proceedings may be easier to win but it is still important to bring criminal proceedings where evidence justifies this.

Third, the scope and clarity of insider trading laws matter. It is difficult to enforce ambiguous laws and such laws can reduce compliance by market participants. In 2003, the Federal Government's Corporations and Markets Advisory Committee recommended changes to insider trading laws to improve their clarity. While the Government since then has had many important corporate law issues to deal with, sufficient time has elapsed for a response to the CAMAC report.

Fourth, effective enforcement of the continuous disclosure rules is important. The operation of these laws (that require listed companies to immediately disclose material information) reduces the opportunities for insider trading. However, there are limits to what can be achieved. It may be precisely where companies are exempt from the continuous disclosure rules — where, for example, they are not required to disclose information because it concerns an incomplete proposal or negotiation — that much insider trading occurs.

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