

An inquiry into the performance of the Australian
Securities and Investments Commission (ASIC).

A Submission by

Professor Dimity Kingsford Smith

and

Students of UNSW Law Studying the Advanced Elective

Securities and Financial Services Regulation, Class of 2013

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Any Correspondence to:

Prof Dimity Kingsford Smith

Faculty of Law,

The University of New South Wales, NSW 2052

d.kingsfordsmith@unsw.edu.au

The names of all the UNSW Law students contributing to this submission are in Section I.

SUMMARY OF RECOMMENDATIONS

SUBJECT / TOR	RECOMMENDATIONS
ASIC Accountability/TOR (b)	<ul style="list-style-type: none"> • ASIC is underfunded: provide further resources for the appointment of talented, knowledgeable and experienced ASIC personnel at all levels; • Adopt detailed annual exchange of Statements of Ministerial Expectations and ASIC Intention.
ASIC Enforcement/ TOR (a) and (c)	<ul style="list-style-type: none"> • Conduct Law Reform Commission review of gaps, duplications, inconsistencies and practically unusable powers in ASIC's investigation and enforcement toolkit; • Consider whether ASIC should be empowered as a compensation as well as deterrence enforcement regulator; • Implement a mix of measures that should improve compensation outcomes; • Tighten the terms and supervision of enforceable undertakings; • Reconsider the inter-action of ASIC, DPP and AFP.
Retail Disclosure/ TOR (a)	<ul style="list-style-type: none"> • Continue to work on retail financial literacy; • Continue work to improve the quality of financial advice; • Consider ASIC powers to intervene in retail financial product terms to ensure fairness; • Consider ASIC powers to prohibit unsuitable products in retail markets; • Continue to fine-tune retail disclosure while acknowledging its limits; • Review the definitions of 'retail', 'wholesale' and 'sophisticated' investor in relation to disclosure.
Licensing/ TOR (a), (d) and (f)	<ul style="list-style-type: none"> • Amend law so banned individuals are excluded from AFSL management and control; • Review and rationalise the gaps, duplications and inconsistencies in ASIC's licensing and registration powers across the statutes it administers; • Require annual AFSL board certification of compliance with license terms and financial services laws; • Review the definitions of 'retail', 'wholesale' and 'sophisticated' investor in relation to licensing.
Training & Competence/ TOR (a)and (f)	<ul style="list-style-type: none"> • Bring Australian financial services training and competence into line with comparable overseas jurisdictions; • Require a national qualification examination; • Specify annual requirements for continuing professional development; • Mandate and specify ethics training and supervised practice for qualification; • Require a relevant tertiary degree qualification in future.
Whistle Blowers/ TOR (a) and (e)	<ul style="list-style-type: none"> • Increase scope of those who can be whistle blowers; • Protect anonymous whistle blowers; • Remove good faith requirement, mixed motives acceptable; • Extend reportable contraventions beyond Corporations Act; • Encourage corporations to protect whistle blowers organisationally.

The Performance of the Australian Securities and Investments Commission (ASIC).

I. Introduction and Terms of Reference

Terms of Reference (TOR) Addressed

The Senate Committee has asked for submissions on the performance of the Australian Securities and Investments Commission (ASIC), with particular reference to:

- a. ASIC's enabling legislation, and whether there are any barriers preventing ASIC from fulfilling its legislative responsibilities and obligations;
- b. the accountability framework to which ASIC is subject, and whether this needs to be strengthened;
- c. the workings of ASIC's collaboration, and working relationships, with other regulators and law enforcement bodies;
- d. ASIC's complaints management policies and practices;
- e. the protections afforded by ASIC to corporate and private whistleblowers; and
- f. any related matters.

This submission concentrates on paragraphs (a), (b) and (e) above, with some matters falling within other paragraphs.

Structure of This Submission

This submission contains an 8 page overview of the issues raised. The overview provides a brief explanation of the significance of an issue, the legal or policy problem we identify and any solution that we propose. The submission also contains a series of short sections which provide greater depth of evidence and analysis, as well as references, in relation to the issues raised in the overview.

This submission concentrates almost exclusively on matters covered by Chapter 7 of the Corporations Act 2001. This is for two main reasons. First, this is the area of the syllabus of the Securities and Financial Services Regulation course the class of 2013 has been studying. Secondly, it is this chapter of the legislation which was at the centre of ASIC's regulatory interest in alleged deficiencies at Commonwealth Financial Planning Limited (CFPL). It was ASIC's performance in responding to these deficiencies which was the proximate reason for this inquiry.

General Approach of This Submission

Assessments of ASIC's performance are sometimes subject to misconceptions: perhaps the most common is that ASIC closely supervises the Australian Financial Services License (AFSL) holders it regulates. ASIC does a certain amount of surveillance of AFSL holders when it is alerted to problems. Supervision is a regulatory mode undertaken by prudential regulators such as APRA, and is usually accompanied by powers to direct aspects of the regulated entity's 'business model' eg to prescribe capital requirements. This submission attempts to bring in both legal analysis and empirical evidence to address such misconceptions about ASIC's role and its performance: it does so in a number of areas below.

ASIC has three main legal and policy toolkits in its regulatory work: disclosure requirements, market integrity enforcement and licensing powers. These are the policy settings and legal powers for regulation that ASIC

inherited from the report of the Wallis Inquiry into Australia's Financial System in 1997.¹ They are at the heart of Chapter 7 of the Corporations Act which applies to retail investment and to the business of CFPL. These regulatory tools are also those reviewed by the Parliamentary Joint Committee on Corporations and Securities into financial products and services in Australia in 2009: better known as the Ripoll Committee.²

It was this inquiry which led to the Future of Financial Advice (FOFA) program of legislation part of which came into operation in July 2012 and part in July 2013.³ The legislation in this program gave ASIC some further powers to enforce duties and prohibit conflicted remuneration for financial advisers in favour of their clients. It also makes it a little easier for ASIC to cancel Australian financial services licenses and ban financial advisers who breach the financial services laws. Overall FOFA involved a small addition to ASIC's toolkit, but not a departure from the Wallis regulatory settings. The reason for this regulatory history is to demonstrate what ASIC has powers to do and what it does not: what ASIC can and cannot be made accountable for.

II. The Accountability of ASIC for Its Powers and Resources: TOR (b)

The ASIC toolkit of disclosure, enforcement and licensing powers should be contrasted with what seems to be the expectations of the Australian community, some of its political leaders and media. There is an expectation that licensing means that ASIC has some control over licensees' businesses. Likewise Australian investors expect that ASIC supervises licensees regularly. When losses occur there is anger and bewilderment that except in the limited area of market operators, participants and securities dealers⁴ ASIC does not have the power or the resources for ongoing supervision. Such expectations demonstrate that Australians are under a misconception that ASIC has a regulatory toolkit with the types of tools that the Australian Prudential Regulatory Authority (APRA) has at its disposal. ASIC is mostly an 'after the event' enforcement regulator (even where it does supervise), and APRA is mostly a 'before the event' or prudential regulator. In enforcement ASIC is also a 'sanctioning' or deterrence and public protection regulator, and as we discuss below, not primarily an investor compensation regulator.

ASIC is already subject to a wide range of accountability measures, both for decisions in relation to individuals and for policies and programs pursuing ASIC's wider legislative purposes.⁵ These may be divided into financial, procedural and substantive accountability measures as Section II describes. It is the mix of these measures which is central to getting the balance right between independence, expertise and efficiency (the reasons for regulatory agencies) and transparency, accountability and legitimacy (so that the agency is acceptable in a democracy). One instrument for adjusting this balance is the exchange of Statements of Expectation and Intent between the agency and the minister. This has been used successfully in some Australian states notably Victoria, and NZ, though less enthusiastically adopted by Commonwealth Government in Australia. We consider a specific, targeted and properly detailed program of regulatory action (not just general statements) communicated annually between minister and agency promotes independence from political influence and augments transparency, accountability and legitimacy. It should bolster independence from the merely commercial interests of industry as well. Another approach is to have more disclosure by the agency of its main operations and funds expenditure: the publication of organisational structures and delegations, the allocation and use of funds and ASIC's recent enforcement reports are examples.

¹ Commonwealth of Australia, *Financial System Inquiry Final Report*, (AGPS, 1997).

² Parliamentary Joint Committee on Corporations and Securities, *Inquiry into Financial Products and Services in Australia* (Commonwealth of Australia, 2009)

³ Insert refs to FOFA and FFOFA acts

⁴ ASIC Supervision of Markets and Participants see six monthly reports since January 2011, most recently REP 327 at: [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rep366-published-21-August-2013.pdf/\\$file/rep366-published-21-August-2013.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rep366-published-21-August-2013.pdf/$file/rep366-published-21-August-2013.pdf) This is mostly in relation to market integrity contraventions such as insider trading.

⁵ S1 & 2 ASICA

Traditional accountability measures concentrate on agency exercise of power, asking whether regulators are acting within power, following fair procedures and providing reasons. A more recent approach is to attempt measuring the performance of regulators, and whether performance improves over time. This is a type of cost – benefit evaluation, to see if taxpayers are getting good value for money. As Section II explains this may be assessed by a regulatory impact statement when bringing in regulations. A related approach is to measure the cost of or the rate of success in the main regulatory functions of an agency. ASIC's enforcement statistics are therefore often considered as a measure of its performance. In Section II one of the students has attempted tables showing the changing cost and success rates of ASIC enforcement. Along with established routines of public audit these efficiency oriented measures of performance safeguard public resources. Another modern approach to accountability is to survey the opinions of 'stakeholders' or 'gate-keepers' affected by a regulator's discharge of its obligations. ASIC has done this three times over the last decade.⁶ Overall these show a general improvement in opinions of ASIC's performance, although investors and consumers rated ASIC much lower than regulated persons and other stakeholders. They were particularly critical of the prevalence of conflicts of interest in the financial sector, the management of conflicts and the professionalism of financial advisers.⁷

The accountability of a regulator can be affected by the structure of its commission. In the US the Securities Exchange Commissioners are overtly political non-executive appointments: the GFC suggests that this model may make a commission more susceptible to political or industry influence. In New Zealand the Financial Markets Authority has a CEO and a non-executive board from industry and related groups. In the UK the Financial Conduct Authority has an executive chair and CEO and a non-executive board from industry and consumer groups. These models rely on individual executives being expert in a broad range of financial activities, immune to industry influence through board composition and fearless 'lone-wolf' decision-makers. In Australia commissioners are fulltime ASIC executives as well as taking decisions as a commission. The executive and collegiate elements of this model make it more robustly independent and provide a better spread of expertise. Though commission structure is important, broader governance learning tells us that structure is less influential than the calibre of personnel appointed.

Emphatically, the most important element of success of any agency is its leaders and personnel. Appropriate expertise and independence, including independence of mind and loyalty to the legislative mandate, are central. We think the increase in ASIC's mandate over the last decade has not been matched by financial appropriations and has stretched its personnel. ASIC is an enforcement, financial disclosure and licensing regulator of financial businesses. It makes sense given ASIC is an enforcement regulator making itself accountable through the publication of enforcement statistics, that many personnel including the most senior, should be expert in the modes of enforcement. Likewise, for ASIC's role as a financial disclosure regulator accounting and auditing expertise and financial literacy experience would seem crucial. As a licensing authority of financial businesses, business expertise from a regulatory perspective is needed. It is our submission that personal calibre, expertise and jealous independence and loyalty to mandate of its personnel are the most important factors of all in making ASIC successful and accountable. This in turn requires financial resources to pay salaries that will attract enough talented, highly trained and experienced personnel, to do the work in a timely fashion.

However, the most important accountability question about ASIC is whether its activities are reducing the bad side effects of regulated activities (eg poor financial advice), and promoting the objects of the regulatory scheme (eg increasing investor confidence). Performance cost statistics and studies of public perceptions cannot answer this question, though they can provide indicators. Whether ASIC is effectively discharging its mandate can only

⁶ Susanbell research, 'Stakeholder survey 2013: Report to the Australian Securities and Investments Commission', (Report to ASIC, Susanbell Research, September 2013), 63.

⁷ Susanbell research above at 24-26

be judged through a matrix of financial, procedural and substantive measures which we elaborate further in Section II, and with a keen eye to what ASIC actually has power to do.

III. What Sort of Enforcement Regulator is ASIC and how has it Performed? TOR (a) and (c)

ASIC has considerable investigation and enforcement powers. These are for sanctioning, deterrence and public protection. Investigation and enforcement is the most expensive tool in ASIC's regulatory kit: enforcement is ASIC's largest expenditure category. This submission takes a broad view of enforcement: it considers the full range of techniques from license cancellation and criminal prosecution to warnings and negotiated programs to improve compliance and organisational culture. An important question about ASIC's enforcement powers and resources, is how much (if any) of its enforcement should be to get investors compensated.

Numerically, ASIC makes significant use of its criminal enforcement powers, certainly by comparison with license cancellations and civil penalty actions. Further evidence of enforcement and success rates and cost, are in Section III. ASIC prefers to prosecute rather than use civil penalties. Although it takes court action against only a tiny fraction of misconduct recorded by it, ASIC is a very successful litigant, with success rates around 90%. In the last decade it has taken more action against large companies, to increase deterrence and public protection. Most of this enforcement action has been for breach of director's duties. ASIC has taken criminal action regarding chapter 7 financial services: eg in Trio and Astarra⁸, Westpoint⁹ and ANZ-Opus Prime¹⁰. It is more sparing with civil penalty proceedings, eg. in Vizard and Storm Financial.¹¹ The reasons are discussed in Section III.

Also in ASIC's enforcement toolkit is the power to cancel licenses and ban individuals from providing financial services. Until July 2012, ASIC had limited legal power to decline a license or to cancel a license. The picture was similar with banning individuals. This legal deficiency allowed many successful (but often unmeritorious) appeals against ASIC licensing and banning decisions at the Administrative Appeals Tribunal. This weakened ASIC's ability to control the quality of license holders and individuals offering financial services. The FOFA licensing reforms have addressed this deficiency to a degree. Though ASIC still does not cancel many licenses, banning individuals has increased sharply in recent years. Individual banning has been the most frequently used sanction in CFPL, Trio and Astarra, Westpoint, ANZ-Opus Prime and Storm Financial.

There is another echelon of enforcement activity through which ASIC works to deter, protect the public and promote compliance. Under the latent threat of court proceedings ASIC may issue an infringement notice or negotiate an enforceable undertaking. An infringement notice may be issued to a listed company where there has been a less serious breach of continuous disclosure requirements. The company then has 28 days to pay a financial penalty and correct its disclosure, or it may choose not to do so, leaving ASIC to bring civil penalty proceedings against it. Enforceable undertakings allow ASIC to negotiate sanctions for a wider range of contraventions with the party investigated: the terms are made public. Undertakings usually require that investors are paid compensation, that there are personnel, training, structural and cultural changes in the business of the party entering the undertaking. Undertakings are 'enforceable' for if the party does not perform it, ASIC can proceed to court on the original contravention. They are especially useful with large 'mass market' retail investor service providers, permitting multiple contraventions to be dealt with in a single intervention. ASIC agreed an enforceable undertaking with CFPL and in the past has done likewise with AMP, Macquarie, ANZ and other licensees. Infringement notices and enforceable undertakings save enforcement dollars. They allow the

⁸ 10 jailed

⁹ 2 jailed and proceedings against 3 discontinued during hearing

¹⁰ 2 jailed and one acquitted

¹¹ Against the two shareholder/directors of the firm.

'regulatory sanction' to fit the 'regulatory contravention' and promote future compliance. However, we argue in Section III that the terms should be tougher, they should be properly supervised to ensure compliance, and ASIC should 'enforce' undertakings in court more regularly rather than renegotiating their terms when they are breached.

ASIC's enforcement powers are mostly for sanctions, not for obtaining investor compensation. However it is clear that investors expect ASIC to obtain compensation, especially where the Financial Ombudsman Service¹², class actions or access to courts are unavailable. Even where these avenues are available, if firms cannot pay there is no Australian financial compensation scheme and insurance proceeds may be unavailable. It is clear that ASIC considers obtaining compensation is important. When it uses its powers to obtain compensation it does so usually for individual investors in financial products and creditors of insolvent companies: it rarely seeks compensation for company shareholders especially of small companies. This is because ASIC must use its powers and regulatory resources in the public interest. Despite limited compensation powers it has been resourceful and successful in strategies which mix court action, enforceable undertakings and negotiation to obtain compensation: examples can be seen in cases such as CFPL, Westpoint, ANZ-Opus Prime and Storm Financial.

Compulsory superannuation in Australia makes everyone in employment an investor at some point in their life. A recent report has recommended against a financial services compensation scheme.¹³ There are serious deficiencies in professional indemnity insurance of licensees as a source of compensation. In these circumstances there are hard choices to be made. On one hand, enforcement to obtain compensation uses resources that might better deter through criminal prosecution, or civil penalty action leading to disqualification or banning. However, compensation will never have the same moral charge as a criminal conviction or civil penalty order, nor instil the same fear as a jail term. It will not cause an individual to be professionally shunned as disqualification and banning may. If traditional deterrence is to be preferred then serious 'fine-tuning' of legislation to rationalise and remove enforcement obstacles is required: we set out the most important of these (eg reforming pecuniary penalty orders) in Section III.¹⁴

On the other hand in the absence of a compensation scheme, an alternative to deal with the 'compensation expectation gap' is to combine several measures. First, raise the ceiling significantly on FOS claims. Then, link AFSL licensing financial and operations systems quality and compliance more tightly to the terms of professional indemnity insurance for licensees. Also, increase ASIC's powers and budget for compensation actions. Further, reform civil penalty actions to remove legal obstacles and encourage ASIC to add compensation to its claims more often: this would improve both deterrence and compensation. Allow ASIC to use the proceeds of pecuniary penalty orders for funding compensation actions, and/or paying compensation in the last resort. Compensation measures, even from a compensation fund, will rarely fully restore investors, but substantial damages orders are an important spur to licensee compliance.

IV. Disclosure in 'Mass Market' Retail Investor/Consumer Markets: TOR (a)

Along with enforcement, disclosure is ASIC's main regulatory tool. Research shows there are serious reasons to doubt the regulatory efficacy of disclosure when as much reliance is placed on it as was the case with the Wallis settings, particularly in retail markets. ASIC has catalogued the difficulties well in a number of reports and consultancy papers: recent ABS research corroborates these views. In essence the literacy and numeracy skills

¹² FOS is not available where the licensed provider has become insolvent (eg Storm Financial) and there maximum amounts which may be claimed at FOS.

¹³ R St John, Compensation Arrangements for Consumers of Financial Services, Future of Financial Advice, 5 April 2013.

¹⁴ Tom Middleton

of the majority of Australians are not adequate for reading and analysing disclosure material for common retail financial products including superannuation. There are also indelible behavioural biases in financial decision making which can lead to unwise decisions. Often disclosure documents seem more apt to protect the issuer or adviser than to inform the investor. We provide more detail in Section IV.

Along with financial regulators world-wide, ASIC's response has been to develop a policy to improve financial literacy. It is accepted that the development of literacy adequate to the tasks set by financial disclosure will take at least one generation, maybe more. Another response, again common overseas, is improving the quality of financial advice. This too requires time: paramount duties to client, remuneration by fees not commissions and improved disciplinary procedures begun in FOFA are reasons for optimism. However, as we argue below there is still work to be done in training and competence, including in ethics and client care. We also think licensees need more incentive to be operationally compliant: so below we propose the annual certification of compliance by the board and senior executives as part of the licensing scheme. We think certification will hasten change to organisations, build a more client-centred ethos and in the long run improve financial advice and broking services.

In the meantime, ASIC remains empowered to require disclosure in retail markets, but it has few other powers to respond to the actual capacities of retail investors. Disclosure remains as central to financial markets as it was when the Wallis report issued in 1997, but continuing efforts to fine-tune it do not address the fundamental difficulties of retail investor incapacity. In retail markets regulators need other regulatory tools in their kit as well. In Britain the 'Treating Clients Fairly' program of the Financial Conduct Authority allows the regulator to intervene in the design of the product, not just place a stop order on disclosure. We think there is also room for ASIC to exercise powers to prohibit the issue of certain products in retail markets, if it is thought they are too complex, risky or leveraged to be appropriate. Finally, we think that two recent court decisions¹⁵ make it clear that there is urgent need to review the definitions of 'wholesale investor', 'sophisticated investor' and 'retail investor' under the legislation, so that any changes to ASIC's toolkit in the retail area can be directed at the right class of investor. We elaborate on the evidence and reasons behind all these proposals in Section IV.

V. Licensing and License Operating Requirements: TOR (a), (d) & (f)

We have noted above that recent FOFA changes have made it easier to cancel licenses and ban individuals. A year later the number of cancellations and bannings has increased but remains modest. We draw attention to a continuing deficiency in banning, more details of which are in Section V. Even if a person is banned they may continue to be influential in a licensed firm as a director, officer or a significant shareholder. The tests for bans and director/officer disqualification are different, and consideration should be given to prohibiting a banned person acting as a director or officer. Similarly, consideration should be given to empowering ASIC to exclude from management a shareholder who is banned. ASIC should have express power to consider the fitness for a license of a firm where a banned person has a significant shareholding.

As discussed already, there is also an expectation gap between the powers and resources ASIC has, and the level of supervision many Australians expect it to deliver. This and the facts of ASIC's intervention at CFPL suggest that particularly in relation to licensees which may be 'too big to cancel' ASIC may require additional tools to ascertain non-compliance, and provoke quicker action by the licensee. We think the board, CEO and CFO should have to certify each year that the licensee is complying with its license conditions and with the financial services laws. This certification should be lodged with ASIC and placed on the firm's website. It should be given within 6 months of the financial year close. If the certification is not lodged within 30 days of the required

¹⁵ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200; *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028.

date, the license should be automatically suspended. If it is not lodged within 3 months of due date, the license should be cancelled automatically and the firm should have to reapply. If the certificate is given and it is subsequently discovered that the licensee was not compliant, and the non-compliance is associated with loss or is serious, it should be an offence. Further ASIC should be more robust in using its powers under s915C *Corporations Act* to suspend the license of even large licensees. In the absence of APRA style supervision we think these suggestions will help to close the gap between the expectations and the reality of ASIC licensing.

VI. Improving Training and Competence in Licensees and Authorised Representatives: TOR (a) and (f)

As just discussed retail investors have limited understanding of financial matters, limited numeracy skills and often act on behavioural biases which do not always lead to good decisions. In a country where every employed superannuant must make investment decisions these difficulties can be addressed by obtaining financial advice and information. This places paramount importance on the technical competence and ethical character of advisers and brokers. The Ripoll Committee recommended an overhaul of education and training and the professionalization of financial advisers. ASIC has sustained evidence from its 'shadow shopping' and other regulatory activity that the competence of advisers remains very unreliable.

In comparable countries (UK, USA, NZ) financial advisers and brokers must pass a national exam to practice. ASIC has proposed this, but eventually settled on a scheme that does not require a national exam. By comparison with other jurisdictions Australian advisers and brokers do not have rigorous standards of initial or continuing education. It is a non-governmental body, the Financial Planning Association which is leading the way. It requires a university degree as the qualification for entry: the Association also offers training programs for the internationally recognised CFP mark and high quality continuing education. Ethical training is part of its CFP program. ASIC proposes a degree qualification for new entrants advising on more complex products, starting in 2019.

To bring Australia into line with comparable jurisdictions we recommend that ASIC revert to its proposal for a national exam, since it will be decades until all entrants have a degree qualification. ASIC should also consider a system of designations of specialist competencies, and perhaps follow the US approach of requiring special training by providers who deal with seniors. We provide further details in Section VI.

VII. ASIC and Whistle-Blowers: TOR (a) and (e)

Protecting whistleblowers is a legitimate aim. Whistle blowing provides an effective internal audit mechanism; often it's only those with insider information who can expose corporate wrongdoing. Whistleblowers face a uniquely serious risk of victimisation both professionally and personally. In light of the recent CFPL revelations, ASIC has acknowledged its shortcomings in being responsive to those who have made disclosures under Pt 9.4AAA of the Act.¹⁶ We make a series of suggestions for changing law and practice in relation to corporate whistle blowers in Australia.

¹⁶ ASIC, Submission No 45 to Senate Committee on Economics, *The Performance of the Australian Securities and Investments Commission*, August 2013, 16 [72].

Section I

UNSW Law Undergraduate Students Contributing to This Submission

Agostino,Anthony
Ancev,Eftim
Babeendran,Suhanthan
Bai,Kevin Shuo
Bhatnagar,Swati Akanksha
Chan,Welton
Chang,Tsung-Lin
Chiang,Timothy
Coorey,Alan Mathew
Do,Daniel
Frew,David Crawshay
Gardner,Jonathan Blair
Garofano,Stephen Patrick
Gillies,Melissa-Ann Marie
Glanville,Kristyn Maree
Grewal,Norah
Hall,Madeline
Huynh,Helen
Kazzi,Charbel
Kumar,Sharlene Sital
Lee,Joshua Wei Min
Lee,Seung One Brian
McEwan,Blair
Moon,Sebastian
Nghe,Wilson
Nguyen,Dan Manh
Poologasundram,Viroshan
Rosewarne, William Colin
Ruslim,Ryan Sylvester
Shieh,Hoy-Lyn Hayley
Suthaharan,Yathavan Prasaanth
Tan,Annie Xue Ann
Terado,Ken Edward
Vamvouklis,Paul
Varsanyi,Priscilla Yong Le
Whitehurst,Isabel
Zhang,Lu Jie Roger

The views in this submission are not those of the University of New South Wales or of UNSW Law. They are the views of Professor Kingsford Smith in her personal professional capacity, but not in her capacity as independent Chair of the Conduct Review Commission of the Financial Planning Association nor in her role as a member of the New Zealand Financial Markets Authority Code Committee. The views of the student contributors to this submission are in their capacity as private individuals who are near the end of their legal training at UNSW Law and have studied and researched the subject matter of the submission in the course Securities and Financial Services Regulation (LAWS3141/JURD 7541).

Section II

The Accountability of ASIC for Its Powers and Resources: TOR (b)

ASIC has a duty to promote investor and market confidence.¹⁷ A necessary condition is to succeed in several regulatory dimensions, especially enforcement, and be seen to do so. This legitimacy as a regulator comes partly from ASIC being transparent and accountable in a number of ways: financially, procedurally, and substantially. Ultimately, ASIC is a *public* institution, which works best when its decisions and processes are seen by the public. We consider in more detail a number of ways in which ASIC is already accountable. Accountability mechanisms may be thought of as 'softer' (such as legislative requirements to publish reports and other information) and others as 'harder' (such as external review by the AAT or ASIC commissioners being dismissed).¹⁸

Financial accountability mechanisms covering ASIC include auditing under the *Financial Management and Accountability Act 1997* (Cth), the requirement to publish regulatory impact statements to the Office of Best Practise Regulation, and oversight by the Auditor-General.¹⁹

Procedural accountability mechanisms are largely concerned with the way in which ASIC exercises its decision-making and enforcement powers. These mechanisms operate at an institutional level, such as dispersion of power across several commissioners, reserve powers with the Governor General to dismiss a commissioner and requirements to abide by public service codes of conduct and values.²⁰ They also include more specific limitations on how investigative powers are used, such as notice requirements and rights to a legal representative when being examined by ASIC. The extent to which ASIC publishes information about decisions and its consultations is not consistent across the different enforcement activities and statutes under which ASIC acts.²¹ Many ASIC decisions are also susceptible to judicial review to ensure compliance with natural justice. Although as Hyland notes, it is not completely clear which decisions this would apply to, for example whether negotiated enforceable undertakings must comply with natural justice.²²

Substantive accountability mechanisms range from softer practices in relation to leadership and employment within ASIC, to internal and external merits review, and ministerial directions. There are also public consultation requirements and requirements to publish reports and other information, giving the public and industry a chance to comment on ASIC policy.²³ As in the UK, ASIC exists in a 'twin peaks' structure of financial regulation with APRA.²⁴ In Australia and UK each has a memorandum of understanding with their prudential counterparts, although unlike the UK, there are no strong accountability mechanisms attached to the ASIC/APRA relationship.

Making a **numerical or financial performance assessment** of a regulator is hindered by the difficulty in obtaining appropriate data. This submission relies upon publicly available information contained in various ASIC reports. Our assessment of ASIC's enforcement performance is limited because:

¹⁷ *Australian Securities and Investment Commissions Act 2001* (Cth) s 1(2)

¹⁸ See generally, J Bird, 'Regulating the Regulators: Accountability of Australian Regulators' (2011) 35 *Melbourne University Law Review* 739

¹⁹ Office of Best Practice and Regulation, *Australia's Best Practice Regulation Requirements* (27/09/2013) Department of Finance and Deregulation <<http://www.finance.gov.au/obpr/proposal/gov-requirements.html#handbook>>

²⁰ *Public Service Act 1999* (Cth) ss 10 and 13

²¹ M Hyland, 'Who is Watching the Watchdog?: A Critical Appraisal of ASIC's Administrative Powers' (2009) 2 *Journal of Australasian Law Teachers Association* 29, 40

²² M Hyland above at 41

²³ *Australian Securities and Investment Commissions Act 2001* (Cth) s 136

²⁴ Georgosouli, A., 'The FCA-PRA Coordination scheme and the Challenge of Policy Coherence' (2012) 8(1) *Capital Markets Law Journal* 62, 62

- Information is presented differently (or omitted) in certain reports;
- ASIC has not provided any methodology which details how the data was prepared; and
- There is no base line to compare ASIC's performance against. This problem was noted by Goodhart, who observed that deciding whether or not the United Kingdom's FSA had met the fourth of its statutory objectives - the reduction in financial crime - would first require data on the extent of financial crime being perpetrated, which does not exist.²⁵

Bearing these limitations in mind we have assembled a limited time-series comparison using data presented in ASIC's annual reports and legal expenditure reports. The increasing number of reports of crime or misconduct in the table below is concerning, especially given that the total level of litigation has fallen. Ultimately this suggests that ASIC is accomplishing less, yet spending more money. However, this may be being caused by limitations in ASIC's data: without a methodology being provided we cannot ensure the figures in the reports have been calculated in the same way and from year to year. For example, it is unclear whether increasing legal expenditure was spent only on litigation or wider enforcement (eg enforceable undertakings, infringement notices) as well. Accepting ASIC's figures as reported, these figures suggest ASIC's enforcement record requires greater scrutiny.

Year	Reports of Crime or Misconduct ²⁶	Total Litigation Concluded ²⁷	Success Rate in Litigation ²⁸	Operating expenses (millions) ²⁹	Legal expenditure (millions) ³⁰
2006/2007	10,682	430	97%	256	N/A
2007/2008	11,436	280	94%	274	54.8
2008/2009	13,633	186	90%	295	70.8
2009/2010	13,372	156	91%	387	80.7
2010/2011	15,634	202	90%	385	72.6
2011/2012	12,516	179	92%	384	81.4

Questions for Further Consideration: The fact remains that in a democracy statutory bodies will never be, and should never be, completely free of political influence. Nor when a large part of their mandate is regulation by enforcement can they ever be wholly transparent, for this would render their enforcement work impossible. However, governments and agencies like ASIC should strive to operate in the public domain where possible. While there are many ways in which ASIC is already accountable there are few checks on dialogue between the responsible minister and ASIC.

²⁵ Charles Goodhart, 'Regulating the Regulators – An Economist's Perspective on Accountability and Control' in Ellis Ferran and Charles Goodhart (eds), *Regulating Financial Services and Markets in the 21st Century* (Hart Publishing, 2001) 151 at 152, 153.

²⁶ ASIC, *Annual Report 2011-12* (2012) 144.

²⁷ ASIC, *Annual Report 2011-12* (2012) 144.

²⁸ ASIC, *Annual Report 2011-12* (2012) 144.

²⁹ ASIC, *Annual Report 2006-07* (2007) 10; ASIC, *Annual Report 2007-08* (2008) 10; ASIC, *Annual Report 2008-09* (2009) 10; ASIC, *Annual Report 2009-10* (2010) 10; ASIC, *Annual Report 2010-11* (2011) 22; ASIC, *Annual Report 2011-12* (2012) 12.

³⁰ 2011/2012: ASIC, *ASIC's Legal Expenditure 2011-2012* (30 October 2012)

<<http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC's+legal+expenditure?openDocument>>

2010/2011: <<http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC%27s+legal+expenditure+2010-2011?openDocument>>

2009/2010: <<http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC%27s+legal+expenditure+2009-2010?openDocument>>

2008/2009: <<http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC%27s+legal+expenditure+2008-09?openDocument>>

2007/2008: <<http://www.asic.gov.au/asic/asic.nsf/byheadline/ASIC%27s+legal+expenditure+2007-08?openDocument>>

Bird argues that statements of Ministerial Expectation are too vague and general to be useful and their use with ASIC has been discontinued.³¹ Statements of Intention from ASIC to the minister setting out the detailed and specific programs, plans and priorities that bring ASIC's mandate, expertise and independence together, have similarly languished. By contrast with Bird, like Craig³² we contend that these processes should be brought into the open, since they occur in the twilight anyway. Having clear detailed annual statements of ministerial expectation and agency intent agreed between the Minister and ASIC would give a democratic imprimatur to the programs of the regulator. It would give a basis for making an appropriate appropriation of resources, including those for the appointment of appropriate personnel for intended programs. Having the ministerial expectations and the agency intentions public would ensure the legislative mandate was considered and ASIC's role as independent expert in operationalising that mandate acknowledged. Making such public statements of expectation and intent also means that other regulators, financial industry participants and investors would be more aware of the direction of regulatory action and ASIC policy.

³¹ J Bird, 'Regulating the Regulators: Accountability of Australian Regulators' (2011) 35 *Melbourne University Law Review* 739

³² P Craig, *Public Law and Democracy in the United Kingdom and the United States of America* (1990 Clarendon).

Section III

What Sort of Enforcement Regulator is ASIC and how has it Performed?

TOR (a) and(c)

One of *the perceptions about ASIC* this submission wishes to address is that ASIC is an *unsuccessful litigant* and an ineffective enforcer. This perception is captured by a respondent to a recent survey by ASIC of its stakeholders: "I feel ASIC don't have too many wins!"³³ The Table in Section II demonstrates that ASIC is a successful litigant, winning around 90% of its cases. ASIC has had some high profile losses in the last half decade.³⁴ This is to be expected if it takes on large defendants in the interest of deterrence and in a system where defendants are rightly protected by the presumption of innocence and proof beyond reasonable doubt. This said we think there are obstacles to ASIC's enforcement performance which could be removed, and we set these out below.

Another enforcement perception we address below is that *ASIC should get compensation for investor losses* through its enforcement activity, rather than using its powers and resources for criminal and civil penalty actions. Thirdly, there is the wide-spread perception that it is an ineffective enforcer because *ASIC does not prevent investment losses*: in the Introduction we pointed out that ASIC has very limited powers over the businesses it licenses, and it is prudential regulation such as APRA is empowered to carry out, that is most apt for prevention. APRA regulates a tiny number of entities by comparison with ASIC, and it would require an unprecedented revolution in powers and resources for ASIC to be able to regulate prudentially. However, we think there are some techniques that ASIC could, if given new powers, employ in its licensing activity which could reduce the loss prevention 'expectation gap', and we outline these in Section V.

ASIC's effectiveness in investigation and *enforcement is hindered by overlapping and inconsistent powers, gaps in its powers and the practical unavailability of some of its legislative sanctions*. As an illustration of this, Middleton points out a gap in ASIC's power to obtain a telecommunications interception warrant itself.³⁵ It must convince the Australian Federal Police to apply for a warrant. This means ASIC's effectiveness depends on the AFP. Further, ASIC is not an authorised recipient of the evidence obtained from the interception.³⁶ Interception evidence is not released to ASIC but directly to Commonwealth DPP: ASIC plays no role in prosecution, despite its expertise.³⁷ Inter-agency relations are also complicated by ASIC's need in some cases to avoid communication with the DPP in the course of a criminal matter, in order to prevent the risk of defendants arguing that ASIC's evidence in related civil or civil penalty proceedings is tainted.³⁸ Although ASIC does have overlapping prosecution powers,³⁹ there is a Ministerial direction that ASIC refers prosecutions to the DPP: again, ASIC's effectiveness depends on another agency.

Across the many statutes it administers ASIC has inconsistent search warrant powers available. ASIC can obtain a search warrant under the credit and some superannuation legislation⁴⁰ only where a person has already failed to comply with ASIC's notice to produce books.⁴¹ This should be aligned with ss 35 and 36 of the *ASIC Act* so ASIC can search without prior warning otherwise the recipient may destroy, alter or conceal books. ASIC is likewise unable to apply for a search warrant without warning by telephone, telex, facsimile or other electronic

³³ Susanbell research, 'Stakeholder survey 2013: Report to the Australian Securities and Investments Commission', (Report to ASIC, Susanbell Research, September 2013), 63.

³⁴ *R v Smith* (Opus-Prime director acquitted) ASIC MR-13-251; *Forrest v ASIC*; *Fortescue Metals Group Ltd v ASIC* (2012) 291 ALR 399; *ASIC v Rich* (2009) 236 FLR 1; *ASIC v Citigroup Global Markets Australia Pty Ltd (no 4)* [2007] FCA 963

³⁵ T Middleton, 'ASIC's Regulatory Powers: Problems and Suggested Reforms' (2013) 31 *Companies and Securities Law Journal* 208 at 212.

³⁶ S 68 *Telecommunications (Interception and Access) Act 1979* (Cth).

³⁷ Middleton above at 213.

³⁸ Middleton above at 213.

³⁹ Middleton above at 215; with overlapping powers, ASIC has prosecuted 26 cases without referral to the DPP.

⁴⁰ See ss 269 and 270 of the *NCCP Act*, ss 102 and 103 of the *RSA Act* and ss 271 and 272 of the *SIS Act*.

⁴¹ Middleton above at 216.

means in an urgent case or where the delay caused by an application in person would frustrate the purpose of the warrant.⁴² There should be changes in line with warrant applications under s 3E of the *Crimes Act 1914* (Cth) or s 225 of the *Proceeds of Crime Act 2002* (Cth). Another complication that makes these amendments desirable is that evidential material seized under a *Crimes Act* search warrant (good for urgency) cannot be used by ASIC for subsequent civil or civil penalty proceedings that pertain to the same set of circumstances.⁴³ There are many other inconsistencies within and between its acts which hinder ASIC's enforcement effectiveness.

Civil penalty provisions were introduced to the Corporations Act as an alternative to criminal prosecution and to give ASIC sanctions to meet non-fraudulent contraventions. The Corporations Act is specific and express that they are to be civil in procedure, rules of evidence and standard of proof. ASIC pays both its own and the defendant's costs if it loses:⁴⁴ this is not so with a loss in criminal prosecution. A number of court interpretations of civil penalty provisions have made them less civil, and more aligned with criminal procedures and standards of proof, making ASIC's prosecution task significantly more difficult despite the express terms of enactment. In some aspects civil penalty action has become practically unavailable as an enforcement tool. Interpreting civil penalty provisions as subject to the privilege against penalties⁴⁵ the decision in *Rich v ASIC* did such damage to ASIC's use of civil penalties as a tool of enforcement, that the decision was reversed by statute.⁴⁶ However, we think the reversal did not go far enough: the legislature should remove the detrimental procedural effects of the penalty privilege not just from disqualification and banning, but from pecuniary penalties too. Amounts paid as pecuniary penalties could then be used to further fund ASIC's enforcement work, and in the absence of a compensation fund, as a last resort source of compensation for loss. The US SEC has some of these powers.⁴⁷

Likewise, the courts have interpreted civil penalty standard of proof as being high on the *Briginshaw* scale⁴⁸ of the civil standard of proof: this requires a standard of proof higher than an ordinary civil damages or compensation action. This 'sliding scale' within the *balance of probabilities* has led to judges requiring "an exactness of proof".⁴⁹ This places a significant burden on ASIC as plaintiff in proving a civil penalty contravention, sometimes practically approaching the criminal standard, despite the terms of the legislation. Together requirements of the penalty privilege and proof in the upper reaches of the *Briginshaw* standard, have given civil penalties some attributes of criminal proceedings, leading to appeals on procedural and evidentiary issues, with costs and delays,⁵⁰ especially when compared to the ACCC's use of the same tool. Civil penalties were introduced to counter some of the notorious difficulties of 'white collar crime' or 'complex fraud' cases: alas, along with adverse costs orders the difficulties we have just described make them an unattractive enforcement alternative for a cash strapped regulator.

The 'best interests' duty on financial advisers introduced in the FOFA reforms,⁵¹ is also a civil penalty provision. It has other shortcomings too which exemplify our criticism that some ASIC sanctions are practically unavailable for use, despite being in the legislation. By contrast with similar best interests provisions in the superannuation and managed investments legislation which are better understood and clearly fiduciary,⁵² the drafting of the FOFA best interests provision has probably reduced it to a negligence standard. Its insertion was accompanied by the repeal of s945A which was a well understood negligence standard: now we have a negligence standard the interpretation of which is entirely unknown and which is a civil penalty provision as well, which s945A was not.

⁴² This is the situation under the *ASIC Act*, *NCCP Act*, *RSA Act* and the *SIS Act*.

⁴³ Middleton above at 218.

⁴⁴ ASIC's loss in *ASIC v Rich* above is said to have cost about \$20 million.

⁴⁵ *Rich v ASIC* [2004] HCA 42 (Sept 2004)

⁴⁶ S1349 *Corporations Act*

⁴⁷ Middleton above argues for changes like this too.

⁴⁸ *Briginshaw v Briginshaw* (1938) 60 CLR 336 at 362-363. The *Briginshaw* test was introduced in 1938 and requires a "higher" level of proof in a civil proceeding setting, if the facts or the sanctions are unusual. In it, Dixon J (as he then was) said: 'the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved *to the satisfaction of the tribunal*'. It is argued that the moral disgrace accompanying a civil penalty contravention, requires proof at the higher end of the *Briginshaw* scale.

⁴⁹ As in *ASIC v Vines* [2002] NSWSC 1223 at [13], per Austin J

⁵⁰ Middleton above at 517.

⁵¹ S 961B *Corporations Act*

⁵² A characterisation which makes the obligation very serious in nature and effect if breached.

The new provision will cause enforcement difficulties not only in the courts, but also to the financial advice industry internal dispute resolvers and to external tribunals such as the Financial Ombudsman and disciplinary panels.⁵³

Number of civil penalty applications issued by ASIC by year		ASIC's success rate – civil penalty orders obtained
Year	No of civil penalty applications issued*	No of applications for civil penalty 25 orders issued
1993	0	No of applications for civil penalty 6 orders outstanding
1994	0	No of applications for civil penalty 19 orders finalised
1995	0	No of finalised matters where civil 18 penalty orders were obtained
1996	5	No of finalised matters where civil 1 penalty orders were NOT obtained
1997	3	
1998	2	
1999	2	
2000	4	
2001	6	
2002	0	
2003	3	
2004 (until end May)	0	
Total	25	

These tables illustrate the low number of civil penalty orders from 1993-2004, as compiled by Welsh⁵⁴. Up-dating these figures is very difficult as ASIC does not publish a break-down of its civil enforcement activity in a way that reveals its civil penalty activity. The latest ASIC Report on Enforcement⁵⁵ states that in the period from July 2011 to June 2013, 89 civil enforcement outcomes were obtained.⁵⁶ It is important to note however that civil enforcement outcomes is something that has a greater scope than just civil penalties.⁵⁷ Anecdotally the trend of limited use of civil penalty provisions in the tables compiled by Welsh is likely continuing, given only a handful of civil penalty orders from 2011-2013 come readily to mind.⁵⁸

Area of Enforcement: July 2011 – June 2013	Civil	Criminal
Number of Outcomes Obtained	89	63

We turn now to *the perception that ASIC should be a compensation enforcer*, though often those who desire this, also want traditional sanctions enforcement as well. ASIC does not have a clear mandate to seek compensation under s 1(2) of the *ASIC Act 2001*. ASIC has few explicit powers to obtain compensation for investors:⁵⁹ one of its main powers requires ASIC to prove a civil penalty contravention, with the difficulties recounted above.⁶⁰ As we described in the overview, ASIC has nonetheless been active and successful in gaining compensation. One of its main strategies has been the use of enforceable undertakings (E/Us). ASIC has been strikingly successful in using its E/U power⁶¹ to obtain compensation for investors and creditors, notably from large providers. E/Us are also intended to be reformatory and to provide a future program of return to compliance and enduring change to organisational culture that will outlast the period of the E/U.

The effectiveness and durability of enforceable undertakings depends on the threat of court enforcement action in the event of non-compliance. Where this threat is not credible the changes E/Us should produce do not endure. E/Us are used in other jurisdictions,⁶² and empirical studies have highlighted a number of issues relating

⁵³ Dimity Kingsford-Smith, *Parliamentary Joint Committee 2011 Inquiry Submission*, 19 September 2011, 6.

⁵⁴ Welsh, M, "Civil Penalties and Responsive Regulation: The Gap Between Theory and Practice" (2009) 33 *Melbourne University Law Review* 921.

⁵⁵ Australian Securities and Investment Commission, 'Report 360: ASIC Enforcement Outcomes: January to June 2013'.

⁵⁶ *Ibid*, at 39

⁵⁷ Enforcement outcomes are defined in the 'Key Terms' as "Any formal action to secure compliance, about which ASIC has made a public announcement"

⁵⁸ See, for example the outcomes obtained by ASIC in *ASIC v Healey* [2011] FCA 717, *ASIC v Hellicar* [2012] HCA 17, *ASIC v Lindberg* [2012] VSC 332.

⁵⁹ S50 *ASICA*; S1317H and 1317HA *Corporations Act*; s1324 & 1325 *Corporations Act* compensation in lieu of an injunction.

⁶⁰ S1317 H and 1317 HA *Corporations Act*.

⁶¹ S 93AA & 93A *ASICA*

⁶² See generally the *Regulatory Enforcement and Sanctions Act 2008* (UK).

to oversight and the ability of a regulator to control financial businesses at all:⁶³ this echoes the points made above about the 'after the event' nature of ASIC's powers. Some E/Us contain terms which are inadequate for ensuring compensation or ongoing compliance. An example is Leighton Holdings, which entered an E/U⁶⁴ following a \$40 million kickback, and breaches of continuous disclosure obligations (in conjunction with three infringement notices amounting to total fines \$300,000; 0.00075% of the bribe amount). No compensatory obligations were imposed for the \$907 million reduction in market share value, though this may be because there is a class action in progress. Some enforceable undertakings do not provide for an independent expert to supervise the implementation of the terms of the E/U; compliance with an E/U is a cost which is likely to be rationalised. Where there is no supervision, it is difficult to prove non-compliance with terms, and the grounds for court enforcement in relation to the initial contravention.

If it is decided that ASIC should have powers and resources to meet the 'compensation expectation gap' then careful thought will be required as to how this should best be done. There is a list of possibilities, but leaving ASIC in the enforcement 'twilight' with high investor expectations and few powers and resources only feeds the compensation misconception.

Issues for Consideration:

We think that the matters we have raised here (and the many others raised by authors like Middleton) are grounds for a comprehensive review of ASIC's investigation and enforcement powers. This review should bring the many statutes that ASIC administers into uniformity, fill gaps and sort out duplication as much as it is sensible to do so. Further, it is nearly 25 years since ASIC was established and many of its central enforcement powers need repair, renovation and up-dating. We think it is crucial that this work be given to a law reform commission which understands the intricate relationship between statutory sanctions, rules of evidence and procedure. Investigation and enforcement is par excellence a legal matter and expert legal knowledge is needed to use the legislative language required to achieve the aims and objects intended. The 'best interests' duty in s961B *Corporations Act* may have avoided the difficulties which lie ahead of it, if it had been given statutory form by those knowledgeable about fiduciary law and enforcement using statutory sanctions. There has been recent high judicial criticism of Australian financial regulation for the types of flaws that we have identified in relation to the recently enacted best interests duty.⁶⁵

In particular we suggest further reform of s1349 CA, and legislative reinforcement of ss 1332 and 1317L CA mandating ordinary civil procedure and rules of evidence and standard of proof for civil penalty actions. An alternate approach is to adopt a single legal principle in the *Evidence Act* (Cth) that applies to all civil penalty provisions in all legislation clarifying that the ordinary civil standard of proof is sufficient, rather than a standard towards the top of the *Briginshaw* scale.

We think reconsideration of s961B CA is necessary, otherwise we predict it will not be used by ASIC. Clarification of ASIC's mandate in relation to compensation, and on ASIC's priorities in relation to traditional deterrence enforcement is required. ASIC will require its compensation enforcement powers to be reconsidered if compensation is to be given a greater role. We also think that after nearly 25 years it may be timely to reconsider and clarify the respective roles of ASIC, the AFP and the DPP in criminal prosecutions.

⁶³Cristie Ford and David Hess, 'Can Corporate Monitorships Improve Corporate Compliance?' (2009) 34 *Journal of Corporate Law* 679, 725.

⁶⁴ ASIC, '12-53MR Leighton Holdings complies with three ASIC infringement notices for alleged continuous disclosure breaches and ASIC accepts compliance enforceable undertaking' (18 March 2012).

⁶⁵ *Forrest v ASIC* [2012] HCA 39; *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028.

Section IV

Disclosure in 'Mass Market' Retail Investor/Consumer Markets: TOR (a) and

(f)

The *Wallis Committee settings and the current disclosure regime* mean that the allocation of risk falls with investors where disclosure is provided and legally sound. With the aid of disclosure, the financial investor or consumer takes responsibility for their own decisions. A key question is the appropriateness of this risk allocation given changing demographics of the retail investor in a country with compulsory superannuation and increased use of the online mode of investing. As we elaborate below, it is also timely for some reconsideration of exactly how to treat the variety of different types of investors whom ASIC regulates. The recent Federal Court decisions in *Bathurst*⁶⁶ and *Wingecarribee*⁶⁷ have made it clear that complex products are being offered to institutional investors (county councils) as sophisticated or wholesale investors, when in reality they are very unfamiliar with the products being offered, and should have been treated as retail investors for whom something much simpler would be suitable.

There is now a rich literature on the short-comings of disclosure in retail investor markets. The list of difficulties is long. Kingsford Smith⁶⁸ has noted research suggesting that:

- Not all consumers actually read disclosure documents, either as a result of information overload, complexity or excessive differences in formatting making inter-product comparison hard; and
- Whilst investors generally care about the disclosed material, few attempt to understand technical aspects of it; and
- Even disclosure materials which identify key features of the product, when read, are not effective either because they are still not understood, or they lack information relevant to the individual, or do not affect decision-making; and
- Consumers have enduring difficulties understanding particular aspects such as disclosure of fees and charges; and
- There is potential for misinterpretation of the disclosure document as something else entirely, such as a disclaimer.

We anticipated above, the need to reconsider the *current investor classification regime* within the CA.⁶⁹ Two recent court decisions shed light on the practical limits of the definitions of 'retail investor', 'sophisticated investor' and 'wholesale investor'. These definitions are to separate the disclosure and other requirements for each of these types of investor: retail investors of course receive the most regulatory protection. The difficulties are partly because the monetary/wealth thresholds in CA s761G(7) have become out-dated, having been based on figures in 2001.⁷⁰ While these financial thresholds protected retail clients for several years, the Westpoint cases showed how relatively easy it was in a country with compulsory superannuation, for comparatively modestly wealthy clients to be financially eligible for 'sophisticated client' products, which they did not understand. In Westpoint investors with very little financial experience were sold notes with a face value of the threshold investment amounts of \$500,000. The NSW councils in *Wingecarribee* and *Bathurst*, although institutions, were also treated as 'wholesale investors' when their financial advisors knew that they had no expertise in the 'grotesquely complex' products their financial officers were persuaded to acquire. They should have been treated as retail investors, despite making investments of over the threshold amounts.

⁶⁶ *Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5)* [2012] FCA 1200.

⁶⁷ *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028.

⁶⁸ Dimity Kingsford-Smith, 'ASIC Regulation for the investor as consumer' (2011) 29 *Companies and Securities Law Journal* 327, 337-338.

⁶⁹ *Wingecarribee* and *Bathurst* above.

⁷⁰ Hall & Wilcox Lawyers, *FOFA: Review of the wholesale and retail clients definition* (3 February 2011) <<http://www.hallandwilcox.com.au/news/Pages/Financial-Services-Update.aspx>>.

Using wealth as a proxy of financial literacy is suitable in some cases but not in others.⁷¹ For example, individuals who suddenly acquire inheritance money or superannuation lump sums⁷² could be placed in a position where they might be legally classified as sophisticated clients, irrespective of their financial experience.⁷³ Additionally, a look at the legal classification regime in the United States reveals that their definition of wholesale investors is quite similar to Australia, however the wealth standard is to be reviewed periodically by the Securities Exchange Commission (SEC).⁷⁴ Accordingly, the legal distinctions between retail and wholesale investors in Australia are in need of review. There are similar difficulties with the 'sophisticated investor' test in s761GA and in s708(8)-(9) CA. This is another example of differently worded tests throughout the legislation which ASIC administers, where the purpose is similar, making ASIC's task of administering the regulation unnecessarily difficult. Additionally, the industry has shown reluctance in using the 'sophisticated investor' test due to the fear of being held liable for an incorrect assessment of their clients.⁷⁵

The *incapacities of retail investors and consumers in financial literacy* were clearly exposed by the results of the ANZ *Financial Literacy* survey. The respondents experienced greater difficulty in understanding more complex products where '[t]here was greater uncertainty about how to assess the performance of a superannuation fund or managed investment (19% unsure in 2011 compared with 13% in 2008 and 8% in 2005)'.⁷⁶ Financial literacy programs appear to be insufficient in satisfying Pearson's second purpose of financial literacy 'to educate people about the financial market and the nature of risk'⁷⁷ and given investors are risk-bearers and that markets are not risk-free.

Furthermore, a recent Australian Bureau of Statistics (ABS) survey of adult literacy produced the following results⁷⁸ for Australians aged 15-74 demonstrated that:

- 47% had scores of Level 1 or 2 in document literacy
- 46% had scores of Level 1 or 2 in prose
- 53% had scores of Level 1 or 2 in numeracy literacy
- 70% had scores of Level 1 or 2 in problem solving ability

The ABS regards a Level 3 score as the minimum required to meet the current knowledge based demands of the current financial environment – a real concern.

Several behavioural biases in investment decision making, augment these retail investor incapacities. Gallery and Gallery explain that investor overconfidence originates from 'self-attribution bias' where success is recognised personally and failures are attributed to bad luck. 'Hindsight bias' is where individuals believe that they can predict the outcome of a future event based on having success in predicting a retrospective event.⁷⁹ The intensity of these biases is evident in the 2011 ANZ Survey of Adult Financial Literacy in Australia. The results revealed that 29% of respondents considered their financial ability and knowledge to be above average, 62% of respondents considered their financial ability and knowledge to be about average and 8% of respondents considered their financial ability and knowledge to be below average when compared to other Australians.⁸⁰

⁷¹ 'Wholesale and Retail Clients – Future of Financial Advice', c, Department of Treasury, [5.5].

⁷² 55% of Australians receiving superannuation benefits in 2007 did so.

⁷³ Department of Treasury, above Options Paper, January 2011.

⁷⁴ Department of Treasury, above Options Paper, January 2011 [6.4].

⁷⁵ Department of Treasury, above Options Paper, January 2011, [7.10].

⁷⁶ Australia and New Zealand Banking Group, ANZ Survey of Adult Financial Literacy in Australia (2011) (survey by The Social Research Centre) <<http://www.anz.com.au/resources/f/9/f9fc9800493e8ac695c3d7fc8cff90cd/2011-Adult-Financial-Literacy-Full.pdf.pdf?MOD=AJPERES>>, 4.

⁷⁷ Gail Pearson, 'Reconceiving Regulation: Financial Literacy' (2008) 8 *Macquarie Law Journal* 45, 46.

⁷⁸ Australian Bureau of Statistics, Adult literacy and life skills survey results, cat. no. 4228.0, ABS, Canberra (2006).

⁷⁹ Gerry Gallery and Natalie Gallery, 'Rethinking Financial Literacy in the Aftermath of the Global Financial Crisis', *Griffith Law Review* (2010) 19(1) 30, 36.

⁸⁰ ANZ Survey, above at 99.

Table 9.2.4c Self-assessed financial ability and financial literacy

Self assessed financial ability and knowledge	Financial Literacy Components				
	Keeping Track of Finances	Planning Ahead	Choosing Financial Products	Staying Informed	Financial Control
<i>Self assessed financial ability/knowledge is ...</i>					
Above average	↑	↑	↑	↑↑	↑
About average	↓	↓	↓	↓	↓
Below average	↓	↓↓	↓	↓↓	↓
Base: Total Sample					

The findings tabulated above from the same financial literacy survey interestingly reveal that ‘those who rate their financial knowledge and ability as about average actually have scores that are slightly below average on all five components of financial literacy’.⁸¹ This supports Willis’ contention that ‘personal finance classes increase confidence without improving ability, potentially leading to worse decisions’⁸² through excessive risk-taking. There are clearly behavioural barriers hindering the effectiveness of financial education programs because as Willis suggests, ‘Overconfident consumers are unlikely to ask for help when they need it and spend too little time and effort on financial decisions... Under-confident consumers tend to shy away from engaging in the information search, planning, and calculations that good financial decisions require’.⁸³ This is suggested by the findings above which reveal that ‘those who feel their knowledge and ability is below average in this area have below average scores on all of the components, with particularly low scores on *planning ahead* and *staying informed*’.⁸⁴

ASIC has been active in researching and publicising these difficulties, in a number of reports and consultancy papers.⁸⁵ Gallery and Gallery are of the opinion that, ‘[D]isappointingly, ASIC offers no specific regulatory responses to address the behavioural impediments to financial literacy’.⁸⁶ However finding a diagnosis to this problem is not easy: it is well understood by financial regulators world-wide that ‘the road to achieving significant change in Australians’ financial literacy levels is a long journey – one that will take at least a generation’.⁸⁷ As changing behavioural biases and enshrined attitudes is a long term objective, further research is required to evaluate the effectiveness of financial literacy programs. As with other financial regulators around the world more work is required to achieve ASIC’s objective to ‘promote the confident and *informed participation* of investors and consumers in the financial system’.⁸⁸

Questions for Further Consideration: Therefore, the disclosure regime must be complemented by other measures as it relates to the retail investor in order to achieve ASIC’s objectives. Improving the quality of financial advice is one approach, and we comment further on this in Sections V and VI. However it is our view that ASIC needs additional powers to intervene in retail investor markets, when disclosure is not enough.

What additional powers might ASIC have? Under the *Financial Services Act 2012* (UK), the product-intervention rule allows the Financial Conduct Authority (FCA) to forcibly, and without consultation with the financial product providers, remove certain product features, prohibit financial promotions, to segments of, or all consumers, which it considers misleading and stop the sale of products altogether. This includes instances where overly complex

⁸¹ ANZ Survey, above n 49, 100.

⁸² Lauren Willis, ‘Against Financial-Literacy Education’ (2008) 94(1) *Iowa Law Review* 197, 202.

⁸³ *Ibid* 203.

⁸⁴ ANZ Survey, above n 49, 100.

⁸⁵ Australian Securities and Investments Commission, *Report 339 Review of the National Financial Literacy Strategy – Background report* (2013); *Report 230 Financial Literacy and behavioural change* (2011); *Report 229 Australian Financial Literacy Strategy* (2011).

⁸⁶ Gerry Gallery and Natalie Gallery, ‘Rethinking Financial Literacy in the Aftermath of the Global Financial Crisis’, *Griffith Law Review* (2010) 19(1) 30, 45.

⁸⁷ Australian Securities and Investments Commission, ASIC consults National Financial Literacy Strategy (2013) <<http://www.asic.gov.au/asic/asic.nsf/byheadline/13092MR+ASIC+consults+National+Financial+Literacy+Strategy?openDocument>>.

⁸⁸ *Australian Securities and Investments Commission Act 2001* (Cth) s 1(2)(b).

financial products are sold to the mass market, including retail investors.⁸⁹ This allows the FCA to address significant consumer risks promptly: indeed, FCA must do so within a year, for the maximum time limit for these product intervention powers is 12 months and cannot be renewed. This product intervention power is different to an ASIC stop order: that is available only in relation to a disclosure document. This power allows changes to product design to promote fairness to investors under the FCA's program, 'Treating Clients Fairly'. This is really a return to a form of merit regulation, a form of regulation quite common until the last 20 years in most retail financial markets in advanced economies.

A related approach would be to give ASIC powers to prohibit the sales of particular products in retail investor markets. So for example, contracts for differences (CFDs) are restricted in retail markets in other countries. These and other complex or highly risky products are simply not available to retail investors. If a regulator has limited supervision powers, and enforcement and compensation are necessarily delayed and fragmented, prohibiting certain types of products may be a small price to pay for not having to take expensive 'after the event' action.

Another suggestion for further consideration is the regulatory power to 'red flag' a product. This strategy means that the regulator 'red flags' by tagging the product in some way as risky or otherwise inappropriate for retail investors. ASIC already has an inverse version of this strategy with its 'investing between the flags' policy.

Finally, for the reasons given above, we consider a review of the definitions of 'retail', 'sophisticated' and 'wholesale' investors seems warranted. This should be in both the disclosure context and in licensing obligations more generally (see Section V).

⁸⁹ Conduct of Business Sourcebook 6.1A.4R.

Section V

Licensing and License Operating Requirements: TOR (a), (d) & (f)

It has been argued that key to ASIC's ability to regulate effectively is being able to effectively project an "image of invincibility".⁹⁰ In a licensing context, ASIC is hindered in pursuing this goal due to having *differently worded powers to perform similar regulatory licensing functions* across the statutes it acts under in both credit and financial services markets.⁹¹ Moreover ASIC is faced with loopholes that allow individuals the subject of its banning orders to indirectly continue to effect the provision of financial services through retaining or obtaining directorship or shareholder control of financial services companies.⁹²

Individuals banned from the financial services sector continuing as a director or shareholder of a licensed entity or authorised representative is a significant shortcoming in the licensing system. When ASIC makes a banning order against a person, they can remain acting as director of their financial services company, even though they cannot provide the financial advice or choose the products to be sold. The licensing changes in the Future of Financial Advice (FoFA) reforms in 2012 did not address this. The problem is that the people who should not have any control over a financial service can still wield influence. Furthermore, people who have been banned can avoid much of its effect by gaining control over another company with an Australian Financial Services Licence (AFSL) by acquiring the majority of its shares. These issues highlight gaps in the licensing regime which need to be filled in order to stop ASIC's banning power being undermined.

We have pointed out that there is a general *misconception about the nature of ASIC's powers under the licensing regime*: many Australians think ASIC has considerable powers to intervene in the business of licensed entities as APRA has, when in fact ASIC does not have these powers. We think that license holders should be required to adopt the public company business form. At the moment many, many license holders are proprietary companies, and only have to produce audited financial statements to ASIC not more generally. We also suggest an annual certification of compliance with license conditions and financial services laws by the boards of ASIC licensed entities which we argue will also assist to close the 'loss prevention expectation gap'. We also think ASIC should use its license suspension powers in S915C Corporations Act more regularly.

Questions for Further Consideration:

We suggest further consideration be given, to an audit of the different powers exercised by ASIC under different statutes in order to bring the language and powers into uniformity where this is possible and makes regulatory sense. We think the licensing and registration powers in relation to which ASIC administers a number of different statutes are good candidates for this sort of rationalisation. We have raised the same point in Section III in relation to ASIC's enforcement powers. Middleton provides a good start in pointing out the areas in which this might be done.

The Committee should consider further the requirement that all AFSL holders have the obligations, especially the financial reporting obligations, of public companies. Further, we think Boards of AFSL holders should have to make a declaration each year, that the licensee is complying with its licensing and financial services laws obligations and it has systems in place that will reasonably assure this. Boards of listed public companies are required to give an annual declaration as to whether the company is solvent, whether the accounts have been

⁹⁰ Ian Ayres & John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York: Oxford University Press, 1992); also D Kingsford Smith 'A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector' (2011) *Univ British Columbia Law Review* 717, 725-726.

⁹¹ Middleton above at 219-221.

⁹² Middleton above at 222-225.

prepared in compliance with accounting standards and whether they provide a 'true and fair' view of the company's financial circumstances.⁹³ In turn the declaration is based on declarations by the chief executive officer and the chief financial officer as to the adequacy of financial record keeping at the company.⁹⁴ We think this financial declaration should be a model for a declaration of operating compliance by licensees. Being made by the Board will require the most senior managers of a licensee to review the operations of the entity, and take personal responsibility for compliance and the systems which produce it. As we have already suggested the signed certificate should be lodged with ASIC and placed on the firm's website. It should be given within 6 months of the financial year close. If the certification is not lodged within 30 days of the required date, the license should be automatically suspended. If it is not lodged within 3 months of due date, the license should be cancelled automatically and the firm should have to reapply. If the certificate is given and it is subsequently discovered that the licensee was not compliant, and the non-compliance causes loss or is serious, it should be an offence.⁹⁵ In the absence of APRA style supervision we think these suggestions will help to close the gap between the expectations and the reality of ASIC licensing.

We also recommend that further action is taken to bring license cancellation and banning powers into line with director disqualification and generally empowering ASIC to exclude from the majority shareholding and management of licensees, individuals who have been banned. As Middleton⁹⁶ points out, there is 'no real correlation' between the ways to ban a licensee under s.920A Corporations Act 2001 (CA) and those to disqualify a director under s.206C CA. Consideration should be given to bringing the provisions into line. With respect to majority shareholders, Middleton suggests that ASIC should use their existing powers of informal investigation to do 'a more detailed scrutiny' of new owners of an existing AFS licensee, 'before they are allowed to provide financial services under that existing licence'. This seems effective and requires little change to the law as they can use s.915C(1)(b) CA to show that the new majority shareholder no longer meets the 'good fame or character' requirements for an AFSL.

Finally, we refer to our discussion of the current investor classification regime within the Corporations Act in Section IV. There we mostly discussed the issue in relation to disclosure: it is however just as important in relation to licensing obligations.

⁹³ S295 *Corporations Act*

⁹⁴ S295A *Corporations Act*

⁹⁵ There is a parallel requirement for financial reporting certification in S344 *Corporations Act*.

⁹⁶ Middleton: ASIC's Regulatory Powers – interception and search warrants, credit and financial services licenses and banning orders, financial advisers and superannuation: Problems and Suggested Reforms: (2013) 31 Co & Sec LJ 208

Section VI

Improving Training and Competence in Licensees and Authorised Representatives: TOR (a) and (f)

Along with financial literacy improving over time, *improving the quality of financial advice for Australians* is probably the most effective strategy to promote investor confidence. Both will take time, but we argue that with *higher standards of training and competence*, the improvement in the quality of financial advice can move more quickly than financial literacy in the general Australian population.

The low level of financial literacy in Australia leads to an investor propensity to assess advice on 'the advisor's confidence, approachability, friendliness or professional manner' without looking too critically at the technical aspects or content of the statement of advice.⁹⁷ This is one of the behavioural biases that can lead to unwise investment decision making that we have discussed in relation to disclosure in Section III. ASIC's 'shadow shopping' campaigns revealed only 3% of statements received by individuals seeking retirement or superannuation advice were labelled by ASIC's expert panel as 'Good' and a further 58% as 'Adequate'. However, 86% of participants felt they had received good quality advice⁹⁸ and only 5% of surveyed participants answered that they mistrusted the given advice.⁹⁹ Senior citizens are seen as more vulnerable consumers, and account for up to 30% of investment fraud victims¹⁰⁰. A key suggestion is the provision of special training to those providing services to seniors, an initiative which can be introduced in Australia to cater for the current ageing population, demanding greater financial advice to ensure post-retirement financial security with compulsory superannuation in Australia.

Case law and the more vigorous international standards demonstrate that increasing requirements for formal qualifications alone does not ensure actual competency will also improve. We therefore advocate for changes which would impose a more uniform and demonstrable standard across the financial services industry and require a period of supervised practise. We would not advocate the current proposal by ASIC to replace the ASIC Training Register with a Class Order.¹⁰¹ This proposal would mean that there is even less control of quality in financial training than at present. We think that this is an area ripe for the injection of further resources, to make sure that training meets the requirements of investors, and qualifies AFSL personnel to comply with their regulatory obligations. For example, a leading criticism of current training is that it is directed too much to the particular objectives of AFSL holders' own organisations and not retail investors. Another criticism is that much training is product specific training, again not really from the perspective of retail investors.

These points were made well in *Hayes v Australian Securities and Investments Commission* [2006] AATA 1306 (20 December 2006) where despite holding extensive formal qualifications and completing years of internal training and experience, '[h]e lacked a basic understanding or awareness of his legal and professional obligations as an adviser to all his clients'.¹⁰² His many contraventions over a three month period, labelled as 'attributable to haste, absence of due care and professional consideration...[and] doing what he had been taught or told to do and was following instructions, which he said was the practice where he was employed'¹⁰³,

⁹⁷ ASIC 'Shadow shopping study of retirement advice' (Report 279, March 2012) 55.

⁹⁸ Ibid 8.

⁹⁹ Ibid 54.

¹⁰⁰ Consumer Financial Protection Bureau, Senior Designations for Financial Advisers – Reducing Consumer Confusion and Risks (2013) p 21

¹⁰¹ Draft CO14-XX, as outlined in ASIC, 'Assessment and approval of training courses for financial product advisers: Update to RG146 (Consultation Paper 215, August 2013)

¹⁰² Discussed at length in Franke and Australian Securities and Investments Commission [2008] AATA 83 (1 February 2008)

¹⁰³ Ibid

demonstrated aptly the dangers of relying too much on the AFSL holder to ensure competence standards. We argue that an inability to effectively draft an SOA and disclose conflicts could possibly have been countered had Mr Hayes been subject to a standardised, nation-wide exam, which would have required him to demonstrate an ability to take a given set of circumstances and devise an appropriate response or strategy. Product and organisation-specific knowledge alone, is insufficient in practice, even if on paper it satisfies formal requirements. It does not promote investor confidence in the industry.

ASIC'S difficulty in enforcing current training standards is evident through appeal decisions taken to the AAT. In a number of cases ASIC's decision to ban an individual or cancel their licence on the basis of incompetence or lack of training or qualifications has been overturned in the AAT¹⁰⁴. As was evident in Saxby¹⁰⁵, ASIC identified lack of adequate training of financial advisers as the training was product specific. ASIC argued that training should instead be focused on the obligations of financial service providers under the Corporations Act, including their ethical duties. The banning was overturned by the AAT as training was found to be in accordance with statutory and ASIC regulatory guide requirements. This demonstrates the need for not only ASIC increasing training requirements, but for supporting legislative reform which reinforces the need to have wider training and competency. These cases occurred prior to the FOFA reforms, and now it may be easier for ASIC to ban an individual for incompetence. This is not clear however for training and competence standards remain an area in which ASIC is very limited by its current powers, and resources. Certainly, as the table below demonstrates, training and competence requirements in Australia lag those in force in comparable countries, including New Zealand.

Questions for Further Consideration:

As a high priority we think consideration should be given to legislating and resourcing ASIC to conduct an annual national examination for the qualification of staff of AFSL holders, and their authorised representatives. This examination could be different for qualifying persons for Tier 1 and Tier 2 products. We think that as in the US, individuals should have to requalify by taking the examination again, say, every 5 years.

We are content that continuing education might be undertaken on a more devolved basis, but we think there is merit in the proposal that some specification by ASIC of minimum areas to be covered (eg client care, ethics training) should be made. Continuing education should be compulsory, annually.

Table of Training and Competency Standards in Comparable Jurisdictions

	Australia	US	UK	NZ
Ethical standards training requirement	None NB: Ethics can be taken into account when it comes to banning orders. However, there is no particular obligation and it is unlikely.	Requires registered advisers to adopt code of ethics	Ethical component required	Code of professional conduct for authorised financial advisers
Qualifications	Tier 1 products: certificate III Tier 2 products: Diploma	Bachelors degree to be a certified financial planner	Diploma	Category 1: AFA (Authorised Financial Advisor) Category 2: QFE (qualifying financial entity)

¹⁰⁴ Example of case: Chapel Road Pty Ltd and Australian Securities and Investments Commission [2003] AATA 660 (14 July 2003)

¹⁰⁵ Saxby Bridge Financial Planning Pty Ltd and Ors and Australian Securities and Investments Commission [2003] AATA 480 (28 May 2003), 130

Formal Training Requirements including continuing education	ASIC: RG 146 No Uniform Exam No enforced on-going training requirement. RG146.14 requires licensees to implement policies and procedures to ensure that their authorised representatives update their knowledge and skills. However, ASIC does not require continuing training courses to be assessed.	Uniform FINRA Series 7 exam, affiliate with a firm and register with the state or SEC 30 hours annually of continuing education of which 2 hours are board of standards approved ethical requirements	Uniform National Exam covering broad range of issues Minimum annual ongoing training requirements (known as professional development activity) of 35hrs.	Uniform Exam on knowledge of Professional Conduct for AFAs and consumer protection law FMA - principle based continued professional development requirements
Demonstrated experience before becoming a professional	None	3 years full-time or equivalent part-time experience in the financial planning field	Requires 1 year of supervised practice - relevant work experience	1 year of supervised experience (SoE) OR Provision of Portfolio of experience (PoE)
Character test	None	None	An individual providing 'customer services' needs to be individually assessed as a 'fit and proper person' by the Financial Services Authority (FSA)	None
Professional requirements	No federal professional standards body NB: however individuals can obtain CFP standing through FPA a professional body for the industry	Professionals can be accredited by FINRA	Institute of Financial Planning provides states of professional standing accredited by the FCA	Can become a certified financial planner (CFP) under IFA
Investor Protection provisions training	None	FINRA has established a number of education outreach programs. Special training requirements for dealing with senior citizens.	No special requirement found	No special requirement found

In Singapore the IBF (Institute of Banking and Finance) encourages financial service providers to achieve certification, whilst promoting the accreditation of financial trainers.¹⁰⁶ Singapore is also now introducing a structured training system in which new entrants into the financial services industry will undergo education and acquire basic competencies to help improve the quality of advice provided¹⁰⁷. Singapore and Hong Kong also adopt a fit and proper test before being admitted into the profession in addition to the UK.

¹⁰⁶ Ong Puay See, 'The IBF's plan to meet demand for higher competency standards' on Hubbis (November 2011) <<http://www.hubbis.com/articles.php?aid=1321580506>>

¹⁰⁷ Wong Siew Ying, 'IBF proposes revisions to Financial Industry Competency Standards' on Channel NewsAsia (29 May 2013) <http://www.smu.edu.sg/sites/default/files/sis/news_room/cna_20130529_1_1.pdf>

Section VI I

ASIC and Whistle-Blowers: TOR (a) and (e)

Since the enactment of Pt 9.4AAA *Corporations Act* in 2004,¹⁰⁸ use of these whistle-blower provisions has been limited.¹⁰⁹ In 2009, an Options Paper on whistle-blowers protection revealed that only 4 had attempted to use the provisions.¹¹⁰ The main limitations of Pt 9.4AAA can be summarised as follows. Firstly, s 1317AA doesn't offer protection to former employees, business partners, financial partners or even members of the public who hold inside information.¹¹¹ They are outside the 'special connections to companies' description.¹¹² Secondly, the whistle-blower must reveal their identity before making the disclosure.¹¹³ The experience of CFPL whistle-blowers reveals the consequences of this threshold. The group didn't,¹¹⁴ and weren't advised by ASIC,¹¹⁵ to reveal their identity: likewise ASIC was not empowered to act on an anonymous tip-off. Thirdly, the discloser must have 'reasonable grounds' that wrongdoing has been done in relation to a particular provision of the 'Corporations legislation'.¹¹⁶ Finally, the legislation imposes a requirement of good faith upon whistle-blowers making disclosures.¹¹⁷ This imposes a high threshold, as often there is more than a single, altruistic motivation for disclosure.

There should be a wider scope and stronger protections available for whistle-blowers under the Act. Legislative reform should be in line with the 2004 Options Paper.¹¹⁸ The scope of the Act should be extended to include former employees, financial service providers, unpaid workers and business partners.¹¹⁹ The issues that can be disclosed should be increased to include all corporate sector wrongdoings, not just in relation to the provisions under the Act, similar to the US approach.¹²⁰ This is so whistle blowing against 'illegal, immoral or illegitimate practices' in the corporate world would be protected.¹²¹ As per the *Public Interest Disclosure Act 1998* in the UK, questions of motive or bad faith should be removed or its significance downplayed. As the Court in *ASIC v PDN* [2008] stated, 'public interest is not confined to the protection of those informers who act from pure altruism'.¹²² As in the US under the *Sarbanes-Oxley Act*,¹²³ anonymous disclosures should qualify for protection.¹²⁴ Unlike the recent UK changes, the 'reasonable grounds' test should be removed.¹²⁵ Consideration should be given to a

¹⁰⁸ *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* ('the 2004 Amendments').

¹⁰⁹ Janine Pascoe, 'Corporate Sector Whistleblowing in Australia: Ethics and Corporate Culture' (2009) 27 *Companies and Securities Law Journal* 524, 525.

¹¹⁰ The Treasury, 'Improving Protections for Corporate Whistle-blowers' (Media Release, No. 032) < The Treasury, 'Improving Protections for Corporate Whistle-blowers' (Options Paper, October 2009).

¹¹¹ The Act s 1317AA(1)(a).

¹¹² ASIC, 'Protection for Whistle-blowers' (Information Sheet, INFO 0052)

<<http://www.asic.gov.au/asic/asic.nsf/byheadline/Protection+for+whistle-blowers>> ('Whistle-blower Info Sheet')

¹¹³ *Ibid* s 1317AA(1)(c).

¹¹⁴ [Ruth Williams, 'Warning: Blowing the Whistle Could Mess Up Your Life', Sydney Morning Herald \(online\), 15 June 2013](http://www.smh.com.au/business/warning-blowing-the-whistle-could-mess-up-your-life-20130614-2o9z0.html) <<http://www.smh.com.au/business/warning-blowing-the-whistle-could-mess-up-your-life-20130614-2o9z0.html>>

¹¹⁵ Adele Ferguson, 'Blow the Whistle, Face the Music', Sydney Morning Herald (online), 4 June 2013 <<http://www.smh.com.au/business/blow-the-whistle-face-the-music-20130603-2nm6x.html>>.

¹¹⁶ *Ibid* s 1317AA(1)(d).

¹¹⁷ The Act s 1317AA(1)(e).

¹¹⁸ The Treasury, above 2009 Options Paper.

¹¹⁹ *Ibid*, Option A.1.

¹²⁰ *Sarbanes-Oxley Act* 31 USC §§ 3729-33.

¹²¹ Senate Select Committee on Public Interest Whistleblowing, Parliament of Australia, *In the Public Interest* (1994) 3.

¹²² FCAFC 123 [51].

¹²³ 31 USC §§ 3729-33.

¹²⁴ Treasury above 2009 Options Paper, Option E.1.

bounty incentive scheme as in the US under the *False Claims Act*.¹²⁶ Finally, consideration should be given to creating a separate Act in relation to private sector whistle-blowers, or it should be incorporated under the current Public Interest Disclosure Bill.¹²⁷

In addition, there should be a further emphasis on changing corporate governance practices within companies. Formal laws in the absence of strong internal whistle blowing mechanisms are insufficient to adequately protect whistle-blowers.¹²⁸ ASIC refers to good corporate governance in its whistle-blower policy.¹²⁹ The ASX Corporate Governance Council recommends that companies promote 'ethical and responsible decision-making'.¹³⁰ Individuals within a company should know they are responsible for reporting unethical practices. Standards Australia has a template covering the establishment, implementation and management of whistle-blower schemes.¹³¹

The UK Financial Reporting Council recommends the audit committees have governance responsibility for whistle blowing and reporting irregularities.¹³² The US *Sarbanes-Oxley Act* requiring the disclosure of codes relating to whistle blowing.¹³³ As under US legislation, Australia should give further consideration to an audit committee role in relation to whistle blowers and a requirement for entities to produce codes of conduct: this could relieve some of the burden on ASIC.

Issues for Further Consideration:

Consideration should be given to ASIC's proposed whistle-blower policy as indicated in their first submission.¹³⁴ Further legislative reform, including whether courts can order production of documents which reveal identity of whistle-blowers should be considered.¹³⁵ Legislative reform of protections offered once the threshold requirements are met – confidentiality requirements and protection against victimisation need to be more accessible, and not dependent on contentious and lengthy litigation. Creation of a comprehensive, national legislative framework for whistle-blower protection – which incorporates protection for public as well as private sector disclosures or solely for private sector disclosures (above and beyond the Act).

¹²⁵ The Act s 1317AA(1)(d).

¹²⁶ Pub.L 107–204 (2002); Ruth Williams and Ben Butler, 'Push to Give Whistle-blowers a Cut', *Sydney Morning Herald* (online), 5 June 2013 <<http://www.smh.com.au/business/push-to-give-whistle-blowers-a-cut-20130604-2no9n.html>>.

¹²⁷ 2013 (Cth).

¹²⁸ Pascoe, above at 525.

¹²⁹ Pascoe, above at 525; ASIC, 'Whistle-blowers: Company Officers' Obligations (Information Sheet) <<http://www.asic.gov.au/asic/asic.nsf/byheadline/Whistle-blowers%3A+Company+officers+obligations?openDocument>>.

¹³⁰ ASX Corporate Governance Council, 'Corporate Governance Principles and Recommendations with 2010 Amendments' (2nd ed), Principle 3 Rec 3.1, 10, 22-25.

¹³¹ Standards Australia, 'Australian Standard on Whistle-blower Protection Programs for Entities' (Guide, AS8004, 2003).

¹³² UK Financial Reporting Council, 'Combined Code on Corporate Governance' (June 2006).

¹³³ US Act s 406; See, Pascoe, above n 2, 533.

¹³⁴ ASIC, Submission No 45 to Senate Committee on Economics, *The Performance of the Australian Securities and Investments Commission*, August 2013, 18.

¹³⁵ See, *ASIC v P Dawson Nominees Pty Ltd* [2009] FCAFC 183 (22 December 2009) ('*ASIC v PDN*'); *ASIC v PDN* [2008] FCAFC 123.