Law Council
OF AUSTRALIA
Business Law Section

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Committee Secretary
Senate Economic References Committee
PO Box 6100
Parliament House
Canberra ACT 2600
By email: economics.sen@aph.gov.au

Dear Sir

Submission to the Senate Economic References Committee Inquiry into the Performance of ASIC

1 Introduction

This letter is a submission to the Senate Economic References Committee inquiry into the performance of the Australian Securities and Investments Commission (**ASIC**) and is made by the Corporations Committee of the Business Law Section of the Law Council of Australia (**Corporations Committee**).

2 Key points

- The Corporations Committee considers that ASIC generally performs well, but is under resourced having regard to community expectations.
- The Corporations Committee does not consider that the legislation under which ASIC is established is in need of reform. However, some targeted reforms in the area of corporate regulation are worth considering.
- The Corporations Committee is concerned about the overuse of mechanisms that abrogate basic rights, such as reversal of onus of proof.
- The Corporations Committee considers that ASIC's general approach to publicity in connection with investigations is appropriate, although the Committee does have some concerns about ASIC's use of publicity in relation to infringement notices and enforceable undertakings.

3 General Comments

3.1 At the outset, the Corporations Committee notes that the Terms of Reference of the Committee's inquiry are very broad. It is not possible for the Corporations Committee to make submissions of the entire area of ASIC's operations in the context of the terms of reference. The Corporations Committee has confined its submissions to specific areas relevant to the Corporations Committee's expertise and experience.

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ASIC's performance

3.2 Overall, the Corporations Committee considers that ASIC generally performs well in discharging its obligations under the corporations legislation, being primarily the *Corporations Act 2001* (Commonwealth) (**Corporations Act**) and the *Australian Securities and Investments Commission Act 2001* (Commonwealth) (**ASIC Act**).

3.3 ASIC's role has expanded greatly over time since the establishment of a truly national corporate and securities regulator, to now include, for example, credit licensing, business names, ASX market supervision, expanded licensing and supervisory responsibilities since the Financial Services Reforms introduced as the sixth tranche of the Corporate Law Economic Reform Program.

3.4 Moreover, during the more than 20 years since the ASIC predecessor started operations in 1991 there has been an increase in community expectations about the quality of financial advice that will be provided by the advisory industry, while there has also been an increased level of direct share ownership by individuals over that time (due in part to the effect of privatisations and demutualisations), as well as an increased level of indirect ownership through superannuation funds, retail, industry and self-managed.

3.5 ASIC has a very wide jurisdiction, with high community expectations of its performance, while not having, in our view, sufficient resources to meet all of those expectations. ASIC has to compete with the private sector for talent with the disadvantage of not being able to pay market-equivalent salaries for people with cutting edge legal and financial expertise and experience. It is not an exaggeration to state that in many cases ASIC should be congratulated for achieving the regulatory outcomes it has achieved with the limited resources at its disposal. Indeed, it should not be forgotten that Australia's financial markets have an enviable reputation around the world, due in part to the quality of the legal framework (including Australia's unquestioned adherence to the rule of law), the quality of the regulatory structures but also due in part to the performance of the financial regulators such as ASIC, APRA and the Takeovers Panel.

3.6 That said, ASIC has no alternative but to make difficult choices about applying its limited resources, often under conditions of uncertainty about the underlying facts and the applicable law – which uncertainty can be compounded by continual law reform (even under the guise of simplification or the pursuit of apparently worthy individual reform objectives).

3.7 In the same way that business judgements should not be viewed merely with the benefit of perfect hindsight, regulatory decisions, particularly those concerning regulatory litigation and prosecutions, should not be judged solely by reference to outcomes. That is, there will be times that ASIC will not be successful in an enforcement action – but if ASIC is criticised unfairly it may not be prepared to risk possible failure to pursue an action that may well have good grounds for success and good policy reasons to be pursued, although it may ultimately prove to be unsuccessful. Hindsight review of ASIC's decisions should have regard only to the information that ASIC reasonably had available at the time of the decision.

Is there a need for law reform?

3.8 The Corporations Committee does not consider that there are serious defects with the legislation under which ASIC is established or the regulatory structures governing Australia's corporations and financial markets. In our view there is no evidence that the

legislation imposes significant barriers to ASIC fulfilling its responsibilities and obligations.

3.9 Indeed, while the length and complexity of the Corporations Act are serious concerns, the Corporations Committee would counsel against any wholesale rewrite of the legislation, or substantial amendments, in part due to so-called "reform fatigue". Even merely trying to simplify legislation may increase compliance burdens due to transition costs and uncertainty. The short-lived Corporate Law Simplification Program in the early 1990s had a limited impact.

3.10 That said, some parts of the Corporations Act are in need of review, in particular:

3.10.1 Chapter 6 (Takeovers), Chapter 6A (Compulsory Acquisitions and Buy-outs), Chapter 6C (Information about Ownership of Listed Companies and Managed Investment Schemes) and Chapter 6D (Fundraising) are reliant for their proper operation on a large number of class orders and exemptions granted by ASIC, meaning that the published text of the legislation is in effect misleading;

3.10.2 Chapter 7 (financial products and services) is likewise reliant on class orders and amendments contained in the regulations in order to operate;

3.10.3 the various provisions relating to disclosure of information and liability of issuers and involved individuals in Chapters 5, 6, 6D and 7 which are inconsistent.

3.11 There are also a number of specific or targeted reforms to the Corporations Act that could be considered to reduce red tape and business costs, including the introduction of a short form merger procedure as is available in a number of overseas jurisdictions, the possible expansion of the role of the Takeovers Panel in relation to schemes of arrangement and continuous disclosure, broadening the reach of the business judgement rule, reducing the use of "infringement notices" particularly in relation to continuous disclosure and generally reviewing provisions that reverse the onus of proof in relation to officers and have the potential to impose liability unfairly in situations where the officer would not be viewed as morally culpable by ordinary community standards.

3.12 But there are, in the view of the Committee, no significant defects in the legislation establishing and empowering ASIC and no evidence that changing the ASIC Act would lead to better regulatory outcomes.

3.13 Moreover, it is the view of the Committee that changing legislation is not always the optimal solution to a given perceived regulatory problem or failure. While amending legislation might be the lever most easily pulled by the Government of the day, it is not always the best measure to respond to a regulatory problem.

3.14 For example, does the apparent problem indicate a systemic issue or is it isolated occurrence? Unless the problem is systemic, a new legislative measure of general application may impose considerable costs on a wide variety of members of the community without corresponding benefit, in order to catch the very small number of cases where there is truly a problem.

3.15 Similarly, are existing laws being enforced adequately? Has the regulator been given adequate resources to do its job of enforcement? If not, there is little point simply giving the regulator a different law - or more laws - to enforce. These are questions that should be asked at the outset, before it is assumed that law reform is the optimum solution for a perceived regulatory problem.

3.16 In the experience of the Corporations Committee, additional regulation invariably adds to business costs, and the benefits do not always justify the additional costs. It follows that in the view of the Corporations Committee, policymakers should always undertake a rigorous cost-benefit analysis before introducing new regulatory measures, and unless there is a clear net benefit (having regard to transitional costs), amendments should not be made. Wherever possible, policy should be stable and steady, and change only in the face a clearly identified need and benefit.

Deficiencies of the efficient market hypothesis, and the rise of behavioural economics?

3.17 In the past an important part of the theoretical basis for much corporate and securities regulation has been based on the efficient market hypothesis (**EMH**), and related assumptions that more disclosure will cure a problem and that investors are rational decision-makers who can use the extra information to make better decisions.

3.18 Recent developments (including various events during the Global Financial Crisis and extensive research work in recent years in the field of behavioural economics) call these EMH-related assumptions into question, and may call for a rethink as to how financial products and markets should best be regulated.

3.19 Distinctions may need to be drawn in terms of regulatory approaches between liquid markets (such as for large listed issuers) and unlisted markets (such as managed investment products), and previous presumptions about the appropriateness of disclosure as the primary regulatory tool may need to be reconsidered.

3.20 The Corporations Committee is aware that ASIC is conscious of these developments and is seeking to respond to them.

3.21 Controversial though it may be, "merits" regulation of financial products for unsophisticated investors may need to be considered in Australia. That is, unsophisticated investors might need to have a limited range of investment choices, that are limited to investments that are appropriate to their needs and circumstances or that have been approved by a regulator such as ASIC.

3.22 That said, the trade-off inherent in "merits" regulation is the danger that investors will not be sufficiently diligent in protecting their own interests when making investments decisions due to an "expectation gap" about what the regulator has actually done in terms of a "merits" review.

3.23 However, such an "expectation gap" no doubt exists to a greater or lesser degree already in relation to financial services licensing and managed investments, whereby some unsophisticated investors no doubt misunderstand the nature of ASIC's current role in relation to licensing and registration of schemes. There is currently little, if any, "merits" regulation, apart from education and experience requirements for licence holders. Despite this, the grant of an AFSL coupled with ASIC's supervisory powers, is taken by some to amount to a "seal of quality". Investors should be disavowed of this notion.

3.24 It is possible that some financial consumers misunderstand the difference between a prudential regulator such as APRA and a conduct regulator such as ASIC. In other words, people may think that ASIC can give comfort to financial consumers in the same way APRA may be taken to protect the interests of depositors or policy holders. However, ASIC has neither the mandate nor the resources to perform such a role, and perhaps more needs to be done to ensure that an "expectation gap" does not exist in this regard.

Rule of law concerns – reversal of onus of proof and abrogation of basic rights; use of infringement notices

3.25 The Corporations Committee notes its concerns in relation to fundamental issues concerning the application of the rule of law in relation to ASIC's area of operation. The effective operation of the rule of law is fundamental to the proper operation of Australia's financial markets and the regulation of those financial markets, and the benefits are often taken for granted and in some cases misunderstood or overlooked. That a citizen should be deprived of liberty or property only on the basis of a known and certain rule applied to proven facts by an impartial tribunal, is a fundamental plank of our democracy.

3.26 The Corporations Committee considers that encroachments on the rule of law though the use of provisions involving the reversal of onus of proof – requiring an individual to prove their innocence to avoid penalty - and the use of "infringement notices" to avoid reliance on legal process, detract from the legitimacy and ultimately the effectiveness of the regulatory regime.

3.27 It follows that making successful prosecutions or other enforcement proceedings easier by removing fundamental rule of law protections from citizens is not the best answer to perceived regulatory problems.

3.28 By way of example, civil penalty proceedings were introduced into the corporations legislation, as elsewhere, to make enforcement proceedings easier due to a less onerous burden of proof – proof on the balance of probabilities rather than beyond reasonable doubt. However, the Courts will (quite rightly in our submission) often, if not always, applied the so-called *Briginshaw* doctrine – requiring persuasive proof to reflect the seriousness of the consequences of an adverse finding (see, eg, the discussion *Morley v ASIC* [2010] NSWCA 331 at [742] to [753]. This has reduced the expected benefit of the reduction in the standard of proof required, while other features of civil proceeding have been modified to have regard to the punitive nature of civil penalty proceedings.

Publicity about ASIC investigations

3.29 There have been various comments or complaints from time to time about ASIC's approach to providing information about ongoing investigations. ASIC's position on this matter is outlined in Information Sheet 152 (Public Comment) and is, in essence, that investigations should remain confidential unless the public interest requires some form of disclosure. The usual practice of ASIC is, therefore, not to make public comment about ongoing or potential investigations.

3.30 In the view of the Corporations Committee, ASIC's approach in this regard is undoubtedly the correct one in principle as a matter of policy and, for the most part, the correct one in practice. It would be, in the view of the Corporations Committee, quite inappropriate for a regulator of any kind to seek to use the mere fact of an investigation (when by definition no factual findings had been made and no decision had been taken to commence enforcement action) to achieve a broader regulatory outcome.

3.31 Moreover, the publication of mere allegations (that may or may not be ultimately proven) can be oppressive towards the individuals involved and damaging even if the allegations are not proven.

3.32 That said, it is true that, as a rule, ASIC should keep complainants informed of the progress of matters in respect of which a complaint has been made, but having regard to the fact that

a complainant or indeed a "whistleblower" will not necessarily be motivated (solely or primarily) by the same regulatory policy objectives as ASIC. Indeed, a complainant or "whistleblower" may have their own interests to pursue and protect.

3.33 The Committee also notes that it has some concerns about the use of publicity by ASIC in relation to infringement notices and enforceable undertakings. ASIC needs to take great care to avoid overreaching in relation to such publicity and seeking to achieve broader policy objectives by publicising that an individual or corporation has paid an infringement notice or agreed to an enforceable undertaking. An individual or corporation may choose to pay an infringement notice or agree to an enforceable undertaking for a variety of reasons.

4 Submissions - Specific Terms of Reference

4.1 We set out below specific responses to each of the specific Terms of Reference.

(a) ASIC's enabling legislation, and whether there are any barriers preventing ASIC from fulfilling its legislative responsibilities and obligations;

4.2 No, in the view of the Corporations Committee there are no significant problems with ASIC's enabling legislation (being the Australian Securities and Investments Commission Act 2001) (**ASIC Act**) that would amount to barriers preventing ASIC from fulfilling its responsibilities and obligations. If anything, as noted above, ASIC is hindered by a lack of resources, both human and financial, and is subject to many competing demands across its wide portfolio of responsibilities. ASIC's problems, whatever they may be, do not derive from defects in ASIC's enabling legislation.

4.3 That said, the complexity of the substantive legislation (in particular the provisions of the Corporations Act noted above) is a problem for both the business community and ASIC as the regulator. But this problem cannot be solved by more legislation.

4.4 The Corporations Committee would encourage the Government and ASIC to explore ways to increase the cross-fertilisation of ASIC and industry, perhaps by way of encouraging secondments (as happens with great success with the Takeovers Panel, involving secondees from law firms supporting the Panel Executive) and rotations of outstanding young practitioners through ASIC as occurs with the Securities and Exchange Commission in the United States of America, where an SEC secondment is viewed as valuable career stepping stone.

(b) The accountability framework to which ASIC is subject, and whether this needs to be strengthened;

4.5 Generally no. In the view of the Corporations Committee, the accountability framework does not need to be strengthened.

4.6 ASIC is an separate statutory agency with its own full-time Commissioners and is accountable to the responsible Minister and to Parliament, while also being subject to oversight by various Parliamentary Committees.

4.7 Moreover, ASIC's decisions are subject in many cases to merits review by the Administrative Appeals Tribunal or the Takeovers Panel, and judicial review by the courts.

4.8 In the view of the Corporations Committee the accountability mechanisms are satisfactory and effective, and an evidence-based case would need to be made to support additional mechanisms or structures.

(c) The workings of ASIC's collaboration, and working relationships, with other regulators and law enforcement bodies

4.9 The Corporations Committee not in a position to comment on ASIC's working relationships with other regulators and law enforcement bodies, but is unaware of any recent evidence of anything unsatisfactory in the working relationship between ASIC and the Director of Public Prosecutions, for example.

(d) ASIC's complaints management policies and practices

4.10 The Corporations Committee has no comment to make on these matters, and is unaware of matters of material concern.

(e) The protections afforded by ASIC to corporate and private whistleblowers

4.11 Properly understood, it is not ASIC's role to protect whistleblowers as such, although there is a clear policy advantage in having citizens being prepared to come forward and provide information to assist regulators. The Part 9.4AAA of the Corporation Act contains specific provisions designed to afford protection to whistleblowers. In the view of the Committee, there is no serious defect in those provisions or the way they have operated in practice.

4.12 Further, ASIC's confidentiality obligations under section 127 of the ASIC Act are the principal means by which the position of whistleblowers can be protected or, more accurately respected.

(f) Any related matters.

4.13 The Corporations Committee refers to the general comments set out above in Section 3.

5 Conclusion and Contact Details

Please contact John Keeves on (02) 8274 9520 or the Chair of the Corporations Committee Marie McDonald on (03) 9679 3264 if you would like further information.

The Corporations Committee would be pleased to provide a representative to attend and give evidence to the Committee should the Committee wish to receive evidence from the Corporations Committee.

Yours faithfully,

Frank O'Loughlin