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Effective Enforcement - the Australian Experience

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1 Introduction

1.1 Recent research has drawn attention to the relationship between enforcement, and good corporate governance. For example, "the so-called "law matters" thesis holds that legal regulation and enforcement is critical to good corporate governance and has particular application to East Asia. "¹ Further, "(there are) good, non-trivial reasons for seeking to enhance corporate governance practices in East Asia."²

1.2 I had the good fortune and the honour to have been in charge of the Australian corporate, securities and markets regulator during most of the 1990s, a decade which will come to be seen as sandwiched between the entrepreneurial excesses of the 1980s, and a series of corporate collapses in the early zeros.

1.3 I certainly came to believe that enforcement was critical to the effectiveness of regulation, if not always, then at least in all of the financial markets areas. In this paper, I shall seek to show how the Australian experience does tend to confirm the propositions set out above. I shall discuss some of the difficult issues which confront those who seek to enforce the regulations which govern securities markets in particular, and outline some of the factors which need to be taken into account in measuring effectiveness.

- Law matters

1.4 First, a few more words about the "law matters" thesis. Walker and Reid, quoted above, continue as follows

Simon Johnson and colleagues have advanced a related hypothesis with application to the Asian crisis. They argue that corporate governance measures, especially protection of minority shareholders, explain the extent of exchange rate depreciation and stock market decline better than standard macro economic measures: in countries with weak corporate governance, worse economic prospects result in more expropriation by managers and a larger fall in asset prices. Both lines of research imply that *legal* corporate governance measures are much more important than previously thought.³

Further, they draw attention to the work of La Porta, Lopez-de-Silanes, Shleifer and Vishny⁴, and observe

...expropriation, self-dealing and abuse of minorities are common manifestations of the principal-agent problem in East Asia [as will be seen, in Australia as well in the 1980s]... Legal protection of financiers (shareholders and lenders) is a central issue in corporate

¹ G Walker and T Reid, Upgrading corporate governance in East Asia, Part 1, [2002] J.I.B.L. 59, at 59. I am indebted to Jane Diplock, a valued former colleague and now chairman of the New Zealand Securities Commission, for drawing my attention to this and several other sources quoted in this paper

² Ibid.

³ Op. Cit., p.62. Emphasis in original; footnotes deleted.

⁴ Op. Cit. p 63

governance and this varies from country to country... In jurisdictions where legal protection is low, "concentration of ownership leverages up legal protection" and helps address the agency problem."

Perhaps more controversially, the same authors quote research by the same team with the following outcomes

The results show that common law countries generally have the strongest, and French civil law countries the weakest legal protections of investors, with German and Scandinavian civil law countries located in the middle. These rankings also hold for accounting standards.⁵

They conclude

The key mechanism is the protection of outside investors.. through the legal system, meaning both laws and their enforcement."⁶

- 1.5 If those propositions describe the position with respect to corporations, then what about the experience with regulation of market activity. The most important aspect of that is probably insider trading. Consider then the following Abstract⁷

The existence and the enforcement of insider trading laws in stock markets is a phenomenon of the 1990s. A study of the 103 countries that have stock markets reveals that insider trading laws exist in 87 of them ,but enforcement – as evidence by prosecutions – has taken place in only 38 of them. Before 1990, the respective numbers were 34 and 9.

Does this matter? We find that the cost of equity in a country, after controlling for the usual suspects, does not change after the introduction of insider trading laws, but decrease significantly after the first prosecution.

- 1.6 Again, this matches my experience. It always seemed to me that the perceptions of the effectiveness of Australia's regulator always seemed to turn (it seemed to me a the time, unfairly) on perceptions of our success, or failure, in dealing with just one aspect of market regulation -insider trading. Successful prosecution requires the proof of s many elements, including the hardest of them all, that the information was price sensitive. Australian law gradually evolved to make it easier, so that our law is now a law about liability for trading while aware of (not "using") price sensitive information not generally available (even that is controversial) – whoever you are – that is, no need to be an "insider". Even then, convictions are rare.

- The Australian context

- 1.7 Australia is a common law country,⁸ but it did have a bit of a problem towards the end of the 1980s. The solution required not only a new regulator, and new laws,

⁵ Op. Cit. P 64

⁶ Ibid.

⁷ U Bhattacharya and H Daouk, The World Price of Insider Trading, Kelley School of Business, Indiana University, 2000

⁸ Cf 1.4 above

but that the regulator should ensure the enforcement of those laws. As a leading Australian financial journalist wrote⁹

The corporate booms and busts of the 1980s were the greatest ever seen in Australian history. The boom saw a bunch of corporate cowboys financed to dizzy heights by greedy and reckless bankers. Large sectors of Australian industry changed hands. Ownership of the major brewing and media companies changed completely. ..Alan Bond built an enormous empire on debt and creative accounting.

The ensuing bust saw awesome destruction. The collapses included Australia's largest industrial group (Adelaide Steamship); the ninth largest enterprise in the nation, measured by revenue (Bond Corporation); nearly half the brewing industry (Bond Brewing); all three major commercial television networks (Bond Media, Qintex, Channel Ten); Australia's largest car renter (Budget); the second largest newspaper group (Fairfax); Victoria's largest building society (Pyramid); and Australia's largest textile group (Linter). Severe problems were faced by Australia's largest company, as measured by revenue (Elders), its largest media group (News) and the other half of the brewing industry (Fosters).

..

The devastation was equally great among the financiers. Total write-offs and provisions by banks and financiers amounted to \$28 billion. Australia's three largest merchant banks (Tricontinental, Partnership Pacific and Elders Finance) had to be rescued by their parents. Two of Australia's four state banks (State Bank of Victoria and State Bank of South Australia) suffered devastating losses and were investigated by Royal Commissions. [One of those] (The SBV) was taken over by the Commonwealth Bank. The other two state banks, the Rural & Industries Bank of Western Australia and the State Bank of New South Wales, were deeply scarred. The four major trading banks (Westpac, National, Commonwealth and ANZ) had to write billions of dollars off their loan books, the suffering being particularly heavy in Westpac and ANZ. The losses of foreign banks operating in Australia were even higher proportionately, some of the worst being those of Hongkong Bank Australia, Standard Chartered, Security Pacific and Bank of New Zealand.

At the end, investors were left excoriating corporate cowboys such as Alan Bond, Christopher Skase and Laurie Connell. While these and other men deserved blame, it should have been spread more widely. Australia, after all, is no stranger to corporate cowboys. The country has had them in almost every decade of its existence. What was truly abnormal about the 1980s was the extent to which they were able to lay their hands on money. Never before in Australian history has so much money been

⁹ Trevor Sykes, The Bold Riders, Allen and Unwin, 1996. Page 1

channelled by so many people incompetent to lend it into the hands of so many people incompetent to manage it.

The banks financed the takeover of old, stodgily managed businesses by new, often unsound managements. Backed by debt from the banks the corporate cowboys drove up asset prices, in particular the prices of businesses, property and equities. The paper castles they built were increasingly vulnerable to any harsh wind. The first cyclone to blow came on 20 October 1987, when the world's share markets lost one-quarter of their value in a single trading session. An overrelaxation of monetary policy then allowed a false boom to continue for more than another year, particularly in the property market too and plunged Australia into a recession.

1.8 At that time, Australia had no single national corporate and securities regulator. There were eight corporate affairs commissions, one in each state and territory, administering mainly but not entirely uniform laws and starved of resources by governments with other priorities, like hospitals and schools, and coordinated by a National Companies and Securities Commission. Attempts had been made at intervals to introduce a national regulator, in order to increase the effectiveness of regulation, but they failed for a mixture of political reasons, the reluctance of the states in particular to give up a source of revenue, and constitutional problems - a quirk meant that the federal government could legislate with respect to existing companies, but not the incorporation process. But the excesses described above finally produced agreement on a deal for the takeover by the federal government.¹⁰ There was a widespread and largely accurate belief that the Australian securities markets were badly regulated during the asset price boom of the 1980s, for a combination of reasons including

- that there were six separate state based stock exchanges,
- eight corporate regulators based in each state and territory whose work extended to market supervision within their states or territories, but each of which was under resourced, and
- inadequate laws.

1.9 The former commissions could not cope with the "excesses". The following extract from Paul Barry's book on Alan Bond¹¹ puts it best.

"Australia had itself to blame for what certain businessmen had been allowed to get away with, because its system of corporate regulation in the 1980's was pathetically inadequate. (I)t is worth considering the

¹⁰ This is a much simplified account of a long and tortuous process, technically resolved only in mid 2001 by a referral of the corporations power by the states to the federal government, and then, only subject to a 5 year sunset.

¹¹ It should be noted that ASIC twice prosecuted Bond, eventually, and obtained guilty pleas. He went to gaol, but was released early on legal technicalities.

difficulties that face any society in combating or preventing corporate crime. It is probably true of almost anywhere that it is easier to steal \$10 million from the shareholders of a public company than it is to take \$1000 from a company's Christmas Club. It is probably also true of any country that the white-collar criminal is far less likely to be convicted and sent to jail than the petty thief. But it is certainly true of Australia. The way we treat the two offenders is salutary: if someone robs the Christmas Club and cannot pay the money back, the police will be called, the culprit will be taken away to be questioned, perhaps even put in the cells overnight. Prosecution and public disgrace will follow. The offender will almost certainly end up in jail and emerge to find his job has gone. But when a company director steals \$10 million from his shareholders, if the corporate regulators find out about it at all, Mr Bigshot will be interviewed in his office, flanked by lawyers who are outraged on his behalf at the slur being cast on his name. He will probably say nothing, but his advisers will assure the investigators that the transactions are perfectly legal and have been approved by the top law firm in the country. It will then be the investigators' luckless task to prove them wrong. Even if they can gather the documentary evidence, they will be lucky to find a jury that can understand it and will convict. That is true almost anywhere in the world – corporate structures, clever lawyers and sheer complexity both protect and sanitise unacceptable conduct.

- 1.10 One of the issues which this paper explores is the best response to wrong doing. The Year 2000 Annual Report of BAPEPAM¹² described the use of administrative sanctions for violations of the Capital Markets Law such as insider trading. For many, insider trading is such a serious allegation that it should be dealt with as a criminal matter, or not at all. But then again, perhaps it is better to deal with it administratively than allow someone to "get away with it".
- 1.11 I heard a radio report recently to the effect that four prominent company directors had been "charged" by the corporate regulator, the Australian Securities and Investments Commission or ASIC¹³. I knew instinctively, from the description of the subject matter, and (I have to say) the short period of time between the discovery of the circumstances and the commencement of proceedings, that this was unlikely, a belief confirmed by reading the press release on the website¹⁴

¹² The Indonesian Capital Markets Supervisory Agency

¹³ The word "charged" connotes criminal proceedings, at least to lawyers. Other similar civil proceedings recently led to a judgement against the defendants, who were described in the press as "guilty", again, a word lawyers have associated with criminal matters, not civil.

It is also worth noting at once that ASIC is unusual and almost unique in being both the securities markets regulator and the corporate regulator (and registrar), as well as consumer protector in the financial sector. Hence it has a larger and more diverse workload than almost all of its securities markets counterparts.

¹⁴ www.asic.gov.au

shortly after. They were instead the subject of what is in Australia a relatively recent innovation, civil penalty proceedings, not criminal charges.

- 1.12 My proposition in this context that the traditional distinctions between civil and criminal proceedings are neither relevant nor helpful when assessing the performance of market regulators. Regulators are under pressure to “get results”, and they, and the media and the community, need to be flexible in the way they view different outcomes.

2 The Australian experience of enforcement in the capital markets in the 1990s

- 2.1 As explained earlier, national companies and securities regulation in Australia effectively commenced in 1991. Austin and Hamilton observed in 1993 that “in recent years, in jurisdictions such as the United States, the United Kingdom and Australia, emphasis has been on pursuing non-criminal or remedial remedies against wrongdoing, rather than simple criminal prosecution. There are two principal reasons for this.

- for procedural reasons relating to fairness to the accused and burden of proof, criminal prosecutions are often time consuming, expensive and uncertain in possible outcome;
- as a policy matter, regulators take the view that it is better to stop the market abuse as soon as possible and take steps to remedy any harm caused to the market, rather than simply punish wrongdoers.”¹⁵

- 2.2 In Australia, we understood that American regulators had focused on 'remedial' rather than 'punitive' enforcement of their securities law:

Enforcement is driven not so much by an interest in punishing the individual violator, but more by an interest in keeping the system on an even keel - eg stopping an issuer from continuing to make fraudulent statements and forcing it to correct past misstatements; or requiring an insider trader to disgorge his ill-gotten gains.’¹⁶

- 2.3 Clearly, securities market regulators need to have both kinds of powers: they need to be able to take action quickly to limit the effect of market contraventions or, where possible, to prevent them from occurring. They need to be able to take reasonably prompt action to remedy any negative effects of market abuses and to

¹⁵ RP Austin and C Hamilton, Regulation of Developing Capital Markets, materials prepared for a seminar for the Asian Development Bank, Manila, 1993.

¹⁶ Michael Mann, 'What Constitutes a Successful Securities Regulatory Regime?', 1993, Vol 3 No 2, *Aust Journal of Corporate Law*, p178. Mann was in charge of international relations at the US SEC at that time, but in accordance with SEC policy, he was speaking and writing as an individual.

maintain investor confidence in the market. On the other hand, regulators also need the power to take criminal prosecutions against wrongdoers, thereby providing the traditional deterrent against wrongdoing which is the purpose of criminal sanctions.

- Preservation, recovery and prosecution

2.4 Michael Mann suggested, also in 1993, that there were two aspects of any effective regulatory regime:

The legal structure or the rules must be easily understandable, and

The rules must be implemented in a predictable and consistent manner¹⁷.

2.5 This traditional approach would suggest that the enforcement strategy of a securities market regulator needs to focus on:

- preservation;
- recovery; and
- prosecution.

2.6 In Australia, the **preservative** powers of the ASIC include:

- the use of common law injunctions and statutory mandatory or restraining injunctions to direct the affairs of a particular corporation;
- the power to apply to the court for appointment of a receiver/manager and seek asset freezing orders;
- the power to seek a winding up or provisional liquidator;
- restraining orders against dealers' and brokers' bank accounts; and
- restraining orders against the disposition or dealing in securities.

2.7 In the United States, the SEC has similar preservative powers at its disposal. Temporary restraining orders may be used to stop wrongdoers from leaving the jurisdiction with their ill-gotten gains. The SEC may also obtain a temporary freeze of assets if there is a danger that these may be dissipated before proceedings are concluded. Court ordered injunctions against future violations are the linchpin of the SEC's enforcement program. Breach of an injunction exposes the violator to the risk of a criminal action for contempt of court.

¹⁷ Mann, op.cit, p178

2.8 Apart from judicial remedies, the SEC also has direct authority to sanction unlawful conduct by securities professionals. It may place limitations on the ability of a broker to act in the market. It may also issue 'cease and desist' orders.

- Prosecution

2.9 Curiously, for all of its justified reputation as an effective regulator, the US SEC does not have the power to prosecute; prosecutions are undertaken by the Department of Justice, but civil penalties for "fraud" are severe. Professor John Coffee, a noted US securities lawyer, commented as follows¹⁸:

[A]pplying the civil law to behaviour that has traditionally been punished criminally might deprive society of its ability to focus censure and assign blame with the moral force that the criminal law may uniquely possess. In short, even if the civil law could provide equivalent deterrence, it may not be able to perform as successfully the socialising and educative roles that the criminal law performs in our society. ... I would suggest that in its characteristic operation, the civil law "prices", while the criminal law 'sanctions'. ... I would argue that the criminal law should be reserved to prohibiting conduct that society believes lacks any social utility, while civil penalties should be used to deter (or "price") many forms of misbehaviour (for example, negligence) where the regulated activity has positive social utility but is imposing externalities on others. This "pricing/prohibiting" distinction is probably consistent with the general public's understanding of the difference between a tax and a civil penalty.

2.10 The new UK FSA does have that power to prosecute. The Australian experience is interesting for the course it has taken, and the unusual outcomes it has produced, and for that reason, as well as my familiarity with it, I shall spend some time on our experience.

2.11 As explained earlier, the Australian Securities Commission was brought into existence by agreement between the states, the territories and the Commonwealth governments as from January 1991, and its first task was seen as enforcing the law on those who were believed to have broken the law with impunity at the expense of the investing public and institutions during the 1980s. What that also did however was to bring the Commonwealth (the national government) into the arena of securities law enforcement directly for the first time. There was an expectation that the new Commission would seek to have an impact quickly by bringing the perpetrators of the "excesses" to court. Indeed, the then chairman publicised a list of his top 16 targets, sending a message very clearly that he and the Commission expected to be judged by how, and when, these were handled.

¹⁸ The Australian Law Reform Commission is at present reviewing civil and administrative penalties. This quotation comes from, and this section owes a great deal to, their discussion paper Penalties, Policy, Principles and Practice in Government Regulation, (the "ALRC Paper"), Australian Law Reform Commission, June 2001 – available on www.alrc.gov.au. The present author is a member of the Advisory Committee on the reference. The final report is to be issued shortly.

The Commission appeared, and appears, to have the power to prosecute, but that right was not straightforward.

- 2.12 The legislative story starts with the ASC Act, now the ASIC Act 2001, section 49 of which, edited for clarity, is as follows

ASIC may cause prosecution to be begun

(1) This section applies where.. it appears to ASIC that a person may have committed an offence against the corporations legislation; and ought to be prosecuted for the offence.

(2) ASIC may cause a prosecution of the person for the offence to be begun and carried on.

- 2.13 So ASIC can prosecute in its own name. But there is also sub section (5), which reads as follows

(5) Nothing in this section affects the operation of the *Director of Public Prosecutions Act 1983*.

- 2.14 That Act sets up the DPP as the independent prosecuting authority for commonwealth crimes, with functions and powers that include (emphasis added)

(a) to institute prosecutions on indictment for indictable offences against the laws of the Commonwealth; and

(b) to carry on prosecutions of the kind referred to in paragraph (a)... **whether or not instituted by the Director**; and..

- 2.15 And, Section 9 (3)

For the purposes of the performance of his or her functions, the Director may take over a prosecution on indictment for an offence against a law of the Commonwealth, being a prosecution instituted by another person...

- 2.16 So what had appeared clear, is not. The ASC, now ASIC, could indeed, and can now commence any prosecution, but the DPP may **take over** any ASIC prosecution, which gives effective control over prosecutions, to the DPP.

- 2.17 Conflict may have been inevitable. The ASC was under pressure to produce quick results in the hit list; but the then ASC Chairman perceived that the DPP was dilatory in acting on these references, and threatened to take matters civilly to overcome the delays, which would have had the effect of excluding the possibility of criminal cases. Matters came to a head in 1992 with a very public dispute between the two heads of the organisations. The ASC chairman noted in March 1992:

The preference [of the ASC] for pursuing civil litigation over prosecutions is in many circumstances a response to temporal demands. The speed and flexibility of the civil/administrative action, particularly in obtaining preservative interim relief, has obvious attractions. The burden

of proof, and the evidential advantages in gathering and using evidence in the face of claims for the privilege against self-incrimination are also strong indicators of the practical advantages in favour of civil enforcement strategies. Combined with a deterrent net cast by the surveillance programs is the deterrent effect achieved by the prospect of the personal and often immediate liability of the defendants for compensation or damages.¹⁹

2.18 However, this approach was criticised by the Director of Public Prosecutions, who said that:

'The ASIC say that there is nothing that a corporate criminal fears more than being stripped of his illgotten gains. I say to you, ... that that is the last thing the corporate criminal is afraid of because he believes that by the time someone wakes up to the fact that he is a corporate criminal there will hardly be a dollar left in the jurisdiction that the regulator can grab and strip from him. What the corporate criminal is really afraid of is going to prison. That is what deters people from committing crime,²⁰

2.19 In response to this conflict, the Australian Attorney General issued a directive to the ASIC requiring it to place greater emphasis on criminal prosecutions. This directive appears on the ASIC website and deserves close attention. It commences with a statement of the Government's policy, as follows:

It is the policy of the Commonwealth Government that the maintenance of a corporate business environment that maximises efficiency and investor confidence requires the striking of an appropriate balance between self-regulation by market participants and effective supervision, investigation and enforcement by the ASC.

Where an investigation by the ASC relates to conduct that may constitute a serious offence under the Corporations Law or the general criminal law, it is the view of the Government that the ASC and the DPP should collaborate to the fullest extent possible to expedite and facilitate the completion of that investigation and the prosecution of any serious offence the prosecution of which is supported by evidence gathered during the investigation.

Recognising that the enforcement powers of the ASC extend also to the institution of civil proceedings in respect of corporate wrongdoing, it is the view of the Government that civil proceedings should not, as a general rule, be regarded as an alternative to criminal proceedings, but that each should be seen as complementing the other and that an assessment should be made in every case whether civil proceedings, criminal proceedings, or both, are appropriate in the interests of justice.

¹⁹ Hartnell, 'Regulatory Enforcement by the ASIC: an interrelationship of strategies' ASIC Digest Update 49 at 48.

²⁰ Joint Committee on Corporations and Securities: Briefing with the Director of Public Prosecutions: Official Hansard Report, 7 September 1992 at 45.

2.20 The Attorney- General therefore directed the ASC and the DPP, both of which fell within his jurisdiction, in these terms

Noting that co-operation and collaboration between the ASC and the DPP has, in certain respects, fallen short of the Government's expectations, I, Michael Duffy, the Attorney-General of the Commonwealth, hereby direct, in pursuance of s 12 of the Australian Securities Commission Act 1989 and s 8 of the Director of Public Prosecutions Act 1983, the ASC and DPP to develop and implement policies for the exercise and discharge of their respective powers and functions so as to comply with the following guidelines.

2.21 The guidelines are lengthy, but basically involve requirements for consultation at staff and regional level, referral of disagreements to the Chairman and the Director personally, and a dispute resolution procedure. It was the first, and remains the only such direction given by a Minister to either the DPP or the ASC (now ASIC). Several observations can be made

- Both agencies jealously guard their independence, and the Direction may therefore appear somewhat at odds with that. Note that under their respective statutes, neither may be directed in specific cases. And this Direction purports to be about policy, but it is really about procedures. There must therefore be some doubt about its validity.
- It appears that no dispute has arisen since the Direction was given; so to that extent, the Direction may be taken to have worked.
- The Government's concern was about civil recovery proceedings, rather than civil penalties as such. Any civil proceedings can act as a bar to subsequent criminal proceedings, which is a major reason why prior consultation was required before ASIC was to commence civil proceedings
- The Direction contemplates that disputes which could not be resolved by discussion between the Chairman and the Director should be referred to the Attorney-General, but that officer, in Australia a politician, has no authority to resolve the issue other than by further discussions.

2.22 The debate has moved on since 1992. The Top 16 cases were finished, eventually, and Hartnell's successor (the writer) stopped the practice of reporting against that list, even earlier than that. Civil penalties were introduced, as discussed below, to give ASIC an alternative to criminal remedies. In 1998, "ASC" became "ASIC" and perhaps in recognition of its perceived overall effectiveness was given wider jurisdiction, over market integrity and conduct in financial services generally (banking, insurance, pensions), as well as consumer protection in the whole of the industry.

2.23 In 1999-2000, ASIC banned 50 people from giving investment advice (34 more than in the previous year). Although its "court results" dropped to an 84% success rate in 461 matters, ASIC achieved its 70% success target (across criminal and civil matters). From July 1999 to December 2000, ASIC actions resulted in 36 prison sentences, 57 investment advisers being banned from practising (20 for life), and

47 people being banned from managing a company. ASIC's most recent Annual Report reveals its current enforcement priorities, to reduce the summary (minor) prosecutions and criminal and civil litigation generally, to deal with "the more complex cases now confronting us" – apparently a reference to the string of corporate collapses which hit Australia in the 2000/01 period. Nevertheless, 25 people were sent to gaol, including sentences of 11, 10 and 9 years, and a further nine of 4 years or more. 72 civil enforcement actions were completed; 29 people were banned from giving investment advice; 16 misconduct actions against auditors and liquidators were concluded, and 46 enforceable undertakings accepted.

Civil penalties

- 2.24 Civil penalties (imposed by courts) are now the primary statutory sanction in the area of directors' duties, although ASIC had until recently brought few such claims. A joint project by ASIC and the Centre for Corporate Law and Securities Regulation published in 1999 found that ASIC had commenced only 14 civil penalty applications relating to ten case situations since 1993. (The law was changed in that year to provide for civil penalties, but only for circumstances arising after that date.) In the study²¹, ASIC officers commented favourably on the benefits of judicial and administrative review.

The common element of **administrative penalties** is that they do not require a decision by a court. Some of these penalties, such as those relating to licensing regimes, are within the discretion of the regulator. Others are set down in legislation as applying when specified events occur. These administrative penalties require the regulator to interpret the legal rules and decide that the penalty applies: for example, by deciding how taxation law applies to a set of transactions, or that the excuse provided by a social security claimant for breaching an activity test is sufficient or insufficient. Some administrative penalties are not enforceable as administrative penalties, but may be paid "voluntarily" in lieu of criminal prosecution, which carries a heavier fine. In Australia there are a few common elements to procedures concerning administrative penalties. Most allow for some element of discretion by the regulator, such as: provisions for remission of all or part of a penalty; provisions allowing the regulator to exempt a person from a particular requirement; and requiring the regulator to interpret legal or factual points in determining whether the penalty applies. Again in Australia most provide for some form of review, although generally not before the penalty becomes enforceable.

- 2.25 There will continue to be those who will press for criminal remedies to be pursued in all cases of deliberate wrongdoing in market places; but we need to face the fact that judges and juries are reluctant to convict and sentence so-called "white collar" criminals unless the cases are clear cut, and unless the defendants have personally profited from their wrong doing. It will usually be sufficient to get the defendants

²¹ Quoted in the ALRC Paper

off, if they can be shown to have taken professional advice at the time, and to have followed that advice. And market offences are both different from and in some respects more difficult to prosecute than traditional crime.

- 2.26 That is why regulators need to understand the full range of remedies available to them, not to seek to rely on traditional ones alone, and push for the adoption of new remedies including enforceable undertakings, discussed below. But they must also be alert to the need for fairness, without which they, and their remedies, will not last long.

3 Reflections on regulation generally²² - a diversion

- 3.1 Whether they regulate standards of nursing homes, aviation safety, the environment or capital markets, regulators do not have an easy task. If they are active in their pursuit of wrongdoers, they are often accused of heavy handedness. If they seek to regulate with a light hand, they are perceived as inept, weak or cowardly. If they establish close links with industry, or consumers, they are regarded as captured, or sold out. If they maintain some aloofness, they are criticised for not understanding the business they are supposed to be supervising. A regulator who is thought to seek publicity is criticised for that, but one who is not frequently in the press or on the airwaves is thought to be hiding.
- 3.2 Professor Malcolm Sparrow of Harvard University visited Australia and spoke at both the ASIC Summer School and the IOSCO Annual Conference in May 2000. His book **‘The Regulatory Craft’**²³ was published at that time. Although he claimed to have no expertise with respect to financial markets, he stimulated many of us²⁴ to reflect on the discipline of regulation and the enforcement of laws, and how his work is relevant especially in economic regulation. We have had the opportunity to reflect on what it means and takes to be an effective regulator, a "regulator with attitude", assertive, not aggressive.
- 3.3 In order to be effective, a regulator must use the various powers and skills available to it appropriately to address both the individual matters and the wider strategic issues that confront it. Applied regulation is not the mere mechanistic, case-by-case enforcement of laws passed or regulations made. A proposition that every potential breach of the law can or ought to be prosecuted, for example, is wrong. Choices have to be made.
- 3.4 I suspect regulators instinctively knew before we read and heard Sparrow, that regulators cannot measure their effectiveness simply by counting prosecutions, or successful prosecutions, or the like; apart from any other reason, every instance

²² This section of the paper is based in part on a paper, that I wrote jointly with my former colleague at ASIC, Bill Coad, published in the *Financial Regulator*, Vol 5 No 4, March 2001, as Measuring Regulatory Success.

²³ Published by Harvard University (Spring 2000)

²⁴ He is reported to have consulted to the UK FSA, and see the speech of Andrew Sheng, Chairman, Hong Kong SFC, to the 2002 ASIC Summer School, at www.sfc.gov.hk

which requires prosecution is something that should not have happened. And it is very hard to count the wrongdoing one has **prevented** – by definition; there usually is nothing to count.

- 3.5 Regulators bring to their work a toolkit, and the skills of their staff. The tools are derived from the powers in the law administered by the regulator. The skills are the resources, human and other, that are drawn together by the regulator to carry out the mission.
- 3.6 Thus the economic regulator's toolbox includes
- issuing guidelines which assist regulated businesses to understand and abide by the law,
 - guidelines to assist other stakeholders such as consumers to understand their rights,
 - keeping records for public access of key information such as persons licensed to practice,
 - making specific regulatory decisions, such as exemptions or authorisations, granting or denying licences,
 - issuing warnings and shaming,
 - investigations,
 - banning orders to stop people practising their profession,
 - obtaining enforceable undertakings,
 - civil court actions for damages,
 - imposing pecuniary penalties (usually on licensed or supervised bodies),
 - seeking court imposed pecuniary penalties,
 - reporting matters to Parliament,
 - public hearings – and
 - (at the end of the list) prosecution .
- 3.7 These tools have to be applied to individual matters in a reactive way (such as dealing with complaints) and sometimes in a mandatory response (such as dealing with applications for licences). They cannot easily be used to fashion a more holistic, creative and preventive approach, to stop a problem arising in the first place.

- 3.8 Economic regulators must be able to demonstrate their cost-effectiveness. If they are locked into types of activity that are reflective of the most obvious and comfortable mix of the tools and skills discussed above, they run some serious risks. Functions such as investigations may be measured in terms of “scalps”. Regulatory functions may be seen in terms of process indicators (numbers of licences handled in X time). Yet neither of these may be good indicators of market place effect, nor result in the best outcome from the viewpoint of the public interest.
- 3.9 These challenges make the Sparrow work so important. Sparrow is the leading expert in the field of the reform of performance of regulatory agencies. A mathematician at university, he started his career in the British police before his move to Harvard.
- 3.10 Police services in some countries have had to respond to political demands for new initiatives in dealing with intractable problems such as drug dealing and organised crime. Sparrow has drawn on that work and his other experiences, especially with customs, tax and environment protection agencies, in their moves to ‘re-invent’ or ‘reform’ government.
- 3.11 As Sparrow says, the important feature that distinguishes regulatory and enforcement agencies from the rest of government is that the core of their mission involves the imposition of duties. They deliver obligations rather than services.
- 3.12 The popular prescriptions for “customer service”-oriented reform focus on, and for a large part work well with, organisations where concepts such as service, customers, quality and process improvement are instinctively accepted as appropriate, and not so well with organisations where concepts like compliance management, risk control or structuring the application of enforcement discretion occur more naturally and frequently. The latter group (compliance management, risk control or structuring the application of enforcement discretion) requires better and more flexible management of the choice of the kinds of *tools* and *skills* described above.
- 3.13 Sparrow does not deny that service and process improvement can be useful in a regulatory context, rather, they will never be enough. He notes that in his time as a police officer only one person he arrested expressed ‘customer satisfaction’.
- 3.14 Regulatory functions represent an anomaly in the context of a customer driven government. Regulators need a broader vocabulary. They need to think not only in terms of customers but stakeholders, citizens, objects, targets for enforcement, beneficiaries, taxpayers and society.
- 3.15 This observation fits comfortably with my experience. For example the general public assistance and information provision functions of regulatory agencies have a strong customer-service orientation but this is much less so in the other roles such as enforcement.

- 3.16 According to Sparrow, regulators should use latitude and discretion to make sensible judgements in dealing with particular situations. The application of blanket prescriptions can lead to foolishness. Sparrow examples a US agency in the area of occupational health and safety. It had the philosophy that citations and penalties, the bigger the better, would have a deterrent effect. It was racking up more egregious cases than any other State. But it still had the worst injury rates. Most injuries were in industries that it did not regard as high hazard. It had to behave differently because, notwithstanding its aggressive enforcement program, insurance premiums were skyrocketing and politicians were saying 'do something'.
- 3.17 Regulators, says Sparrow, do have discretion both in terms of how to apply their powers and how to allocate their resources. In the process they do much more than administer and enforce the law. They provide guidance, solve problems, build partnerships and sometimes seek to influence behaviours that are not regulated.
- 3.18 A collaborative partnership for example may alleviate a problem. Guiding an industry to self regulate may be a quicker means of securing a result in some, but not all, instances. But such partnerships are not driven by a customer-service motivation, or by the desire to please, rather they should be driven by the pursuit of some clearly articulated goal.
- 3.19 Sometimes a partnership might in effect be formed 'under duress'. He gives the example of a cease-fire strategy in Boston that aimed to reduce youth homicide among gangs. The police 'partnership' with the gangs, which aimed to cease youth homicides, involved the police 'promise' that violent offences would be met by a coordinated inter-agency 'pull every lever' approach not just against the individual offender but against the whole gang.
- 3.20 In the Australian capital market context ASIC has effectively formed a partnership with the Australian Stock Exchange to share the regulation of the stock market. This is constituted by a series of Memoranda of Understanding, under which the ASX imposes, on a real time basis, the rules of trading. ASIC reinforces that with official regulation and penalties. This is a cooperative partnership. A partnership under duress may describe an undertaking given by say a financial provider to lift its game, with the threat of Court proceedings kept 'in the air'.
- 3.21 Sparrow says that all this indicates the emergence of a new *regulatory craftsmanship* specifying risk-concentrations, problem areas or patterns of non-compliance, and designing interventions that effectively control or reduce them. His studies have noted that many agencies may already have 'balanced compliance strategies' that will seek to specify a mix of tools and the resource allocations among them. But they do not integrate the work of the different tools around a specific risk. Under these balanced compliance strategies, once the overall activity levels have been specified, each 'tool', 'function' or 'program' is allowed to operate in isolation.
- 3.22 An 'integrated compliance strategy' (problem solving approach) *organises the tools around the work*; it identifies important risks and then develops multi-functional

responses. Working out what the major problems or risks are and which ones to give priority to, should be the subject of careful assessment and agreement in consultation with stakeholders.

- 3.23 In short he says that regulators should ‘pick important problems and fix them’. They are not doing their job if they merely react to ‘what comes in the door’.
- 3.24 While political requirements in the OECD countries in particular in the last decade have focussed on regulatory results that actually deal with an issue (eg achieving a reduction of accidents) and on the prevention of red tape, Sparrow believes many in the regulatory audience (including many politicians) still only seem to understand the enforcement numbers game. Regulators and their overseers tend to look to ‘head counts’ even if they relate to outcomes rather than outputs. This may not provide good insight into ‘fixing problems’.
- Implications for economic regulators generally
- 3.25 *Firstly*, recognition that it is a *special* craft. Finding the right mix of strategies and managing their implementation in the regulatory environment is not easy.
- 3.26 The trick is *how to get the best regulatory leverage to obtain a result*. And it can be frustrating. So much so that a weary regulator may see a ‘quick fix’ such as ‘trial in the media’ as attractive when the alternative appears to be proceeding via ‘rulebook’ investigative processes, that can take so long as to render the regulatory intent null.
- 3.27 The people management issues are also special. The people who undertake regulatory and enforcement work, particularly that which is more complex, are special people - often driven by the reward of working in the public interest and not maximising financial or commercial reward. Motivation and management in this context is part of that special craft, not the least because the staff may have their own views about how the public interest is best served.
- 3.28 Management in the applied regulatory context is as complex as management in a market or financial process. And it is often more closely scrutinised by the public, politicians, the media, and administrative bodies.
- 3.29 *Secondly* much of the business of a regulatory agency will still be driven by what comes in the door. There are irresistible forces; for example the public, and the newspapers and the politicians will expect individual matters to be addressed, so complaints must be dealt with. Releasing organisational capacity to be used in preventive ways for dealing with a wider issue or problem will bring about organisational tensions; staff whose job it is to deal with complainants will be uncomfortable having to turn even more of them away. Of course, if systemic problems are solved there should eventually be fewer complaints, but that takes time to happen.
- 3.30 In each agency there tend to be silos of activity where reactive work is done using a standard mix of skills and tools that reflect some established norms. There are

balanced compliance strategies in terms of program allocations and policy directions for the programs, but much less integration of tools to address a particular problem or issue.

- 3.31 There are often also background philosophies in these silos that silently influence what is done. Law enforcers tend to assume that a good range of investigative and Court work will act as a deterrent to others. Economic regulators may take a different view, tending to think that the simplest way of getting a result is detailed rule making. For a particular problem neither may be right. This is the major issue to which I will return shortly.
- 3.32 *Thirdly*, stepping outside this daily grind to undertake an issue-related, preventive approach as suggested by Sparrow, may have to be a gradual affair, starting with the more pressing issues. But as Sparrow rightly underscores, a regulator that ignores the need to adopt such an approach runs the risk of becoming irrelevant to contemporary or emerging issues. The regulator who plays the tune on the same old set of instruments may continue to provide a 'good set of numbers' and meet populist demand, but it may not deliver the required market effect.
- 3.33 *Fourthly*, general business efficiency models only apply to regulators to a limited extent. Something needs to be tailored to better assess their work. Process efficiency measures can be applied to pseudo commercial process areas carried out in the regulator (of which there may be a number). But to try to straight-jacket the whole of a regulator's performance into that position is artificial. It runs the risk of falling back to old numbers measures such as 'heads on sticks', which may not in many cases deliver an underlying result.
- 3.34 Review bodies such as Parliamentary Committees have a real opportunity to assist here, by ensuring that the accountability requirements are practical and meaningful (perhaps based partly on the 'stories' of the type that Sparrow refers to) and not swayed too much by artificial straining to have regulators look like a commercial business.
- 3.35 *Finally*, the Sparrow thesis challenges regulators to be much more innovative. Some regulatory and enforcement agencies are going down this track. A focus on dealing with important problems in a results oriented way might require regulators to be less conservative and to 'dust off' some of the tools that get infrequent use. An example in the Australian context (I make no claim that it is relevant in Indonesia) is the use of public hearings and public reports. Regulators like ASIC should consider their power to expose systemic issues via public hearings or reports as a highly strategic part of their armoury in light of the approach articulated by Sparrow.
- 3.36 Agencies also need to do other things to hone their internal structures and procedures not only for identifying and targeting problems and issues to be dealt with, but also to deal with them in a seamless fashion.
- 3.37 The issues confronting regulators today, especially capital markets regulators, are increasingly *international in substance* and thus raise questions about the ability of

one country to regulate such markets. They bring hard tasks for domestic regulators whose local and traditional tool kits may not provide the answers and may need much supplementation from other aids such as international partnerships. But the real challenge is that some of the current tools, such as the use of domestic criminal laws ('heads on sticks'), may in practice become irrelevant in this global context, even if they still have a place locally.

- The impact in Australia

3.38 What ASIC has in its toolkit is almost all of the toolkit set out earlier²⁵; the major exception is the power to fine, discussed below, and there is as we have seen, a question over its own prosecution powers.

3.39 It is all very well to have so many possibilities in the toolkit; who makes the decisions on using them, and how. The ALRC observed that in its recently expanded consumer protection role in financial services ASIC has adopted a risk control approach similar to that advocated by Sparrow, and quotes ASIC as follows:

It is clear to us that only dealing with individual transactions, after the event as they come through the regulator's door as a complaint, is not necessarily the best way to achieve our consumer protection regulatory outcomes. We have had to focus on how best to achieve broad results across our new jurisdiction, on identifying high risk areas, on trying to deal with conflict before it results in serious investor harm, and working with a variety of other groups and other organisations to get maximum leverage and impact for our efforts.

3.40 ASIC told the ALRC that it had identified the following features of a risk control approach in the financial services area:

- a) identifying important areas of regulatory risk through research projects, consumer surveys, analysis of market trends and products;
- b) understanding the needs of vulnerable consumers through research; and
- c) using other risk identification techniques such as liaising with stakeholders, surveillance of the marketplace and assessing risks based on complaints received.

3.41 But ASIC has not found this straightforward:

[M]any regulators such as ASIC cover a wide range of responsibilities and it is a challenge to identify, set and implement systemic 'problem solving responses' across all those activities. We need to think and manage in terms of a complex portfolio of regulatory initiatives and projects across our organisation. This is very demanding of management

²⁵ See para 3.6 above

reporting, information and analysis systems and especially senior management decision-making processes.

We will use the right tool to achieve the best outcome. This may include criminal prosecutions, civil applications and administrative banning, which are part of ASIC's set of enforcement options, but it may also include other tools which we think may be equally effective, in the right circumstances. In particular, it seems to me that a pro-active stance to prevent misconduct or breaches of legislation, by education and consumer alerts, may sometimes be more effective and reach a wider audience more cheaply and effectively, than a conviction or civil order.

3.42 In the next section, I describe some of the particular issues which have arisen in Australia.

4 The different kinds of sanctions

4.1 ASIC recently commenced civil action in the Supreme Court of Victoria against directors of a company called Water Wheel Holdings Ltd., alleging that the directors allowed the company to incur further debts after the company became insolvent, contrary to the *Corporations Law* and sought orders from the court that the directors personally pay compensation for the benefit of the company's unsecured creditors; that the directors be prohibited from managing any corporation for such period as the court thinks fit; and for the imposition of monetary penalties of up to \$4 million on each of the directors.

4.2 In announcing the proceedings, Mr David Knott, ASIC chairman, stated that:

It is important to emphasise that these are not criminal proceedings. The breaches of law alleged by ASIC are sufficiently serious to seek orders against the defendants for both compensation and civil penalties.

4.3 The directors not only deny the claim in substance; they dispute that it is civil in nature. And as we shall see, the characterisation of the proceedings as civil, or criminal, is having a significant impact on the way it is proceeding. An important first step in this discussion is to define what we mean by the different kinds of sanctions.

4.4 The contents of the regulatory toolkit described earlier can be broadly characterised as administrative, civil, or criminal remedies - although some may not readily fit any such category.

- Criminal remedies are those resulting in a finding of guilt or innocence and a punishment *imposed by a court* such as gaol, a monetary payment called a fine (recovered by the state), some combination or refinement on those lines, such as a suspended sentence. As the ALRC Paper noted, "The purpose of criminal penalties is traditionally considered to be deterrence

and punishment, (whereas) civil and administrative penalties may be crafted with an aim to deter, compensate or make reparation for certain unlawful activity.”

- Civil penalties are requirements imposed by courts, usually involving the payment of money, and not involving gaol. The ALRC noted that there is a “working assumption that civil penalties are less onerous than punishments meted out at criminal law.” Since the recipient has the benefit of not having a conviction of a crime against their name, one wonders about the logic of that, but it is probably inevitable, because the criminal penalty simply should appear to be greater. It is true as the ALRC also observed, that some civil penalties can impact more severely than criminal penalties, where they result in loss of livelihood - yet the standard of proof and so on required for such a decision will be less than for the crime.
- Administrative penalties can take a variety of forms, but never gaol, and are imposed by the regulator. And as the ALRC Paper observed, “ a regulated person may perceive and experience an outcome as a penalty, whereas the regulator may categorise the same action as remediation or cost recovery.” Again, regulators can impose sanctions such as licence removal, in one sense a form of capital punishment.

4.5 The ALRC noted the importance of the distinction:

The categorisation of penalties as administrative, civil or criminal has significant consequences for procedures relating to proof, enforcement and protections for the regulated. Criminal conviction carries a social stigma and may lead to other civil disabilities, such as being barred from serving as a company director or public official. Where a criminal penalty is involved, law and practice generally:

- place a high burden and standard of proof on the prosecution;
- impose greater ethical obligations of candour, fairness and disclosure on the prosecution;
- confer a privilege against self-incrimination, a right to silence and protection against double jeopardy upon the accused; and
- extend the range and severity of sentencing powers.

Civil proceedings, including civil penalty proceedings, are characterised by a variable standard of proof at or above the balance of probabilities, mutual discovery and pleadings.

It is not always easy to determine whether a penalty is administrative, civil or criminal although the recently enacted Australian *Criminal Code*

Act 1995 will identify which penalties are criminal and which are civil largely by requirements for a fault element.

- 4.6 Even where the legislation explicitly specifies that civil penalty procedures will apply, whether by distinguishing liability or otherwise, courts may blur the distinctions. The Supreme Court of Victoria accepted the directors' argument in the Water Wheel case that ASIC was using the civil courts to bring a quasi-criminal matter. The judge rejected an application from ASIC that would have required the directors to file an early defence. Instead he ordered ASIC to file its case against the directors.
- 4.7 The ALRC concluded on this matter by saying that its review "invites a thorough analysis and debate on the relationship between civil and criminal penalty proceedings including whether any distinction should be retained or whether legislation should craft explicit processes for regulatory offences, with more or less protections afforded to the accused depending on the seriousness of the matter and the severity of the penalty. "
- Enforceable undertakings
- 4.8 An enforceable undertaking is a relatively new weapon in the enforcement armoury. It builds on the older, civil remedy of applying to the court for an order that a party carry out some duty under the law, or stop doing something which it is claimed, is in breach of the law. Such proceedings could be and frequently were settled by agreement, with the court accepting an undertaking or promise by the defendant **to the Court** to do or not do what the regulator (or other claimant – the right to seek such orders may not be limited to regulators) had been complaining about. A breach of such an undertaking, if proved, could be punished as a contempt of court.
- 4.9 This new, statutory device is different from an undertaking to the Court. The main differences between an undertaking to ASIC and an undertaking to the Court are that:
- (a) an undertaking to the Court may only be given when a Court action has been commenced. ASIC does not have to commence Court action before it can accept an undertaking under the ASIC Act; and
 - (b) an undertaking to the Court may be enforced in the same way as an injunction; that is, a breach of an undertaking to the Court may itself be the subject of contempt proceedings.
- 4.10 The ALRC characterised enforceable undertakings as "a relatively new and ostensibly effective enforcement response for ASIC."²⁶ ASIC acquired this ability in July 1998 and secured 25 in the first year, 62 in the second, and 46 in the third. ASIC has published a comprehensive Practice Note about its approach to the use

²⁶ ALRC Paper at 30

of these undertakings.²⁷ It states that enforceable undertakings will not be used as a substitute for a likely criminal prosecution, or as an alternative to civil penalty proceedings, in relation to compliance with an ASIC instrument, or where the matter is referred to the Companies Auditors and Liquidators Disciplinary Board (CALDB) or the Takeovers Panel. ASIC stated to the ALRC and in annual reports that enforceable undertakings are "more versatile than any of those remedies, and may be used to achieve outcomes which might not be available by those means, and which are more focused (eg adoption of a compliance regime, restriction of a person's securities business or practice as an auditor). It may not accept undertakings at an early stage of investigations because not enough may be known about the circumstances and facts."²⁸

- 4.11 The ALRC found that "enforceable undertakings appear to be popular with regulators and regulated. The flexibility of undertakings has enabled ASIC to secure timely and cost effective outcomes that would not be achievable by court order, offering tangible benefits for affected parties, and the prospect of lasting improvement in market conduct by the corporation involved. One of the benefits of enforceable undertakings is that they enable regulators to tailor their enforcement response to individual circumstances, taking personal and industry considerations into account. However, these undertakings are not a 'quick fix'. Drafting of undertakings requires considerable time and effort for both parties. The regulator must consider whether an enforceable undertaking is an appropriate outcome in the circumstances, whether it is likely to be complied with, whether it is likely to be an efficient resolution of the matter, and whether there is an acknowledgment of the breach or cause for concern."
- 4.12 ASIC emphasised to the ALRC that they only accept enforceable undertakings where there is evidence of a breach of the Act that would otherwise justify litigation²⁹

"Early notification and cooperation with the regulator make it more likely that an undertaking will be accepted in place of court action. Undertakings generally include measures to protect against future misconduct, so that parties are to some extent funding against themselves. Parties can be required to comply with the terms of the undertaking and/or compensate persons who have suffered loss as a result of the breach. The undertaking is agreed by the regulator and defaulting party. When the regulator accepts the undertaking from a suspected contravener, that person is legally required to abide by the obligations. Under the legislation, if the Court is satisfied that the person has breached a term of the undertaking, the Court may make all or any of the following orders:

an order directing the person to comply with that term of the undertaking;

²⁷ ASIC Practice Note 69

²⁸ ALRC Paper at 30

²⁹ ALRC Paper at 31

an order directing the person to pay to the Commonwealth an amount up to the amount of any financial benefit that the person has obtained directly or indirectly and that is reasonably attributable to the breach;

any order that the court considers appropriate directing the person to compensate any other person who has suffered loss or damage as a result of the breach;

any other order that the court considers appropriate.”

4.13 The Practice Note sets out these examples of enforceable undertakings:

ASIC may accept an undertaking from the Promisor that it will:

- (a) pay damages to identified third parties, along with a description of the process for bringing this about;
- (b) refrain from taking part in the management of a certain corporation for a set period of time;
- (c) remove a website at which securities advice is given by an entity contrary to the Law and to refrain from replacing it;
- (d) cease promoting an illegal fundraising scheme and/or to bring the scheme into compliance with relevant provisions of the Law within a defined period of time;
- (e) inform the market to correct some previous false or misleading disclosure or any continuing misapprehension for which it is responsible;
- (f) set up and implement an internal compliance plan and to report periodically to the market;
- (g) refrain from acting as a broker without a licence;
- (h) remedy the deficiencies in the company's structure and administration system by taking certain specified action;
- (i) compensate the beneficiaries of a superannuation entity for any loss suffered as a result of its misleading conduct whilst acting as trustee;
- (j) remedy unacceptable circumstances in relation to a takeover by carrying out certain necessary action; and
- (k) perform a community service obligation, for example, to increase consumers' knowledge of particular financial services.

- **Publicity**

4.14 The bare concept of publicity as an enforcement weapon does not appear in the list of tools to be used by a regulator set out in 3.6 above. Yet some market participants, at least in Australia, seem to think some regulators use publicity as a deliberate weapon. I would argue that effective regulation, and good public administration, require openness and transparency of approach by regulators, and that they should use proper means of disciplining the market. They should not take the easy way of bad mouthing market participants to friendly journalists who love a good story, even when no proper means of taking action is available.

4.15 Indeed one of the main criticisms of the predecessor regulator to ASIC and the ASC, which caused it to be replaced, was that it regulated by background briefings

to the media, instead of openly. That preference may have been as much due to lack of funds to take on court actions, as to any policy preference. Leaking the fact of an investigation damaged the reputation of those under investigation even when nothing came of the investigation. On the other hand, there should be no back room deals to settle issues of concern either; and every opportunity should be taken to publicise outcomes in order to achieve a regulatory effect.

4.16 It is no surprise therefore that ASIC has a published policy³⁰ on this subject, the philosophy of which is described as follows:

As the corporate regulator, we are responsible for maintaining the integrity of Australia's capital markets. We are accountable to Parliament and the public for our investigations and the enforcement actions arising from our investigations. By publicising details of our enforcement actions, we inform:

- (a) the public of what we are doing about people who break the law; and
- (b) industry about the standards we expect and the consequences of failing to meet these standards.

4.17 The matter is also mentioned in the enforceable undertakings Practice Note, in these terms

ASIC is committed to adopting enforcement strategies which foster a culture of compliance. One such strategy is the publication of enforcement outcomes. Given that the usual alternative to offering an enforceable undertaking involves the prospect of publication of an adverse finding by a Court, the Panel or the CALDB, ASIC regards it as appropriate that the subject and terms of an enforceable undertaking be made public.

4.18 The substance of the main policy is as follows

In general, ASIC will neither confirm nor deny the existence of an investigation unless it is in the public interest to make a statement.

ASIC will normally only comment on action we are taking against an individual when the enforcement action has begun, ie:

- (a) charges have been laid (that is, no earlier than the time of arrest or the first court appearance on the charges, commenced by summons); or
- (b) the civil or administrative proceeding has begun.

Where an investigation has concluded and enforcement action has not yet commenced, in cases of significant public interest where comment must be made, ASIC will normally say that an investigation has been concluded and that the appropriate enforcement action (if any) is being considered.

ASIC will generally issue a media release when:

- (a) charges are laid;
- (b) significant civil actions and administrative actions which involve public hearings commence; and
- (c) we refer a case to the Corporations and Securities Panel.

³⁰ ASIC Policy Statement 47

ASIC will not publicise matters which are the subject of private hearings, such as Companies Auditors and Liquidators Disciplinary Board (CALDB) references, when they commence.

Where ASIC publicised the laying of charges, ASIC will publicise the outcome, including withdrawal of charges, acquittal or successful prosecution. If a matter is appealed, ASIC will ordinarily publicise the outcome of the appeal.

In the same way, where ASIC is a party to civil litigation, ASIC will issue a media release on the outcome of that litigation.

ASIC will generally issue a media release on the outcome of administrative proceedings, including merits review by the Administrative Appeals Tribunal. In these cases, the media release will include the name of the person against whom the proceeding was taken and the nature of any penalty imposed.

ASIC will not settle any civil proceeding or enter into an enforceable undertaking on the basis that the terms of settlement or parties will be confidential. In general, ASIC will publicly announce the terms of settlement and the fact and nature of the enforceable undertaking.

- 4.19 Note the fairness elements as ASIC strives to keep a balance between keeping the market informed but not trampling on the rights of market participants. ASIC will not enter secret deals, but will always publish a press release even when it "loses".
- 4.20 It is fair to say that in Australia, the regulator whose publicity has attracted most comment in recent years has been the Australian Competition and Consumer Commission. Its chairman has from time to time been accused of judging companies in the media rather than through formal means. A recent court case discussed this issue, and noted that the ACCC had issued over 400 media releases in total in the 1997-1998 and 1998-1999 financial years. It was accepted that it had educational and guidance functions which it achieved through the publication of views on provisions of the Act and of other material. But its conduct in a particular matter³¹ involving the Electricity Supply industry was strongly criticised in these words

There are two matters to which it is necessary to draw attention. Both relate to the manner in which the ACCC conducted itself in its dispute with ESAA and the electricity suppliers. The first is simply a matter for comment. In his evidence Professor Fels [ACCC chairman] indicated on a number of occasions that, in light of the issues that have achieved prominence in this proceeding, he would have been more careful in what he said in press releases and comments to the media. He took the view that in a media release it has to be "really simple". I do not wish to question the use of the media made by the ACCC in publicising its views. I would merely suggest that, as the agency responsible for policing s.52 of the TP Act, [which deals with false and misleading representations] it properly can be expected to set the example of care in its own representations to the public.

³¹ Electricity Supply Association of Australia. v.ACCC [2001] FCA 1296

Secondly, Professor Fels has not been reluctant to question in public forums the legal advice of those Queens Counsel who advised ESAA or its members. ... he characterised as "absurd" the view that Division 2 of Part V might not apply to the supply of electricity. And he has not been slow to raise the threat of civil and criminal proceedings under the TP Act against electricity suppliers who publicise or who might be minded to publicise views about the implied warranties that differ from the Commission's view. I refer by way of example to the ACCC's letter of 1 May 1997.

The stances so taken may constitute good public theatre. Whether they represent good public administration is another matter. There is a very real prospect that the view the ACCC has taken of Division 2 of Part V will be found to be incorrect. At the moment, as the ACCC's counsel in this proceeding properly acknowledges, whether and if so how the implied conditions apply to electricity supply contracts is a matter of debate about which there can be respectable opinions on both sides of the argument. To describe the opinions supporting one side of the debate as "absurd" borders on the mischievous.

4.21 These words support my proposition that regulators have to be measured and responsible in their use of the media; they have the power and authority of the state behind them, and they should not behave in a way which can be construed as bullying, even if that was not their intent.

- Notice to affected persons before penalties issued

4.22 The ALRC observed a "common characteristic of administrative penalty regimes ... that there is no general rule that a person be notified that a penalty may be imposed, or that they have an opportunity to be heard or to contest the applicability of a penalty before it becomes enforceable. The regulator's issue of a notice requiring payment, or action in withholding payments that would otherwise be due, is considered sufficient."³²

4.23 That strikes the present author as surprising and undesirable, unless the penalty is a routine sanction for a late filing or other, reasonably self-evident violation. The ALRC observed that in matters of substance relating to ASIC, such as disqualification or banning orders, an order may only then be made after the person has been given an opportunity to be heard.

- Direct fining power for the regulator

4.24 As noted earlier, even the direct power to prosecute is not always available to regulators; yet some have the power to impose pecuniary penalties directly. Self-

³² ALRC Paper at 33

regulators have traditionally had that power over their members, but the non-judicial imposition of fines by government regulators is less common.

- 4.25 In a speech on 12 August 2001, the present chairman of ASIC confirmed that ASIC will continue to press for powers to impose fines for market offences, particularly for inadequate disclosure, and to reassess the effectiveness of other remedies for these offences. Here is part of what he said:

Civil Penalties

The introduction of the civil penalty regime through the Corporate Law Reform Act in 1993 reflected an awareness of the legislature of the need to address those parts of the Corporations Law of which a breach was technically an offence, but for which the Courts might be reluctant to impose criminal sanctions because of the absence of 'criminality'. We have seen Parliament continue to expand their application. For example, on 1 July 1998 a number of statutory provisions involving share capital transactions and the management of managed investment schemes were added. Again with the commencement of the CLERP legislation in March of 2000 the provisions to which a civil penalty order applied were expanded. Under FSR we will also gain a new civil penalty regime for market offences including a breach of the continuous disclosure provisions for the first time. We welcome these developments.

It would however be wrong to assume that these reforms alone will deliver the necessary 'sharp end' to deal effectively with issues like late disclosure or partially inadequate disclosure. The need to institute formal proceedings, even of a civil nature, is not necessarily the best means of regulating and improving disclosure conduct. Moreover, there are issues connected with the burden of proof and with the Courts' approach to evidentiary and procedural requirements in civil penalty matters that may tend to limit their practical use to ASIC. For example, while intervention by ASIC often confirms inadequate disclosure and leads to additional information being released to the market, there is seldom sufficient evidence to support a prosecution once the corrective information has been released.

It is for those reasons that I earlier this year raised the question of the regulator being given power to issue fines for market offences. There is usually a deep drawing of breath when regulators ask for additional powers and I accept that such requests demand careful scrutiny. However, I do not believe that this proposal is either unique or ground breaking. Such a debate has certainly been conducted in the UK where our regulatory counterpart, the Financial Services Authority (FSA), has been given considerable powers to levy financial penalties. Their powers are contained in the Financial Services and Markets Act 2000 which commences in November, and follow a long tradition of similar penalties for market offences in the UK (formerly exercised by SROs). The FSA may impose a financial penalty where a firm has breached an FSA rule

regarding compliance; where a firm or a person has breached a Principle – which sets out the Standard of Conduct expected of firms or 'approved person' employed by regulated firms; where an issuer of securities, or an applicant for listing, has breached the Listing Rules; and where there has been Market Abuse by any person.

This last point is particularly interesting as under the Market Abuse provision, the FSA can impose a penalty on any person, whether that person is regulated or not, who engages in behaviour which:

- is likely to give a false or misleading impression as to the supply, demand, price or value of an investment; or,
- is likely to distort the market in investments, or
- is based on information which is not generally available to other market users.

In Australia, I think that such powers could be especially effective in the case of companies failing to make full and prompt disclosure to shareholders. There should, in my view, be a penalty for making late disclosure which currently escapes effective recourse and provides little disincentive for sloppy practice.

Whilst we acknowledge the role of the ASX as having front line responsibility for ensuring continuous disclosure, I believe that a power by ASIC to impose fines of substance would add discipline to the market's processes – not just because of their financial impact but more importantly perhaps through their public nature. I do not believe that it would be reasonable on the ASX, as the market operator, to be charged with this additional regulatory responsibility.

- 4.26 These thoughtful comments deserve close attention, but whether the statutory regulator should be entrusted not only with wide investigative powers, but also the direct power to impose significant penalties, is a matter on which different views will undoubtedly be held.