Submission from:

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SENATE INQUIRY INTO PENALTIES FOR WHITE COLLAR CRIME

Thank you for the opportunity to make a submission to the committee.

I note that the terms of reference for the inquiry are the inconsistencies and inadequacies of current criminal, civil and administrative penalties for corporate and financial misconduct or white-collar crime, with particular reference to:

(a) evidentiary standards across various acts and instruments;
(b) the use and duration of custodial sentences;
(c) the use and duration of banning orders;
(d) the values of fine and other monetary penalties, particularly in proportion to the amount of wrongful gains;
(e) the availability and use of mechanisms to recover wrongful gains; and
(f) penalties used in other countries, particularly members of the Organisation for Economic Co-operation and Development.

My particular interest and focus is in the regulation of insider trading and my submission relates to this particular form of white collar crime and the relevant penalties. The recommendations contained in my submission are based on my academic research, the findings of which have been published in refereed papers and other publications.[1]

Insider trading is a complex, controversial offence with a reputation for being under-prosecuted, although the Australian Securities and Investments Commission ("ASIC") has been active in insider trading enforcement in recent years. It is prohibited in order to protect market integrity, so that those who participate in securities markets can be confident that people who have access to inside information are not able to unfairly exploit that advantage. In order to ensure that potential insider traders are appropriately deterred from engaging in that conduct, and to ensure that those who do engage in insider trading are appropriately punished, I make the following recommendations:

(i) The evidential standards for insider trading should not be altered in criminal or civil proceedings.

(ii) The maximum custodial sentences for criminal convictions for insider trading do not need to be increased – however, I recommend that consideration be given to legislating for a mandatory minimum sentence of six months' imprisonment for all convicted insider traders, other than in the most extenuating circumstances.

(iii) A person who is convicted of insider trading in criminal proceedings will be subject to an automatic disqualification from managing a corporation. However, leave can still be granted to allow the person to manage a corporation. I recommend that the relevant provisions be amended so that a court may only grant such leave if satisfied that the offender is otherwise subject to a penalty of appropriate personal and general deterrence. I also recommend that this form of disqualification apply where a person is found liable for insider trading in civil penalty proceedings.

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[1] In particular, please see, J Overland, "Insider Trading, General Deterrence and the Penalties for Corporate Crime" (2015) 33 *Company and Securities Law Journal* 317; J Overland, "The Possession and Materiality of Information in Insider Trading Cases" (2014) 32 *Company and Securities Law Journal* 353; and J Overland "Will John Gay's Sentence for Insider Trading Really Deter Others?" *The Conversation*, 26 August 2013. For a full list of my publications on the topic of insider trading and corporate crime, please see: http://sydney.edu.au/business/staff/julietteo

(iv) Civil penalties for insider trading are not consistent with those available in overseas jurisdictions, being significantly lower, and should be increased to a maximum of $765,000 or three times the profit made or loss avoided, whichever is greater.

(v) Fines can be imposed in criminal proceedings at multiples of the profit earned or loss avoided, but not in civil proceedings – this deficiency should be remedied in accordance with the recommendation set out in (iii) above.

(vi) Confiscation of the profit earned is available in criminal proceedings for insider trading but not in civil proceedings – this deficiency should be remedied to also enable the confiscation of profits in civil penalty proceedings for insider trading.

1. What is insider trading?

Insider trading is prohibited under section 1043A of the *Corporations Act 2001* (Cth) (the "*Corporations Act*"). In *Mansfield and Kizon v R* (2012) 87 ALJR 20, the majority of the High Court summarised the nature of insider trading as follows:

> The *Corporations Act 2001* (Cth) prohibits trading in securities by persons who possess information that is not generally available and know, or ought reasonably to know, that, if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of the securities.[2]

Insider trading can therefore be broadly described as having the following elements:

(i) a person possesses certain information;

(ii) the information is not generally available;

(iii) if the information were generally available, it would be material information;

[2] *Mansfield and Kizon v R* (2012) 87 ALJR 20 at 21.

(iv) the person knows (or ought reasonably to know) that the information is not generally available and that, if the information were generally available, it would be material information; and

(v) while in possession of the information, the person trades in relevant financial products or procures another person to do so, or communicates the information to another person likely to do so.

The current maximum criminal penalty for insider trading for individuals is 10 years' imprisonment and a fine of the greater of $765,000 or three times the profit made or loss avoided.[3] The current maximum civil penalty for insider trading for individuals is a fine of $200,000.[4]

2. Evidentiary Standards for Insider Trading

Insider trading can be pursued under both criminal and civil proceedings in Australia. Insider trading has been a criminal offence since it was first prohibited by statute in the 1970s. Civil proceedings for insider trading were introduced under the *Financial Services Reform Act 2001* (Cth) in order to assist in overcoming perceived difficulties in prosecuting insider trading and to make it easier for ASIC to bring insider trading proceedings. Criminal proceedings for insider trading apply the criminal standard of proof, requiring that the elements of the offence are proved "beyond a reasonable doubt". Civil penalty proceedings for insider trading apply a lower standard of proof, based on "the balance of probabilities" and using civil rules of evidence.[5]

However, AISC has brought very few civil proceedings for insider trading – unsuccessful civil proceedings were brought in *ASIC v Citigroup* (2007) 160 FCR 35; in *ASIC v Petsas and Miot* (2005) 23 ACLC 269 the two respondents admitted liability; and the corporation Hochtief Acktiengesellschaft has recently admitted insider trading in civil proceedings which are yet to be finalised. Thus civil penalty proceedings have hardly provided the fillip which may have been expected. The level of the burden of proof has perhaps not been the major obstacle to the successful prosecution of insider trading cases, but rather the existence of appropriate evidence to prove the elements of the offence. Indeed, the case of *ASIC v Citigroup* demonstrated that, even with the availability of civil penalty proceedings, the

[3] Section 1311 and Schedule 3 of the *Corporations Act.*

[4] Section 1317G of the *Corporations Act.*

[5] Explanatory Memorandum to the Financial Services Reform Bill 2001 (Cth), [2.78]-[2.79].

complexities and technicalities associated with pursuing alleged insider traders remain – the challenges in detecting incidents of insider trading; the complexity of insider trading laws and resulting interpretational difficulties; the limited judicial consideration of insider trading laws; and, in particular, the obstacles to proving the knowledge element of the offence.

There have been past law reform proposals suggesting that the difficulties in prosecuting insider traders could be addressed by reversing the onus of proof or introducing rebuttable presumptions into the law. For example, it has been suggested that it might be appropriate to introduce a rebuttable presumption that senior company officers are aware of any inside information known to their companies.[6] However, such presumptions are contrary to the general presumption of innocence. It is not appropriate to reverse the onus of proof in criminal or civil proceedings merely because particular crimes or civil breaches are difficult to prove. An increased focus on insider trading enforcement and the resourcing of insider trading investigations, both of which have been seen in recent years, is a more appropriate response to the difficulties in prosecuting insider traders.

Accordingly, I do not recommend that any change be made to the evidentiary burden or the onus of proof which applies to insider trading in criminal or civil proceedings.

3. The Use and Duration of Custodial Sentences for Insider Trading

Custodial sentences are only available when a person is convicted of the crime of insider trading – they are not available in connection with civil proceedings for insider trading.

The current maximum custodial sentence of 10 years' imprisonment for insider trading was increased in 2010 from the previous maximum of five years' imprisonment as a result of amendments made to the *Corporations Act* by the *Corporations Amendment (No 1) Act 2010* (Cth). In March 2014, ASIC published the a Report 387: *Penalties for Corporate Wrongdoing* ("*Penalties for Corporate Wrongdoing Report*") , in which it noted that the maximum term of imprisonment of 10 years' for insider trading in Australia is "generally comparable with those in other jurisdictions, with the exception of the maximum term of imprisonment in the [USA] which is 20 years".[7] The other maximum prison terms for insider trading are: Canada – 10 years; Hong Kong – 10 years; and the United Kingdom – seven years.

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[6] Corporations and Markets Advisory Committee, *Insider Trading Proposals Paper* (2002), p 31.

[7] ASIC*, Penalties for Corporate Wrongdoing Report*, p 16.

However, while the maximum custodial sentence which may be given for insider trading is 10 years' imprisonment, the sentences imposed in even the most serious of cases have still not approached that maximum. Offenders can only be sentenced in accordance with the penalties that applied at the time they engaged in the relevant conduct, so there are to date only a few convicted insider traders who have been sentenced in accordance with the current maximum penalties. In March 2015, in the case of *Director of Public Prosecutions (Cth) v Kamay and Hill* [2015] VSC 86, Mr Luke Kamay received a sentence of seven years and three months' imprisonment, which was the longest sentence imposed for insider trading at that time. His conduct was described by Hollingworth J of the Supreme Court of Victoria as the "worst case" of insider trading to be seen in Australia, but the custodial sentence which was imposed was still below the current maximum available.[8] Earlier this month an even more lengthy sentence for insider trading was imposed on Steven Xiao, the former managing director of Hanlong Limited, who was sentenced to eight years and three months in prison. Mr Xiao's crimes were described by the Hall J of the Supreme Court of New South Wales as "falling at the most serious end of the spectrum", following a guilty plea.

If offenders who engage in the "worst" and "most serious" cases of insider trading do not receive the maximum available sentence, it is hard to argue that the criminal penalties need to be increased. An increase in the maximum penalty available for insider trading will not necessarily result in the imposition of greater terms of imprisonment by sentencing judges, who are bound to consider the matters specified in legislation, such as section 16A of the *Crimes Act 1914* (Cth), as well as taking into account issues of consistency. It is generally accepted that, when sentencing offenders, there should be similar results for similar cases – this principle aims to ensure that there is public confidence in the judicial process and to support the concept of general deterrence.[9]

Rather than increasing the maximum custodial sentence which may be imposed for insider trading, it would be appropriate to focus on ensuring all convicted insider traders are sentenced to a term of imprisonment. It was stated by the Court of Criminal Appeal in the case of *R v Doff* (2005) NSWCCA 199 at [56], that ordinarily a convicted insider trader in a "position of trust" would expect to receive a custodial sentence, and Finkelstein J stated in *ASIC v Petsas & Miot* [2005] FCA 88 at [13] that "even a

[8] It appears that a discount from the maximum available custodial sentence was given as a result of the offender's guilty plea.

[9] See, for example, *Griffiths v The Queen* (1977) 137 CLR 293 per Jacobs J at 327; Australian Law Reform Commission, *Report 103: Same Crime, Same Time, Sentencing of Federal Offenders,* April 2006, at [5.18].

first time offender who pleads guilty to insider trading is likely to suffer a term of imprisonment ... of between three to six months." However, there are two notable cases in which this did not occur: Mr Bart Doff (*R v Doff* (2005) 23 NSWSC 50) and Mr John Gay (*R v Gay* [2014] TASSC 22) were both convicted of insider trading but neither received a custodial sentence. While Mr Doff was not regarded by the trial judge as a "true insider" because he was acting as a real estate agent, had no connection to the relevant company, and did not seek out the information, Mr Gay was the chair of the relevant company, Gunns Ltd, and had come into possession of the relevant inside information in connection with his role, so was clearly a "true insider" in a "position of trust". Many have commented on the leniency of the sentence imposed on Mr Gay.[10]

While the availability of increasingly severe penalties may appear to have a general deterrent effect, it is the actual penalties imposed on those convicted of insider trading which are most likely to have an impact. Potential insider traders are unlikely to be deterred from engaging in insider trading just because a greater maximum sentence is possible, if they regularly see that those who are convicted of insider trading are not given a severe sentence. Thus, when the penalties imposed, even for the cases considered to be in the "worst category", do not approach the existing maximums, an arbitrary increase of maximum penalties is unlikely to have a significant impact on deterrence.

While judicial discretion must be preserved in matters of sentencing, consideration should be given as to whether it is appropriate to legislate for a minimum sentence of six months' imprisonment, other than in the most extenuating circumstances, for those convicted of white collar crimes such as insider trading. This ensures that all potential offenders are aware that imprisonment is a certainty for those identified and convicted of insider trading, thus increasing the deterrent effect of the penalty.

[10] "'I think the whole country was' disappointed with the original penalty": ASIC Chairman Greg Medcraft: Darby A, "John Gay Insider Trading Case Back to Court for Proceeds of Crime Action", *The Sydney Morning Herald* (4 June 2014). See, also Professor Ian Ramsay, Centre for Corporate Law at Melbourne University: ABC News, "John Gay's Insider Trading Fine Takes Some by Surprise", *ABC News Online* (23 August 2013), http://www.abc.net.au/news/2013-08-23/former-gunns-boss-john-gay-faces-sentencing-for-insider-trading/4907194; Mr Ian Curry, Chairman of the Australian Shareholders Association: Denholm M, "Former Gunns Boss John Gay Fined Rather Than Jailed for Insider Trading", *The Australian* (23 August 2013).

4. The Use and Duration of Banning Orders in connection with Insider Trading

A person who is convicted of insider trading in criminal proceedings is automatically disqualified from managing a corporation for a period of five years, due to the operation of section 206B(1)(b)(i) of the *Corporations Act*.[11] However, he later successfully brought an application to the Supreme Court of Tasmania for leave to manage two private corporations under section 206G of the *Corporations Act*.[12]

ASIC had opposed the application for Mr Gay to be given leave to manage the two private corporations on a number of grounds, including that it would "undermine the punishment and general deterrent effect of the sentence imposed". ASIC highlighted the fact that the original sentencing judge has expressly referred to the disqualification as a relevant factor.[13] However, Pearce J of the Supreme Court of Tasmania focused primarily on whether the public needed protection, rather than on a deterrent effect of the disqualification, and granted leave to Mr Gay.

While a person who is convicted of insider trading will be automatically disqualified from managing a corporation, the deterrent and penalty effect of the disqualificaiton is diminished if leave to manage a corporation is easily obtained. Accordingly, I recommend that section 206G of the *Corporations Act,* which permits a Court to grant leave to manage a corporation to a disqualified person, be amended to provide that, where a person has been disqualified from managing a corporation because they have been convicted of a criminal offence under the *Corporations Act*:

> The Court may only grant leave if satisfied that the person is otherwise subject to a penalty of appropriate personal and general deterrence.

There is no automatic disqualification from managing corporations for a person found liable for insider trading in civil penalty proceedings. This may, in part, be because there was no civil liability for insider

[11] Section 206B(1) of the *Corporations Act* provides that: "A person becomes disqualified from managing corporations if the person: ... (b) is convicted of an offence that: (i) is a contravention of this Act and is punishable by imprisonment for a period of greater than 12 months."

[12] See *Re Gay* [2014] TASSC 22.

[13] *Re Gay* [2014] TASSC 22 at [32].

trading at the time that section 206B of the *Corporations Act* was enacted. However, ASIC may apply to the Court under section 206C of the *Corporations Act* seeking disqualification of such a person.[14]

In order to increase the penalty and deterrent effect (both specific and general) for civil liability for insider trading, I recommend that a person found liable for insider trading in civil penalty proceedings should also be automatically disqualified from managing a corporation under section 206B of the *Corporations Act* for five years. Accordingly, I recommend that section 206B to also provide for automatic disqualification if a person:

> a declaration is made under: (i) section 1317E (civil penalty provision) that the person has contravened section 1043A(1) or (2).

5. The Value of Fines and Other Monetary Penalties, Particularly in Proportion to the Amount of Wrongful Gains for Insider Trading

In addition to a maximum term of 10 years' imprisonment, the maximum fine that can be imposed for a criminal conviction for insider trading is a fine of $765,000 or three times the profit made or loss avoided, whichever is greater.[15] In the *Penalties for Corporate Wrongdoing Report,* ASIC concluded that the maximum criminal fines for individuals were "generally comparable to most other jurisdictions",[16] and it is noted that, for individuals, the maximum fines are: Canada – the greater of $CAD 5 million (approximately $AUD 5.25 million) or three times the benefit gained; Hong Kong – $HKD10,000,000 (approximately $AUD 1.44 million); the United Kingdom – an unlimited fine; and the USA - $USD 5 million (approximately $AUD 5.6 million).

For civil penalty proceedings, the maximum fine that can be imposed is a fine of up of $200,000.[17] In the *Penalties for Corporate Wrongdoing Report*, ASIC noted that this is significantly lower than the maximum fine available for civil breaches of insider trading in other jurisdictions: Canada – a fine of up

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[14] Section 206C(1) of the *Corporations Act* provides that: On application by ASIC, the Court may disqualify a person from managing corporations for a period that the Court considers appropriate if: (a) a declaration is made under: (i) section 1317E (civil penalty provision) that the person has contravened a corporation/scheme civil penalty provision; ... and (b) the Court is satisfied that the disqualification is justified.

[15] Section 1311 and Schedule 3 of the *Corporations Act.*

[16] ASIC*, Penalties for Corporate Wrongdoing Report*, p 16.

[17] 1317G of the *Corporations Act.*

to $CAD 1 million (approximately $AUD 1.05 million); Hong Kong – an unlimited fine; the United Kingdom – an unlimited fine; and the United States of America – a fine of up to three times the benefit gained.

A fine which is calculated by reference to the amount of the unlawful profit made or loss avoided is more likely to be a significant deterrent and will make potential offenders less likely to be willing to risk the possibility of detection. Accordingly, I recommend that the maximum fine for civil penalty proceedings for insider trading be increased to the same maximum as for criminal proceedings – a maximum of $765,000 or three times the profit made or loss avoided, whichever is greater - in order to increase the general and specific deterrent effect of the penalty.

6. The Availability and Use of Mechanisms to Recover Wrongful Gains for Insider Trading

In Australia, the *Proceeds of Crime Act 2002* (Cth) can be applied to seize the proceeds of insider trading in connection with a criminal prosecution, as a form of disgorgement. This action is not available in connection with civil penalty proceedings. ASIC noted in the *Penalties for Corporate Wrongdoing Report* that disgorgement is available in civil proceedings for insider trading in each of the other jurisdictions it examined – being Canada, Hong Kong, New Zealand, the United Kingdom, and the USA - but not in Australia.[18]

The confiscation of a profit made or loss avoided, in criminal or civil proceedings, provides an additional deterrent to those who may be tempted to engage in insider trading. In order to have greater consistency with the position in other jurisdictions, and to give an additional deterrent effect, I recommend that a profit made or loss avoided by insider trading be subject to disgorgement in civil penalty proceedings.

7. Concluding remarks

In order to maintain and protect the integrity of our securities markets, so that investors do not lose confidence and consider that insiders are able to unfairly benefit from the use of information that is not publicly available, prospective insider traders must be appropriately deterred from engaging in such conduct. Insider trading is widely acknowledged as a crime that is extremely difficult to detect and

[18] ASIC, *Penalties for Corporate Wrongdoing Report*, p 20.

prosecute and it is because of these difficulties that general deterrence is of particular importance. Accordingly, those who might be tempted to engage in insider trading, on the assumption that they are unlikely to be caught or convicted, or severely punished if they are, need to be deterred from considering such activity. If those who are convicted or found liable in civil penalty proceedings are seen to be subject to serious and significant penalties, the deterrent effect will be much greater.

I appreciate the opportunity to make a submission. Please feel free to contact me if I can be of any further assistance.

Yours sincerely

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