Consultation Process - Proposed Industry Funding Model for the Australian Securities and Investments Commission (ASIC)

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Rather than a formal submission, I thought it was best if I referred you to a book I have authored on ASIC, entitled *Australia's 'Company Law Watchdog': ASIC and Corporate Regulation*, which was published in early February 2015 by Thomson Reuters.

In Chapter 9 of the book, I deal with the general problems that ASIC faces which are arguably impeding its efforts to be an effective corporate regulator. Those problems include that ASIC is overburdened and underfunded. I have attached a copy of the relevant chapter and ask that you look in particular at the section "ASIC Overburdened and Underfunded" at pp 24-34 (In the final copy of the book, this section appears at pp 328-336).

In my book, you will see that I argue for an alternative funding model where Government funding is provided in a way that closely links ASIC's substantial revenue (from its registry functions) with its regulatory activities, rather than the user-pays model. I should also mention that I attended a roundtable on 21 September 2015 (in Brisbane) as part of the consultation process on the issue of industry funding, where it was pointed out to my and others' surprise that the possible privatisation of ASIC's registry functions was a separate issue and not within the scope of the Government's consultation process on the industry funded model. It seems odd that this is the case because if ASIC loses its registry functions, which it appears it will with the tender process now underway, its revenue will substantially decrease thereby increasing the intense funding pressure that ASIC has come under. It also, of course, makes the adoption of the model I propose an impossibility.

Furthermore, if the user-pays model is ultimately adopted, I recognise that as far as enforcement of major matters is concerned, ASIC will still have its Special Enforcement Account. The real problem, however, is that the balance of this account is likely to be reduced (instead of increased as the Senate report into ASIC's performance in 2014 recommended) as the Government pursues 'budget repair', making ASIC's ability to take enforcement action in large and complex matters even less than was the case previously. Certainly, when the balance was $30 million (as at February 2014), there were concerns that it was inadequate to enable ASIC to cope with such matters and if one considers that ASIC's costs in pursuing Andrew 'Twiggy' Forrest and Fortescue Metals (seeking civil penalties) were $30 million alone, it is clear that these concerns are real. Moreover, while s 90 of the *Corporations Act* makes provision for ASIC to recover costs, there is uncertainty surrounding how and if ASIC will be able to recover costs under this provision.

In light of the above from an enforcement perspective, which is my main research area, doubts must be had about ASIC's ability to adequately enforce the law, which fortifies the position I have taken in my book that the user-pays model is not the path that we should follow in Australia. The Government is committed to balancing the budget, but I reiterate the question I have asked in my book namely, "at what cost?" - "If ASIC is to be 'respected and feared' and a clear and unmistakeable message sent, backed-up and continually reinforced by actions, that it will use the enforcement tools at its disposal to 'uphold accepted standards of conduct and the integrity of the markets', … it will not be able to *if* it is inadequately resourced and people know it, especially to undertake major litigation against large corporations" and well-resourced individuals.

Comments made at the roundtable on 21 September by industry representatives, such as "ASIC should report to them" and "ASIC should have a cap on its budget" are also quite alarming and only serve to confirm the concerns raised in my book about ASIC losing its independence.

CHAPTER 9

TECHNICAL PROBLEMS FACED BY ASIC THAT ARE UNDERMINING ITS ABILITY TO BE AN EFFECTIVE REGULATOR

9.1 Introduction

When ASIC commenced operating on 1 January 1991 as the ASC,[1] it was a specialist regulatory body with administrative and enforcement responsibility for the corporations legislation.[2] From 1998, however, when it was renamed ASIC,[3] it took on new responsibilities. In addition to being the 'company law watchdog',[4] it took on the administration of laws relating to consumer protection and the regulation of financial products and services, such as superannuation, insurance and deposit-taking and, from 2002, credit.[5] More recently, it has taken on further responsibility in the area of consumer credit from the States and Territories,[6] and direct market supervision from the ASX,[7] as well as margin loan supervision and responsibility for unfair contract legislation.[8] In May 2012, the registration of business names was also transferred from the States and Territories to ASIC.[9]

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1 See *Australian Securities and Investments Commission Act 2001* (Cth) s 8(1) (note) (*ASIC Act*), which provides that "ASIC was established by section 7 of the *Australian Securities and Investments Commission Act 1989* and is continued in existence" under the present *ASIC Act* by virtue of s 261. The *Australian Securities and Investments Commission Act 1989* (Cth) was enacted as the *Australian Securities Commission Act 1989* (Cth): see *Financial Sector Reform (Amendments and Transitional Provisions) Act 1998* (Cth) s 2(2), sch 1, sch 5 item 7.

2 *ASIC Act* s 11(1), which provides that "ASIC has such functions and powers as are conferred on it by or under the corporations legislation". Section 5(1) defines 'corporations legislation' to mean the current *ASIC Act* and the *Corporations Act 2001* (Cth) (*Corporations Act*), formerly the *ASIC Law* (see *Australian Securities and Investments Commission Act 1989* (Cth) s 1B(1)) and *Corporations Act 1989* (Cth) s 82 (*Corporations Law*) respectively.

3 *Financial Sector Reform (Amendments and Transitional Provisions) Act 1998* (Cth) s 2(2), sch 1, sch 5 item 7; Commonwealth, *Gazette: Special*, No S 316, 30 June 1998.

4 ASIC, 'Your Company and the Law', Information Sheet No 79, 10 May 2010.

5 *ASIC Act* s 12A, which provides that ASIC has administrative responsibility for the regulatory regimes in relation to these matters under various statutes including the *Insurance Contracts Act 1984* (Cth), the *Superannuation (Resolution of Complaints) Act 1993* (Cth), the *Life Insurance Act 1995* (Cth), the *Retirement Savings Accounts Act 1997* (Cth) and the *Superannuation Industry (Supervision) Act 1993* (Cth).

6 As D'Aloisio (former ASIC chair) has explained: 'On 1 July 2010, ASIC became the national regulator for consumer credit and finance broking. This means that home loans, personal loans, credit cards, consumer leases, pre-arranged overdrafts and line of credit accounts, among other products and services, are now regulated under Commonwealth legislation and administered by ASIC': see T. D'Aloisio, Chairman's Report, *ASIC Annual Report 2009-2010*, p 6. See also below, n 8.

7 On 1 August 2010, ASIC assumed responsibility for supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

8 It should be noted that the failure of Opes Prime, a provider of securities lending facilities and another

On its website, ASIC provides a brief description of its responsibilities in these different areas:

> As the *corporate regulator*, we are responsible for ensuring that company directors and officers carry out their duties honestly, diligently and in the best interests of their company.
>
> As the *consumer credit regulator*, we license and regulate people and businesses engaging in consumer credit activities (including banks, credit unions, finance companies, and mortgage and finance brokers). We ensure that licensees meet the standards – including their responsibilities to consumers – that are set out in the *National Consumer Credit Protection Act 2009* (Cth).
>
> As the *markets regulator*, we assess how effectively authorized financial markets are complying with their legal obligations to operate fair, orderly and transparent markets. We also advise the Minister about authorizing new markets.
>
> As the *financial services regulator*, we license and monitor financial services businesses to ensure that they operate efficiently, honestly and fairly. These businesses typically deal in superannuation, managed funds, shares and company securities, derivatives, and insurance.[10]

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large lender, Lift Capital, and the turmoil at stockbroker Tricom Securities were behind the government's further expansion of ASIC's mandate to equip it with new powers to regulate financial products linked to some of these collapses. Margin loans, for instance, became regulated as financial products under the *Corporations Act* in November 2009: *Corporations Legislation Amendment (Financial Services Modernisation) Act 2009* (Cth) sch 1. The changes to margin lending contained in this Act were part of the federal government's actions to regulate consumer credit nationally. In addition, the new *Australian Consumer Law*, which is a single, national consumer law dealing (inter alia) with unfair terms in consumer contracts, was enacted as sch 2 to the *Competition and Consumer Act 2010* (Cth) (formerly the *Trade Practices Act 1974* (Cth)) by *Trade Practices Amendment (Australian Consumer Law) Act (No 1) 2010* (Cth) sch 1 pt 1. Schedule 3 pt 1 amends the *ASIC Act*, inserting parallel provisions to those in the *Australian Consumer Law* in relation to financial products and services. From 1 July 2010, ASIC therefore assumed responsibility for administering this new law dealing with unfair terms in consumer contracts for financial products and services.

9 See also, eg, Economics References Committee, *Performance of the Australian Securities and Investments Commission*, Report to the Senate, June 2014, pp 495-496, Appendix 4, for a timeline setting out ASIC's increasing responsibilities since its establishment (Senate inquiry into the performance of ASIC).

10 See ASIC website <www.asic.gov.au>, "About ASIC: Our role" (accessed 4 January 2014).

Although today ASIC has other functions, this book has focused on its effectiveness in its original, and arguably its primary, role – the administration and enforcement of the corporations legislation.[11] However, a consideration of ASIC's expanded role as Australia's corporate, markets, financial services and consumer credit regulator, is relevant. Has ASIC the capacity to adequately discharge all, or indeed any, of these functions given that it operates in an environment of limited regulatory resources?[12] These concerns about the adequacy of ASIC to fulfil its regulatory functions assume greater significance in light of its seemingly ever-expanding mandate,[13] which concerns were recognised by the Senate inquiry into ASIC's performance,[14] which also noted ASIC's incredibly broad remit in comparison to other regulators in key jurisdictions.[15] Indeed, inconsistent regulatory laws in the different areas ASIC regulates[16] and differences across ASIC's regime between the types and size of penalties for comparable types of wrongdoing[17] are factors, which compound the enormous challenge ASIC faces in seeking to carry out these functions and which have led ASIC to argue, amongst other things, for a review of penalties across the corporations legislation to ensure that they are set at appropriate levels as well as a broader range of penalties to become more responsive to misconduct, with, for example, multiple of gain penalties or penalties combined with 'disgorgement' considered.[18] Further, even though this chapter highlights that

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11 See further discussion below, Section 9.2, *The Role of ASIC as the 'Company Law Watchdog'.*

12 See further discussion below, Section 9.3.2, *ASIC Overburdened and Underfunded*.

13 See in particular, above nn 5-9.

14 See Senate inquiry into the performance of ASIC, above n 9, in particular, Ch 25, *ASIC's responsibilities and funding: problems with the current framework and suggested changes.*

15 Ibid, pp 401-402. In the US, eg, ASIC's securities and markets regulatory counterpart is the Securities Exchange Commission (SEC), with some functions also performed by the Federal Commodity Futures Trading Commission (CFTC) and state authorities. However, the body charged with financial products and services regulation is the Consumer Financial Protection Bureau (CFPB), while credit and financial services licensing is carried out by state authorities. The Public Company Accounting Oversight Board (PCAOB) is tasked with the regulation of auditors, although this is overseen by the SEC. Reflecting the chapter 11 bankruptcy and reorganisation system in place in the US, corporate insolvency is dealt with by specialist bankruptcy courts with an office in the Department of Justice (the US Trustee Program) responsible for overseeing the administration of bankruptcy cases. Similarly, in the UK, ASIC's securities and markets regulation functions are performed by the Financial Conduct Authority (FCA). The FCA is also responsible for market supervision and governance (through the UK Listing Authority, a division of the FCA). Additionally, the FCA is tasked with financial products and services regulation and financial services licensing. However, the FCA is not responsible for matters relating to the corporations law generally, such as enforcing directors' duties. Company registration is carried out by Companies House, an executive agency of the Department for Business, Innovation and Skills.

16 See further discussion below, Section 9.3.4, *Inconsistencies in ASIC's Regulatory Laws*.

17 Eg, providing credit without a licence can attract a civil penalty up to ten times greater than the criminal fine for providing financial services without a licence: see ASIC, "ASIC Reports on Penalties for Corporate Wrongdoing", *Media Release 14-055*, 20 March 2014; and ASIC, *Penalties for Corporate Wrongdoing*, Report 387, June 2014, pp 16-17.

18 See, eg, *Penalties for Corporate Wrongdoing*, ibid, pp 168-171. See further discussion below, Section 9.3.3, *Size and Range of Penalties*.

ASIC shares responsibility for some of these areas with other regulators – such as the Australian Prudential Regulatory Authority (APRA), the Australian Competition and Consumer Commission (ACCC) and the Australian Taxation Office (ATO)[19] – it will be argued, most importantly, that instead of making for better regulation, ASIC action may be inhibited because those regulators operate under differing and inconsistent laws.

In addition to these problems, this chapter traverses a range of other more general problems faced by ASIC that could be undermining its capacity to be an effective regulator, including criticisms that it may not be keeping a close enough watch on the market it regulates by failing to respond to early warning signs of corporate misconduct or troubling trends in Australia's corporate world and the lack of competitive remuneration of ASIC staff.

9.2 The Role of ASIC as the 'Company Law Watchdog'

In this role, ASIC faces many regulatory challenges. In the first place, while corporate regulation requires ASIC to take action 'to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it',[20] this is only one of six objectives listed in s 1(2) of the *ASIC Act*. ASIC's other regulatory objectives set out in s 1(2) are:

(a) to maintain, facilitate, and improve the performances of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy ; and
(b) to promote the confident and informed participation of investors and consumers in the financial system; and
(c) [(c) has been deleted and replaced by detailed provisions in the ASIC Act]; and
(d) to administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements; and
(e) to receive, process, and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it; and
(f) to ensure that information is available as soon as practicable for access by the public.

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19 See discussion below, Section 9.3.5, *Sharing of Regulatory Responsibility*.
20 See the *ASIC Act*, s 1(2)(g).

There is also the difficulty that ASIC must balance these statutory objectives with its limited resources.[21] Doubts must be had about ASIC's ability to properly discharge all of these functions, especially when there are already concerns about ASIC's ability to take appropriate enforcement action against those who breach the law. In recent years, the Commonwealth Government has provided additional funding to ASIC to enable it to cope better with corporations and individuals whose access to financial resources is such that ASIC has found it difficult to deal with them effectively.[22]

Further, tension exists between some of these objectives. This makes ASIC's task to achieve effective corporate regulation even harder. For instance, action ASIC might take to promote confident and informed participation of investors and consumers could impact negatively on business by significantly increasing compliance costs. This tension can be seen in the following statement that was made in the Treasurer's *Statement of Expectations* issued to ASIC in April 2014, which outlined the Government's expectations about ASIC's role and responsibilities, its relationship with the Government and issues of transparency and accountability and operational matters:[23]

> The Government's vision is for ASIC to be a high performing and responsive agency that administers a principles based regulatory framework in a way that minimises compliance costs for business and the community, provides stability, is efficient and effective, and that *balances* the objectives of ASIC's statutory objectives set out in the ASIC Act.[24]

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21 This is quite apart from the argument made in this chapter that ASIC is overburdened by its extremely wide mandate and lacks the necessary resources to fulfil its many responsibilities.

22 See earlier discussion in Chapter 1, nn 136-145, noting also the enforcement special account that is available to ASIC, discussed in more detail below, nn 161-163 and 178-179.

23 See Treasurer's *Statement of Expectations*, April 2014, which statement is published on the ASIC website (accessed 27 August 2014). As part of the response to the *Review of Corporate Governance of Statutory Authorities and Office Holders*, conducted by Mr. John Uhrig (the *Uhrig* report) and the report of the *Taskforce on Reducing Regulatory Burdens on Business* (the *Banks* report), the Australian Government agreed that Ministers would issue Statements of Expectation to statutory agencies, such as ASIC, with the aim that Ministers would be able to provide greater clarity regarding government policies and objectives concerning individual authorities, including the policies and priorities they would be expected to observe in carrying out their operations, while also respecting the independence of those authorities. This is the latest *Statement of Expectations*. The previous *Statement of Expectations* issued by the then Treasurer, Peter Costello, on 20 February 2007 to the Chairman of ASIC and his *Statement of Intent* in response made on 27 June 2007 are also available on the ASIC website.

24 Ibid, p 3 (emphasis added).

The significance of this statement also lies in expecting ASIC to focus on finding an appropriate 'balance' between competing regulatory objectives, where there is not always a clear answer to this question. Indeed, there will be disagreement as to what approach strikes the appropriate balance.[25] Further, it is evident that ASIC may well have different priorities and goals at various times.[26]

It could be argued, for example, that when, in the wake of the global financial crisis (GFC) and economic downturn, attention was re-focussed on regulation[27] and on ASIC's protection and public interest objectives, these objectives were more significant at this time than ASIC's business facilitation objectives, which appears to be in contrast to the present time. Even though the Government has stated in the *Statement of Expectations* to ASIC that 'ASIC plays a key role in achieving a sound and effective financial and corporate regulatory framework' and highlighted its objectives 'to maintain, facilitate and improve the performance of the financial system (including fair and efficient markets), promote the confident and informed participation of investors and consumers, and conduct an efficient registry,'[28] the

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25 Argued by analogy with the comments made by Middleton in the context of the investigative and enforcement powers of Australian regulators, including ASIC. Of the competing public and private interests involved, where the need to maintain a 'balanced approach' has also been emphasized, Middleton says that the issues are often complex and that strong arguments favouring each of these interests may be made, so that there will be disagreement as to what approach strikes the necessary balance: see T. Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege under the Laws Governing ASIC, APRA, the ACCC and the ATO – Suggested Reforms" (2008) 30 *Australian Bar Review* 282, pp 287-288.

26 Eg, in Chapter 6, this book discussed the change in focus of ASIC's enforcement activities, reported in its *Annual Report 2000-2001*, from pursuing relatively minor matters to increased resourcing of complex major matters. This was so that ASIC could respond more effectively to the spate of major corporate collapses which occurred at that time, including those of One.Tel and HIH: see earlier discussion in Chapter 6, Section 6.4.1, *2000-2001 Annual Report*.

27 Thus, at least initially, breathing new life into the long-running debate about 'regulation' or 'deregulation' with renewed calls for regulation and government intervention on the basis that the market and 'voluntary' or 'self-regulation' had failed: see earlier discussion in Chapters 2, nn 2, 50-55; and 3, n 34, noting that market failure has historically been the main justification for regulation and calls for improved regulation, particularly in the area of corporate regulation. See also, eg, J. Eyers, "Regulation Will Rise: Redfern", *AFR*, 24 October 2008, p 52; and D. Lachman, "Backlash Heralds a Switch to Overregulation", *AFR*, 23 October 2008, p 79, for examples at the time of the opposing views in the 'regulation/deregulation' debate. Eyers reported that Redfern, ASIC's former enforcement chief, stated that the crisis in the capital markets and credit crunch 'put companies in triage. Next comes greater intervention". On the other hand, Lachman, who employed the old, familiar arguments that have traditionally been used to support 'deregulation', opined that the political backlash against the global financial system would produce "an excessive regulation of financial service activities that would stifle competition and innovation". Since then, with global and Australian financial conditions having generally improved and ASIC having claimed that important steps were taken in 2009-2010 to reduce the likelihood of a recurrence of the conditions that led to the GFC: see ASIC, *Annual Report 2009-2010*, p 12, this debate has lost momentum.

28 See *Statement of Expectations*, above n 25, p 1. ASIC's strategic priorities should also be noted. They are to ensure: confident and informed investors and financial consumers; fair and efficient markets; and efficient registration and licensing. These strategic priorities reflect ASIC's mandate under the *ASIC Act*

Government nevertheless has also made it clear that it expects that 'ASIC will take into account the Government's broad policy framework, including its deregulation agenda in performing its role and meeting its responsibilities'.[29] This deregulation agenda has been acknowledged by ASIC in its *Statement of Intent* when it responded to the Government's *Statement of Expectations* in July 2014 in several important ways. In the first place, it features in one of the major challenges ASIC has identified for itself in the future, namely of 'balancing free markets and confident and informed participation by investors and financial consumers, with a particular focus on deregulation'.[30] Secondly, ASIC has outlined the steps it has already taken to address what it describes as 'the burden which unnecessary red tape can impose on business,'[31] as well as the new initiatives it will progress to reduce red tape for individuals and businesses.[32]

While this book has argued that ASIC's business facilitation goals may be more significant presently than they have been at other times, this is not to say that ASIC will pursue these objectives at the expense of maintaining the integrity of the market. Maintaining the integrity of the market has consistently been one of ASIC's fundamental priorities. Testimony to this are the many public statements made by ASIC,[33] including Greg Medcraft, current ASIC chair, who, in a recent speech said that ASIC will cut red tape and reduce compliance costs 'provided it does not undermine our strategic priorities of ensuring investors and financial

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and they appear in many public documents published by ASIC on its website: see, eg, ASIC, *Penalties for Corporate Wrongdoing*, above n 17, p 9; and ASIC, *Annual Report 2013-2014*, p 2.

29 Ibid. Here it is explained that the Government is overhauling the process for creating, implementing and reviewing new regulation, which includes a process within Government where the costs and benefits of additional regulation are carefully balanced, and the costs of new regulation are offset. The Government's deregulation agenda involves ASIC, among other things, looking for opportunities to reduce compliance costs for business and the community and contributing to the Government's $1 billion red and green tape reduction target. It should be noted that all Australian governments, irrespective of their political persuasion, have been committed to reducing red tape for business to varying degrees, so that this is not a new phenomenon. There was, eg, the Better Regulation program of the Howard Coalition government and the deregulation agenda of the former Rudd and Gillard Labor government as discussed in Chapter 3, n 52.

30 See ASIC, *Statement of Intent*, July 2014, p 1. See also G. Medcraft, "What ASIC Expects of Directors", Speech to the Australian Institute of Company Directors, 24 June 2014, p 3 as a further example of ASIC acknowledging the Government's deregulation agenda in a similar fashion as a challenge and in similar terms: 'balancing free markets and investor protection, with a particular focus on deregulation'.

31 Ibid, p 3. Eg, ASIC has reviewed its forms and identified opportunities to remove or streamline approximately 10% of the forms businesess and individuals submit to it, thus reducing compliance costs and saving time. ASIC also has a strong record of including regulatory best practice principles into its policy development, and has consistently complied with Office of Best Practice Regulation requirements.

32 Ibid. Eg, ASIC will continue to comply with the Government's enhanced Regulatory Impact Analysis requirements, noting the Government's special emphasis on compliance costs, in addition to balancing the impacts of regulation on business and the community with the regulatory benefit.

33 See, eg, a review of its annual reports, such as ASIC, *Annual Report 1999-2000*, 7. It states that ASIC's "mission is to achieve maximum credibility for Australian financial and securities markets and, therein, for Australian companies".

consumers are confident and informed, and markets are fair, orderly and transparent'.[34] Even Costello, when he was Treasurer whose approach was that ASIC's main role was to maintain confidence in the market and not to interfere with it,[35] which is arguably also the approach taken today,[36] made the following statement that underscores ASIC's protection and public interest objectives:

> In administering the corporations regulation regime, a key role for ASIC is to ensure the integrity of the market. By exercising sufficient vigilance and pursuing those companies and individuals who breach the law, ASIC will deter improper and illegal conduct.[37]

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34 See Medcraft, "What ASIC Expects of Directors", above n 30, p 8. See also generally ASIC website, 'About ASIC: Our role', which contains such statements as: 'We contribute to Australia's economic reputation and wellbeing by ensuring that Australia's financial markets are fair and transparent, supported by confident and informed investors and consumers' (accessed 7 September 2014).

35 This argument is based on Costello's economic approach to corporate law reform, which could be likened to the approach that a chief function of corporate law is to provide legitimacy to business decision-making: see R. Tomasic, "The Challenge of Corporate Law Enforcement: Future Directions for Corporations Law in Australia", (2006) 10 *University of Western Sydney Law Review* 1, p 15. See also discussion below, n 42, of 'efficient markets theory' (that markets operate most efficiently when there is minimum regulatory interference), which guided the 1981 report of the Committee of Inquiry into the Australian Financial System (the *Campbell* Inquiry) and the *Wallis* Inquiry of 1997.

36 See, eg, Medcraft, "What ASIC Expects of Directors", above n 30, p 3; and G. Medcraft, "Parliamentary Joint Committee: Opening Statement", Speech, 5 September 2014, p 2, where he says that: 'Our fundamental objective is to allow markets to allocate capital efficiently to fund the real economy and, in turn, economic growth. This contributes to improved living standards for all Australians'. But note that certain developments in the financial sector have led to the questioning of, and even divergence from, some of the principles that informed the *Wallis* Inquiry, including the principles of 'efficient markets theory' that buttress Australia's financial system. They include the growth in superannuation in Australia which, because of the compulsory nature of the system, is regarded as an exception to efficient markets theory in Australia's financial system. This led, eg, to the report of the 2010 *Review of Governance, Efficiency, Structure and Operation of Australia's Superannuation System* (the *Cooper* Review) disagreeing with the *Wallis* Inquiry's conclusion that superannuation fund members should be treated as rational and informed investors who are protected by disclosure and conduct requirements: *Final Report*, June 2010, part 1, p 8. It should also be noted that the latest review of the financial system that is currently underway, the Financial System Inquiry chaired by David Murray AO, has been tasked with refreshing the philosophy that underpins Australia's financial system: The Hon Joe Hockey MP (Treasurer), "Financial System Inquiry", *Media Release*, 20 December 2013. See also http://fsi.gov.au/ (accessed 11 October 2014). In the meantime, however, and despite developments that have transformed the financial sector, the Senate committee has commented that 'the *Wallis* Inquiry remains influential' as evidenced by Medcraft stating in a 2012 newspaper opinion article that ' the *Wallis* Inquiry discussed "vital ideas", such as adopting a flexible approach to regulation, which remain relevant to ASIC's surveillance and risk-based regulatory approach': Senate report into the performance of ASIC, above n 9, p 43, citing G. Medcraft, "Surveillance Doesn't Remove the Risk Factor, *AFR*, 17 September 2012, www.afr.com (accessed 10 July 2013). See also below, n 89.

37 See Costello, *Statement of Expectations*, above n 23, p 2.

Although market integrity has always been and remains a priority for ASIC today, ASIC sought to forcefully make the point in its 'main submission' to the Senate inquiry[38] and in its *Statement of Intent*, that its 'statutory role does not involve preventing the risk of all investor losses or ensuring full compensation for investors in all instances where losses arise'.[39] Indeed, ASIC has routinely made such statements in an effort to better educate the public about its role. Perhaps, the comments made by former ASIC chair, Tony D'Aloisio, best describe ASIC's approach, notwithstanding that they were made in September 2010. D'Aloisio said that:

> ASIC is a regulatory oversight body and not a guarantor of last resort against risk and corporate failure.[40]

D'Aloisio added:

> We provide regulatory oversight but that doesn't mean we take the risk out of investing or out of financial products and services.
>
> It is sometimes suggested that ASIC should prevent losses or failures.[41] However … the *Corporations Act*, the principal piece of legislation for which ASIC is

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38 ASIC provided nine submissions in total to the Senate inquiry. This submission was made in October 2013 and addressed all of the inquiry's terms of reference (*Submission 45.2*). ASIC and the committee referred to it as ASIC's 'main submission'.

39 See ASIC, *Submission 45.2*, ibid, p10; and *Statement of Intent*, above n 30, p 1. In its main submission to the Senate inquiry, ASIC went on to elaborate on this point thus: "Our underpinning regulatory objectives, regulatory tools, and resources are not intended to prevent many of the losses that investors and consumers will experience. This is true of every financial market regulator" and "is an issue that goes to the heart of what financial market regulation is intended to achieve, and thus to community expectations about ASIC's performance. Unlike prudential regulators, market conduct regulators such as ASIC do not have the same focus on preventing institutional collapse and the losses this may bring".

40 See T. D'Aloisio, Chairman, ASIC, Speech to American Chamber of Commerce in Australia (AmCham), "ASIC's Forward Agenda", Melbourne, 3 September 2010, p 4, available on the ASIC website (accessed 17 November 2010).

41 See, eg, discussion below, n 60. But see *Submission 116*, pp 1-2, to Senate inquiry on the performance of ASIC, above n 9, p 322, on the point of unrealistic community expectations including 'a strong public perception that ASIC should be proactive in stopping … corporate misconduct from occurring in the first place'. Jason Harris from the University of Technology, Sydney (UTS) Faculty of Law, commented: 'Criticisms based on a failure to prevent corporate scandals or collapses represent a misunderstanding of the focus of corporate regulation in Australia. Australia's corporate regulatory framework is based largely on the disclosure paradigm. Rather than vetting documents (such as prospectus documents and annual reports) ASIC is merely a body that receives copies of those documents. It is up to investors to read the information and make a complaint if they discover a problem. I'm sure ASIC does act proactively where it has reason to do so, but with over 2 million companies to deal with ASIC cannot read and assess every document.'

responsible, arose out of the *Campbell* Committee and *Wallis* Inquiry. These committees were heavily influenced by the group of economic theories known as the 'Efficient Markets Hypothesis'.

The underlying philosophy of these theories (and hence of the *Corporations Act*) is to allow markets to operate with a minimum of interference – to allow risk and allow investors to price risk.[42]

ASIC's role in this regime is limited and can be likened to a road traffic authority or police force. We oversee the system. But, unfortunately accidents can still happen. Unlicensed drivers can be on the road. When accidents do happen, we turn up at the scene, clear the mess, care for the injured and punish the wrongdoers … ASIC also examines the scene of the accident and makes or recommends changes to Government (through Treasury) to improve road safety ...

We also look for roads where accidents can happen and try and fix them ahead of time and we are constantly looking (through a wide range of surveillance work) for unlicensed drivers. But it is not the intention of the *Corporations Act*, and *ASIC is not resourced, to be on every road and at every intersection.*

ASIC is very much an oversight line of defence. The primary line of defence comes from the law and policy makers and the gatekeepers (e.g. Board and auditors) and investors and their judgements on risk. Retail investors, financial consumers and creditors need to be careful to assess risks and make informed decisions.[43]

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42 See also discussion above, nn 35-36. In its main submission to the Senate inquiry, *Submission 45.2*, above n 38, p 17, ASIC has also made this point that "our market-based system for investment and capital raising, which has served Australia's development well, inevitably involves investors assuming an amount of risk in order to make a return".

43 D'Aloisio, "ASIC's Forward Agenda", above n 40, pp 4-5 (emphasis added). The comments in the last paragraph in particular also reflect the influence of 'decentred' regulation on ASIC's strategies discussed in Chapter 3, Section 3.1.1, *Julia Black: Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a 'Post-Regulatory World'*. But see discussion below, nn 98-100, of problems concerning such strategies, especially reliance on the significant regulatory role 'gatekeepers' are expected to perform.

Nevertheless, the Senate inquiry has concluded in its report that ASIC needs to do a better job in explaining its role to the public, thus recommending, for example, that 'ASIC include on all registry search results and extracts a prominent statement explaining ASIC's role and advising that ASIC does not approve particular business models'.[44] That said, however, even if approving particular business models is not a function of ASIC, this arguably does not absolve ASIC from any responsibility for the enormous losses sustained by investors resulting from collapses such as those of Westpoint (2006), Fincorp (2007), Opes Prime (2008), Storm (2009) and more recently, Banksia and Trio Capital (2012) and LM Investment Management (2013).[45] This is because while there is the view that investors cannot expect to be protected from their own greed or stupidity,[46] a common complaint in all of these cases has been that ASIC 'appear[ed] to miss or ignore clear and persistent early warning signs of corporate wrongdoing or troubling trends',[47] to use the words of the Senate report.

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44 See Senate report into the performance of ASIC, above n 9, p xxix (Recommendation 35). Other recommendations include ASIC promoting 'informed participation' in the market by making information more accessible and presented in an informative way (Recommendation 39): ibid, p xxx; and ASIC considering the aims and purposes of its website with a view to redesigning it so as to achieve these with particular attention given to explaining its role clearly on its website's home page: ibid, p xxxi (Recommendation 40). The latter recommendation also says that in designing its website, special attention should be paid to providing a 'for consumers' category of information and redesigning the homepage to make key information and services more prominent and media releases less prominent.

45 Details of these collapses were discussed earlier in Chapter 8, nn 165-166 (Westpoint and Fincorp), 203 (Opes Prime), 221 (Trio Capital) and 222 (Storm). But see also below, Section 9.3.1, *Criticisms ASIC not 'Close to the Market'*. As far as the collapse of Banksia is concerned, Banksia was a debenture issuer and exempt from the prospectus requirements so that when investors rolled over their debenture investments, they did not receive a prospectus or any form of disclosure about changes in risk. According to Middleton, Banksia could have been described as a 'shadow bank'. 'Shadow banking' is where debenture issuers, money market funds or other businesses make themselves look like a bank by offering other services to investors such as EFTPOS facilities and credit cards. These businesses act like a bank, eg, by accepting savings accounts and term deposits, so that investors think of them as a bank. They believe that when they invest with those businesses, their investments are as safe as investing with a bank, but where in fact those businesses do not fall within the definition of 'banks': see definition of 'banking business' and the requirements in the *Banking Act 1959* (Cth), ss 5,7, 8 and 9, that are prudentially regulated by APRA: T. Middleton, "ASIC's Regulatory Powers - interception and search warrants, credit and financial services licences and banning orders, financial advisers and superannuation: Problems and Suggested Reforms" (2013) 31 *Company and Securities Law Journal* 208, pp 232-3.

46 This view was expressed in relation to the collapses of Westpoint and Fincorp: see The Editorial, "Fincorp Shows ASIC Needs More Intelligence", *The Weekend AFR*, 31 March - 1 April 2007, p 62, but it is relevant to all of these cases since they all involved high risk investments. Westpoint investors, eg, were offered a 'fixed' return of 6 percentage points above bank deposit rates, a margin that should have reminded them of the old saying that 'if something sounds too good to be true, it usually is', while Fincorp was offering up to 8.5 per cent on its current debenture issue and up to 10 per cent on past issues to its investors.

47 See Senate report into the performance of ASIC, above n 9, p xvii. As noted earlier in Chapter 8, n 205, although the committee made this finding in the context of ASIC's work in consumer credit since 2002, which was the first of two case studies (The other was the Commonwealth Financial Planning Limited (CFPL) scandal) that in particular assisted it to assess ASIC's performance and which had set the groundwork for its report, it also states that this was one of the key findings that 'surface[d] and

9.3 Problems Faced by ASIC

9.3.1 Criticisms ASIC not 'Close to the Market'

When D'Aloisio was appointed ASIC chair,[48] he stated that it was important to 'conduct a review of the organisation using a fresh set of eyes'.[49]

That review, announced on 8 May 2008, aimed 'to better position ASIC to respond to changes in the market'[50] resulted in a new structure and new appointments[51] with that structure largely in place today.[52]

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resurface[d] in different contexts'. See also Section 9.3.1, *Criticisms ASIC not 'Close to the Market'*, where this theme of ignoring or failing to take action on early alarm bells is developed.

48 D'Aloisio was appointed ASIC chair on 13 May 2007.

49 See D'Aloisio, Chairman's Report, ASIC, *Annual Report 2006-2007*, p 5.

50 See ASIC, "ASIC Announces Executive Appointments", *Media Release 08-191*, 22 August 2008. See also ASIC, *Annual Report 2007- 2008*, p 5, for the results of the stakeholder survey that preceded ASIC's strategic review and which formed the basis of its review.

51 Importantly, the restructure, which became effective on 1 September 2008, basically entailed the abolition of the four former directorates (Enforcement, Regulation, Compliance and Consumer Protection) and their replacement by smaller stakeholder teams (including accountants and auditors; insolvency practitioners; corporations; market participants; investment managers; superannuation funds; deposit-takers; credit and insurance providers) and enforcement/deterrence teams, each focussing on different areas and headed by a Senior Executive Leader. This had as its objective 'to bring sharper focus to the investigation and prosecution of serious misconduct': see "ASIC Announces Executive Appointments", ibid. See also J. Cooper, *ASIC Hot Topics*, an edited version of a presentation made to the Institute of Actuaries of Australia/Finsia, Business Luncheon, Sydney, 17 July 2008, p 4, ASIC website (accessed 11 November 2008). This is what then ASIC Deputy Chairman had to say about the strategic review when he posed the question: 'What does it mean for the industry? - The aim is for ASIC to: better understand the markets it regulates; be more forward-looking in examining issues and assessing systemic risks; be much clearer in outlining to the market why it has chosen to intervene and the behavioural changes it is seeking; and have a clearer set of priorities.' On the issue of how this would be achieved, Cooper listed that ASIC would make additional investment in market research and analysis; appoint an experienced external Advisory Panel drawn from sectors of the economy to advise ASIC's Commission on market developments and potential systemic issues; abolish the former 'silo' directorates of ASIC and replace them with 'outward-focused' stakeholder teams; recruit more senior-level personnel from the markets; appoint more Commission members; and train up existing staff through industry secondments. See further D'Aloisio, Speech: "ASIC's Forward Agenda", above n 40, p 12. As part of ASIC's strategic review, D'Aloisio stated that ASIC had also made significant changes to its handling of major litigation, including:

- creating smaller deterrence teams with more senior practitioners;
- establishing ASIC's Chief Legal Office to review and be involved in important strategic and tactical (legal) issues;
- clarifying the decision-making process for cases, particularly for strategic and public interest considerations;
- advising the market early on why a particular case is being taken on and its public interest significance;
- working more closely with the DPP on criminal matters; and
- selective use of external law firms if additional expertise is considered necessary.

52 The structure put in place in 2008 has been retained, but there have been some refinements: see, eg, Chairman's Report, *ASIC Annual Report 2009-2010*, pp 6-7, explaining a reallocation of responsibilities between the Chairman and Deputy Chair. ASIC's Market Integrity teams were also placed under a new

No doubt these changes aimed at making ASIC more nimble and 'closer to the market' (to use D'Aloisio's words)[53] were a response to the growing pressure that ASIC had come under at the time to improve its performance. Pressure built as a consequence of the public battering and criticisms of ASIC in the press over its conduct of major cases[54] and over the collapsed

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Commissioner. According to D'Aloisio, '[t]hese changes [were to] rebalance work within the Commission and ensure that there [was] a full-time Commissioner to oversee the critical transfer of surveillance from the ASX and the proposed introduction of market competition'. ASIC also streamlined its team structure by reducing the number of deterrence/enforcement teams from eight to six, and by reducing the number of stakeholder teams from fourteen to eleven. For a recent depiction of ASIC's organisational structure: see, eg, Senate report into the performance of ASIC, above n 9, p 22, *Figure 3.1: ASIC's corporate structure (as at October 2013)*. It shows that ASIC's overall organisational structure separates its operations into three broad 'clusters': markets; investors and financial consumers; and registry and licensing, where the stakeholder and enforcement teams referred to above are within these broad operations areas.

53 See above n 50. It should also be noted that these changes were favourably reported on in the press. One commentator said, eg, that the intention of replacing the former directorates with stakeholder teams was to replace 'cumbersome, bureaucratic, process-oriented units with smaller, flexible customer-centric ones': see A. Jury, "Chanticleer - Regulator Tries to Reinvent Itself', *AFR*, 9 May 2008, p 76. Yet another commentator stated that 'the corporate watchdog has moved to beef up its market expertise with a series of senior executive appointments', noting that 'more than a third came from the private sector': see A. Midalia, "ASIC Moves To Boost Street Cred", *The Weekend AFR*, 23-24 August 2008, p 7. However, there were also criticisms: see, eg, E. Johnston and P. Durkin, "ASIC Directors Resign" *AFR*, 12 June 2008, p 3, where with a number of significant resignations announced ahead of the restructure, including the resignations of former high profile enforcement chief, Jan Redfern, and former head of compliance, Jennifer O'Donnell, it was argued that 'these departures represent[ed] a significant set-back' for ASIC as it was midway through a series of complex investigations, that included Opes Prime, and legal actions against former directors of James Hardie and AWB. While criticisms have been made of the outcomes achieved in these cases, discussed in Chapters 6, 7 and 8, eg, the failure to bring any criminal actions in the James Hardie and AWB matters, it is difficult, if not impossible, to assess whether those outcomes would have been substantially different if ASIC had had the benefit and experience of these former ASIC senior personnel.

54 These cases include the long-running civil penalty case against former One.Tel directors, Rich and Silbermann: see, eg, The Editorial, "Days of Their Lives: One.Tel, the Book", *AFR*, 6 February 2007, p 46, which made criticisms about the prolonged nature of ASIC's enforcement action and length of time it was taking to progress this matter to final hearing (and which ASIC ultimately lost in November 2009: In *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, [56], Austin J criticised ASIC's case for being 'excessively long and burdensome'); and the civil penalty case against former executives of AWB, which even now has not been finalised against all defendants, more than ten years after the fall of the Iraqi government. While in November 2008, the civil penalty proceedings against these defendants (with the exception of the proceedings against Lindberg for whom criminal proceedings were 'not on the cards') had been stayed pending a decision on whether criminal actions would be instigated: see *AWB Ltd: Australian Securities and Investments Commission v Flugge [No 1]* (2008) 21 VR 252 (Robson J), which is the proper course of events (given that the courts will delay the civil proceedings until the criminal case is completed to protect the fundamental 'right to silence' that a defendant in a criminal prosecution has which would be compromised by allowing civil proceedings with similar facts to take place if a person is also a defendant or witness), it nonetheless added significant time and expense to ASIC's enforcement action against these defendants. As far as the proceedings against Lindberg are concerned, these also proved to be protracted. This is because ASIC tried unsuccessfully in early 2009 to amend the case against him by adding new allegations relating to an AWB internal investigation called Project Rose, the so-called 'Tigris transaction' and AWB's responses to the UN's *Volcker* inquiry: *Re AWB Ltd: Australian Securities and Investments Commission v Lindberg [No 3]* [2009] VSR 209 (Unreported, Robson J, 28 May 2009). When ASIC subsequently lost its appeal to include the amendments: *Australian Securities and Investments Commission v Lindberg* [2009] VSCA 235 (Unreported, Maxwell P, Dodds-Streeton and Mandie JJA, 9 October 2009), it filed a second civil penalty case concentrating on the new allegations. However, ASIC suffered a major defeat on 9 December 2009

high profile property investment schemes of Westpoint, Fincorp, and Australian Capital Reserve (ACR),[55] and the spectacular collapse of stockbroking firm, Opes Prime,[56] occurring on its watch. Criticisms typically included ASIC being 'quarantined from market intelligence',[57] 'asleep on the job',[58] and 'on the backfoot'[59] in not acting early and effectively when it should arguably have been aware of emerging problems and/or possible misconduct.[60]

Notwithstanding the restructure, however, similar criticisms of ASIC's unresponsiveness or slow response to early warning signs or reports of possible breaches of the law have continued to be a recurring theme, not only in the press concerning the subsequent collapses of, for example, Storm, Banksia, Trio Capital and LM Investment Management[61] and

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when Robson J of the Supreme Court of Victoria threw the second case out of court as an abuse of process: see *Re AWB Ltd: Australian Securities and Investments Commission v Lindberg [No 10]* [2009] 76 ACSR 181, 185 and 235. Robson J permanently stayed this second case, stating (at 184): "If the second proceeding is not stayed, ASIC will have achieved by the second proceeding that which they could not achieve by amendment". See also P. Durkin, "ASIC Humiliated Again", *AFR*, 10 December 2009, p 5. It should be noted that the Victorian Court of Appeal later allowed the appeal by ASIC against this decision: *Australian Securities and Investments Commission v Lindberg [No 2]* (2010) 265 ALR 517, 534-535 (Maxwell P, Buchanan and Weinberg JJA). See also ASIC, "ASIC Successfully Appeals Permanent Stay on Second AWB Case", *Media Release 10-29AD*, 19 February 2010.

55 See earlier discussion in Chapter 8, nn 164-169 and 202; and below, n 57 and 59. See also, eg, R. Harley, "Collapse! Why More Investors are Taking the Fall: Regulators are Under Pressure as More Innocent Investors Get Burned", *The Weekend AFR*, 2 – 3 June 2007, pp 1, 21 -23.

56 Opes Prime collapsed in April 2008.

57 See, eg, "Fincorp Shows ASIC Needs More Intelligence", above n 46.

58 B. Frith, "ASIC Asleep On The Job: Brokers Should Not Be Allowed To Deny Clients' Equitable Rights", *The Australian*, 10 April 2008, p 18. Frith reported on what he described as 'the manifest unfairness' of the treatment of many clients of Opes Prime, revealing what he thought was 'a complete failure' of ASIC 'in one of its fundamental roles – to ensure market integrity'.

59 See, eg, J. Collett, "Human Cost of ASIC Failures", *The Sydney Morning Herald*, 6 June 2007, p 8; and P. Manning, "Danger Do Not Enter", *AFR*, 21 July 2007, p 24.

60 In the case of Opes Prime, eg, there were claims that ASIC failed to act to prevent massive losses being suffered by investors even after it and the ASX were warned that the broker had slipped below the mandatory liquidity threshold six weeks before it collapsed: see D. Hughes and M. Drummond, "Parliament to Probe ASIC Role in Collapses", *AFR*, 27 February 2009, p 6. These claims were made to the parliamentary inquiry discussed below, nn 66 and 69 -70, which not only examined ASIC's conduct in relation to Opes Prime, but also Storm. Regarding Fincorp, it should be noted that ASIC had forced Fincorp to refund $75 million to investors in 2005 after an argument over the wording of the prospectus. ASIC also put 2 stop notices on another prospectus, but later revoked them in 2006. Similarly with Westpoint, its activities had come to ASIC's attention in 2002 and in May 2004, ASIC had commenced proceedings against a Westpoint company seeking a determination by the court on whether certain promissory notes offered should have been offered as financial products under the corporations legislation, but ASIC claimed that it 'was not aware of the apparently large scale involvement of licensed financial planners advising on Westpoint products' at this time: see The Hon Peter Costello, *House of Representatives Hansard*, 21 May 2007, p 139.

61 Concerning LM Investment Management, see, eg, T. Boyd, "Credibility of ASIC Suffers Blow", *AFR*, 30 July 2013, p 44, where ASIC came under fire for allegedly failing to act on emerging problems early. Boyd reported that ASIC was warned in October 2012 about the risk that the fund raising techniques of the LM group were posing for investors, which was well before the 2013 $1 billion collapse of the LM Investment Management empire.

scandals such as the CFPL scandal,[62] but also, in a number of parliamentary inquiries, including the most recent Senate inquiry. As such, it will be argued that despite the considerable efforts that ASIC has made to better understand the market it regulates,[63] this has not been enough for ASIC to achieve a full understanding and appreciation of Australia's corporate world with the result that ASIC's capacity to identify and respond to potential problems and/or wrongdoing is still wanting.[64]

The Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS), which conducted a dedicated inquiry into the collapse of Trio Capital (which left the victims of a superannuation fraud having lost $176 million in superannuation funds) was critical, for example, of both ASIC and APRA regarding their tardiness to act in relation to the fraud in this matter,[65] while as part of its 2009 inquiry into financial services and products, the PJCCFS in examining ASIC's actions concerning Storm, emphasised the failure of ASIC to act early to prevent further losses.[66] This is despite evidence that D'Aloisio was reported as giving the Senate Estimates Committee earlier that year, that not only did ASIC not have the power 'simply to act to prevent this [financial] model',[67] but no more could have been done to warn Storm's clients since 'neither earlier surveillance, nor more recent complaints, provided any smoking gun for ASIC'.[68] In addition to the PJCCFS, however, commenting that ASIC 'may have recognised earlier that Storm's practices were problematic if ASIC's risk-based auditing processes were more effective',[69] it is telling that suggestions were made to it that ASIC's approach in being 'too reactive' was due to its limited resources.[70]

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62 See, eg, J. Eyers and C. Yates, "CommBank Covered up Scandal", *AFR*, 27 June 2014, pp 1 and 44.

63 See also discussion below, n 85.

64 It should be noted that previous attempts by ASIC to improve its workings have not always met with success. The expansion of its former Compliance directorate 'to give greater emphasis to real-time regulation' in 2006, for instance, did not result in it being better placed to act so as to prevent further losses from similar collapses – Fincorp and ACR. The Compliance directorate was expanded in the aftermath of the Westpoint collapse and criticism that ASIC could have prevented the massive losses from it if it had been more proactive: see ASIC, "Working for Australia: ASIC Annual Report 2005- 06", *Media Release 06- 378*, 31 October 2006.

65 See PJCCFS, *Inquiry into the collapse of Trio Capital*, May 2012, p xx.

66 See PJCCFS, *Financial products and services in Australia*, November 2009, discussed in Senate inquiry into ASIC's performance, above n 9, p 228. As part of its 2009 inquiry, as noted above n 60, the PJCCFS had also considered ASIC's actions relating to Opes Prime. Submissions, including those by individuals aggrieved by the Opes Prime and Storm collapses were also made to the Senate inquiry into the performance of ASIC, ibid: see, eg, *Submission 280* (Opes Prime) and *Submission 393* (Storm). See also below, nn 71 and 136.

67 This statement is in line with the statements D'Aloisio made above, nn 40-43.

68 Quoted in Hughes and Drummond, "Parliament to Probe ASIC Role in Collapses", above n 60.

69 PJCCFS, *Financial products and services in Australia*, above n 66, p 4. But note ASIC's performance was not a central issue in the report of the PJCCFS. Instead, that committee made proposals for legislative

A dominant theme in the submissions to the Senate inquiry were also about ASIC's 'slow response and its failure to join up the dots'.[71] Moreover, the Senate committee reported that the complaints which were made by those recounting individual experiences of ASIC's inaction or failure to pay attention to early warning signs were widespread and not simply confined to matters such as Storm or CFPL.[72] Additionally, they were drawn from many sections of Australia's corporate world.[73]

However, of particular concern is that the Commonwealth Ombudsman noted in his submission that one of the most frequent complaints lodged with his office about ASIC was that it failed to investigate and/or take enforcement action in regard to a report of wrongdoing or breach of legislation,[74] and that a former enforcement adviser at ASIC, Niall Coburn, was among those who made strident criticisms of ASIC's culture.[75] According to Coburn, ASIC seemed to lack 'a culture of urgency, proactivity and flexibility', with its processes driven by 'a management culture that has a wait-and-see attitude'.[76] Furthermore, the comments that Coburn made in arguing that ASIC needs to have the right skill set as well as the right culture, highlight that previous concerns about the ability of regulatory staff to understand and deal with complex cases[77] still exist. He commented that '[o]ften ASIC complaint staff

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changes that led to the Future of Financial Advice (FOFA) reforms. FOFA became mandatory on 1 July 2013 (and was voluntary from 1 July 2012).

70 See, eg, P. Drum, CPA Australia, *PJCCFS Hansard*, Inquiry into Financial Products and Services in Australia, 26 August 2009, p 68. See also discussion below, nn 88-95.

71 See Senate inquiry into ASIC's performance, above n 9, p 229. Those submitters who commented on ASIC's tardiness in responding to reports of possible contraventions of the law included not only retail investors, but also registered ASIC agents, licensed financial planners and liquidators. Some of the evidence before the committee recounted individual experiences. For instance, Anne Lampe, who had worked at ASIC's media unit spoke of writing articles after Storm's collapse when she learnt first-hand from financial advisers about the lead-up to the failure. According to Lampe, the advisers were aware of what was occurring at Storm and had 'contacted ASIC well before its demise warning that Storm was over-leveraging elderly clients and had put them in a one-product-suits-all model rather than taking into account investors' individual needs to draw up an appropriate financial plan. The advisors reported that investors were at great risk. One lot of intel came from an internal Storm source': ibid, 232, citing *Submission 106*, p 3. Organisations such as the Institute of Chartered Accountants, Australian Shareholders' Association (ASA) and Consumer Law Action Centre expressed other concerns. The ASA, eg, was concerned about ASIC's complaints management policies and practices, which to the affected party, seemed to be 'reactive and not alert to potential problems': ibid, p 230.

72 Ibid, p 232.

73 Ibid.

74 Ibid, pp 230-231, *Submission 188*, p 6.

75 See in particular, ibid, pp 251-254 for criticisms of ASIC lacking a culture of receptiveness and generally being 'remote' and 'bureaucratic'. See further discussion below, n 102.

76 Senate inquiry into ASIC's performance, above n 9, p 253, citing N. Coburn, *Proof Committee Hansard*, 21 February 2014, p 1.

77 See Chapter 1, n 117. See also below, n 141.

are inexperienced in both commercial matters and understanding evidential issues'[78] and that 'you don't send a chicken out to deal with a crocodile – ASIC are sending the wrong individuals to trace or deal with these wolves who have ripped off mums and dads and then escaped internationally'.[79]

Accordingly, the evidence seems to support the view that ASIC does not deal with complaints in an adequate fashion and that instead, it 'ignores grassroots warnings of impending collapses and crisis'.[80] This is in spite of Medcraft having asserted in June 2012 and his continuing to employ the traffic accident analogy of his predecessor discussed above[81] that ASIC was 'very focused on proactive surveillance, by working with the media to call things early, to try to warn consumers … [and] … be proactive not just being, if you want, the ambulance that arrives at the scene of the accident when it occurs'.[82]

It is, therefore, not surprising that the Senate committee in its report identified the need for ASIC to become 'a far more proactive regulator ready to act promptly but fairly'.[83] To that end, in relation to ASIC needing to be alert to emerging problems and/or misconduct, the committee made a variety of statements and recommendations. However, the author has concerns with many of these and is far from convinced that even if ASIC seeks to change and take steps to respond to issues raised in the Senate inquiry, which to some extent ASIC claims it has done already,[84] that it will be any more successful than it has been in the past

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78 Senate inquiry into ASIC's performance, above n 9, p 253, citing Coburn, *Proof Committee Hansard*, ibid, p 1.

79 Senate inquiry into ASIC's performance, ibid, citing Coburn, *Proof Committee Hansard*, ibid, p 2.

80 Senate inquiry into ASIC's performance, ibid, p 227, citing *Submissions 130,132, 136, 140, 141, 156* and *160*.

81 See above, n 43.

82 G. Medcraft, Chairman, ASIC, *PJCCFS Hansard*, Statutory Oversight of the Australian Securities and Investments Commission, 22 June 2012, p 13, cited in Senate inquiry into ASIC's performance, above n 9, p 227. But note seemingly inconsistent statements made by Medcraft in September 2012: G. Medcraft, Chairman, ASIC, *PJCCFS Hansard*, Statutory Oversight of the Australian Securities and Investments Commission, 12 September 2012, pp 14-15, concerning ASIC's ability to conduct proactive surveillance being constrained by its resources, discussed below, nn 89-95.

83 Senate inquiry into ASIC's performance, above n 9, p xx.

84 See Medcraft, "Parliamentary Joint Committee: Opening Statement", above n 36, pp 3-4, where Medcraft said that "[w]e have been improving our processes and procedures to address concerns raised. This involves three main elements: 1. improving our communication across the board; 2. a focus on identifying emerging risks; and 3. a commitment to strong and swift enforcement action". Further, he set out how ASIC is going about making improvements under the headings, 'Communication', 'Emerging Risks' and 'Enforcement'. But this has only been done in very broad terms. Eg, on communication, Medcraft has stated that "we have already made changes to ensure our operational teams have the skills and commitment to deal effectively and sensitively with whistleblowers" without any explanation or indication as to how this has been achieved. Similarly, on emerging risks, where he asserts "[w]e are listening to concerns

with the many initiatives it has undertaken over the years, including before and after its 2008 restructure, to better understand the market it regulates.[85]

Among the author's concerns are those that relate to recommendations for ASIC to 'review its surveillance activity with a view to making it more effective in detecting deficiencies in internal compliance arrangements'[86] and in light of the CFPL matter to 'undertake intensive surveillance of other financial advice businesses', such as Macquarie Private Wealth (MPW).[87] A major problem with ASIC being able to address the issue of improving surveillance, however, is the level of its resources. As we have seen, ASIC has made it clear on numerous occasions that it is 'not resourced to be on every road and at every intersection',[88] including by Medcraft, who has stated in terms of proactive surveillance that "[w]e are not resourced to be looking at everybody'.[89] Medcraft said this after the release by ASIC publicly of its surveillance coverage figures for the first time,[90] which he also said was important in 'explaining to Australians that ASIC is not a prudential regulator, not a conduct

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raised through complaints, reports of misconduct and breach reports, and we are focused on intelligence from our wide range of stakeholders", there is no evidence presented to support that ASIC will respond more effectively than it has in the past . It also ignores the problems of reliance on others in the regulatory process, discussed below, nn 98-100.

85 Examples of significant initiatives include ASIC's *Better Regulation* program launched in May 2006. This program included the *ASIC Service Charter*, which has been maintained. It outlines the most common interactions ASIC has with the public and reports on its performance for the relevant financial year. This program also included ASIC's *Strategic Plan 2005-2010*, which set out ASIC's five key goals and strategies for this period. Those goals and strategies were to: 1. Help consumers make better financial decisions; 2. Strengthen the integrity of Australian corporations; 3. Sustain confidence in our financial markets; 4. Unlock new value form public information; and 5. Create a more flexible organisation: ASIC, *Strategic Plan 2005-2010: Working Together For Fair and Efficient Markets and Confident, Informed Consumers.* This document was published on ASIC's website (accessed 11 November 2008). In addition, a review of ASIC's annual reports shows efforts to build support for compliance and good practice by ASIC engaging in such activities as staff giving presentations to people from the markets, financial services, industry, companies and government agencies, conducting summer schools bringing together international and Australian speakers and consulting with peak industry and professional organisations and consumers. ASIC's 2008 strategic review also drew on the views of the 1,250 respondents to the stakeholder survey referred to above at n 50, to identify what ASIC did well and where it needed to improve.

86 See Senate inquiry into ASIC's performance, above n 9, p xxv (Recommendation 10).

87 Ibid (Recommendation 11). See also Medcraft, "Parliamentary Joint Committee: Opening Statement", above n 36, p 4, for a discussion of the developments with the MPW matter.

88 See above n 43.

89 See G. Medcraft, ASIC, *PJCCFS Hansard*, Oversight of ASIC, 12 September 2012, pp 14-15.

90 See ASIC, *Annual Report 2012-2013*, pp 16-17. See also Senate inquiry into ASIC's performance, above n 9, pp 33-34, *Table 4.1: ASIC's surveillance coverage of regulated populations in 2012 -13*. These figures showed the number of staff allocated to each of its stakeholder teams, the number of regulated entities they oversee and, for the first time, the number of years it would theoretically have taken to conduct surveillance on every regulated entity. For instance, they reveal that ASIC had 29 staff members that oversaw 3,394 AFS licensees authorised to provide personal advice and 1,395 AFS licensees authorised to provide general advice; 49 staff members that oversaw 21,690 public companies, including 1,983 listed entities (excluding foreign companies); and 38 staff that oversaw 86 audit firms and the financial reports of 1,983 listed entities (excluding foreign companies) and 26,000 unlisted entities.

and surveillance regulator' and warning them that 'frankly what we have is a system based on self-execution' that relies on people, especially 'gatekeepers to do the right thing'.[91] Professor Kingsford Smith in her work, commenting on ASIC's 2009-2010 surveillance coverage statistics also makes the point about ASIC's lack of resources in the context of ASIC not being able to achieve responsive regulation in the financial services sector. She states that these statistics demonstrate 'in very brutal terms of resources and enforcement policy, there is at present no realistic prospect of developing anything approaching a regular surveillance or inspection program'.[92] Additionally, staff at the International Monetary Fund reported in 2012 that "ASIC is hampered in its ability to carry out proactive supervision because of a lack of budgetary resources".[93] Accordingly, with budget cuts to ASIC's funding announced and occurring already,[94] regrettably ASIC's ability to carry out proactive surveillance will 'substantially reduce' across the sectors it regulates, and in some cases stop.[95] It also means that ASIC's dependence on 'gatekeepers' will be greater than was previously the case,[96] which is acknowledged in the following statement made by the Senate committee:

> Given the resource constraints and knowledge gaps that a body like ASIC will always encounter, the committee has also designed recommendations intended to make the regulatory system more self-enforcing … To achieve this, ASIC needs to work effectively with other industry and professional bodies that share ASIC's goals. In particular, ASIC needs to ensure that it has strong, constructive and cooperative relationships with all … gatekeepers … [as well as] work with companies to

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91 Medcraft, *PJCCFS Hansard*, above n 89. But see discussion below, nn 98-100.

92 D. Kingsford Smith, "A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector" (2011) 44 *University of British Columbia Law Review* 695, p 724. Despite this, she maintains that inspections in the financial sector can still be an effective regulatory measure as 'they remind the regulated entity that the regulator is paying attention to what they do, or fail to do': ibid, p 735. See further ibid, pp 736-737, for other suggested strategies, including allocating a key officer to each regulated entity and requiring regulated firms to report events to ASIC, that while not contraventions of the corporations legislation, indicate changes in the firm's circumstances.

93 See International Monetary Fund, *Australia: Financial System Stability Assessment*, IMF Country Report, no 12/308, November 2012, pp 25-26.

94 As noted in Chapter 1, nn 152-153, in May 2014, the Government announced that it would reduce ASIC's funding by around $120 million over four years. This is in addition to the increased 'efficiency dividend' of $47 million over that period, and other savings measures:.Australian Government, *2014-2015 Budget: Budget Related Paper No 1.16*, Treasury Portfolio Budget Statements, May 2014, p 159. See also discussion below, n 118.

95 See *Senate Estimates: Opening statement*, ibid, p 3. Medcraft also went on to say: "For obvious reasons, we do not want to identify to the market the areas where we will not be conducting proactive surveillance".

96 See also *Senate Estimates: Opening statement*, ibid, where Medcraft also said that: "We will rely more on the intelligence we get from misconduct reports and the complaints we receive".

strengthen their internal compliance regimes and their systems for reporting non-compliance to ASIC.[97]

The first of two particular difficulties highlighted here is the ambitious regulatory role that has been ascribed to 'gatekeepers'. As scholars, such as Stephen Bainbridge have pointed out, gatekeepers, in particular auditors, failed to prevent scandals such as Enron and WorldCom in the US and One.Tel and HIH in Australia,[98] thereby demonstrating that gatekeepers are not always reliable and may not perform their regulatory role adequately.[99] The PJCCFS in examining the collapse of Trio Capital also found that the present system of gatekeepers failed in that case. Furthermore, the PJCCFS declared that '[t]here is no reason to believe that this system will be any more successful in detecting fraud in the future',[100] which also brings us to a consideration of the second problem, namely how ASIC is viewed not only by those relied upon to act as gatekeepers, but generally by others such as the individuals and entities it regulates and the 'experts' (retired and highly respected business people, lawyers, academics and former senior public servants) that the committee has also said that ASIC should rely on to assist it to identify and minimise potential risks.[101]

In this regard, while there is the concern that ASIC must remain ever mindful to tread a careful path lest it be criticised for being 'captured' by business, it is perhaps more significant that there has been the attitude, identified by Tomasic and Bottomley in their interviews with directors of the top 500 public companies in Australia and their professional advisers, that Australian corporate regulators are generally regarded as 'outsiders'.[102] Notwithstanding that these interviews took place between 1990 and 1991, and that, since then, as alluded to earlier, ASIC has made and no doubt will continue to seek to make significant efforts to better

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97 Senate inquiry into ASIC's performance, above n 9, p xxi.

98 See generally S. Bainbridge, *Corporate Governance after the Financial Crisis*, Oxford University Press, 2012, ch 6. See also J. Black, "Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis" (2012) 75 *Modern Law Review* 1037.

99 See Black, ibid, p1049, cited in Senate inquiry into ASIC's performance, above n 9, p 32. In support of this proposition, the examples Julia Black used also include auditors in such corporate collapses as Enron as well as what the GFC revealed about credit rating agencies.

100 *Inquiry into the collapse of Trio Capital*, above n 65, Parliamentary Paper No 138/2012, pp111-112, also cited in Senate inquiry into ASIC's performance, ibid.

101 Senate inquiry into ASIC's performance, ibid, p xx. See also recommendations to this effect, eg, requiring ASIC to establish a pool of experts from which to draw when concerns emerge about a poor compliance culture in a particular company: ibid, p xxiv (Recommendation 8), where the special expert would review and report back to the company and ASIC on suspected compliance failings with the process funded by the company in question.

102 See R. Tomasic and S. Bottomley, *Directing the Top 500: Corporate Governance and Accountability in Australian Companies*, Allen & Unwin, Sydney, 1993, p138.

understand the market,[103] one has to wonder whether negative perceptions of ASIC as 'bureaucratic' and 'remote'[104] or the notion that ASIC is an 'outsider' can ever be fully addressed? This is especially in view of the tendency for the relationship that ASIC has with the individuals and entities it regulates to be confrontationalist, particularly in situations where the regulated need to respond to enquiries from ASIC, which the Senate committee even acknowledged.[105] As Baldwin and Black in their research observe:

> Firms know that any information they give to the regulator may potentially be used against them in an enforcement action, and this can have a chilling effect on their cooperation with that regulator.[106]

Furthermore, it is understandable that their response when ASIC asks for information is to 'call their lawyers'.[107] Kingsford Smith makes a similar argument that "[f]irms turn to their lawyers, not to the regulator for a negotiation about how the complaint might be resolved'[108] and that instead of the ensuing conversation being about 'deeper difficulties – which might be better diagnosed if firms understood that through regular visits the regulator intended at least initially to be reasonable, and to persuade and support rather than prosecute', it is likely to focus only on the particular complaint.[109] Conversely, for ASIC it also means that the conversation that might have been had to afford it the opportunity to achieve a better understanding of core problems has been lost.

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103 See above, nn 84-85.

104 See, eg, above n 75.

105 See Senate inquiry into ASIC's performance, above n 9, p 38.

106 See J. Black and R. Baldwin, "Really Responsive Risk-Based Regulation" (2010) 32 *University of Denver Law & Policy* 181, p 199. This observation was made in the context of the theory of regulation developed by these scholars, discussed earlier in Chapter 3, Section 3.4.2, *'Really Responsive Regulation'*. Notwithstanding that they have called it 'really responsive risk-based regulation' in this 2010 article, what they present is essentially the same theory. At p 182, eg, Baldwin and Black explain that 'really responsive risk-based regulation' is a 'strategy of applying a variety of regulatory instruments in a manner that is flexible and sensitive to a series of factors', which results from the need for risk-based regulators to 'attune the logics of risk analyses to the complex problems and the dynamics of real-life scenarios'.

107 See ibid, p 199, who quoted an Australian lawyer (Note on file with authors) as saying this in regard to ASIC. Interestingly, the lawyer contrasted the position with APRA, saying that "[w]hen APRA asks for information, firms give it to them'. According to Baldwin and Black, this was because even though APRA has a model of intensive supervision for its high-risk financial institutions, this does not involve using formal enforcement actions unlike ASIC, which they believe has moved to respond to non-compliance with a much more deterrence-based approach.

108 Kingsford Smith, "A Harder Nut to Crack?" above n 92, p 734.

109 Ibid.

It is for these reasons, therefore, that other statements by the committee such as those requiring ASIC to 'develop an internal management system that fosters a receptive culture that would ensure that misconduct reports or complaints indicative of a serious problem lodged with ASIC are elevated to the appropriate level and receive due attention'[110] seem elusive. This is particularly so given that serious concerns also remain about the capacity of ASIC staff to understand and cope with complicated matters expressed, for example, by Coburn above.[111]

Part of the problem seems to stem from the lack of competitive remuneration of ASIC staff. While it may be that public service is seen as rewarding,[112] competitive remuneration of ASIC staff, and before that, NCSC (and CAC/CAO staff), has been an ongoing challenge adversely affecting their ability to attract and retain staff.[113] Further, although in recent years briefing out big trials to outside law firms has been an increasing trend for ASIC[114] and there have been some pay increases for senior management, this has not been the case for the middle and lower ranks of ASIC employees.[115] Therefore, if there is any chance of the

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110 See Senate inquiry into ASIC's performance, above n 9, p xxi.

111 As noted above, nn 77-79.

112 See, eg, J. Eyers, "Regulation Will Rise: Redfern", AFR, 24 October 2008, p 52, reporting on the views of former enforcement chief, Redfern. Redfern was reported as saying: "You get a pushback about having to take a pay cut for a couple of years. But the public service is incredibly rewarding. You won't get more interesting work". These were the comments she made when describing the reluctance of Australian law firms to offer secondees to ASIC to assist with the particular skills it required, pointing out that this was in stark contrast to law firms in the US, where it is very common to send relatively senior lawyers through the "revolving door" as a regulator, where they spend a few years before returning to private practice.

113 See earlier discussion in Chapter 1 for discussion of these problems, which affected the NCSC under the former cooperative scheme of corporate regulation. See also, eg, ASIC, *Annual Report 2003-2004*, p 9, that reported on concerns about ASIC salary levels which fell behind not only those in the private sector, but behind those in other comparable agencies, which was impacting adversely on its ability to attract and retain staff.

114 For instance, ASIC special counsel, Georgina Hayden, ran the James Hardie case initially, but in late 2007 the law firm, Clayton Utz, was briefed to take over. Similarly, as noted in Chapter 7, n 222, Mallesons Stephen Jacques (now King & Wood Mallesons) was also briefed in 2007 to run the regulator's case against Fortescue Metals and Forrest, taking over from the Australian Government Solicitor, that had commenced the proceedings in 2006.

115 See, eg, P. Cleary, "Frustration of ASIC's Foot Soldiers", *AFR*, 2 September 2009, p 60. Cleary wrote that: 'Senior management have been awarded massive pay rises, highly paid external consultants from the big law firms are increasingly dominating major investigations, while demoralised staff complain of facing belligerent senior managers who are attempting to marginalise them and cut pay and conditions'. He also wrote that, while the funding increase to ASIC in the May 2009 budget of $63m should have made things easier, it appeared that most of this money was being spent on highly paid consultants and senior management pay rises (ASIC's *2008- 2009 Annual Report* shows that senior executive remuneration rose 25% to $11.98 million, with the highest-paid executive receiving between $670,000 and $684,999). Moreover, commenting on ASIC's appointments from the market after its strategic review and restructure, eg, of former Mallesons Stephen Jacques partner, Belinda Gibson, who was first appointed as a commissioner (and later as ASIC Deputy Chair in May 2010), Cleary said that although these appointments deepened ASIC's skill base, they also aggravated the resentment felt by the middle and

perception of ASIC improving, which the author believes it must, so that working there, even if it is only for a few years is considered 'a badge of honour' or 'a prized entry in one's resume', as has been the experience of those who have worked at the US SEC,[116] it is imperative that the Commonwealth government increases ASIC funding to enable ASIC salary levels to be increased so that they are more in line with the private sector, thereby ensuring that ASIC attracts and retains talented staff. The author recognises that it is unlikely in the foreseeable future that the Government will adequately resource ASIC in this fashion due to present fiscal circumstances with budget cuts[117] and ASIC staffing levels declining,[118] as well as suggestions for changes to the way ASIC should be funded – through a user-pays system of industry levies and privatisation of its corporate registration and other administrative functions.[119] However, the author maintains that the Government resourcing ASIC so that it can pay its staff appropriately is necessary as part of also increasing ASIC's overall funding as will be argued below, failing which might cast doubts once again on the will of the Government to tackle corporate misconduct as some scholars argued was the case previously.[120] Furthermore, it will be seen that the Government's ability to increase ASIC's funding is a real option and not just a 'pipe dream' if funding arrangements are changed so that there is a direct link between the substantial revenue raised by ASIC and the funding it receives, which is the case with the SEC,[121] which is also the closest equivalent overseas counterpart of ASIC.[122]

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lower ranks over what he described as 'management's penchant for importing expertise' instead of building up the capacity of staff.

116 See A. Jury, "Chanticleer – Regulator Tries To Reinvent Itself', *AFR*, 9 May 2008, p 76.

117 See above, n 94 and below, 9.3.2 *ASIC Overburdened and Underfunded.*

118 n June 2014, Medcraft made certain statements to the Senate Estimates Committee concerning ASIC's budget position. They included, that '[i]n the 2014-2015 financial year, $44 million or around 12% has been cut from ASIC's operating budget' and that 'on average staffing levels will reduce by 209. This is a change from 1,782 to 1,573'. He also said that in anticipation of the cut to ASIC's budget, ASIC had been proactive in conducting a voluntary redundancy campaign: see G. Medcraft, *Senate Estimates: Opening statement*, 4 June 2014, p 2. See also Chairman's report, ASIC *Annual Report 2013-2014*, p 4, where Medcraft repeated these statements about ASIC's funding and outlook.

119 See in particular, below, n 151.

120 See, eg, P. Grabosky and J. Braithwaite, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies*, Oxford University Press, Melbourne, 1986, p 28. See also Tomasic and Bottomley, *Directing the Top 500*, above n 102, p 236. These scholars questioned the will of both the government and regulators to tackle the problem of corporate misfeasance especially in view of the inadequate resources provided by the government to the NCSC which seriously affected its ability to take enforcement action. This point is discussed in Chapter 1, Section 1.3.4, *NCSC: Lack of Resources*.

121 The fees collected by the SEC offset the government appropriations it receives, and in recent years total fees roughly equate to the funding the SEC receives through appropriations resulting in most appropriated funds being returned: US SEC, *Fiscal Year 2012 Agency Financial Report*, November 2012, p 36 www.sec.gov/about/secpar/secafr2012.pdf (accessed 16 September 2014).

122 See below, n 181. This is notwithstanding that ASIC has a wider regulatory remit than that of the SEC as discussed above, n 15.

9.3.2 ASIC Overburdened and Underfunded

It almost goes without saying that there is plainly a correlation between ASIC's list of responsibilities, the funding it receives and the outcomes it can achieve.[123] ASIC certainly reiterated this point in its main submission to the Senate Inquiry as it has done so often on other occasions:[124]

> What we are able to achieve also depends on our level of funding … ASIC can only achieve what it is resourced to do. Funding levels should be set by reference to Government and community expectations of what ASIC should deliver …[125]

Many individuals and organisations who presented evidence to the inquiry agreed that ASIC is underfunded[126] and that its growing regulatory remit[127] had impacted negatively on its performance as a result of either ASIC being entrusted with a longer and more diverse list of responsibilities, or because the extra funding provided to enable it to fulfil new responsibilities has been inadequate.[128] Jason Harris' evidence, for example, was that:

> In recent years, two trends regarding ASIC have emerged. Firstly, ASIC has been given increasing responsibility for important areas of corporate and financial regulation, including stock market regulation, financial services licensing, consumer

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123 See also Senate inquiry into ASIC's performance, above n 9, p 395.

124 See, eg, "What ASIC Expects of Directors", above n 30, p 4, where Medcraft stated: "[w]e do the best we can with our resources and powers to catch those who break the law".

125 See ASIC, *Submission 45.2*, above n 38, p 11.

126 See Senate inquiry into ASIC's performance, above n 9, p 397. But note some were less sure, eg, Levitt Robinson Solicitors who argued that 'ASIC's failures cannot be blamed on budgetary constraints, given ASIC's apparent profligacy in the deployment of public money spent on, or in outsourcing legal services': *Submission 276*, p 11, cited in ibid, p 398. The author, however, believes that ASIC is underfunded and as we have seen in Chapter 7, eg, when ASIC has decided to bring civil penalty proceedings against powerful and well-resourced defendants, those proceedings have proved to be expensive and protracted where, if anything, the resources of ASIC are likely to be more constrained. The Senate report made this point more strongly in highlighting the supervision coverage figures discussed above n 90, which it concluded emphasise 'the challenges ASIC faces in fulfilling its regulatory responsibilities with its current resources' as well as the disparity between ASIC's financial resources and those of the large firms it regulates: ibid, p 400. Indeed, the conclusion also reached that ASIC's enforcement special account presently seems inadequate for ASIC to run large and complex cases, discussed below, nn 161-163, is revealing. This was despite Medcraft's evidence which stressed the availability of this account in particular to dismiss concerns expressed to the inquiry that ASIC did not have the funds to pursue legal actions against large companies/'the big end of town': see G. Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 9 February 2014, p 28, cited in ibid, pp 272-273.

127 As noted above, nn 3-9.

128 See Senate inquiry into ASIC's performance, above n 9, p 397.

> protection in financial services, business names registration and credit regulation. These matters add to ASIC's already full regulatory brief covering general corporate regulation and administrative matters (document lodgments, searches and maintenance of registers). During this time while ASIC's funding has increased, much of the funding has been tied to particular projects (such as key investigations into HIH and other high profile matters),[129] and the numbers of staff working at ASIC has only increased from 1221 in 2000 to 1738 in 2012 (according to ASIC's Annual Reports).[130] The increases in funding and staffing are wholly inadequate to account for exponential increase in ASIC's responsibilities.[131]

Indications that ASIC was underfunded and already overburdened before it took on new responsibilities for market supervision and consumer credit in 2010[132] and, consequently, not able to cope well with enforcement as part of its responsibilities is provided in several instances. The first instance concerns what occurred with Storm. Suggestions that ASIC's failure to carefully monitor and act early to prevent further losses in this matter due to constraints on its resources are noted above.[133] Additionally, the length of time it took ASIC to investigate Storm before it launched any legal proceedings in such a serious matter suggests that it was overburdened and lacked the resources to take appropriate action.[134] Indeed, in June 2010 the Committee on Corporations and Financial Services – chaired by Bernie Ripoll (which has oversight of ASIC activities) criticised ASIC publicly over its '19-month investigation' into Storm's collapse warning it needed to progress the investigation to action by the end of July.[135] However, it was not until November and December 2010 that ASIC commenced legal proceedings against various banks (including the Commonwealth

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129 As noted in Chapter 1, nn 136-145.

130 See also Chapter 1, n 123 and accompanying text. There, it is noted that in 1984, the combined staff numbers of the NCSC and CACs/CAOs totalled around 1,400, which is comparable to the overall number of staff employed by the ASIC, which on average has been around 1,500, although it did increase to its highest level in the 2012- 2013 financial year to 1,844 on a full-time equivalent (FTE) basis, before the most recent cuts in funding and staffing levels discussed above, nn 94 and 118. Note that there is also some minor variation in the figures given regarding the number of staff employed by ASIC in 2012. According to ASIC's *2012-2013 Annual Report*, p 19, the figure is 1,844, while in Harris' submission it is 1,738 and in Medcraft's *Opening statement* to the Senate Estimates committee, above n 118, it is 1,782.

131 *Submission 116*, p 1.

132 See above, n 7.

133 See discussion above, n 70.

134 It should be noted that ASIC, once it commenced its investigation into Storm in December 2008, commenced negotiations on an enforceable undertaking: see ASIC, *Submission 378* to the PJCCFS inquiry into financial products and services in Australia, above n 66, p 16.

135 See D. Hughes, "Rumbles over Storm Probe", *AFR*, 23 June 2010, p 51. At the time, ASIC's investigation was still underway, nearly seven months after the parliamentary review, discussed above n 66, and recommendations into the collapse were completed.

Bank of Australia (CBA), Bank of Queensland and Macquarie Bank) and former directors of Storm (Emmanuel and Julie Cassimatis).[136] In the meantime, there were also reports that the head of ASIC's financial services team and the investigation into Storm, Tim Castle, a barrister, resigned in March because "under-resourcing had hampered efforts to collect enough information to launch prosecutions".[137]

It is interesting that around this time in 2010, ASIC also came under attack after it was revealed that it used its coercive, information-gathering powers 18,625 times over the preceding three years.[138] Amongst other things, ASIC's heavy use of these powers raised concerns that the regulator was employing the powers indiscriminately and that it lacked the resources to properly analyse material provided.[139]

Further, in relation to ASIC's new responsibility for supervision and surveillance of financial markets and participants which it took over from the ASX in August 2010, concerns were expressed about ASIC's capacity to properly discharge its responsibility in this area.[140] Again this suggests that even at this time, ASIC lacked the expertise and resources to do so and was overburdened.[141] Concerns were also raised about ASIC's new surveillance system not working properly, which prompted a Senate committee questioning D'Aloisio about this on 21 October 2010.[142] D'Aloisio's response was that there was a 'settling-in-period' with the new system "particularly where you are looking at where you set your warnings and what

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136 See https://storm.asic.gov.au . ASIC's subsequent actions and approach in this matter have also been widely questioned: see eg, the settlement it reached with the CBA discussed in Chapter 8, n 222. Note also the many submissions criticising ASIC's performance made to the Senate inquiry, eg, *Submissions 18, 41, 44, 82, 84, 87, 88, 90, 172, 236, 278* and *301*. But see ASIC's defence of its actions in this matter: *Submission 45.2*, above n 38, p 118.

137 See Hughes, "Rumbles over Storm Probe", above n 135.

138 See, eg, J. Eyers, "ASIC Slated over 18,625 Ultimatums", *AFR*, 13 October 2010, pp 1 and 4. See also Chapter 1, Section 1.3.3, *Powers of ASIC*, for a discussion of these powers, which include forcing people and companies to produce information, attend interviews, answer questions and give all reasonable assistance.

139 Ibid.

140 See, eg, ibid.

141 This is notwithstanding that ASIC received $387 million in government funding for the financial year ended 30 June 2010 (up 31% on the previous financial year), according to its annual report tabled in parliament on 28 October 2010. Part of this funding was spent preparing for ASIC's new role as market supervisor: see K. Burgess, "Tide Begins to Turn for ASIC", *AFR*, 29 October 2010, p 8.

142 See D. Crowe, "Market Scrutiny under Control: ASIC", *AFR*, 22 October 2010, p 10. On assuming responsibility for its new role from the ASX, ASIC hired about 20 former ASX staff to form its monitoring team. It also bought the same software used by the ASX. But the regulator had to customise the software known as Smarts, and did not gain the benefit of the 'calibrations' made by ASX staff over many years to adjust the system for local conditions.

comes up", but not surprisingly, he assured the committee that there was no risk to the scrutiny of the market.[143]

As a result of these concerns and those expressed to the Senate inquiry discussed above, it is also not surprising that options were suggested to lessen the regulatory burden on ASIC. The main ones were to:

1. privatise ASIC's corporate registration and other administrative functions, or transfer these to another government agency;
2. split ASIC into smaller regulators along the lines of its broad business areas; and
3. transfer responsibility for consumer protection to the ACCC or create a new consumer protection agency.[144]

Of these, ASIC losing some of its functions (consumer protection in financial services) in the way suggested by 3 appears to be the best solution that would free up ASIC and consequently, resources, to focus on its more traditional responsibilities, especially corporate regulation and enforcement.[145] It would also mean if consumer protection in financial services became the responsibility of the ACCC,[146] that concerns over the current framework that have existed ever since the *Wallis* inquiry resulted in the transfer of responsibility for this area from the ACCC to ASIC would be overcome. The Productivity Commission in 2008, for example, reported that the financial services carve out from general consumer law caused some uncertainty about whether the ACCC or ASIC had jurisdiction,[147] while Allan Fels (a

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143 Ibid.

144 See Senate inquiry into ASIC's performance, above n 9, pp 402-407.

145 But note there have also been suggestions to transfer ASIC's insolvency functions to the Australian Financial Security Authority (formerly called the Insolvency & Trustee Service Australia (ITSA)), which was recommended by the committee's 2010 report: Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, Parliamentary Paper No 179/2010, Parliament of Australia, Canberra: see Senate inquiry into ASIC's performance, ibid, p 405, citing, eg, J. O'Brien, *Proof Committee Hansard*, 19 February 2014, pp 55 -56. For Professor Justin O'Brien, this was in addition suggesting that the current division of consumer protection responsibilities between ASIC (for consumer protection in financial services and products) and the ACCC (for consumer protection in the remaining sectors of the economy) needed review.

146 But note that there have been calls for the creation of a body dedicated to consumer protection in financial services: see, eg, J. Wheeldon, *Proof Committee Hansard*, 2 April 2014, p 23, cited in Senate inquiry into ASIC's performance, ibid, 405. Wheeldon, a former ASIC employee argued that ASIC is overburdened to the detriment of its ability to protect retail investors, declaring that: 'the millions of people who are putting money into the superannuation system … are the ones who have been let down the most by ASIC'.

147 See Senate inquiry into ASIC's performance, ibid, p 406, citing Productivity Commission, *Review of Australia's Consumer Policy Framework*, vol 1, report no 45, 30 April 2008, p 24. The Productivity

former ACCC chairman) and Fred Benchley (a former editor of the *AFR*) expressed similar views in a number of newspaper reports, including that '[t]he natural home of financial consumer protection is the ACCC, not the carve-out to ASIC created by Wallis';[148] and the government should consider making the ACCC the sole consumer regulator, including for financial services since'[c]arving out these powers for ASIC has not worked'.[149]

Regarding the other proposals, although the author believes that 2 (ASIC being split along clusters or tasks) might also be a solution, sadly it seems that the course the Government might follow is to privatise ASIC's registry function set out in 1. This is in light of the Government's announcement in May 2014, as part of the 2014-2015 Budget, that a scoping study would be undertaken into future options for ASIC's registry functions.[150]

However, this course and the adoption of a new user-pays funding model for ASIC, which is also 'on the cards'[151] are fraught with problems. In the first place, it is highly unlikely that privatisation of ASIC's registry functions will lead to lower costs as has been suggested,[152] despite criticisms about the high fees ASIC levies on business and individuals to fulfil their obligations to provide information as well as access information.[153] Rather, privatisation will lead to even higher fees being charged by a commercial operator as has been the experience to date with the privatisation of public enterprises and utilities not just in Australia but overseas. Moreover, the argument of the Community and Public Sector Union (CPSU) that because the registry functions raise 'a reasonably significant source of income[154] and would appear to be a monopoly service', it would be in the public interest for an Australian

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Commission recommended the restoration of the economy-wide jurisdiction of the ACCC for consumer protection, but with ASIC continuing to be primarily responsible for financial services regulation.

148 A. Fels and F. Benchley, "Consumer Watchdog Tipped to Get More Bite as Rudd revolution Gains Pace", *The Age*, 5 April 2008, p 2, quoted in Senate inquiry into ASIC's performance, ibid.

149 A. Fels and F. Benchley, "Rudd's Consumer Activism Over the Top", *Sydney Morning Herald*, 21 March 2009, p 4, quoted in Senate inquiry into ASIC's performance, ibid.

150 See Australian Government, *2014-2015 Budget – Budget Paper No 2*, May 2014, p 117. The Senate committee had recommended this after it said that ASIC's corporate and business names registry function should be transferred elsewhere 'to allow ASIC to concentrate on its core functions' : See Senate inquiry into ASIC's performance, above n 9, p xxxii (Recommendation 49). But see below, nn 158-160 and Figures 8 and 9.

151 A user-pays system was also recommended by the Senate committee: see Senate inquiry into ASIC's performance, ibid, p xxxii (Recommendation 50).

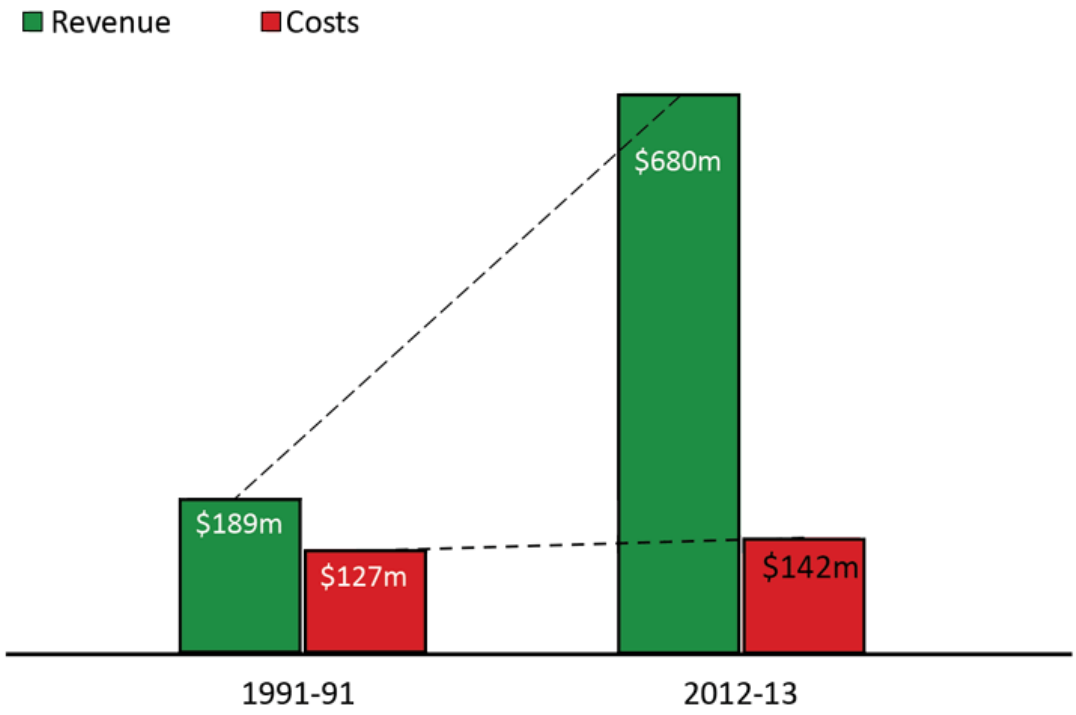
152 See, eg, *Submission 263*, pp 3, 8 to Senate inquiry into ASIC's performance, ibid, pp 403-404.

153 Ibid.

154 See in particular below, Figure 8.

government authority to be tasked with these functions, instead of them being privatised[155] has merit. But, more importantly the reason why these registry functions should remain the province of ASIC is because otherwise ASIC would suffer a substantial reduction in its revenue as demonstrated in the Figures below (which also show how the revenue ASIC collects and the cost of performing certain regulatory tasks have changed over time).

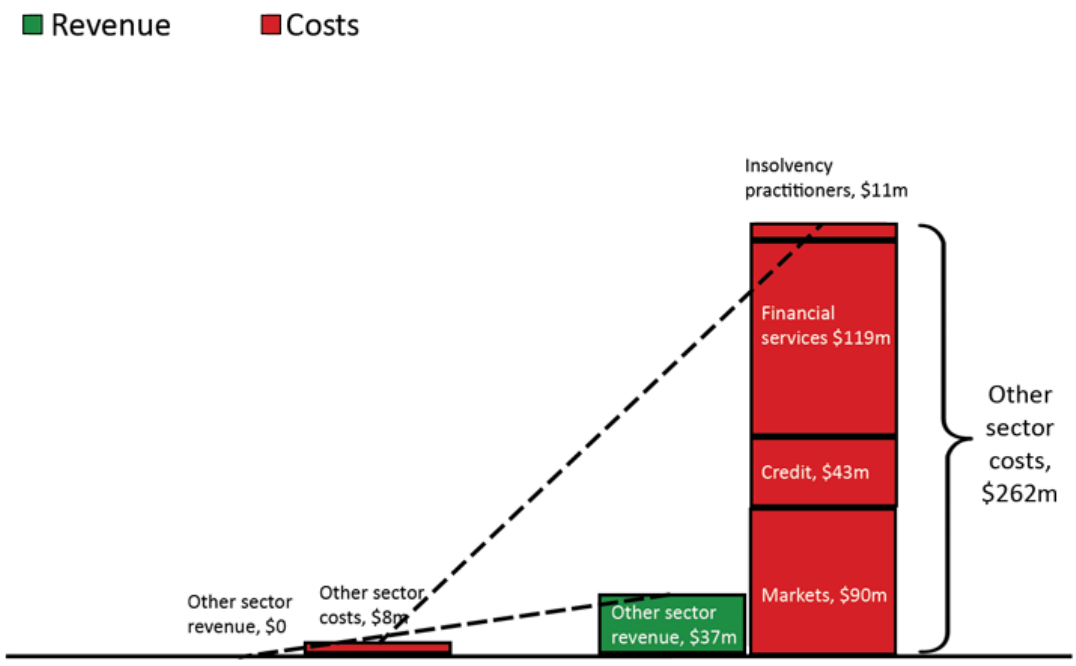
Figure 8: Revenue and costs – companies, business names and searches 1991-2013 (nominal amounts)[156]



155 See A. Waters, CPSU, *Proof Committee Hansard*, 19 February 2014, 64, cited in Senate inquiry into ASIC's performance, above n 9, p 404. Note that the Governance Institute of Australia suggested the possibility of the devolution of ASIC's registry functions to a body, which would be the equivalent of the UK's Companies House as a way of leaving ASIC able to devote resources to its other legislative, surveillance and enforcement responsibilities: See Governance Institute of Australia, *Submission 137*, p 6, cited in ibid, p 402.

156 This figure appears as Figure 25.2 in Senate inquiry into ASIC's performance, ibid, p 411. Revenue is from companies, business names and searches; costs are from regulating companies, including administering business names and searches. Source: ASIC, *Submission 45.7*, p 2.

Figure 9: Revenue and costs – all other sectors 1991-2013 (nominal amounts)[157]



Figures 8 and 9 reveal that ASIC's revenue from companies, business names and searches in 2012-2013 was $680 million, while its revenue from all other sectors was only $37 million.[158] Accordingly, if ASIC lost its registry functions (using the 2012-2013 figures by way of example), it appears at first instance that only $37 million would be available[159] for ASIC to carry out 'core functions', such as regulating corporations which cost $142 million.[160] However, there is the enforcement special account that is available to ASIC,[161] which in

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157 This figure appears as Figure 25.3 in Senate inquiry into ASIC's performance, ibid. 'Other sectors' includes insolvency practitioners, AFS licensees, credit providers, exchange market operators, market participants and consumers. 'Financial services' includes financial advisers, insurers, responsible entities, superannuation fund trustees, deposit takers, investment banks, consumers and custodians. Source: ASIC, *Submission 45.7*, p 3.

158 Note these figures are estimates only, and are not adjusted for inflation.

159 This is *if* ASIC was permitted to retain this revenue and not return it to consolidated revenue.

160 From Figure 8, it can be seen that the cost of regulating corporations has fallen in real terms since ASIC was established. This is principally due to technological advances.

161 A special account is an appropriation mechanism that sets aside an amount of consolidated revenue that is available for specified purposes. The enforcement special account was set up to 'give ASIC the flexibility to conduct major investigations into, and bring legal and/or administrative proceedings against individuals and corporations in relation to possible corporate or financial services misconduct when required, without the need to seek additional Budget funding'. The intention was that the investigations and proceedings 'would typically relate to matters for which ASIC could not absorb the costs without significantly prejudicing its existing general enforcement role, and/or those matters which are critical to continued public confidence in the corporate regulatory framework': see G. Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p 28, cited in Senate inquiry into the performance of ASIC, above n 9, p 273. See also Explanatory Statement, *Financial Management and Accountability Act 1977:* Determination 2006/31 to establish a Special Account, pp 1-2.

February 2014 had a balance of around $30 million,[162] which still means that there would have been a shortfall of $75 million to deal with corporate regulation.[163]

But if the new user-pays funding model is introduced to replace the current framework, industry levies will be the means by which ASIC would be funded.[164] Despite arguments that this cost-recovery system of levies would be fairer in the way that it impacts on business in that 'those that generate the need for regulation should pay for that regulation',[165] the big fear with the user-pays system is the threat that it poses to ASIC's independence. Robbie Campo, Deputy Chief Executive of Industry Super Australia, has clearly articulated this concern in stating that if ASIC is funded by industry-based levies, the disadvantage is that:

> it changes the nature of the relationship that ASIC has with industry. If there are parts of industry that are providing a greater level of funding, it might alter the perception of the independence of the regulator from those parts of the industry.[166]

Further, although Professor Kingsford Smith recognised that a user-pays levy would support a regulatory regime that was self-executing as Medcraft also argued,[167] she has issued the caution that it is vital to ensure that the public interest be reflected in any changes to the manner in which ASIC might be funded in the future, emphasising that:

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162 See Medcraft, *Proof Committee Hansard*, ibid, cited in Senate inquiry into the performance of ASIC, ibid.

163 This is because in 2012-2013, corporate regulation cost $142 million, but when there would only have been $67 million (made up from the revenue from other sources and a further $30 million from the enforcement special account) available. The Senate report also found that currently ASIC's enforcement special account seems inadequate for ASIC to cope with major litigation and recommended that the balance of this account should be 'increased significantly': see Senate inquiry into the performance of ASIC, ibid, p xxvii (Recommendation 22).

164 A small proportion of ASIC's functions are presently funded by industry levies. Operators of domestic licensed financial markets regulated by ASIC and some market participants are subject to an annual levy. Levies collected by APRA and the ATO also cover some of ASIC's costs: see APRA, *Annual Report 2013*, p 81.

165 See G. Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p 29, cited in Senate inquiry into ASIC's performance, above n 9, p 412. Medcraft also said that he thought user-pays systems are 'far more transparent' and could encourage better self-regulation and lead to better regulatory outcomes. But see discussion below, n 168. See also, ibid, p 409, where according to Medcraft, 80 percent of ASIC's revenue of $680 million from company regulation and business names registration, as shown in Figure 8 above, comes from small business.

166 See R. Campo, Deputy Chief Executive, Industry Super Australia, *Proof Committee Hansard*, 20 February 2014, p 32, cited in Senate inquiry into ASIC's performance, ibid, p 409. But note that she also acknowledged the equity argument that industry-based arrangements would ensure that the cost of regulation is borne by those that give rise to the greatest regulatory burden.

167 See discussion above, n 165.

> [i]f you have the entire regulatory revenue coming from levies, particularly in a concentrated market such as Australia where a lot of the levy income might come from a very few players, you have to watch out for undue influence coming from those who pay.[168]

The author, therefore, maintains that instead of this user-pays approach being adopted, the Government should simply change the way it funds ASIC so that there is a direct link between its funding and substantial revenue. From the Figures above, it can be seen that the total revenue ASIC collected in 2012 -2013 was $717 million,[169] but it was returned by ASIC to consolidated revenue.[170] Furthermore, apart from the few exceptions noted above,[171] the bulk of ASIC's funding (which in 2012-2013 was $350 million in appropriation revenue)[172] has no relationship with the revenue ASIC collects.[173] The fact that ASIC also collects significantly more revenue than its operating expenses is significant, especially with the steady growth in revenue from *Corporations Act* fees. Indeed, data compiled from ASIC's annual reports show that between the 2000-2001 and 2012-2013 financial years, ASIC produced an operating surplus for 11 of the 13 financial years, with an average of $16.7 million surplus each year.[174] ASIC's most recent *2013-2014 Annual Report* also shows that ASIC produced a significant surplus – collecting $737 million for the Commonwealth when its operating expenses were only $405 million in 2013-2014.[175]

One must, therefore, question why is ASIC's funding being cut and projected to decline?[176] Obviously, it is part of the Government's commitment to balance the Budget, but at what cost? If ASIC is to be 'respected and feared' and a clear and unmistakeable message sent, backed-up and continually reinforced by actions, that it will use the enforcement tools at its disposal to 'uphold accepted standards of conduct and the integrity of the markets', as the

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168 See D. Kingsford Smith, Proof Committee Hansard, 19 February 2014, 53, cited in Senate inquiry into ASIC's performance, above n 9, p 414.

169 See also ASIC, *Annual Report 2012-2013*, p 19.

170 As required by s 81 of the Constitution: see Senate inquiry into ASIC's performance, ibid, p 407.

171 See above, n 164.

172 See ASIC, *Annual Report 2012-2013*, p 19.

173 See Treasury, *Submission 154*, p 4, cited in Senate inquiry into ASIC's performance, above n 9, p 407.

174 See Senate inquiry into ASIC's performance, ibid, pp 395- 396 and Figure 25.1: *ASIC's operating revenue, expenses and staff levels, 2000-01 to 2012-13*. Source: figures for operating revenue and expenses taken from research prepared by the Parliamentary Library, based on cash flow statements found in ASIC's annual reports. Figures for staff levels also taken from ASIC's annual reports.

175 See ASIC, *2013-2014 Annual Report*, p 24. ASIC also received $347 million in appropriation revenue in 2013-2014, compared with $350 million in 2012-2013.

176 As noted above, nn 94 and 118.

Senate report has exhorted that it should,[177] it will not be able to *if* it is inadequately resourced and people know it, especially to undertake major litigation against large corporations. Some interesting comments that arguably reveal the Senate committee's concerns about the Government's approach and likely future actions regarding funding for ASIC relate to ASIC's enforcement special account. In recommending that this account be bolstered to ensure that threats of litigation against large corporations are credible after concluding that '[a]t present, ASIC's enforcement special account [of around $30 million] appears inadequate for allowing ASIC to fund large and complex cases',[178] the committee added:

> the government will need to exercise restraint to ensure this is effective; the government should not access the funds or reduce the funding given to ASIC because its enforcement special account has a healthy balance.[179]

Furthermore, arguments that ASIC should be funded on a user-pays model based on the prevalence of this model with overseas regulators, most notably the UK's FCA which is funded in this manner from industry levies,[180] are ill-founded. This is because this argument ignores the fact that the FCA is not a general corporate regulator in the mould of ASIC or the SEC,[181] with enforcement of breaches of directors' duties being largely a matter of private enforcement.[182] Due to the relatively few private derivative actions commenced against miscreant directors by shareholders, a leading corporate scholar in the UK, Professor Andrew Keay, has suggested that there may be a need for the public enforcement of duties by the

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177 See Senate inquiry into ASIC's performance, ibid, p xxi. This is an instance of the report recognising the major influence that strategic/responsive regulation and the pyramid model have had on corporate law in Australia: see further, ibid, Chapters 4: Regulatory theories and their application to ASIC, pp 28-30, where the author's work is cited extensively: see, eg, under the heading 'Responsive regulation', p 28, citing V. Comino, "Towards Better Corporate Regulation in Australia" (2011) 26 *Australian Journal of Corporate Law* 6, p 7.

178 As noted above, n 163.

179 See Senate inquiry into ASIC's performance, above n 9, p 278.

180 See Senate inquiry into ASIC's performance, ibid, pp 408-409, citing FCA, Business Plan 2013/14, www.fca.org.uk/static/documents/business-plan/bp-2013-14.pdf , pp 53, 55 (accessed 17 September 2013). The estimated amount required to fund the FCA's budgeted costs for the year ending 31 March 2014 was £432.1 million, which was the figure employed in determining the fees that were charged.

181 Note discussion above, n 121, where the SEC is funded in the manner the author is agitating for – linking government appropriations to revenue.

182 As noted in Chapter 1, n 103 and above, n 15. See also discussion below, n 189.

establishment of such a regulator so that there is an enhancement of corporate governance in the UK.[183]

9.3.3 Size and Range of Penalties

In addition to the argument made in this book that the imposition of light penalties by the courts in serious civil penalty cases (such as James Hardie) raises questions about the use of civil penalties under the civil penalties regime for sanctioning breaches of directors' duties and their ability to deter future wrongdoing,[184] there is the issue that the current size of penalties (criminal and civil) set by the corporations legislation and the limited range of penalties under the legislation may be contributing to the enforcement difficulties ASIC faces in this area. Most submissions to Treasury in 2007 when it undertook a review of sanctions in corporate law, for example, suggested that civil penalties under the *Corporations Act* – the $200,000 maximum on pecuniary penalties for individuals – which have been in place since they were introduced in 1993,[185] should be increased.[186] Indeed, in October 2013 in ASIC's main submission to the Senate inquiry, ASIC itself has argued for a comprehensive review of penalties (criminal and civil) in the corporations legislation and for a strengthening of the penalty regime.[187]

In March 2014, ASIC also published a report after undertaking an analysis which compared the penalties for a range of wrongdoing available to it with penalties available to overseas regulators, other Australian regulators and across ASIC's regime, with a view to determining whether the penalties available to ASIC are generally available, proportionate and consistent

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183 See generally A. Keay, "The Public Enforcement of Directors' Duties" (16 January 2013). Available at SSRN: http://ssm.com/abstract=2201598 or http://dx.doi.org/10.2139/ssm.2201598 ; (2014) 43 *Common Law World Review* 89.

184 See in particular, Chapter 6, Section 6.4.7.2.5, *Gillfillan.*

185 But as noted in Chapter 6, n 78, in 2004 civil penalties under the *Corporations Act* were extended to include bodies corporate, with a maximum penalty for a body corporate of $1 million for breach of a financial services civil penalty provision.

186 Treasury, Australian Government, *Submissions: Review of Sanctions in Corporate Law*, 2007, http://archive.treasury.gov.au/contentitem.asp?ContentID=1285 cited in Penalties for Corporate Wrongdoing, above n 17, p 22.

187 This point was noted earlier in Chapter 8, nn 107-108: see ASIC, *Submission 45.2*, pp 169- 173 to Senate inquiry into the performance of ASIC, above n 9. See also Senate inquiry into the performance of ASIC, pp xxi, where the committee stated that to assist ASIC, the penalties currently available for contraventions of the legislation it administers should be reviewed to ensure they are set at appropriate levels and that monetary penalties may also need to become more responsive to misconduct; and xxxi, recommending an inquiry into the current criminal and civil penalties available across the legislation ASIC administers (Recommendation 41).

with those available for comparable wrongdoing.[188] The findings and observations of that important report on penalties will be discussed below. However, it should be noted that as a result of the report recognising that the way other jurisdictions deal with enforcement of directors' and officers' duties and penalties primarily through common law and equitable principles differs 'too markedly' with enforcement in Australia to compare this type of wrongdoing, it was not included in its analysis.[189] Nonetheless, the report did not completely ignore this area and made some comparisons.[190]

In the criminal arena, ASIC's report is most significant for identifying that much higher prison terms are available in the US than in Australia,[191] as well as there being higher prison terms available in Australia for similar wrongdoing.[192] This position led the author to argue in Chapter 8 that the maximum prison term of five years currently available for corporate offences under s 184 of the *Corporations Act* should be set higher and that judges should impose tougher sentences to ensure that wrongdoers are punished and that the law is credible.[193] Additionally, the level of fines – the maximum fine of $220,000 available for individuals – who commit criminal breaches of their duties as directors under the corporations legislation should arguably be increased since maximum fines set by Parliament should reflect how serious such offences are perceived to be, especially when such fines are addressing criminal contraventions as the worst possible wrongdoing at the apex of the

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188 See Penalties for Corporate Wrongdoing, above n 17, pp 11-12. The penalties considered that are available in other jurisdictions with comparable legal systems (that is, in Canada (Ontario), Hong Kong, the UK and the US) and in the Australian context concerned those relating to what the report identified as similar types of wrongdoing, notwithstanding that, in practice, how they are defined in legislation and how penalties are calculated can differ significantly, citing, eg, the difficulties in comparing the treatment of insider trading in the US and Canada discussed in B. Schecter, "How the SEC and OSC Differ in their Approaches to Trading Offences", *Legal Post*, 2014. The types of wrongdoing include contraventions involving insider trading, market manipulation, continuous disclosure, false statements to the market, inappropriate advice, unlicensed conduct, fraud and false or misleading representations.

189 See Penalties for Corporate Wrongdoing, above n 17, pp 4 and 12.

190 See, eg, of the maximum prison terms, discussed below, nn 191.

191 In particular, in contrast to the maximum prison term of 5 years available for fraud under s 184 of the *Corporations Act*, the maximum prison term for fraud in the US is 20-25 years. While s 184 (dealing with criminal offences of the duties to act in good faith and not to make improper use of positon or information in ss 181-183) is not specifically directed towards fraud, conduct that amounts to fraud also frequently raises issues of acting in good faith by directors and officers and dishonest conduct: see Penalties for Corporate Wrongdoing, above n 17, pp 15 and 16, Table 3: *Comparison of prison terms (years).* This point was also made earlier: see discussion in Chapter 8, nn 110, 112-114.

192 The maximum prison term for fraud in Australia is ten years. This is for fraud offences under state and territory criminal legislation, as noted earlier in Chapter 8, n 104, and under, eg, s 1041G of the *Corporations Act* (dishonest conduct): see *Penalties for Corporate Wrongdoing*, ibid, pp 56 -58 and Table 21: *Maximum penalties for fraud in Australia (criminal).* See also ibid, p 25, Table 8: *Maximum penalties and disgorgement for insider trading.* The maximum prison term for insider trading under s 1043A of the *Corporations Act* is also ten years.

193 See Chapter 8, n 118 and accompanying text.

enforcement pyramid. The following statement by ASIC which it made in its 2014 report supports such arguments:

> Recent domestic and international corporate scandals have emphasized there is increasing community and public expectation that those who are involved in corporate wrongdoing will be punished. The size of recent penalties imposed for corporate wrongdoing has led to commentary about the appropriateness of the current penalty levels under the legislation we administer.[194]

Relying on the views of an American legal commentator, who has characterised 'white collar crime' as being about 'greed and self-aggrandizement' that 'responds to fear',[195] further support for the above arguments is provided by ASIC also stating:

> This means that, if fear of contravention is not high enough, or the deterrent impact is not strong enough, greed will prevail and wrongdoing may ensue. For example, if a penalty for particular wrongdoing is set too low, a wrongdoer may conclude that paying the penalty is worth the benefit obtained in engaging in the wrongdoing – it may be perceived by the wrongdoer simply as a cost of doing (albeit illegal) business.[196]

Regarding non-criminal monetary penalties, ASIC's 2014 report also made some significant findings. They include that there is a broader range of civil and other administrative penalties available in other jurisdictions, most notably the 'disgorgement' feature of civil penalties imposed, for example, in the UK and the US, thereby removing the financial benefit (such as profits gained or losses avoided) that arises from the misconduct.[197] As such, with 'disgorgement' being a vehicle for preventing unjust enrichment, disgorgement orders can

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194 Penalties for Corporate Wrongdoing, above n 9, p 8, citing, eg, recent comments made by Chief Justice Warren of the Supreme Court of Victoria, reported in M. Dunckley, "Top Judge Warns of Harsher Sentences for Corporate Crimes", *AFR*, 7 January 2014, p 3.

195 See D. Feige, How to Deter White Collar Crime", *The Nation*, 11 July 2005, cited in Penalties for Corporate Wrongdoing, ibid, p 11.

196 Penalties for Corporate Wrongdoing, ibid. See also Chapter 5, n 103, for the well-recognised problem with fines being regarded merely as a business cost.

197 Penalties for Corporate Wrongdoing, ibid, p 5. See also ibid, p 20, where ASIC explains that in criminal matters, it can brief the Commonwealth Director of Public Prosecutions (DPP) and the Australian Federal Police (AFP) to bring an action to confiscate the proceeds of crime under the *Proceeds of Crime Act 2002* (Cth). However, it does not currently have any equivalent disgorgement provisions in ASIC-administered legislation for civil penalty proceedings.

potentially deliver a considerable deterrent impact by reducing the likelihood that wrongdoers will view penalties to be just a business cost.[198] The report also found that the penalties are higher in those jurisdictions.[199] Additionally, in the Australian context the report found that the maximum civil penalties available to ASIC are lower than those available to other Australian regulators[200] and are fixed amounts, not multiples of the financial benefit obtained from the misconduct.[201]

Notwithstanding that these findings relate to a range of wrongdoing,[202] where differences in penalties across the legislation administered by different Australian regulators, for example, might be explained to some extent by the different contexts in which they operate,[203] such findings highlight that Parliament should consider in the first place, increasing the range of civil penalties to include 'disgorgement' for breaches of directors' duties. In this way, as ASIC claims, by having a range of penalties available, this ensures that an 'enforcement pyramid' is provided which allows ASIC 'to calibrate our response with sanctions of greater

198 See also Penalties for Corporate Wrongdoing, ibid, p 19.

199 See Penalties for Corporate Wrongdoing, ibid, pp 18-19, Table 5: *Comparison of civil and administrative penalties for individuals ($AUD*), which compares the penalties available in other countries to those available in Australia. It shows, eg, that the maximum civil penalty in Australia for insider trading is $AUD200,000 (for an individual) compared with the maximum non-criminal penalty in the US which is up to three times the benefit gained and for control persons, the maximum penalty is the greater of $AUD1.1 million or three times the benefit obtained.

200 See Penalties for Corporate Wrongdoing, ibid, pp 21-22, Table 7: *Comparison of maximum civil penalties in Australia*. This Table shows, eg, the maximum civil penalties that ASIC can pursue ($AUD1.7 million for bodies corporate) and the civil penalties available to other Australian regulators (up to $AUD17 million for bodies corporate, which is available to the Australian Transaction Reports and Analysis Centre (AUSTRAC)). But note that the report also sought to provide context when considering some of the differences between the maximum penalties available to different regulators. While those regulators generally have comparable and complementary remits – concentrating on ensuring fair and transparent markets and promoting competition and fair trade (including through the countenance of money laundering) for the benefit of confident and informed investors, consumers, businesses and the community – it pointed out that they can also be distinguished. For instance, that part of AUSTRAC's remit that also tries to counter the financing of terrorism supports the severity of penalties available to it beyond the maximum expected in ASIC's context. Similarly, when considering the level and type of penalties available to the ACCC, discussed below, n 201, it should be borne in mind that the ACCC regulates restrictive trade practices which can have far reaching sector-wide and economic ramifications, eg, in industries that might be regarded as fundamental to Australia's infrastructure, such as rail, communication and energy. However, some of the differences identified in penalties available for similar corporate wrongdoing types across the legislation administered by different regulators are difficult to understand, eg, s 12DB of the *ASIC Act* provides a maximum penalty of $1.7 million for corporations that make false or misleading representations, while s 29 of the Australian Consumer Law (at Sch 2 of the *Competition and Consumer Act 2010* (Cth)) administered by the ACCC provides a lower penalty of $1.1 million for making false or misleading representations about goods or services.

201 See Penalties for Corporate Wrongdoing, ibid. Table 7 also shows, eg, that for cartel conduct the ACCC can seek a civil penalty that is the greater of $10 million, three times the value of the benefits obtained that are reasonably attributable to the contravention or 10% of the annual turnover of the company (including related entities).

202 See above, n 188.

203 See above, n 200.

or lesser severity commensurate with the misconduct', which is aimed to deter other breaches, and promote greater compliance.[204] Secondly, they emphasise that Parliament should consider raising the level of penalties set under the corporations legislation – the $200,000 upper limit on pecuniary penalties for individuals – for contraventions of directors' duties to enable monetary penalties to be more responsive to misconduct, with multiple of gain penalties considered.[205] The availability of higher penalties might also encourage ASIC to consider pursuing civil penalties more than it does presently so as to lift their profile as a more viable enforcement option.

Yet another reason why these findings relating to penalties are important is that they highlight a further problem namely, that there are inconsistencies in the laws that govern Australian regulators, with differences in the penalties available to those regulators identified in ASIC's report providing just one illustration of this larger problem. This issue of inconsistencies in the laws of Australian regulators will be discussed later.[206]

However, before doing so, it should be appreciated that there are also inconsistencies across the different pieces of legislation ASIC administers – including the *National Consumer Credit Protection Act 2009* (Cth) (*NCCP Act*), the *Superannuation Industry (Supervision) Act 1973* (*SIS Act*) and the *Retirement Savings Accounts Act 1997* (Cth) (*RSA Act*) – not only in regard to penalties for similar types of wrongdoing, which ASIC's report also identified,[207] but also, for example, with the search warrant powers that are available to ASIC under those various pieces of legislation.[208]

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204 See Penalties for Corporate Wrongdoing, above n 17, p 4.

205 Penalties for Corporate Wrongdoing, ibid. See also discussion in Chapter 6, nn 85-87.

206 See below, Section 9.3.6, *Inconsistent Laws of Australian Regulators*.

207 See Penalties for Corporate Wrongdoing, above n 17, p 6, which found that across legislation administered by ASIC, there are differences between the types and size of penalties for similar wrongdoing. For instance, the provision of financial services without an Australian financial services (AFS) licence attracts a criminal penalty under the *Corporations Act* with the maximum fine that may be imposed on an individual being $34,000. In contrast, an individual who engages in credit activity without an Australian credit licence is subject to the same criminal penalty, or alternatively a civil penalty up to ten times greater – that is, up to $340,000 under the *NCCP Act* .

208 See discussion below, Section 9.3.4, *Inconsistencies in ASIC's Regulatory Laws*.

9.3.4 Inconsistencies in ASIC's Regulatory Laws

Because the focus of this book is corporate regulation, the existence of inconsistencies in the various regulatory laws ASIC administers besides the corporations legislation due to its expanded role as Australia's corporate, markets, financial services and consumer credit regulator[209] will only be discussed briefly. Moreover, the purpose of doing so is simply to underline that the already difficult challenge for ASIC posed by its increased regulatory responsibilities in trying to discharge those responsibilities, which challenge Medcraft himself has acknowledged,[210] is exacerbated.

In a recent article, Middleton also dealt with the issue of inconsistencies in ASIC's regulatory framework, as well as what he identified as 'gaps, uncertainty and weaknesses' in that framework to make the same point.[211] A stark example of inconsistencies in the legislation ASIC administers is found in relation to the search warrant powers that may be available to it.[212] While Middleton discusses a number of inconsistencies in this area,[213] this book will only deal with inconsistencies regarding the prior warning aspect of search warrants to highlight some of the problems confronting ASIC.

A major difficulty with search warrants under ss 269 and 270 of the *NCCP Act*, ss 271 and 272 of the *SIS Act* and ss 102 and 103 of the *RSA Act* is that ASIC could only obtain a search warrant where there has already been non-compliance with a notice to produce books. This means that the recipient of the notice is forewarned that ASIC requires particular documents

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209 See in particular, above nn 5-10.

210 See, eg, generally G. Medcraft, ASIC Chairman, *Special Report: ASIC: Outlook for Enforcement 2012-13* , http://www.clmr.unsw.edu.au/resource/accountability/regulatory-design/thomson-reuters-report-asic-outlook-enforcement-2012-13 (accessed 16 October 2014).

211 See Middleton, "ASIC's Regulatory Powers", above n 45, p 208. An example relates to ASIC not having the power to receive evidential material obtained from telecommunications interception warrants, and the requirement that it must convince the AFP to apply for the warrant. Middleton argues that in cases involving market manipulation and insider trading (where offences are difficult to detect and often involve complicated networks of perpetrators who employ sophisticated technological methods which avoid paper or other easily traceable forms of communication and where offences often occur in 'real time' so that records of the telephone conversations are the only real evidence), ASIC not having this power does not promote ASIC's regulatory objectives in s 1(2) of the *ASIC Act* of enforcing the corporations legislation in a timely and efficient manner. This problem is discussed in ibid, pp 211-215.

212 See Middleton, "ASIC's Regulatory Powers", ibid, pp 216 -219. Middleton identifies ASIC's search warrant powers as 'one of the greatest areas of inconsistency'. The other is its inconsistent regulatory powers concerning superannuation and retirement funds, discussed in ibid, pp 230-232.

213 Those inconsistencies are in relation to computers and electrical equipment and reasonable assistance and use of evidential material in civil, civil penalty and criminal proceedings, which are discussed in "ASIC's regulatory powers", ibid, pp 216-218.

and, therefore, has the opportunity to alter, destroy or conceal books prior to the execution of the warrant, thereby reducing the effectiveness of ASIC's investigation. In some cases, the problem of prior warning could be lessened by ASIC making increased use of its power to require production of books 'forthwith' followed by an immediate issue of the warrant where there is non-compliance.[214] However, as Middleton explains this power is only expressly available under s 87(b) of the *ASIC Act* and s 315 of the *NCCP Act*.[215]

Reforms were made to ss 35 and 36 of the *ASIC Act* and, since 13 December 2010, ASIC has been able to apply for an ASIC search warrant without first having to issue a notice to produce books.[216] ASIC can now obtain an ASIC search warrant without prior warning provided it has power in the circumstances of the case to issue a notice to produce books pursuant to s 28 of the *ASIC Act.*[217] However, Parliament has failed to pass equivalent reforms to the other legislation set out above, so that ASIC can only obtain search warrants under those pieces of legislation where a person has failed to comply with a notice to produce books with all the risks that that entails, for instance, for destruction of documents. Consequently, this does not promote the early detection of breaches or a timely enforcement response for suspected breaches under these Acts.[218]

In the case of suspected criminal contraventions of Commonwealth law, it should be noted that ASIC, with the assistance of the AFP, can obtain a search warrant under s 3E of the *Crimes Act 1914* (Cth) (*Crimes Act*) or s 225 of the *Proceeds of Crime Act 2002* (Cth) (*Proceeds of Crime Act*) without prior warning. Section 3R of the *Crimes Act* authorises that a search warrant can be applied for by telephone, telex, facsimile or other electronic means in an urgent case or where the delay caused by an application in person would frustrate the effective execution of the warrant, while s 3R (5) provides that the issuing officer must inform the applicant by telephone, telex, facsimile or other electronic means of the terms of the search warrant and the day on which and the time it was signed. Equivalent provisions are

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214 See J. Kluver, "ASIC Investigations and Enforcement: Issues and Initiatives" (1992) 15 *University of New South Wales Law Journal* 31, 44.

215 See Middleton, "ASIC's Regulatory Powers", above n 45, p 216.

216 These reforms were introduced by the *Corporations Amendment (No 1) Act 2010* (Cth).

217 See Middleton, "ASIC's Regulatory Powers", above n 45, p 216, citing Parliament of Australia, Senate Economics Legislation Committee, Higher Penalties and Improved Detection Powers for Insider Trading and Market Manipulation Offences, 17 November 2010, [3.19], http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=economics_ettecompleted_inquiries/2010-13/corps_amendment_2010/report/c03.htm (viewed 13 March 2011)

218 Middleton, "ASIC's Regulatory Powers", ibid, p 216.

found in ss 229-230 of the *Proceeds of Crime Act*. But there are no express provisions under the *ASIC Act*, the *NCCP Act*, the *SIS Act* or the *RSA Act* that allow ASIC to obtain search warrants by telephone, telex, facsimile or other electronic means.

The author agrees with Middleton's comments that the lack of uniformity and weaknesses in the legislation ASIC enforces are partly the result of successive Federal governments taking an 'ad hoc',[219] 'piecemeal'[220] or 'kneejerk'[221] approach to the development of Australian regulatory laws and that isolated and ad hoc reforms to such laws are inadequate to 'flip markets in vice to markets in virtue', to use the language of John Braithwaite.[222] With differences in the penalties available to ASIC across the legislation it administers as well as across other domestic regulators identified in ASIC's 2014 report,[223] these comments are equally applicable to the way that those regulatory laws relating to penalties have developed. The author, therefore, supports Middleton's call for the Government to adopt a more 'holistic' and principled approach to reform,[224] which also includes the reform of penalties. Furthermore, the author agrees with Middleton that increased harmonisation of the legislation that ASIC administers would lead to 'greater clarity, fairness and public confidence' in the regulatory regime and promote ASIC's regulatory objectives outlined in s 1(2) of the *ASIC Act*, especially more timely and cost-effective regulatory outcomes and compliance, thereby resulting in more effective regulation.[225] Consistent with the desire for greater harmonisation, the author believes that this would involve the Government increasing both the level and range of penalties (criminal and civil) available under the corporations legislation for breaches of directors' duties suggested above. This is in view of, for instance, the availability

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219 Middleton, "ASIC's Regulatory Powers", ibid, 209, citing D. Knott (a former Chairman of ASIC), "The regulatory Perspective _The Case for International Accounting Standards". International Accounting Standards Word Setter's Conference, Hong Kong, 18 November 2002, p 2. http://www.asic.gov.au/asic/pdfib.nsf/LockupByFileName/HK_speech_181102.pdf (viewed 8 May 2013).

220 Middleton, "ASIC's Regulatory Powers", ibid, citing G. Pearson, "Risk and the Consumer in Australian Financial Services Reform" (2006) 28 *Sydney Law Review* 99, pp 104, 108 and 109.

221 Middleton, "ASIC's Regulatory Powers", ibid, citing R. Baxt, "Thinking about Regulatory Mix – Companies and Securities, Tax and Trade Practices" in P. Grabosky and J. Braithwaite (eds), *Business Regulation and Australia's Future*, Australian Institute of Criminology, Canberra, 1993, p 119.

222 J. Braithwaite, *Markets in Vice, Markets in Virtue*, Federation Press, Leichhardt, 2005, p 147; and J. Braithwaite, *Restorative Justice and Responsive Regulation*, Oxford University Press, Oxford, 2002, pp 239-240, cited in Middleton, "ASIC's Regulatory Powers", ibid.

223 See above, nn 200-201 and 207.

224 Middleton, "ASIC's Regulatory Powers", above n 45, p 235. According to Middleton, this would require it to undertake a thorough review and examination of all the regulatory laws that presently govern ASIC's powers (to properly identify the strengths, weaknesses and inconsistencies in each of those laws) prior to a consideration of what reforms should be made.

225 Middleton, "ASIC's Regulatory Powers", ibid, citing P. Grabosky, "Australian Regulatory Enforcement in Comparative Perspective" in Grabosky and Braithwaite, above n 221, p 21.

of higher maximum prison terms (ten years) for comparable criminal offences to offences under s 184 of the *Corporations Act* (five years).[226]

9.3.5 Sharing of Regulatory Responsibility

The fact that ASIC shares responsibility for some of the areas it is regulates with other Australian regulators, including APRA, the ACCC and the ATO,[227] might suggest that concerns about ASIC's capacity to properly discharge its many functions are alleviated by lessening that regulatory burden. However, it will be seen that this overlap has resulted in problems, caused mainly by inconsistencies in the laws governing those regulators.[228] Part of the reason why the regulatory burden on ASIC does not appear to have been improved to any significant degree could be because some of those regulators arguably have relatively weak enforcement records. In the case of the collapse of HIH in March 2001, which involved contraventions of legislation within the regulatory responsibilities of both ASIC and APRA, for example, both came under strong criticism for failing to respond to early alarm bells and possible wrongdoing when well before its collapse, the financial position of HIH had been subjected to scrutiny in the media and in several stockbrokers' reports that were critical of the company's management, particularly the management style of Ray Williams (one of the most senior figures in the HIH group of companies), as well as, HIH's business and investment practices.[229] But, unlike ASIC, which has since successfully completed civil penalty proceedings and pursued criminal action against those involved in the HIH collapse,[230] the enforcement action taken by APRA in this matter has not met with the same level of

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226 As noted above, n 192.

227 See discussion in Chapter 1, n 11. ASIC and APRA, for instance, share regulatory responsibility for the *SIS Act*, the *RSA Act*, the *Life Insurance Act 1995* (Cth) and the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* (Cth). This overlap of ASIC's and APRA's regulatory functions also arises under the corporations legislation, where all corporate financial entities are regulated by ASIC, but, at the same time, APRA is responsible for the prudential regulation of some of these entities. ASIC also performs consumer protection functions relating to the financial services provided by corporations that are prudentially regulated by APRA: see ss 12BAA(7), 12BAB(1) and 13(6) and Div 2, Pt 2 of the *ASIC Act*. See also Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege Under the Laws Governing ASIC, APRA, the ACCC and the ATO", above n 25, pp 290-291, for a more comprehensive discussion of regulatory overlap between not only ASIC and APRA, but between it and the other Commonwealth regulators in addition to APRA, namely the ACCC and the ATO that Middleton argues share common regulatory problems, have overlapping investigative and enforcement responsibilities and share a relationship of interdependence with ASIC.

228 See Section 9.3.6, *Inconsistent Laws of Australian Regulators*.

229 See earlier discussion in Chapter 6, *Section 6.4.4 HIH*.

230 See earlier discussion in Chapter 6, Sections 6.4.41, *HIH: Civil Penalty Proceedings*; and 6.4.4.2, *Criminal Proceedings*.

success.[231] Additionally, those regulators face the same problems as ASIC in having to balance their regulatory functions and objectives with their limited resources.[232]

9.3.6 Inconsistent Laws of Australian Regulators

Indeed, rather than make for better regulation, Middleton's research[233] has identified a major difficulty with this regulatory overlap. Just as Middleton has identified inconsistencies and weaknesses in ASIC's regulatory framework,[234] it is not surprising that he has also found that although ASIC, APRA, the ACCC and the ATO have common investigative and enforcement powers (including powers to conduct oral examinations, issue notices to produce books and obtain search warrants),[235] those powers are governed by inconsistent and, in some cases, unclear laws[236] that deal with the operation of the 'privilege against self-incrimination',[237] the 'penalty privilege',[238] and 'legal professional privilege'[239] (including the availability of

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231 While APRA obtained disqualification rulings against a number of non-executive directors of HIH banning them from acting as a senior manager or director of an insurance company, three of those non-executive directors had their disqualification ruling overturned on appeal by the Administrative Appeals Tribunal (AAT): see T. Boyd, "AAT Clears Former HIH Director", *AFR*, 12 January 2010, 39.

232 See discussion above, n 21.

233 See Middleton, "The Privilege against Self-incrimination, the Penalty Privilege and Legal Professional Privilege under the Laws Governing ASIC, APRA, the ACCC and the ATO", above n 25. See also generally R. Wilkins, 'Duplication and Inconsistency of Regulation in a Federal System' in Grabosky and Braithwaite (eds), *Business Regulation and Australia's Future*, above n 221, pp 181-182; and R. Shoer, 'Self-Regulation and the Australian Stock Exchange' in Grabosky and Braithwaite ibid, p 108, where it is argued that Australian Commonwealth regulators are not effectively achieving their objectives because they operate within a regulatory environment that is characterised by laws that are inconsistent, lack clarity and uniformity.

234 See Section 9.3.4, *Inconsistencies in ASIC's Regulatory Laws.*

235 These powers are provided for by the legislation that governs each of these bodies. The investigative and enforcement powers of ASIC under the corporations legislation is discussed briefly in Chapter 1, Section 1.3.3, *Powers of ASIC*.

236 See Middleton, "The Privilege against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, pp 283-284.

237 See discussion in Chapter 7, nn 112 and 118 -120, for a discussion of this important privilege and the rationale for it.

238 The 'penalty privilege' is also discussed in detail in particular in Chapter 7, nn 121-123, and in its discussion of the High Court's decision in *Rich v Australian Securities and Investments Commission* (2004) 220 CLR 129; 209 ALR 271 (*Rich*).

239 'Legal professional privilege' essentially means that, at common law, confidential communications between clients and their lawyers do not have to be given in evidence or otherwise disclosed by clients or their lawyers (unless the lawyers have obtained their clients' consent). Legal professional privilege applies to confidential communications between clients, their lawyers and third parties made for the dominant purpose of use in litigation (whether contemplated or actual) or made for the dominant purpose of giving or receiving legal advice: see Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 297, n 67, citing *Esso Australia Resources Ltd v Commissioner of Taxation* (1999) 201 CLR 49; 168 ALR 123; *Pratt Holdings Pty Ltd v Commissioner of Taxation (Cth)* (2004) 207 ALR 102 at [2] and [84]; *In the Matter of Southland Coal Pty Ltd (Rec & Mgrs Apptd) (in liq)* (2006) 59 ACSR 87; 203 FLR 1 at [14]; and ss 118 and 119 of the *Evidence Act 1995* (Cth). The rationale for this fundamentally important privilege is to maintain client confidentiality and to promote

'evidential immunity'[240] where these privileges are abrogated). He contends that these inconsistencies are having a negative impact on the effectiveness and efficiency of all those regulators to carry out their regulatory functions, as well as not facilitating proper functioning of the Australian economy.[241] Thus, relevantly ASIC action may well be inhibited because co-regulators are operating under differing and inconsistent laws.

The author agrees with Middleton[242] that it is 'incongruous' that ASIC, APRA, the ACCC and the ATO currently do not have the same investigative and enforcement powers, especially in relation to the same conduct and transactions where, as seen in the HIH matter,[243] the contravening conduct or transactions fall within the regulatory responsibilities of two or more of these regulators.[244] He gives as an example that an individual could be compelled by ASIC to provide information that is otherwise protected by 'client legal professional privilege' whereas the ACCC and the ATO (when acting under the taxation

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the administration of justice by encouraging people to seek legal advice: see ibid, 298, n 76, citing *Greenough v Gaskell* (1883) 39 ER 618 at 621; *Attorney-General (NT) v Maurice* (1986) 161 CLR 475 at 487 and 490; 69 ALR 31; *Ritz Hotel Ltd v Charles Ritz Ltd (No 22)* (1988) 14 NSWLR 132 at 133-4; *Dalleagles v Australian Securities Commission* (1991) 4 WAR 325; 6 ACSR 498 at 506; *Trade Practices Commission v Ampol Petroleum (Vic) Pty Ltd* (1994) 54 FCR 316 at 320; 127 ALR 533; *Grant v Downs* (1976) 135 CLR 674 at 685; 11 ALR 577; *Baker v Campbell* (1983) 153 CLR 52 at 88, 116-17 and 127-8; 49 ALR 385 at 393, 415, 432-3 and 444; and *Pratt Holdings Pty Ltd v Commissioner of Taxation (Cth)* (2004) 136 FCR 357; 207 ALR 217; 2004 ATC 4526 at [13[and [83].

240 'Evidential immunity' protects from admission, the answers given by an examinee at the regulators' oral examination, and the documentary evidence obtained by the regulator, in any subsequent legal proceedings that the regulators may bring. It can comprehend use evidential immunity, where the answers given by an examinee are not admissible and/or 'derivative use immunity', where the answers given by an examinee cannot be used by the regulator/prosecutor to gather other incriminating evidence (derivative evidence or secondary evidence derived from the original evidence/answers) for admission against that examinee in any subsequent legal proceedings.

241 See Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 282. See also ibid, pp 286-287, for Middleton's definition of 'effective' regulation and discussion below, n 253.

242 Ibid, p 292.

243 See discussion above, nn 229-231.

244 See ibid, p 291. Besides HIH, Middleton gives a number of case examples of overlapping investigative and enforcement responsibilities. They include one of Australia's largest fraud cases involving the National Australia Bank's $360 million currency trading losses incurred as a result of unauthorised trading by staff, which had prudential consequences, including possible contraventions of the *Banking Act 1959* (Cth), (enforced by APRA), of the *Corporations Act* (enforced by ASIC) and of the taxation legislation (enforced by the ATO). This case is discussed, eg, in N. Robinson, "Soothing Part of NAB Culture", *The Australian*, 3 May 2006, p 2. Other cases are the Vizard case, discussed in Chapters 7 and 8, and the now abandoned Offset Alpine case: see generally *Kennedy v Australian Securities and Investments Commission* (2005) 142 FCR 343; 218 ALR 224, which involved alleged contraventions of legislation within the regulatory spheres of ASIC and the ATO. (At p 290), Middleton points out that the fact that ASIC, APRA, the ACCC and the ATO often investigate cases of mutual interest or concern and enforce contraventions based on common conduct or common transactions is also recognised in various Memoranda of Understanding between them.

legislation), if also investigating the same conduct, could not compel release of that privileged information.[245]

Middleton also discusses the High Court's decision in *Rich v Australian Securities and Investments Commission* (*Rich*),[246] where he reaches similar conclusions to this book, that affording defendants the protection of the penalty privilege in civil penalty proceedings, has created significant procedural and enforcement difficulties for ASIC.[247] He also discusses recent amendments made by s 1349 of *Corporations Act* [248] that have resulted in the removal of this privilege in relation to proceedings concerning disqualification,[249] notably to make the point that Parliament failed to enact equivalent amendments in relation to the ACCC's then

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245 See ibid, pp 297-298, for a discussion of the laws governing the operation of this privilege that give rise to this inconsistency, including decisions such as *Corporate Affairs Commission NSW v Yuill* (1991) 172 CLR 319, 108 ALR 609, which indicates that the client's legal professional privilege has been impliedly abrogated in ASIC's investigations and *The Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission* (2002) 213 CLR 543, which indicates that this privilege may be claimed in the ACCC's investigations.

246 (2004) 220 CLR 129 (Gleeson CJ, McHugh, Gummow, Hayne, Callinan and Heydon JJ, Kirby dissenting). This case was discussed in detail earlier in Chapter 7, Section 7.3.1, *The Rich case and the Penalty Privilege.*

247 See Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, pp 313-315. One such difficulty Middleton discusses relates to examinees in ASIC's oral examinations having the benefit of 'use' evidential immunity, which he argues prejudices ASIC's ability to obtain a disqualification order from the court (under the *Corporations Act*, ss 206C and 206E) or to make an administrative disqualification or banning order (including orders suspending or cancelling an Australian financial services license) (under the *Corporations Act*, ss 206F, 853D(4) (b) and 853D(5)(a), 913B(5), 914A(3), 915C(4), 920A(2) and 920D(3)). Prior to the *Rich* case, the predominant view established by the case law was that proceedings seeking to disqualify a person from managing a corporation, or proceedings seeking to ban a person from participating in a particular industry, were more like civil proceedings because they were 'preventative' or 'protective', rather than 'penal' or 'punitive' in nature: *Australian Securities and Investments Commission v Adler (No 5)* (2002) 42 ACSR 80 at 97-99 (Santow J); *Adler v Australian Securities and Investments Commission* (2003) 179 FLR 1 at 147 (Giles J); *Australian Securities Commission v Kippe* (1996) 137 ALR 423; 67 FCR 499 at 506-507 (von Doussa, Cooper and Tamberlin JJ); *Felden v Australian Securities and Investments Commission* (2003) 45 ACSR 111 at 194-195 (Member AI Linbury); and *Saxby Bridge Financial Planning Pty Ltd v Australian Securities and Investments Commission* (2003) 46 ACSR 286 at 293, 371-373 (Deputy President R P Handley). This meant that, where an examinee claimed the penalty privilege before answering a question at an oral examination, those answers would be admissible – that is, not excluded by the 'use' evidential immunity in ss 68(3)(6) and 76(1)(a) of the *ASIC Act* – against that examinee in subsequent proceedings in which a disqualification or banning order was sought. The majority of the High Court in the *Rich* case holding that civil penalty proceedings for disqualification orders under s 260C of the *Corporations Act* were proceedings that exposed a person to a penalty and therefore attracted the operation of the penalty provision meant that, where an examinee claimed the penalty privilege in ASIC's oral examination, oral evidence given by that examinee, which may expose that person to the risk of the court either making a 'punitive' disqualification order or ASIC making a 'punitive' administration or banning order, would not be admissible against that examinee in any subsequent proceedings because of the 'use' evidential immunity in ss 68(3)(b) and 76(1)(a) of the *ASIC Act*.

248 Section 1349 of the *Corporations Act* which commenced operation on 31 December 2007 was introduced by the *Corporations Amendment (Insolvency) Act 2007* (Cth).

249 See Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, pp 315-316; and Chapter 7, nn 103- 104 for details of the amendments made by s 1349 of the *Corporations Act*.

new disqualification power found in s 155 of the *Trade Practices Act 1974* (Cth) (now s 86E of the *Competition and Consumer Act 2010* (Cth)); ASIC's, APRA's or the ATO's administrative disqualification powers under ss 120A, 131 and 132 of the *SIS Act*; and APRA's administrative disqualification powers under s 33 of the *RSA Act* and s 25A of the *Insurance Act 1973* (Cth).[250]

As a consequence of Parliament failing to adopt a uniform approach to resolving the investigative and enforcement problems that have arisen from the *Rich* case[251] for all the regulators (including APRA, the ACCC and the ATO) that have disqualification powers, Middleton states:

> [T]here is no uniform statutory regime governing the operation of the penalty privilege in the regulators' punitive enforcement proceedings (including civil penalty proceedings for disqualification orders and administrative proceedings for disqualification or banning orders.[252]

Middleton, therefore, calls for Federal Parliament to standardise the operation of this penalty privilege and the other privileges through reform of the laws governing ASIC, APRA, the ACCC and the ATO,[253] which he argues:

> will bring order and cohesion where complexity now reigns, give the regulators, the regulated and the judiciary clear guidance as to the applicable rules and procedures in all regulatory matters; and would promote more timely and cost-effective regulatory outcomes and more effective regulation of the Australian economy.[254]

The author agrees that this course should be followed, particularly since the adoption of a uniform approach, in this case to the operation of privileges, would go some way in achieving an 'effective' regulatory regime, the hallmarks of which can be summed up as:

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250 Ibid, 316.
251 (2004) 220 CLR 129.
252 Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 283.
253 Ibid, p 286.
254 Ibid, pp 282-283.

> [C]lear principles that are predictably implemented are the building blocks of good regulation.[255]

This is notwithstanding that the Australian Law Reform Commission (ALRC) argued in its recent report on *Client Legal Privilege in Federal Investigations*[256] that Parliament should not adopt a 'one size fits all' approach to the operation of legal professional privilege in the context of federal investigatory bodies. The author agrees with Middleton that while the ALRC dealt with a variety of investigatory bodies where many of those bodies do not have any commonalities,[257] in contrast ASIC, APRA, the ACCC and the ATO should be treated the same as they share common regulatory problems and have overlapping investigative and enforcement responsibilities,[258] as well as, a relationship of interdependence.[259] Indeed, it is because of this sharing of regulatory problems, overlap of responsibilities and the relationship of interdependence between ASIC and these other co-regulators that the potential to impede ASIC action due to them operating under inconsistent and, in some cases, unclear laws is increased. There is evidence, for example, that individuals with 'deep pockets' are prepared to exploit ambiguities in the regulatory laws as a tactical device to cause delay.[260]

While this book supports Middleton's calls for uniformity in the operation of the privileges through reform of the laws governing ASIC, APRA, the ACCC and the ATO, the opinions of

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255 See M. Mann, "What Constitutes a Successful Securities Regulatory Regime?" (1993) 3 *Australian Journal of Corporate Law* 178, p 182 and Chapter 2, Section 2.3, *What is 'Effective' Regulation?* See also Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, pp 286-287, for an interesting discussion in the context of the regulators' investigative and enforcement powers of the tension between the public interest that underpins the necessity for regulation, the public interest served by the privileges (eg, the privilege against self-incrimination serves the public interest by preserving a fair balance between the state and individuals and ensures that the onus is on the prosecution to prove its case thereby upholding the integrity of the accusatorial system of criminal justice) and the private interests of the regulated. Middleton argues that whatever the agreed 'balanced approach' is, that approach should be applied uniformly or equally to all the regulatory regimes which govern ASIC, APRA, the ACCC and the ATO.

256 ALRC, *Privilege in Perspective: Client Legal Privilege in Federal Investigations*, Report 107, [7.131], at <www.austlii.edu.au/au/other/alrc/publicaitons/reports/107> (Accessed 2 October 2010).

257 Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 285.

258 See discussion above, nn 227, 229-232 and 244.

259 Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, pp 289-290 for a discussion of the interdependent relationship of these regulators which relies on mutual cooperation, including the exchange of investigative information. For instance, the activities of ASIC and APRA that promote financial disclosure in corporate transactions and financial accounts also assists the ATO to carry out its revenue collecting function.

260 Ibid, p 285, citing Braithwaite, *Markets in Vice, Markets in Virtue*, above n 222, p 147; and Braithwaite, *Restorative Justice and Responsive Regulation*, above n 222, pp 239-240.

Middleton and the author differ on what that uniform approach to resolving the enforcement problems in relation to the penalty privilege should be.

Middleton suggests that the legislation governing the regulators' oral examination powers should be amended (in accordance with the *ASIC Act*)[261] by expressly abrogating the penalty privilege and the privilege against self-incrimination for natural persons and corporations and by affording natural persons, but not corporations, 'use' evidential immunity but not 'derivative use' evidential immunity in regard to their answers in any subsequent criminal or penal proceedings.[262]

The amendments made by s1349 of the *Corporations Act* that abrogate the penalty privilege in disqualification proceedings[263] are inconsistent with Middleton's suggestions for reform.[264] This is because not only has the penalty privilege been abrogated, but so has the right to claim 'use' evidential immunity, with s 1349(4) of the *Corporations Act* establishing that such immunity afforded by s 68(3)(b) of the *ASIC Act* does not apply. In other words, where an examinee claims the penalty privilege before answering a question at ASIC's oral examination, those answers are admissible against that examinee in subsequent proceedings where a disqualification or banning order is sought.

The author believes that the amendments made by s 1349 of the *Corporations Act*, which restore the legal position that existed prior to *Rich* by abrogating both the penalty privilege and resulting 'use' evidential immunity in proceedings when an application for a disqualification order is made are a step in the right direction.[265]

Middleton believes that the reforms he suggests for affording evidentiary immunity where the penalty privilege (and privilege against self-incrimination) have been abrogated 'balances' the public and private interests.[266] The author disagrees. In civil penalty proceedings brought by ASIC where the penalty privilege has been abrogated, the abrogation of the 'resulting'

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261 See earlier discussion in Chapter 1, Section 1.3.3, *Powers of ASIC*.

262 Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 296.

263 See discussion above, nn 248-249.

264 Middleton himself acknowledges this: see Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 316.

265 But see further discussion, below, nn 272-273.

266 Middleton, "The Privilege Against Self-incrimination, the Penalty Privilege and Legal Professional Privilege", above n 25, p 296.

evidential immunity is arguably also necessary to achieve the 'higher public policy interest of effective corporate regulation' in the same way that the abrogation of both legal professional privilege and evidential immunity under the *James Hardie (Investigations and Proceedings) Act 2004* (Cth) concerning ASIC's investigation of James Hardie was regarded as essential to secure this higher public policy interest.[267]

Prior to the *Rich* case,[268] ASIC was making good use of civil penalties and succeeded in obtaining them in a number of high profile cases.[269] Since the *Rich* case, however, the utility of civil penalties has been undermined. ASIC faces procedural and evidential problems resulting from the way the courts have tended to resolve disputes about procedure in civil penalty proceedings by resort to criminal, instead of civil, analytical frameworks.[270]

Further, even though the reforms made by s 1349 of the *Corporations Act* reinstate the law that existed before the *Rich* case in proceedings for disqualification, Chapter 7 of this book has highlighted that the procedural and evidential difficulties resulting from the *Rich* case remain for ASIC in civil penalty proceedings where it is seeking other civil penalties, such as a pecuniary penalty. It was explained that this is because proceedings for pecuniary penalties under s 1317G of the *Corporations Act* have always been treated by the courts as penal in nature and have always been proceedings 'for the imposition of a penalty' in terms of s 68(3)(b) of the *ASIC Act* and thereby attracted the penalty privilege and 'use' evidential immunity.[271] Accordingly, since it is also 'incongruous' that disqualification orders and pecuniary penalty orders (both being penal in nature) are given differential treatment under the legislation referred to above in terms of the operation of the penalty privilege and 'use' evidential immunity, the author argued that Parliament should, at a minimum, make reforms that standardise the operation of the penalty privilege. It is suggested that those reforms should not allow the penalty privilege to be raised where ASIC is pursuing a civil penalty – *either* a pecuniary penalty *or* disqualification – but preclude ASIC from taking criminal

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267 See Explanatory Memorandum to *James Hardie (Investigations and Proceedings) Act 2004* (Cth), at [1.4] and [4.23] – [4.25]. See also Middleton, ibid, 301, where he comments that, the Government believes that the public must have confidence in the regulation of corporations, corporate conduct, financial markets and services and that this confidence may have been undermined if ASIC's investigations into the James Hardie Group were hindered by claims of privilege. According to the Government, the privileged material could have contained crucial evidence relating to the purpose and nature of the relevant transactions.

268 (2004) 220 CLR 129.

269 See discussion in Chapter 6 of such cases, eg, Sections 6.4.4-6.4.5, *HIH;* and *Water Wheel*.

270 See generally Chapter 7.

271 See Chapter 7, n 106.

action against these defendants.[272] If this course was followed, the author believes that Parliament would also need to enact individual reforms to the relevant regulatory laws governing civil penalty proceedings initiated by those other Australian regulators that are empowered to bring such proceedings, thereby achieving a uniform approach urged by Middleton.

The ideal solution, however, would be the introduction of a 'new procedural road map'[273] to govern the law and procedure of civil penalty proceedings. This map should apply not only to ASIC's civil penalty proceedings, but to those of all Australian regulatory agencies that have the power to bring such proceedings. If this occurred, ASIC would be better placed to be a more effective regulator.

9.4 Conclusion

While this book has focussed on ASIC's role as the 'company law watchdog' in its assessment of whether ASIC is an effective regulator, this chapter has highlighted that ASIC's increasing responsibilities have created difficulties for it in seeking to fulfil this role. In the first place, the fact that ASIC has many other responsibilities as Australia's corporate, markets, financial services and consumer credit regulator casts doubt on its capacity to properly carry out all, or indeed, any of its regulatory functions operating as it does in a resource-precious environment. In addition, rather than make for better regulation, the sharing of regulatory responsibility for some of these areas with other Australian regulators has made the achievement of effective regulation harder, particularly because of inconsistent laws governing the investigative and enforcement procedures of those regulators. Uniform laws are required, especially those pertaining to the civil penalty proceedings of those regulators, preferably by the enactment of a 'new procedural road map' to resolve the law and procedure of civil penalty proceedings. Significantly, this would place ASIC in a better position to implement a strategic approach to enforcement by allowing civil penalties under Pt 9.4B to assume their proper place among the upper levels of the enforcement pyramid and be a more effective regulator of the corporations legislation. The potential for unclear and inconsistent laws to hinder ASIC action would also be removed.

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272 See Chapter 7, n 108.

273 See Chapter 7, Section 7.5, *The Solution.*

Besides the difficulties resulting from ASIC's overly ambitious mandate and limited resources, this chapter has also considered other more general problems encountered by ASIC that could be weakening its ability to be an effective regulator. Those difficulties include criticisms that ASIC is not 'close to the market' by appearing to miss or ignore early alarm bells of corporate wrongdoing or brewing problems, the lack of competitive remuneration of its staff and concerns about the current size and limited range of penalties (criminal and civil) available to ASIC in the corporations legislation not assisting it to pursue remedies for contraventions of directors' duties, especially when there are inconsistencies in the size of penalties across legislation administered by ASIC and other Australian regulators for equivalent types of wrongdoing.[274] As such, Parliament increasing both the size and range of penalties (criminal and civil) available to ASIC under the corporations legislation deserves serious consideration. Perhaps, most importantly, however, is the issue of uncertain funding for ASIC, where Parliament should be encouraged to change ASIC's funding model in the manner suggested by the author so that there is a direct link between the substantial revenue it earns and the government appropriations it receives. Although it is impossible to resource ASIC to a level where it could deal with all the complaints it receives, this course would plainly mean better funding that could result in more competitive remuneration of ASIC personnel which would enable ASIC to attract and retain talented staff particularly as it continues to face an array of challenges in a rapidly changing environment, including fulfilling the fundamental responsibility it has for policing market integrity in an era of a competitive stock market, as well as, positioning it to be a more effective corporate regulator.

274 See, eg, discussion above, n 17.