29 October 2013

Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Committee Secretary

Inquiry into the Performance of the Australian Securities and Investments Commission

The Rule of Law Institute of Australia (the Institute) thanks the Committee for the opportunity to make a submission to its Inquiry into the performance of the Australian Securities and Investments Commission (ASIC).

The Institute is an independent and not-for-profit body. It does not receive any government funding.

The objectives of the Institute include:

- Fostering the rule of law in Australia, including the freedom of expression and the freedom of the media;
- Reducing the complexity, arbitrariness and uncertainty of Australian laws;
- Reducing the complexity, arbitrariness and uncertainty of the administrative application of Australian laws;
- Promoting good governance in Australia by the rule of law; and
- Encouraging truth and transparency in Australian Federal and State governments, as well as government departments and agencies.

The Institute makes the following submission in relation to the terms of reference.

1. INTRODUCTION

The context of the current Inquiry is the failure of ASIC to take decisive action after it had been informed by a number of whistleblowers that the activities of certain lenders in the financial planning arm of the Commonwealth Bank (Commonwealth Financial Planning Limited ("CFPL")) and the environment in which they operated generally, was of grave concern and endangering the position of vulnerable clients. It is not the result of inadequate legislative powers being given to ASIC.

The manner in which ASIC has dealt with complaints from individuals who have lost money as a result of fraudulent or ill-explained lending processes and complaints from whistleblowers, is

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inadequate. The volume of submissions received by this Inquiry detailing the financial loss and trauma suffered is indicative of a serious problem in the way in which ASIC manages its own investigative, regulatory, prosecution and penalty powers.

The result of ASIC's misuse of its powers is a loss of faith in the rule of law because of the inability of the law to protect vulnerable members of the community. The existence of a regulatory body that fails to exercise its powers in an effective accountable way gives rise to a false sense of security and reliance by the public.

2. ASIC HAS SUFFICIENT POWERS

The *Australian Securities and Investments Commission Act 2001* ("the ASIC Act") is some 380 pages long, and has been amended on a number of occasions during its relatively brief life. Section 251 of the ASIC Act provides for a general, broadly expressed, regulation-making power pursuant to which the *Australian Securities and Investments Commission Regulations 2001* have been made. In addition, ASIC administers the *Corporations Act 2001* (c2800 pages long), the *Insurance Contracts Act 1984* (115 pages) and the *National Consumer Credit Protection Act 2009* (c600 pages long) as well as the regulations made under those Acts.

The ASIC Act gives ASIC a wide range of powers to investigate, examine persons, inspect books, require disclosure of information, cause a prosecution or a civil proceeding to commence, conduct hearings and make orders subsequent to those proceedings, as well as undertake regulatory action through a number of bodies constituted under the ASIC Act.

ASIC's investigative powers extend to require persons to comply with an examination order. Section 68 of the ASIC Act provides that the fundamental rule of law privilege against self-incrimination does not apply. It states:

> "(1) For the purposes of this Part, of Division 3 of Part 10, and of Division 2 of Part 11, it is not a reasonable excuse for a person to refuse or fail:
> (a) to give information; or
> (b) to sign a record; or
> (c) to produce a book;
> in accordance with a requirement made of the person, that the information, signing the record or production of the book, as the case may be, might tend to incriminate the person or make the person liable to a penalty.
>
> (2) Subsection (3) applies where:
> (a) before:
> (i) making an oral statement giving information; or
> (ii) signing a record;
> pursuant to a requirement made under this Part, Division 3 of Part 10 or Division 2 of Part 11, a person (other than a body corporate) claims that the statement, or signing the record, as the case may be, might tend to incriminate the person or make the person liable to a penalty; and
> (b) the statement, or signing the record, as the case may be, might in fact tend to incriminate the person or make the person so liable.

(3) The statement, or the fact that the person has signed the record, as the case may be, is not admissible in evidence against the person in:

(a) a criminal proceeding; or

(b) a proceeding for the imposition of a penalty;

other than a proceeding in respect of:

(c) in the case of the making of a statement—the falsity of the statement; or

(d) in the case of the signing of a record—the falsity of any statement contained in the record."

ASIC in conjunction with the Federal Police now also has powers to tap telephones for suspected serious offences.

The investigative powers of ASIC are more than adequate and there can be no excuse of lack of powers.

3. ASIC FAILED TO EXERCISE ITS EXISTING POWERS

Section 1(1) of the ASIC Act provides that the objects of the Act are:

"(a) to provide for the Australian Securities and Investments Commission (***ASIC***) which will administer such laws of the Commonwealth, a State or a Territory as confer functions and powers under those laws on ASIC; and

(b) to provide for ASIC's functions, powers and business; and

(c) to establish a Corporations and Markets Advisory Committee to provide informed and expert advice to the Minister about the content, operation and administration of the corporations legislation (other than the excluded provisions), about corporations and about financial products and financial markets; and

(d) to establish a Takeovers Panel, a Companies Auditors and Liquidators Disciplinary Board, a Financial Reporting Council, an Australian Accounting Standards Board, an Auditing and Assurance Standards Board and a Parliamentary Joint Committee on Corporations and Financial Services."

According to section 1(2) of the ASIC Act, in performing its functions and exercising its powers:

"... ASIC must strive to:

(a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

(b) promote the confident and informed participation of investors and consumers in the financial system; and [*paragraph (c) is omitted in the current edition of the Act*]

(d) administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements; and

(e) receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it; and

(f) ensure that information is available as soon as practicable for access by the public; and

(g) take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it."

As submissions to this Inquiry demonstrate, including ASIC's own submission, it has not been successful in achieving the aim of promoting confidence amongst investors and consumers either in the particulars of the CFPL or generally. The Institute is further concerned with ASIC's interpretation of section 1(2)(b) due to its failure to promote confidence in the matters the subject of the Inquiry. By focussing on working with businesses to address complaints from within with a lack of transparency and accountability, ASIC has failed to act in a timely manner in its response.

4. PERCEPTION THAT ASIC DOES NOT INVESTIGATE BIG BUSINESSES

There is a perception that ASIC does not seriously investigate big businesses.

Nowhere is this more evident than with insider trading and misleading information in takeovers. Small fish are caught but not big businesses.

This perception undermines the rule of law and the public's confidence in the system must be restored.

5. WHAT SHOULD BE DONE

(1) No kneejerk reaction – no extra powers

The problem is not a lack of power by ASIC. The various pieces of legislation empower ASIC, yet it is the failure to exercise them properly that has given rise to the issues the subject of the Inquiry. There should be no kneejerk reaction by giving ASIC more powers, however, there is no doubt that the Corporations Act requires, in substance, modifying.

ASIC's enabling legislation also needs to be re-drafted to achieve the appropriate balance between:

(i) a principles-based approach with the flexibility that it offers;

(ii) a rule-based regulation using prescriptive rules which provide certainty but inflexibility; and

(iii) a compliance-oriented regulatory approach.[1]

Most importantly, it should incorporate rule of law principles including the privilege against self-incrimination, the presumption of innocence and the reduction of the complexity, arbitrariness and uncertainty of the ASIC Act and its administrative application. That will result in greater trust of, and respect for, ASIC within the community which is critical to its effective functioning. The answer is not giving ASIC further powers but to re-orient its outcomes according to a rule of law framework.

A rule of law approach is consistent with the work of regulatory theorists such as Tyler[2] who argue that people's perception of the fairness and justice of a regulator affects their voluntary compliance with the law. In their critique of the effectiveness of regulatory approaches taken by the Australian

Consumer and Competition Commission titled "The Fels Effect",[3] Parker and Nielsen describe Tyler's findings as follows.

> "He sees people's evaluations of both the regulator's procedural justice and their substantive justice as relevant to their evaluations of the legitimacy of regulators. His findings show that people are more likely to comply with a regulator that they see as legitimate as a matter of procedural justice, even where compliance with the law leads to outcomes that are not in their self-interest, or do not accord with their own personal sense of substantive justice. By contrast, when people see regulators as not procedurally just, this can break down willingness to comply."[4]

According to the theory of responsive regulation formulated by Ayres and Braithwaite, regulators need to fine-tune their enforcement strategies in light of the particular context, adopting a range of strategies to match the environment and stakeholder interests.[5]

Parker and Nielsen describe the theory of responsive regulation as follows.

> "The regulatory agency needs to be both procedurally and substantively just, while simultaneously accommodating and flexible, perceived as capable and publicly known to be capable, of tough and effective enforcement action when a breach occurs."[6]

In terms of making the choice of which strategy to employ in a particular context, Adler has also argued that the choice needs to be informed by what he terms as a philosophically based morality. That is to say, the choice needs to take into account the relative importance of potential outcomes that can include economic efficiency and welfarist outcomes.[7] This is an argument also advanced by Parker who states:

> "... responsive regulation scholarship and practice must include consideration of substantive legitimacy and morality, not just procedural fairness and cooperation."[8]

Both of these approaches are consistent with a rule of law approach, highlighting the importance of embedding a rule of law approach into ASIC's operations and strategies and a rule of law outcome as desirable in creating a feedback loop of increased voluntary compliance with the law. The response to the current concerns over ASIC's performance should not be a simplistic one of "getting tougher", but becoming fairer, more just, and more accountable.

(2) Need for proper legislative protection to whistleblowers and journalists

The fact that the current Inquiry results from pressure from investigative journalists informed by whistleblowers, with parallels to the exposure of corrupt behaviour by the Reserve Bank and Securency and Note Printing Australia staff and as well as the allegations about corruption within Leighton Holdings by investigative journalists is indicative of a lack of accountability of executive agencies (as discussed below). These three examples of the media being critical to the regulation of ASIC itself makes clear the fundamentality of the rule of law principles of freedom of expression and freedom of the media. The terms of reference of the present Inquiry, which are broad enough to allow it to consider these three examples of allegations of corruption and wrongdoing on a massive scale, as well as the Storm Financial collapse and the complaints made against a range of banks and

lending institutions in submissions to this Inquiry, can be regarded as an opportunity for ASIC to demonstrate its capacity for responsive regulation at a watershed moment in its history.

One might be tempted to do away with the investigative powers of ASIC and leave it to journalists and whistleblowers to inform the Commonwealth Director of Public Prosecutions of suspected breaches. This would save many millions of dollars.

There is however a proper role for ASIC in investigative and monetary compliance – but there is also a proper role for whistleblowers and investigative journalists.

There is however no adequate statutory protection for whistleblowers and investigative journalists.

The lack of effective protection afforded to whistleblowers was addressed in the Institute's submission to the Senate Inquiry into the *Public Interest Disclosure Bill 2013*.[9] In that submission, the Institute pointed out the vagaries and deficiencies in the Bill making the legislation extremely difficult to interpret and inadequate in its coverage.

The history of the Commonwealth Bank's whistleblowers, who alerted ASIC to allegations of corruption within the CBA in October 2008, as described in a number of newspaper articles by investigative journalists Adele Ferguson and Chris Vedelago, is sobering. The extensive delays in responding to the concerns appropriately with enforcement action and providing the public information as self-described by ASIC in its submission enabled corrupt practices to continue and vulnerable consumers to lose more. No action was taken by ASIC until the whistleblowers visited its office sixteen months after writing to it. ASIC failed to take action against one of the financial planners most implicated, allowing him to continue to defraud clients in the meantime. In that submission, ASIC accepts that its communications with the whistleblowers was "not adequate".[10]

As reported by Ferguson, one of the whistleblowers, Jeff Morris, has pointed out that the ASIC submission did not consider the need for protection of whistleblowers.

> "That's probably because, in reality, there is none. They left me to negotiate my own exit from CBA and when I raised a concern about death threats I believed had been made, I was told by my ASIC contact in a rather offhand manner, 'It's probably bull…. but if you're worried, go to the police.'"[11]

Investigative journalists Nick McKenzie and Richard Baker who exposed the corrupt dealings of the Reserve Bank staff and Securency have had difficulties in protecting their sources from exposure, culminating in the decision by two of the whistleblowers to identify themselves as police witnesses in the trial of the staff concerned, and to tell their story to the ABC's Four Corners program titled "Cover Up" which aired on 20 September 2013. In that program, the whistleblowers discuss the blockages and personal attacks they faced in response to their whistleblowing.[12]

As the Institute has argued in its submission on the *Public Interest Disclosure Bill 2013*, Australia needs uniform, clear and effective protections for whistleblowers who play a crucial role in making government accountable. Similarly, there needs to be uniform shield laws to provide protection for journalists' sources to allow the media to expose illegal activity.[13]

(3) Avenue for complaints if ASIC fails to act promptly

The rule of law requires that government regulators respond to consumer concerns and be held accountable for their practices. It is insufficient for government regulators to tell consumers and investors to be careful and self-educate themselves in the complex area of financial services, particularly when the ASIC Act itself is nearly 400 pages in length. The information asymmetry in this area between vulnerable consumers and large financial corporations is too great for this kind of approach.

The failure of ASIC in the present matter and others highlights the need for the appointment of an independent officer within ASIC to monitor progress with compliance and to liaise with the public.

It is possible for the appointment to be independent of ASIC, but this may cause administrative difficulties and should only be done if the other suggestion fails to work.

The appointment, with sufficient support staff, must be responsible to report to Parliament annually on performance. This will give the required independence. At this stage it is considered that it is sufficient that the person "names and shames" without having other powers.

(4) The Senate Economics Committee

ASIC is answerable to hearings of the Senate Economics Committee in the Budget Estimates Hearings. Appendix A to this submission sets out the Institute's analysis of data collated from the Australian Parliament House website regarding responses by ASIC to questions asked of it.

That data shows a continuing trend of lateness is responding to questions over 2012 and 2013 which has worsened in 2013. In February 2013, out of a total of 110 questions asked, 96 were answered more than 30 days late. In June 2013, all 290 questions asked were answered more than 30 days late. This data shows a disregard for a very important parliamentary accountability measure.[14]

The Committee should establish a mechanism for monitoring the failure to answer questions and the failure to properly answer questions. This should include the process of investigations and keeping the public informed.

(5) Model litigant rules

The failure of regulatory agencies to act in accordance with their model litigant obligations has been documented by the Institute. In *Morley & Ors v ASIC* [2010] NSWCA 331 the NSW Court of Appeal was critical of the manner in which ASIC approached the James Hardie litigation and failed to call a particular witness. While the High Court in *Australian Securities and Investments Commission v Hellicar [2012] HCA 17* subsequently overturned the decision of the Court of Appeal in that respect, the Institute remains concerned about the lack of transparency and adherence to the model litigant obligations by regulatory agencies.

The Institute's position is that the model litigant obligations that apply to Commonwealth agencies, as set out in Appendix B of the *Legal Services Direction 2005* ought to be enforced by the Attorney General as provided for in s.55ZG(2) of the *Judiciary Act 1903*. There is presently no transparency

about breaches of the *Legal Services Direction* and minimal information provided in the Annual Reports of the Attorney-General's Department. It is not sufficient for breaches of the model litigant obligations to be paid for by way of costs orders made against government agencies in court cases, because ultimately it is the taxpayer who funds those costs. Government agencies must be subject to the law as much as individuals and organisations.

Given the importance of public perception in regulatory theory as discussed above, these perceptions need to be addressed in a thorough and well-informed manner that takes into account rule of law principles and engages with regulatory theory. Simply increasing the funding of ASIC or re-drafting its enabling legislation will not suffice in the absence of a principled review of its functioning. Further, there needs to be a plan for ASIC's optimal performance based on rule of law principles.

If the Institute can be of any further assistance please do not hesitate to contact me.

Yours faithfully

Robin Speed
President

[1] For an accessible discussion of varying approaches see Chapter 2 of the Australian Law Reform Commission's Report on Regulatory Privacy at http://www.alrc.gov.au/publications/4.%20Regulating%20Privacy/regulatory-theory.

[2] Tom R Tyler, *Why People Obey the Law*, Princeton University Press, 2006

[3] Christine Parker and Vibeke Lehmann Nielsen, "The Fels Effect: Responsive Regulation and the Impact of Business Opinions of the ACCC, *Griffith Law Review* (2011) Vol 20 No 1

[4] Note 3 above at 98-99.

[5] Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate*, Oxford University Press, 1992.

[6] Note 3 above at 100.

[7] Matthew D Adler, *Regulatory Theory*, PennLaw available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1553781

[8] Christine Parker, "The 'Compliance Trap':the Moral Message in Responsive Regulatory Enforcement" (2006) *Law and Society Review* at p.36. Parker has argued however that regulators must be mindful of what she refers to as the "compliance trap" which occurs when they do not have political or community support for their "moral messages". The compliance trap can lead to the situation in which the agency seesaws between punitive action and capitulation to industry at p.32.

[9] See http://www.ruleoflaw.org.au/public-interest-disclosure-bill-2013/

[10] See para 73 of the submission to this Inquiry by ASIC dated August 2013.

[11] See http://www.smh.com.au/business/asic-asleep-on-the-job-over-cba-20130805-2ra39.html

[12] http://www.abc.net.au/4corners/stories/2013/09/30/3857148.htm

The description of the program reads:

"Next week on *Four Corners* two whistleblowers-turned star police witnesses from RBA companies, Note Printing Australia and Securency, reveal for the first time how they discovered bribes were allegedly being paid... and how the most senior figures in Australia's worst corporate corruption scandal got away with allegedly egregious governance failures.

"That someone can get away with it so blatantly, a board, and a chairman... you know it, it's not right."
Whistleblower

For the past four years the Governor of the Reserve Bank, Glenn Stevens, has maintained that neither he nor officials knew about the alleged payments before 2009. We find out exactly who knew what and when.

Until now the Federal Police and the corporate watchdog, the Australian Securities and Investments Commission (ASIC), have been unwilling to investigate board members of the Reserve Bank companies, despite evidence that some of them allegedly failed in their duties, allowing corruption to flourish.

"This is the worst corruption scandal in our history, not because of the amount of money that's been involved, but because the most respected institutions of our country have failed to discharge their responsibilities to the public." **Dr David Chaikin, University of Sydney Business School**

[13] http://www.ruleoflaw.org.au/uniform-national-shield-laws-freedom-of-speech/

[14] Data set out at http://www.ruleoflaw.org.au/asic-and-senate-estimates/

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