INSIDER TRADING IN AUSTRALIA

PART 3

THE ETHICAL DIMENSION

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Insider trading conduct has been criminalized in various statutes in Australia at least since 1970. In this time, not one conviction for insider trading has been recorded, and there have been only a handful of prosecutions. Nevertheless, it is now clear that insider trading has been extensively practised in Australia for many years. The 1974 report of the Senate Select Committee on Securities and Exchange (The Rae Committee) documented the existence of many incidences of insider trading in the early 1970s. There is not much evidence to show that the extent of insider trading in the 1980s is any less, as we documented in an earlier report which also drew upon the data upon which this report is based.\textsuperscript{1} As the failure to enforce insider trading laws cannot be attributed solely to the internal problems facing regulatory authorities, we need also to look beyond them to the values and attitudes which are to be found amongst practitioners and investors in the securities industry in Australia. Although the failures of the regulatory authorities in dealing with insider trading are serious ones, as we have illustrated elsewhere,\textsuperscript{2} the persistence and intractability of insider trading as a phenomenon is as much due to the tolerance, and indeed, the encouragement, of it within the securities industry at large.\textsuperscript{3}

Whilst the extent of insider trading is in part a reflection of greed and opportunity, it has also became ingrained or institutionalized within the practices of actors in the securities market. This report will seek to document and to explain this phenomenon. In an earlier study we argued that the formal legal system did not reach very far into the regulation of the securities industry, despite the existence of governmental regulatory bodies such as the Australian National
Companies and Securities Commission (NCSC) and the State and Territory Corporate Affairs Commissions (CACs). Semi-official bodies such as the Australian Stock Exchange (ASX) and its state branches have done even less to extend the reach of formal legal rules into the securities industry. As a consequence, insider trading is either left unregulated at all, or it is largely dealt with by informal and private methods. This means that insider trading is poorly regulated as the ethical standards of those in the securities industry have largely remained low, so that there is considerable tolerance for such conduct. Paradoxically, the very existence of official regulatory agencies facilitates the continued presence of poor ethical standards, as the industry can readily say that insider trading is a problem for the agencies, rather than for industry itself, to deal with. In other words, the existence of the regulatory agencies provides a degree of symbolic reassurance to the general public, whilst practitioners in the securities industry know all too well that they have little to fear from the regulators, provided that they are not too blatant in their practices.

Interestingly, there is very little support within the securities industry for greater self regulation as this would shift responsibility for the regulation of insider trading to the industry itself. This shift is opposed by many in the industry because it is likely to reflect poorly upon the public perception of the practices of the securities industry. At the same time, it would create greater conflict of interest problems which would be almost impossible to resolve due to the close peer group bonds which exist in the industry. As the securities industry depends greatly upon the networks within it for the spread of market information, there is a reluctance to threaten these linkages. "Whistle blowing" is much less likely than in some other areas. This of course, ensures that the
regulatory agencies remain largely ineffective. It also illustrates the critical significance of shared ethical values within the industry.

(2) BACKGROUND AND METHODOLOGY

This report is part of a wider study of insider trading in Australia which has sought to raise the level of debate on this often emotional and controversial subject. The study arose in the context of increasing concerns in this country regarding the incidence and implications of insider trading and its possible impact upon the market for securities and for law enforcement. Following the publication of the Anisman Report,5 by the NCSC in 1986, there was a widespread reaction that more evidence about the nature and extent of insider trading as a problem in Australia was called for. Of course, the publicity surrounding the enforcement of insider trading laws in the United States, and to a lesser extent in Britain, led many to believe that insider trading may also be a problem that faces securities markets in this country. With the support of the Australian Criminology Research Council and of most members of the Australian Ministerial Council on Companies and Securities we decided that it was timely to seek to inject some more concrete evidence into the Australian insider trading debate.

The study is based upon a national series of interviews with officials and professionals in four Australian cities. These were Canberra, Melbourne, Perth and Sydney. We also obtained mail responses from officials in other capital cities. Our research was assisted greatly by the support which we received from the relevant Federal and State Attorney's General and Commissioners for Corporate Affairs and their staff in each jurisdiction other than Queensland, as well as from the
Australian Stock Exchange branches in each city that we visited. The National Companies and Securities Commission also proved to be most helpful during the course of this research. We were also able to obtain access to principals and staff in over twenty broking houses. In fact, only two interviewees were not at the partner/director level. As well, we were able to speak to at least a dozen partners undertaking corporate and takeover law work in the four largest law firms in Melbourne, Perth and Sydney. The study also included merchant bankers, financial advisers, representatives of industry groups and financial journalists. Our interviews with each of these individuals often took up to two hours and sometimes even more. We were surprised by the willingness of these busy professionals to be so generous with their time and that of their colleagues. We sometimes found that the person that we had arranged to interview also brought along one or two other colleagues to participate in the survey. This certainly served to enrich the study greatly, although it had the effect of prolonging interviews quite considerably.

This analysis is based upon about 2000 pages of questionnaire responses which we collected. The questionnaire contained 66 questions and was open ended in design to allow us to explore related issues as they arose during the course of the interview. We had a core group of 30 questions that all interviewees were asked to answer and the remaining questions were designed for particular industry groups, such as brokers, lawyers and enforcement officials. The questionnaire was pre-tested with interviews in Canberra late in 1987, with the main body of interviews taking place in Perth in February 1988 and in Melbourne and Sydney in May 1988. A number of other shorter field trips involving interviews of regulatory officials in Canberra, Melbourne
and Sydney took place during the first half of 1988. Library research of
legal issues is certainly much to be preferred over this kind of fairly
arduous field work. On the whole, we spoke to, or received responses
from, a total of 99 persons and conducted a total of 79 interviews in
Australia. One of us also interviewed enforcement and stock exchange
officials as well as insider trading researchers in London, Toronto and
Washington to obtain comparative insights for the Australian study.
This research has also demonstrated quite vividly that empirical
research can provide invaluable insights into the operation and meaning
of corporate and securities law, adding a vital dimension which is
simply not available from the limited body of case law in this broad
area.

(3) THE EXTENT OF INSIDER TRADING

When researching the extent and effects of insider trading, we
frequently came across observations which reflected upon the nature of
business ethics in the securities industry. As we found, insider trading
is commonplace in Australia. One estimate is that perhaps up to 5% of
all securities transactions are affected by insider trading. It could well
be higher than this, although it is impossible to put a precise figure on
the level of insider trading. However, as one securities lawyer put it
"insider trading does not have to be widespread to be a matter of
concern". This is because, as one regulator explained "if a market is
seen as 'unfair' then both the confidence of the players and the
credibility of the Australian market are harmed". In other words,
securities markets can be seriously damaged or even destroyed (as
occurred in New Zealand and Hong Kong) by the existence of insider
trading.
Insider trading occurs throughout Australia, although it may be more blatant in some cities, such as Perth and Sydney. Lawyers, regulators and merchant bankers saw it as being embedded within our securities market. One regulator typically observed that "...the very nature of the market is such that insider trading goes on all day, every day". Similarly, one lawyer noted that "generally the passing of confidential information is prevalent", and another observed that "as market rigging and ramping are present a lot, so also is insider trading". Also, a lawyer who believed that insider trading should not be a criminal offence told us that "...there is no doubt that insider trading is out there and that it definitely goes on more than just a little"; yet another lawyer observed that "insider trading does exist, and probably more than people want it to exist". The funds manager of a very large Australian institution told us that insider trading is "very extensive" and that it occurs because of the manner in which information was passed around within the industry, as he saw it, "with little respect for confidentiality and a lack of care or concern".

Brokers face a real dilemma in dealing with the problem of insider trading and therefore frequently resort to comforting rationalizations of their conduct. The nature of this dilemma was explained by one broker when he said that "brokers need information to survive, sometimes it might be inside information". This was seen by another broker to lead many to "drive regulation to the wire, irrespective of morality". Supporting this view, various financial journalists writing for major city newspapers, concluded that insider trading conduct was "entrenched" or "ingrained" in Australia. This was attributed to the existence of "greedy people all over the place", as well as due to peer group pressure to
engage in insider trading. One stock exchange official aptly described insider trading as "the public scar" of the securities industry. All but one of the stock exchange officials that we interviewed believed that insider trading harmed the market. Nevertheless one broker seemed to sum up the prevailing view of insider trading when he remarked that "...within the industry we are laid back about insider trading". This is so at least until there is a good chance of a conviction for insider trading.

(4) THE EFFECTS OF INSIDER TRADING: CASINO CAPITALISM

One way of assessing ethical attitudes to insider trading is to seek to assess the perceived effects of such conduct. Most interviewees made the expected "motherhood" statements such as that insider trading is unfair to those who do not have the inside information or that it was desirable to seek to achieve "a level playing field", but these views were almost invariably qualified by some other statements. As one lawyer saw it, "the law has a role to inhibit it, but not to stop insider trading entirely". One explanation of this qualification was offered by another lawyer when he said that "the degree of harm depends upon the circumstances of a particular stock". Most other groups in the industry also saw insider trading as being harmful in some way. Once again, this was usually seen in terms of unfairness and resort was often made to a currently fashionable metaphor, such as the "level playing field". One regulator described insider trading as "unfair in the same way as a fixed horse race is unfair; it gives the Australian market a bad image". At one level, the philosophy of the level playing field is based upon the ethical principal of fairness of opportunity. However, this principle was often undermined or qualified by descriptions of the securities market as akin to a casino. The assumption here is that participants voluntarily
assumed the risks involved. There was generally little sympathy for being overly protective to the disadvantaged, such as "widows and orphans", whose funds were invested. One broker explained that brokers "...are philosophically unhappy with insider trading but are driven by greed". Another broker observed that as a result, insider trading "...has been tacitly condoned. Brokers are keen to write business and they sniff out and assess information and trade for themselves or their clients. Self interest comes first for many brokers". Similarly, another broker remarked that insider trading "...is tolerated as long as it is not too blatant. The market would not work without insider trading". Another added that "the industry tries to promote it - it has a vested interest [in insider trading]". This situation may be aptly described as "casino capitalism".

Although it seems that many brokers tend to take a pragmatic view of ethical values, there are still many brokers, especially those in well established firms, who expressed what seemed to us to reflect a genuine abhorrence of insider trading. These tended to be older brokers, who did not easily fit into the "yuppie" stereotype with which brokers are portrayed in the mass media. One Melbourne broker, for example, sagely reflected this more ethical viewpoint when he told us that "when I started in this industry I was told that insider trading was like having your hand in somebody's pocket". He went on to say that "most people are thoroughly decent". Another Melbourne broker explained that those who tolerated insider trading were merely "the bad apples". Although the "bad apple" thesis is a comforting one, it is somewhat misleading, for as one financial adviser put it "there is an enormous amount of hypocrisy in the industry". Another explained "people will deal with you as long as you are not caught".
The effects of insider trading have often been articulated by reference to theories derived from the American securities market, such as those developed by Professor Henry Manne. These arguments were generally rejected in highly charged ethical language. For example, it is argued by some academics that one beneficial effect of insider trading is that it acts as a price escalator and helps to bring the price of securities to their proper level more quickly, than would occur without insider trading taking place. Similarly, it is also argued in defence of insider trading that it provides an incentive to management to be even more entrepreneurial than they would otherwise be. These arguments were almost uniformly criticized or dismissed. One lawyer, for example, exclaimed that "the Manne argument is bullshit. It is just a rationalization for dishonesty". As to the proper price argument, another lawyer observed that "insider trading can also set an artificial price as the information can be misleading". Regulators were also generally unimpressed by these academic arguments, which were repeatedly seen as being immoral. One regulator described the Manne approach that insider trading encourages entrepreneurial activity as "a short term view which ignores the longer term moral question". Likewise, another regulator stated that "insider trading is immoral and, far from providing incentive for managers, may be seen as diverting them from their real purpose". One lawyer also noted, expressing a general view, that "the executive incentives argument has no credence as executives should be rewarded in other ways", such as through their salary or through executive share options. Speaking of the executive incentives part of the Manne argument, one merchant banker described it as a "twisted form of morality", and another financial adviser felt that perhaps insider trading might be informationally efficient, but it was
"not ethical or moral". Market observers spoke in equally strident moral terms against these arguments. Perhaps most surprisingly, even the brokers, also decisively rejected the Manne argument. Many took issue with the idea that there was such a thing as the "proper" price and argued that prices were often artificially set in order to satisfy creditors or to avoid income tax. Brokers rejected the market accelerator argument because insider trading was seen as being "for the benefit of a few". As another broker observed, "it sounds fine but if someone benefits along the way that is not right". Reaction to the executive incentives argument amongst brokers was also strong, as the following comments show - "it is wrong to bribe them"; "it is a breach of confidentiality" and "they are not entitled to the information and should not trade". Paradoxically, then, although the usual academic arguments in defence of insider trading found little support, there appeared to be a considerable degree of tolerance of insider trading, suggesting that insider trading may be seen as a tolerable form of deviance within the broader context of speculative casino capitalism of the 1980s. Indeed, this may be so if we look at the reportedly minimal effect of insider trading upon market confidence.

(5) INSIDER TRADING AND MARKET CONFIDENCE

To fully assess the effects of insider trading upon market confidence it might be most useful to also look at the views of investors. However, considerable guidance can be gained from the views of professional advisers, regulatory officials and other market observers. The prevailing view amongst brokers and stock exchange officials was that insider trading had not damaged confidence, although perceptions of insider trading, especially in the media were seen as being potentially
damaging. Market observers were fairly equally divided on the question as to whether insider trading has affected market confidence. Lawyers and regulators also denied that insider trading had actually affected confidence in the market, and, indeed, it was felt that a few convictions of insider traders might do more damage to market confidence. We might well ask why the effects of insider trading have been so slight. Answers to this question tell us something about the morality of the market place for securities. When asked whether insider trading had undermined confidence in stock markets, one broker explained that "people are prepared to live with a degree of insider trading and other market abuse". This was said by other brokers to be due to the fact that "in speculative stocks people are basically gamblers", and that the market was "like the race track". Once again, the metaphor of casino capitalism seems to be apt to encompass these views. Similarly, a financial adviser observed that "people accept insider trading as part of the market background". This is particularly so in regard to those who are involved in the market on a continuing basis. Another of the financial advisers noted that "the perception that insider trading is rife has undermined the confidence of small investors but not the big players - the professionals". Market observers echoed this message. As one put it, "people are aware of insider trading going on and have not been stopped from trading in shares". This may be because, as another observer explained, "people think that business is a bit dirty and that success comes from corruption".

Lawyers expressed similar sentiments. One told us that "people will still have a flutter. Insider trading is almost accepted as one of the risks of trading". Another lawyer noted that "insider trading hasn't undermined confidence as people think it is normal. It actually takes a lot to deter
people from being greedy". Small investors seem to be most likely to be wary of investing due to insider trading, while big investors, institutions and professionals continue to invest despite their cynicism about market morality. According to one broker "...insider trading creates a degree of cynicism that only the big boys know what is happening and therefore tends to keep people away". Likewise, a lawyer told us "the people that I deal with professionally had always had a cynical view of the stock market, they are wary, but they still gamble". When asked whether his clients were concerned about the existence of insider trading, another lawyer replied that they were not "because the big players are cynical and wordly wise". Another large firm lawyer's reply was that "clients purport to be concerned about insider trading. However, they rationalize that this information is available to everyone". In a similar view, two regulators remarked that "people will accept a certain level of wrongdoing", especially as "institutional investors expect that some insider trading will occur".

(6) THE TOLERANCE OF INSIDER TRADING

We further pursued the theme of the effects of insider trading upon the willingness of persons to enter the market and upon the attitudes of professional advisers. One financial adviser answered, when asked about the attitude of his professional colleagues to insider trading, that "no one will ever say so, but we tolerate it". At the same time there is a considerable stress upon the appearance of a high professional ethic in some sectors of the industry, though at times these views appeared to be less than convincing. Lawyers and accountants were seen to have the highest ethical standards. A financial adviser told us that "respectable professionals would not risk their career or reputation to
insider trade”. Another financial adviser added that “lawyers and accountants are aware that insider trading is illegal and unethical but brokers are not”. Many brokers sought to give the impression that “there is a genuine distaste for people who indulge in it”, but there were other brokers who took a more critical attitude to their colleagues. One broker said of his professional colleagues that “they know it happens and there is a degree of acceptance of its prevalence”. This same view was put most bluntly by a leading Sydney broker, when he exclaimed that “we are all thieves in this industry” and that there would be no damage from a person being known as an insider trader. Another broker noted that “while you would not have dinner with him, somebody will deal with him”. Stock exchange officials confirmed the existence of ambivalence in attitudes to insider trading. Thus we were told that “...it is not acceptable but perhaps there is some tolerance”, and that although “brokers want to stamp it out...[they] do not want over-wide regulation”.

On the whole, insider trading is not widely discussed amongst actors in the industry. A lawyer told us that “brokers sometimes would rather not know about it”, and another added that “brokers don't like it much when it is discussed”. However, another reported that “insider trading doesn't upset brokers a lot. Insider trading is part of people's dealing activity”. Talk of insider trading is clearly not a taboo subject, but it seems to cause greater irritation to brokers due to its potential to strike at the very heart of the broking industry. Moreover, brokers seem to have the greatest difficulties in grappling with conflict of interest situations. This is illustrated by many brokers who are prepared to house trade, that is to trade as principal, after obtaining price sensitive information through selective briefings from companies or through
"road shows", or presentations, put on by these companies for brokers and institutional investors. A lawyer summarized a common viewpoint when he explained that "in legal firms there is a lot of potential for conflicts of interests, although actual conflicts are rare. Brokers have a more practical approach to conflict of interest, i.e. they don't handle conflicts well". Ultimately, conflict of interest problems are likely to be avoided by having highly developed professional standards. These are clearly very weak in some sectors of the industry. Ethical standards seem to be particularly high in the large commercial law firms, although it was said by some lawyers that "there are smaller [legal] firms in the securities area about whom I do not have confidence". This may be due to the fact that smaller firm lawyers are more akin to entrepreneurs in the way that they operate than the larger firm lawyers who, in contrast, "regard the practice of law as their primary endeavour". However, generally speaking, as a group the brokers were at the opposite end of the ethical spectrum from the lawyers, although there are many established broking houses which are widely acknowledged as having very high ethical standards.

(7) RISK TAKING, STIGMA AND INSIDER TRADING

The low risk of detection and prosecution for insider trading has helped to entrench an easy morality in the securities industry. Insider traders tend to fall into two broad groups. There are those who are ignorant of the law against insider trading and there are those who are aware of the law against it but believe, nevertheless, that the risk is worth taking. Some of the latter are quite sophisticated in the ways in which they execute their insider trading transactions. As one broker saw it, "the average person would not give detection a moment's thought. The big
operators calculate the risks and do it offshore all the time". Another broker highlighted the fact that "it depends on their morals. The risk of detection is lowish; of prosecution it is low and even if found guilty the penalty is low". Financial advisers confirmed this picture. One financial adviser provided this observation on the whole issue of insider trading "persons who frequently inside trade are aware of the risks and go to great lengths to avoid detection. The risks of detection would be higher if there were people investigating and enforcing". Other traders however give little thought to the risks involved.

This generally cavalier attitude to the risks of insider trading was confirmed by the views of the lawyers and the regulators whom we interviewed. A lawyer in a large law firm saw it in these terms, "everyone thinks he can get away with it. They pay lip service to the Code, but then ignore it". Indeed, many felt that most insider traders did not even bother to assess the risks of detection. As another lawyer observed, "subconsciously they may do this, but they never really think about it. They talk themselves into believing that the market is aware and don't give section 128 much thought". Another lawyer confirmed this view adding that "most [insider traders] wouldn't even go through that mental process of assessing the risks of insider trading". This attitude was partly explained by another lawyer when he said that as "instances of insider trading are not clear-cut to people involved they don't think of it as insider trading". Regulators tended to confirm this general perception. One further elaborated upon this view by telling us that "most traders are aware of the lack of successful prosecutions. If there are no records or witnesses, then the chances of prosecution are low". Another approach was simply to suggest that "most people are not aware that what they are doing is the offence of insider trading". This
was nicely illustrated by the reaction of one merchant bank executive
"is that insider trading? I've been doing that for years". If this is so, it
is an indictment upon the lack of depth of essential legal knowledge in
the industry. It also suggests that perhaps the law should be amended
to make it more widely comprehensible. Although brokers often sought
to down-play the significance of insider trading as a problem, they still
acknowledged the existence of cavalier moral attitudes. A broker of the
old school said, "many people go through a process of rationalization and
overlook the impact on others. They are self-focused". Another related
comment was that "those with criminal minds do not worry about the
penalty. They expect not to be caught and are concerned only with
profit".

These responses led us to look more closely at the level of stigma which
was attached to insider trading by securities market professionals.
Insider traders were unlikely to be publically identified with by too
many of those that we interviewed but, on the other hand, they would
be unlikely to be driven from the industry either. It was said of the
insider trading broker that "he could still deal. As long as he pays he is
okay", or that "somebody would deal with him" despite the fact that "the
stigma of being associated with undesirable activity is powerful". On
the other hand, other brokers noted that to be known as an insider
trader would mean that "it would be hard to hold a position of trust",
although, as a lone broker lamented "the market has become amoral
over the last 10-20 years".

The stigma of being an insider trader would however tend to be greater
amongst the traditional professionals such as lawyers and accountants.
Real damage seems only likely to occur in the event of a conviction. For
many insider traders, the stigma of insider trading may be somewhat benign. One lawyer summed it up very well when he said that "insider trading is a badge of courage at the moment. It gives you a certain cachet which some people don't want. But, if your values are making plenty of money you won't care, except if you are convicted". This view was repeatedly confirmed by others. As another lawyer observed, "in some commercial circles it would be very damaging to be known as an insider trader. But, some others who do it would not worry about the damage to their reputation if they profited". Also, we were told that "it doesn't matter too much at the moment if you are known as an insider trader, except if you are successfully prosecuted". Similarly, it was put to us that "it would be pretty damaging if convicted, but if you were not convicted, a broker with such a reputation would not have trouble staying on". This was because, as other lawyers saw it, "there would be some who would continue to go to a broker to get the good oil" or that "the insider trader would still have a clientele amongst the rogues". Finally, another lawyer told us that "people with poor reputations keep popping up and this doesn't stop other people from dealing with them". Once again, there is clear evidence of considerable tolerance of insider traders.

Despite the fact that many of them may have poor reputations, they are unlikely to be ostracized or driven from the industry by their colleagues. We sometimes wondered whether the real crime was to be stupid enough to be caught rather than just to be engaging in illegal conduct. In other words, self regulation or professional discipline works poorly in relation to criminal conduct which is perceived to be commonplace.
It is clear that the stigma attaching to insider trading is only likely to be meaningful when it is coupled with the possibility of imprisonment. One lawyer explained that "it comes down to making people sit up and take note. A criminal prosecution brings with it a stigma. This is an important thing for management to avoid". Nevertheless, there is a widespread view, as put by one regulator and perhaps shared by the general community, that "magistrates just won't send prominent businessmen to gaol". So, we might ask what the social purposes of criminalizing insider trading actually are. Three suggested goals of insider trading regulation were put to those interviewed. We asked interviewees: "which of the following purposes do you see as being the most realistic goal of insider trading regulation: punishment, orderly marketing or symbolic reassurance". It was quite clear to almost everyone that punishment was not considered in the industry to be a realistic goal of regulation, due simply to the lack of any convictions. As a result, most tended to opt for the other two goals. Some groups stressed orderly marketing as being the more realistic goal, whilst the more cynical or as we would conclude, the more realistic, saw the goals of insider trading regulation in terms of symbolic reassurance. Of course, these two goals tend to overlap, as many pointed out.

One of the lawyers argued that the goal of insider trading regulation should be to achieve deterrence "but at the moment it is just a symbolic measure". On the other hand, another common view expressed by lawyers was put in the following terms, "punishment for its own sake has no value. An orderly market should prove attractive to investors". The regulators also tended to opt for one or other of these goals. In the
words of one, "since no one has ever been convicted, the practical view is that the regulation is largely symbolic". However, most regulators felt that the symbolic goal was less than adequate. A typical observation was that, "reassurance is the goal, but it is more than symbolic; and this is of course connected to an orderly market". Likewise, the stock exchanges saw the aim of regulation in this area as the provision of reassurance to investors, although there was a reluctance to characterise this reassurance as being merely symbolic in nature. Financial advisers were also equally divided in choosing between these goals. One observer said with some feeling, "I hope it is better than symbolic reassurance". We can conclude that the appearance of an orderly market has important symbolic significance in the current scheme of insider trading regulation.

This was confirmed by the responses we received when we asked whether investor confidence in Australian stock markets suffer if insider trading laws were repealed. Most brokers, felt that the repeal of our insider trading laws would damage Australia's image amongst international investors. Similar views were held by other groups. A Sydney lawyer, for example, remarked that "repeal would be a hopeless idea. It would affect confidence significantly. Internationally, repeal would deter those investors who are worried about a level playing field". Some thought that the effect of repeal would be less within Australia than internationally. As another Sydney lawyer graphically put it, "the effect of repeal would be muted. If section 128 were repealed, the US investor would see our market as like that of Hong Kong, that is, less reliable as a market. The effect of section 128 is always in the background. People don't see a casino [because] section 128 is there". Nevertheless, the "casino" is still there underneath the
A different slant was taken by a Perth lawyer who felt that "the rules stop people from engaging in the worst excesses". Another lawyer felt that "there would be an enormous adverse reaction if it was a free for all. The system would break down". Some believed however, that this was overstating the likely effects of repeal, although the predominant view pointed to the negative consequences of repeal. One of the regulators said that "the fact that insider trading is an offence under the Securities Industry Code and that share prices are monitored by the regulatory bodies must instil some confidence in the investors. The mere act of removing or radically changing the laws would only serve to convince investors that insider trading had become prolific".

The purpose of having an insider trading prohibition is seen to be to avoid the worse market excesses, or as it was often put, to avoid a situation of "Rafferty's Rules". It is clear that these regulations also have an important goal of symbolic reassurance, while allowing "normal" insider trading to continue unaffected. Provided that an orderly market is not significantly affected insider traders, it seems, are largely allowed to operate as they see fit, as long as they are not too blatant, and, even then assuming they are detected, they are unlikely to be formally prosecuted but may instead be informally encouraged to leave the industry.

(9) CONCLUSIONS

Attitudes to insider trading are closely related to prevailing patterns of business ethics within the securities industry. This relationship is not just a matter of greed, although greed is obviously a key underlying motivation for many within the industry. The real issues concern such
factors as the culture of tolerance of insider trading, the casino mentality, peer-group support for insider traders, the low stigma attaching to insider trading, and the largely symbolic role of law and regulation in this area. There are obviously different ethical values at play within the industry. Some professionals, such as lawyers, accountants and many older and more established brokers clearly espouse and practise very high ethical standards, although we found that even they were very reluctant to come forward and complain about insider traders or be prepared to give evidence against them. Many others in the industry are however much more relaxed about their commitment to ethical standards. Often this was seen to be due to ignorance of the law or a lack of interest in it. For those who know of the law's existence the widespread knowledge that the law has not been enforced very well, if at all, has contributed to a largely cavalier approach to the criminal law. At the same time, the existence of criminal laws and regulatory structures which theoretically deal with insider trading has led many to see insider trading as a matter for the agencies and not for the industry itself. This partly explains the almost non-existent emphasis upon improving their own ethical standards upon the part of those working in the industry. The most common response to this problem is to say that the law had not failed in this area, but that it had not been enforced. This is however to avoid the issue, as the law is unlikely to be able to be enforced without support from industry itself. In critical areas, this is simply not forthcoming, although there may be some small change beginning to occur in this regard in Australia, such as with the likely provision of expert witnesses by Stock Exchanges to assist in prosecutions. This is very limited and the continued effect of peer group pressure against assisting policing authorities and the traditional Australian "Ned Kelly" attitude to
authority, which provides social support to the lawless element, is such that the enforcement agencies are unlikely to be able to be much more effective.

It is clear that insider trading laws exist to create confidence in orderly marketing arrangements and, to this extent, they have goals of symbolic reassurance. Their function is certainly not to punish or to deter insider traders. At best, they serve to moderate gross examples of insider trading, although it is well known that large insider trading transactions can be readily made off-shore. In practice, the laws simply create an illusion. To the uninformed, the market is being controlled but, to those who are more knowledgable - the market participants - the laws pose no realistic threat at all. It is clear that in relation to insider trading, both the formal and informal legal controls are weak or ineffective and that private and peer group controls are sporadic and unreliable. Prevailing patterns of business ethics have served to entrench and perpetuate this situation. This is despite the fact that insider trading is described as fraudulent, dishonest, or criminal, and that it is widely recognised as unfair to those who trade with the insider trader. It is also despite the recognition by those who profess concern for market efficiency that insider trading has an especially damaging effect on the market's efficiency. These factors are clearly not the decisive ones, and the compelling conclusion is that there must be some other factor at work such as the values embedded in the prevailing business culture of the Australian securities industry. As we have suggested, these problems lie deep within a casino-like approach to capitalism, which has become so dominant in the 1980's. However, this may have reached such proportions as to fundamentally undermine core markets which are at the heart of the capitalist system itself. The ethical foundations
of capitalism may never have been very deep, but, in respect of insider trading, it is clear that the ethical foundations of the securities industry are quite superficial indeed and perhaps built upon shifting sands. Maybe it is time to re-assess the market's ethical sub-structure and to return to more fundamental values.

REFERENCES


3. In this study, insider trading was defined by reference to the terms of s.128 of the Australian Securities Industry Code 1980. Sections 128(1) and 128(2) of that code are in the following terms:

   128(1) A person who is, or at any time in the preceding 6 months has been, connected with a body corporate shall not deal in any securities of that body corporate if by reason of his so being, or having been, connected with that body corporate he is in possession of information that is not generally available but, if it were, would be likely materially to affect the price of those securities.

   128(2) A person who is, or at any time in the preceding 6 months has been, connected with a body corporate shall not deal in any securities of any body corporate if by reason of his so being, or having been, connected with the first-mentioned body corporate he is in possession of information that-

   (a) is not generally available but, if it were, would be likely materially to affect the price of those securities; and

   (b) relates to any transaction (actual or expected) involving both those bodies corporate or involving one of them and securities of the other.

