AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

10 June 2010

Corporations Amendment (No 1) Bill 2010
Corporations and Financial Services Division
The Treasury
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Dear Sir/Madam

Corporations Amendment (No 1) Bill 2010 – market misconduct penalties

We are pleased to provide comments on Corporations Amendment (No 1) Bill 2010 and related Acts, specifically in relation to the market misconduct penalties provisions.

The Australian Institute of Company Directors is the second largest member-based director association worldwide, with over 26,000 individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

We have focused our comments only on those amendments dealing with criminal penalties for insider trading and market manipulation, interception and search warrants and clarification of criminal liability. We agree with the Explanatory Memorandum statements that insider trading and market manipulation offences cause serious harm to the fair and efficient functioning of Australia's financial markets. Changes to the law should only be made if the current law is found to be inadequate. In addition, any new laws should be proportionate to the matter being regulated and minimise unintended consequences.

Corporate Law Reform & "Knee Jerk" Policy Response

The Australian Institute of Company Directors supports the need for changes to the corporate law to deal with changing circumstances, unexpected events and the broad range of reasons which justify law reform. However, the law reform process can be *ad hoc* at times and the result is that the Corporations Act 2001 (Act) has become difficult to navigate and understand. There are numerous sections that have been grafted onto the Act over time and the provisions are now very complex. In short, a more

holistic, strategic and less "knee jerk" approach must be taken in relation to corporate law reform to ensure that agreed policy outcomes are achieved.

In this case, the Exposure Draft is 11 pages long and it is accompanied by a 37 page Explanatory Memorandum. It is relatively brief in comparison with previous reform packages, but it is still a significant package and amends three major statutes. The Exposure Draft was issued on 20 May 2010 with submissions due by 10 June 2010. Although the changes are the product of earlier proposals, three weeks is still too short a time in which to properly consider and assess the legislative package. This approach is not consistent with holistic, strategic and measured law reform.

Penalties for Market Offences and ASIC Powers

The Australian Institute of Company Directors considers that the existing laws and the ASIC and ASX policies are appropriate and sufficient to deal with the spreading of false or misleading information and no further regulation is required. We do support the concept of increased penalties proposed in the Exposure Draft. However, we have specific concerns about the proposed amendments which are discussed below.

Schedule 3 – Consistency and Level of Penalties

Under Schedule 3 new table item 310, the penalties in relation to individuals for insider trading are doubled in terms of imprisonment and financial penalty but the penalties for corporations are quadrupled. In both cases, there is an additional potential penalty based on three times the value of the benefits obtained (individuals and corporations) or 10% of turnover (corporations).

In the case of market manipulation, the term of imprisonment for individuals is doubled but the financial penalty is increased by 22.5 times. In the case of corporations, the financial penalty is increased by 45 times with the added potential penalty of three times the value of the benefits obtained or 10% annual turnover.

Although significant penalties for breaches of the Act by individuals and corporations are appropriate, these increases are inconsistent in the calculation of their level of application and unprecedented in terms of corporate law reform. The penalties for insider trading and market manipulation will now be considerably out of step with penalties for other offences which is not appropriate.

We accept that it is legislative drafting policy to use penalty units as the measure of penalty in the statute itself, but it is not readily apparent other than to the well informed what dollar value attaches to a penalty unit or indeed where this information can be found. It would be helpful if the term were defined in the Bill. For example the Bill could include a definition as follows:

> "'Penalty unit'" means $110 or the amount fixed from time to time under section 4AA of the Crimes Act 1914".

The Explanatory Memorandum also refers to penalty units without stating the dollar value of a penalty unit. The purpose of an Explanatory Memorandum is to explain in clear and simple terms what is proposed. We suggest that in future as a matter of policy all Explanatory Memoranda use dollar values so that the level of penalty is clear.

An individual is now subject to a potential penalty of at least $495,000 and a corporation of at least $4,950,000. The penalty for a corporation is ten times the penalty for an individual which is inconsistent with the longstanding policy that the differential between individual and corporate penalties be a five times multiple. We note that this is dealt with by the proposed amendment to section 1312. However, this amendment is not referred to in the Explanatory Memorandum and no reasons are given to justify the departure from this longstanding policy.

If the benefits cannot be determined (and this might be a rare case) we are unsure why the penalty should then move to 10% of turnover (which itself might have to be based on court calculation). It seems that any company with a turnover of $50,000,000 or more is at risk by virtue of that fact alone. Turnover is not a measure of profitability.

The drafting of Item 310 suggests that a court will have no discretion to determine the level of fine - for a company it will be at least $4,950,000 and in the case of an individual not less than $495,000.

Annual Turnover

Under the definition in the proposed section 761A, a court will be required to estimate the turnover for the balance of the period as a component of potential punishment if the 12 month period has not concluded at the time of sentence. This is inconsistent with the principle that a penalty based on annual turnover is only relevant if the court is unable to determine the benefit obtained by the accused. It is not clear how a court will be in any better position to determine projected turnover.

Annual turnover has arguable relevance as a factor in determining appropriate penalty, it may be better if annual turnover were based on the turnover for the immediately preceding financial year. In the case of companies with audited accounts the figure is more readily determined which would save court time and the costs involved in producing evidence and experts' reports to determine an appropriate figure. It would be unfair if a court were to assess penalty based on projected turnover which turns out to be greater than actual turnover.

Australian Securities and Investments Commission Act 2001

There is an inconsistency between the right of the occupier to observe the search (proposed in section 36A(3)(b) and the searching of two or more areas at the same time (proposed in section 36A(5)). If the right of the occupier to observe the search is fundamental, as it normally is in a search by warrant, the ability to search in areas which cannot be observed removes this right. The inconsistency should be removed because it is possible that a multiple area search might otherwise be open to challenge.

Amendments to the Telecommunication (Interception and Access) Act 1979

We note that the proposed addition of subsection 5D(5C) adds to a long list of serious offences in the Act. Insider trading and market manipulation are serious offences but we query why these would be regarded as the only offences against the Act which are regarded as serious and warranting telephone interception.

In our March 2009 Corporations and Markets Advisory Committee submission on market integrity we did do not support the introduction of any form of compulsory recording of

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telephone conversations and other electronic forms of communication, such as SMS because they are an inefficient evidentiary mechanism. We note that similar provisions in relation to the recording of calls during takeovers were repealed in 2007 on the basis that they had not increased the protection of security holders and imposed significant costs on the parties involved.

In addition, insider trading and market manipulation breaches may be subject to civil proceedings and civil penalty. What happens if telephone surveillance anticipating criminal proceedings produces evidence which justifies civil proceedings? In that case, there should be safeguards that prevent evidence gained by telephone surveillance being used in proceedings for a civil penalty.

The Australian Institute of Company Directors supports a well resourced regulator with strong investigative powers. We have noted recent press comment which deals with ASIC's assumption of greater responsibilities from 1 July 2010 and its questionable capacity to take on that responsibility. It may be that the powers proposed in the Bill will not be used in fact if ASIC does not have the resources to do so. As it is, ASIC's Annual Report 2008- 2009 (pages 28-29) states that its investigative work in the insider trading and market manipulation area is based on increased investigative work produced results. However, we note that there are currently low levels of referrals and investigations. Of the 49 referrals from ASX for insider trading, 12 were referred on for investigation (24.5%) and of 18 referrals for market manipulation, 10 were referred on for investigation (55.5%). With this track record and limited resources, it is difficult to conceive that enhanced interception powers given to ASIC will necessarily lead to more investigations and enforcement.

We would be happy to elaborate on any of the points made in this submission should this be required. Please contact Gabrielle Upton, Legal Counsel and Senior Policy Officer on (02) 8248 6635.

Yours faithfully

Rob Elliott
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