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Institute of Public Affairs

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Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Secretary

Submission to the Senate Economics References Committee Inquiry into Australian Securities and Investments Commission Investigation and Enforcement

This submission has been prepared for the Senate Economics References Committee regarding its inquiry into the Australian Securities and Investments Commission investigation and enforcement activities. The aspects of the terms of reference which are dealt with in the submission are:

> The capacity and capability of the Australian Securities and Investments Commission (ASIC) to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct, with particular reference to:
> …
> (b) the balance in policy settings that deliver an efficient market but also effectively deter poor behaviour;…
> (d) the range and use of various regulatory tools and their effectiveness in contributing to good market outcomes;
> (e) the offences from which penalties can be considered and the nature of liability in these offences;
> (f) the resourcing allocated to ensure investigations and enforcement action progresses in a timely manner; …

This submission makes the following findings:

- Imposing criminal penalties with respect to corporate offending, based on the disproven theory of marginal general deterrence, is not effective at deterring bad behaviour.
- Imposing criminal penalties is a disproportionate response to corporate wrongdoing.
- White collar offenders should not be incarcerated, but should be made to financially pay for their crimes through restitution.

In making this submission, we understand that part of the catalyst for this Inquiry is the view that ASIC is not conducting enough investigations and prosecutions.[1] The recommendations

[1] Shane Wright, '"ASIC must get better": Watchdog to face two-year Senate inquiry into its handling of complaints,' *The Sydney Morning Herald*, 27 October 2023

…/2

in this submission do not support this sentiment. The Committee will benefit considerably by receiving evidence-based recommendations which can be used to ensure that the activities of ASIC are conducted in a manner which is of greatest utility to the community.

1 ASIC's purpose, activities, size, and scale

In order to understand the capacity of ASIC, the best reference point is its budget. The revenue of ASIC is approximately $422 million in appropriation revenue from the government. ASIC also received approximately $68 million of own-source revenue.[2] Thus it has a budget of approximately half a billion dollars annually. Its main resource is its staff: ASIC has approximately 2,000 equivalent full-time employees.[3] Given the size and manpower of ASIC, it is important to ensure these resources are meeting its legislative responsibilities in a proportionate and efficient way.

In making this submission, it is important to understand the overarching role of ASIC. ASIC describes its legislative responsibilities as being to strive to:

- maintain, facilitate and improve the performance of the financial system and entities within it in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy
- promote confident and informed participation by investors and consumers in the financial system
- administer the law effectively and with minimal procedural requirements
- receive, process and store – efficiently and quickly – the information we receive
- make information about companies and other bodies available to the public as soon as practicable
- take whatever action we can, and which is necessary, to enforce and give effect to the law.[4]

The above aims and activities are very broad and somewhat nebulous. It is necessary to strip them back to the core elements that are necessary for the market to operate fairly and efficiently. For this to occur, two broad key elements need to be satisfied.

The first is the need for the absence of complex and burdensome compliance and regulatory hurdles. That is, it must be relatively easy for all people and entities to undertake transactions without undue compliance requirements.

The second is substantive in nature, and this is where the enforcement aspect applies. People must be able to easily access relevant information relating to financial transactions so that they can make informed decisions regarding whether to participate in market transactions. The relevant information must be accurate and readily comprehensible. In relation to information, there are two base requirements. First, the minimal standard that must always be met is that it must be free of misleading or deceptive representations. Second, there is a positive

<https://www.smh.com.au/politics/federal/corporate-watchdog-to-be-grilled-over-its-handling-of-complaints-20221027-p5bte7 html>.
[2] Ibid, 146.
[3] Ibid, 218: As of 30 June 2022, ASIC had a total of 1,947 full time equivalent employees.
[4] Australian Securities and Investments Commission, *Annual Report 2021-2022* (2022) <https://download.asic.gov.au/media/10dg0aqv/asic-annual-report-2021-22_full.pdf, 9.>.

requirement; namely, that the information provided to consumers must be accessible and accurate.

2 Imposing criminal penalties with respect to corporate offending, based on the disproven theory of marginal general deterrence, is not effective at deterring bad behaviour

The primary role of ASIC is to ensure that institutions comply with the law and do not mislead or deceive consumers and more specifically to ensure that institutions do not unfairly or unlawfully deprive people of their money and other resources. The important issue that then arises is how this goal can be achieved most efficiently and effectively. Enforcement is the 'sharp end' of ASIC's law-obedience activities. In determining how ASIC should undertake its enforcement and investigative activities, it is important to understand what can be achieved through coercive commands and the imposition of adverse consequences on entities that do not comply with the law. To that end, the harshest consequences that ASIC pursues are criminal sanctions, the most severe of which is imprisonment.

Orthodox thinking suggests that compliance with the law can be achieved by taking strict enforcement actions that carry harsh penalties against companies and their officers and to promulgate the outcome of these actions to the market. This in fact is a stated approach of ASIC: 'as a priority, we target cases of high deterrence value and those involving egregious harm or misconduct, particularly towards vulnerable consumers'.[5]

In keeping with this goal, in 2021-2022 ASIC secured criminal convictions against 33 people, with 13 of these receiving prison terms. It also secured 61 civil penalties.[6]

The downside of this approach is that it carries a very heavy resource burden. Criminal actions often cost millions of dollars to prosecute. To this end, it is notable that ASIC in the last financial year spent over $42 million dollars on legal and forensic expenses.[7]

It is assumed that spending millions of dollars on a single criminal (or civil) prosecution is a sensible allocation of resources because these types of actions will send a strong message in the financial market sector that breaches will be met with harsh consequences and hence will deter other breaches. However, there is often a discord between common sense and reality. The belief that harsh penalties deter crime is an example of a (intuitively appealing) myth that has been debunked by research. This reality has an important impact on how ASIC should be undertaking its investigative and enforcement activities.

The view that there is a connection between harsh penalties and lower offending is termed general deterrence. General deterrence seeks to dissuade potential offenders with the threat of anticipated punishment from committing similar offences by illustrating the harsh consequences of offending.

There are two forms of general deterrence. Marginal general deterrence is the view that severe penalties reduce the incidence of crime. It contends that imposing increasingly harsh penalties will reduce crime. Absolute general deterrence is the more modest claim. It concerns the

[5] Ibid, 42.
[6] Ibid, 43.
[7] Ibid, 158: These expenses are not itemised; however, it is assumed that much of this expenditure is on briefing barristers in criminal matter.

threshold question of whether there is any connection between criminal sanctions, of whatever nature, and the incidence of criminal conduct. Absolute general deterrence does not require or support the imposition of harsh sanctions. In order for it to be effective, any sanction which people find unpleasant (such as a fine) is sufficient.

The evidence suggests that marginal deterrence is a flawed theory, while absolute general deterrence does work. There is a large body of literature devoted to this issue. Marginal general deterrence seems to be flawed in relation to all penalty types – even the threat of capital punishment does not reduce the incidence of crime.[8] In a similar vein, the Victorian Sentencing Advisory Council has observed the futility of increasing prison terms in pursuit of enhancing deterrence.[9]

Criminologists have established that the most effective mechanism for deterring crime is not prescribing harsh penalties but putting in place enforcement mechanisms which increase the likelihood that people will be apprehended – and prosecuted – if they commit crime. Research establishes that people do generally engage in a cost-benefit analysis before committing a crime, but the decision-making process is shallow. When contemplating committing crime, an individual will factor in the likelihood of being apprehended into their decision-making. If the likelihood is high, they often desist from the crime. However, a low-risk assessment of being caught will make it more probable that they will engage in criminal behaviour, irrespective of the gravity of sanction if they are convicted. [10] Thus, there is no established connection between higher penalties and lower crime, but a very strong connection between high police visibility and reduced crime.

Theoretically, it would seem that in the case of market offences general deterrence would be more effective because the offences are always planned and offenders are better placed to undertake a cost-benefit analysis of their conduct.[11] Yet, there is no evidence to show that even white-collar offenders are influenced by the heavy penalties imposed on others.[12]

ASIC often engages in criminal and civil actions and often against high-profile offenders – some of which are successful. Yet, there is no evidence that these actions produce benefits to the wider community or that they lead to greater compliance of market regulations. High profile successful prosecutions include a seven-year prison term handed down to insider trader Lukas Kamay,[13] and $390,000 in pecuniary penalties imposed against Stephen Vizard for misusing confidential board information.[14] Against this there have also been a number of failed ASIC prosecutions which involved the expenditure of millions of dollars of taxpayers money. For example, in In *ASIC v Mitchell (No 2)* [2020] FCA 1098, ASIC brought civil proceedings

[8] Daniel S. Nagin and John V. Pepper, *Deterrence and the Death Penalty* (National Research Council, 2012) 102.
[9] Donald Ritchie, 'Does Imprisonment Deter? A Review of the Evidence' (Sentencing Advisory Council, 2011) 2, 11.
[10] Mirko Bagaric and Theo Alexander, 'The Capacity Of Criminal Sanctions to Shape the Behaviour of Offenders: Specific Deterrence Doesn't Work, Rehabilitation Might and the Implications For Sentencing' (2012) 36 *Criminal Law Journal* 159, 160.
[11] Elizabeth Szockyj, 'Imprisoning White-Collar Criminals?' (1999) 23 *Southern Illinois University Law Journal* 485, 493-94.
[12] Mirko Bagaric et al., 'The Fallacy of General Deterrence and the Futility of Imprisoning Offenders for Tax Fraud' (2011) 26 *Australian Tax Forum* 511.
[13] *Kamay v The Queen* [2015] VSCA 296.
[14] *Australian Securities and Investments Commission v Vizard* [2005] FCA 1037.

against two directors of Tennis Australia for what at best could be described as technical breaches of their directors duties in the context of negotiating a television rights deal. While a pecuniary penalty order was made in favour of ASIC, the substantive allegations were rejected with the judge labelling some of ASIC's allegations as spurious.

The important upshot of the above analysis is that while there does not seem to be a link between higher penalties and less crime, there is a connection between lower crime and the perception in people's minds that if they commit an offense they will be apprehended and subjected to some form of sanction. In short, the best way to compel people to comply with the law is to make them think that if they transgress it is likely that they will be caught.

3 Imposing criminal penalties is a disproportionate response to corporate wrongdoing

There is an additional, more wide-ranging, reason for reducing ASIC's focus on prosecuting criminal offences. Corporate (or white-collar) offenders[15] cost society nearly $150,000 per year to imprison. They present no risk to our safety and are normally productive members of the community. Society would benefit considerably if instead of following our instinct to severely punish white-collar offenders, we forced them to contribute to society by paying restitution to their victims and paying additional taxation. We now set out these premises more fully.

There is an understandable human inclination to punish people who obtain an unfair advantage by stealing money or assets. We understand that. It is an emotional instinct felt by most people. This often results in white-collar offenders being sentenced to the harshest sanction in our system of law – imprisonment.

However, white-collar offenders differ from most offenders in important respects. They do not pose a threat to our physical safety or sexual autonomy. Often they cause no harm to an identifiable victim. Additionally, white-collar offenders are often productive members of the community, and have financial assets.

The cost to the taxpayer of each prisoner per year is $405 per day ($147,000 annually).[16] To this end, it is notable that Australia has one of the highest prison rates in the world. Our approach to corporate offenders meaningfully contributes to this problem. The most recent data from the Productivity Commission shows that for the 2021-22 year there were 41,176 prisoners in Australia (which is a rate of 204 inmates per 100,000 adult population). This compares to 30,082 prisoners in Australia 10 years earlier (a rate of 169 per 100,000 adults).[17] This trend is consistent with the pattern over the past three decades, which has seen nearly a tripling of the

[15] White-collar crime involves the taking money or property (such as shares) or avoiding a legal obligation (such as a tax liability) without legal justification by an individual who is in a position of substantial influence regarding the relevant transaction. Common examples of white-collar offences include tax and social security fraud and insider trading offences. The types of people who commit white-collar offences tend to have the following traits: they are - married; well-educated and have high level skills; middle class and have financial assets; have strong ties to their community and family; no prior criminal history; and are in their late thirties or early forties. See further, Mirko Bagaric and Morgan Begg, 'Make Them Pay, Proposed Sentencing Reforms for Fraud Offences', Submission to the NSW Sentencing Council Inquiry on Fraud and Related Offences (2022): <https://sentencingcouncil nsw.gov.au/documents/our-work/fraud/FR05.pdf>.

[16] Productivity Commission, *Report on Government Services 2023* (31 January 2023) Table 8A.19; this is for the financial year 2021-22. <https://www.pc.gov.au/ongoing/report-on-government-services/2023/justice/corrective-services>

[17] Ibid, Tables 8A.4 and 8A.5.

prison rate during that time. More than 40% of prisoners have not committed sexual or violent offence.[18]

There were 664 offenders who were imprisoned for fraud, deception, and related offences.[19] It is a myth that fraud offenders (of whom corporate offenders are one sub-category) are dealt with leniently. The most recent data from the Victorian Sentencing Advisory Council shows that for the period 2015-2016 to 2019-2020, 157 offenders were sentenced in the Higher Courts for obtaining a financial advantage by deception and of these 63% received a prison term.[20] Total effective imprisonment lengths ranged from five months to 11 years and the median principal imprisonment term two years. As a ratio of the maximum possible sentence, the median principal sentence for the crime of obtaining a financial benefit by deception exceeded that for numerous sexual and violent offences, including recklessly causing injury, armed robbery, indecent assault.[21]

Further, the dividend of prison is small. In 2020-21, 45.2% of prisoners released from prison after serving a sentence in 2018-19 returned to prison within two years of release.[22] The dividend from imprisoning white-collar offenders is non-existent. This is because white-collar offenders represent a unique class of offenders. The method of punishment used is unsuited to the nature of the offence. In short, reasons for this include that:

- White collar-offenders do not constitute a risk to the safety of people in the community;
- White-collar offences often cause no harm to any individual;
- From the perspective of harm caused, their crimes are often no more serious than government waste; and
- White-collar offenders often suffer collateral harm through reputational damage when caught.[23]

3 White collar offenders should not be incarcerated, but should be made to financially pay for their crimes through restitution

A more appropriate response to white-collar offending is possible because we can directly attack the motivation for the offences – greed – and precisely measure in dollar terms the benefit from the crime and can match this exactly with a proportionate response. There are more intelligent, evidence-based approaches to dealing with white-collar offenders. The objectives for dealing with white-collar offenders should be to:

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[18] Australian Bureau of Statistics, *Prisoners in Australia* (24 February 2023), table 3; <https://www.abs.gov.au/statistics/people/crime-and-justice/prisoners-australia/2022#data-downloads>.
[19] Ibid.
[20] Sentencing Advisory Council, 'Sentencing Snapshot 254: Sentencing Trends for Obtaining a Financial Advantage by Deception in the Higher Courts of Victoria 2015-16 to 2019-20' (30 March 2021); https://www.sentencingcouncil.vic.gov.au/snapshots/254-obtaining-financial-advantage-by-deception>.
[21] Clinton Free, 'Let's be 'smarter' not 'harder' on white collar crime', *The Australian Financial Review,* (Online, 14 April 2021); <https://www.afr.com/companies/financial-services/let-s-be-smarter-not-harder-on-white-collar-crime-20210330-p57fam>. See further, Mirko Bagaric and Morgan Begg, 'Make Them Pay: Proposed Sentencing Reforms for Fraud Offences (Submission to the NSW Sentencing Council Inquiry on Fraud and Related Offences, 2022).
[22] https://www.pc.gov.au/research/ongoing/report-on-government-services/2022/justice. Table CA.4. The rate of prisoners returning to prisons within two years of release increased from 44.1% in 2015-16.
[23] Mirko Bagaric and Morgan Begg, 'Make Them Pay, Proposed Sentencing Reforms for Fraud Offences', Submission to the NSW Sentencing Council Inquiry on Fraud and Related Offences (2022): <https://sentencingcouncil nsw.gov.au/documents/our-work/fraud/FR05.pdf>.

- Impose penalties that are proportionate to the seriousness of the crimes;
- Ensure that the sanctions do not unnecessarily punish taxpayers; and
- Compel offenders to contribute ill-gotten gains back to the victims and community more generally.

These objectives can be met by making misconduct the focus of enforcement activities, which involves identifiable victims, with a view to securing reparation for the victims. It has been demonstrated that victims of financial transgressions want to have their money returned.[24] Of course, some offenders will not have the means to repay the amounts stolen. This should not be a barrier to the making of these orders. Most offenders are of working age and will at some point derive income. When they do, a portion of their income should go towards repaying the amounts stolen from the victims. This debt to the victims should never be forgiven or expiated – in the same way that HECS are never expiated. In addition to this, fines should be imposed on top of the restitution order and these sums should go to general revenue.[25] Rather than costing society money to incarcerate corporate offenders, these offenders should contribute financially to society.

In particular, there is no community benefit secured from pursuing criminal cases in instances where directors of companies have contestably been imprudent in their reporting on other obligations. Such oversights and transgressions should not occur, but there are more proportionate ways to deal with such matters – including restitution orders and civil fines.

It is understood that this would require legislative change beyond the immediate focus of this Inquiry, however, the Committee is encouraged to examine reforms to white-collar sentencing options more broadly.[26]

We would like to thank the committee for the opportunity to make this inquiry. We welcome the opportunity to engage further with the inquiry as it conducts this inquiry.

Regards

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[24] Ibid.
[25] Ibid.
[26] This reform proposal does come within the scope of reference (e) in this Inquiry: ‘the offences from which penalties can be considered and the nature of liability in these offences’.