

Failures of the Australian Securities and Investments Commission

A Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

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26 October 2018

Introduction

This submission is made in response to the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, published on 28 September 2018.

I thank the Commission for the opportunity to make this submission.

The Commission has identified a disturbing pattern of behaviour in a number of large financial institutions. This behaviour has included numerous breaches of the laws administered by ASIC. Sadly, the Australian people have been let down by the failure in many instances of ASIC to take rigorous action against those who have breached the law. In particular, the scarcity of criminal prosecutions has left an impression that the regulator is not treating the breaches with the seriousness they require.

In relation to ASIC's regulation of financial institutions, the Interim Report includes the following statement:

When contravening conduct comes to its attention, the regulator must always ask whether it can make a case that there has been a breach and, if it can, then ask why it would not be in the public interest to bring proceedings to penalise the breach.¹

As a broad statement of public policy, that is unassailable. This submission attempts to identify additional considerations that the Commission has not discussed in its Interim Report.

ASIC's regulatory functions require a balancing act. It is more than just a 'corporate cop'. It has a statutory obligation to strive to "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".²

Sometimes perceived failures by ASIC are actually instances where ASIC has taken the best course open to it bearing in mind its obligation to balance several factors, including (but not limited to) the enforcement of the law. In addition, ASIC is subject to outside constraints that limit its ability to enforce the law to the extent that the community is entitled to expect.

There are of course instances where ASIC could have done better. This submission accepts that but tried to present balancing arguments to enable a broader appreciation of the policy challenges that ASIC faces.

I was employed by ASIC as an executive officer from 2004 to 2014. My position with the organisation at the time of my retirement was Senior Manager, Strategic Intelligence. I do not presently have any legal or financial relationship with ASIC or with any of its members or staff.

¹ Interim Report, page 277.

² *Australian Securities and Investments Act 2001* (Cth) ("ASIC Act"), subsection 1(2).

ASIC cannot prosecute

Some breaches of the law described in the Interim Report are so serious that civil litigation is insufficient as a remedy. In these cases the need for public denunciation of wrongdoing means only criminal prosecution will suffice. However, such prosecutions have been relatively scarce in the matters under review.

The Interim Report states, “Rarely has ASIC gone to court to have the defaulting party penalised. The criminal prosecutions that have been brought have all been directed at individuals.”³ This comment leaves the reader with the impression that ASIC is able to prosecute offenders. However, with minor exceptions ASIC cannot bring criminal proceedings for breaches of the laws it administers.

Subsection 49(2) of the ASIC Act provides that, “ASIC may cause a prosecution ... to be begun and carried on.” However, that is qualified by subsection 49(5), which states that, “Nothing in this section affects the operation of the *Director of Public Prosecutions Act 1983*.” The latter Act empowers the CDPP to take over a prosecution commenced by ASIC and discontinue it.

ASIC’s authority to prosecute is further diminished by the 1992 direction of its Minister regarding prosecutions. This direction was made under section 12 of the ASIC Act, and is the only instance of the exercise of that ministerial power over ASIC’s functions. The effect of the direction is to prohibit ASIC from commencing a prosecution without the consent of the CDPP. Consent is never given, except for the prosecution of some minor offences.

ASIC can seek to have the CDPP bring criminal proceedings and routinely does so. However, ASIC has of necessity a close working relationship with CDPP, and through that relationship it would have a keen appreciation of the types of matters that CDPP would be prepared to prosecute, and which it would not. While a failure by ASIC to seek prosecution might be due to a lack of willingness or effort on ASIC’s part, it might also be due to a well-founded expectation that CDPP would refuse to prosecute in a particular case. Seeking such a prosecution would not only be futile, it would be a waste of resources better devoted to other courses of action.

ASIC lacks the resources for numerous large-scale civil actions

In the Interim Report the Commissioner notes that, “Of course ASIC, like any regulator, must make choices and assign priorities on the basis of resources. I need no persuasion that litigation is expensive. The expense is not just of financial outgoings but of the time and effort expended by staff. Their number is limited. As was the tenor of ASIC’s evidence, resources spent on litigation represent an opportunity cost to it in respect of other forms of enforcement.”⁴

Compared with the costs of the litigation that it might be expected to bring, ASIC’s resources are small. In 2016-17 ASIC’s legal expenditure was \$87.9 million, including \$20.5 million on external legal services.⁵

The banks and other large businesses against which ASIC has sometimes failed to bring litigation, as noted by the Commission, are of course extremely well resourced and strongly motivated to defend themselves in any proceeding. Like anyone subject to litigation by the state, those businesses are entitled to utilise all available legal defences. Not surprisingly, it can cost a great deal to succeed in litigation against them. The amount that ASIC might spend on a major case could exceed \$10 million

³ Interim Report, page 271.

⁴ Interim Report, page 286.

⁵ Detailed at Appendix 1.

and cost recoveries might amount to very little of the expenditure.⁶ ASIC must therefore be extremely careful in picking which battles to fight when other options are available. A single action against a bank is likely to require the resources equal to those of many other, smaller actions. Sometimes ASIC is forced to choose not to litigate and instead take other courses of action.

The result is that ASIC fails to bring proceedings against a large number of individuals and companies for which the organisation has strong evidence of breaches of the law. Sometimes ASIC is able to obtain a degree of justice through other means – such as by accepting an enforceable undertaking – but in other instances the wronged parties must fall back on their own resources to obtain justice. All too often that simply means no justice at all.

Litigation is not always the best course to take

In deciding how to deal with a matter ASIC needs to balance a range of factors which might include the use of resources, the obligation to enforce the law, and the need to compensate consumers who have been harmed by breaches. Sometimes providing adequate and relatively speedy compensation is best done through an approach that does not use litigation but instead uses enforceable undertakings.

Mr Mullaly of ASIC provided insights into those decisions in his evidence. In response to the question, “Does ASIC have a view about whether it is preferable for it to pursue court proceedings against larger entities?” Mr Mullaly’s response was:

It depends on the ... particular facts of each matter. Certainly, one of the considerations that we give to both commencing an investigation but also to the type of outcome that we will seek is whether that outcome will have an impact on the market, whether it will change behaviour, both specifically and more generally.⁷

Later, responding to the question, “Are you able to summarise for the Commissioner what the advantages of an enforceable undertaking are?” he responded:

Well, we are able to get agreement with the entity providing the enforceable undertaking. We can be quite specific about what it is that we would like changed in terms of those compliance processes. We’re able to get independent oversight in relation to that and then, in a sense, a follow-up as well. So if an independent expert makes recommendation that further changes are required under the enforceable undertaking, that’s what will generally occur: those additional changes are made. Something that’s a little bit harder to get under an administrative proceeding.⁸

In his witness statement to the Commission, Mr Mullaly points out that, in relation to breaches by major banks, ASIC has obtained more than \$700 million in compensation remediation or return of funds to investors.⁹ Mr Kell of ASIC pointed out in his oral evidence that the amount might eventually exceed \$1 billion.¹⁰

An enforceable undertaking has advantages that are not available through litigation. Apart from large cost savings, it may allow ASIC to force a change in an organisation’s practices (“culture”) as well as obtain compensation much faster than through legal action. Whatever else, it will provide a more certain outcome for ASIC and affected consumers.

⁶ For years with available data, the highest level of costs recovered (as a percentage of legal expenditure) was less than 5 per cent.

⁷ Oral evidence of Tim Mullaly, Senior Executive Leader, Financial Enforcement Team, ASIC, 1 June 2018, page P-3021.

⁸ Oral evidence of Tim Mullaly, page P-3025.

⁹ Witness statement of Tim Mullaly, paragraph 30.

¹⁰ Oral evidence of Peter Kell, Deputy Chairman, ASIC, 17 August 2018, page P-5254.

ASIC's funding is only a fraction of the revenues it collects

The level of funding available to ASIC is ultimately the decision of the Parliament, although in practical terms the decision is made by the Treasurer acting with the advice of his Department. In 2016 the Department proposed the concept of “industry funding” or “cost-recovery” to fund ASIC’s operations.¹¹ This concept was implemented from 1 July 2017.

Under the industry funding model now in place, “ASIC’s regulatory activities ... continue to be funded through direct appropriation from the Commonwealth Budget, with the appropriation to be offset by levies and fees charged to industry.”¹² For reasons that are not explained, ASIC’s companies and business names registration function (the “registry business”) was excluded from the industry funding model.

It is clear, however, that the registry business was excluded simply because it generates large profits for the Commonwealth. The lion’s share of revenues generated by ASIC – over \$700 million – comes from that business. Its expenses are not published but would be only a small fraction of the revenue figure. The revenue accrues not to ASIC but to the Commonwealth Treasury.

ASIC’s appropriations over the past decade have been less than half of the amount that it has collected on behalf of the Treasury. In that period ASIC has collected revenue for Government (fees and fines) that exceed its appropriations by more than \$4 billion.¹³ That \$4 billion is effectively the profit that Government has made from the regulation of companies and financial services.

Put in terms of the businesses that ASIC regulates, the profit margin accruing to Government from ASIC’s activities has been 56 per cent. That is, for each dollar sent to the Treasury by ASIC, the Treasury had to spend only 44 cents. In the most recent financial year the Government’s profit margin rose to 64 per cent and its take after expenses approached \$700 million.

I am not making an argument that ASIC should have an increased budget, or that it should be able to use all of the revenue it generates. There may be broader questions of policy that justify providing ASIC with only its current level of funding. But if ASIC has insufficient funding to conduct the level of regulation that now seems to be expected of it, while the Treasury reaps billions in profits from ASIC’s operations, then the responsibility for that insufficiency lies not with ASIC but with ASIC’s political masters.

¹¹ The Department of the Treasury, *Proposed Industry Funding Model for the Australian Securities and Investments Commission: Proposals Paper*, December 2016.

¹² *Proposals Paper*, page 7.

¹³ Figures are detailed in Appendix 2.

Appendix 1: ASIC's legal expenditure

<i>Financial year</i>	<i>External legal expenditure (\$m)</i>	<i>Internal legal expenditure (\$m)</i>	<i>Total legal services expenditure (\$m)</i>	<i>Costs recovered (\$m)</i>
2007-08	16.9	37.9	54.8	
2008-09	27.5	43.3	70.8	1.8
2009-10	30.5	50.2	80.7	1.6
2010-11	20.3	52.2	72.6	0.7
2011-12	13.9	67.5	81.4	3.5
2012-13	17.0	57.7	74.7	2.7
2013-14	7.8	59.6	67.3	
2014-15	8.9	53.9	62.7	
2015-16	18.9	58.6	77.2	
2016-17	20.5	67.5	87.9	

Note: Totals may not add due to rounding.

Source: "ASIC's legal expenditure", <https://asic.gov.au/about-asic/what-we-do/how-we-operate/asics-legal-expenditure/>, accessed 17 October 2018.

Appendix 2: Appropriations to ASIC and fees and fines collected by ASIC

<i>Financial year</i>	<i>Appropriations to ASIC (\$m)</i>	<i>Fees and fines collected by ASIC (\$m)</i>	<i>Surplus of fees and fines over appropriations (\$m)</i>	<i>Appropriations as proportion of fees and fines</i>
2008-09	307.8	551.7	243.9	55.8 per cent
2009-10	370.2	581.5	211.3	63.7 per cent
2010-11	324.0	622.1	298.1	52.1 per cent
2011-12	304.3	663.6	359.3	45.9 per cent
2012-13	350.0	717.4	367.4	48.8 per cent
2013-14	346.8	762.8	416.0	45.5 per cent
2014-15	311.9	823.6	511.7	37.9 per cent
2015-16	311.4	876.2	564.8	35.5 per cent
2016-17	341.6	920.2	578.6	37.1 per cent
2017-18	353.2	1 049.5	696.3	33.7 per cent
Totals	3 321.2	7 568.6	4 247.4	43.9 per cent

Note: Totals may not add due to rounding.

Source for 2008-09 to 2016-17: ASIC annual reports, <https://asic.gov.au/about-asic/corporate-publications/asic-annual-reports/>, accessed 17 October 2018.

Source for 2017-18: Australian Securities and Securities Commission Budget Statements, Tables 2.1 and 3.7, https://static.treasury.gov.au/uploads/sites/1/2018/05/08_Australian-Securities-and-Investments-Commission-1.pdf, accessed 25 October 2018.77