UNIVERSITY OF AUCKLAND LAW SCHOOL RESEARCH CENTRE

FOR BUSINESS LAW

SECURITIES REGULATION AND INSIDER TRADING

SEMINAR AUCKLAND NEW ZEALAND 26 JULY 1996

WELLINGTON NEW ZEALAND 29 JULY 1996

TEN CONCLUSIONS

The Hon Justice Michael Kirby AC CMG

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Insider trading is not the kind of matter which attracts unanimity of opinion. Philosophical and economic differences, as well as different approaches to the role of law and the use of sanctions and remedies available to law, influence the responses which different commentators offer.

Nonetheless, it is helpful to record some of the conclusions which the participants in the seminars expressed and which can be offered as at least a starting point for the next stage of the development of New Zealand law and policy on this topic.

As a foreigner, and as a judge, it is not my part to attempt to guide New Zealand law-making on insider trading in one direction or another. The conclusions I state here are no more those which I derived from the discussions which I have heard. They represent my perception of the general consensus of participant commentary. But it remains for those who know more about New Zealand's legal, political and financial environment to say whether they represent ideas that should be followed, or not.

1. ***No laughing matter:*** The seminars have been attended by goodwill and even some humour. Engraved on our memory are the photographs shown by Professor Barry Rider of one of the relatively few persons convicted of insider trading in the United Kingdom, lifting a glass of champagne to the kind-hearted judge who committed him to a custodial institution where life was far from severe. Although there has been humour, insider trading, at its heart, is not a laughing matter. It involves the breach of fiduciary duty by persons acting selfishly for their own advantage. Not to put too fine a point on it, it involves rip-offs by people with power and inside

information to the disadvantage of those who lack such power and information.

2. ***Proper role of criminal law:*** Although the acts constituting insider trading are difficult to define, and even more difficult to prove without prohibitive cost or distortion of the criminal justice system, the fact remains that the central notion of insider trading concerns anti-social conduct which is serious and morally reprehensible. Any such conduct is usually the province of the criminal law. Indeed, as Professor Barry Rider pointed out, there may well be general criminal offences which can be invoked where fraud involving misuse of office and personal gain can be proved. It should not be beyond the wit of lawyers and the skill of legislative drafters to define specific offences of insider trading with particularity. To say that, in those jurisdictions where such offences exist, there have been few convictions is not necessarily to demonstrate that a criminal offence should not be enacted. The criminal law exists, in part, to set society's standards; in part, for educative purposes; and in part to deter conduct for fear of punishment and attendant publicity following prosecution and conviction. Anecdotal evidence was placed before the

seminars that, at least in one jurisdiction in Australia business-people are conscious of the criminal offences and are regularly advised to conduct themselves so as to avoid infringing the criminal law.

3. ***Priorities in crime:*** The failure of the criminal justice system, in those jurisdictions where specific offences exist for insider trading, to bring criminal prosecutions to success presents, in a sense, a case study in the incapacity of the modern legal system, particularly in the field of complex crime. It is, or should be, a source of embarrassment for those who are engaged in the enforcement of the criminal law, that exquisite attention is typically paid to anti-social conduct of little consequence to society as a whole whilst large-scale insider trading goes on undetected and unpunished. This is yet another instance of the sense of priorities that occasions cynicism about the institutions of the law and of justice. Citizens observe that the small fish are caught, processed and punished whilst the big fish swim away.

4. ***Special features of New Zealand's market:*** Nevertheless, there are some special circumstances in New Zealand which make it necessary to adjust and carefully adapt models of insider trading law, developed for other jurisdictions. These include the relatively small population of the country, the comparatively small securities industry and the fact that, in such an environment, financial information has a virtually inevitable tendency to spread more rapidly than in the large impersonal financial centres of the world. This reality about the personal and professional inter-connections of those involved in the financial marketplace in New Zealand must be kept in mind in designing laws that will be both effective and just to deter and sanction insider trading.

5. ***General difficulties of regulation:*** As well as this, there are some general difficulties which are presenting not only to New Zealand but to other like economies when it comes to the design of insider trading laws. The phenomenon of transborder data flows facilitates the "round robins" by which the involvement of insider traders in apparently innocent international financial transactions can readily be disguised. In addition to this technological development,

there is the economic and political phenomenon of the downsizing of the public service and the privatisation of the financial marketplace that make it difficult to persuade governments to institute regimes in relation to insider trading which involve public sector institutions. Politicians of most persuasions are now unsympathetic to the creation of new protective institutions having implications for the budget and enlargement of the public service.

6. ***Present law is not working:*** Nevertheless, the general consensus was that the current laws to sanction insider trading in New Zealand reflected in the *Securities Amendment Act* 1988 (NZ) is not working effectively to deter and punish insider trading. Indeed, it was suggested that any individual shareholder who braved the numerous impediments in order to prosecute proceedings against an alleged insider trader deserved the civil equivalent of the Victoria Cross "for litigious valour". Because of the impediments, demonstrated in the relatively few cases which have been brought to the courts of New Zealand, it cannot be said that the New Zealand legislation has operated as an efficient sanction and thus as an effective deterrent to those

tempted to engage in insider trading. In particular, it has not had the effect which the use of the civil remedy was said to promise, viz the disgorgement of the profits made by the insider trader to the benefit of the company, its shareholders and (in part) the litigant. The New Zealand law is a unique response to the problems of insider trading. It represents a relatively weak link in the chain of legislation that exists in most English-speaking developed countries. It gives the appearance of affording a sanction; but the reality falls far short of that appearance.

7. ***Current reform proposals are inadequate:*** The most recent proposals for the amendment of New Zealand legislation were put forward in a letter to the Minister dated 27 June 1995 which was made available to the participants in the seminars. Indeed, a consideration of those proposals was a major focus of the seminar. The New Zealand Securities Commission is to be congratulated for the careful way in which it has consulted the expert and general community about the reform of New Zealand laws on this contentious topic. Nonetheless, the consensus of the seminars appeared to be that the proposed reforms also fell short of providing an effective

deterrent. Many commentators expressed the view that the seminars merely tinkered with the present legislative scheme which had been shown to be incompetent, so that no confidence could be had that, if enacted, the reforms would achieve a significant change in the present position in New Zealand.

8. ***Desirable directions of reform:*** Amongst the participants who put forward proposals for reform, there was a broad consensus that the reforms should rather take the following directions:

(8.1) There should be a greater role for the Commission and possibly for the Serious Crime Unit. The Commission, in its latest draft, has acknowledged the arguments for such a change. However, it has suggested that the enlargement of its powers should be considered in the wider context of a review of the Commission's powers rather than in the specific context of insider trading. Nevertheless, a proactive Commission is a feature of virtually all legal systems similar to that of New Zealand. Most participants appeared to think that the time had come for the New Zealand Commission to

be afforded like powers. This would permit it to set standards and to bring proceedings where they were truly justified, rather than relying upon individual litigants who manage to get through the several gateways provided by the current legislation but who may have agendas of their own.

(8.2) A specific and carefully designed criminal offence should be introduced in order to express the high standards expected of persons operating in the financial market; to deter those who are inclined to misuse information gained from office for their personal advantage; and to reinforce education in proper ethical standards.

(8.3) Any such criminal offence should be expressed in such a way as to attach its punitive consequences to conduct that is plainly morally reprehensible. The criminal law should not be concerned with punishment of those whose offence is technical only but morally blameless.

9. ***Need for empirical data:*** There was also a general consensus of participants that the Commission, or some other appropriate body, should attempt to gather more

empirical and anecdotal data about the extent and forms of insider trading as they exist in New Zealand at this time. The difficulty of obtaining such data was acknowledged. Some consideration might be given to the legislative analogies afforded in the fields of drug offences where indemnities are provided to minor players in order to catch the major offenders. Similar indemnities should be considered in the case of insider trading so that the market might be cleansed of operators who misuse their corporate offices, which they hold in trust for others, to their personal advantage, including to the advantage of their families and friends.

10. ***Report on seminars:*** Finally, there was a consensus that the deliberations at the seminars should be reported to law journals to stimulate further debate, to the New Zealand Securities Commission, to the incoming Minister and Shadow Minister responsible for legal policy in this area and to the incoming New Zealand Parliament, which has the responsibility of upholding the integrity of the New Zealand securities industry.