

Chapter 3

Higher penalties and improved detection powers for insider trading and market misconduct offences

3.1 This chapter examines the bill's provisions to enhance the Australian Securities and Investments Commission's (ASIC) search warrant powers to detect insider trading and market manipulation offences and enable an interception agency to apply for telecommunications interception warrants to investigate these offences. The chapter begins by outlining the bill's provision to increase criminal penalties for insider trading and market misconduct offences.

Higher penalties for insider trading and market misconduct offences

3.2 The bill increases the penalties associated with breaches of the insider trading and market misconduct provisions in section 7.10 of the *Corporations Act*. This misconduct includes false trading and market rigging, artificially maintaining a trading price, dissemination of information about illegal transactions, false or misleading statements, inducing persons to deal in financial products and dishonest conduct in relation to a financial service or product.¹ Currently, the maximum criminal penalty for insider trading is five years imprisonment and/or 2000 penalty units, while the maximum criminal penalty for market manipulation offences is five years imprisonment and/or 200 penalty units.

3.3 In his Second Reading Speech, the Parliamentary Secretary to the Treasurer, the Hon. Mr David Bradbury MP, explained that insider trading and market manipulation can 'distort Australia's financial markets and cause serious harm to their fair and efficient functioning'. Further, he noted that the benefit to be gained from engaging in insider trading or market manipulation often far outweighs the maximum penalty that can currently be imposed for a breach.²

3.4 Accordingly, the bill will increase the maximum criminal penalties for both insider trading and market manipulation to ten years' imprisonment and/or the greater of 4500 penalty units, or three times the profit gained or loss avoided.³ Currently, 4500 penalty units is \$4 950 000 for a corporation and \$495 000 for an individual.

3.5 Witnesses to this inquiry supported these amendments.

1 Mr Geoff Miller, Treasury, *Proof Committee Hansard*, 3 November 2010, p. 2.

2 The Hon. Mr David Bradbury MP, Second Reading Speech, *House of Representatives Hansard*, 29 September 2010.

3 Explanatory Memorandum, p. 14.

Improved offence detection powers

Search warrant powers

3.6 The bill amends the current search warrant power in the ASIC Act to permit ASIC to apply for a search warrant without first having to issue a notice to produce for the material sought. Treasury told the committee that the Act's current requirement for a notice to produce has meant that ASIC's search warrant power is rarely used. When the power is sought, the documents are often destroyed. Accordingly, the search warrants employed by ASIC are often only used in criminal proceedings under section 3 of the Crimes Act.⁴

3.7 While the bill removes the notice to produce requirement from the Corporations Act, the new search warrant provisions will retain various other protections. An application to the court for a search warrant may only be made in a situation where a notice to produce a document under sections 30, 30A, 31, 32A and 33 could also be issued. These notices may only be issued where the requirements of section 28, regarding the permitted purposes for seeking records, are actually satisfied.

Sections 28 and 35 of the ASIC Act

3.8 ASIC's power to apply for a search warrant is set out in section 35 of the ASIC Act. This section obliges ASIC to require the production of corporate records under another provision of Division 3 and only if those records are not produced may ASIC then apply for a search warrant.⁵ Division 3 (section 28) relates to section 35 insofar as it sets out the parameters within which ASIC may exercise its powers.

3.9 Section 28 of the ASIC Act requires that ASIC's search warrant powers are only exercised:

- in connection with the performance or exercise of ASIC's functions or powers under the corporations legislation;
- for the purposes of ensuring compliance with the corporations legislation;
- in relation to an alleged or suspected contravention of the corporations legislation, or another law which relates to a corporation; and
- in connection to an investigation under Division 1 of the ASIC Act.

Submitters' concerns with the provision

3.10 Several groups have expressed concern with the bill's search warrant provision. Mr Stephen Blanks, Secretary of the New South Wales Council for Civil Liberties, contrasted the bill's provision on search warrant powers with the process that ASIC uses to apply for a search warrant under the *Crimes Act 1914*. He noted that

4 Mr Geoff Miller, Treasury, *Proof Committee Hansard*, 3 November 2010, p. 3.

5 Rule of Law Institute, *Submission 7*, p. 5.

the primary way that ASIC is able to obtain search warrants is through the Crimes Act. Through this avenue, there must be a suspected criminal offence for which the search warrant is necessary. Mr Blanks reasoned:

To the extent that the power in the ASIC Act is additional to and separate from the power in the Crimes Act, one assumes that the power in the ASIC Act is going to be used in situations where there is not an investigation of a criminal offence underway...To have a search warrant as the first port of call in a non-criminal investigation is inconsistent with the principles applying to coercive powers that have been floating around for at least the last 10 years.⁶

3.11 Mr Malcolm Stewart, Vice President of the Rule of Law Institute, elaborated on this issue. He explained to the committee that currently, ASIC must have a reasonable suspicion that an offence has been committed. Under the provisions of the bill, however:

There no longer has to be any reasonable suspicion of anything. There does not have to be the commission of any offence or reasonable suspicion of that offence—there does not even need to be a reasonable suspicion of a contravention in a civil sense of any of the acts that ASIC oversees either.⁷

3.12 The Institute fears that the bill's provision 'confers on a regulator even more coercive powers than it already has' and that this power is operationally unnecessary.⁸ Mr Stewart told the committee that as insider trading and market manipulation are criminal offences, ASIC already has adequate powers to gain a search warrant under section 3 of the Crimes Act. He argued that ASIC does not need this additional power to gain a document on a premises.⁹

3.13 The Senate Standing Committee for the Scrutiny of Bills also criticised the bill's provisions on ASIC's search warrant powers. It expressed concern that the Explanatory Memorandum does not explain the reasons for the bill's search warrant power provisions and in particular:

...whether the proposed power is too broad, what safeguards are in place to ensure that their use would be for a proper purpose and proportionate to the circumstances, and whether they are consistent with other similar powers.¹⁰

6 Mr Stephen Blanks, New South Wales Council for Civil Liberties, *Proof Committee Hansard*, 3 November 2010, p. 21.

7 Mr Malcolm Stewart, Rule of Law Institute, *Proof Committee Hansard*, 3 November 2010, p. 22.

8 Rule of Law Institute, *Submission 7*, p. 3.

9 Mr Malcolm Stewart, Rule of Law Institute, *Proof Committee Hansard*, 3 November 2010, p. 23.

10 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest 8/10*, 27 October 2010, p. 19.

ASIC's view (and a response)

3.14 In evidence to the committee, ASIC's Deputy Chairman Ms Belinda Gibson, emphasised that the Commission does not currently have power to obtain a search warrant under civil and administrative actions. She argued that ASIC needs the new powers to ban a financial participant pending a criminal determination, and thereby protect the public from a person who has breached the Act.¹¹

3.15 Ms Gibson gave the following example to illustrate ASIC's need for search warrant powers in addition to the current Crimes Act option:

If you take an instance where we suspect a Ponzi scheme by which we think a financial adviser is taking investors' money, that would be a criminal act. To prepare and take a case to trial can take many years. It may be that we could use the evidence in an administrative banning and so protect the public by stopping that person giving financial advice and then work up a case. In the Crimes Act, we could not use evidence we might get from a telephone intercept about the operations of that scheme in a banning proposition; we could only use it in a criminal prosecution.¹²

3.16 Nonetheless, Ms Gibson told the committee that ASIC does not envisage using its new search warrant powers frequently. She noted that the Australian Federal Police has many other responsibilities and that executing the search warrant is 'very resource intensive'. She added: 'I envisage that we would generally only use a search warrant power where we think there might be destruction' (of evidence).¹³

Section 28

3.17 ASIC told the committee that in its view, section 28 of the Act does constrain the use of section 35. Ms Gibson added there 'could be some legislative tweak to make that clearer, but the words of section 35 invoke section 28'.¹⁴

3.18 However, the Rule of Law Institute has criticised the bill for removing the two step process currently required under section 35. It argued that the effect of the proposed amendment is that ASIC's power to issue a search warrant is no longer limited by the parameters contained in section 28.¹⁵ The Institute argued that ASIC's power to apply for a search warrant should be subject to specified safeguards which ensure that it is for a proper purpose in connection with its statutory functions. However, even this safeguard would allow ASIC to obtain a search warrant in circumstances where there may be no breach of the Corporations Act or any other law

11 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 32.

12 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 34.

13 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 35.

14 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 33.

15 Rule of Law Institute, *Submission 7*, p. 5.

or provision. The Institute thereby recommended that ASIC's power to apply for a search warrant be subject to the safeguards contained in section 28 of the ASIC Act.

3.19 Treasury's interpretation is that these safeguards are already in place in the bill:

The section quite clearly states that the search warrant may seek the production of books that could be required to be produced—and we listed a whole range of sections in our introductory speech. Those sections are tied to section 28 of the ASIC Act. Section 28 lists a whole range of purposes for which books can be sought, and none of those powers can be exercised unless it is for one of those purposes. For the search warrant power, although it does not explicitly refer to the section 28 purpose, it says it can only seek books for which you could actually seek under the other sections—and you can only seek books under those other sections.¹⁶

Calls to review the search warrant provision

3.20 The committee is aware of proposals to review the bill's search warrant powers. The Rule of Law Institute recommended in its submission that the Senate Economics Legislation Committee:

...should seek advice from ASIC which reassures the Senate that ASIC has in place central records, procedures and safeguards to ensure that it does not act in an arbitrary manner.¹⁷

3.21 The Senate Standing Committee for the Scrutiny of Bills has sought the Treasurer's advice about the scope of ASIC's proposed search warrant powers and the safeguards against the abuse of these powers. Pending this advice, the committee has noted that these provisions may be considered 'to trespass unduly on personal rights and liberties, in breach of principle 1(a)(i) of the Committee's terms of reference'.¹⁸

Telecommunications interception powers

3.22 The bill also includes the insider trading and market misconduct provisions in Part 7.10 of the Corporations Act in the list of serious offences in section 5D of the *Telecommunications Interception Act 1979*. Accordingly, an interception agency will be able to apply for telecommunications interception warrants in the course of investigations into insider trading and market manipulation offences.¹⁹

16 Mr Daniel McAuliffe, Treasury, *Proof Committee Hansard*, 3 November 2010, p. 9.

17 Rule of Law Institute, *Submission 7*, p. 3.

18 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest 8/10*, 27 October 2010, p. 18.

19 Explanatory Memorandum, p. 18.

3.23 ASIC itself will not be a telecommunications intercept (TI) agency. The main TI agency will be the Australian Federal Police (AFP). ASIC will have a role assisting the AFP in its prosecution of offences using the information that the AFP obtains.²⁰

3.24 The Parliamentary Secretary's Second Reading Speech explained the need for enhanced telecommunications interception powers to detect insider trading and other market manipulation offences. Mr Bradbury told parliament that:

...these offences by their very nature involve complex networks of people, technological sophistication and avoidance of paper and traceable communications. In addition, the transactions often occur in real time, meaning that telephone conversations are often the only evidence of the offence.²¹

3.25 The Senate Standing Committee for the Scrutiny of Bills also expressed concern that the provisions relating to telecommunications interception warrants may trespass unduly on personal rights and liberties, in breach of principle 1(a)(i) of the committee's terms of reference.

3.26 The New South Wales Council for Civil Liberties commented in its submission that:

It is alarming to observe the extent of function creep of powers, originally justified in relation to terrorist offences and those that threaten life or serious bodily harm, to lesser crimes. The proposed change would permit the full range of warrants to be issued to interception agencies, for offences concerning insider trading and market manipulation. It is paradoxical for a bill which seeks to protect the privacy of shareholders in one respect to then allow such intrusions. CCL shares the concern raised in their submission by the Rule of Law Institute on this matter.²²

3.27 Others supported the bill's provision on TI powers. Chartered Secretaries Australia, for example, told the committee that:

...we are supportive of the provision of telephone interception warrants in relation to insider trading and market manipulation. Our reason for that is that we think that those particular issues are extremely difficult to prove without those powers and we think that the same public policy rationale should apply to their use for insider trading and market manipulation—that is, telephone interception warrants—as currently applies to their use in the investigation of money laundering and cybercrime. They are very difficult

20 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 32.

21 The Hon. Mr David Bradbury MP, Second Reading Speech, *House of Representatives Hansard*, 29 September 2010.

22 New South Wales Council for Civil Liberties, *Submission 8*, p. 2.

to crimes to prove and we think without those powers they remain very difficult crimes to prove. That is why we support them.²³

ASIC's view of the bill's telecommunications interception powers

3.28 ASIC told the committee in its evidence that it does not expect the new telecommunications intercept powers to be frequently used. Ms Gibson noted that the magistrate would have to be satisfied that it would assist the investigation. The investigator—the AFP—would need evidence of 'a pattern of successful trading across a succession of stocks by a potential trader and would then be able to see a person building a position in a stock'. Ms Gibson recalled only 'three or four instances' in her three years working at ASIC where there was a suspected ring of insider traders.²⁴

3.29 Treasury also outlined the process for telecommunications interception:

In the normal course of events we would expect ASIC to conduct its normal investigations, using its normal powers, to come across a circumstance where it believes a TI warrant is justified. Because it cannot apply itself, it would have to go to an intercept agency and convince that agency to apply resources to the investigation. So it would actually have to convince that TI agency, just on the information that it has already gathered, that there is sufficient evidence to justify that step and also that the offences that are allegedly occurring are sufficiently serious enough for it to prioritise its own work and to actually start an investigation. Of course, that agency, once it was convinced, would then have to go to court and would have to convince the court that there was sufficient evidence and it was sufficiently serious to justify the issue of a warrant.²⁵

ASIC's coercive powers

3.30 This inquiry has also elicited broader comment critical of the extent and secrecy of ASIC's coercive powers. The Rule of Law Institute highlighted in its submission that there is no published information on how ASIC executes its current powers. It argued that ASIC should make publicly available:

- the basis upon which ASIC initiates a coercive order;
- whether it does so based on a reasonable suspicion that there has been a breach of the law;
- how it ensures that the approving officer is a different person and in a different division from the initiating or recommending officer; and

23 Ms Judith Fox, Chartered Secretaries Australia, *Proof Committee Hansard*, 3 November 2010, p. 11.

24 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 32.

25 Mr Daniel McAuliffe, Treasury, *Proof Committee Hansard*, 3 November 2010, p. 6.

- how often it conducts an internal review of its extensive set of coercive powers and what these reviews have concluded.²⁶

3.31 To this end, the Institute recommended that the proposed amendments to the ASIC Act be excised from the bill and referred to the Australian Law Reform Commission as part of a review of the use of coercive powers by regulators. It also recommended that ASIC publish on its web site a set of procedures which demonstrate that it has appropriate checks and balances to ensure that it uses its coercive powers 'sparingly and with appropriate discretion'.²⁷

3.32 The New South Wales Council for Civil Liberties noted that law enforcement agencies are required to report to the relevant Attorney General and to Parliament the numbers of interception warrants applied for and executed each year, and on the success of those cases in obtaining evidence. It argued that similar reporting requirements should be placed on ASIC's search powers before the bill's amendment comes into force.²⁸

3.33 The committee asked ASIC to comment on the criticism that it does not report enough on its use of coercive powers. Ms Gibson responded:

...we were looking into our reporting of the use of our coercive powers and we were reviewing that benchmark with other regulatory agencies. Our preliminary view is that there is not extensive reporting of the exercise of a 'notice to produce' document or so on, but we are looking at whether there should be some better reporting of those coercive powers. We do not use telephone intercepts now so I cannot report that we would be using any. On the question of accessing search warrants, I have some data on that. In all cases we have to keep search warrants with the federal police. That is required by the legislation and that will not change. We have had some 20 investigations over the last three years for which the police would have executed some 82 warrants overall.²⁹

Committee view

3.34 The committee recognises that the issue of ASIC's coercive powers, and the need for a better system of public disclosure of the use of these powers, is an issue that is broader than this inquiry. These issues are nonetheless relevant to several witnesses' concerns that any new coercive powers that ASIC acquires through this legislation are adequately safeguarded and properly disclosed.

26 Rule of Law Institute, *Submission 7*, p. 4.

27 Rule of Law Institute, *Submission 7*, p. 7.

28 New South Wales Council for Civil Liberties, *Submission 8*, pp. 2–3.

29 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, 3 November 2010, p. 3.

Recommendation 1

3.35 The committee recommends that if ASIC does acquire new search warrant and telecommunications interception powers to investigate insider trading and market misconduct offences, it is required to state in its Annual Report:

- the number of times it has used each of these powers;
- the number of times that ASIC referred an insider trading or market misconduct matter to the AFP for investigation for the possible use of the phone interception power; and
- the nature of the use of these powers in each circumstance.

3.36 The committee notes that law enforcement agencies are required to report to the relevant Attorney General and to Parliament the numbers of interception warrants applied for and executed each year.³⁰ ASIC, and the interception agencies that investigate insider trading and corporate misconduct offences, should be subject to similar disclosure requirements.

Recommendation 2

3.37 The committee recommends that the bill be passed.

Senator Annette Hurley
Chair

30 See Office of the Australian Building and Construction Commissioner, 'Compliance powers reports', <http://www.abcc.gov.au/abcc/PerformanceReports/Compliancepowersreports/> (accessed 10 November 2010).