The insider trading generally available and materiality carve-outs: Are they achieving their aims?

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ABSTRACT

The article outlines and critiques Australian insider trading case law dealing with the generally available and materiality carve-outs. It explores the potential links from these elements to the economic efficiency and market fairness goals. Ultimately, it suggests that Australian policy-makers, regulators and the judiciary may need to take a step back to reconsider the intended rationales and operations of the insider trading regime. Community and market participant views on enforcement of market abuse in Australia are already very negative. Moreover, it is difficult to reconcile some of the case law with the achievement of economic efficiency and equal access in the marketplace.

(2009) 27 C&SLJ 234

Introduction

The primary rationales supporting the Australian insider trading regime are economic efficiency and market fairness. The specific insider trading provisions that the judiciary and scholarly commentators suggest reflect the efficiency goal are the requirements in ss 1042C and 1042D of the Corporations Act 2001 (Cth) (the Act) that the relevant information be material to price and not generally available. [1]

However, notions of efficiency and fairness adopted by Australian policy-makers, regulators, scholars and the judiciary in relation to insider trading are increasingly divergent, and these differences in approach have important consequences for investors. The applied efficiency and fairness approaches largely determine the boundaries of prohibited securities market conduct, the extent of investor protection provided by the regulation, and ultimately wealth distribution across the market.

In 1986, the Anisman Report recommended that Australia adopt equality of access to information as the primary rationale for insider trading regulation. [2] Similarly, in 1989 the Griffiths Committee indicated that the benefits of insider trading regulation include equal access to securities information for all investors and the promotion of economic efficiency through improved investor confidence in the integrity of the market. [3] The Committee rejected the Manne arguments that insider trading promotes efficiency and that it is a legitimate reward for enterprise. Moreover, it indicated that even if insider trading enhances market efficiency by faster dissemination of information, the negative effects of insider trading on investor confidence outweigh these efficiency benefits. [4]

Mason P acknowledged the views of the Griffiths Report in R v Firns 38 ACSR 223 at 231. [5] However, his Honour suggested that the clear initial policy approach to promote market fairness became obscured in the legislative process, and this did not happen through oversight. Mason P indicated (at 234) that the readily observable test was intended to promote economic (2009) 27 C&SLJ 234 at 235 efficiency, reflecting the concerns by the Griffiths Committee and Parliament not to penalise individual initiative and diligence and to encourage cleverness, swiftness and efficiency. As such, the market fairness or equal access paradigm could not be the sole basis for interpretation of the criminal insider trading provisions. A broad interpretation of the generally available element was required to promote economic efficiency (at 232). His Honour highlighted (at 234) that the readily observable matter element is opaque because of the conflicting nature of the equal access and economic efficiency goals embedded within the definition of generally available. [6]

The nature and scope of the Australian insider trading provisions are largely determined by the generally available and materiality carve-outs or exemptions. Interpretation or application of these tests overlaps. [7] The materiality determination adjusts the nature and scope of the generally available carve-outs, the protection provided to uninformed investors, and the extent of equal access to information in the marketplace.

This article examines the generally available and materiality carve-outs. It explores the potential and actual links from these elements to the economic efficiency and market fairness goals. Ultimately, it suggests that Australian policy-makers, regulators and the judiciary may need to take a step back to reconsider the intended rationales and operations of the insider trading regime prior to consideration of the individual provisions.

The author suggests that the regime framework is not fully coherent on a theoretical or empirical basis. At a theoretical level, the Griffiths Report rejected the Manne approach and indicated that economic efficiency is best enhanced when investors are confident about the integrity of the market. Similarly, the majority of the Corporations and Markets Advisory Committee (CAMAC) indicated that...
The focus of the insider trading prohibition should be on information that the market expects should be disclosed to all participants on an equal basis. To permit trading in these circumstances could give the informed persons an unfair advantage over other market participants and undermine confidence in the fairness and integrity of financial markets.\[6\]

However, Mason P indicated in *Firns* that the economic efficiency and equal access goals are incompatible. Similarly, most Australian legal commentators suggest that the efficiency and equal access goals are in conflict or must be traded off to some extent.

At an empirical level, insider trading case law has established a materiality test based on short-term price efficiency. This approach can be expected to significantly limit the nature and scale of insider trading actions that the Australian Securities and Investments Commission (ASIC) initiates, particularly in relation to systemic insider trading involving groups of market participants. It makes it difficult for ASIC to prosecute traders who intentionally trade in the securities of a company after a partial increase in trading volumes or the security price. Insiders may also escape liability if they are able to manipulate their trading to achieve only gradual price gains or losses rather than a sudden price hike or fall. In addition, the test excludes scenarios where the relevant information becomes material when combined with other available information.

Since 2002, there have been, on average, two successful insider trading actions a year, and market participants and the broader public generally perceive the regime as ineffective or lacking teeth.\[9\] Respected practitioners suggest that the insider trading activities of most concern are trading based on private knowledge of takeover bids, capital raisings and other price-sensitive announcements.\[10\] These activities on a combined basis represent a significant proportion of the price-sensitive information released to the market, with large amounts of money at stake.

When trading is based on private knowledge about pending bids, capital raisings or earnings announcements, any potential short-term efficiency gains are likely to be more than outweighed by the negative effects on investor confidence in the integrity of the market.\[11\] Over the longer term, if investor perceptions on the level and enforcement of market abuses such as insider trading do not improve, market participation is likely to wane, with consequential negative impacts on long-term economic efficiency.

The next part of the article provides a summary of the insider trading provisions, followed by a discussion of the generally available and materiality tests respectively. The link from these elements to the policy goals of economic efficiency and market fairness is then considered and the following part discusses whether the carve-outs are achieving their aims. The final part provides a conclusion.

### The insider trading provisions

The specific insider trading provisions in Australia that the judiciary and scholarly commentators suggest reflect the efficiency goal are the requirements that the relevant information be material to price and not generally available.\[12\]

#### The generally available element

The generally available element is generally available under s 1042C of the Act if

- it consists of readily observable matter (readily observable matter test);\[13\] or

- it has been made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in ... financial products of a kind whose price might be affected by the information; and since it was made known, a reasonable period for it to be disseminated among such persons has elapsed (published information test);\[14\] or

- it consists of deductions, conclusions or inferences made or drawn from readily observable matter or published information (analysis test).\[15\]

The generally available element includes a number of limbs. Section 1042C(1)(a) is commonly referred to as the readily observable matter test, s 1042C(1)(b) is known as the published information test, and the s 1042C(1)(c) limb may be referred to as the analysis test. The terms readily observable matter, persons who commonly invest and reasonable period are not defined in the Act.

#### Published information test

The published information test incorporates several sub-elements:

- the manner in which the relevant information must be disseminated;
the investors to whom the information must be disseminated: and

the period for which the information must be disseminated prior to trading. (2009) 27 C&SLJ 234 at 237

Manner of disseminationSection 1042C(1)(b) does not provide any guidance on the manner in which information must be disseminated. However, in Kinwat Holdings Pty Ltd v Platform Pty Ltd [1982] Qd R 370; (1982) 1 ACLC 194, the filing of an affidavit on public record, a newspaper article, and a letter to the stock exchange were held to be dissemination under the published information test. Similarly, in R v Firms 36 ACSR 223 information released in open court constituted public dissemination. Notably, Mason P suggested in Firms that what constitutes published or readily observable information is significantly changed by the advent of new technologies such as the world wide web.

Dissemination to whomThe phrase persons who commonly invest was included within s 1042C(1)(b) to ensure dissemination of the relevant information to a cross-section rather than to only a small sector of investors. Nevertheless, some commentators argue that dissemination to professional investors is sufficient on the basis that this allows rapid impounding of the relevant information into the share price.

Dissemination periodThe reasonable period requirement was included to prevent an insider getting an unfair start on other market participants. Policy-makers and legislators have generally declined to provide bright line guidance on the required period of time. The means of dissemination, the complexity of the information, trading volumes, investor interest in the relevant security, and market conditions, all impact on the speed and accuracy of the absorption of information into security prices. Further, when information is not released through the Australian Securities Exchange (ASX), investors may not know that particular information is available or where it is available.

When materially price-sensitive information is released through the ASX, the relevant securities are suspended from trading for 10 minutes after release to allow investors to absorb the information prior to trading. However, some companies prefer to release significant news, such as half yearly or preliminary final results, outside of market trading hours to allow more complete absorption by the market prior to trading.

Readily observable matter and analysis tests

Readily observable matter and analysis testsThe readily observable matter and analysis carve-outs were drafted to ensure that individuals are not penalised for using initiative and diligence. Investors are permitted to trade on information garnered from astute observation or from independent research of generally available information. More specifically, the readily observable matter exclusion seeks to ensure that trading is permitted based on information or facts directly observable in the public arena even when the information does not fall within the published information test. The analysis exclusion seeks to ensure that trading is permitted on information when it is based on deductions and conclusions which investors, brokers or other market participants may make based on independent research of generally available information.

(2009) 27 C&SLJ 234 at 238

Uncertainties on the nature and scope of the generally available tests are highlighted in insider trading case law.

Generally available case law


Hannes was employed as an executive director of Macquarie Bank. The bank was advising on a takeover of TNT. However, Hannes was not part of the takeover team and he had no authority to access the confidential bid-related information.

On 17 September 1996, a person identifying himself as M Booth instructed Ord Minnett brokers to acquire purchase options in TNT at a strike price of $2 with a maturity date in November 1996. On 2 October 1996, the takeover for TNT was announced at a share price of $2.45, resulting in a profit on the options in the order of $2 million. On 11 August 1999, Hannes was convicted of several charges, including one of insider trading. Hannes successfully appealed to the New South Wales Court of Criminal Appeal with a new trial ordered on all counts: see R v Hannes (2000) 158 FLR 359; 36 ACSR 72 at 72. However, Spigelman CJ found, with Studdert and Dowd JJ agreeing, that there had been no error of law in relation to the information, readily observable matter, generally available and materiality elements of the insider trading charge (at 73).

Spigelman CJ indicated (at 118) that brokers’ reports that referred to TNT as a takeover candidate prior to the relevant insider trading event were deductions, conclusions and inferences made from matter that was generally available. However, the brokers’ reports and newspaper articles on TNT’s vulnerability to a takeover and the estimated valuations were not relevant to the issue of general availability (at 122). The broker’s analyses were not of the character of the particularised information because the information in the brokers’ reports was not about the
prospect that there would be a takeover at a price above $2. Further, there was no evidence indicating the information that TNT had appointed MCF as advisers was generally available (at 118).

R v FirnsCarpenter Pacific Resources (Carpenter) was a listed company on the ASX. The main business of Carpenter was holding exploration licences in Papua New Guinea, including one held through a subsidiary M. In December 1993, the Papua New Guinea Government introduced a new regulation that effectively stripped away most of the value of the exploration licence of M: see R v Firns 38 ACSR 223 at 223. In March 1994, M challenged the validity of the regulation in the courts and lost at first instance (at 223). M then appealed to the Supreme Court of Papua New Guinea. On Friday, 28 July 1995 at around 9.30 am, the Supreme Court of Papua New Guinea announced in open court that the appeal had been upheld and the regulation was invalidated (at 223).

Firns was notified of the court decision by his father, a director of Carpenter, around 10 am on 28 July. He purchased two lots of shares in Carpenter the same day. Carpenter notified the market of the court decision through the ASX on Monday, 31 July at around 1.30 pm (at 223).

Firns was convicted in the New South Wales District Court of two insider trading charges under s 1002G of the Corporations Law. In a subsequent appeal to the New South Wales Court of Criminal Appeal, the two key issues were, first, whether the information traded on by Firns was generally available under the readily observable matter test, and secondly, whether the trial judge had misdirected the jury by informing it that the issue was whether the court decision was readily observable in Australia (at 223).

(2009) 27 C&SLJ 234 at 239

Mason P and Hidden J held that the decision of the Supreme Court of Papua New Guinea was readily observable:

[(E)verything that happens in open court is capable of being observed and reported upon at (238). |24|] The information embodied in the … judgment was available, understandable and accessible to a significant group of the public, that is, those present and capable of being present in court (at 236). Carruthers AJ dissented from this finding.

Mason P acknowledged that the primary policy rationale for introducing insider trading regulation was to ensure that the market operates fairly with all participants having equal access to relevant information. His Honour noted the view of the Griffiths Committee that even if insider trading enhances market efficiency by faster dissemination of information, the negative effects of insider trading on investor confidence outweigh these efficiency benefits. However, Mason P suggested that the clear initial policy approach to promote market fairness was obscured in the legislative process. The drafters who added the phrase readily observable matter to the insider trading provisions intended to promote economic efficiency. This reflected concerns by the Griffiths Committee and Parliament not to penalise individual initiative and diligence and to encourage cleverness, swiftness and efficiency (at 234).

More specifically, the readily observable matter test was added to the generally available definition because of concerns that under the draft definition information directly observable in the public arena would not be regarded as generally available, as it had not been ‘made known’ (at 233). It was considered that a person could be liable for insider trading when trading in securities on the basis of an observation that the company had excess stocks in a yard, when this was clearly not the intention of the provisions (at 233). [I]It was not intended that the provisions would regard as inside information such things as deductions and conclusions which investors, brokers or other market participants may make based on independent research of generally available information (at 233).

Mason P indicated that the words readily observable matter are opaque, and legislative assistance is blurred by the conflicting [equal access and economic efficiency] goals embedded in the essentially two-pronged definition of ‘information generally available’ (at 234). The Parliament therefore left the courts with a scheme embodying the ‘information generally available’ test (at 230), resulting in a difficult interpretative task (at 234). Ultimately, Mason P concluded that the market fairness or equal access paradigm could not be the sole basis for interpretation of the criminal insider trading provisions. Instead, a broad interpretation of the term generally available was required to promote economic efficiency (at 232).

(2009) 27 C&SLJ 234 at 240

Carruthers J in dissent suggested that Mason P was interpreting the phrase readily observable matter as readily available material. His Honour pointed out (at 243) that [m]aterial may be available but not observable. Further, the insider trading provisions were undoubtedly designed to protect investors by promoting equal access to information for investors (at 240). There is a remarkably high percentage of the Australian public who hold securities … Shareholders in companies listed on the … ASX cannot now be regarded as a small elite section of the Australian community (at 240). Within this framework, the legislature did not intend members of the public to have to meticulously search for relevant investor information. No evidence was presented at the trial showing that the Papua New Guinea Supreme Court judgment was posted on the internet (at 243). Carruthers J concluded (at 242) that if the provisions are interpreted to mean that information need not be generally available to the Australian investing public, the protection offered to the Australian investing public by the provisions is nugatory.


On 30 July 2003, a jury found Rivkin guilty of a charge of insider trading under s 1002G(2). The information which was the subject of the charge was conveyed in a telephone conversation on the morning of 24 April 2001 between Rivkin and McGowan. McGowan, the executive chairman of Impulse Airlines, gave evidence that he informed Rivkin during the telephone call about a proposed merger of the Impulse business with Qantas because his purchase of a property from Rivkin was subject to approval of the merger by the Australian Competition and Consumer Commission. However, he indicated that he advised Rivkin that he could not trade in Qantas shares until the deal was publicly
Materiality

The courts have indicated that the generally available issue overlaps with the materiality (at 454). However, any breach of the continuous disclosure obligations was considered by the ASX and ASIC to have been concerned on 19 August 2005 that confidentiality may have been lost under ASX Listing Rule 3.1A.2 (at 454). The ASX did not pursue Toll for any breach of its continuous disclosure obligations by not notifying the market earlier of its proposed bid for Patrick (at 454). An ASIC file of a conversation with officers of the ASX indicated they were concerned on 19 August 2005 that confidentiality may have been lost under ASX Listing Rule 3.1A.2 (at 454-455). However, any breach of the continuous disclosure obligations was considered by the ASX and ASIC to have been inadvertent (at 454).

The courts have indicated that the generally available issue overlaps with the materiality issue. [25]

## Materiality

Following the telephone call, Rivkin directed a SEATS operator, Mr Kerstens, to purchase 50,000 Qantas shares on behalf of Rivkin Investments (at [35]). On 30 April, prior to the public announcement of the merger through the ASX, Mr Rivkin instructed Mr Kerstens to sell the Qantas shares at $2.85, resulting in a trading profit of $2,664.94 (at [40]).

Rivkin appealed against his conviction and sentence to the Court of Criminal Appeal, but the appeal was dismissed. In its judgment, the court indicated (at [178]) that the Crown had to establish that the information was not generally available, and, in the course of doing so, it had to exclude the existence of deductions, conclusions or inferences. This required circumstantial proof. The Crown was able to provide this by pointing to the absence of any information in relation to 'the deal' in press reports, media releases and analysts' reports of the kind that might have been expected, had the information been generally available ... and to the price movements on 1 May (at [179]) following the public announcement of the merger. The Crown was also entitled to rely on evidence concerning the confidentiality of the negotiations (at [179]).

The Australian Securities and Investments Commission initiated a number of claims against Citigroup, including two alleged insider trading contraventions under s 1043A of the Act. The first of these claims alleged that the instruction given to Manchee to discontinue buying Patrick shares constituted information under s 1043A and the subsequent sales of the Patrick shares constituted insider trading by Citigroup. The second alleged that because senior officers of Citigroup knew about the likely takeover bid by Toll of Patrick, knowledge of Manchee's trading in the Patrick shares was attributable to Citigroup so as to make the company liable for insider trading (at 428).

Jacobson J dismissed both of the insider trading claims in the Federal Court of Australia. The first claim failed because Manchee was not an officer of Citigroup, and in any event, the claim had not established that Manchee traded with knowledge that Citigroup was acting for Toll in relation to the Patrick takeover. The second claim failed because at the time of the Manchee sales, Citigroup had Chinese walls in place that satisfied the requirements of s 1043F, a defence provision (at 428).

Jacobson J confirmed that the test of whether material is readily observable is not whether the particular matter was widely observed but whether it could have been known (at 495-496). According to Jacobson J (at 495), the question of whether a matter is readily observable is one of fact. Observability does not depend on proof that persons actually perceived the information; the test is objective and hypothetical ... [Further, where] the information is a matter of supposition, the question of whether it is generally available depends on whether the supposition is capable of being made or drawn by other investors based on readily observable matter or information that has been made known ...

In addition, s 1042C(1)(c) does not require that the market has had a reasonable time to absorb the information (at 496).

To determine what a reasonable and diligent investor would have been able to observe or deduce from readily observable material prior to the alleged insider trading, Jacobson J considered contemporaneous reports, speculation and rumours and the levels and prices of trading in the stock. His Honour concluded (at 498) that while the supposition that Citigroup was acting for Toll was not generally available, ... if it had been available, ... it would not have had the requisite material effect. Jacobson J indicated that such investors could be expected to have known there was a substantial likelihood of a takeover of Patrick, based on the bid rumours in the newspapers and in other professional outlets, a rally in the share price, and increased trading volumes in Patrick's stock on the day before the bid was announced through the ASX (at 496-498).

The ASX did not pursue Toll for any breach of its continuous disclosure obligations by not notifying the market earlier of its proposed bid for Patrick (at 454). An ASIC file of a conversation with officers of the ASX indicated they were concerned on 19 August 2005 that confidentiality may have been lost under ASX Listing Rule 3.1A.2 (at 454-455). However, any breach of the continuous disclosure obligations was considered by the ASX and ASIC to have been inadvertent (at 454).

The courts have indicated that the generally available issue overlaps with the materiality issue.
Materiality

Information is material under s 1042D of the Act if the information would, or would be likely to, influence persons who commonly acquire financial products in deciding whether or not to acquire or dispose of the products.

The materiality test includes the likely effects of disclosure of the information on investors and on the relevant share price. The information must be important enough to affect the relevant security price, as well as sufficiently unexpected that it has not been incorporated into the share price. [26]

Potentially material to investors and share price

Potentially material to investors and share price Cooke J suggested in [1977] 2 NZLR 225 that determining whether matters are sufficiently material to require disclosure involves an evaluation of both the likelihood of the event occurring and the magnitude of the effect of the event on the company’s performance. However, information may be found likely to materially affect the investment decisions of those commonly investing in the securities even if the effect of the disclosed information on the share price eventually turns out to be immaterial.

In ICAL Ltd v County Natwest Securities Australia Ltd 6 ACLC 467 Bryson J found the information was not important or valuable and would therefore have little material effect on the relevant share price. In contrast, in Riley v Jubilee Mines NL (2006) 59 ACSR 252 Sanderson M held that information that WMC had drilled holes on the defendant’s tenement would have been likely to have influenced persons who invested in the defendant’s shares and the defendant’s stock price (at 253, 310-314). The exploration results were significant and should have been released to the market under ASX Listing Rule 3A. [27]

(2009) 27 C&SLJ 234 at 243

In other cases, knowledge of an intended application to convert notes at a ratio significantly different from market expectations, [28] a proposed takeover, [29] a future earnings announcement, [30] a pending liquidation, [31] and a court decision [32] have been found to be material by the courts.

In addition, the court indicated in R v Rivkin [2004] NSWCCA 7 at [132], [134] that information is more likely to be material when the information source is considered by investors to be reliable or credible. [33]

Finally, while a new piece of available information may be immaterial or not price-sensitive in itself, the additional information may complete a mosaic of information, which as a whole constitutes material information. [34]

There is not always a clear line between what is price sensitive and what is not ... A particular piece of information may, when fitted together with other information ... affect the company’s share price. [35]

Notably, in the United States, information is generally considered to be material under securities law if there is a substantial likelihood that a reasonable investor would view the information as having significantly altered the ‘total mix’ of information ... available. [36]

Incorporated within the share price

Incorporated within the share price Spigelman CJ confirmed in R v Hannes (2000) 158 FLR 359; 36 ACSR 72 at 121 that while the prospect of something may have a lesser effect on a security price than the actuality, what actually happened is still relevant to the assessment of the materiality of the prospect. If a significant level of probability of a takeover had already been factored into the share price, then that may have made a difference to the materiality issue (at 136). In R v Rivkin [2004] NSWCCA 7, the information was material because the fact of the price rise, after the announcement, meant the market had not factored in the disappearance of one of the players (at [196]). In contrast, in Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4) (2007) 160 FCR 35; 62 ACSR 427, Jacobson J found (at 497-498) that an action for insider trading would have failed under the materiality test, because at the time of the alleged insider trade, the share price already reflected knowledge of the takeover. The share price had already moved to a price which reflected a substantial likelihood of a takeover [from Toll], although "not necessarily with Citigroup acting for the bidder" (at 497-498).

The insider trading provisions and the economic efficiency and market fairness goals: A review

The insider trading provisions and the economic efficiency and market fairness goals: A review A select review of insider trading case law and policy and scholarly commentary is provided to highlight the difficulties or uncertainties
in applying the insider trading provisions, particularly the \(2009\) \(27\) C\&SLJ \(234\) at \(244\)
generally available and materiality elements, to achieve economic efficiency and market fairness in the marketplace. The selected material is initially split according to whether it relates predominantly to the goal of economic efficiency or market fairness, and within the efficiency and fairness categories, it is outlined chronologically.

Economic/ market efficiency

Economic/ market efficiency \(\text{Gambotto v WCP Ltd} \text{In } \text{Gambotto v WCP Ltd (1995) 182 CLR 432;} \) 16 ACSR \(1\) the joint judgment by the High Court emphasised that a shareholder’s interest cannot be valued solely by the current market value. A fair price for shares may depend on factors such as assets, market value, dividends, the nature of the corporation and its likely future (at \(10\), Mason CJ, Brennan, Deane and Dawson JJ). McHugh J indicated that there is [n]o doubt in the long term the share price of a company will reflect its fundamental earnings capacity or value (at \(18\)). However, the intrinsic value of a company can remain unnoticed by the market for long periods of time. McHugh J suggested (at \(18\)) that share prices are far more volatile than the underlying assets they represent because \(\text{[t]he 'herd mentality' exists in the stock market as in other areas of life.}\)

\(\text{R v Hannes} \text{In } \text{R v Hannes (2000) 158 FLR 359;} \) \(36\) ACSR \(72\) at \(136\) Spigelman CJ indicated that if a significant probability of a takeover had already been factored into the share price, then that may have made a difference to the materiality issue.

\(\text{R v Firns} \text{In } \text{R v Firns} \) \(38\) ACSR \(223\) Mason P suggested that the clear initial policy approach of the insider trading regime to promote market fairness was obscured in the legislative process, because the drafters who inserted the phrase readily observable matter into the provisions intended to promote economic efficiency. As such, the market fairness or equal access paradigm could not be the sole basis for interpretation of the criminal insider trading provisions. Instead, a broad interpretation of the term generally available was required to promote economic efficiency (at \(232\)).

His Honour indicated (at \(234\)) that the equal access and economic efficiency goals embedded in the essentially two-pronged definition of generally available information are incompatible or in conflict. The Parliament therefore left the courts with a scheme embodying the ambiguous embrace of the market fairness (equality of access) and market efficiency theories, resulting in a difficult interpretative task (at \(234\)).

\(\text{R v Rivkin} \text{See } \text{R v Rivkin (2003) 198 ALR 400;} \) \(45\) ACSR \(366\); \(\text{R v Rivkin [2004] NSWCCA 7.} \) In \(\text{R v Rivkin [2004]}\) NSWCCA \(7\) the court held (at \(196\)) that the relevant information was immaterial if prior to its communication, ‘the market had factored in a good chance that due to the price war, one of the players would disappear’. However, the evidence presented did not establish this.

Australian Securities and Investments Commission v Citigroup \(\text{In } \text{Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4) (2007) 160 FCR 35;} \) \(62\) ACSR \(427\) Jacobson J found (at \(497-498\)) that an action for insider trading would have failed under the materiality test. The share price had already moved to a price which reflected a substantial likelihood of a takeover [from Toll], although ‘not necessarily with Citigroup acting for the bidder’ (at \(497-498\)). While the supposition that Citigroup was acting for Toll was not generally available, \(\ldots\) if it had been available, \(\ldots\) it would not have had the requisite material effect (at \(498\)).

Market fairness

Market fairness

Equal access theory

The equal access theory differs significantly from the informational parity theory. As Blackmun J stated in \(\text{Chiarella v United States 445 US 222 at 252 (1980): (2009) 27 C\&SLJ 234 at 245}\)

\(\text{[T]here is a significant conceptual distinction between parity of information and parity of access to material information. The latter gives free rein to certain kinds of information advantages that the former might foreclose, such as those that result from differences in diligence or acumen. (37)}\)

In practice, equal access investor demands are generally restricted to information provided by companies about themselves. Such access does not prevent anyone from ferreting out, processing, disseminating or trading on publicly available or legally obtainable information. \(\text{[38]}\) Informational advantages among traders can be gained through insightful analysis of public information without having access to inside or outside information.

Griffiths Committee

The Committee rejected the Manne arguments that insider trading promotes efficiency and that it is a legitimate reward for enterprise. Moreover, it indicated that even if insider trading enhances market efficiency by faster dissemination of information, the negative effects of insider trading on investor confidence outweigh these efficiency benefits. \(\text{[39]}\) The Report identified the benefits of insider trading regulation as equal access to securities information for all investors; improved compliance by officers with their fiduciary duties owed to shareholders; minimisation of losses to companies, investors and shareholders; and the promotion of economic efficiency through improved investor confidence in the integrity of the market. \(\text{[46]}\)

\(\text{Exicom Ltd v Futuris Corp Ltd \text{In } \text{Exicom Ltd v Futuris Corp Ltd (1995) 61 FCR 337;} \) \(18\) ACSR \(404\) Young J
indicated (at 407-409) that there is an inherent tension between the criminal sanctions associated with insider trading that require strict construction by the courts and the investor protection goal that should be construed beneficially (that is, liberally). His Honour concluded (at 409) that while the insider trading provisions are designed to allow fair play in the marketplace, ..., one must not be too free in its construction because otherwise people who have taken proper advice and have intended to act legally may, through some technicality, find themselves in prison.

Companies and Securities Advisory Committee Insider Trading Report The 2001 Companies and Securities Advisory Committee insider trading report \(^{(41)}\) described the market fairness rationale or theory in terms of an unerodable information advantage approach. \(^{(42)}\) The report suggested that the insider trading prohibition does not seek to eliminate the risks or the trading advantages of participants due to superior skill, time, or commitment – the prohibition only applies to trading based on price-sensitive information that all market participants cannot gain access to by ordinary research, skill or analysis. \(^{(43)}\)

This description of the market fairness rationale may derive from, or be based on, the unerodable advantage approach developed by Brudney in the United States. Brudney described an unerodable information advantage as

\[
\text{[t]he inability of a public investor with whom an insider transacts on inside information ever lawfully to erode the insider's informational advantage ... The unfairness is not a function merely of possessing more information – outsiders may possess more information than other outsiders by reason of their (2009) 27 C&SLJ 234 at 246 diligence or zeal – but of the fact that it is an advantage which cannot be competed away since it depends upon a lawful privilege to which an outsider cannot acquire access.} \quad ^{(44)}
\]

Brudney argued that those who obtain information by virtue of a corporate insider’s position or through the release of confidential information should not be allowed to profit from their informational advantage, because this information effectively allows these investors to trade without risk and other investors cannot legally obtain access to this information regardless of initiative, diligence or acumen. \(^{(45)}\) However, he accepted that trading in securities involves risk and those who use their initiative, diligence or acumen to legally discover or analyse information should be allowed to profit from any resulting informational advantage. Brudney acknowledged the need to promote market and allocative efficiency and did not seek to offset individual disparities of power, wealth, diligence or intelligence. \(^{(46)}\) Further, he conceded the difficulties involved in determining which information is lawfully available, when information has been made public, which information is material, and the mosaic information issues. \(^{(47)}\) These issues highlighted by Brudney are generally encompassed within the elements of generally available and materiality in Australia.

Corporations and Markets Advisory Committee Insider Trading Report The majority of CAMAC in 2003 suggested that

The focus of the insider trading prohibition should be on information that the market expects should be disclosed to all participants on an equal basis. To permit trading in these circumstances could give the informed persons an unfair advantage over other market participants and undermine confidence in the fairness and integrity of financial markets. \(^{(48)}\)

**Australian scholarly commentary**

Australian scholarly commentary Mannolini \(^{(49)}\) argued that the market fairness rationale has indiscriminate application to insiders, ‘outsiders’ and diligent market analysts alike ... thus inhibiting the allocative efficiency of the market. He suggested that a more sophisticated approach to insider trading would involve concepts of fraud on the market with civil remedies available to disgruntled parties. \(^{(50)}\)

Semaan et al. \(^{(51)}\) also argued that Australian insider trading regulation is too focused on notions of fairness at the expense of efficiency and this has resulted in regulation that is too encompassing. They suggested that while there is no case law in Australia that defines market efficiency, there has been growing acceptance of the efficiency arguments in the United States. \(^{(52)}\) They noted that the position of broker-analysts creates a tension between the aims of the continuous disclosure and insider trading regulations. They admitted that broker-analysts have the ability to ask questions that can reveal price-sensitive information. However, they suggested that trading on this information can assist with price efficiency. \(^{(53)}\)

Similarly, Golding and Kalfus \(^{(54)}\) suggested that the premise of the ASIC Grapevine paper \(^{(55)}\) and the ASX Guidance
Note 8 is investor confidence and equal access to information without any (2009) 27 C&SLJ 234 at 247 considerations given to market efficiency. This is described as problematic because equal access to information for all investors is not necessarily consistent with the cost effective dissemination of information to advance market efficiency. [56] Jacobs [57] determined that

the market fairness theory operates in an indiscriminate, majority-focused fashion that cannot look to the justice of the individual case ... because underpinning the theory is a benevolent concern for investor protection. The theory requires identification of an unfair advantage vis-à-vis an insider and the majority outsiders.

Jacobs argued that the market efficiency theory espoused by Mason J in Firns is prescient and more reflective of global markets. [58] He also suggested that the proposal by the CAMAC majority acknowledged the shift towards a market efficiency rationale driven by globalisation imperatives. [59] Lyon and du Plessis [60] indicated that the Griffiths Report [61] shifted the insider trading policy objectives to market fairness (or equal access) and market efficiency. They suggested that insider trading is unfair when other investors cannot obtain the same information by competitive means and the trading becomes a riskless (or reduced risk) undertaking. [62] However, in practice the equal access theory does not guarantee actual information symmetry for all investors ... [because] market fairness and equal access are modified by the ... objective of ... market efficiency. [63] In some instances, principles of fairness must be traded off to achieve efficiency. [64] The generally available and readily observable tests are cited as examples of this trade-off.

Loke [65] argued that while the insider trading provisions go a long way toward creating a level playing field, the parity of information norm necessarily has its limits. [A] strict adherence to the parity of information norm risks clogging up the channels of information flow and ... the smooth operation of the mechanisms of market efficiency. [66] Loke hoped a pragmatic regard for economically beneficial practices tamper [sic] the otherwise broad sweep of the widely framed proscriptions. [67]

Notably, Anisman and Justice Michael Kirby were not convinced by the Manne price efficiency arguments. Justice Kirby suggested that Manne’s arguments or criticisms must be addressed. However, his Honour indicated that Manne’s thesis can be adequately answered based on notions of market fairness. [68]

Taking a different approach, Qu [69] argued that Mason J’s judgment promoting market efficiency paves the way for adopting a property rights theory that would provide more certainty for insider trading adjudication. Whincop also advocated a property rights approach. [70]

Analysis: Are the generally available and materiality carve-outs achieving their aims?

Analysis: Are the generally available and materiality carve-outs achieving their aims? This part of the article uses the selected material on the insider trading provisions and the economic efficiency and market fairness goals to consider whether the generally available and materiality carve-outs are achieving their aims.

Readily observable, efficiency and fairness

Readily observable, efficiency and fairness The judgments in Gambotto v WCP Ltd (1995) 182 CLR 432; 16 ACSR 1 adopt a view (at 10, 18) that although markets are fundamentally efficient over the longer term, inefficiencies can arise during shorter periods. [71]

Mason P suggested in R v Firns 38 ACSR 223 at 230 that the market fairness and economic efficiency rationales are incompatible and the merging of these goals within the legislative provisions resulted in blurred legislation. His Honour suggested that the readily observable matter test was included to promote economic efficiency. [72] As such, a broad interpretation of the generally available element was required to promote economic efficiency. Impliedly, equality of access needs to be extinguished to some extent in order to promote economic efficiency (at 232-234). Most Australian commentators also assume a conflict between the economic efficiency and equality of access goals. However, no published material has been found that systematically explains what this conflict is.

Mason P and the scholarly parties advocating a greater emphasis on efficiency appear to be promoting a price signalling theory. Manne argued in the 1960s that insider trading is desirable on the basis that it provides price signals to the market, thereby enhancing security pricing efficiency. [73]
The Manne argument that insider trading enhances market efficiency assumes first, that insider trading provides effective price signalling to the market; secondly, this price signalling is the most efficient mechanism for incorporating the relevant information within the share price; and thirdly, this short-term informational or price efficiency optimises market-wide efficiency. For Manne's price signalling argument to apply to an economic efficiency goal, the insider trading price signals must impact on the allocation of real capital.

It is generally acknowledged that dissemination of information through insider trading can be a slow and noisy process. As Kahan suggested,

\[(d)\]erivative disclosure of insider information through insider trading activities is ... an imprecise means of communicating information: insiders may hide their trading activity; other market participants may not be able to distinguish between trades motivated by insider information ...; and even if detected, \((2009)\) 27 C&SLJ 234 at 249 insider trades would be only a noisy indicator of the significance of the insider information for company value.

Private trading incentives can also encourage delays in public announcements, reducing price efficiency. In addition, when insider trading is permitted, all noisy and uncertain signals may result in increased speculative trading activity, leading to a reduction in share price accuracy and increased price volatility.

In any event, information that is revealed through insider trading generally becomes public information soon after the insider trading occurs. Any market efficiency gains are therefore generally restricted to a few hours or days, with little if any impact on capital allocations. Thus, even if one accepts the Manne argument that insider trading allows earlier incorporation of the relevant information into the share price and that insider trading enhances market efficiency, economic allocations (and not merely secondary allocations or trades) that are impacted by short-term price efficiency gains are minimal.

Importantly, Fama, who developed the efficient capital market hypothesis, indicated that the primary role of the capital market is allocation of ownership of the economy's capital stock. Fama suggested that an ideal market is one in which prices provide accurate signals for resource allocation: that is, a market in which firms can make production-investment decisions, and investors can choose among the securities that represent ownership of firms' activities under the assumption that security prices at any time fully reflect all available information.

The current author agrees with the Griffiths Committee that the primary rationales of insider trading regulation are economic efficiency and equal access. Short-term price efficiency and market efficiency goals are generally only secondary goals which are intended to translate into economic efficiency or capital resource allocation decision-making.

Further, the author concurs with the Griffiths Committee and the CAMAC majority that the equal access and economic efficiency goals are complementary rather than incompatible or in conflict. As Meier-Schatz suggests, the investor confidence argument stands at the crossroads of efficiency and fairness considerations ... a regulatory system for protecting investors ... may ... concomitantly provide an efficient allocation of financial resources.

Ultimately, the success of developed markets in allocating resources efficiently depends on a multi-layered complex structure of institutional and behavioural factors. However, there is increasing empirical evidence suggesting or inferring that economic efficiency is best achieved in contemporary securities markets when concepts of market fairness, such as equality of access and investor confidence, are promoted through transparent corporate disclosure in the public arena. Open and transparent disclosure of corporate information to all stakeholders promotes belief in the notion that the market is a level playing field and sustains investor confidence, with consequential fairness and efficiency benefits. At the same time, open and transparent disclosure of corporate information in the public arena enables widespread monitoring of corporate and market conduct, assists with the minimisation of fraud, and promotes robust competition necessary to achieve economic efficiency.

\((2009)\) 27 C&SLJ 234 at 250

Some parties have suggested that empirical evidence on the investor confidence theory or argument is unconvincing. However, recent global events have starkly highlighted just how critical transparency and investor confidence are to efficient markets and economies.

**Materiality test**

Materiality test The materiality principles in Hannes, Rivkin and Citigroup are based on a short-term price efficiency goal. This approach is likely to have been significantly influenced by judicial developments in the United States.
and by Australian academic commentary that generally argues for a greater emphasis on efficiency goals. These cases held that materiality may be extinguished when a significant level of probability, a good chance, or a substantial likelihood of a takeover is factored into the target company share price. As such, the bid information may be deemed immaterial even though the full takeover premium has not been reflected in the target share price prior to the public announcement of the bid through the ASX.

Consider a hypothetical insider trading case against professional traders who were privately informed of the pending bid by Toll for Patrick. The Patrick share price increased 13% from the close on 18 August to the close on 19 August and 5% from 18 August intra-day high to the close on 19 August. The price jumped a further 4% on 22 August when the bid was announced through the ASX. Under the materiality approach adopted by Jacobson J, were the insiders who had actual knowledge of the Toll bid by lunchtime on 18 August free to trade without risk of insider trading liability because of the newspaper reports, rumours and the increasing trading volumes in the Patrick securities? Such traders could make very significant profits at the expense of uninformed traders. Alternatively, was the materiality of the bid information extinguished by lunchtime on 19 August? If so, there were still significant profits to be made.

In practice, the profits made on 18 and 19 August by informed traders may have amounted to many millions of dollars. It is likely that there was a transfer of at least some profits on a riskless basis to investors who knew of the Toll bid, from investors who invested on the basis that the companies were in compliance with their continuous disclosure obligations or who made their investment decisions based on a revised fundamental valuation taking into account the Patrick profit downgrade announced on 18 August.

An approach that determines materiality based on the link between the relevant information and short-term price movements is at best a simplistic view of market reality. Few experienced market practitioners would confidently assert that markets and individual security prices are typically efficient on a short-term basis. The relationship between price-sensitive information and share prices is complex. Share prices are impacted by many factors and information that is impounded into prices is constantly changing. In practice, it is often not possible to determine the impact of individual pieces of information on a security price or the timing of any impact.

A materiality test based on short-term price movement makes it difficult for ASIC to prosecute traders who intentionally trade in the securities of a company after a partial increase in trading volumes or the security price. This test also allows insiders to escape liability if they are able to manipulate their trading to achieve gradual price gains or losses rather than a sudden price hike or fall. Trading may also be permitted where the relevant information becomes material when combined with other available information.

**Readily observable, initiative and diligence and independent research**

Readily observable, initiative and diligence and independent research practitioners would confidently assert that markets and individual security prices are typically efficient on a short-term basis. The relationship between price-sensitive information and share prices is complex. Share prices are impacted by many factors and information that is impounded into prices is constantly changing. In practice, it is often not possible to determine the impact of individual pieces of information on a security price or the timing of any impact.

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The nature and scope of the insider trading provisions

The nature and scope of the insider trading provisions practitioners have consistently indicated that the insider trading activity of most concern occurs when persons trade on information that is not in the public arena or not accessible by all investors, such as advance private knowledge of takeover bids, capital raisings and company earnings news. These views suggest that it is important for Australian policy-makers to consider whether, and to what extent, traders in the following scenarios can be caught and successfully prosecuted under the existing or proposed insider trading provisions:

- trading based on the release of price-sensitive information to institutional investors at private briefings;
- trading based on the release of price-sensitive information to analysts and institutional investors at general analyst briefings or during conference calls without open access;
- trading based on the release of price-sensitive information to investors at general analyst briefings or during
trading based on price-sensitive information in an analyst report; and

- trading based on private knowledge of a pending takeover bid or capital raising.

To the extent that these scenarios are considered to fall within the insider trading prohibition, the next issue to consider is at what point the trading should become legitimate on the basis that the information is no longer material.

**Conclusion**

The object of restrictions on insider trading is to ensure that the securities market operates freely and fairly, with all participants having equal access to relevant information. Investor confidence, and thus the ability of the market to mobilise savings, depends importantly on the prevention of the improper use of confidential information. [105]

Australian policy-makers, regulators and the judiciary may need to take a step back to reconsider the intended
rationales and operations of the insider trading regime. The existing framework is not fully coherent on either a theoretical or empirical basis. There is little agreement among parties on
• the appropriate rationales or goals of the insider trading regime;
• the appropriate nature and scope of the insider trading provisions; and
• the important classes of conduct that ought to be deterred under the regime.

It is generally agreed that the policy rationales supporting insider trading regulation are economic or market efficiency and market fairness. However, assumed views of efficiency and fairness by Australian policy-makers, regulators, scholars and the judiciary in relation to insider trading are widely divergent. Mason P and most Australian scholarly commentators suggest that these goals are incompatible or that the economic efficiency and equal access goals must in practice be traded off. In contrast, the present author argues that the primary goals of insider trading regulation are economic efficiency and equal access, and these goals are generally complementary or symbiotic. Short-term price efficiency and market efficiency are generally only secondary goals that are intended to translate into economic efficiency.

The success of developed markets in allocating resources efficiently depends on a multi-layered complex structure of institutional and behavioural factors. Nevertheless, there is increasing empirical evidence suggesting or inferring that economic efficiency is best achieved in contemporary securities markets when concepts of market fairness such as equality of access and investor confidence are emphasised and when there is transparent corporate disclosure in the public arena.[106] Recent global events have starkly highlighted the importance of the confidence factor to the efficient workings of capital markets and real economies.

Justice Kirby has suggested that(2009) 27 C&SLJ 234 at 254 there needs to be a more wholehearted endeavour to understand what the insider trading prohibition is concerned with ... so that ... we [can] identify the ambit of the prohibition and the people and activities who are to fall within it ... while there are no easy answers, the beginning of wisdom is to ask the right questions. [107]

One of the right questions to ask is what insider trading activities are of most concern to market participants. Practitioners have consistently answered that the conduct of most concern is trading based on private information relating to pending takeover bids, capital raisings and earnings releases. [108] Recent successful insider trading actions in Australia and the United States also suggest that these are high-risk areas.

The nature and scope of the Australian insider trading provisions are largely determined by the generally available carve-outs and the materiality determination. Recent insider trading cases have established a materiality test based on a short-term price efficiency theory. This established materiality approach can be expected to significantly restrict potential future insider trading actions. ASIC is only likely to initiate enforcement action against individuals or persons very early in the leakage or tippee chains when information is clearly not generally available and when there has been no, or only minimal, price or trading volume response.

When trading is based on private knowledge about a pending bid, capital raising or earnings announcement, any potential short-term efficiency gains are likely to be more than outweighed by the negative effects on investor confidence in the integrity of the market. [109]

Trading by investors with private knowledge of a pending bid is based on misappropriated information and is virtually riskless, while trading based solely on observations of increased volumes or prices is speculative and risky. Trading based on private knowledge about pending capital raisings or earnings-related information that has not been released through the ASX might also be classified as misappropriated information. Many investors cannot get access to this information and there is an unerodable information advantage.

Market participant, business and consumer perceptions or views on the efficacy of the Australian insider trading regime are already very negative. Some of the largest institutional investors complain about significant levels of insider trading and information asymmetry. [110] In contemporary markets, transparency and investor confidence are paramount, as highlighted in the current global financial and economic crises. Over the longer term, if investor perceptions on the level and enforcement of market abuses on the ASX such as insider trading do not improve, market participation is likely to wane, with consequential negative impacts on long-term economic efficiency.

It is suggested that the following questions require consideration and debate prior to any decision on amendments to the insider trading provisions:
• What constitutes economic efficiency, market fairness, individual initiative and diligence and independent research?
• How should these rationales or concepts apply to the insider trading regime and the broader corporate disclosure framework?
• What are the most important areas of conduct that ought to be prohibited under the regime? and

• On this basis, are the generally available and materiality tests or carve-outs achieving their aims?

Footnotes

1 BComm, ACA (NZ); ASIA exams, SIE (Dip) (UK); DipFS (FP), LLB (Hons) (Aust); currently a part-time lecturer and doctoral researcher in law at the University of New South Wales. The author thanks Professor Buckley, Martin North and the anonymous referee for their insightful feedback.


4 Commonwealth, House of Representatives Standing Committee on Legal and Constitutional Affairs, Fair Shares for All: Insider Trading in Australia (October 1989) (Griffiths Report) at [3.3.4].

5 Griffiths Report, n 3.

6 See also Ampolex Ltd v Perpetual Trustee Co (Canberra) Ltd (No 2) (1996) 14 ACLC 1514 at 1522 (Rolfe J).


9 See North G, "The Australian Insider Trading Regime: Workable or Hopelessly Complex" (2009) 27 C&SLJ (forthcoming). This article provides a summary of the successful insider trading actions in Australia since 2002. Although some of these cases are against market professionals, none deal with systemic insider trading issues.


11 Griffiths Report, n 3; CAMAC Report, n 8, p 48. See also United States v O'Hagan 521 US 642 at 658-659 (1997) where Ginsberg J suggested that investors likely would hesitate to venture their capital in a market where trading based on misappropriated non-public information is unchecked by law. An investor's informational disadvantage vis-à-vis a misappropriator with material, non-public information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill.

12 R v Firns 38 ACSR 223 at 233; Lyon and du Plessis, n 1, pp 9, 36-54.

13 Corporations Act 2001 (Cth), s 1042C(1)(a).

14 Corporations Act 2001 (Cth), s 1042C(1)(b).

15 Corporations Act 2001 (Cth), s 1042C(1)(c).


18 Explanatory Memorandum, n 16 at [328].

19 Griffiths Report, n 3 at [4.5.3]; R v Firns 38 ACSR 223 at 233; Lyon and du Plessis, n 1, p 36.


21 Explanatory Memorandum, n 16 at [326]-[327].

22 Explanatory Memorandum, n 16 at [326]. [328]; R v Firns 38 ACSR 223 at 233.

23 Explanatory Memorandum, n 16 at [327]; R v Firns 38 ACSR 223 at 233.

24 Mason P cited the Shorter Oxford Dictionary definition of public: open to general observation, existing, done or made in public, manifest, not concealed.


26 Materiality is generally based on an objective reasonable person test, but individual circumstances may be taken into account: Flavel v Roget (1990) 1 ACSR 595 at 602-603.

27 ASX Listing Rule 3A(1) was replaced by ASX Listing Rule 3.1.

28 Ampolex Ltd v Perpetual Trustee Co (Canberra) Ltd (No 2) (1996) 14 ACLC 1514.


30 ASIC, "Former Harts Executive Director Jailed for Insider Trading", Media Release 04-415 (17 December 2004); R v McKay (2007) 61 ACSR 470; ASIC, "Brisbane Research Analyst Pleads Guilty to Insider Trading
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Griffiths Report, n 3 at [3.3.4].

See eg Kirby, n 68, pp 154, 168.
ASIC, n 10, pp 82-83. See also North, n 9; Allen Consulting Group, n 10, pp 13-14, 19, 30, 35.

Retail investors are likely to be even more negatively impacted than these institutional investors because of relatively poorer access to information.