

# Chapter 3

## Oversight of ASIC

### Introduction

3.1 This chapter outlines the committee's inquiry into the activities of ASIC and the operation of the corporations legislation as required under section 243(a)(i-iv) of the ASIC Act. The following issues are discussed:

- ASIC's actions following the Senate Economics References Committee inquiry into the performance of ASIC;
- ASIC's 2012–13 annual report;
- ASIC's statements of expectations and intent;
- emerging issues (including social impact bonds, digital currencies, high frequency trading and dark pools); and
- penalties available to ASIC.

3.2 The committee's oversight of ASIC during the first year of the 44<sup>th</sup> Parliament has been undertaken while two significant inquiries have been underway:

- the Senate Economics References Committee inquiry into the performance of ASIC, discussed further in the next section; and
- the Financial System Inquiry (FSI).

3.3 The FSI, announced by the Treasurer in December 2013, has been examining how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth. Previous financial system inquiries, including the Campbell Report in 1981 and Wallis Report in 1997, were catalysts for major economic reforms in Australia. The FSI is required to submit a final report to the Treasurer in November 2014.<sup>1</sup> The committee has received private briefings on the FSI from an industry expert and the secretariat of the FSI. The committee has also considered the interim report of the FSI.<sup>2</sup>

3.4 In carrying out its duties, the committee has been mindful to maintain its statutory oversight of ASIC, while avoiding duplication with the inquiries discussed above. In addition to inquiring into ASIC's statutory obligations in this report, the committee has also taken the opportunity to examine the Takeovers Panel and a range of proposals for the reform of the Panel's operations.

---

1 Financial System Inquiry, <http://fsi.gov.au/>, (accessed 22 October 2014).

2 Financial System Inquiry, <http://fsi.gov.au/>, (accessed 22 October 2014).

3.5 As the Senate Economics References Committee inquiry into ASIC's performance has now concluded, and the government has responded to the recommendations of this inquiry, the committee intends to resume its detailed scrutiny of ASIC's operations and the way that these agreed recommendations are being implemented by ASIC.

### ***Senate Economics References Committee inquiry into ASIC***

3.6 This section discusses some of ASIC's actions following the tabling of the report on the inquiry into the performance of ASIC by the Senate Economics References Committee in June 2014. The inquiry ran over many months, received 474 submissions and examined many areas of ASIC's performance, including ASIC's handling of serious misconduct at Commonwealth Financial Planning Limited.<sup>3</sup> The inquiry identified significant areas for improvement, while also recognising good work that ASIC has done in a challenging environment.<sup>4</sup> The report made 61 recommendations, including the following recommendations to the committee:

#### **Recommendation 52**

*The committee notes that the Parliamentary Joint Committee on Corporations and Financial Services could be well-placed to monitor ASIC's performance against the government's statement of expectations and ASIC's statement of intent. The committee recommends that the Parliamentary Joint Committee consider this as part of its statutory ASIC oversight function.*

#### **Recommendation 53**

*The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services consider how it could undertake its statutory duties in a way that places a greater emphasis on emerging issues and how action could be taken to pre-empt widespread investor losses or major frauds. As a first step the Parliamentary Joint Committee could, on an annual basis, reserve a public hearing to emerging issues, taking evidence from both ASIC and relevant experts.*

#### **Recommendation 54**

*The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services inquire into the various proposals which call for a lifting of professional, ethical and educational standards in the financial services industry.<sup>5</sup>*

3.7 On 14 July 2014, the committee accepted recommendations 52–54 and established an inquiry into proposals to lift the professional, ethical and education standards in the financial services industry. The committee also addresses recommendations 52 and 53 in this report.

---

3 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 52, pp xvii–xxii, 485.

4 Senate Economics Reference Committee, *Media Release*, 26 June 2014.

5 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. xxxiii.

3.8 On 24 October 2014, the government responded to the 61 recommendations of the Senate Economics References Committee inquiry into the performance of ASIC. This response identified areas in which ASIC had already taken action to implement some of the recommendations, including:

- establishing an Office of the Whistleblower to improve the way ASIC deals with whistleblowers (Recommendation 13);
- revamping the ASIC website to improve communications and enhance transparency (Recommendation 40);
- increased monitoring of enforceable undertakings (Recommendation 25); and
- work towards the establishment of a register of financial advisers (Recommendation 44).<sup>6</sup>

3.9 During its ASIC oversight hearing on 5 September 2014, the committee questioned ASIC on its actions in relation to the Senate Economics References Committee inquiry report. ASIC emphasised that it was a learning organisation and informed the committee how it was responding to the three main themes of the report: communication, enforcement action and early identification of risks:

[I]t is also about communicating better about what we do up-front and giving people a better understanding of the financial system they are operating in, particularly for consumers.

A second area is around tough, fast enforcement action as a broader theme coming out of the report. Rather than any particular process that has changed, it is more ASIC's recognition that the expectation of the community is for tougher and faster enforcement action.

...a very strong focus on early identification of risk and using our strategic intelligence team and coordinating that with the work of the individual stakeholder teams and enforcement teams to get access to intelligence and data to analyse that better to try to identify risk as early as we can.<sup>7</sup>

3.10 The committee also questioned ASIC about how it was improving its complaint handling, including triaging of complaints to identify areas that warrant attention. Mr Day from ASIC informed the committee that:

...when matters originally come in they are looked at and an executive level officer will decide what this matter generally, as a theme, seems to be about, and we have a keyword analysis that we apply on that basis...If it is obviously of a very serious nature that is well known to us as an issue, or if the party that the information is about is clearly something we are already

---

6 Senator the Hon Mathias Cormann, Minister for Finance, Acting Assistant Treasurer, *Government response to the Senate inquiry into the performance of ASIC*, media release, 24 November 2014; Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, pp xxv, xxviii, xxxi.

7 Mr Greg Kirk, Senior Executive Leader, Strategy Group, ASIC, *Committee Hansard*, 5 September 2014, p. 23.

looking at, then those things will get escalated very quickly—referred into existing investigations and existing surveillances and those types of things.<sup>8</sup>

3.11 The committee questioned ASIC on the data-matching mechanisms used to identify misconduct that may be occurring and how individuals involved in misconduct are identified. ASIC informed the committee that:

The keyword approach identifies the type of misconduct that has been alleged, and on a quarterly basis we run reviews to say, 'How many times has this keyword come up?' We can do analysis then, and that is disseminated right across the commission to our senior executive group, and they disseminate it to their own teams. So we are looking, again within my group, to see if there are any spikes or anything changing in that area.<sup>9</sup>

3.12 The Senate Economics References Committee inquiry into the performance of ASIC recommended that ASIC carefully examine its complaint handling and misconduct reporting systems, with a view to ensuring that serious matters are given appropriate attention.<sup>10</sup> The government response to the inquiry agreed in part to recommendation 19. The response also states that following a review, ASIC has made significant improvements, including increased telephone contact with people reporting misconduct, implementing new procedures for responding to misconduct reports and monitoring of customer satisfaction. Another review of complaints management is planned for 2016.<sup>11</sup>

#### *Committee view*

3.13 The committee welcomes ASIC's efforts to date in response to the inquiry into its performance by the Senate Economics References Committee. The committee will continue to monitor how ASIC responds to the inquiry and consider the government response to the report. The committee will also continue to monitor ASIC's complaint handling. Following the government response to the Senate economics report, the committee will place a particular focus on the status and efficacy of ASIC's actions in response to the report, in particular with respect to:

- treatment of whistleblowers and actions in response to the information provided; and
- enforcement action against individuals and corporations.

---

8 Mr Warren Day, Senior Executive Leader, Assessment and Intelligence and Victorian Regional Commissioner, *Committee Hansard*, 5 September 2014, p. 39.

9 Mr Warren Day, Senior Executive Leader, Assessment and Intelligence and Victorian Regional Commissioner, *Committee Hansard*, 5 September 2014, p. 39.

10 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 19, p. xxvii.

11 Australian Government, *Australian Government response to the Senate Economics References Committee Report: Performance of the Australian Securities and Investments Commission*, 24 October 2014, pp 10–11.

## ASIC's 2012–13 annual report

3.14 This section discusses the 2012–13 annual report of ASIC. Annual reports of bodies established under the ASIC Act are subject to scrutiny by the Senate Economics Legislation Committee under Senate Standing Order 25(20).<sup>12</sup> Therefore, in conducting its review of the 2012–13 ASIC annual report, this section of the report will focus on the statutory requirements under the ASIC Act. ASIC's activities and the operation of the corporations legislation are discussed later in this chapter.

### *Statutory requirements*

3.15 Statutory requirements for the ASIC annual report are set out in section 136 of the ASIC Act. The requirements cover tabling, distribution and the contents of the annual report.

### *Tabling and distribution*

3.16 The 2012–13 ASIC annual report was provided to the Minister on 17 October 2013, presented to the Senate on 30 October 2013, tabled in the Senate on 12 November 2013 and tabled in the House of Representatives on 13 November 2013.<sup>13</sup> As a result, the legislative requirements as set out below were satisfied:

- Section 136(1), ASIC Act: the ASIC Chairperson, must as soon as practicable after 30 June in each financial year, prepare and give to the Minister a report on ASIC's operations during that financial year; and
- Section 136(3), ASIC Act: the Minister must cause a copy of each annual report to be tabled in each House within 15 sitting days of that House after the day on which the Minister receives the report.<sup>14</sup>

3.17 Section 136(4) of the ASIC Act requires that 'the Minister must cause a copy of each annual report to be sent to the Attorney-General of each State and Territory as soon as practical after the Minister receives the report.' ASIC indicated to the committee that it released the annual report on its website and sent the link to various stakeholders, but did not confirm that the Attorney-General of each state and territory had been provided with a copy as required by section 136(4).<sup>15</sup> The committee looks forward to receiving advice that section 136(4) is satisfied in future.

### *Contents of the annual report*

3.18 The statutory requirements for the contents of the ASIC annual report are set out in sections 136(2)(a–k) and 136(2A) of the ASIC Act. Table 1 lists where in the 2012–13 ASIC annual report the requirements are met.

---

12 The Senate, *Standing Orders and other orders of the Senate*, February 2014, p. 28.

13 Senate Economics Legislation Committee, *Annual reports (no. 1 of 2014)*, March 2014, p. 39.

14 ASIC Act, s. 136.

15 ASIC, Correspondence to the committee, 22 October 2014.

**Table 1: Statutory requirements for the ASIC annual report**

| <b>Section</b>         | <b>Reporting requirement (ASIC Act)</b>  | <b>Coverage in the 2012–13 Annual Report (page numbers)</b>  |
|------------------------|--|--|
| 136(2)(a)              | Specific goals and priorities pursued by ASIC  | Chairman's report (pages 2–4)  |
| 136(2)(b)              | Progress that ASIC has made towards achieving its goals  | Chairman's report (pages 2–4)  |
| 136(2)(c)              | Matters that adversely affected ASIC or hindered pursuit of its goals  | Chairman's report (pages 2–4)  |
| 136(2)(d)              | Performance against performance indicators   | Chairman's report and performance against service charter (pages 2–4, 60–61)   |
| 136(2)(e)              | Exercise of ASIC's power under Part 15 of the <i>Retirement Savings Accounts Act 1997</i> and under Part 29 of the <i>Superannuation Industry (Supervision) Act 1993</i>   | No applications were made to do so (page 153)  |
| 136(2)(f)              | ASIC's monitoring and promotion of market integrity and consumer protection  | Markets regulated population and staffing (pages 13–14), release of new market integrity rules (page 40)   |
| 136(2)(g)              | Joint audit firm inspections with US and Canadian bodies   | One audit firm was inspected jointly with the United States Public Company Accounting Oversight Board (PCAOB). Information was shared with PCAOB. No joint inspections or information shared with the Canadian Public Accountability Board (page 153). |
| 136(2)(h)<br>136(2)(i) | Financial statements required by section 49 of the <i>Financial Management and Accountability Act 1997</i> (FMA Act). Audit report on those statements under section 57 of the <i>Financial Management and Accountability Act 1997</i> | The financial statements are provided in the annual report (pages 83–140). The delegate of the Auditor-General indicates that ASIC's financial statements have been prepared in accordance with the FMA Act (pages 81–82).                             |
| 136(2)(j)              | Operation of the <i>Business Names Registration Act 2011</i>   | Business name registry services are covered on pages 15, 48–49, 122  |
| 136(2)(k),<br>136(2A)  | Information relating to the exercise, by ASIC, members of ASIC, or staff members, of prescribed information gathering powers.  | ASIC's powers are listed on pages 158–159, along with information on how the powers were used.   |

*ASIC Act and the ASIC 2012 – 13 Annual Report (section and page numbers are shown in the table above)*

---

*Committee view*

3.19 The committee notes that the 2012–13 ASIC annual report includes a compliance index. However, the compliance index does not identify the source of all the mandatory requirements listed in the compliance index. In addition, some of the requirements for the annual report set out in section 136 of the ASIC Act are not included in the compliance index.

**Recommendation 1**

**3.20 The committee recommends that the compliance index of ASIC annual reports clearly set out the source of all mandatory and statutory requirements, including section 136 of the ASIC Act.**

3.21 The committee also notes that ASIC has undergone and will continue to undergo significant changes. Monitoring of trends will be important to determine the effectiveness of the changes. The committee questioned ASIC in relation to trends and on a number of matters from the annual report, including recruitment, the graduate program, infringement notices and penalties, structural change and the impact of the growth in superannuation, and transparency in decision making.<sup>16</sup>

3.22 The ability of the committee to provide effective oversight of ASIC is partly dependent on access to information showing trends in ASIC's performance. The annual report contains useful information on recent performance, including some trend information on page 152 of the annual report. At a public hearing in March 2014, the committee specifically asked ASIC to enhance the provision of trend data and information in future annual reports.<sup>17</sup>

**Recommendation 2**

**3.23 The committee recommends that in future annual reports, ASIC include performance data over longer periods to allow trends in performance to be analysed.**

**ASIC's statement of expectations**

3.24 This section discusses the committee's consideration of ASIC's performance against the government's statement of expectations, which was updated in April 2014. ASIC's statement of intent in response to the government's statement of expectations was updated in July 2014.<sup>18</sup>

3.25 The Senate Economics References Committee recommended that the committee monitor ASIC's performance against the government's statement of expectations and ASIC's statement of intent as part of its statutory ASIC oversight

---

16 *Committee Hansard*, 28 March 2014, pp 13–14, 16, 17, 26.

17 *Committee Hansard*, 28 March 2014, p. 27.

18 ASIC Statement of Expectations and Statement of Intent, <http://www.asic.gov.au/asic/asic.nsf/byheadline/Statement+of+expectations+and+statement+of+intent?openDocument>, (accessed 11 September 2014).

function.<sup>19</sup> At its September 2014 oversight hearing the committee questioned ASIC about several aspects of its performance against the government's statement of expectations including the areas discussed below.

3.26 The government's deregulation agenda forms a significant part of the government's statement of expectations for ASIC. There is a requirement for ASIC to look for opportunities to reduce compliance costs for business and the community and contribute to the government's \$1 billion red and green tape reduction target.<sup>20</sup> ASIC informed the committee that:

A target was set for savings on an annualised basis of around \$40 million per year. We have achieved that target already. We still have quite a degree of time to run before the relevant period ends. In terms of how we have achieved that target, there are a number of ways. A significant part of ASIC's role is facilitating business. To that end, we have what we call relief powers. They are in fact an ability to provide waivers for the law where the law operates in an anomalous or unintended way. We receive thousands of applications to exercise those powers each year. We would grant those waivers in—it varies—between about 70 and 80 per cent of cases, and that is a significant cost saving for business.<sup>21</sup>

3.27 Finding the right balance between reducing the regulatory burden on business while maintaining sufficient protections for consumers and investors is an underlying theme of much of ASIC's work. ASIC informed the committee that:

In our response to the government's statement of expectations, we have said that we are focused on the deregulatory agenda, but it is within the context of making sure that the fundamental objective of what we have to achieve is to make sure that investors have trust and confidence. Whatever we do, that goes to the heart of what we do—trust and confidence.<sup>22</sup>

3.28 ASIC also undertakes work on potential law reform options with a deregulatory focus. A number of law reform options were identified in Report 391 *ASIC's deregulatory initiatives*, including:

- simplifying wholly owned financial reporting relief;
- allowing market stabilisation activities in appropriate circumstances;
- enabling automatic registration for managed investment schemes under section 601EB of the Corporations Act;

---

19 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 52, p. 426.

20 Australian Government, *Statement of Expectations – Australian Securities and Investments Commission*, April 2014.

21 Mr John Price, Commissioner, ASIC, *Committee Hansard*, 5 September 2014, pp 9–10.

22 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 5 September 2014, p. 12.

- replacing the requirement for an unlisted disclosing entity to lodge continuous disclosures with ASIC with a requirement to instead publish disclosures on the entity's website; and
- amending the content of the forms to be lodged under section 671B (information about substantial holdings) to address market concerns.<sup>23</sup>

3.29 In addition, the Corporations Act has been significantly modified by regulations and ASIC class orders over a period of time. These modifications can make it difficult to navigate the law. ASIC indicated to the committee that it has suggested a legislative rationalisation project to amend Chapter 7 of the Corporations Act to take into account modifying regulations. ASIC advised the committee that in their view the project:

...would reduce the complexity of Chapter 7 and improve the transparency of the law and assist users of Chapter 7 to identify and understand the relevant regulatory requirements more easily. It may also improve compliance and reduce expenses on legal services after an initial transition period, though we have not undertaken a detailed analysis of the financial costs associated with a rationalisation of Chapter 7.<sup>24</sup>

#### *Committee view*

3.30 The committee notes ASIC's performance against the statement of expectations and welcomes ASIC's contributions to deregulation, while maintaining protections for consumers and investors. As noted earlier in this chapter, the committee's examination of ASIC has been undertaken in the context of avoiding unnecessary duplication of the FSI and the Senate Economics References Committee inquiry into the performance of ASIC. The committee will carefully examine ASIC's implementation of the government responses to both inquiries and will continue its detailed scrutiny of ASIC's performance in the next oversight report.

3.31 The committee supports the general principle of reducing the complexity of Chapter 7 of the Corporations Act. The committee will continue to monitor ASIC's performance against the government's statement of expectations and ASIC's contribution to deregulation.

### **Emerging issues**

3.32 As noted earlier in this chapter, the Senate Economics References Committee recommended the committee increase its focus on emerging issues that have the potential to lead to widespread investor losses and fraud.<sup>25</sup> In this report, the committee considers emerging issues relating to social impact bonds, digital currencies, high-frequency trading and dark pools.

---

23 ASIC, *Answer to question on notice*, 5 September 2014, (received 3 October 2014).

24 ASIC, *Answer to question on notice*, 5 September 2014, (received 3 October 2014).

25 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, recommendation 52, p. xxxiii.

3.33 The committee questioned ASIC on its approach to emerging issues. ASIC informed the committee that it continuously seeks to detect and understand emerging systemic, product/sector and firm issues. ASIC has implemented a number of initiatives to better understand the regulated industries, and to proactively detect and respond to emerging issues. These initiatives include:

- outwardly focused stakeholder teams;
- an Emerging Risk Committee;
- an External Advisory Panel, Director Advisory Panel, Market Supervision Advisory Panel, and a Consumer Advisory Panel;
- a strategy group to pursue ASIC's strategic priorities and address strategic risks;
- monitoring trends in reports of misconduct;
- engaging with other regulators; and
- communicating with stakeholders.<sup>26</sup>

### ***Social impact bonds***

3.34 This section discusses the committee's consideration of social impact bonds. Social impact bonds are also referred to as social benefit bonds or social innovation bonds. Social impact bonds offer an alternative source to direct taxpayer funding or philanthropic funding of social services or social enterprise.

3.35 Governments using social impact bonds for a particular activity or service enter a contractual agreement with an intermediary or bond-issuing organisation that raises capital from a variety of independent sources including banks, foundations and individuals. If the project achieves its objectives, government repays the investors with returns based on the savings the government accrues as a result of the program's success. Social impact bonds shift the risk of investment from the public to the private sector.<sup>27</sup>

3.36 In 2009 the Rockefeller Foundation<sup>28</sup> provided a grant to Social Finance UK to develop an innovative finance tool called the social impact bond which was intended to use private dollars to fund proven programs designed to reduce or

---

26 ASIC, *Answer to question on notice*, 5 September 2014, (received 3 October 2014).

27 Pettus, A., *Pay for progress: social impact bonds*, *Harvard Magazine*, July August 2013, <http://harvardmagazine.com/2013/07/social-impact-bonds> (accessed 22 November 2013).

28 The Rockefeller Foundation is a philanthropic organisation in the USA devoted to funding impact based innovation around 4 themes: Revalue Ecosystems; Advance Health; Secure Livelihoods; and Transform Cities. For more information see: <http://www.rockefellerfoundation.org/>

eliminate social problems.<sup>29</sup> Since this time Social Finance UK has developed social impact bonds in relation to criminal justice, homelessness, vulnerable children, unemployment, adoption and drug rehabilitation.<sup>30</sup>

3.37 The first social impact bond, released in 2010 and called *The One*, aims to reduce reoffending amongst male prisoners leaving Her Majesty's Prison Peterborough in the United Kingdom who serve a sentence of less than 12 months. During the Peterborough Prison pilot, experienced social sector organisations provide intensive support to 3,000 short-term prisoners over a six year period, both inside prison and after release to help them resettle into the community. The program will be evaluated over the six year period and the first available data towards the target objective will be available in year four of the program.<sup>31</sup>

3.38 In the United States of America, the Obama administration has allocated \$US100 million for seven 'pay for success' pilot programs (similar to social impact bonds).<sup>32</sup>

3.39 Social impact bonds are described as a risk free option for governments as they pay only if the program delivers on its stated objectives. However as noted by McKinsey and Company, social impact bonds do not offer a perfect solution for financing every social problem.

[Social impact bonds] are structured to get proven solutions to scale with no risk to public budgets—governments pay for the solutions only if they work. But despite this risk shifting, a [Social impact bond's] structure involves several actors—each charging a fee or return. As a result, this tool is a more expensive way to scale programs than if government simply contracted directly with a service provider. These additional costs will be worth it in many cases, but SIBs won't be suited to every situation.<sup>33</sup>

#### *Social impact bonds in Australia*

3.40 In 2010, the Productivity Commission in its report, *Contribution of the not-for-profit sector*, found that there was 'potential for greater social innovation but the business planning capabilities and incentives for collaboration need to be

---

29 Joseph, J., 'Social Innovation in Acceleration: Building the Social Impact Bond Ecosystem', *Forbes*, 4 November 2013, available at <http://www.forbes.com/sites/skollworldforum/2013/04/11/building-the-social-impact-bond-ecosystem/> (accessed 22 November 2013).

30 Social Finance UK, <http://www.socialfinance.org.uk/work/sibs> (accessed 25 November 2013).

31 Social Finance UK, <http://www.socialfinance.org.uk/resources/social-finance/social-impact-bonds-one-service-one-year> (accessed 25 November 2013).

32 Senate Economics References Committee, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, November 2011, p. 150.

33 McKinsey and Company, *From Potential to Action: Bringing Social Impact Bonds to the U.S.* May 2012, <http://mckinseysociety.com/social-impact-bonds/>, (accessed 22 November 2013).

strengthened.<sup>34</sup> The Productivity Commission also found that there was a need to strengthen the capacity for not-for-profit organisations to access debt financing for social investment.<sup>35</sup>

3.41 In November 2011, the Senate Economics References Committee tabled a report titled *Investing for good: the development of a capital market for the not-for-profit sector in Australia* (2011 Economics Committee Report). The 2011 Economics Committee Report explored options for developing a mature capital market for the social economy sector in Australia and found that many not-for-profit organisations lacked a steady revenue stream to attract investment and the collateral to guarantee loans. They were also grant focussed and risk averse to debt and equity capital, and lacked the capacity and organisational structure to raise equity capital.<sup>36</sup>

3.42 Other constraints for accessing capital reflected the limitations of mainstream financial institutions which were:

...unaware of the needs of social economy organisations, while others are dissuaded by the large transactions costs relative to the capital required by these organisations. In addition, the market has been stymied to some degree by the lack of an enabling regulatory environment and, in particular, the lack of targeted incentives for financial intermediaries.<sup>37</sup>

3.43 The Economics committee reported on attempts to quantify the potential size of the social impact investment market, with the United States market estimated at up to US\$120 billion and approximately CAD\$30 billion in Canada.<sup>38</sup> The Economics committee noted that the Centre for Social Impact has noted that 'the potential scale of the capital market for social investment in Australia could be worth \$10 billion, with \$7 billion identified in managed funds and a further \$3 billion in superannuation funds.'<sup>39</sup>

3.44 The Economics committee recommended:

- action to examine ways to create incentives to invest in a social bond market in Australia;

---

34 Productivity Commission, 'Key Points', *Contribution of the not-for-profit sector*, 11 February 2010.

35 Productivity Commission, 'Key Points', *Contribution of the not-for-profit sector*, 11 February 2010.

36 Senate Economics References Committee, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, November 2011, p. xix.

37 Senate Economics References Committee, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, November 2011, p. xix.

38 Senate Economics References Committee, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, November 2011, p. 132.

39 Senate Economics References Committee, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, November 2011, p. 132.

- identifying policy areas where social impact bonds could be applied, including intractable problems in indigenous communities; and
- implementing a social impact bond trial.<sup>40</sup>

3.45 In 2013, the Senate Legal and Constitutional Affairs References Committee, as part of its inquiry into justice reinvestment, considered the possible use of social investment tools in relation to the justice system. The committee concluded:

...that there is much that appeals about the justice reinvestment approach particularly its use of comprehensive data collection and rigorous analysis to create all-inclusive, cohesive program options that target the determinants of crime and thereby reduce offending and spending on prison.<sup>41</sup>

3.46 In March 2013, the New South Wales government announced Australia's first contract using social impact bonds to fund UnitingCare Burnside's New Parent and Infant Network (Newpin) program that works intensively with struggling families to keep them safely together. On 4 June 2013, Social Ventures Australia announced they had successfully raised the required \$7 million to finance the bond, one month before the scheduled close.<sup>42</sup>

3.47 In June 2013, the NSW government announced the signing of a contract for a second pilot, a Resilient Families Service provided by The Benevolent Society. The aim of that pilot is to strengthen family functioning and relationships, and ensure children's safety and wellbeing in order to prevent children entering into out-of-home-care.<sup>43</sup>

3.48 The committee had private briefings from three Australian experts on social impact bonds. The committee also sought information from ASIC at its March 2014 oversight hearing. ASIC informed the committee that:

Social Bonds are debentures under the *Corporations Act 2001*. If offered to retail investors the disclosure, trustee and licensing provisions of the Act would apply to any charitable or not-for profit issuer of Social Bonds. ASIC provides relief to charities from some of the requirements of the Act in connection with the issuing of debentures. If the debentures are issued by state or territory governments or certain exempt bodies, the Corporations Act provisions generally do not apply.

---

40 Senate Economics References Committee, *Investing for good: the development of a capital market for the not-for-profit sector in Australia*, November 2011, pp 157–158.

41 Senate Legal and Constitutional Affairs References Committee, *Value of a justice reinvestment approach to criminal justice in Australia*, June 2013, p. 61.

42 NSW Treasury, 'Social benefit bonds trial in NSW', available at [http://www.treasury.nsw.gov.au/site\\_plan/social\\_benefit\\_bonds/social\\_benefit\\_bonds\\_trial\\_in\\_nsw\\_FAQs](http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs), (accessed 25 November 2013).

43 NSW Treasury, 'Social benefit bonds trial in NSW', available at [http://www.treasury.nsw.gov.au/site\\_plan/social\\_benefit\\_bonds/social\\_benefit\\_bonds\\_trial\\_in\\_nsw\\_FAQs](http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs)

We note that the issuance of these financial products can be accommodated within the regulatory settings of the Corporations Act.<sup>44</sup>

*Committee view*

3.49 The committee considered whether there would be value in conducting an inquiry into the adequacy of current regulatory arrangements for social impact bonds. The committee concluded that such an inquiry would have value when more experience had been gained from some of the existing and planned uses of social impact bonds in Australia and overseas. The committee will continue to monitor developments around social impact bonds.

***Digital currencies including Bitcoin***

3.50 This section discusses the committee's consideration of developments in digital and cryptographic currencies including Bitcoin.

3.51 Bitcoin technology commenced in 2009 and has a number of unique features, which distinguish it from mainstream currencies.<sup>45</sup> Bitcoin is a decentralised digital currency system that operates using a peer-to-peer network. Unlike other currencies, it has no central authority or government backing.<sup>46</sup> The essential characteristics of the Bitcoin system are:

- there is no 'mint' or other trusted parties;
- participants may be anonymous;
- new coins are 'mined' through a cryptographic process; and
- the same cryptographic process is used to prevent double spending.<sup>47</sup>

3.52 Initially Bitcoins could be obtained for less than a dollar each but in November 2013 Bitcoins were valued at around \$1000 per Bitcoin.<sup>48</sup> Bitcoins can now be traded for other currencies or for a growing range of goods and services. Bitcoins can be bought from currency exchanges and the options for purchasing and using Bitcoins are growing. Exchanges make money from Bitcoins by taking a fee for transactions. There have been some 'crashes' of Bitcoin exchanges, leading to uncertainty in the future of the currency.

---

44 ASIC, *Answer to question on notice*, 28 March 2014, (received 9 May 2014).

45 Lee Suckling, *A Guide to Bitcoin*, *Sydney Morning Herald*, 1 June 2013.

46 Daniel Miller, *Bitcoin explained: the digital currency making millionaires*, *ABC News*, 13 December 2013.

47 Alan L Tyree, *Bitcoin*, 29 June 2011, <http://austlii.edu.au/~alan/bitcoin.html>, (accessed 22 October 2014).

48 Daniel Miller, *Bitcoin explained: the digital currency making millionaires*, *ABC News*, 13 December 2013.

3.53 Bitcoin cannot be analysed in terms of traditional banking law concepts and due to its intangible nature it may be difficult to regulate, especially by any domestic government.<sup>49</sup>

3.54 Some governments are attempting to increase scrutiny of digital currencies. In July 2013 the central bank of Thailand declared that trading in Bitcoins, or using them to buy or sell goods, was illegal. The central bank stated that, '...due to lack of existing laws to deal with the virtual currency, and its nebulous place in the financial industry, they were outside of applicable existing laws and therefore illegal'.<sup>50</sup>

3.55 The Australian Tax Office has released guidance information and rulings on crypto currencies including Bitcoin. The guidance notes indicate that:

Transacting with Bitcoins is akin to a barter arrangement, with similar tax consequences.

The ATO's view is that Bitcoin is neither money nor a foreign currency, and the supply of Bitcoin is not a financial supply for goods and services tax (GST) purposes. Bitcoin is, however, an asset for capital gains tax (CGT) purposes.<sup>51</sup>

3.56 The committee received a private briefing on crypto currencies including Bitcoin and sought further evidence at a public hearing. ASIC has published information for consumers about virtual currencies and the risks associated with using these currencies on its MoneySmart website. ASIC informed the committee of its approach to Bitcoin:

Virtual currencies such as Bitcoins are a developing area globally. ASIC monitors new developments in the marketplace and, accordingly, ASIC is considering whether and how the legislation it administers, such as the Corporations Act, applies to virtual currencies.

ASIC's view is that Bitcoins themselves (and other virtual currencies) are not financial products and are not regulated under the legislation we administer. Unlike Australian dollars or other traditional currencies, Bitcoins are not issued by a central bank and do not give the Bitcoin holder any right to make payments in this form.

ASIC is consulting with other Australian regulators that are also giving consideration to the regulation of virtual currencies. This includes both financial regulators and law enforcement agencies that are examining the

---

49 Alan L Tyree, *Bitcoin*, 29 June 2011, <http://austlii.edu.au/~alan/bitcoin.html>, (accessed 22 October 2014).

50 Roundtree, D, *Champing at the Bitcoin: Bitcoin, Regulators and the Law*, *Communications Law Bulletin*, Vol 32.4, October 2013.

51 Australian Taxation Office, *Tax treatment of crypto-currencies in Australia – specifically Bitcoin*, <https://www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/>, 20 August 2014, (accessed 16 October 2014).

use of Bitcoin in criminal activities. Additionally, the regulation of Bitcoins is being considered by regulators and policy makers internationally.<sup>52</sup>

#### *Committee view*

3.57 The committee notes that the Senate Economics References Committee has a current inquiry into digital currencies, covering the development of an effective regulatory system, the impact of digital currencies on the Australian economy and how Australia can take advantage of digital currency technology. The committee will continue to monitor the development of digital currencies.

#### ***High-frequency trading and dark pools***

3.58 Since August 2010, ASIC has had responsibility for the supervision of real-time equities trading on Australia's domestic licensed markets. Part of ASIC's remit is to examine market changes and determine the adequacy of the existing regulatory regime.<sup>53</sup> Australia's financial markets are undergoing significant structural and behavioural changes.<sup>54</sup> Two areas of evolution, both within Australia and globally, involve high-frequency trading and dark liquidity (also referred to as dark venues or dark pools) are discussed below.

3.59 Dark liquidity refers to client orders that are matched away from the 'lit' exchange market. There is no pre-trade transparency with dark trading because the orders are not displayed on order books and are 'not known to the rest of the market before the orders are matched as executed trades'.<sup>55</sup> Dark trades in Australia can occur on both the public exchange markets, such as the ASX's Centre Point and hidden orders on Chi-X's order book, as well as at unlicensed venues away from the markets.<sup>56</sup>

3.60 High-frequency trading is a subset of algorithmic trading. ASIC distinguishes high-frequency trading from algorithmic trading and notes that high-frequency trading exhibits the following characteristics:

- high daily portfolio turnover;
- high order-to-trade ratios where large numbers of trades are cancelled in comparison to trades executed;
- flat or near flat positions at the end of the trading day;

---

52 ASIC, *Answer to question on notice*, 28 March 2014, (received 9 May 2014).

53 Australian Securities and Investments Commission, *ASIC supervision of markets and participants: July to December 2012*, Report 327, February 2013, p. 4.

54 Australian Securities and Investments Commission, *Dark liquidity and high-frequency trading* Report 331, March 2013, p. 5.

55 Australian Securities and Investments Commission, *Dark liquidity and high-frequency trading*, Report 331, March 2013, p. 12.

56 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, Number 2, May 2013, p. 26.

- 
- holding positions for as little as seconds or fractions of a second; and
  - reliance on the ability to be faster than competitors and to take advantage of services such as direct electronic access and co-location.<sup>57</sup>

3.61 In mid-2012, ASIC established two taskforces to inquire into and report on high-frequency trading and dark liquidity. The following reports from the taskforces were released in March 2013:

- Report 331: Dark liquidity and high-frequency trading; and
- Consultation Paper 202: *Dark liquidity and high-frequency trading*.

3.62 The committee considered the above reports in its May 2013 report on ASIC oversight, covering issues including:

- inconsistency between lit markets and dark venues;
- detrimental impacts on efficient price formation in lit markets;
- conflicts of interest between market participants and clients; and
- impacts on investor confidence.<sup>58</sup>

3.63 In response to concerns about dark liquidity and high-frequency trading, the government introduced Market Integrity Rules relating to dark liquidity and automated trading that took effect between May 2013 and May 2014. On 19 May 2014 ASIC released a review of the above rules which indicated that the trends in dark liquidity that were of some concern have discontinued. The review showed that:

- fairness issues associated with below block size dark orders stepping ahead of lit orders have been addressed;
- the bid-offer spread is more equitably distributed between parties executing below block size dark trades;
- the meaningful price improvement rule and change in block tier thresholds has not affected bid-offer spreads; and
- participants can now trade smaller blocks away from lit markets where they would have traditionally faced higher market impact costs.<sup>59</sup>

3.64 The committee has received correspondence raising concerns about systematic trading and price manipulation of particular equities. The committee raised some of these concerns with ASIC.

---

57 Australian Securities and Investments Commission, *Dark liquidity and high-frequency trading*, Report 331, March 2013, pp 12–13.

58 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, Number 2, May 2013, p. 27.

59 ASIC, media release 14-105MR, *ASIC reports on dark liquidity rules*, 19 May 2014.

3.65 ASIC informed the committee about its Market Analysis Intelligence (MAI) system, which is built around algorithmic trading technology. The MAI system provides ASIC with an enhanced capability to detect, investigate and prosecute trading breaches. The system provides sophisticated data analytics to identify suspicious trading in real time and across markets to identify breaches including inside trading and market manipulation.<sup>60</sup>

#### *Committee view*

3.66 Following a demonstration of the MAI system in September 2014 by ASIC, the committee is reassured that ASIC currently has the capability to detect and investigate misconduct in Australian financial markets. The committee is mindful that there will continue to be market participants with access to rapidly evolving technologies, who will seek to trade unfairly outside the rules. ASIC must remain vigilant and vigorously pursue technological changes to maintain its capacity to detect and investigate misconduct in Australian financial markets. The committee will continue to monitor its performance in this area.

### **Penalties**

3.67 This section discusses the committee's consideration of penalties available to ASIC. ASIC raised the issue of penalties with the committee in its opening statement at the March 2014 oversight hearing. At the September 2014 oversight hearing Mr Medcraft informed the committee that:

We are in finance so fear versus greed governs a lot of behaviour. Therefore, unfortunately you have to make sure that people think twice about breaking the law. The fact you that you have a fear of being detected and then you have a fear when somebody does find you of what will happen. They are the two big principles of behaviour.<sup>61</sup>

3.68 In March 2014, ASIC released Report 387 *Penalties for corporate wrongdoing*. Report 387 examined whether penalties for corporate wrongdoing in Australia were proportionate and consistent by comparing ASIC's penalties across ASIC, other Australian regulators and other countries. Report 387 covered misconduct that occurs in the corporate, financial markets or financial services sectors, involving insider trading, market manipulation, continuous disclosure, false statements to the market, inappropriate advice, unlicensed conduct, fraud, and false or misleading representations.<sup>62</sup> The main findings of ASIC's Report 387 were that:

- on a comparison across ASIC's regime, there are differences between the types and size of penalties for similar wrongdoing. For example, providing credit without a licence can attract a civil penalty up to ten times greater than the criminal fine for those who provide financial services without a licence;

---

60 Mr Greg Medcraft, Chairman, ASIC, *Opening statement*, 28 March 2014, pp 7–8.

61 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 5 September 2014, p. 34.

62 ASIC, Media Release, 14-055MR, *ASIC reports on penalties for corporate wrongdoing*, 20 March 2014.

- on a comparison with other Australian regulators, the maximum civil penalties available to ASIC are lower than those available to other regulators and are fixed amounts, not multiples of the financial benefits obtained from wrongdoing; and
- on an international comparison, maximum criminal penalties (jail and fines) are broadly consistent with those available in other countries, there are significantly higher prison terms in the US, and higher fines in some overseas countries for certain offences. There is a broader range of civil and administrative penalties in other countries, penalties are higher, and in some countries penalties include disgorgement, which is the ability to remove financial benefit from wrongdoing.<sup>63</sup>

3.69 Mr Medcraft provided some examples of the differences between penalties available to ASIC and the Australian Competition and Consumer Commission (ACCC):

The second thing is that we compared them between ourselves and other Australian law enforcement agencies. Again, we found, for example, that for individuals the maximum penalty that we can levy at the moment is \$200,000 for a breach of corporations law. For the ACCC, for example, the maximum is \$500,000. On corporations, the maximum we can levy is currently \$1 million. For the ACCC, it is \$10 million or the higher of three times the benefit.<sup>64</sup>

3.70 ASIC also informed the committee that they considered that changes were needed to the indexation of penalties and to relate penalties to the benefit gained from the misconduct:

First of all, they are not indexed to inflation. Many of them were set 20 years ago so with inflation they are half as effective. They probably should be in units. Secondly, at the end of the day they do not really reflect fear versus greed. For example, there is no concept that on the amount of harm or loss you cause the penalty is a multiple of that. If you think about it, if you do insider trading and you make a million bucks but the penalty is \$50,000, you would probably do the trade.<sup>65</sup>

3.71 The former Chief Executive Officer of the New Zealand Financial Markets Authority Mr Sean Hughes noted the difference between penalties in Australia and New Zealand:

I noticed in its submission to the financial system inquiry that ASIC provided a comparison between penalty regimes and that, by and large—and I am summarising here—Australian penalties were mostly larger than the ones that apply in New Zealand. There are some instances where they

---

63 ASIC, Media Release, 14-055MR, *ASIC reports on penalties for corporate wrongdoing*, 20 March 2014.

64 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 28 March 2014, p. 16.

65 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 5 September 2014, p. 34.

are the same. I think there is one example where they are less, and that relates to the three times rule for disgorgement.<sup>66</sup>

3.72 The Senate Economics References Committee inquiry into the performance of ASIC gave some consideration to penalties available to ASIC and commented that:

ASIC's enforcement role is one of its most important functions. ASIC needs to be respected and feared. It needs to send a clear and unmistakeable message, backed-up and continually reinforced by actions, that ASIC has the necessary enforcement tools and resources and is ready to use them to uphold accepted standards of conduct and the integrity of the markets. To assist ASIC with this, the penalties currently available for contraventions of the legislation ASIC administers should be reviewed to ensure they are set at appropriate levels. Monetary penalties may also need to become more responsive to misconduct, with multiple of gain penalties or penalties combined with disgorgement considered.<sup>67</sup>

3.73 The Senate Economics References Committee went on to make the following recommendation in relation to penalties available to ASIC:

Recommendation 41

The committee recommends that the government commission an inquiry into the current criminal and civil penalties available across the legislation ASIC administers. The inquiry should consider:

- the consistency of criminal penalties, and whether some comparable offences currently attract inconsistent penalties;
- the range of civil penalty provisions available in the legislation ASIC administers and whether they are consistent with other civil penalties for corporations; and
- the level of civil penalty amounts, and whether the legislation should provide for the removal of any financial benefit.<sup>68</sup>

3.74 The government response to the inquiry indicated that the government would consider recommendation 41 as part of its broader response to the FSI.<sup>69</sup>

3.75 The FSI is also considering penalties available to ASIC. The interim report of the FSI sought views on a review of the penalty regime in the Corporations Act and observed that regulators' mandates and powers are generally well defined and clear; however, more could be done to emphasise competition matters. In addition, the FSI

---

66 Mr Sean Hughes, *Committee Hansard*, 5 September 2015, p. 5.

67 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. xxi.

68 Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. xxxi.

69 Australian Government, *Australian Government response to the Senate Economics References Committee Report: Performances of the Australian Securities and Investments Commission*, 24 October 2014, p. 21.

noted that ASIC has a broad mandate, and the civil and administrative penalties available to it are comparatively low in relation to comparable peers internationally.<sup>70</sup>

3.76 The FSI interim report also identified that there were gaps in ASIC's penalties compared to other jurisdictions:

ASIC's mandate also has important gaps when compared to major domestic and international jurisdictions. For non-criminal proceedings, ASIC does not have the power of disgorgement available in Canada, Hong Kong, the United Kingdom and the United States. ASIC cannot impose fines on AFSL holders, although it can suspend or revoke their licence.<sup>71</sup>

3.77 The FSI interim report sought views from stakeholders on whether a stronger penalty regime could strengthen the impact of ASIC's enforcement action and provide a more effective deterrent message against misconduct. The FSI interim report suggested that a review of penalties under ASIC-administered legislation explore:

- the adequacy of maximum criminal penalties;
- the availability and level of civil penalties, including the potential of using multiples of benefit obtained and converting the current maximums into penalty units;
- the availability of administrative penalties; and
- introducing disgorgement in non-criminal proceedings to remove any financial benefit, including profits or avoided losses, obtained illegally.<sup>72</sup>

#### *Arguments against raising penalties*

3.78 The committee has not had the opportunity to examine arguments about raising penalties available to ASIC. However, Mr Hughes drew the committee's attention to challenges that can arise for civil liberties if regulators have an ability to set their own penalties:

If I could answer your question this way: my experience has been that funds generally go back into the public purse and therefore it is then a question of the head of the agency negotiating with government as to what proportion of that they receive. I do believe, if I were putting a civil libertarian hat on, that there could be a question about whether it is appropriate for regulators to set their own fines without any form of judicial or other independent oversight. I do believe it would be important to have some checks and balances in place.<sup>73</sup>

3.79 The committee also questioned ASIC about penalties in relation to insider trading and proceeds of crime. ASIC confirmed that penalties had been increased for

---

70 Financial System Inquiry, *Interim Report*, July 2014, p. xxxvii.

71 Financial System Inquiry, *Interim Report*, July 2014, p. 3-125.

72 Financial System Inquiry, *Interim Report*, July 2014, p. 3-127.

73 Mr Sean Hughes, *Committee Hansard*, 5 September 2015, p. 6.

criminal insider trading where fines can be three times the benefit gained. However, civil penalties for insider trading are lower.<sup>74</sup> ASIC also acknowledged that it was uncommon to find insider trading without a criminal element.<sup>75</sup> ASIC informed the committee that similar issues arose for proceeds of crime cases:

The insider trading provision is the same. The requirement is the same whether we pursue it criminally or civilly. It is the same test. Obviously the standard of proof is different and the mechanics of the litigation are different, but it is the same legislative requirement. ASIC makes a decision as to whether it is better pursued criminally or, alternatively, whether it is better pursued civilly. It may depend on that standard of proof and the seriousness of it. The issue here is whether the civil remedies are adequate, and it might explain why almost all of our insider trading cases are pursued criminally. So we do pursue that and we do pursue proceeds of crime.<sup>76</sup>

#### *Committee view*

3.80 Noting the above evidence and that ASIC's penalties have not been reviewed for over a decade,<sup>77</sup> the committee supports a thorough review of ASIC's penalties being undertaken by the government along the lines suggested by the FSI and the Senate Economics References Committee. The main source of information presently available is Report 387, which was prepared by ASIC. The committee would therefore encourage the government to undertake a thorough consultation process to ensure that a broad range of stakeholders are able to contribute their views.

3.81 The committee notes that the government intends to respond to the final FSI report taking into account feedback following the interim report. It is the committee's view that unless the interim report has generated a sufficient body of additional evidence from a range of stakeholders regarding ASIC penalties, the government should follow the recommendations of FSI and the Senate Economics References Committee and hold an inquiry prior to determining a new penalty regime.

### **Recommendation 3**

**3.82 The committee recommends that the government undertake a review of penalties available to ASIC and that the review include a broadly based consultation process.**

## **Senator David Fawcett**

### **Chair**

---

74 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 5 September 2014, p. 34.

75 Ms Cathie Armour, Commissioner, ASIC, *Committee Hansard*, 5 September 2014, p. 34.

76 Mr Chris Savundra, Senior Executive Leader, Markets Enforcement, ASIC, *Committee Hansard*, 5 September 2015, p. 35.

77 ASIC, *Supplementary submission 45.2 to Submission 45*, p. 13.