maurice blackburn lawyers

28 February 2023

Committee Secretariat
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam,

We welcome the opportunity to provide feedback in relation to the Committee's inquiry into the Australian Securities and Investments Commission (**ASIC**) investigation and enforcement.

Maurice Blackburn Pty Ltd is a plaintiff law firm with 34 permanent offices and 30 visiting offices throughout all mainland States and Territories. The firm specialises in personal injuries, abuse law, medical negligence, employment and industrial law, dust diseases, superannuation (particularly total and permanent disability claims), negligent financial and other advice, and consumer and commercial class actions. The firm also has a substantial social justice practice.

Since the establishment of our class actions practice in 1998, we have acted in more class actions than any other plaintiff law firm.[1] We have obtained close to $4 billion in compensation for class members in a range of different class actions including shareholder and investor cases, superannuation cases, consumer lending actions, product liability claims, cartel cases and mass tort claims.

Maurice Blackburn regularly acts on behalf of victims of the kinds of misconduct regulated by ASIC, including inadequate or misleading financial product disclosure, inappropriate financial advice and irresponsible consumer lending. In some proceedings we have relied on documents or information gathered by ASIC to support the allegations made in our clients' proceedings.

We therefore welcome the opportunity to provide a submission to the Committee's review of the capacity and capability of ASIC to undertake proportionate investigation and enforcement action.

[1] V Morabito, "The First Twenty-Five Years of Class Actions in Australia" Fifth Report: An Empirical Study of Australia"s Class Action Regimes (2017) (Morabito Fifth Report), 35.

Our Submission:

Previous inquiries on ASIC's enforcement role

ASIC's enforcement role has been considered by several major recent inquiries and commissions. In particular the Financial System Inquiry, a dedicated ASIC Enforcement Review and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**FSRC**) all consistently concluded that more must be done to deter large-scale corporate misconduct.[2]

Maurice Blackburn agrees with the conclusion recently expressed in the FSRC report that misconduct cannot be effectively prevented if there is an overemphasis on educative and persuasive strategies at the expense of enforcement activity.[3] Unless legislation and other forms of regulation are firmly backed by the prospect of adverse consequences for compliance failures, corporations will adapt to exploit any perceived enforcement weaknesses.

We also agree with the oft-expressed view that the breadth of ASIC's role, and the sheer volume of economic activity falling within its remit, make effective enforcement action a substantial and difficult undertaking.[4]

Any discussion of ASIC's capacity and capability to undertake proportionate enforcement action must be framed by these two high-level considerations: the critical role that effective enforcement plays by both redressing and preventing corporate and financial services misconduct, and the huge volume of economic activity ASIC is expected to regulate.

Matters raised by the Committee for consideration

The Committee's terms of reference task it with considering '[t]he capacity and capability of [ASIC] to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct' with particular reference to seven specific considerations.

Maurice Blackburn considers that the specific matters raised by the Committee for consideration in effect fall into two distinct categories:

> Items (a), (b), (d) and (e) deal with the regulatory tools available and the extent to which they are effective in deterring misconduct without unduly hampering lawful economic activity.
>
> Items (c), (f) and (g) deal with evaluating the effectiveness with which those tools have been deployed by ASIC in practice across its broad remit.

We therefore address the Committee's terms of reference in two parts:

1. The effectiveness of the regulatory framework and

2. The extent to which the tools available within that framework have been effectively employed in practice.

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[2] *Financial System Inquiry*, (Final Report, November 2014), 236 – 237; *ASIC Enforcement Review* (Taskforce Report, December 2017) xix; *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 424 – 425.
[3] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 424 – 425.
[4] *Financial System Inquiry*, (Final Report, November 2014), 236; *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 430 – 431.

Part 1 - An Effective Regulatory Framework

Related Terms of Reference:

Consideration of the capacity and capability of ASIC to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct with reference to:

> a. the potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action
>
> b. the balance in policy settings that deliver an efficient market but also effectively deter poor behavior
>
> 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

Maurice Blackburn notes that 'dispute resolution' and 'compensation schemes' are not defined in the Committee's terms of reference. On the face of it, those terms are broad enough to encompass a wide range of outcomes including entirely voluntary remediation programs, compensation arrangements made pursuant to enforceable undertakings, negotiated settlements and court-ordered compensation following regulatory or private litigation.

With that in mind, far from distorting efficient market outcomes or regulatory action, effective dispute resolution and compensation schemes provide a means of *correcting* what would otherwise be distorted markets.

Financial markets are inevitably characterised by both information asymmetries and moral hazard, both of which are widely recognised as conducive to market failure.[5]

The risk is not merely theoretical, as is evident both from the litany of misconduct which led to the establishment of the FSRC and the scale of the additional wrongdoing newly uncovered by it.

In order to mitigate the effects of information asymmetry and to reduce the impact of moral hazard, there must be a mechanism to ensure that all (or at least a substantial proportion) of the costs of wrongdoing are internalised by the wrongdoers, rather than visited upon innocent market participants. The payment of compensation goes some way towards achieving that outcome.

It becomes particularly important in circumstances where the maximum penalties available to ASIC pale in comparison to the quantum of the damage caused by misconduct.[6] In such a situation, compensation which involves payment of an amount proportional to the level of harm caused acts as a more effective (and, by definition, proportionate) deterrent than the imposition of a civil penalty.

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[5] Adam Steen, Dianne McGrath and Alfred Wong, 'Market Failure, Regulation and Education of Financial Advisors' (2016) 10(1) *Australasian Accounting, Business and Finance Journal* 4, 13; *Financial System Inquiry*, (Final Report, November 2014), 236; *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 1-3.

[6] Adam Steen, Dianne McGrath and Alfred Wong, 'Market Failure, Regulation and Education of Financial Advisors' (2016) 10(1) *Australasian Accounting, Business and Finance Journal* 13.

Without the prospect of compensatory payments, the risk of a civil penalty may be perceived as a relatively minor cost of doing business.

There are limitations on the extent to which damages can restore economic balance, however, if the available compensatory remedies are unduly narrow in scope. In some situations, benefits accruing to the wrongdoer as a result of misconduct far exceed the compensable losses caused, such that purely compensatory damages can result in underdeterrence.

The potential for such a disparity to arise is illustrated by recent litigation brought by Rural Funds Management Limited (**RFM**) against activist short seller Bonitas Research LLC (**Bonitas**).

Bonitas published a report on 6 August 2019 opining that managed investment schemes operated by RFM, which were listed on the ASX under the ticker RFF, were fundamentally worthless.[7] In the wake of the report, RFF's unit price fell from a closing price of $2.34 on 5 August 2019 to $1.35 on 6 August 2019, before being placed in a trading halt. Based on the number of units issued as at 30 June 2019,[8] that equates to a drop in market capitalisation of approximately $331 million. As Bonitas noted when it released the report, it had a 'short interest in RFF's stock and [stood] to realise significant gains in the event that the price…declines'.[9]

RFM brought proceedings in the Supreme Court of New South Wales and succeeded in establishing that Bonitas' report was misleading and/or deceptive within the meaning of both the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth).[10] However, because the breaches did not involve contravention of a *civil penalty* provision of the *Corporations Act*, the Court held that damages should be quantified solely by reference to the out-of-pocket costs incurred by RFM in responding to the report. RFM was thus awarded $519,784 plus interest and party/party costs of $368,974.[11]

Damages of that nature are effectively an economic irrelevancy to short sellers with a theoretical upside referable to the quantum of the decline in market capitalisation.

Having regard to this example, Maurice Blackburn believes that the most obvious way to maintain proportionality would be to provide for the Court to deprive wrongdoers of the profits obtained as a result of actionable misconduct.[12] Quantifying damages in this way directly removes the economic incentive to engage in unlawful but profitable behaviour.

We note that the report of the ASIC Enforcement Review recommended a mechanism which would allow ASIC to apply for disgorgement of profits in the course of civil penalty proceedings.[13] The report referred to, but rejected, concerns that the availability of a disgorgement order might result in wrongdoers being penalised twice if an equitable order for disgorgement was sought.[14]

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[7] *Rural Funds Management Limited as Responsible Entity for the Rural Funds Trust and RF Active v Bonitas Research LLC (**RFM v Bonitas**)* [2020] NSWSC 61, [32] - [36].
[8] For the number of units on issue see RFF Financial Statements for the Year Ended 30 June 2019, p 7. (https://www.asx.com.au/asxpdf/20190827/pdf/447wmcgg1r2vgl.pdf).
[9] *RFM v Bonitas* [2020] NSWSC 61, [11].
[10] *RFM v Bonitas* [2020] NSWSC 61, [70].
[11] *RFM v Bonitas* [2020] NSWSC 61, [142]-[144], *RFM v Bonitas (No 2)* [2020] NSWSC 335, [7]-[8].
[12] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1) 427.
[13] *ASIC Enforcement Review* (Taskforce Report, December 2017), 75 – 76.
[14] *ASIC Enforcement Review* (Taskforce Report, December 2017), 76.

We agree that the remedy of disgorgement of profits would go some way towards addressing underdeterrence, however we consider that it would be most efficiently utilised as a means of redress for the victims of misconduct. That would bring the process into line with the equitable mechanism and would enable any relationship with compensatory damages to be accounted for within the same proceeding (noting that in many instances there will be at least partial overlap between the 'out of pocket' losses suffered by victims of misconduct and the profits obtained by the perpetrators).

It would also be consistent with the existing scope of compensatory damages for breach of a civil penalty provision under s 1317HA of the *Corporations Act 2001* (Cth) which provides for profits resulting from a contravention to be included 'in determining the damage suffered by a person, scheme or fund for the purposes of making a compensation order.'

As to the nature of the liability for which offences can be considered, we make two observations.

i. First, in our view it is particularly important to ensure that enforcement options are appropriately tailored to deal with systemic organisational wrongdoing as well as individual misconduct. When addressing the conduct of corporations, it is easy for an enforcement gap to arise if the standard of subjective liability is too onerous.

   Without an objective standard of liability, profitable but unlawful conduct can persist as a result of flawed management and information systems, such that wrongdoing is either quarantined to low levels within the organisation or in effect distributed among individuals. Companies which tolerate or fail to detect misconduct without bearing the costs of doing so can thereby avoid being penalised and obtain a competitive advantage over those which take active steps to prevent it.

   The inevitable end result of allowing a competitive advantage to those who engage in misconduct is that misconduct proliferates as responsible organisations are forced out of the market.

ii. Secondly, and relatedly, the application of a high subjective bar to liability is inappropriate in a financial market which is necessarily characterised by information asymmetry.

   Rather, it is appropriate that those who misstate the true position as to facts that are uniquely within their own knowledge and control should be prevented from causing loss to others or profiting from their own misstatements.[15]

[15] See *Yorke v Lucas* (1985) 158 CLR 661 at 675 per Brennan J.

Part 2 - Effective Regulation in Practice

Related Terms of Reference:

Consideration of the capacity and capability of ASIC to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct with reference to:

> c. whether ASIC is meeting the expectations of government, business and the community with respect to regulatory action and enforcement
>
> f. the resourcing allocated to ensure investigations and enforcement action progresses in a timely manner
>
> g. opportunities to reduce duplicative regulation; and
>
> h. any other related matters

Having addressed the framework within which enforcement takes place, the second part of this submission will address several practical considerations about the way in which enforcement activity has been, and in our view should be, conducted.

As a starting point, Maurice Blackburn agrees with the findings of the FSRC that a regulator which places undue focus on negotiation and persuasion, as distinct from enforcement action, runs the risk of regulatory capture – and in that situation, regulated entities may come to see compliance as optional.[16]

The scope of ASIC's remit, its resource constraints and the undeniable importance of its educative and persuasive role have historically resulted in enforcement action taking a back seat.[17] The absence of effective enforcement, and the consequential lack of any real deterrent effect, enabled misconduct of the kind uncovered both before and during the FSRC to proliferate.

Following the delivery of the FSRC Final Report, ASIC took note of its findings, committed to implementing its recommendations, developing a new 'Why not litigate?' enforcement strategy, and establishing an Office of Enforcement to oversee its focus on 'increased and accelerated' Court-based outcomes.[18]

In the report of the FSRC, the Commissioner had noted that there were signs ASIC was adjusting its enforcement strategy and had recognised that change was needed. [19] On the face of it this appeared to be a positive development with the potential to bring about a cultural shift, such that institutions engaged in wrongdoing could now expect to be held to account.

However the Commissioner pointed out that there were five reasons to be cautious about whether that commitment could and would be sustained:

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[16] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 424 - 425.
[17] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 425.
[18] *ASIC Corporate Plan 2019 – 2023* (August 2019), p 2.
[19] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 425.

- the breadth of ASIC's remit;
- an 'entrenched culture' of defaulting to negotiation rather than enforcement;
- the fact that remediation, while important, is not the only matter a regulator should be concerned with;
- the potential disparity between remediation and the economic harm caused by misconduct; and
- the lack of an accountability mechanism over ASIC's enforcement activity.[20]

The Commissioner's cautionary note proved to be prophetic.

In August 2021, ASIC released a Statement of Intent (responding to a Commonwealth statement of expectations) in which enforcement has again taken a back seat.

The new Statement of Intent emphasised ASIC's desire to avoid hampering economic activity, and refocuses on the educative and cooperative aspects of ASIC's role.[21] This appears to be a reversion to the kind of regulatory inaction which enabled widespread misconduct of the kind dealt with by the FSRC.

Maurice Blackburn is concerned that ASIC's newfound commitment to tougher enforcement appears to have fallen by the wayside, within just two years of the delivery of the FSRC final report calling for ASIC to take a more active approach.

The concentrated technical expertise and resulting information asymmetries which make financial markets prone to market failure also pose obstacles to enforcement. Financial services regulators work closely with regulated institutions to gather information, develop standards, consult on policy changes and carry out similar non-enforcement activity.

In the course of doing so, and in order to facilitate that work, regulatory officials inevitably develop close working relationships with officers of regulated entities. While that dynamic is conducive to cooperative outcomes, it can result in underenforcement as the regulator is reluctant to jeopardise cooperative relationships by transitioning to an adversarial stance.[22]

In contrast to regulated financial institutions, the consumers of financial services (such as retail investors) often form dispersed groups with no cohesive bargaining power and little access to technical information. As a result, their interests may not find a voice in the regulatory process, despite the fact that they are the very market participants regulation aims to protect.[23]

This is a recurring problem in regulatory practice, one that can be solved by adopting a regulatory process that recognises an equal role for third parties who stand outside the traditional model of regulation in which only the state and the regulated entities play an active role.[24] In order for regulatory 'tripartism' of this kind to work, an appropriate vehicle must exist for the aggregation and representation of the interests of market participants.[25]

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[20] *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, vol 1), 425.
[21] ASIC, *Statement of Intent* (August 2021) (https://asic.gov.au/about-asic/what-we-do/how-we-operate/accountability-and-reporting/statements-of-expectations-and-intent/statement-of-intent-australian-securities-and-investments-commission-august-2021/)
[22] Saule Omarova, 'Bankers, Bureaucrats and Guardians: Toward Tripartism in Financial Services Regulation' (2011) 37(3) *Journal of Corporation Law* 621, 630-631.
[23] Ibid.
[24] See, for example, Ian Ayres and John Braithwaite, 'Tripartism: Regulatory Capture and Empowerment' (1991) 16(3) *Law & Social Inquiry* 435, 439.
[25] Saule Omarova, 'Bankers, Bureaucrats and Guardians: Toward Tripartism in Financial Services Regulation' (2011) 37(3) *Journal of Corporation Law* 621, 635-637.

Maurice Blackburn believes that Australia's class action regime provides an important vehicle for aggregating the interests of consumers and vigorously representing their interests, one that is well-suited to making sure that consumers themselves have a 'seat at the table' in the regulatory process.

To that end, we would strongly support the adoption of a regulatory strategy that expressly recognises the parallel roles of public and private enforcement, and facilitates information sharing and cooperative action between participants in both spheres.

Our suggested approach would facilitate enforcement of private rights as the default, market-based mechanism for addressing the *economic* impact of misconduct by compensating loss and, through disgorgement of profits, removing the economic benefits to wrongdoers. ASIC would then be freed up to deal with the cooperative, standard-setting side of its role, while taking a more targeted approach to enforcement by focusing on punitive and protective regulatory outcomes such as enforceable undertakings, criminal and civil penalties and banning orders.

That delineation of focus, coupled with a collaborative approach between public enforcement agencies and consumers engaged in vindicating their private rights, would facilitate complementary, rather than duplicative, enforcement.

The complementary role that class actions play in addressing misconduct has been recognised by the regulators themselves:

- In 2012 Greg Medcraft, then Chairman of ASIC, described class actions as a 'good, market-driven solution', noting that ASIC would divert its resources elsewhere if wrongdoing was likely to be addressed by a class action.

- The chairman of ACCC described private litigation under consumer legislation as a 'terrific' means of enforcement. Both noted that in some cases funding limitations prevented them from pursuing enforcement.[26]

- Medcraft reiterated these views in 2014 in the wake of substantial cuts to ASIC's budget, which he said would necessitate increased reliance on class actions as a means of enforcing securities legislation.[27]

- At a Senate Estimates Committee hearing in 2017, officers of ASIC explained the decision to accept only partial compensation for consumers as motivated in part by a lack of resources and the fact that the uncompensated subgroup could seek redress through alternative means, including a class action.

  Officers of ASIC noted that the agency's primary focus was on encouraging behavioural change through a range of methods including non-compensatory enforcement techniques such as enforceable undertakings. Where that can be achieved quickly, it was not considered a priority for ASIC to devote significant time and resources to attempting to recover full compensation.[28]

It is thus clear that class actions have a role to play in addressing each of the major obstacles facing ASIC in ensuring effective regulation. By providing a coherent and assertive

[26] Alex Boxsell, 'Regulators Praise Private Court Actions', *The Australian Financial Review* (Sydney), 5 April 2012, 59.
[27] Shaun Drummond, 'ASIC Chief Sets Sights on Financial Advisors', *The Age* (Melbourne), 25 June 2014, 24.
[28] Evidence to Senate Economics Legislation Committee, Parliament of Australia, Canberra, 2 March 2017, 11-13 (Tim Mullaly, Senior Executive Leader, Australian Securities and Investments Commission).

voice for the disparate individuals who are wronged by large scale misconduct, they offer a solution to regulatory capture.

By vindicating private rights, they offer a market-based mechanism which does not deplete the regulator's constrained resources. And by redressing the economic harm caused by misconduct, they allow the regulator to take a more targeted approach to enforcement, leaving it to focus on cooperative engagement and, when necessary, to take punitive and protective action by seeking civil or criminal penalties and imposing banning orders.

Maurice Blackburn believes that a more formalised cooperative stance between ASIC and participants in collective private litigation, involving information sharing protocols, consultation and coordination, would be an effective means of ensuring appropriate, targeted enforcement while reducing the burden on public resources.

We would welcome the opportunity to participate in discussions on the form that would take.

We would be pleased to discuss our submission in more detail with the Committee if that would be beneficial. Please do not hesitate to contact me and my colleagues via [redacted] if we can further assist with the Committee's important work.

Yours faithfully,

[redacted]

Andrew Watson
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Maurice Blackburn Lawyers