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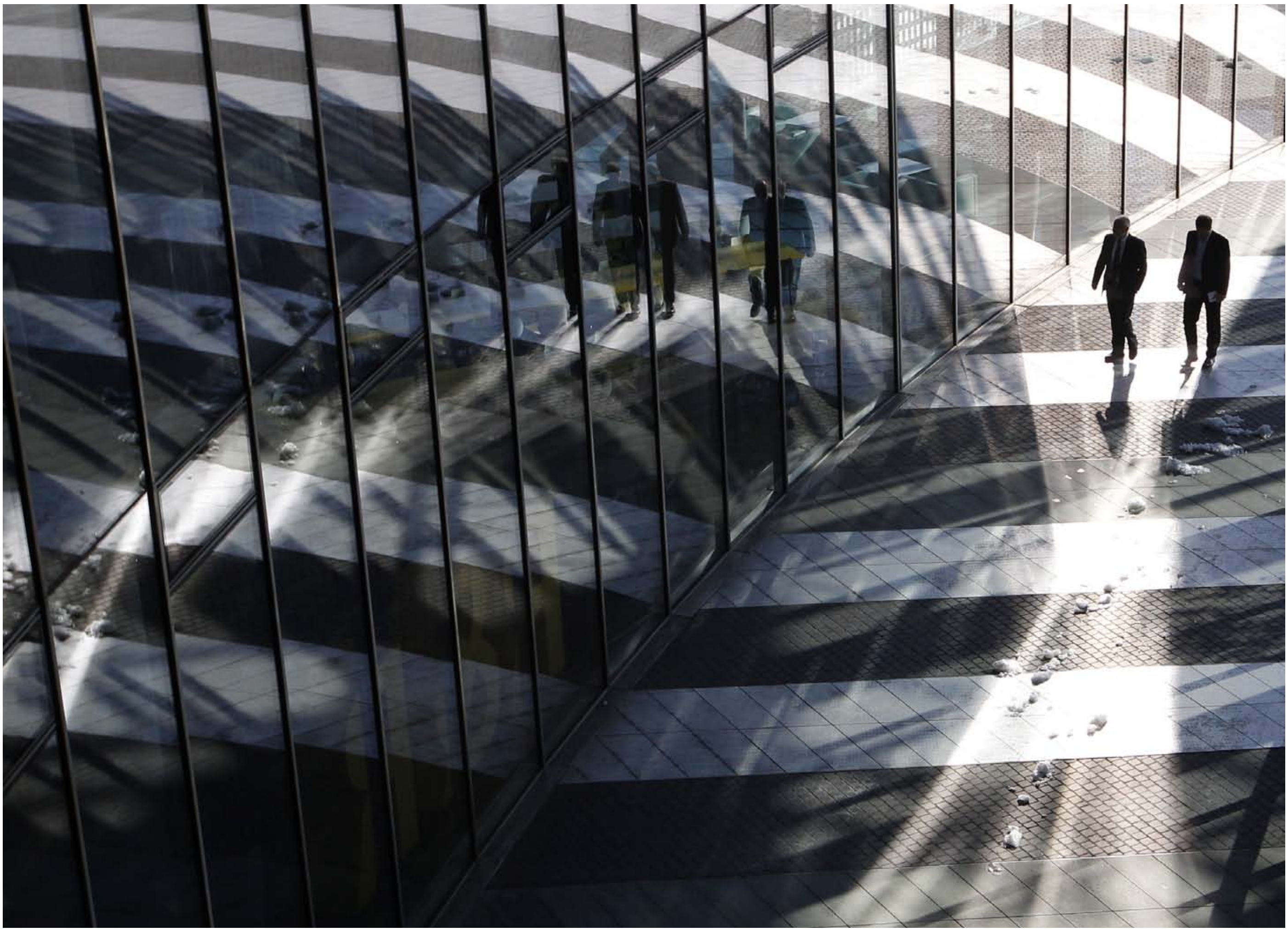

SPECIAL REPORT

ASIC: THE OUTLOOK FOR ENFORCEMENT 2012-13

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THE FOLLOWING WRITERS CONTRIBUTED TO THIS SPECIAL REPORT:

NATHAN LYNCH

Nathan Lynch is the head regulatory analyst for Thomson Reuters' Governance, Risk and Compliance operations in the Asia-Pacific region. Nathan joined Thomson Reuters's London office in 2000. He returned to Australia in 2002 and has written about regulatory affairs, anti-money laundering and compliance developments for Thomson Reuters' Compliance Complete service across the Asia-Pacific region ever since.

Nathan is a member of the Australasian Compliance Institute and has presented workshops at the ACI's annual governance, risk and compliance conference. Nathan also appears regularly in print and electronic media as a specialist commentator on financial markets and regulation.

WIETSKE JARVIS-BLEES

Wietske Jarvis-Blees is a regulatory analyst for Thomson Reuters GRC in Australia & New Zealand. She has worked previously as a financial journalist for publications including Risk, Asia Risk and Operational Risk and Regulation, covering derivatives, structured products and risk management. Her specialist fields of interest include securities and banking regulation, enforcement cases and global developments that affect Australia (e.g., FATCA and Dodd-Frank).

Wietske holds a Masters degree in global political economy from the University of Sussex in the UK, and a first-class degree in International Relations and French from the University of Sussex and France's Institut d'Études Politiques de Grenoble.

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INTRODUCTION

In May of this year, Greg Medcraft notched up his first year as the head of the Australian Securities and Investments Commission (ASIC). Medcraft, a former investment banker with a 30-year career at Société Générale, had made it clear during his first year that change was afoot. He repositioned the regulator to be more open and transparent in its dealings with stakeholders. He was also a rare breed of ASIC chairman that came from an industry rather than a legal background, giving him a new practitioner-focused perspective on the role.

The message Medcraft sent to the financial services sector during the first year of his five-year term was unequivocal: ASIC will work with the industry, will engage in dialogue, and will be careful about increasing the regulatory burden on firms. But there was a quid pro quo: gatekeepers will be held to account for their actions and ASIC will come down hard on those that try to exploit this environment of mutual responsibility.

In keeping with this new temperament at the regulator, ASIC has placed a number of industry participants on notice that they will face more scrutiny in the year ahead. These include directors of public companies, consumer credit providers, shadow brokers (or indirect market participants), distributors of complex retail products and those who manage the country's A$1.4 trillion superannuation savings pool. The latter group includes financial advisers, custodians, superannuation trustees, investment managers, research houses, credit rating agencies, auditors and accountants.

At the same time, ASIC has embraced the new spirit of openness under Medcraft. It has become more adept at using the media and has moved away from the insular approach taken by Medcraft's predecessor, Tony D'Aloisio, a lawyer who liked to make his greatest regulatory statements through enforcement action and the courts.

As a case in point, in February ASIC held a media conference to release an 11-page information sheet setting out publicly the regulator's approach to enforcement. The paper detailed how ASIC reaches its key enforcement decisions and why it might respond to different breaches in different ways. Medcraft and his deputy chairman, Belinda Gibson, were open and forthright during their discussion and made it clear they were extending trust to the industry—but also expecting to see a level of maturity and responsibility in return. Misconduct would not be treated lightly.

The press conference and the paper were both a reflection of how ASIC intends to engage with the industry over the remaining four years of Medcraft's tenure: openly, in a spirit of collaboration, but with an ever-present threat of swift enforcement action for those that try to ignore their responsibilities.

As Justin O'Brien, director of the Centre for Law, Markets and Regulation at the University of New South Wales, puts it: "It's a velvet glove concealing a pretty significant steel fist."

At a critical time for the so-called gatekeeper professions, Thomson Reuters' Governance, Risk and Compliance has taken the opportunity to put together a white paper on the regulatory hot spots for the 2012-13 year. The paper outlines ASIC's main regulatory priorities, the approach it will take to supervision and enforcement in the year ahead and the industry sectors that need to consider themselves on a heightened state of compliance alert.

We hope you find this report useful in setting your compliance priorities for the financial year ahead.

Nathan Lynch
Head Regulatory Analyst, Australia & New Zealand
Thomson Reuters
Governance, Risk & Compliance

MEET THE REGULATOR

GREG MEDCRAFT: "AN OUNCE OF PREVENTION": ASIC OUTLINES CASE FOR PREEMPTIVE REGULATION

The Australian Securities and Investments Commission (ASIC) may have come under criticism for being slow to act in the past, but that is not the future trajectory its chief executive has in mind. In an exclusive interview with Thomson Reuters Governance, Risk and Compliance, ASIC chairman Greg Medcraft stated that the regulator would focus on active surveillance as part of a strategy to deal with risk and misconduct in a timely fashion.

"If there is one lesson we can learn from the global financial crisis, it is that regulators need to be more proactive. It has become very clear that an ounce of prevention is worth a pound of cure and that means that regulators will need to be more courageous and stand up when they have concerns," Medcraft said.

UPPING THE ANTE ON SURVEILLANCE

An active surveillance strategy will be at the core of this policy, along with regular industry interaction, Medcraft said.

"Surveillance is a critical component of effective regulation. If you look at the global standards of regulation, one of the most important aspects of any strong regulatory system is the frequency and intensity with which surveillance programmes are undertaken on a regulated population," Medcraft said.

He said regular surveillance yielded both preventative and deterrence benefits. "Part of it is a simple case of 'cops on the beat'. People know you are watching so there is an element of deterrence, but it also helps us in our analysis of potential future problems," he said.

"Surveillance often leads us to identify potential problem areas where additional guidance might be warranted and it certainly adds value in terms of prevention."

As part of this strategy, ASIC has recently established an emerging risk committee, which convenes on a monthly basis to discuss global and thematic emerging risks. In addition, each month, the group analyses in detail the surveillance plans provided by two out of 12 stakeholder teams tasked with analysing specific local sectors. Medcraft said that the initiative was yielding benefits, in terms of deepening the team's understanding of potential sectoral issues brewing under the surface, as well as from a system-wide risk management perspective.

"Part of the objective is to focus on a couple of sectors, but more importantly it ensures that we connect the dots across the organisation. This system helps us to identify whether a risk that emerges in, for example, the financial advice sector might also have implications for, say, the fund management sector. It is all about trying to be as proactive as we can be and making sure we have the right tools in place to do so," Medcraft said.

INDUSTRY COOPERATION

Another channel that will be employed by the regulator is cooperation with industry, a stance partly motivated by Medcraft's history as chief executive of the Australian Securitisation Forum (ASF). "I'm not a great fan of regulatory red tape and intervention. Having headed up an industry association, I believe in good self-regulation. That does not mean 'no regulation', but it means having an industry that helps market participants comply with the law or indeed go beyond the law. If you are a good industry, the best way of preventing intervention is to ensure you do not fail to meet the standards that are expected of you," he said.

Medcraft said that firms' compliance arrangements played a crucial role in this process. "It is a very important message that goes to the heart of companies' compliance arrangements. Compliance should be seen as an investment, not as a necessary evil, and if compliance professionals can ensure they have strong arrangements in place then hopefully we will not have to pay them a visit," he said.

DETERRENCE

While prevention is clearly the preferred cure, Medcraft said that where necessary, ASIC will not shy away from prosecution. "We will not hesitate to pursue big cases. Nobody is out of our range and that is a very important message," Medcraft said, pointing to the regulator's new role as market supervisor as one area where it would not hesitate to use its powers.

"Now that we directly supervise the market, we have the resources, we have the systems, we have the power and we have the people to monitor the market. In addition, now that we regulate the market as well as the participants we are in a far better position to connect the dots and work with compliance professionals inside the organisations that we regulate, and the result is that we have a lot more investigations underway," Medcraft said.

The basis of ASIC's decision to take civil or criminal action—soon to be set out in the form of enforcement guidance—typically depends on three considerations. These are the amount of harm or loss to the party or parties; the costs involved versus the regulatory benefits; and the availability of evidence. Based on those three principles, ASIC determines the appropriate sanctions, which might be adding a condition to a licence, a removal of a licence or the pursuit of a civil or criminal liability.

In reality, however, Medcraft conceded that the availability of evidence frequently limits the regulator's ability to take action. "The availability of evidence, unfortunately, is an important factor. We come across cases quite frequently where the amount of harm or loss is dreadful and you can see that the regulatory benefit would far outweigh the cost, but if you don't have the evidence to support what you are going to pursue then unfortunately you don't pursue the matter," he said.

This was another reason why, ultimately, ASIC preferred to focus on preventing incidents from occurring in the first place.

"At the end of the day, being a regulator is about leveraging your resources between what are essentially reactive and proactive strategies. Similar to policing, it is a question of either waiting until the crime occurs or putting more officers on the street to prevent it from happening in the first place. Since preventing problems tends to be far more cost-efficient than prosecuting in court, we focus heavily on the preventative side of regulation," Medcraft said.

MEET THE REGULATOR

GREG YANCO: ASIC EFFORTS TO TACKLE INSIDER TRADING STARTING TO YIELD RESULTS

Insider trading and market manipulation are high on the Australian Securities and Investments Commission's agenda, and the regulator is becoming increasingly adept at identifying them, Greg Yanco, senior executive leader for market and participant supervision stated in an exclusive interview with Thomson Reuters Governance, Risk and Compliance. The regulator had a sophisticated system at its disposal that allowed it to both recognise in real time when an unusual trade was conducted, as well as "play back" the market to clarify what was known at the time of trading, Yanco said. Coupled with the regulator's information gathering powers, that meant ASIC was becoming more successful at both spotting insider trades and market manipulation, and prosecuting the offences.

"We are actually watching every trade, and we are getting pretty good at tracking people down. The extent to which we can delve into people's activities can be quite surprising to those involved," Yanco told Thomson Reuters.

The first step in the supervisory process consists of real-time market surveillance via the SMARTS real-time market surveillance system. This system monitors the orders, including amendments and cancellations, trades and quotes with respect to every listed company on a daily basis. By capturing this trading activity, the regulator is able to determine what constitutes normal trading activity with respect to any one company and, as soon as trades move outside of these parameters, an alert is generated.

"There is a whole series of alerts that we look at, including alerts that indicate unusual volumes and unusual price movements, but there are also alerts that pick up on potential market manipulation or other contraventions," Yanco said.

Yanco said that it was important to note the regulator did not just track share trading activity on the stock exchange, but was equally across manipulation of synthetic exposures, for example, through derivatives-based strategies and contracts for difference (CFDs).

"We have seen several cases where people attempted to trade on inside information using CFDs or derivatives, thinking those trades may escape our attention. In actual fact, however, we have access to information about trading in derivatives and CFDs. In addition, the CFD providers have an interest in notifying ASIC when there is a potential breach, since they trade as principal and will lose as a result of inside trades and market manipulation," Yanco said.

Of the alerts flagged to ASIC, most are readily explainable, but those that are not will be referred for further investigation. Over the period from July 2011 to December 2011, a total of 20,029 trading alerts were generated, with 131 matters referred. Of those 131 referrals, 23 matters ended up being investigated for either insider trading, market manipulation or breaches of market integrity rules and continuous disclosure obligations.

At this stage, the regulator can reconstruct the market situation at any point in time, by replaying the bids, offers and trades of the security in question. That allows ASIC to reconstruct what information may have been available when the order was placed and is a critical part of the analysis. Where the inquiry indicates that there may have been a breach, the matter will be first referred to a triage committee that further examines the analyst reports. If this committee decides there is a case, it will be put to the deterrence team, which will develop the case further to present to the Commonwealth Director of Public Prosecutions (CDPP) for criminal prosecution. From this point, the question whether a case can be successfully prosecuted depends on the level of proof that can be collected in relation to the crime.

"The common challenge we encounter is actually demonstrating that the manipulation has occurred. While a trading professional might be able to recognise a particular trading pattern as constituting market manipulation, a judge or jury who is not used to the dynamics of the market might not understand how that trading process has been manipulated, so that is a challenge for our people and for the CDPP. Similarly, where insider trading is concerned, linking the information to the person who has traded in order to prove that they knew the information is usually the greatest challenge," Yanco said.

Over the course of the past six months to December, ASIC has successfully prosecuted one case of insider trading and one case of market manipulation, while a further three people agreed to plead guilty to the offence. In those cases, Yanco said the evidence collected by the regulator was substantial enough for ASIC to prove that insider trading had in fact occurred.

"In these cases, we were able to demonstrate pretty clearly that there was an issue and, after these people were confronted with the evidence, they made the decision to plead guilty. We are typically quite keen to bring the information we do have to the attention of the person of interest to allow them to form a view as to what they should do," Yanco said.

PREVENTION IS THE BEST CURE

While the regulator is targeting insider trading, Yanco said that prevention remains the best cure. "We expect gatekeepers to be alert to the possibility that there may be some form of insider trading or manipulation, but really what we look for them to do is do things to prevent that," he said.

That means tightly controlling information on significant events, which should only be passed on a "need-to-know" basis and conducted and documented via a secured knowledge management process.

"We have seen instances where accounting firms have got a system with all the corporate advisory work available to a group that goes well beyond just the corporate advisory team, and that has been abused. The more people who know inside information, the greater the chance that something will go wrong," Yanco said. "Similarly, people who do provide advice on these cases should sign off on any share trading they may wish to engage in."

Where a company does come across potential instances of insider trading, however, they are well-advised to bring the matter to ASIC's attention, while in some cases there may also be a legal obligation to do this. "If there is a problem, we will work with the company as best as we can to ensure that the inquiry is conducted discreetly. There can be reputational damage and, until we form a view that charges might need to be laid, the intention is to not negatively affect the reputation of the company or person involved," Yanco said.

SUPERVISION AND ENFORCEMENT: THE TOP REGULATORY PRIORITIES

The head of the Australian Securities and Investments Commission has set out the agency's three key priorities under his leadership. Greg Medcraft, chairman of ASIC, said the regulator would focus on three critical areas in the coming years: protecting the country's superannuation savings pool, taking an active supervision approach, and dealing with the increasing complexity of financial products. Medcraft said that the regulator would work within the reality of falling budgets by targeting its resources where they would be most effective. He said that the growth of the country's superannuation savings pool over the next decade would create a huge regulatory obligation for ASIC to ensure that investors' interests are being adequately protected.

"The growing regulatory perimeter, particularly with the exponential growth in superannuation – more products, more investors and greater investment funds – increases risk in the financial system," Medcraft said. "Superannuation is expected to grow to A$3 trillion over the next decade. It will grow at twice the rate of the economy. This will increase ASIC's regulatory perimeter as more investors come into the system and the money invested increases."

In view of this, ASIC has put so-called gatekeeper professions on notice that they will face greater regulatory scrutiny in an effort to protect Australia's pool of retirement savings. These industries include financial advisers, custodians, superannuation trustees, investment managers, research houses, credit rating agencies, auditors and accountants.

In terms of supervision, Medcraft said it was incumbent upon ASIC to take a more proactive approach to regulation, rather than simply carrying out its statutory role as a reactive regulator. He said that while ASIC's reactive regulation is mandatory – effectively coming to the scene after an accident – it has a lot of discretion as to how proactive it becomes. This can be done through a number of channels including engagement with stakeholders, more active surveillance (both desk-based and on-site), providing better investor education and issuing regulatory guidance.

"To be proactive and forward looking you need to be able to identify which sectors pose the greatest risk. This requires a detailed understanding of the sector – understanding that is only gained through stakeholder engagement and surveillance," Medcraft noted. "This means ASIC needs to maintain its high level of engagement with the industry and continue its risk-based surveillance."

The third dynamic that will drive ASIC's approach to regulation under Medcraft is the increasing complexity of the financial system – both in terms of the products on offer and the markets themselves. There is also greater scope for Australian investors to invest overseas in "frontier" or emerging markets. This changing landscape creates regulatory risk and increases the risks to investors, be they retail investors or managed funds.

"The ever-growing range of products and investor operations means the regulator needs to be much more vigilant and proactive. This process of increased complexity is likely to continue in the future, especially while equity markets remain volatile and investors look elsewhere for yield," Medcraft noted.

STANDING BEFORE THE SENATE

Medcraft's comments echoed his appearance at the Senate Economics Committee in Canberra earlier this year. Medcraft said the regulator accepted that the government was committed to reducing the agency's funding in line with the Commonwealth "efficiency dividend". In that context the regulator needed to target its resources according to its risk-based priorities, even if that meant neglecting some areas where there was perceived to be a lower risk to investors.

Medcraft said that the government would essentially "get what it paid for" with ASIC. As such, it was up to the government to determine the appropriate level of funding to allocate. With those funds, it was then ASIC's duty to get the best regulatory outcomes from that investment.

"The matter of how much funding is provided to ASIC is a matter for government. My objective is to look at the outcomes that we've set for the Australian people and to take the resources we have to make sure that we leverage those resources to achieve the outcome that we need to achieve," Medcraft told the committee.

"You can have an ASIC at A$250 million, A$350 million or A$450 million but that's a matter for government. It does come back to what level of resilience you want in the financial system. Our job is to focus on those outcomes and to leverage the resources we have to best achieve those outcomes – including the powers that we have as well as the financial resources."

In terms of ASIC's regulatory focus in coming years, the growth of the superannuation savings pool is

expected to create a huge supervisory challenge. Recent incidents such as the collapse of Storm Financial and the Astarra/Trio funds have highlighted the risk to superannuation investors, who typically invest for the long term. As such, they are often inclined to take greater risks and any fraudulent activity can take a long time to emerge because of the mandated age limit on redemptions.

Medcraft said that ASIC would need to pour significant supervisory resources into the superannuation and fund management sectors to ensure that investors' retirement savings were being protected.

"There are probably three things that are going to be very important, I think, looking forward to the next decade. One is the growth of superannuation. In the markets the growth of superannuation is expected to continue at seven or eight percent per annum over the next decade or so, which will outstrip the growth of the economy," he said.

In general, Medcraft said that ASIC was taking a more active approach to supervision and this would continue in coming years. He said that the global financial crisis (GFC) had highlighted how important it was for regulators to identify problems early, rather than waiting to be an "after the incident" policeman. He said that the most visible change for regulated entities would be the frequency of site visits and active supervision from ASIC, including shadow shopping exercise and the like.

"One thing I've been very focused on is surveillance and getting cops on the beat a lot more," Medcraft said. "The GFC has really changed the equation in that regulators can no longer afford to be reactive. What we've learned is you've got to be proactive. One important thing is that means having cops on the street rather than having them back in the police station."

The third significant priority for ASIC will be the increasing complexity of financial markets and products, which Medcraft believes is creating new potholes for unwary investors. "Financial product complexity is growing with things like contracts for difference, synthetics, market complexity with HFT, algo trading," Medcraft told the committee.

He said that ASIC would continue to take a harder line on gatekeepers that pushed complex products on unsophisticated retail investors. The regulator will also be forced to take a more vigilant approach to market regulation as the complexity of the market has increased significantly with the advent of market competition.

On the whole, Medcraft said that regulated entities should expect ASIC to continue to take a more visible approach to supervision, and to target its supervision and enforcement tools in the areas that pose the greatest risk to market integrity and investor confidence. This would also require ASIC to be nimble in the way that it allocates resources.

"We're very risk-based so a big driver in the way we allocate resources is risk-based. In our surveillance area at the moment a very important thing in regulation if you're proactive is the frequency and intensity of surveillance, so for example at the moment we visit on average each RE [regulated entity] every seven years. So that's with our resources what we currently allocate," Medcraft said.

The ASIC chairman said that firms should expect the frequency of those visits to increase if they found themselves conducting business that poses a high risk to investors. "It's important for the community to understand that we're being very transparent – much more transparent I think than in the past – in terms of showing in the annual report what staff are allocated to particular areas," he said.

CONSUMER CREDIT: THE TARGET AREAS FOR SUPERVISION

The Australian Securities and Investments Commission (ASIC) is working with stakeholders and the consumer credit industry to set out its enforcement targets and priorities under the new national regulatory regime. Officials from ASIC said the regulator needed to make risk-based decisions about the most appropriate areas to target its supervision and enforcement budget. The regulator needs to make a decision on whether it will generate better outcomes by focusing on fringe lenders or the mainstream lenders, with the latter generally being larger and more compliant but also affecting much greater numbers of clients.

Greg Kirk, senior executive leader for deposit takers, credit and insurers at ASIC, said the regulator was inevitably forced to make a risk-based determination on how it can generate the "best bang for its regulatory buck". In the case of consumer credit, fringe lenders are engaged in the most spectacular levels of non-compliance but only affect relatively small pools of consumers. The bigger financial services firms, on the other hand, tend to avoid the obvious or negligent breaches but will affect huge numbers of consumers when they get things wrong.

Kirk said ASIC was currently in the process of setting its enforcement priorities and was reaching out to stakeholders for input.

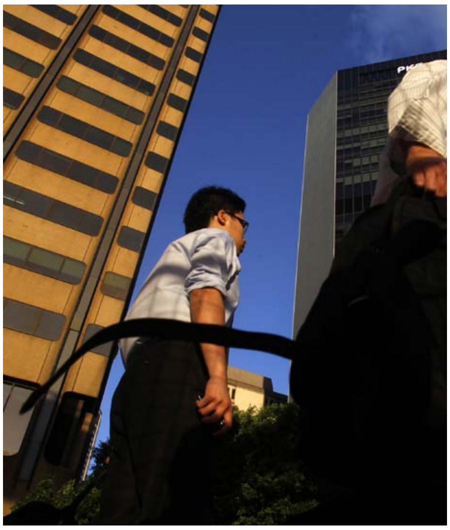
"With mainstream providers the things they tend to do that come in conflict with the regime are going to be on the margins. They're mildly in breach or there's a questionable practice. On the fringes, however, we have people who are potentially operating completely illegally or they're licensed and they don't comply with the regime," Kirk explained.

"We have limited resources and there will never be enough resources to do everything we would like to do in the regulatory space around credit. So we have to make choices between doing things in relation to mainstream providers or smaller providers."

Consumer groups have been complaining of flagrant abuses by some of the smaller fringe lenders who are continuing to ignore their regulatory obligations under the National Consumer Credit Protection Act 2009 (NCCP). Some of them are drafting their lending agreements to circumvent the regulatory obligations — for instance, by rolling contracts over every two months and avoiding the 48 per cent threshold for annual interest rates by repositioning interest costs as administration fees. This has allowed some of them to operate outside the consumer protections enforced under the new regime.

Kirk said that even though the most egregious breaches were taking place at the margins, ASIC could not simply direct allof its supervision and enforcement budget to those areas. It needs to find a balance between policing extreme misconduct that affects small numbers of consumers and policing the less egregious breaches among mainstream providers — even though the damage they may cause is less obvious.

"That's a constant question for us: how much of our resources should we spend on big mainstream providers that affect an awful lot of consumers, but those effects tend to be more minor? As opposed to spending a lot of the resources on a few smaller fringe players who don't deal with many customers at all but can have a very exploitative approach and can have a very bad outcome for the consumers involved," Kirk noted.



DIFFICULT DECISIONS

Greg Medcraft, chairman of ASIC, said that ASIC was having to make some difficult decisions about how to best target its enforcement spending in coming years. He said that under its present budget constraints ASIC is only able to make supervisory contact with a fraction of the regulated community every year.

"Enforcement remains a cornerstone of what we do. But it is a matter for government to determine the resources that ASIC has. Our job is to basically leverage those resources to the best of our ability," he said.

Medcraft said that under its current funding, for example, it is only able to make contact with a financial planner on average once every 31 years. In that environment it was largely reliant upon tip-offs to assist and consumer complaints to alert the supervision team to areas where it should be focusing its resources.

"If we do identify a significant matter we will take it on and then it's a matter, in terms of the more proactive side of ASIC, of taking a risk-based approach to allocating resources," he said.

LEGAL MATTERS: ASIC POINTS TO GREATER USE OF 'PLEA BARGAINS' IN ENFORCEMENT CASES

The Australian Securities and Investments Commission (ASIC) has opened the door to greater use of sentence discounting, and possibly even immunity, for defendants who provide information to the regulator in cases of misconduct. Earlier this year the regulator released an information sheet (IF151) setting out the situations in which it would recommend sentencing leniency for a defendant. The regulator said it was keen to clarify publicly the situations where it would work with the Commonwealth Director of Public Prosecutions (CDPP) to offer sentencing discounts to try to encourage greater cooperation from defendants. This could include immunity for someone who provides information that leads to the prosecution of another party.

In IF151 the regulator states that cooperating with the regulator in investigations may benefit a "person of interest" in a number of ways. It says that early notification of a breach or cooperating with an investigation will influence ASIC's decision on which enforcement tools or remedies it will use. It notes, however, that it is limited in its ability to provide any watertight guarantees as the CDPP conducts most criminal prosecutions. As such, the regulator can recommend that the CDPP take a lenient approach in return for cooperation but this is not guaranteed. In the CDDP's parlance, this process is known as "charge negotiation".

"It is the CDPP that ultimately determines (after consultation with ASIC) whether or not charges should be laid and the appropriate charges for most criminal matters. Early notification of breaches and cooperation may be relevant to the CDPP's considerations, as set out in the prosecution policy of the Commonwealth," the information sheet notes.

The document also sets out instances where cooperation in civil investigations may lead ASIC to seek "less severe remedies". Cooperation in this respect can include providing early notification of breaches and voluntarily participating in interviews with ASIC officers.

"A person who cooperates with us in these matters may benefit through discussions with ASIC about the most appropriate remedies to be sought. We may similarly recognise the ways that a person has cooperated with us before commencing civil proceedings and will take into account the degree of cooperation provided by the person during our investigation when determining the type of remedies sought, the content of our submissions to the court, or whether to negotiate a resolution of the matter," ASIC said.

STRENGTHENING IMMUNITY

Belinda Gibson, deputy chairman of ASIC, said that while the regulator has not specifically mentioned immunity agreements in the paper it is an option that will be considered. ASIC was limited in what it could promise a "person of interest", because of the critical role of the CDPP, but this is an approach the regulator will recommend in specific cases. "In that paper we refer to that somewhat cryptically at the back where we say that we will have a discussion with the DPP. That's what that discussion is all about – because only it can give immunity in a prosecution," she said.

Gibson said that, unlike the Australian Competition and Consumer Commission (ACCC), ASIC was unable to offer a blanket policy on immunity because of the limit to its regulatory remit. The "charge negotiation" that might apply in an insider trading case, for instance, might not be relevant to a breach of the consumer credit regulations.

"We do [agree to] immunity arrangements from time to time. The usual immunity arrangement, as with cartels, is that you come and tell us first and report someone and then we'll give you immunity. It's hard to have an over-reaching immunity [policy] in the context of the width of our remit. The ACCC's remit, for instance, is only cartels and it follows international practices there," Gibson said.

The issue of plea bargaining or charge negotiation in Australia is complex, given the interplay between regulators, the public prosecutors and the courts. Local regulators have been less inclined to follow their counterparts in the United States, where plea bargaining is used widely.

One case that highlighted the dangers for defendants was the recent insider trading case involving Sydney trader John Hartman. In that case Hartman admitted guilt early and agreed to cooperate with regulators by providing information on his alleged accomplice. In return, he was given a four-year prison sentence, one of the harshest Australia has seen. While the case was later reduced on appeal, it highlights the uncertainty of any charge negotiations in the Australian legal and regulatory environment. In the meantime, the subject of Hartman's allegations is yet to be charged.

Discussing the Hartman case, Gibson revealed that ASIC and the CDPP had supported the defence's claim that Hartman's sentence was excessive. The revised sentence was a good outcome and reflected the cooperation that the defendant had provided, she said.

"The Court of Appeal has revised that sentence and the DPP, with our support, made a number of submissions in that case. We made a number of submissions to Mr Hartman in that respect, so we didn't oppose the proposition that it was a high sentence relative to other things," Gibson said.

OPEN AND TRANSPARENT REGULATION

In addition to encouraging cooperation from "persons of interest", the latest enforcement guide is also part of a generally more transparent culture at ASIC. Under new chairman Greg Medcraft, the regulator is trying to give stakeholders a better understanding of how ASIC makes the decision to pursue some cases and overlook others. It said that this was a key part of encouraging confidence in the financial markets.

"I'm generally in favour of more transparency where we can, and this is, I think, a reflection of that," Medcraft said. "The message from this document is to basically explain to Australians, in general, when we will pursue cases and what tools we have available to us in pursuing those cases – and on what basis we incentivise people to perhaps cooperate with us."

Medcraft said that the commission would make decisions on the cases to pursue based on a range of factors, including the level of harm or loss as a result of the misconduct, the cost of enforcement action versus the regulatory benefit, and the availability of evidence. The regulator will also consider the alternatives that are available to secure an acceptable regulatory outcome, for example, enforceable undertakings.

In cases where ASIC pursues prosecutions, Medcraft said that it was important to secure a result that acted as a deterrent to others. ASIC cannot pursue all of the cases that come before it, so the deterrent effect of lengthy prison sentences is critical, he said.

"Coming from the United States where they're very heavy on corporate crime, I think for most white collar criminals it scares the hell out of them going to jail. So I think having severe penalties at times is appropriate," Medcraft said.

Gibson said that the CDPP agreed with ASIC, both in the value of offering "discounts" for cooperation and the need for strong enforcement outcomes where it is warranted. She also said ASIC was realistic about the number of major enforcement cases it could take on under its current level of funding.

"This [approach] really says, 'You can't possibly take on everything that might go wrong in this market.' So we have to weigh things up," Gibson said. "If there are three particular types of conduct that look very bad, for example, and the fourth is the same you don't have to go to court to prove the same case again. Or you might say, if there's a large community [of financial market participants] that's particularly affected you have to take action, whereas if it's a small community you don't have to take action."

Medcraft added that it was important for both stakeholders and staff at the regulator to have a clear understanding of how ASIC makes these complex enforcement decisions. "They are principles and they are principles that we follow, so our staff know them and the public knows them," he said.

EXCHANGE-TRADED FUNDS: KEEPING THE GATEKEEPERS IN CHECK

The Australian securities regulator has identified exchange-traded funds (ETFs) as a product area that will face heightened regulatory scrutiny to ensure that investors are not facing unnecessary risks. In a recent report the Australian Securities and Investments Commission said it had been monitoring the ETF industry closely. This scrutiny will continue in line with regulators in other key jurisdictions and the work of the International Organisation of Securities Commissions (IOSCO).

In Report 282, entitled "Regulation of Exchange-Traded Funds", ASIC outlines how ETFs are regulated in Australia and how the proposed principles from IOSCO would affect the industry. This regulator said that identifying the regulatory risks associated with ETFs was in line with its duty to promote confident and informed investors and "fair and efficient" financial markets.

The report noted that, under the Corporations Act 2001, ASIC has a range of regulatory powers relating to ETFs. In late 2011, the regulator conducted surveillance at the offices of some responsible entities of ETFs using its powers under section 601FF of the Corporations Act to check compliance. This formed part of its program of risk-based surveillance of responsible entities and included verifying appropriate documentation in a number of important areas of compliance risk.

"We took this opportunity to have broader discussions with key staff involved in management of the ETFs to inform our understanding of the industry. We also had meetings with other stakeholders, including certain ratings agencies," the regulator noted in REP 282. "In developing this report and considering how to use our powers, we have been involved in ongoing consultation with the ETF industry and will continue to liaise with the industry in the future."

ASIC noted that ETFs can provide a convenient and low-cost way for investors to diversify and receive returns close to the performance of market indexes or other assets, often with lower fees than traditional managed funds. There are risks, however, with "synthetic" ETFs that investors need to understand. While standard, "physical" ETFs generally invest in the underlying investments they are designed to track, synthetic ETFs also use derivatives, such as swap agreements, to achieve similar outcomes. ASIC said the benefits to investors of synthetic ETFs may include access to new and varied asset classes and low performance "tracking error". The key risks, however, include increased complexity and counterparty risk.

Greg Tanzer, ASIC commissioner, said the regulator would continue to exercise its regulatory powers in relation to ETFs to ensure that consumers are being adequately protected.

"The regulation of ETFs in Australia is in line with proposed international standards and reflects consideration of the issues identified in IOSCO's consultation. Our view is supported by surveillance of current ETF issuers in Australia and discussions with industry participants," Tanzer said.

"[ASIC] will continue to watch this area closely to help reduce some of the complex regulatory risks that continue to emerge."

The ETF industry in Australia attracts significant funds. As of 2012, approximately A$4.3 billion, based on ASX data, is invested in ETFs in Australia, with a high level of retail participation. The ETF industry is continuing to expand, with new types of ETFs and new issuers continuing to emerge, according to ASIC's figures.

STOCKBROKING: ASIC TARGETS 'SHADOW BROKING' SECTOR

The Australian market regulator has placed so-called "shadow brokers" on notice that they will be under increased scrutiny over the next 12 months as the regulator steps up its proactive supervision of the sector. In its most recent market supervision report, the Australian Securities and Investments Commission (ASIC) noted that independent market participants (IMPs) had emerged as an area of heightened compliance risk. Some of the issues that ASIC has identified include: unauthorised discretionary trading, breaches of the client money rules, misleading advertising – for instance, incorrect use of the term "stockbroker" and incorrect statements about past returns, and inadequate supervision of advisers.

ASIC describes an indirect market participant as a broker that is not itself a market participant, but instead accesses the market through an accredited market participant. In Report 215, ASIC said there were around 150 of these indirect market participants in the local marketplace. This figure has grown to exceed the number of licensed market participants – full-scale brokers – which now stands at around 90.

Jamie Coot, chair of the Australasian Securities Dealers Association (ASDA), said that there was a growing trend for experienced stockbrokers to move to "boutique investment houses" that act as indirect market participants. This trend accelerated after the financial crisis, with the number of shadow brokers increasing by 35 percent since 2007. This was driven in large part by the consolidation in the sector and the growing compliance overheads for market participants, Coot said.

Elmer Funk Kupper, chief executive of the ASX, said recently that he expected to see an increase in the number of market participants that become IMPs in response to new obligations such as ASIC's market supervision fees, best execution and the increasing complexity of the markets following the advent of Chi-X.

"Brokers face much higher technology costs as they need to be ready for this multi-market structure and they face higher compliance costs. It's not yet certain where that will land. We believe that the outcome will be negative for many smaller brokers who cannot compete in the new world of high-frequency trading that demands higher compliance costs and higher technology costs," Kupper said, following the ASX's latest results announcement.

The supervision team at ASIC is well aware of the regulatory challenges concerning indirect brokers and the need to boost supervision in that area. Belinda

Gibson, deputy chairman of ASIC, said that indirect market participants should be aware that they are "on notice" and the regulator will increase its surveillance.

"We talked about these issues in the market supervision report that we put out a few weeks ago. The so-called managed discretionary account issues are a concern for us and we're looking at a lot of brokers in that regard. We're not necessarily finding something but it is part of our proactive surveillance – looking at how they manage the oversight of the face-to-face brokers," Gibson said.

ASIC would like to extend some of its market integrity rules to cover indirect brokers but this would be in the medium term. It will meanwhile regulate IMPs using its powers to oversee any holder of an Australian Financial Services Licence (AFSL).

"We have put it on the record that we would like to see some of the market integrity rules that particularly affect market conduct being applied to IMPs. But we do already regulate that sector. They have financial services licences and so we're there and looking at them. We're very carefully looking at how they face their clients, which is not a matter for market rules, it's a matter for existing rules about financial advice," Gibson said.

In Report 277, which details ASIC's supervision of market participants in the second half of 2011, the regulator said that the main triggers for "remedial action" were unauthorised discretionary trading services, breaches of the Corporations Act requirements on client money, concerns about advertising (particularly by indirect market participants), inadequate supervision of advisers by participants, and inadequate monitoring of securities trading by participants. While these concerns related to both market participants and indirect brokers, ASIC said that there were some areas of concern specific to IMPs.

"We continue to monitor whether participants are identifying clients correctly as retail clients, and as a result meeting the appropriate level of disclosure and 'know your client' requirements that apply," the regulator said.

REGULATORY 'HOT SPOTS'

The concerns regarding conduct in the shadow broking sector have reached the highest levels at ASIC, with chairman Greg Medcraft pointing out his concerns at this year's Summer School conference. Medcraft said that ASIC would take a proactive approach to indirect market participants based on the powers that it has, rather than waiting on reforms to the Market Integrity Rules (MIRs).

"We're focusing on our surveillance and the frequency and intensity of surveillance," he said. "This is a good example of proactive regulation. We're saying, 'Well, this is an area of risk and the law is the law'. But at the same time we're basically saying 'What can we do to make sure that this sector is more resilient?'"

Compliance officers have concerns about the quality of controls within the indirect broking community. Unlike market participants, which are used to regulation and the obligations of compliance, many IMPs are small operations with minimal overheads. As such, they often run on a minimal compliance framework and try to avoid regulatory scrutiny. In situations where they do attract scrutiny, the regulator often picks up deeper problems within these firms.

DISCRETIONARY TRADING

One of the challenges with indirect brokers is the fact that they have access to a market participant's trading platform and – in the case of managed discretionary accounts – can place orders on behalf of their clients. In a number of regulatory investigations ASIC has found that representatives have placed trades without client authorisation. This challenge is not unique, however, to indirect brokers. There have been numerous cases involving market participant brokers whose staff have also misused managed discretionary accounts.

In practice, an indirect broking firm can monitor electronically in "real time" any transactions involving client accounts. If indirect brokers have this as a condition of their AFSL, compliance experts believe that it could go a long way to improving standards across the sector.

DIRECTORS' DUTIES: ASIC CHAIRMAN REVEALS VITAL LESSONS FROM JAMES HARDIE DECISION

The chairman of the Australian Securities and Investments Commission (ASIC) spoke out in May about the regulator's hard-won legal victory over seven former non-executive directors (NEDs) of the building group James Hardie Industries. Greg Medcraft said the case clarified a number of critical points of law in relation to how regulators should conduct litigation and enforcement cases. It also builds upon the recent spate of case law setting out the responsibilities that apply to directors' under the Corporations Act 2001.

Corporate Australia has been following the James Hardie case closely, given its implications for company directors and senior executives. The win in the High Court yesterday comes after more than six years of appeals and legal wrangling between ASIC and the former directors. The High Court ruled that the seven non-executives breached their duties in February 2001 when they approved a misleading announcement to the Australian Stock Exchange. The release claimed that a separate trust the company had set up for asbestos victims was fully financed when in fact it had a A$1.3 million shortfall.

In February 2007, ASIC began its civil penalty proceedings in the Supreme Court of New South Wales against seven NEDs and three former company officers for breaching s180(1) of the Corporations Act. ASIC won the case but, on subsequent appeal, the decision was overturned. The New South Wales Court of Appeal found that ASIC owed a "duty of fairness analogous to that owed by a Crown prosecutor" which it had breached by not calling a "material" witness. The witness in question was David Robb, James Hardie's solicitor, who had supervised the preparation of the draft board minutes and had attended the February board meeting.

The appeal court found that ASIC had an obligation of fairness in civil penalty proceedings, which included an obligation to call all material witnesses. In its appeal, which was heard in October 2011, ASIC argued that while it has an obligation to act as a model litigant, that obligation does not include a duty to call all material witnesses. In its decision yesterday, the High Court agreed with this view and overturned the lower court's decision. It ruled that there was no basis for inferring that Robb would have given evidence that was favourable to the respondents.

"ASIC not calling him caused no unfairness. If it had, it would be wrong to respond by discounting the cogency of other evidence led at the trial. The question would be whether there had been a miscarriage of justice requiring a new trial," the court said.

In celebrating the win yesterday, Medcraft said the case had clarified some significant issues regarding directors' duties and the exercise of ASIC's enforcement powers. He said the case would be "studied in boardrooms across Australia and in legal circles" and was already having a deterrent effect on corporate misconduct.

"This sends a deterrent message to all directors, that they need to take care in terms of the accuracy of the statements that they actually issue to the market. I think that is really important and I think it's important that Australians can have trust and confidence in what's actually delivered," Medcraft said following the decision.

"It just reminds Australians that … we will as always take on the hard cases and we will fight them to the best of our ability. Our objective is to make sure that nobody is beyond the reach of the law."

In terms of regulatory outcomes, Medcraft said the case confirmed that directors have an obligation to make sure that any announcements they issue to the market are accurate. He added that, when viewed alongside the recent *Centro* and *Leighton* decisions, there was a strong body of case law on the expectations for directors under the Corporations Act 2001.

"We want Australians to be confident and informed when they invest – particularly that gatekeepers, being directors, can be relied upon in terms of doing what is expected of them," Medcraft said. "You should disclose in a timely fashion. What you disclose should be disclosed accurately because Australian investors are going to rely on that information to invest in your stock."

When viewed together the three cases also highlighted the importance of being able to read company financial statements. "If you think about it the finances of a company are the essential lifeblood of the company. If you're the steward of a company being a director you should be able to read a set of accounts," Medcraft said.

ENFORCEMENT OUTLOOK

Securing an outcome against the James Hardie directors has consumed a huge amount of time and resources from within ASIC's enforcement unit over the past six years. Medcraft would not comment on the cost of the protracted case but said that it was well worth pursuing at many levels. He said the decision to pursue the matter all the way to the High Court was consistent with the enforcement policy that ASIC released in February.

"In terms of our approach to enforcement I've said very clearly there are four key factors. First, the amount of harm or loss; secondly, the cost versus the public benefit; thirdly, the availability of evidence; and fourthly, whether there's any alternative course of action. We'll continue to apply those principles to determine whether we'll go to court," he said.

It remains to be seen what penalties ASIC will recommend when the matter returns to the Court of Appeal. From a litigation perspective, the case has re-established ASIC's obligations as a model litigant. Medcraft said it confirms that, in relation to civil proceedings, the regulator does not have an obligation to call all material witnesses.

"There are model litigant rules that we follow. Those model litigant rules for civil cases do not require us to call all material witnesses. So basically we followed the principles that were laid down for civil cases for model litigant rules. The purpose of this High Court challenge was that the Court of Appeal decision was effectively changing that practice, so the law is now clarified. In civil cases there is no requirement to call all material witnesses," the ASIC chairman said.

RIPPLE EFFECTS

In the future, Medcraft said ASIC was confident that the case would have a huge deterrent effect for directors. This was a major consideration when the regulator decided to take on high-profile cases such as this. "The deterrent effect of this is actually very important. What it does is make it absolutely clear that if you're a director and you issue a statement as a company, whether it be directors or executives, that the information you provide should be accurate. I think Australians expect nothing less," he said.

Medcraft also argued that the case would send out a strong message that ASIC will not offer leniency to high-profile individuals or shy away from difficult cases if it is in the public interest to pursue them. He said that ASIC subscribed to the "walk softly and carry a big stick" approach to regulatory enforcements.

"The message should be very clear that if in fact we consider it is appropriate we will actually take you on – no matter who you are," Medcraft said.

As a financial regulator with strong experience in the industry, Medcraft said he preferred to take a collaborative approach to securing enforcement outcomes. He said that he personally preferred to resolve a problem through negotiation rather than taking it to court.

"Enforcement and going to court is one of the tools we have to achieve our outcomes. And we will never be reluctant to use it if we think that's required. But that's not to the exclusion of basically starting with engagement with an industry or a problem, and what we do in surveillance and guidance and education. So I'm very much of the view that we've got to look at the availability of all the tools available to us to achieve the outcomes we want," Medcraft said.

THROUGH THE LOOKING GLASS: APPLYING ASIC REGULATION IN A GLOBAL CONTEXT

AUSTRALIAN INSIDER TRADING LAWS WOULD HAVE CAPTURED EINHORN, SAY EXPERTS

The decision by the UK Financial Services Authority (FSA) to fine U.S. hedge fund Greenlight Capital and its owner, David Einhorn, £7.2 million for market abuse would have been an equally likely outcome in Australia. Last month, the FSA fined Greenlight Capital and Einhorn a total of £7.2 million for selling shares after receiving a tip that Punch Taverns plc was planning an offering that would dilute the fund's position in the pub operator.

Before receiving the information Einhorn, a prominent figure in the hedge fund community, had told a Bank of America Merrill Lynch broker involved in the offering that he did not want to be made an insider. He is subject to a separate disciplinary action.

Subsequently, on June 9, 2009, a call between Einhorn, the broker and an executive of Punch Taverns, was set up on a "non-wall-crossed basis". During this call, the broker and an executive of Punch Taverns told Einhorn that Punch was at an advanced stage of the process towards the issue of a significant amount of equity, probably within a timescale of around a week, with the principal purpose of repaying Punch's convertible bond and creating headroom regarding certain covenants in Punch's securitisation vehicles.

Following the call and ahead of the fund raising announcement, which was made on June 15, 2009, Einhorn reduced its shareholding in Punch from 13.3 percent to 8.89 percent. This action caused the Punch share price to drop by 29.9 percent, but allowed Einhorn to avoid losses of approximately £5.8 million. At the centre of the FSA's case against Einhorn was its allegation that he should have known that the information he traded on was price-sensitive, even though he had asked not to be made an insider and had been told by participants on the call that he had not been wall-crossed.

While the FSA acknowledged that no single piece of information divulged to Einhorn during the Punch call in isolation amounted to inside information, it said that, when taken together, the pieces of information did constitute inside information since they revealed the purpose and anticipated size and timing of the issue. According to the FSA, Einhorn should have recognised this information as such, and should not have traded on the basis of it.

The FSA said in a press release: "Investment professionals are expected to handle inside information carefully regardless of whether they have been formally wall-crossed. This was a serious case of market abuse by Einhorn and fell below the standards the FSA expects, particularly due to Einhorn's prominent position as president of Greenlight and given his experience in the market."

Lawyers in the U.S. told Thomson Reuters that the fact pattern in the Einhorn case would have been unlikely to occur in the U.S. and that, if it did, the Securities and Exchange Commission (SEC) would probably not file charges.

"THE AUSTRALIAN CASE"

In Australia, however, market experts have said that the case would look very similar to the UK resolve. First, if the trades had been conducted in Australia, there is every chance Einhorn would have been at risk of contravening Australia's insider dealing laws. That is because of the breadth of the meaning of the term "inside information" in the legislation, which ensures the prohibition captures a wide range of circumstances.

According to ss1042A and 1043A of the Corporations Act 2001, the insider trading offence applies if: (a) a person possesses certain information; (b) the information is not generally available; (c) the person knows, or ought reasonably to know, that the information is not generally available; (d) if the information were generally available, it would be material in the sense that it would, or would be likely to, influence persons who commonly acquire securities in deciding whether to buy or sell the relevant securities; (e) the person knows, or ought reasonably to know, that if the information were generally available, a reasonable person would expect it to be material; and (f) while in possession of the information, the person trades in those securities (that is, buys or sells those securities) or procures another person to do so.

In the case of listed securities, it is also a contravention if a person in possession of such information communicates the information to another person if the first person knows or ought reasonably to know that the other person would be likely to deal in the securities. Nor is "tipping", which refers to the passing on of material non-public information, allowed.

Belinda Gibson, deputy chair of the Australian Securities and Investments Commission (ASIC), told Thomson Reuters that from a legal perspective, the Australian definition of insider trading was comparatively straightforward. Provided the information was considered non-public and price-sensitive, Einhorn's actions would have been in contravention to the law.

Gibson said: "Under our law, if you have the information, you know it is secret and price-sensitive, and you still decide to trade on the basis of that information, you have a problem."

TO CROSS OR NOT TO CROSS

The fact that Einhorn had expressly refused to be wall-crossed would be irrelevant, if it was ruled that he was in possession of non-public and price-sensitive information.

James Lonie, partner at Henry Davis York in Sydney, said: "Under Australian law, the fundamental question would revolve around whether he was in the possession of price-sensitive inside information. The fact that he declined to cross the wall is irrelevant if he possessed the information and then traded."

This broad definition of what constitutes insider trading extends to "soundings", the official terminology for gauging the interest of potential investors in a potential transaction. Depending upon the nature of the sounding, it may involve the disclosure of inside information (for example, asking someone whether they want to cross the wall in relation to a proposed capital raising).

Foreign market participants should be careful to note that under Australian law it is entirely possible that the mere question of being asked to cross the wall could be considered inside information, regardless of whether they refuse to sign a non-disclosure agreement.

Jonathan Gordon, partner at Blake Dawson in Sydney, told Thomson Reuters: "Whether a sounding can be considered inside information depends on the circumstances. If enough information is provided to lead the person receiving the call to consider that a material transaction is about to occur, then even if the person declines to be wall-crossed, the person may nevertheless be considered to have price-sensitive information which is not generally available. If they deal in securities while in possession of that information, they are at risk of contravening the insider trading provisions."

ASIC's Gibson said: "It depends on how much you say before you invite them to cross the wall. If you say I want to talk to you about a takeover bid for a certain company, would you be prepared to come over the wall, then I would say yes that is a problem. It is very important that, during soundings, the names of the parties involved are not disclosed, or sufficient information to identify the parties."

Gibson said that the potential uncertainty around this issue was one reason why, in 2009, ASIC had issued a consultation on the handling of confidential information. Following the consultation, the regulator asked the Australian Financial Markets Association (AFMA) to develop a set of guidelines for sounding, which were published in November 2011. These guidelines, which were established in close dialogue with the regulator, outline how market participants should handle confidential information received by them, and how sounding should be conducted. In addition, Chartered Secretaries Australia (CSA) and Australasian Investor Relations Association (AIRA) published guidelines for corporate on handling confidential information in 2010.

BEST PRACTICE

Duncan Fairweather, executive director at AFMA, told Thomson Reuters that the AFMA guidelines had been established to improve market understanding of best practice on handling confidential information.

"Part of the debate around the Einhorn case has been around what the market understands should be proper practice for handling confidential information in the UK. The purpose behind our development of the guidelines is to make broadly available to the market in Australia what is considered to be best market practice which reflects common practice among AFMA members," he said.

Lonie said that market participants who involuntarily found themselves in the possession of inside information could consider a number of solutions. "If a client was unwittingly contaminated with inside information, there are a number of possible courses of action. The client could be "cleansed" if the material information became publicly known or ceased to be material. Effective Chinese Walls may also be relevant. Finally, in some circumstances only dealing with a person who is also an insider could be considered" he said.

Gordon said that the scope of the Australian insider trading regulations often came as a surprise to offshore traders, including hedge funds. "In Australia it is commonly a question asked by our hedge fund clients. They want to ensure they comply with the regulations, but are often surprised at how broad the prohibition in Australia is, and how readily it can attach to someone, even when they do not want to be in the possession of insider information," he said. He added, however, that on balance the Australian regulations were generally clear and there was no need for further guidelines.

Lonie said that brokers and hedge funds in the Australian market place should, and typically did, take note of the insider trading regulations. "It is a question that often comes up in Australia. There are certainly cases where brokers and hedge funds are concerned not to be contaminated with inside information because they do not want to be restricted from trading, which is ultimately their business," Lonie said. He agreed, however, that the regulations and guidelines were sufficiently clear.

THE BROKER RESPONSIBILITY

While it is likely that Einhorn would have been caught on the grounds that he traded based on inside information, under Australian law, the broker could also be held liable for communicating information despite Einhorn's refusal to cross the wall. According to Guideline 3.6, a proposed sounding should not proceed if the identified person at the institution does not verbally agree to treat the information it will receive as confidential. If the information is potentially price-sensitive, the institution should be reminded of its ongoing requirement to comply with applicable insider trading laws and should acknowledge this verbally before the sounding.

A pro forma sounding script provided with the guidelines states: "We would like to discuss with you confidential information in relation to an entity listed on [insert relevant Australian securities exchange, e.g., ASX] that may have a material effect on the price or value of financial products of the entity.

We will do so only on the basis that:

• you agree not to disclose the information to anyone within your organisation except on a need-to-know basis and subject to these restrictions, or to anyone outside your organisation, unless our prior consent is obtained; and

• you and your organisation agree not to do anything that breaches the insider trading laws contained in the Australian Corporations Act.

These restrictions will continue until the information is made generally available by or on behalf of the entity or is no longer price-sensitive. Please acknowledge that you understand these restrictions and agree to be bound by them.

If the person replies no, terminate process with that person.

If the person agrees to proceed, continue."

Gordon said: "Ordinarily, where a participant has crossed the wall and become subject to obligations of confidentiality, the bank or broker would have a good argument that it had a reasonable expectation that the participant would not deal. If, however, the participant actually declines to be wall crossed but nevertheless is allowed to receive inside information, that is information which is price sensitive and not generally available, it may be harder for the bank or broker to make out that argument.

That, in turn, could expose the bank or broker to the risk of themselves insider dealing if inside information was communicated to that person."

A REGULATORY CLAMPDOWN

If the legal definition of insider trading is broad, Australia's regulator is also increasingly clamping down on insider trading. In its most recent supervision of markets report, published on February 7, 2012 the regulator announced that insider trading detection, investigation and prosecution would continue to be a priority for ASIC.

Over the course of the six months from July to December 2011, the regulator had referred six potential cases of insider trading for investigation. Over the same period, one case of insider trading was successfully prosecuted, resulting in two years' imprisonment by way of an intensive correction order, while another three people agreed to plead guilty to insider trading. That was fewer than during the first six months of the year, when 17 potential insider trading cases were referred for investigation, but according to Greg Yanco, senior executive leader for market and participant supervision at ASIC, that result was partially a reflection of work conducted behind the scenes.

Yanco explained: "We have done a lot of work behind the scenes with corporate advisers and participants around information security, highlighting the need for gatekeepers to actively ensure the information is kept secure and the list of insiders is kept to a minimum. In addition, we are promoting that corporate advisers have arrangements in place for people to get their own personal trading pre-authorised," he said.

"While we recognise that a decline in corporate activity may have also contributed to the decline in referrals, we do believe that these actions, coupled with an increase in publicity and some significant prosecutions, have had an impact," he said.

The regulator also noted, however, that it had continued to see trading activity which pointed to the potential misuse of confidential information on the part of persons employed by companies providing advice on mergers, acquisitions and other significant corporate transactions. Over the course of the last six months, ASIC said that it had visited two major accounting firms to raise its concerns regarding the segregation of confidential information within their firms. Looking ahead, ASIC said it would continue to "actively monitor and vigorously pursue" any possible misconduct of this type. The regulator also encouraged firms to ensure the security of information in their possession.

Gibson said that ASIC's deterrence policy would be very much a continuation of last year's strategy. For deterrence, the next six months would be a case of "steady as we go". She said: "There are a number of prominent cases on trial, we have got seven cases on insider trading before the courts, although not all these cases will be heard in the next six months."

She added that from ASIC's perspective the main challenge of prosecuting insider trading cases was typically proving that traders possessed information that was price-sensitive.•

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