

Chapter 3

Integrity risks

Introduction

3.1 This chapter considers whether the integrity arrangements of the Australian Securities and Investments Commission (ASIC) are sufficient to meet current and future challenges. The chapter discusses the following issues:

- conflicts of interest that arise in the financial services sector;
- the adequacy of ASIC's integrity and anti-corruption arrangements; and
- specific integrity risks for ASIC employees.

Background

3.2 Conflict of interest is a term widely used in the financial services sector. The Organisation for Economic Co-operation and Development (OECD) defines a conflict of interest as occurring when 'an individual or a corporation (either private or governmental) is in a position to exploit their own professional or official capacity in some way for personal or corporate benefit'.¹

3.3 The Productivity Commission noted the impact of conflicts of interest on competition in the financial services sector, stating that:

...commission-based remuneration structures create conflicts that may limit competition and mean that at times the money flow is at odds with acting in a consumer's best interest. These conflicts are particularly apparent where banks, as the creators of a financial product, are integrated with other entities that market, sell or advise on these same products.²

3.4 For many in the community, the scandals revealed by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) appear to epitomise the conflicts of interest by individuals and corporations in positions of trust which have exploited customers for personal and/or corporate gain.

3.5 The Royal Commission's interim report noted that:

All the conduct identified and criticised in this report was conduct that provided a financial benefit to the individuals and entities concerned.³

But almost every piece of conduct identified and criticised in this report can be connected directly to the relevant actor gaining some monetary benefit

1 Organisation for Economic Co-operation and Development, *Glossary of Statistical Terms*, July 2007, <https://stats.oecd.org/glossary/detail.asp?ID=7206> (accessed 12 February 2019).

2 Productivity Commission, *Competition in the Australian Financial System*, 29 June 2018, p. 24.

3 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, 28 September 2018, p. 301.

from engaging in the conduct. And every piece of conduct that has been contrary to law is a case where the existing governance structures and practices of the entity and its risk management practices have not prevented that unlawful conduct.⁴

3.6 The World Bank considers that when a position of trust is abused and conflicts of interest are taken advantage of for private or corporate gain, these actions are corruption.⁵ While conflicts of interest do not always lead to corruption, corruption almost always requires a conflict of interest:

When it comes to corruption, there is almost always a common denominator: a conflict of interest. A conflict of interest exists when an individual or corporation has the opportunity – real or perceived – to exploit their position for personal or corporate benefit. Corruption occurs when the individual or corporation takes advantage of that opportunity and indeed abuses their position for private gain.⁶

3.7 Regulatory agencies play a key role in ensuring integrity and public trust in government, but their location at the intersection of money and government power makes them particularly vulnerable to corruption.⁷

3.8 Victoria's Independent Broad-based Anti-corruption Commission (IBAC) noted that conflict of interest is a particular risk with regulatory authorities where employees work collaboratively with the industries they regulate, and because some regulatory bodies receive revenue from the industries they regulate. IBAC has summarised four factors that are drivers of corruption risks in regulatory authorities as follows:

Lack of transparency

IBAC found that reporting of regulatory outcomes varied across regulators, particularly the breadth of information being reported back to the regulated entities. The report notes that by providing transparency through public reporting, regulators can help assure the community that they are operating with integrity.

4 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, 28 September 2018, p. 302.

5 The World Bank, *Helping Countries Combat Corruption: The Role of the World Bank*, September 1997, p. 8.

6 Kelly Todd, Forensic Strategic Solutions, *Why corruption always requires a conflict of interest*, 28 October 2016, <https://www.forensicstrategic.com/blog/why-corruption-always-requires-a-conflict-of-interest> (accessed 12 February 2019).

7 David, Donaldson, The Mandarin, *Regulating the regulators: IBAC warns of corruption risks*, 26 July 2018, https://www.themandarin.com.au/96333-regulating-the-regulators-ibac-warns-of-corruption-risks/?utm_campaign=TheJuice&utm_medium=email&utm_source=newsletter (accessed 30 July 2018/12 February 2019).

Industry and regulatory capture

With an increased reliance on private industry to deliver what were once public services, there is potential for conflicted relationships. This can lead to 'regulatory capture', where regulators and their employees potentially align their values and actions with that of the industry they are regulating – rather than with the values and legislated purpose of the regulator.

Integrity history of employees

Regulators often require specialised skills and experience to perform work such as inspections and enforcement. It can be difficult to recruit and retain the best employees for these positions as these skills may also be in high demand in the private sector. Such competition could mean that employees with problematic histories of misconduct or corrupt conduct in other agencies are considered for employment in public bodies because they hold the requisite skills.

Targeting by organised crime groups

Many employees of regulatory authorities have high levels of access to sensitive personal and business information, sometimes with low levels of accountability. The cultivation of these employees is an attractive way for organised crime groups to facilitate their criminal activities.⁸

3.9 Managing conflicts of interest and identifying and addressing corruption is central to building and maintaining integrity. The Western Australia Integrity Coordinating Group defines integrity as:

...earning and sustaining public trust by serving the public interest; using powers responsibly; acting with honesty and transparency; and preventing and addressing improper conduct.⁹

3.10 In the past, Australia has had a strong reputation for integrity and anti-corruption institutions. However, evidence suggests that Australia's standards on integrity and anti-corruption may be falling. Australia is now ranked 13th among OECD countries and its corruption perception index has fallen steadily from 85 in 2012 to 77 in 2017.¹⁰

3.11 The Australian Commission for Law Enforcement Integrity (ACLEI) considers that the starting point of anti-corruption system design is to consider how corruption occurs and who benefits. It has identified the following corruption prevention myths:

8 Independent Broad-based Anti-corruption Commission, *Corruption risks associated with public regulatory authorities*, summary of report, July 2018, p. 2.

9 Chris Field, 'The fourth branch of government: the evolution of integrity agencies and enhanced government accountability', *Australian Institute of Administrative Law Forum*, No. 72, 2013, p. 25.

10 Transparency International, *Corruption Perceptions Index 2017*, https://www.transparency.org/news/feature/corruption_perceptions_index_2017, (accessed 12 February 2019).

- **Bad apples:** Thinking that corruption is always the domain of a 'bad apple' or rogue employee—a corrupt individual acting alone—can draw attention away from considering organisational vulnerability and integrity systems as a whole.
- **It's all about the money:** Assuming that vulnerability to corruption is always driven by financial gain can mean missing possible indicators. Personal benefit might take other forms, such as social reward, ideological satisfaction, or excitement.
- **Training will fix it all:** Formal training and education is often the first solution offered when issues become apparent—because it's measurable and quickly implementable. However, organisations should appreciate the influence that informal situations have on establishing a desired culture.
- **The slippery slope:** Believing that the 'slippery slope' to corruption is inevitable because of making one mistake or poor decision can be self-perpetuating. Early intervention is possible, if organisational integrity systems are strong, fair and employees have trust in them.
- **Only frontline staff are at risk:** Non-operational staff may be as vulnerable, and less prepared to respond, to improper approaches. Many have similar or higher levels of access to sensitive information and systems as their operational colleagues do.¹¹

ASIC's integrity and anti-corruption arrangements

3.12 ASIC informed the committee that it manages internal and external fraud risks under its Fraud Control Plan and Fraud Control Policy. The Fraud Control Plan includes a summary of identified internal and external fraud risks associated with ASIC's activities and functions, and sets out ASIC's approach to managing fraud risk through the risk management framework which is based on nine elements of the Commonwealth Risk Management Policy.¹²

3.13 Professor A J Brown argued that ASIC suffers from the same problem as most other Commonwealth agencies in lacking sufficient independent oversight, support and assurance to ensure the adequacy and performance of its internal integrity and anti-corruption systems, due to the general weaknesses of the Commonwealth integrity system. Professor Brown noted that:

In particular, the combination of the APS Code of Conduct regime and AFP-oversighted corruption investigations are not up to standard as a system for ensuring that integrity risks and issues are handled consistently and appropriately in agencies, nor for providing independent oversight or

11 Australian Commission for Law Enforcement Integrity, *Corruption Prevention Myths: ACLEI top 5 corruption prevention myths*, <https://www.aclei.gov.au/corruption-prevention/corruption-prevention-myths> (accessed 12 February 2019).

12 Australian Securities and Investments Commission, answers to questions on notice, 1 August 2018 (received 15 August 2018).

ensuring that high-risk misconduct cases are independently investigated rather than simply dealt with 'in house', where necessary.

As one of the 7 agencies that are members of the AFP-led Fraud & Anti-Corruption Centre but not subject to the jurisdiction of ACLEI, ASIC is one of the agencies [where] these gaps are particularly evident.¹³

3.14 The ASIC Capability Review recommended that ASIC should no longer be required to employ staff under the *Public Service Act 1999*. This is consistent with the earlier findings of the Financial Systems Inquiry. The Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018 which was passed on 17 September 2018 will give effect to the above recommendation. The change is intended to support ASIC to more effectively recruit and retain staff in positions requiring specialist skills. It will bring ASIC into line with other financial regulators (the Australian Prudential Regulation Authority and the Reserve Bank of Australia).¹⁴

3.15 ASIC staff will be employed on behalf of ASIC and not on behalf of the Commonwealth. ASIC staff will be subject to an ASIC Code of Conduct and ASIC Values, to be determined by the ASIC Chairperson. ASIC staff under the ASIC Act will not be subject to the Australian Public Service Values and Code of Conduct. The ASIC Chairperson is required to uphold and promote the ASIC Values. The Chairperson of ASIC is also required to take reasonable steps to minimise conflicts of interest by having adequate disclosure of interest requirements that apply to all staff employed by ASIC.¹⁵

3.16 While the above approach retains a set of values and code of conduct under an employment contract, it lacks the oversight by a statutory external agency and as a result, weakens ASIC integrity and anti-corruption measures.¹⁶ A separate question remains as to whether a set of values and a code of conduct provide sufficient integrity and anti-corruption arrangements. On this point, Commissioner John Price indicated that:

...the existing arrangement we've had around contractual arrangements and staff needing to maintain appropriate professional standards have been most effective indeed, and I'm not sure that any change of legislation through moving out of the Public Service will alter that in any way.¹⁷

13 Professor A J Brown, answers to questions on notice, 1 August 2018 (received 27 August 2018).

14 Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018, *Explanatory Memorandum*, 28 March 2018, p. 9, https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6087 (accessed 12 February 2019).

15 Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018, *Explanatory Memorandum*, 28 March 2018, pp. 9 and 10–11.

16 *Committee Hansard*, 17 August 2018, pp. 7–8.

17 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 17 August 2018, p. 8.

3.17 ASIC advised it had not undertaken a comparison of its integrity and anti-corruption arrangements with the arrangements for peer regulators in the United States, Canada, United Kingdom (UK), Singapore, Hong Kong and Japan. ASIC argued that such a comparison would cause an unreasonable and significant diversion of ASIC's regulatory and legal resources.¹⁸ Such a comparison could be facilitated through ASIC's participation in the International Organisation of Securities Commissions (IOSCO). ASIC is on the board and the former ASIC Chairman Mr Greg Medcraft was Chairman of IOSCO for several years, starting from March 2013.¹⁹

3.18 The committee sought Treasury's view on the adequacy of ASIC's current integrity and anti-corruption arrangements. Initially, Treasury responded by stating that:

Treasury considers that ASIC is best placed to answer questions about the precise nature and range of the integrity and anti-corruption arrangements that apply to it.²⁰

3.19 The committee informed Treasury that it considered it not best practice for agencies to be responsible for determining whether or not their own governance arrangements are adequate and, in particular, whether their own integrity and anti-corruption arrangements are adequate. The committee requested Treasury to reconsider its answer. In its second response, Treasury stated that:

Treasury refers to the information ASIC has provided on its internal and external governance frameworks in its response to the Parliamentary Joint Committee Secretary's letter of 1 August. Treasury notes that those frameworks are similar to those that govern other independent regulators such as the Australian Prudential Regulation Authority and the Australian Competition and Consumer Commission.²¹

3.20 The Commonwealth Ombudsman is able to investigate complaints from people who believe they have been treated unfairly or unreasonably. From 2016–17 to 2017–18, the Commonwealth Ombudsman received 352 complaints of which 20 were investigated. The Commonwealth Ombudsman receives less than one complaint per year about ASIC's Professional Standards Unit. The Commonwealth Ombudsman noted that, while it does not review the adequacy of ASIC's integrity arrangements, the complaints data do not indicate any inadequacy.²²

18 Australian Securities and Investments Commission, answers to questions on notice, 1 August 2018 (received 15 August 2018).

19 International Organisation of Securities Commissions, 'Greg Medcraft of ASIC re-elected IOSCO Board Chair', *Media release*, 2 October 2014, p. 1.

20 Department of the Treasury, answers to questions on notice, 1 August 2018 (received 15 August 2018).

21 Department of the Treasury, answers to questions on notice, 30 August 2018 (received 14 September 2018).

22 Office of the Commonwealth Ombudsman, answers to questions on notice, 1 August 2018 (received 14 August 2018).

3.21 The Commonwealth Ombudsman had conducted one own-motion investigation into an alleged conflict of interest regarding the granting of regulatory relief. The Ombudsman concluded that there was no evidence to suggest that ASIC's decision to grant regulatory relief was contaminated by conflict of interests. However, the Ombudsman did make three recommendations regarding ASIC's management of the disclosure of a possible conflict of interests and its efforts to address issues raised by the disclosure.²³

3.22 ASIC has previously identified how corruption risks arise from its role as a regulator. These risks fall into three areas:

- (a) Potential corruptors may stand to make a financial profit, or otherwise enhance their commercial interests, by obtaining access to the information and intelligence that ASIC collects as a result of ASIC's regulatory functions.
- (b) Alternatively, potential corruptors may seek to benefit from favourable treatment such as the imposition of lower penalties, improper determinations of relief applications, or other biased decisions.
- (c) ASIC staff may seek to gain a profit or benefit for themselves or others...may use ASIC powers and discretions for an improper purpose, and may protect unlawful activity by diverting attention or otherwise manipulating surveillance and investigations.²⁴

3.23 The rest of this chapter seeks to explore the integrity risks arising from favourable treatment (regulatory capture) and where staff seek to gain a benefit for themselves or others.

Regulatory capture risks

3.24 Regulatory capture refers to instances where regulators are excessively influenced or effectively controlled by the industry they are supposed to be regulating. There are three areas in which particular risks arise for regulatory capture:

- staff moving between industry and regulatory jobs;
- secondments; and
- where regulatory staff are embedded in private sector organisations (that is, required to conduct their work within the workplace of industry participants, away from their home base at the regulator).

3.25 While all three types of staff movement bring certain advantages, there are also attendant risks for regulatory capture and corruption. Mr Shipton, Chairman of ASIC, acknowledged this at a recent hearing:

23 Office of the Commonwealth Ombudsman, answers to questions on notice, 1 August 2018 (received 14 August 2018).

24 Australian Securities and Investments Commission, *Submission 5* to the Parliamentary Joint Committee on the Australian Commission for Law Enforcement Integrity, Inquiry into the jurisdiction of the Australian Commission for Law Enforcement Integrity, May 2016, p. 6.

Regulatory capture is a big issue for us. We have studied very closely some very interesting and important examples of regulatory capture out of the United States. We've actually already had training for our supervisory teams on regulatory capture. We will be having very frequent checks in with them and disclosures and training with the supervisory team about how to watch out for regulatory capture.²⁵

ASIC secondments

3.26 ASIC uses secondments to and from industry to:

- fill temporary vacancies and provide opportunities for staff to increase their knowledge and skills;
- develop a multi-skilled workforce;
- strengthen relationships with key regulators and the private sector;
- deepen ASIC's regulatory expertise;
- retain and develop ASIC's high potential talent; or
- develop leaders with a diverse perspective.²⁶

3.27 Private sector secondments are also facilitated through section 122 of the ASIC Act. This does not alter the existing employment relationship and means that the home organisation will continue to pay the secondee. Partial or full payment may be recovered from the host agency by invoice.²⁷ Senior Executive Leaders must approve all private sector secondments.²⁸

3.28 ASIC's secondment policy recognises that conflicts of interests or compromised security may be risks, particularly with private sector organisations that ASIC regulates. The policy notes that these risks can be mitigated by:

- ensuring mandatory security clearances are completed and approved before the secondment commences;
- designing secondment positions to offer meaningful work without exposure to potential conflicts; and
- liaising with external secondment partners and risk and security services in advance and during the secondment to ensure any potential conflicts are considered and addressed by the Chief Legal Office. This includes any agency-specific legislation security protocols and mandatory training requirements.²⁹

25 Mr James Shipton, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 19 October 2018, p. 14.

26 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 5.

27 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 8.

28 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 7.

29 Australian Securities and Investments Commission, *Secondment Policy*, 2013, p. 10.

3.29 The potential risks arising from secondments were highlighted when the Senate Economics References Committee recommended that the Commonwealth Ombudsman consider undertaking an own motion investigation into an allegation of a conflict of interest for a secondee from a financial services firm in relation to ASIC's decision to grant regulatory relief in 2005. The Ombudsman found that there was no evidence to suggest that ASIC's decision to grant relief was contaminated by conflict of interest or other undue influence.³⁰

3.30 However, the Ombudsman noted that:

- ASIC did not comply with its own internal policies for dealing with conflicts of interest; and
- the final report of ASIC's internal investigation into the allegations could not be produced, making it difficult to assess whether the investigation was appropriate in all the circumstances.³¹

3.31 The Ombudsman went on to make the following observations:

The Ombudsman acknowledges that secondment arrangements can be highly beneficial. Secondments involving private sector organisations have the potential to improve a regulator's knowledge and understanding of the operating environment of the entities it regulates.

However, it is critical that public sector agencies, and regulators in particular, appropriately identify and manage the possible conflicts of interest that are inherent in secondment arrangements. The processes for doing so should be robust and transparent in order to maintain public confidence in the integrity of agencies' internal processes and decision making.³²

3.32 In 2014, ASIC informed the committee that in the previous five years there had been 41 secondments of ASIC staff to industry, with 90 per cent of those being SES or executive staff. In the same period, 14 staff had been seconded from industry to ASIC, all at the executive level.³³

30 Commonwealth Ombudsman, *Australian Securities and Investments Commission: Own motion investigation into the management of a conflict of interest matter in 2005*, November 2015, p. 4.

31 Commonwealth Ombudsman, *Australian Securities and Investments Commission: Own motion investigation into the management of a conflict of interest matter in 2005*, November 2015, p. 4.

32 Commonwealth Ombudsman, *Australian Securities and Investments Commission: Own motion investigation into the management of a conflict of interest matter in 2005*, November 2015, p. 4.

33 Australian Securities and Investments Commission, answers to questions on notice 28 March 2014 (received 5 May 2014).

ASIC staff embedded in banks

3.33 In August 2017, ASIC announced that its supervisory staff will be embedded with banks to monitor governance and compliance with laws. The purpose is to detect, respond to and remediate any failures in systems, procedures or decision-making processes inside financial institutions that could lead to, or are leading to, unacceptable outcomes for the consumers of financial services. ASIC also noted that:

We want to increase the probability that the average person inside financial institutions will come across and spend time with a supervisory officer. We believe that that will change the mindset in thinking, decision-making and their application to the daily work.³⁴

3.34 That said, embedded staff face increased risks of regulatory capture and corruption because of their proximity to those they regulate. ASIC informed the committee that it was aware of the risks and was taking precautions, including rotation between banks, limiting the amount of time away from ASIC, and ensuring the deployed staff are sufficiently senior. In addition, staff are also undergoing training, including examining case studies, to prevent regulatory capture in Australia.³⁵

Other integrity risks

Real-time surveillance of markets

3.35 In 2013, ASIC assumed responsibility for supervision of real-time trading on Australia's domestic licensed equities and future markets. Since that time, the nature of the markets has changed dramatically and the scope of ASIC's supervisory responsibilities has increased. ASIC supervises 125 market participants, trading across seven equities and futures markets, on which the securities of more than 2000 listed entities are traded. More than 960 000 trades are made per day, compared with 520 000 in 2010.³⁶ Those seven markets are a subset of over 50 markets now operating in Australia.³⁷

3.36 ASIC implemented its Market Analysis and Intelligence (MAI) system in 2013 to provide sophisticated data analytics and identify suspicious trading in real time and across markets, as well as greater levels of detection of insider trading. MAI is built around algorithmic trading technology, and gives ASIC the ability to analyse trade data for patterns and relationships. The new system was designed, built and hosted by First Derivatives, and is based on technology used in financial markets

34 Mr James Shipton, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 17 August 2018, p. 3.

35 Mr James Shipton, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 17 August 2018, p. 3.

36 Australian Securities and Investments Commission, *Fifth anniversary of ASIC market supervision*.

37 Australian Securities and Investments Commission, *Annual report, 2016–17*, p. 20.

for market data capture, alerts and analytics and high frequency and algorithmic trading.³⁸

3.37 While the MAI system can provide substantial benefits to identifying suspicious activity, it also comes with some attendant integrity risks. In particular, the capacity of staff to discount or ignore information can allow others to benefit. Training and active supervisory monitoring are required to reduce the potential for such situations from arising.

ASIC staff trading

3.38 It is very important that any trading or participation in financial services by ASIC employees is legal and perceived by the public to be fair. Where ASIC staff engage in trading in shares and derivatives and participate in financial services in other ways, there is the potential for conflicts of interest to occur.

3.39 ASIC's Commissioners are subject to a Statement of Obligations, which includes a requirement to make the following disclosures to the Minister in writing:

- any direct or indirect pecuniary interest they have in a business in Australia, or any body corporate carrying on a business in Australia;
- any direct or indirect pecuniary interest in financial products or other interests regulated by ASIC; and
- any agreement, understanding or expectation that they will resume a previous business relationship or enter into a new business relationship when they cease to be a Commissioner and any related severance arrangement or ongoing financial arrangement (ASIC Act, s. 123).³⁹

3.40 That said, the *Public Governance, Performance and Accountability Act 2013* (PGPA Act) also places the following obligations on ASIC Commissioners:

- exercise due care and diligence (s. 25);
- act honestly, in good faith and for a proper purpose (s. 26);
- not improperly use their position to gain an advantage for themselves or others or to cause detriment to ASIC or anyone else (s. 27);
- not improperly use information (s. 28); and
- disclose details of their material personal interests (s. 29).

3.41 The Statement of Obligations provides that Commission members, like all ASIC staff, must obtain approval before they or their connected persons trade in

38 Australian Securities and Investments Commission, 'ASIC's next generation market surveillance system commences', *Media release 13 316MR*, 25 November 2013.

39 Australian Securities and Investments Commission, *Statement of obligations – ASIC Commissioners*, <https://asic.gov.au/about-asic/what-we-do/how-we-operate/asics-internal-governance/statement-of-obligations-asic-commissioners/>, (accessed 12 February 2019).

financial products (as defined in ASIC's Staff Trading Policy) or pre-register for an Initial Product Offering.⁴⁰

3.42 The UK Financial Conduct Authority's published code of conduct includes a section on staff trading that requires staff to seek clearance in advance of carrying out any trades in relevant organisations (including contacting brokers) and must complete the trades in two working days. Approval is not normally given to dispose of investments held for less than six months to avoid any perception of an abuse of information. Employees are prohibited from trading in contracts for difference, spread betting, wagering contracts, and fixed odd bets on UK companies and UK markets. Investing in a fund of contracts for difference is permitted.⁴¹

3.43 The US Securities and Exchange Commission standards of ethical conduct also address employee share trading and include the following provisions:

- members and employees are prohibited from purchasing or selling any security while in possession of material non-public information regarding that security;
- members and employees are prohibited from recommending or suggesting to any person the purchase or sale of security; and
- members and employees are prohibited from a wide range of trading activities.⁴²

ASIC's surveillance of the dark web

3.44 The 'dark web' refers to the portion of the internet that can only be accessed with additional networking protocols and software. Within the dark web, marketplaces exist which enable criminals to anonymously buy, sell and exchange goods and services, including malicious software and illegal substances. The dark web can also provide access to sensitive networks, payment card data, bank account information, brokerage account information and hacking services. Some of these activities occur within closed internet forums which require both sellers and purchasers to have demonstrated trust or reputation with forum administrators and users before being provided with access.⁴³

40 Australian Securities and Investments Commission, *Statement of obligations – ASIC Commissioners*.

41 UK, Financial Conduct Authority, *Code of Conduct*, January 2016, p. 8.

42 US Securities and Exchange Commission, *Supplemental standards of ethical conduct for members and employees of the Securities and Exchange Commission*, July 2010, p. 775.

43 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 4.

3.45 As the use of the dark web continues to grow, dark web marketplaces may be used to facilitate financial crime. The dark web presents challenges for law enforcement as it is difficult to directly access.⁴⁴

3.46 ASIC has indicated that there are difficulties in developing surveillance capabilities to monitor the dark web, including:

- the ability to assume identities in order to 'gain trust' to access closed dark web forums;
- the protection of its systems and information from the dark web;
- the obscuring of internet protocol addresses to use the web anonymously;
- the immediate jurisdictional access to 'threat actors' who are largely operating outside Australia; and
- lack of technological software and tools that have a specific focus on financial crimes, as typically the focus is on narcotics and terrorism.⁴⁵

Other issues with implications for ASIC's integrity

3.47 In addition to the issues already considered in this chapter, there are a number of other issues which have arisen since previous inquiries considered ASIC's integrity and anti-corruption arrangements:

- ASIC's increasing role as a law enforcement agency;⁴⁶
- ASIC's proposal that it be prescribed as a law enforcement agency in the Crimes Regulations 1990 for the purposes of Part IAC of the *Crimes Act 1914* (Crimes Act) on assumed identities;⁴⁷
- ASIC's indication that it would support law reform to:
 - harmonise and enhance ASIC's search warrant powers with those in the Crimes Act (for example, to allow ASIC to operate or secure electronic devices);
 - provide ASIC with access to telecommunications intercept material to investigate and prosecute serious offences; and

44 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 4.

45 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 5.

46 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 3.

47 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 10.

- allow ASIC to obtain and share telecommunications data with its foreign counterparts which will help with, for example, the investigation of dark web activity facilitated by actors located overseas;⁴⁸
- ASIC's participation in joint taskforces and operations with other law enforcement agencies;
- ASIC's industry funding model;⁴⁹
- the proposal to grant ASIC broader competition powers;⁵⁰
- the recommendation by the Productivity Commission that all banks should appoint a Principal Integrity Officer obliged by law to report directly to their board on the alignment of any payments made by the institution with the new customer best interest duty;⁵¹
- the scale of corporate crime which is estimated to cost Australia more than \$8.5 billion a year and account for approximately 40 per cent of the total cost of crime in Australia.⁵² This figure is likely to increase following the revelations of the Royal Commission;
- the legislative proposal for ASIC's expanded role in relation to whistleblowing in the private sector, including the ability to make class orders to exempt companies from the requirement to have a whistle-blower policy;⁵³ and
- the extent to which ASIC would benefit from ACLEI's proactive educational role on anti-corruption measures.

Committee view

3.48 The committee considers previous inquiries into ASIC's integrity and anti-corruption risks did not have access to evidence on:

- the revelations of the Royal Commission and the extent of the crime occurring in the financial services section;

48 Australian Securities and Investments Commission, *Submission 11* to the Parliamentary Joint Committee on Law Enforcement, Inquiry into the impact of new and emerging information and communications technologies, January 2018, p. 10.

49 Australian Securities and Investments Commission, *Industry funding factsheet*, June 2018.

50 The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Government takes action to enhance ASIC's capabilities', *Media release*, 28 March 2018.

51 Productivity Commission, *Competition in the Australian Financial System*, 29 June 2018, p. 24.

52 The estimates refer to figures quoted in Attorney General Department, 2016, Improving enforcement options for serious crime: Consideration of a Deferred Prosecution Agreements scheme in Australia, *Public Consultation Paper*, p. 1.), <https://www.ag.gov.au/Consultations/Documents/Deferred-prosecution-agreements/Deferred-Prosecution-Agreements-Discussion-Paper.pdf> (accessed 12 February 2019).

53 Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2018.

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- the extent to which the definition of serious and organised crime law enforcement agencies does not accord with the community standards and legislated definitions by the Parliament;
 - the pervasive nature of conflicts of interest in the financial services sector that turn into corrupt events when positions of trust are abused;
 - regulatory capture risks arising from ASIC's secondments, flow of staff between ASIC and industry, and ASIC's new plan to embed its staff in industry;
 - corruption risks arising from the involvement of ASIC staff in trading;
 - corruption risks arising from ASIC's real-time surveillance; and
 - corruption risks arising from ASIC's surveillance of the dark web.

Regulatory capture

3.49 The committee considers that regulatory capture is a significant issue faced by Australian regulators generally, given the size and power of corporations that operate in Australia. ASIC faces particular risks due to the financial benefits to be gained by participants in the financial services sector and the close interaction of ASIC staff and the industry it regulates. The committee notes that ASIC has been criticised for being a timid regulator⁵⁴ and is concerned that such timidity could be a result of regulatory capture.

3.50 While the committee has not sought to examine in detail the nature and extent of regulatory capture, the perception that regulatory capture has occurred:

- weakens ASIC's ability to perform its role;
- increases ASIC's vulnerability to corruption risks; and
- deprives ASIC of vital information from consumers and industry participants that lose trust in ASIC and no longer report misconduct.

3.51 The committee notes that regulatory capture is a significant integrity issue which affects ASIC and this has been supported by the findings of the Royal Commission. This, together with the public perception of ASIC as a timid regulator, adds significant emphasis to the need for ASIC's integrity and anti-corruption arrangements to be strengthened.

Other integrity risks

3.52 The committee observes that ASIC officers working on the real-time surveillance system are exposed to two very significant corruption risks. Industry participants may seek to corrupt them to not notice or report certain events, or to leak insider information.

⁵⁴ Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. xviii.

3.53 The committee notes that integrity and corruption risks arising from ASIC staff participating in trading were not considered by the Parliamentary Joint Committee on the ACLEI inquiry or the Senate Select Committee on a National Integrity Commission. ASIC staff being involved in trading presents an inherent conflict of interests. As noted earlier in this chapter, where conflicts of interest are acted on, they potentially become corrupt acts.

3.54 The committee considers that it is vital for ASIC staff to be beyond reproach and to be perceived to be so. The committee is not convinced that the measures that are currently in place are sufficient to guarantee that ASIC staff are perceived, by those they regulate and the public, to be free from conflicts of interest. In particular, the committee is not convinced that the existing share trading governance process in ASIC would be able to identify all instances where ASIC staff (particularly those involved in market monitoring and information technology) have access to inside information which could be used to benefit from trades.

3.55 The committee considers that the corruption risks arising from ASIC staff continuing to be involved in trading adds further weight to arguments to enhance ASIC's integrity and anti-corruption arrangements. Consequently, the committee believes that further consideration should be given to whether ASIC staff should be allowed to engage in trading at all.

3.56 The committee notes that ASIC is proposing reforms to allow it to address the challenges presented by the dark web. Some of these reforms, such as the ability to assume identities, would represent significant additional powers that warrant appropriate oversight. In addition, working undercover and gaining the trust of dark web forums would expose ASIC officers undertaking those roles to significantly greater corruption risks than has previously been the case.

3.57 The committee considers that, if such reforms are progressed, they would add significant weight to the case for ASIC to be placed under a suitable external integrity regime.

Conclusion

3.58 The committee notes that ASIC has embarked on a review of its conflicts of interest process and approach. During the next parliament, the committee will be interested in hearing from ASIC on the outcomes of this review and the steps that ASIC is taking to address conflicts of interest and associated integrity risks.

3.59 The committee is concerned that ASIC's responses to questions about integrity and anti-corruption arrangements are focussed on fraud and do not reflect a sufficiently broad and sophisticated understanding of the types of issues identified by the Victorian IBAC and the specific risks identified in this chapter. The committee is also concerned that the Treasury, as the portfolio agency responsible for ASIC, was not able to effectively respond to questions on the adequacy of ASIC's integrity and anti-corruption arrangements.

3.60 It is essential for ASIC to be perceived as being beyond reproach, and to be driven by an unconditional commitment to upholding the law without conflicts of interest that could lead to corruption.

3.61 Subject to the findings of the Royal Commission, the committee considers there is merit in an independent external risk assessment of ASIC's integrity and anti-corruption arrangements to be undertaken by an integrity and anti-corruption expert with reference to:

- the integrity of ASIC's performance of all its functions, particularly in the broader sense of observing proper practice;
- risks associated with regulatory capture;
- whether ASIC's decisions on whether to pursue litigation or negotiated settlements are completely unencumbered from the influence of those it regulates; and
- whether closer scrutiny of ASIC's integrity and anti-corruption arrangements would improve ASIC's performance as a regulator.

3.62 The committee also considers there is merit in ASIC working with IOSCO to conduct a comparative analysis of integrity and anti-corruption measures being undertaken in similar jurisdictions.

Recommendation 2

3.63 The committee recommends that ASIC work with the International Organisation of Securities Commissions to conduct a comparative analysis of integrity and anti-corruption measures being undertaken in similar jurisdictions.

