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Inquiry into Australian Securities and Investments Commission investigation and enforcement

A SUBMISSION TO THE SENATE ECONOMICS REFERENCES COMMITTEE

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28 FEBRUARY, 2023

Introduction

1. The author thanks the committee for extending an invitation to make a submission to this inquiry.

2. This submission proceeds from the point of departure that **ASIC's efficacy**, and especially its **enforcement record**, are **poor**; and that similar findings against ASIC, for example, the 2014 Senate Inquiry and the 2018 FSRC, have not resulted in meaningful improvements.

3. As such this Inquiry is presented with both a challenge and an opportunity: to **succeed where others have failed**.

4. In this submission I will provide an analysis of several points of failure. This list is not comprehensive, but nonetheless presents faults which, I argue, are essential to address.

5. In particular the submission will provide analysis of:
   5.1. the **Twin Peaks** model, and why it matters that we only have **One and a Half**;
   5.2. the implications of a ***capacity* regulator;**
   5.3. cases perceived to be strong, but where ASIC often declines to litigate (or: *the legal advice said we* ***don't have a case*** conundrum);
   5.4. the implications of the ***reasonable basis*** requirement for litigation, and the manner in which that is determined;
   5.5. Professor Ramsay's findings (the ***86 from 900*** *question*).

6. Finally, the submission will provide recommendations.

7. In preparing this submission the author has endeavoured to draft a submission which is brief, and not excessively dense. Requests for further details on any of the points raised would be welcomed.

Author's expertise

8. The writer is an Australian academic, specialising in financial system regulation; the 'Twin Peaks' financial system regulatory model; combatting misconduct in retail financial markets; regulator efficacy; regulatory enforcement; the UK's *Treating Customers Fairly* framework (located with the UK's Twin Peaks regime); and financial regulatory theory. The author has written and published widely on ASIC.

9. The author has provided advice on these topics to governments (South African National Treasury; New Zealand FMA; UK House of Commons House of Lords APPG; CGAP/World Bank;

EU Parliament; South Korean Parliament etc) and, by invitation, to Australian Inquiries (FSRC; Senate Committees; Australian Law Reform Commission; Financial Regulator Assessment Authority).

Instead of two peaks, we got one and a half

10. The 'Twin Peaks' model regulates the financial industry with two, peak, independent regulators: one regulates for prudential soundness ('prudential'), the other enforces proper standards of market conduct and consumer protection ('conduct').

11. The Twin Peaks model was not developed in a vacuum. It was devised because of the observable and demonstrable failings of the other three models of financial system regulation.[1]

12. Twin Peaks advocates for a bifurcation of the functions of prudential and conduct, again for good reasons: the observable and demonstrable failings of the alternatives.

13. Its central thesis proceeds as follows:
    13.1. The financial industry needs to be regulated. Arguments can be made as to whether other industries also need to be regulated, but similar arguments are untenable for the financial industry.
        13.1.1. This is due to *systemic stability* considerations – financial crisis risks – that apply to the financial industry, but not to other industries. Put simply, if Woolworths went bankrupt, it would not affect Coles. If Virgin went bankrupt, it would not affect Qantas. If KPMG went bankrupt, it would not affect PWC. But if any one of our major banks became insolvent, it would pull the remaining banks down with it.
    13.2. Part of what drives this systemic risk is the unavoidable fragility, baked into the business model, that is innate to modern banking. Specifically:
        13.2.1. Maturity mismatching – the practice by which banks finance their loans with demand[2] depositors' funds. Put differently, banks make loans repayable, potentially, over decades, but finance those loans with funds which the bank may have to return immediately. This presents a risk of insolvency.
        13.2.2. Fractional reserve lending – the practice by which only a percentage of depositors' funds are kept in reserve, and the remainder on-lent.
        13.2.3. Maturity mismatching and fractional reserve lending make banks vulnerable to large amounts of sudden deposit withdrawals. As a result, they are required to keep a percentage of depositors' funds in reserve (approximately three per cent). Under this arrangement, if even a small number of depositors (3.5 per cent, for arguments sake)

[1] For more, see: Andrew D. Schmulow, "The Four Methods of Financial System Regulation: An International Comparative Survey", *Journal of Banking and Finance Law and Practice*, Vol. 26, no. 3 (8 December, 2015).

[2] Every Australian who earns a wage must by law have that wage paid into a bank account. Those wage payments are an example of a *demand deposit.* That is to say, a deposit, repayable immediately, on demand.

withdrew their funds at once, a profitable, well-managed bank, with a strong balance sheet, could find itself insufficiently liquid, and therefore unable to refund depositors. In effect, a cash-flow problem, but one that will leave the bank insolvent.

13.2.4. Insolvency at one bank spreads quickly to other banks, as depositors at other banks panic, and withdraw their funds. This would herald a financial crisis.

13.3. This risk is referred to in the literature as *bank runs* (depositor flight) and *contagion* (the transmission of depositor panic from one bank to other banks).

13.4. Circumstances which can give rise to increased bank fragility and depositor panic can occur overnight (for example, a sudden, unexpected currency depreciation).

13.5. For these reasons the need to prudentially manage banks and their financial soundness is well understood, as is the need for prudential regulation generally.

14. Twin Peaks' first innovation is to recognise the importance of prudential regulation, by establishing a prudential regulation peak which is dedicated to, and focused on, the task of prudential soundness, and nothing else.

14.1. Within that innovation is also the innovative step – first introduced in Twin Peaks – of taking a more wholistic approach to prudential regulation, by assessing the financial resilience of financial conglomerates.

14.2. Further, within that innovation, is an acknowledgment that the break-down of the division between banks and insurers gave rise to *bancassurance* – banks that were also insurers, and insurers that were also banks – in the English-speaking world (long a feature of continental European finance).

14.3. For the first time Twin Peaks proposed a holistic approach to the prudential management of the entire financial industry, by brining insurance (general, re-, life and health), superannuation, and other potential bank counter-party risks (building societies etc) under the supervision of one, whole-of industry, stand-alone prudential peak.

14.4. When Twin Peaks was devised and proposed in 1997 it was genuinely foresightful. Ten years later, during the GFC, when AIG collapsed, a new appreciation was obtained of the significance of counter-party risks to the banking industry. We also better understood that, in certain circumstances, insurers can represent vulnerability to, or the potential to exacerbate, systemic risks. All these lessons underscore the superiority of the Twin Peaks model, and its ability to respond to these challenges, through the creation of a peak prudential supervisory agency.

15. Alongside prudential, Twin Peaks proposed a mirror-image of the first peak, but dedicated to conduct. At the time that Twin Peaks was proposed, arguments in favour of a dedicated conduct peak centred on aggregating particular, specialist skills, necessary to enforce good conduct and protect consumers. In addition, the manner in which those skills would be deployed, and the approach taken to regulation and enforcement by a conduct peak, would be so fundamentally different from a prudential peak, as to make the two functions irreconcilable.[3]

[3] Prudential *tweaks levels and pulls levers* (liquidity coverage ratios, capital adequacy ratios, etc), whereas conduct punishes breaches of the law. Generally speaking, prudential employs economists, conduct employs lawyers. Prudential is co-operative and consultative; conduct is prescriptive and adversarial. Prudential tends to be *ex ante*, conduct *ex post*, etcetera.

16. Twin Peaks recognised that prudential and conduct may at times move in opposite directions. For example, prudential regulators favour bigger, better-capitalised banks, as these are more resilient in times of crisis. But bigger invariably means fewer. Conversely, conduct regulators favour more competition, as this delivers better consumer outcomes and a more efficient, dynamic industry. But more competition means more banks. More banks will unavoidably include smaller, less well-capitalised banks. These two approaches are irreconcilable.

17. As a result, Twin Peaks recognises that in supervisory agencies where both conduct and prudential are combined, one function will play second fiddle to the other (usually prudential would be prioritised over conduct). This would have the effect, over time, of either deep inadequacies in the prudential health of the industry, or deep systemic flaws in the efficiency, integrity and transparency of the industry, and in the outcomes it would achieve for both consumers, and other industries.
    17.1. These were part of the findings handed down in the aftermath of the GFC:
        17.1.1. The United States Senate Inquiry into the sub-prime disaster, which found that prudential was prioritised, and conduct abandoned, and led, post-GFC, to the creation of a new conduct peak, (the CFPB).
        17.1.2. The House of Commons House of Lords reports into the collapse of Northern Rock and Halifax Bank of Scotland, which found that conduct was prioritised at the expense of prudential. This led to the dissolution of the UK's combined prudential and conduct regulator, the FSA, and the creation of a dedicated prudential (PRA) and dedicated conduct (FCA) authority.

18. As a result, Twin Peaks' second innovation is the creation of a peak conduct regulator, dedicated to the supervision of the entire financial industry (but only the financial industry); aggregative of the specialised skills required to enforce the law in such a specialised and sophisticated industry; independent of the prudential peak; and with an equal say at the Council of Financial Regulators. This peak would be charged with ensuring that market misconduct would be punished, and that consumers would be protected.

19. A dedicated conduct regulator for the financial industry is necessary for other reasons, which include:
    19.1. The financial industry has deeper market penetration than any other industry. An estimated 99.94% of Australians over the age of 14 have a bank account.
    19.2. The number of transactions in which the industry engages daily is so large, that misconduct across even only a small percentage of the high-volume types of transactions that the financial industry performs, has the potential to become systemic.
    19.3. No other industry innovates as quickly. Protecting consumers from harm, at the potential scale at which harm can occur, requires specialist, dedicated conduct supervision.
    19.4. A United States SEC type of regulator that enforces the *Corporations Act* (excluding financial services) would be a reactive supervisor, whose main function would be to punish after a breach has occurred.

19.4.1. However, while supervision of the financial industry also requires a supervisor that will react to breaches of the law, it also requires a forward looking, risk-based regulator that will, as the name suggests, identify the most pressing risks and work to mitigate them. That can include instances where the regulator does not see an occurrence of harm (breach), but rather the potential for harm in the future (as is envisaged by the ASIC product intervention powers regime). This is potentially extremely difficult to get right. It requires what I would describe as the ability to *foresee the unforeseeable.* What McCraw calls "the ability to see around corners"*.* For that, a different regulatory ethos from that described in 19.4 above, is necessary. One which is not simply reactive and prescriptive, but proactive, pre-emptive, intrusive, but also educative.

20. In 1997, what Twin Peaks' designer (Dr Michael Taylor) could not have envisaged, were the lessons that came out of the GFC ten years later; lessons which profoundly affected our appreciation of what the Twin Peaks model provides. These included:
    20.1. That market misconduct and consumer abuse – not only bad for those who are its victims – can also have a systemic stability effect. This was the lesson of the sub-prime disaster (market misconduct and reckless and predatory lending writ large), and the way it metastasised into a global financial crisis.
    20.2. That to refine the approach we take to ensuring systemic stability, we must recognise that, while we accept that prudential is essential to the task, we must also accept that conduct is too; and that this realisation be enlivened in a stand-alone peak, whose responsibility it is to drive conduct, and has the authority to do so as an equal to, and independent of, prudential.
    20.3. In 1998, Australia became the first country to adopt Twin Peaks, and remained an outlier of one. But in the aftermath of the GFC, and the lessons learned, various other countries adopted Twin Peaks (Belgium, the UK, New Zealand, South Africa), and more than a dozen other countries have indicated a desire to do likewise. With each of those that adopted, Australia's Twin Peaks was used as the benchmark.[4]
    20.4. In each of those other jurisdictions, there has been created, a dedicated financial-industry prudential regulator and a financial-industry conduct regulator.

21. The irony is therefore withering, in that Australia – the benchmark example of Twin Peaks – does not have a **dedicated financial-industry prudential regulator** and a **financial-industry conduct regulator**. Instead, what we have is a dedicated financial-industry prudential regulator and a **financial-industry-and-every-other-industry-and-everything-to-do-with-licensing-reporting-corporate-governance-(generally)-insolvency-money-commerce-business-and-the-economy-except-partnerships conduct regulator**.

22. This is not what Twin Peaks envisaged. Moreover, a failure to adhere to what Twin Peaks envisages is not an exercise in doctrinal purity. It emanates from the practical solutions devised in response to previous, observable points of failure, in other styles of regulatory architecture.

[4] To which can be added The Netherlands. The Netherlands adopted Twin Peaks prior to the GFC. But in the aftermath of the bank insolvencies the country suffered during the crisis, a renewed focus was placed on the Australian model in the reforms enacted by the Dutch Bank.

22.1. Moreover, while the failings of ASIC are multitude, some of its failings echo those of the former UK mega-regulator, the FSA. In particular, that the FSA's focus was too broad,[5] and that this impinged upon the regulator's efficacy. In response, and when the UK adopted Twin Peaks after the GFC, the FCA was created. This has a much narrower mandate: conduct in financial services and nothing else.

23. As such, I support the view that one of the crucial impediments to ASIC's efficacy, is that its **remit is too wide**.

24. Set against this narrative are the findings of the FSRC. In his Final Report, Commissioner Hayne addressed the issue of the breadth of ASIC's remit, within the context of whether a dedicated financial industry authority would be preferable. He stated:

> *Altering ASIC's remit would mark a sharp departure from the twin peaks model. I am not persuaded that the two principles underpinning the twin peaks model of financial regulation should now be abandoned or should be given substantially different effect by dividing ASIC's regulatory role… Importantly, I have no doubt that Treasury was right to say that 'the impact of the breadth of remit on a regulator is largely a function of its leadership and resourcing (including staffing)'. As Treasury said '[w]ith strong leadership and adequate resources (including staff), a broad remit is not a problem'. But one of the chief challenges for leadership of a regulatory agency is fostering a proper culture. And as I sought to make plain in the Interim Report, the criticisms I made of ASIC were about the ways in which it responded to reports of misconduct, ways that might be seen as reflecting the prevailing culture of the agency… In my view the enforcement culture of ASIC, not the size of ASIC's remit, should be the focus of change.*[6]

24.1. It is with these findings that I beg – respectfully – to differ. In my view, Commissioner Hayne got it wrong, because, in my view, respectfully, he missed the point.

24.1.1. The first point has been canvassed: **ASIC is not a conduct-in-the-financial-industry regulator**. Instead it is a **conduct-in-the-financial-industry-and-every-other-industry-and-everything-to-do-with-licensing-reporting-corporate-governance-(generally)-insolvency-money-commerce-business-and-the-economy-except-partnerships regulator**.

24.1.2. The second point which, in my respectful submission, the FSRC missed, was when it provided support for the notion that with the right leadership and adequate resources, ASIC's remit could be managed. In theory, yes with the right leadership and adequate resources ASIC could successfully discharge its mandate. But then, it is also true to say, that with the right leadership and adequate resources, *anything is possible in the best of all possible worlds.* The reality is that a vast remit is **more difficult to achieve**, and things that are more difficult to achieve, are ones where **success is less likely**. In practice, leadership is always imperfect, and resources are never adequate. The result:

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[5] Her Majesty's Treasury, (July 2019), "Financial Services Future Regulatory Framework Review. Call for Evidence: Regulatory Coordination," London (UK), available at <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/819025/Future_Regulatory_Framework_Review_Call_for_Evidence.pdf>, § 1.6, p 4.

[6] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, "Final Report", Vol. 1, Financial Services Royal Commission, 1 February 2019, p 423.

in theory, ASIC could successfully discharge a very wide remit. But in practice, **successfully discharging a very wide remit is less likely**.

24.1.3. International experience across the G8, the G20, or the major economies of the OECD, is one in which financial regulation is littered with failures and crises – occasions where supervisors can be said to have sat atop a bomb, unaware, up to and including the moment it went off. The task of regulating the financial industry – the most difficult industry of all to regulate – is so fraught with difficulties, pitfalls, and opportunities to fail, that the most prudent approach to the task is *to hope for the best but plan for the worst* (all except the hope for the best part. That provides no benefit). A prudent approach would be to start with the assumption that whatever framework we put in place will probably fail. The best we can do is to try to stall that failure for as long as possible. An approach as pessimistic as this, more usefully motivates towards the construction of a framework for financial regulation which has the absolute best possible chance of success, under extremely adverse circumstances.

24.1.4. Such an approach would understand the value of pursuing whatever outcome is not just in **theory capable** of being achieved, but far more importantly, **in practice is more likely** to be achieved.

25. For these reasons, ASIC's remit must be seen for what it is: not an ancillary matter of little or no bearing on ASIC's success, but rather a significant impediment. Without the removal of that impediment, no matter how much success is achieved in rectifying ASIC's culture, that alone will not be enough. **ASIC's remit is a problem, and it must be fixed**.

ASIC is a capacity regulator

26. ASIC in its supervision and regulation of the financial industry is a *capacity* regulator.

27. That is to say, in its regulation and supervision of the financial industry ASIC must concern itself with supervision that is fundamentally different from that performed by, for example, the US SEC.

27.1. Regulators like the SEC have their jurisdiction activated when they find the law has been breached.

27.2. ASIC does that too with financial services. But it does far more.

27.2.1. In financial services ASIC must enquire into the capacity of a financial services firm to adhere to the law (for example in granting a licence). This involves an evaluative assessment different from that performed by a pure securities regulator.

27.2.2. Put differently, in its company registration function ASIC does not determine whether the applicant will be able to meet, for example, its reporting obligations. It simply grants status as a company, and will pursue that company if and when it fails in its reporting obligations. This is quite different from the enquiries into an applicant's ability to comply with the law, which ASIC must consider in granting licenses in financial services.

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28. This is in addition to the need for ASIC to be pre-emptive, intrusive and educative, as opposed to simply reactive and prescriptive.

29. This further supports arguments in favour of establishing a dedicated financial-services conduct peak.

The *we've taken legal advice that states we don't have a case* conundrum

30. ASIC has on numerous occasions declined to litigate matters that would appear to be both serious and worthy of litigation.

31. One such example is ASIC's refusal to litigate against members of Westpac's Board, for turning a blind-eye to money-laundering breaches. At the time ASIC stated that, on the basis of the advice they had received, and on public policy grounds, they would not pursue Directors of Westpac.

32. That advice is not available to be scrutinised by members of Parliamentary Committees, even those charged with oversight over ASIC. Put differently, ASIC is able to hide behind advice, but keep that advice confidential.

33. This presents a risk, especially for a regulator that has been found in the past (2014 Senate Inquiry, 2018 FSRC) to be a reluctant litigator, especially towards large firms.[7]
    33.1. It is of note that Westpac emerged during the FSRC as a feared adversary to ASIC. Westpac's litigation budget exceeds that of ASIC's, and under its former CEO, Westpac developed a reputation as litigious, and willing to drag proceedings out, until they had exhausted ASIC's allocation for their case.
    33.2. It is within this environment that ASIC declined to prosecute Westpac Directors.

34. This raises legitimate questions in the minds of the public. As the representatives of the public in the legislator, it is of note that not even MPs or Senators can investigate the reasons behind ASIC's decisions – because the advice upon which those decisions rests remains confidential.

[7] Research published by Professor Ian Ramsay, in which he analysed ASIC enforcements over a ten-year period (preceding the FSRC), demonstrated that of the several thousand matters ASIC had pursued, it had only pursued four cases against the big four banks. This despite the fact that the vast majority of instances of misconduct uncovered by the FSRC were perpetrated by the big four banks and AMP. Commonwealth Bank was described by Commissioner Hayne as the gold-medallists for misconduct. Yet despite this ASIC, it appears, has bulked-up its enforcement tally by pursuing *low-hanging fruit*. That is to say, small- and medium-sized firms, unpossessed of the resources needed to significantly oppose ASIC.

35. These legitimate questions are attenuated when we compare ASIC's refusal to pursue Directors of Westpac for breaches of their director's duties in connection with anti-money laundering legislation, but their stated intention to pursue Directors of Star Casino, for breach of the same duties.
    35.1. One of the reasons advanced by ASIC for pursuing Directors at Star was that they had had constructive notice of the risk of AML/CTF breaches, thanks to the Inquiries into Crown (NSW Bergin Inquiry, Victorian Finkelstein Inquiry). But Westpac Directors had exactly the same constructive notice, albeit for a longer period of time, thanks to the outcome in *AUSTRAC v Commonwealth Bank* (in which CBA paid a $700 million fine – the largest fine to date in Australian history. Surpassed by the $1.3 billion fine paid by Westpac for similar breaches, some 26 months later).
    35.2. Westpac stood accused by AUSTRAC – a Commonwealth enforcement agency. Star stood accused merely by the *Sydney Morning Herald*.
    35.3. Westpac's Board, and in particular the risk committee, had had notice of non-compliance from AUSTRAC for six years, and multiple red-flag reports from their auditors. Star was put on notice by the *Sydney Morning Herald,* and one auditor's report.
    35.4. AUSTRAC cannot provide the number of Star's breaches. For Westpac the number was assessed at 23 million breaches.

36. Under these circumstances it is inexplicable that ASIC will not pursue Westpac Directors for breaches of their duty to prevent AML/CTF breaches, but will pursue Directors of Star Casino. This inexplicability cannot be resolved, because the merits advice remains confidential.

37. In light of the fact that AUSTRAC had sufficient evidence to have a fine of $1.3 billion against Westpac confirmed by the Federal Court, ASIC's refusal to pursue Westpac Directors, for the same series of breaches, raises legitimate questions in the minds of the public.
    37.1. Especially when these facts are assessed in combination with ASIC's poor past enforcement record.

38. Moreover, legal advice – especially in respect of large, complex matters, is seldom unqualified. Of all the matters that Commissioner Hayne put forward in his Final Report as warranting prosecution, and which ASIC has declined to litigate, based on the legal advice they received, it is almost a certainty that some of that advice would have been qualified. That is to say, the advice cautioned that only *if x can be proven is there a prospect for the outcome y*. In which case it is not strictly correct to assert that the advice advised against litigation. Rather it is *ASIC's interpretation of that advice* that has mitigated against litigation. Again, in light of ASIC's past failures, this raises legitimate questions in the minds of the public: if a former High Court Judge saw enough evidence to warrant litigation, but ASIC does not?

39. In instances where it is more likely that ASIC would lose, it is still not an excuse to not ever litigate. Commissioner Hayne made the point that where the matter is serious enough, and even if they think their prospects for success are small, ASIC should litigate nonetheless. And if the outcome is a loss, then at least that will expose serious gaps in the law, which the legislature can

then fill. In short, Commissioner Hayne stated that there will be times when ASIC must fight to lose.

40. As such, the current regime, in which legal advice to ASIC cannot be reviewed, is untenable. Parliament must at least acquire to itself the power to review legal merits advice, provided to ASIC, *in camera*, such that client confidentiality is not breached. This could be by way of an advisory panel of eminent legal academics and retired judges, possessed of the expertise to understand the advice they are reading, and reach a conclusion as to whether the advice is credible and/or whether ASIC's interpretation of the advice is accurate.

Litigation must be on a *reasonable basis*

41. In determining whether to bring a case to court ASIC must satisfy a two-step test:
    41.1. The case must have prospects for success. To quote ASIC:[8]
    - *whether reliable and admissible evidence is available to prove the alleged misconduct*
    - *the prospects of any litigation we might bring.*

    41.1.1. This test is discussed in the section above.
    41.2. Litigation must be on a *reasonable basis*. Again, to quote ASIC:[9]

    Expected public benefit in taking enforcement action

    We will consider:

    - *whether enforcement action is likely to clarify the law and help participants in financial markets to better understand their obligations*
    - *the time and cost required for each type of enforcement action*
    - *the time since the misconduct took place*
    - *whether any affected investors or consumers have any special vulnerabilities*
    - *whether a particular enforcement action is proportionate to the nature, severity, impact and prevalence of the misconduct*
    - *whether the particular enforcement action will result in the effective and efficient administration of justice.*

    41.3. In providing context for the above, ASIC explains as follows:[10]

    Broader public benefit

[8] Australian Securities and Investments Commission, "ASIC's approach to enforcement", series edited by Australian Securities and Investments Commission, report number: 151, Australian Securities and Investments Commission, 21 December 2022, p 8-9.

[9] Ibid.

[10] Ibid., p 2-3.

We are more likely to select matters that involve significant public interest or concern, or where enforcement action will benefit the public, for example:

- *enforcement action that is likely to influence other market participants by sending an effective deterrence message to the market*
- *testing or clarifying of important legal obligations for the benefit of market participants*
- *misconduct that is likely to continue or escalate unless we intervene*
- *enforcement action that will maintain public trust and confidence in our financial system and markets.*

Issues specific to the case

For each matter, we also consider the following issues when determining whether to undertake a formal investigation:

- *whether the matter is in our jurisdiction*
- *the nature of the misconduct – such as whether it was dishonest, deliberate or involved a high level of recklessness*
- *the impact of the misconduct – including the amount of money lost, the number of investors or consumers affected and the impact on them*
- *the time since the misconduct occurred – as action to address old misconduct may have less impact*
- *whether the misconduct is repeated or continuing*
- *whether reliable evidence is in our possession or likely to become available to prove the alleged misconduct.*

42. Taking the above factors into account we find the following factors in support of litigation:

42.1. Westpac Directors, incumbent at the time AUSTRAC launched proceedings, were running the bank when at least some of the 23 million breaches of AML/CTF occurred. As such it appears clear that pursuing directors for those breaches would satisfy the following:

42.1.1. *whether enforcement action is likely to clarify the law and help participants in financial markets to better understand their obligations* (doubtless pursuing Westpac Directors would have helped others in similar positions understand that their obligations would not be satisfied by turning a blind eye)*;*

42.1.2. *the time since the misconduct took place* (continuously for six years, up to and including the time when AUSTRAC launched proceedings)*;*

42.1.3. *whether a particular enforcement action is proportionate to the nature, severity, impact and prevalence of the misconduct* (the misconduct totalled 23 million breaches of the Act, and included transaction services for child abuse material – which Westpac had been warned about, but ignored. Westpac shareholders paid a $1.3 billion fine)*;*

42.1.4. *enforcement action that is likely to influence other market participants by sending an effective deterrence message to the market* (by failing to pursue Westpac Directors the message sent to the market is that certain entities are above the law)*;*

42.1.5. *testing or clarifying of important legal obligations for the benefit of market participants* (see 42.1.1 above)*;*

42.1.6. *enforcement action that will maintain public trust and confidence in our financial system and markets.*

42.2. Westpac had been on notice about AML failings since 2013, and indeed they implemented a non-approved money transaction platform ("Litepay") that by-passed reporting requirements to AUSTRAC, and was in breach of the *AML/CTF Act.* It appears these facts would satisfy the following:

42.2.1. *whether a particular enforcement action is proportionate to the nature, severity, impact and prevalence of the misconduct* (see 42.1.3 above)*;*

42.2.2. *the nature of the misconduct - such as whether it was dishonest, deliberate or involved a high level of recklessness* (Westpac ignored repeated warnings about failures in their AML/CTF regime).

42.3. In declining to pursue Westpac Directors, ASIC stated that the advice they had received on the merits, combined with public policy considerations (reasonable basis test), precluded them from pursuing the matter.

43. In light of the facts, and by comparison to Star Casino, it is difficult to understand how the Westpac case would not satisfy the test in 41.1, above. And under current Parliamentary accountability mechanisms, we will never be able to understand how that could be. As stated earlier, this is untenable.

44. In light of ASIC's stated framework for measuring reasonableness in pursuing a matter, it is even less explicable that ASIC concluded that public policy would mitigate against further action. This advice too, is kept confidential.

45. Questions must arise as to the process by which ASIC makes these public policy assessments, even if we leave to one side the fact that the assessments themselves are kept confidential.

45.1. Does ASIC seek the opinion of Barrister, who assesses the criteria, and then determines whether it would meet public policy grounds?

45.2. Or does ASIC make this assessment itself, to determine whether it would meet public policy grounds?

46. Because either alternative involves a high degree of interpretation; the imposition of personal values in the mind of the person making the assessment; and a claim by the person making the assessment to know either the mind of the Attorney-General, or the expectations and views of the broader public. None of which can be done without a significant degree of personal bias.

46.1. This alone needs to be understood and challenged. Without seeing the assessments themselves (assuming they exist in written form), because they fall under the rubric "confidential", we nonetheless should at least understand how the reasonable basis test is undertaken, and by whom.

46.2. This in turn may provide insights into what is in reality only an ostensible framework (41.2 above, and 41.3 above), but one which is malleable in the hands of those who wield it, in order to produce whatever outcome they seek. Put differently, is the *reasonable basis* a catch-all for ASIC to use when it cannot find flaws in the merits, but wants to avoid litigation nonetheless?

46.3. Ideally, and because such public policy / reasonable basis assessments are *less likely* to contain information of a confidential attorney-client nature, it appears intuitive that

assessments made on public policy / reasonable basis grounds should not be kept confidential, and should be provided to Parliament on request.

46.4. Failing which the public policy / reasonable basis advice upon which ASIC relies should be shared on an *in camera* basis. The counter-argument, that there be a blanket refusal to provide these assessments to Parliament, so that it may exercise oversight, is untenable.

Professor Ramsay's findings

47. In article published in the *Company and Securities Law Journal*, two eminent Australian legal academics investigated CDPP prosecutions, under an FOI application, over a ten-year period.[11]

48. The findings[12] are cause for concern. They include the following:

48.1. "[t]hat the findings indicate limited levels of criminal enforcement considering the data represents 10 years of federal prosecutions under two very significant corporate law statutes."

48.2. The authors identified 715 cases, in which 1,427 penalties were prosecuted.

48.3. However, those 1,427 penalties were comprised of only 86 unique sections across both the *Corporations Act* and the *ASIC Act*. The *Corporations Act* alone creates almost 900 sections that could be utilised in prosecutions.

48.3.1. Of those 86 sections, an even greater reliance is placed on a mere 19 sections (these are sections applied more than ten times each, across the ten-year period under analysis).

48.4. Of the sections that were used, in the vast majority of cases from the ten-year sample, the CDPP only relied on sections from the *Corporations Act*, and ignored the *ASIC Act*: of 715 cases prosecuted, 700 were under the *Corporations Act* (97.9 per cent); only 15 were under the *ASIC Act* (2.1 per cent).

48.5. There is a high rate of success in prosecution outcomes (which indicates either that the CDPP are exceptionally good lawyers, or that they do not take on difficult cases). See remarks at 39 above.

48.6. Penalties imposed by the courts are of limited severity.

48.6.1. It may be argued here that had others of the remaining 814 sections in the *Corporations Act* been deployed, and assuming they were proven, the penalties may have been higher.

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[11] Gilligan, George and Ian Ramsay, "Is There Underenforcement of Corporate Criminal Law? An Analysis of Prosecutions under the ASIC Act and Corporations Act: 2009–2018," *Company and Securities Law Journal*, Vol. 38 No. 6, (2021), pp. 435-458.

[12] Ibid., p 8.

> *As discussed earlier, given the pervasiveness and extent of misconduct scandals in Australia, including the misconduct in the financial services industry revealed by the Hayne Inquiry, these represent low levels of prosecutions over a 10-year period.*[13]

48.7. Most of the CDPP prosecutions were against individuals (in small firms), few were against corporations. Gilligan and Ramsay state:

> *In December 2018 at the end of the period under review, there were 2,655,141 companies registered in Australia. Table 6 shows that in 2018 there were only six cases of prosecutions against corporations involving a total of 26 counts. So, in 2018 [and similarly in other years] an extremely small percentage, 0.00044% of the overall total 2,655,141 companies were prosecuted by the CDPP under the ASIC Act or Corporations Act.*[14]

48.8. The CDPP's most successful prosecutions were where it alleged a defendant failed to lodge an annual report with ASIC.[15] Hardly a difficult matter to prove, and of little or no impact on systemic misconduct, or dysfunctional culture. Put differently: these prosecutions were concerned with administrative breaches, not honesty breaches.

48.9. The authors conclude with this damning assessment:

> *Given the scale of business misconduct in Australia in recent years, the fact that there have been only 715 prosecutions by the CDPP under two very significant corporate law statutes over a 10-year period is arguably low and reflects a limited level of criminal enforcement. Also, a relatively small number of sections comprise the bulk of prosecution activity over the 10-year period. For example, prosecutions under the five most extensively used sections in the Corporations Act constitute 36.9% of all cases (or matters) and 46.4% of all counts (or prosecutions under particular sections of the Corporations Act). There were only 118 prosecutions of corporations over the 10 years of the study period. The data on penalties reveals that actual custodial sentences served are a low number, only 104 in total over the 10- year period and that the median sentence for those 104 cases is 16.5 months. Fines imposed by courts tend to be low.*[16]

49. Within the context in which this Senate Inquiry is taking place, and the findings cited above, we should assume that the full gamut of the law is not being deployed by the CDPP; that its over-reliance on a mere 9.5 per cent of the sections available to it is indicative of a lack of expertise in, and knowledge of, the two Acts. For one thing, the *ASIC Act* in many parts repeats the *Corporations Act*. But this is no bar to alleging contraventions of both, and it is inexplicable – other than due to a lack of knowledge and expertise – that the CDPP would not allege breaches of every section in every Act that they could.

50. The question that must be asked is, who is responsible for determining which sections of the two Acts should be prosecuted? And so, by implication, where does the lack of expertise in, and knowledge of, the two Acts reside?

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[13] Ibid., p 9.

[14] Ibid., p 11-12.

[15] Ibid., p 16.

[16] Ibid., p 21.

50.1. Is it the CDPP which makes all the decisions about which sections to prosecute? Do they receive a brief from ASIC with only the evidence and no views on which sections have been breached? In which case it is the CDPP alone that is responsible for this failure. If that is so, then the CDPP must remedy its human capital shortfalls, and employ prosecutors who have an extensive knowledge of the two Acts. Or at least employ one person with extensive knowledge of the Acts, to oversee prosecutors that are charged with prosecuting crimes under the two Acts.

50.2. Is it ASIC that submits a brief to the CDPP, with evidence, and conclusions about which sections it thinks have been breached? In which case the CDPP is partly to blame, for not knowing about, and adding other sections to the brief; and it is partly ASIC's fault for not knowing and understanding the two Acts better, and being able to advise the CDPP about what other sections could be a basis for prosecution.

51. The writer is unable to answer these questions. However, it is hoped that the Committee will see the utility in the enquiries proposed, and will pursue them to determine which authorities (ASIC and/or CDPP) make the decisions about which sections to prosecute.

52. Whichever authority it is, it is my view that they lack expertise across the full gamut of sections available to them, and are excessively conservative about exploring the use of sections other than the 86 upon which they exclusively rely.

53. That authority / those authorities (ASIC and/or CDPP) should be required then to submit a plan on how they will remedy this expertise shortfall. One potential solution would be to appoint a panel of advisors, comprised of eminent academics and retired judges, who will advise ASIC and/or the CDPP on what sections of the Acts should be included for consideration.

54. I add, as a post-script to this section, the following: when ASIC refers matters to the CDPP, if the CDPP decides there is no prospect for a successful prosecution, then the matter dies there. Such decisions are not, in my understanding, routinely communicated to ASIC.

54.1. This should change, so that if the CDPP declines to prosecute, at least the matter in question can be referred back to ASIC, for consideration of a pecuniary penalty, or administrative action.

Recommendations

55. Supervision and regulation of conduct in financial services should be performed by a dedicated conduct-in-financial-services peak, aggregative of the skills and expertise needed, deeply knowledgeable about financial products and services, specialised in Chapter 7 of the *Corporations Act*, and with a culture that is willing – indeed eager – to enforce the law, including with difficult cases and complex matters.

55.1. Three options are available:

55.1.1. Under the *ASIC Act* allowance is made to constitute a separate division within ASIC for this task. In my opinion, this would be the worst option, as it would not separate this division from a broader corporate culture at ASIC, which has found, repeatedly, to be defective.

55.1.2. Constitute the regulator as a separate division within the ACCC. In my opinion there would be several advantages to this approach:

55.1.2.1. The ACCC has an excellent track-record of enforcement, and a strong enforcement culture.

55.1.2.2. It is deeply steeped in notions of protecting consumers and preventing harm.

55.1.2.3. The ACCC has a robust culture, strong enough to protect such a division from attempts to pressure or bully the division into forbearing from enforcing the law, by powerful, influential and well-resourced adversaries.

55.1.2.4. The ACCC has a history of pursuing matters that require new interpretations of the law. As such, in my view, the ACCC's culture would not be as excessively conservative in using the full gamut of the law, as ASIC's culture presently is.

55.1.3. The third option would be to establish a new regulator – one which would take with it ASIC's remit in respect of financial services. This new authority – the Financial Conduct Authority (FCA), for arguments sake – would be a wholly independent peak, charged only with conduct in financial services, independent, and analogous to APRA.

55.1.3.1. Such an authority would be able to build its own enforcement culture, and specialise in those aspects of supervision of financial services in which the ACCC is not as adept: specifically those aspects that require capacity assessments.

55.1.3.2. In establishing the CFPB in the United States, Senator Elizabeth Warren stated that "people are policy." By this she meant that securing the right people to put in leadership positions is crucial in the formative years of a new agency, and will reverberate far into the future. The CFPB's success to date stands as a testimony to her wisdom.

55.1.3.3. If a new FCA began with leadership like that afforded to the ACCC, under its foundation Chair, Alan Fels, then such an agency could, in time, become as effective as the ACCC is today.

55.1.3.4. The disadvantage in establishing an FCA would be the political and industrial pressure that it would encounter, if it decided to pursue large financial entities.

56. Establish within either a new FCA, or within a division within the ACCC, a dedicated litigation and prosecution unit, whose purpose would be to gain expertise in, in particular, court enforcements.

57. ASIC must be required to provide to Parliament, *in camera* if necessary, or to an advisory panel of eminent jurists, merits advice which ASIC purports advised against litigation. At least in respect of the matters recommended for prosecution by Commissioner Hayne, and the potential breach of director's duties at Westpac and CBA, in connection with AML/CTF breaches.

57.1. This is crucial to understanding, for example, how Star Casino Directors stand to be prosecuted, but not Westpac Directors.

57.2. If the advice was against prosecution, and unqualified, in all of these cases, then the reasons for the advice, and the conclusions reached, must be capable of being compared, at least in respect of Westpac and Star Casino.

57.3. If the advice in all of these cases is unqualified, and the reasons and conclusions in Westpac and Star Casino comport with one another, good and well. In that case ASIC will have substantiated their position.

57.4. However, if the advice is qualified, then it is ASIC that has decided against litigation, not the advice they have received.

57.5. If the reasons and conclusions in Star Casino and Westpac do not comport, then the question must be asked, why did ASIC accept contradictory advice?

58. Either way, Parliament (or an advisory panel to Parliament) must be given mechanisms by which to assess ASIC's refusals to litigate. The current arrangement creates a black hole; an impenetrable and opaque arrangement which is preventing effective Parliamentary oversight.

59. The arguments presented in 57 above, and 58 above, apply *mutatis mutandis* to public policy / reasonable basis for litigation advice, which ASIC has received: this advice must be made available to Parliament in order to facilitate scrutiny of that advice, and what would often be highly subjective conclusions therein on what would constitute a reasonable basis for litigation.

60. Parliament must determine whether the CDPP's failure to prosecute anything other than less than 10 per cent of the sections at its disposal in the *Corporations Act*, and almost none of the *ASIC Act*, is a failure on the part of the CDPP, or ASIC.

60.1. Whomever is to blame, rectification can be achieved by employing suitably qualified individuals and/or constituting and advisory panel of eminent jurists, to inform either ASIC or the CDPP of what other sections it should be deploying.

60.2. The CDPP must be encouraged to refer matters it refuses to prosecute back to ASIC, and ASIC must then be charged with investigating pecuniary and/or administrative penalties.

61. It is my view that if these recommendations were to be adopted, and in light of the regulatory arrangements evident elsewhere, and evidence of what has, and has not, succeeded elsewhere, that the current, highly dysfunctional regime, would be significantly and demonstrably improved.