An analysis of penalties under ASIC administered legislation: scoping the issues—Paper 1

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MAY 2015
WORKING PAPER NO.071/2015 / PROJECT NO.T021

This research was supported by the Centre for International Finance and Regulation, which is a Centre of Excellence for research and education in the financial sector, funded by the Commonwealth and NSW Governments and supported by other consortium members www.cifr.edu.au.
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AN ANALYSIS OF PENALTIES UNDER ASIC ADMINISTERED LEGISLATION:
SCOPING THE ISSUES

WORKING PAPER NO. 1

31 May 2015

George Gilligan, Paul Ali, Andrew Godwin, Jasper Hedges and Ian Ramsay

ABSTRACT

This working paper is the first published output of an eighteen month (December 2014 – June 2016) research project conducted by staff at the Melbourne Law School that examines enforcement and penalties regimes under legislation administered by the Australian Securities and Investments Commission (ASIC). During 2015 and early 2016 the project will conduct a review of selected penalties over a ten year period from 2005 to 2014. This paper is an introductory publication that scopes the issues that will be examined in the course of the project. The paper begins with a brief overview of the project and identifies topics that will be considered as the project progresses. Part II discusses key findings in ASIC’s Report 387: Penalties for Corporate Wrongdoing which compares the penalties available to ASIC in relation to comparable regulators in other jurisdictions. Part III examines current debates about corporate wrongdoing and the adequacy of penalties, including the impact of recent parliamentary inquiries. Part IV explains ASIC’s regulatory and enforcement functions and briefly discusses the policy rationales that underlie such functions. Part V presents a preliminary set of data on ASIC's enforcement activity sourced from its six monthly Enforcement Reports. Part VI makes initial observations in relation to comparable financial market regulatory agencies in other jurisdictions by reference to various criteria, including funding models. Part VII concludes the working paper.

I INTRODUCTION

This working paper is the first publication of an eighteen month research project that will conduct a review of selected penalties available to the Australian Securities and Investments Commission (ASIC) over a ten year period from 2005 to 2014. The project will examine penalties from both a domestic and comparative perspective, building on work performed by ASIC in Report 387: Penalties for Corporate Wrongdoing, released on 20 March 2014 (see Part II for further discussion of Report 387). Australia will be the predominant focus of the project while selected enforcement activities in other jurisdictions will be examined to situate the domestic research within a comparative framework. The research project will approach the issues from a primarily empirical point of view, which will complement the comparative legal analysis performed by ASIC in Report 387.

1 George Gilligan is a Senior Research Fellow, Paul Ali an Associate Professor, Andrew Godwin a Senior Lecturer, Jasper Hedges a Research Fellow and Ian Ramsay Professor and Director of the Centre for Corporate Law and Securities Regulation (CCLSR), Melbourne Law School. We acknowledge the financial support for the project ‘An Analysis of Penalties Under ASIC Administered Legislation’ received from The University of Melbourne and the Centre for International Finance and Regulation (CIFR) which is funded by the Commonwealth of Australia and NSW State Government and other consortium members (see http://www.cifr.edu.au). Email: george.gilligan@unimelb.edu.au.

The research project will produce a series of research papers up until June 2016. The purpose of this introductory working paper is to provide background information and a preliminary overview of the issues that will be explored in the course of the project. Our second paper will be completed by the end of July 2015 and constitutes the first part of our research on penalties in the area of financial services, which has been the subject of significant controversy and scrutiny in recent years. This second paper will present the results of our analysis of court proceedings from 1 July 2011 to 30 June 2014 at which either a criminal sanction or a pecuniary civil penalty was imposed on a person or corporation for contravening Chapter 7 of the Corporations Act 2001 (Cth). In addition to continuing our research into financial services, subsequent papers will address, among other topics: methodological issues that arise in assessing the efficacy of corporate regulatory regimes; key trends in ASIC’s use of enforceable undertakings; and penalties imposed in directors’ duties matters.

Our domestic research on the above topics, among others, will serve to complement ASIC’s own work on penalties, particularly as some topics such as directors’ duties fell outside the scope of the comparative analysis of maximum penalties in Report 387.3 As ASIC explains in Report 387, Australia’s laws in relation to directors’ duties differ from other jurisdictions to such a degree that a comparative analysis of directors’ duties would not be meaningful. Only certain regulatory issues and jurisdictions are suitable for international comparison. At each stage of the research project, careful consideration will be given as to whether the forms of wrongdoing and regulatory structures in the selected jurisdictions are sufficiently similar to yield meaningful comparisons with penalties available under ASIC administered legislation.

II ASIC’S REPORT 387: PENALTIES FOR CORPORATE WRONGDOING

A fundamental objective of regulation and regulated actors such as ASIC is to persuade those who are regulated to comply with the law. Penalties regimes and their associated deterrent capacity are central to influencing the rational actor decision-making capacities of those who are regulated. The assumption underlying this regulatory calculus is that the rational actor regulated community will, based upon their experience and knowledge evaluate the likely benefits and costs of engaging in various types of behaviour. If certain forms of non-compliant behaviour offer sufficient potential degrees of reward, then a crucial challenge for the regulator is to recalibrate the decision-making matrix of the regulated through not only enforcement activity such as significant surveillance and sufficient likelihood of detection, but also anticipated costs via available penalty regimes.

The stated purpose of ASIC’s Report 387 is to:

‘...outline the penalties available for a range of corporate wrongdoing under legislation administered by ASIC to enable consideration of whether they are proportionate and consistent with those for comparable wrongdoing:

(a) in overseas jurisdictions (i.e. Canada (Ontario), Hong Kong, the United Kingdom and the United States); and

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3 See ibid, pp. 5, 13.
It is important to engage in such comparative research because as ASIC stresses:

‘Effective regulation depends on achieving enforcement outcomes that act as a genuine deterrent to misconduct…Central to effective enforcement are penalties set at an appropriate level, and having a range of penalties available for particular breaches of the law.’

Report 387 seeks to achieve its twin purposes by comparing maximum penalties for similar types of corporate wrongdoing under different legislation and, on the basis of that comparison, examining how the penalties available to ASIC compare internationally and whether these available penalties are: ‘…proportionate and consistent.’ Report 387 further directs this comparison by examining penalties for different types of market misconduct such as market manipulation, insider trading and making false statements to the market; and financial services misconduct such as fraud, unlicensed conduct, false or misleading representations and inappropriate advice. The central conclusions made by ASIC are that:

‘…both the maximum terms of imprisonment and fines available in Australia are broadly consistent with those available in the overseas jurisdictions surveyed; and non-criminal monetary penalties—including administrative penalties and disgorgement—are not as widely available and are lower in Australia when compared with the overseas jurisdictions surveyed.’

Regarding maximum imprisonment terms, of the four overseas jurisdictions surveyed in Report 387 three are largely comparable with Australia but in the United States (US) there is a marked difference. For example, the maximum term for disclosure offences in Australia is 5 years, but in the US it is 20 years, and for unlicensed conduct offences in Australia the maximum is 2 years and in the US it is 20 years. Even more marked perhaps are the differences between Australia and the other jurisdictions surveyed regarding the imposition of civil and administrative penalties for individuals. For example maximum civil penalties in Australia for insider trading are Aus$200,000, whereas they are unlimited in Hong Kong and the United Kingdom (UK), in the US the greater of Aus$1,100,000 or three times the benefit gained, and in Canada Aus$1,050,000. There are similar discrepancies between Australia and the other jurisdictions regarding market manipulation, disclosure, false statements, etc.

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5 Ibid, p.4.
6 Ibid.
7 Ibid, p.15.
8 Ibid, p.16.
9 ‘Civil’ penalties are non-criminal court-imposed sanctions, while ‘administrative’ penalties are non-criminal sanctions imposed by ASIC itself. A range of administrative penalties are available to ASIC. For example, in relation to financial services providers, ASIC may suspend or cancel financial services licences, make temporary or permanent banning orders to prevent a person from providing financial services, vary or impose conditions on financial services licences, and direct licence holders to provide certain information about their business, activities or services, among other actions. See ASIC’s Regulatory Guide 98, Licensing: Administrative Action against Financial Services Providers for further information on ASIC’s administrative powers in relation to financial services providers.
unlicensed conduct and inappropriate advice.\textsuperscript{10} However, some Australian regulatory agencies do have greater flexibility and capacity than ASIC in these areas, at least with respect to contraventions by body corporates:

‘For example, for cartel conduct [by a body corporate], the Australian Competition and Consumer Commission (ACCC) can seek a civil penalty that is the greater of $10 million, three times the value of the benefits obtained that are reasonably attributable to the contravention or 10% of the annual turnover of the company (including related entities).’\textsuperscript{11}

Australia also seems to be out of regulatory step with the other jurisdictions in terms of ASIC’s capacity to seek to have courts impose disgorgement penalties in non-criminal proceedings regarding the wrongdoing behaviours surveyed. Due to existing statutory constraints ASIC has very limited scope to seek disgorgement of profits and other financial benefits gained whereas in the US disgorgement can be sought across all the categories surveyed, Canada in all but disclosure, the UK all but unlicensed conduct, and Hong Kong in all but disclosure and unlicensed conduct.\textsuperscript{12}

\textbf{III CONTEMPORARY DEBATES ABOUT PENALTIES FOR CORPORATE WRONGDOING}

As a result of the Global Financial Crisis (GFC), there is a heightened focus on the adequacy of penalties for corporate wrongdoing in Australia and other countries around the world. That increased focus has been highlighted in some jurisdictions such as the US by heavy sentencing imposed upon some individuals who have been convicted of using corporate forms to engage in harmful behaviour such as defrauding investors. Perhaps the most well-known example of this is the 150 year term of imprisonment handed to Bernie Madoff by a New York court in June 2009 after he had pleaded guilty to eleven federal felonies he had committed via his wealth management business, which the court-appointed trustee estimated had cost his clients more than US$18 billion. This prison sentence has been seen by some commentators as signifying a new post-GFC punitiveness towards financial crime, especially if the offenders are seen as high-profile financial actors.\textsuperscript{13}

However, is this supposed new punitiveness a systemic reality? As a counterbalance to this particular view there has been concern amongst some members of the judiciary, the academe, the general public and the media in the US that poor and pernicious organisational business practices revealed by the GFC led to only one criminal prosecution against one individual. The individual in question was a mid-lower level Goldman Sachs banker Fabrice Tourre, a prosecution that was depicted in the media as: ‘...the little fish who did not get away...’\textsuperscript{14} or the US Securities and Exchange Commission (SEC) nailing a minnow while the whales (in Tourre’s case senior executives at Goldman Sachs) avoided

\begin{footnotesize}
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\item[\textsuperscript{11}] Ibid, p.6.
\item[\textsuperscript{12}] Ibid, p.20.
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prosecution. This prosecutorial reality throws the subject of penalties for individual and corporate wrongdoing onto centre stage, especially the issue of why so few high status offenders receive prison sentences.

In recent times, especially in the financial sector, when corporate wrongdoing has been penalised, penalties have been largely monetary upon the firm in general, rather than imprisonment terms upon individuals. For example, the largest bank in the US JP Morgan agreed in January 2014 to a settlement of US$2.6 billion for its role in the Bernie Madoff frauds cited above. As a result: ‘...tallying up the bank’s largest fines over the past two years totals more than $25 billion that JP Morgan has paid out to settle a wide range of accusations of misconduct.’ This is an astonishing total and raises the question, especially in the context of penalties regimes, of whether financial penalties really curb or disincentivise poor corporate behaviour and whether the market takes financial penalties into account in pricing risk and share value. It is noteworthy that JP Morgan remains the most successful bank in the US despite repeated and costly regulatory infringements. In 2013 JP Morgan negotiated a US$13 billion settlement with the US Department of Justice (DOJ) and other US agencies to: ‘...resolve federal and state civil claims arising out of the packaging, marketing, sale and issuance of residential mortgage-backed securities (RMBS) by JP Morgan, Bear Stearns and Washington Mutual prior to Jan. 1, 2009.’ JP Morgan has also been involved in the Libor scandal. The European Commission ruled in October 2014 that: ‘...JP Morgan, participated in an illegal bilateral cartel aimed at influencing the Swiss franc Libor benchmark interest rate between March 2008 and July 2009...JP Morgan was fined €61,676,000 after benefitting from a reduction of its fine for its cooperation with the investigation under the Commission’s 2006 Leniency Notice, as well as a 10% reduction for agreeing to settle the case with the Commission.’ The scale of the Libor scandal was acknowledged by former Assistant Attorney General of the DOJ Lanny A. Breuer: ‘Libor will prove to be one of the largest, if not the largest white-collar case in history.’

The fines imposed upon JP Morgan are enormous, but there remains doubt about whether financial penalties are the right form of penalty to achieve specific and general deterrence. Specific deterrence seeks to prevent the perpetrator from offending, while general deterrence is aimed at discouraging other potential offenders from committing similar offences. In the case of financial penalties, the concern is that such penalties are treated as an operational risk and thus do not achieve the desired deterrent effect. By contrast, the

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prospect of being sentenced to a term of imprisonment may serve as a more significant deterrent. In the wake of the GFC, there appears to be increasing recognition of the importance of criminal penalties in countering corporate wrongdoing, as seen in developments in the UK and European Union.

One notable attempt to bolster criminal penalties is their introduction in the UK for senior banking executives who engage in reckless management in section 36 of the Financial Services (Banking Reform) Act 2013 (UK) (Banking Reform Act). The offence was created at the recommendation of the Parliamentary Commission on Banking Standards, which concluded that ‘...there is a strong case in principle for a new criminal offence of reckless misconduct in the management of a bank.’ However, while the maximum penalties are substantial – 7 years imprisonment and/or an unlimited fine – the offence is criticised for being unduly narrow and difficult to prove. The offence only applies to senior managers who take decisions which cause financial institutions to fail and it must be proven that the manager is aware of a risk that the implementation of the decision may cause the failure of the institution. It has been suggested that the difficulty of prosecuting the offence may lead to a diminishing deterrent effect over time.

Section 62 of the Banking Reform Act is just one part of a wider reform in the UK that seeks to improve governance and accountability in the financial services sector following the GFC. This reform includes the ‘Senior Managers Regime’, the ‘Certification Regime’ and the ‘Conduct Rules’, which together are aimed at improving standards of conduct across the sector. The new laws, which will come into force on 7 March 2016, are explained in detail in the Financial Conduct Authority’s (FCA) ‘Final Rules’, published on 7 July 2015. Importantly, the new laws will only apply to ‘relevant firms’, which includes banks, building societies, credit unions and Prudential Regulation Authority-designated investment firms. However, the Final Report of the Fair and Effective Markets Review (FEMR), published in June 2015, has recommended extending certain elements of the new laws to a ‘...wider range of regulated firms, covering at least those active in FICC [Fixed Income, Currency and

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Commodities] wholesale markets. The elements recommended for extension include ‘...regulatory pre-approval and “Statements of Responsibility” for senior managers; certification of individuals with the potential to pose “significant harm” to a firm or its customers; and enforceable Conduct Rules for individuals.’ The FEMR Final Report did not formally recommend extending section 62 of the Banking Reform Act: ‘The Review has not identified a case to extend this offence to other institutions simply because they are active in the FICC markets, where their failure would not pose a systemic and prudential threat to public funds and the economy.’ The FEMR did however recommend increasing the scope and severity of sanctions for market offences, including lengthening the maximum prison sentence for criminal market abuse from seven to ten years.

Following the GFC and the Libor Scandal, the European Union has also made moves to strengthen criminal penalties for corporate wrongdoing. On 2 July 2014, Regulation (EU) No 596 on Market Abuse and Directive 2014/57/EU on Criminal Sanctions for Market Abuse came into force in the European Union, repealing the original Directive 2003/6/EC on Insider Dealing and Market Manipulation (Market Abuse). The new Market Abuse Regulation and Directive update and strengthen the original Directive in various ways, including increasing both the scope and severity of sanctions for market offences. While the original Directive only required Member States to adopt administrative sanctions that are ‘...effective, proportionate and dissuasive...’, the new Directive provides for uniform criminal offences of insider dealing and market manipulation across Member States and maximum penalties of at least four and two years’ imprisonment for serious offences. The European Union explains that the new Regulation and Directive will ‘...strengthen the fight against market abuse across commodity and related derivative markets, explicitly ban the manipulation of benchmarks, such as EURIBOR and LIBOR, and reinforce the cooperation between financial and commodity regulators. Since the sanctions currently available to supervisors often lack a deterrent effect, sanctions will be tougher and more harmonised.’ Member States are required to implement the Regulation and Directive by July 2016; however, the UK and Denmark have opted out of the Directive as both countries already have criminal sanctions for market offences.

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27 Ibid.
28 Ibid.
31 Ibid.
36 European Parliamentary Research Service Briefing, Criminal Sanctions for Financial Market Abuse, 30 January 2014,
The adequacy of penalties has also been a controversial issue in Australia in recent years. One notable example of this controversy is the matter involving the former Chairman of forestry company Gunns Ltd, John Gay. In August 2013 Mr Gay was convicted of an insider trading offence, resulting in him being fined $50,000 and disqualified from managing corporations for five years. Gunns Ltd was an ASX Top 100 company at the time and Mr Gay was the most senior executive to have been convicted of insider trading in Australia. The matter is the subject of an ongoing proceeds of crime action, as Mr Gay allegedly grossed $3.1m and netted $798,000 from the offence. The perceived leniency of the penalties imposed on Mr Gay has attracted widespread criticism.

Similar to the US, UK and European Union, there has been much disquiet in Australia about levels of perceived corporate wrongdoing and the adequacy of the penalties that are imposed. This has been particularly the case in the finance sector; first, regarding the advice that individual investors have been receiving from some finance professionals, and second, how financial organisations that employ, or have commercial relationships with these finance professionals have reacted to complaints from customers about the financial advice received. These concerns have been highlighted by a number of high profile public inquiries. For example, on 26 June 2014 the Senate Economics References Committee released its much anticipated Final Report into the performance of ASIC. The report is a substantial document, 519 pages in length ranging across a diverse range of topics including not only general issues such as ASIC’s role, regulatory theories in relation to ASIC, credit laws, the Financial Ombudsman, corporate whistleblowing, ASIC enforcement, financial literacy, financial planners, governance and accountability structures, but also a very specific focus on Commonwealth Financial Planning Limited (CFPL). CFPL is a wholly owned subsidiary of Australia’s largest bank the Commonwealth Bank of Australia (CBA). CFPL operates under the business advice structure of Colonial First State (CFS) which is also part of CBA.

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The media release accompanying the Senate Report is withering in its criticism of CFPL and CBA. It describes past practices at CFPL as ‘appalling’, and the conduct of a number of CFPL advisers as: ‘...unethical, dishonest, well below professional standards and a grievous breach of their duties.’ The Committee stated: ‘The CFPL scandal needs to stand as a lesson to the entire financial services sector. Firms need to know that they cannot turn a blind eye to rogue employees who do whatever it takes to make profits at the expense of vulnerable investors.’ In particular, Committee Chair Senator Bishop lamented CBA’s response to the CFPL scandal: ‘That a major financial institution could have tolerated for so long conduct that included apparent criminal behaviour is not easy to accept.’

There has been continuing political fallout from the toxic sales culture at the heart of the CFPL debacle despite the somewhat belated efforts of CBA itself to defuse such fallout. These efforts include, most notably in July 2014 the announcement by CBA of improved compensation measures to victims via its Open Advice Review Program (OARP) and the appointment of former High Court judge Ian Callinan as chair of CBA’s Independent Review Panel (IRP), which will hear appeals from financial planning customers dissatisfied with compensation offered by the bank’s OARP. However, while CBA has received widespread media condemnation, similar to the US example of JP Morgan cited earlier, the market does not appear to have taken these concerns into account in any significant way when evaluating its trading position or share price. CBA chairman Mr Narev himself has stated that CBA has not seen a ‘discernible’ number of their customers not wanting to deal with the bank as a result of the advice scandal and financial market reaction in terms of CBA share price movement has been negligible. This was also noted by Justin Bratling, Chief Investment Officer of Watermark Funds Management who commented on the week following the release of the damning Senate Committee report: ‘There was not a single research note written during the week from any of the analysts...and for a company that has generated $9 billion worth of profit this year, the advisory business is very small. It’s a rounding error really in the overall profitability of the bank.’ So, as with the JP Morgan example, does the reality that neither CBA customers nor investors seem to be unduly perturbed by the CBA/CFPL scandal indicate that in the financial sector at least, current penalty regimes lack deterrent capacity? If they do, the key questions are, should there be change, and if so, what should change?

The lesson for the ‘entire financial services sector,’ to use Senator Bishop’s phrase, is that problems associated with lack of accountability and deflection of responsibility apply not only to the activities of individual financial planners, but also sometimes can be widespread within organisations. Moreover, these have contributed to substantial harm to many thousands of Australian investors in recent years, while not necessarily having a negative impact on the share price of employing organisations. This raises the question of the

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43 Ibid.
adequacy of sanctions for poor behaviour, not only in respect of the scale of penalty maxima available, but also the likelihood of penalties being applied to individual financial professionals and senior executives within organisations that engage in wrongdoing, and in turn how this affects prevailing ethical standards within business organisations. These concerns regarding the maxima and application of penalties are reflected in Recommendation 9 of the Senate Report: ‘The Committee recommends that the government consider increased penalties and alternatives to court action, such as infringement notices, for Australian financial services licensees that fail to lodge reports of significant breaches to ASIC within the required time.’

Scandals such as CFPL raise important questions about the core operational cultures of financial institutions like CBA and how they affect the relationships between poor behaviour, the likely detection and prosecution of such behaviour, the potential penalties that they may be subject to, and how risk/reward calculus on these issues might impact upon their internal organisational processes. This organisational calculus informs not only what value they place on prioritising the well-being and best interests of their clients, but also the integrity of the people whom they employ and the extent to which they promote integrity within the workplace environments that they control. The Senate Committee in Recommendation 54 of its Final Report stated that: ‘The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services inquire into the various proposals which call for a lifting of professional, ethical and education standards in the financial services industry.’

The Parliamentary Joint Committee accepted Recommendation 54 and established an inquiry. It took submissions, held public hearings and issued its report in December 2014. It made fourteen recommendations, including the establishment of an independent Finance Professionals Education Council but it did not specifically address the issue of penalties regimes.

There have been relatively few reviews or inquiries that have considered the adequacy of penalties for corporate wrongdoing in any depth in Australia. In January 2001, the federal Attorney-General requested that the Australian Law Reform Commission conduct a review of Commonwealth laws relating to administrative and civil penalties. The review was wide-ranging, covering regulatory theory, corporate responsibility, enforcement avenues, procedural fairness and penalty setting, among other topics. The final report, ALRC Report 95, was tabled in March 2003 and contained twenty-eight sets of recommendations. Given the broad scope of the review, its recommendations on penalty setting were general in nature. For example, Recommendation 26-1 of the Report provided that ‘[i]n setting civil

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47 Ibid.
50 See ibid, pp. 1-8.
51 See ibid, pp. 25-55.

penalties, legislators should have regard to whether the level set will achieve the aim of deterrence, which is the principal purpose. 52 Some of the more specific recommendations included setting monetary penalties for corporations five times higher than penalties for natural persons for the same contravention 53 and using multiples of financial gain as a method for setting monetary penalties. 54 The Report also contained several recommendations in relation to the interaction between different types of penalties 55 and a list of factors to consider in setting penalties in individual cases. 56 However, it did not comment specifically on the adequacy of current penalty regimes.

The Australian Government did not formally respond to ALRC Report 95, although its Guide to Framing Commonwealth Offences, Civil Penalties And Enforcement Powers substantially incorporates the principles discussed in Report 95. 57 The Guide was originally published in 2004 and the most recent edition was released in September 2011. 58 As the title of the Guide suggests, it provides advice of a general nature to those responsible for developing or amending Commonwealth offences, including advice on framing and setting penalties. 59 It stresses the need for penalties to act as an effective deterrent 60 and recommends setting maximum penalties for profitable offences as a multiple of the gain obtained. 61 It also recommends that prison sentences should be no less than 6 months, as they are reserved for serious offences, 62 and that non-monetary sanctions should be considered as an alternative to, or in combination with, monetary sanctions in order to effectively deter corporate crime. 63 However, like ALRC Report 95, the Guide does not critically examine whether the current penalties are adequate.

Drawing on ALRC Report 95 and the Guide to Framing Commonwealth Offences, Treasury conducted a more targeted review of penalties for corporate wrongdoing in 2007, A Review of Sanctions in Corporate Law. This Review examined civil and criminal sanctions in the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth). 64 The initial consultation paper raised a number of issues relating to the adequacy and administration of penalties, including, for example: whether there is too

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52 Ibid, p. 51.
53 See ibid, Recommendation 26-4.
54 See ibid, Recommendation 26-6.
55 See ibid, p. 54.
56 See ibid, p. 53.
60 See ibid, p. 38.
61 See ibid, p. 41.
62 See ibid.
63 See ibid, p. 42.
much focus on criminal sanctions; whether civil penalties act as a sufficient deterrent; the magnitude of criminal and civil penalties; the severity of penalties relative to the financial gains of offenders; the problem of corporations shifting the financial impact of penalties onto third parties such as consumers or shareholders; and the resource-intensiveness of different enforcement options. Treasury received nineteen submissions in response to the consultation paper from a range of individuals and organisations but a final report was not produced.

A recent influential public inquiry which has considered the issue of penalties regimes available to ASIC is the Financial System Inquiry (FSI), chaired by former chairman of both CBA and the Future Fund Mr David Murray AM. The FSI’s final report was released on 7 December 2014 by Treasurer Joe Hockey. In addition to recommending that the Commonwealth Government should provide ASIC with banning powers in relation to financial services, Recommendation 29 stated that: ‘The maximum civil and criminal penalties for contravening ASIC legislation should be substantially increased to act as a credible deterrent for large firms. ASIC should also be able to seek disgorgement of profits earned as a result of contravening conduct.’ The report also emphasised the need for ASIC to be adequately resourced, the stated objective of Recommendation 29 being to ‘[e]nsure ASIC has adequate funding and regulatory tools to deliver effectively on its mandate.’

Of the various reviews and inquiries that have been conducted into penalties and related matters in Australia, the FSI’s final report provides perhaps the strongest statement yet that current penalties and enforcement practices are perceived to be inadequate. However, it is important to remember that the report is not government policy and the Government may or may not decide to accept its recommendations. Treasurer Hockey stressed when releasing the report that: ‘The Government intends to consult with industry and consumers before making any decisions on the recommendations. This consultation will occur up until 31st March 2015.’ On 24 July 2015 the Government announced a capability review of ASIC ‘…to ensure that ASIC has the appropriate governance, capabilities and systems to meet [its] objectives and future regulatory challenges,’ which forms part of its response to the FSI. Given the extensive and public nature of the inquiry, it seems likely that at least some of the FSI’s recommendations will influence government policy, which may include extending the range of powers and penalties available to ASIC. This is the backdrop in Australia for the current debate about penalties regimes available to ASIC.

65 See ibid, p. 16.
66 See ibid, p. 18.
67 See ibid, pp. 17, 20-22.
68 See ibid, p. 21.
69 See ibid.
70 See ibid, p. 24.
73 Ibid.
IV ASIC’S REGULATORY AND ENFORCEMENT FUNCTIONS

ASIC is a law enforcement agency with 70 per cent of its resources allocated to surveillance and enforcement with three strategic priorities:

‘(a) promoting investor and financial consumer trust and confidence;
(b) ensuring fair, orderly and transparent markets; and
(c) providing efficient and accessible registration.’

Based on information in ASIC’s 2013-2014 Annual Report its regulated populations and responsibilities include, in addition to registry and licensing services:

**Investors and financial consumers**

(a) Deposit-takers, credit and insurers: 168 authorised deposit-takers; 5,837 Australian credit licensees; 29,798 credit representatives; 97 licensed general insurance companies; 28 life insurers; 12 friendly societies; 636 non-cash payment facility providers; 12 trustee companies.

(b) Financial advisers: AFS licensees licensed to provide personal advice (3,391 licensees) or general advice (1,454 licensees); 2 ASIC-approved external dispute resolution schemes.

(c) Investment banks: 25 investment banks; 250 hedge fund managers/ responsible entities; 61 retail OTC derivative providers; 7 credit rating agencies; 29 wholesale electricity derivatives dealers.

(d) Investment managers and superannuation: more than $1 trillion funds under management; 165 superannuation fund trustees; 485 active responsible entities; 3,673 registered managed investment schemes; 614 foreign financial service providers; 718 custodial service providers.

**Markets**

(a) Corporations (including emerging mining and resources companies): 2.12 million registered companies, of which 21,767 are public companies, and 2,252 are listed entities (including registered schemes and foreign companies).

(b) Financial market infrastructure: 40 authorised financial markets; 6 licensed clearing and settlement facilities.

(c) Insolvency practitioners: 696 registered liquidators; 9,822 companies entering external administration.

(d) Financial reporting and audit: 4,729 registered company auditors; 28,000 companies required to produce financial reports; 7,073 SMSF auditors.

(e) Market and participant supervision: 133 market participants; 800 securities dealers; 7 markets.

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Table 1 shows how many ASIC employees are responsible for the regulated populations and how frequently ASIC conducts routine surveillance of selected entities within those populations. In some instances, ASIC supplements this routine surveillance with reactive surveillance to target particular risks or concerns. For ease of expression, entities that are not subject to routine surveillance but are instead reviewed on a solely reactive or primarily reactive basis have been excluded from the right-hand column of Table 1.\textsuperscript{77}

**Table 1**: ASIC's surveillance of regulated populations\textsuperscript{78}

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<thead>
<tr>
<th>Regulated populations</th>
<th>No. of employees</th>
<th>Frequency of surveillance</th>
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<td><strong>Investors and financial consumers</strong></td>
<td></td>
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<td>Deposit-takers, credit and insurers</td>
<td>68</td>
<td>Largest 4 Authorised Deposit-taking Institutions (ADI): 1 year</td>
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<td></td>
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<td>Remaining 164 ADIs: 13 years</td>
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<td></td>
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<td>125 insurers: 7 years</td>
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<td>12 trustee companies: 7 years</td>
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<td>5,706 non-ADI credit licensees: 37 years</td>
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<td></td>
<td>25 investment banks:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>0.5 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>25 investment banks:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>61 retail OTC derivative providers: 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7 credit rating agencies: 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Investment managers and superannuation:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Top 25 active responsible entities: 2 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9 highest risk active responsible entities: 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 highest risk superannuation fund trustees: 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>20 major custodians:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2.9 years</td>
</tr>
<tr>
<td></td>
<td>**</td>
<td>Small business compliance and deterrence:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6,223 companies in the 5 highest risk industries for the potential to conduct illegal phoenix activity: 29 years</td>
</tr>
<tr>
<td><strong>Markets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporations</td>
<td>48</td>
<td>21,767 public companies, including 2,252 listed entities:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• all control transactions for listed entities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• a significant proportion of prospectuses</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• a small sample of entities in areas of emerging risk:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1 year</td>
</tr>
<tr>
<td>Financial market infrastructure</td>
<td>22</td>
<td>18 licensed financial markets: 1 year</td>
</tr>
<tr>
<td></td>
<td></td>
<td>6 licensed clearing and settlement facilities: 1 year</td>
</tr>
<tr>
<td>Insolvency practitioners</td>
<td>23</td>
<td>696 registered liquidators: 3.7 years</td>
</tr>
<tr>
<td>Financial reporting and audit</td>
<td>30</td>
<td>Financial reports of:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• top 500 listed entities: 3 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• remaining 1,500 listed entities: 9 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 2,100 unlisted public interest entities: 25 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• 100 large proprietary companies: 54 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Audit firms that audit listed entities:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• largest 4: 1.5 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• next 18: 2.5 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• remaining 64: 10.3 years</td>
</tr>
<tr>
<td>Market and participant supervision</td>
<td>62</td>
<td>133 market participants: 3.3 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>100 larger securities dealers: 4 years</td>
</tr>
</tbody>
</table>

\textsuperscript{77} It is unclear from ASIC's Annual Report 2013-2014 how many employees are responsible for the ‘small business compliance and deterrence’ population within the area of ‘investor and financial consumers’.

ASIC’s regulatory remit is extensive and its powers and regulatory mission are summarised in these terms:

‘We regulate corporations, managed investment schemes, participants in the financial services industry and people engaged in credit activities under a number of Commonwealth laws. These laws include the Corporations Act 2001 (Corporations Act), the Australian Securities and Investments Commission Act 2001 (ASIC Act) and the National Consumer Credit Protection Act 2009 (National Credit Act).

The ASIC Act directs ASIC to “take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.”

We use our enforcement powers to detect and deal with unlawful conduct, to recover money in appropriate circumstances and sometimes to prevent unlawful conduct before it happens. By doing this we deter future misconduct.’

Given these strategic priorities, powers and stated regulatory mission, the central goals that shape ASIC’s enforcement practices are: strategic significance (e.g. extent of the harm or loss); benefits of pursuing misconduct (e.g. cost-effectiveness); features of the matter (e.g. available evidence); and non-investigative alternatives. Some of the more punitive approaches that ASIC can follow include: civil financial penalties; criminal financial penalties; and prison terms and community service orders. ASIC also has the flexibility to adopt enforcement strategies that may be: compensatory; corrective; preservative (e.g. ensuring assets remain within jurisdictional authority); protective (e.g. disqualification orders); or aiming for a negotiated resolution (e.g. enforceable undertakings). ASIC constructs its enforcement approach in matters utilising these rationales and available enforcement tools. Consequently there are a range of factors that ASIC may consider in deciding which remedy to pursue including: the nature and seriousness of the suspected misconduct; the conduct of the person or entity after the alleged contravention; the relative strength of the case that ASIC believes it has; the expected levels of public benefit; mitigating factors; the likelihood that the person or the entity’s behaviour will change in response to a particular action; and the likelihood that the business community is generally deterred from similar conduct through greater awareness of its consequences.

One well-known effort to explain regulatory processes has been the pyramid strategies of regulation first promoted by Ayres and Braithwaite. These regulatory pyramids which form part of responsive regulation approaches have been widely applied by regulators in practice and by those analysing regulation in action. For example Gilligan, Bird and Ramsay in Figure 1

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80 Ibid, pp.3-4.
81 Ibid, pp.4-6.
82 Ibid, pp.6-7.
83 Ibid, pp.8-9.
84 I. Ayres and J. Braithwaite, Responsive Regulation, Transcending the Deregulation Debate (Oxford University Press, 1992).
below show how directors’ duties have been enforced in a pyramid fashion in corporate law in Australia.\textsuperscript{85}

Figure 1: Enforcement pyramid regarding directors’ duties under corporate law

It is a sensible strategy for both the regulators and the regulated, and for other key stakeholders such as the state and consumers, that the vast proportion of regulatory interaction, including enforcement, should take place at the lower levels of the pyramid, especially its base. Assuming that good regulatory compliance outcomes are achievable using these strategies, it is much more cost-effective. The difficulties of course arise with actors who may be inclined to ignore their regulatory obligations, as seen for example in the earlier discussion of the CFPL scandal. Another challenge is when actors are ignorant of what may constitute a serious breach of their regulatory obligations and thus a more severe regulatory response from higher up the pyramid may be appropriate. The rationale is that depending on the circumstances of the breach and the offender, different levels of regulatory response from persuasion, to warning letter, to civil penalty, to criminal penalty, to licence suspension and licence revocation may be applied. This rationale largely reflects the working practice of much of ASIC’s enforcement activity and the Australian justice system more generally.

V PRELIMINARY DATA ON ASIC’S ENFORCEMENT ACTIVITY

ASIC’s six monthly Enforcement Reports provide some insight into its enforcement activity and how it is responding to the challenges discussed in the preceding parts of this working paper. The first Enforcement Report was issued in March 2012 covering the period July to December 2011 and the most recent was issued in January 2015 covering the period July to December 2014. In these reports ASIC divides its areas of enforcement into four broad regulatory areas: market integrity; corporate governance; financial services; and small business compliance and deterrence. Enforcement activity in these four broad areas is classified across five enforcement methods: criminal; civil; administrative remedies; enforceable undertakings/negotiated outcomes; and public warning notices.

The following tables and figures present a preliminary set of data extracted from the Enforcement Reports. For the purposes of this preliminary analysis, ASIC’s classification and definitions of regulatory areas and enforcement activities have been adopted. As noted in Part I of the paper, when the research project turns to examining penalties in comparative jurisdictions, careful consideration will be given as to whether, and to what extent, it is possible to conduct a meaningful comparison between the selected jurisdictions in respect of these regulatory areas and enforcement activities.

Table 2 presents the aggregate ‘enforcement outcomes’, as defined by ASIC, in the period 1 July 2011 to 31 December 2014. This data was prepared by aggregating the data from the seven individual Enforcement Reports that have been published to date. From 2013 onward, ASIC has prepared tables which aggregate the previous two years’ of data. However, some inconsistencies between the individual tables and the aggregate ones were identified. To ensure that the data is consistent, only the individual tables have been relied upon in preparing Table 2 and Figures 2 through to 11.

Table 2: Aggregate ASIC Enforcement Outcomes from 1 July 2011 to 31 December 2014

<table>
<thead>
<tr>
<th>REGULATORY AREA &amp; WRONGDOING TYPE</th>
<th>ENFORCEMENT METHOD →</th>
<th>Criminal</th>
<th>Civil</th>
<th>Administrative remedies</th>
<th>Enforceable undertakings/negotiated outcome</th>
<th>Public warning notice</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market integrity</td>
<td></td>
<td>43</td>
<td>6</td>
<td>48</td>
<td>9</td>
<td>0</td>
<td>106</td>
</tr>
<tr>
<td>Insider trading</td>
<td></td>
<td>33</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>34</td>
</tr>
<tr>
<td>Market manipulation</td>
<td></td>
<td>6</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>Continuous disclosure</td>
<td></td>
<td>0</td>
<td>2</td>
<td>14</td>
<td>2</td>
<td>0</td>
<td>18</td>
</tr>
<tr>
<td>Market integrity rules</td>
<td></td>
<td>0</td>
<td>0</td>
<td>33</td>
<td>2</td>
<td>0</td>
<td>35</td>
</tr>
<tr>
<td>Other market misconduct</td>
<td></td>
<td>4</td>
<td>3</td>
<td>0</td>
<td>4</td>
<td>0</td>
<td>11</td>
</tr>
<tr>
<td>Corporate governance</td>
<td></td>
<td>51</td>
<td>24</td>
<td>35</td>
<td>20</td>
<td>1</td>
<td>131</td>
</tr>
</tbody>
</table>

86 Further statistics on ASIC’s enforcement activity in relation to market integrity are available in its reports on supervision of markets and participants, available at http://asic.gov.au/regulatory-resources/markets/supervision/#market-supervision-report
Figure 2 displays the aggregate enforcement outcomes in each regulatory area from 1 July 2011 to 31 December 2014. This Figure shows that ‘small business compliance and deterrence’ accounts for the vast majority of ASIC’s enforcement outcomes. In turn, Table 2 indicates that ‘action against directors’ accounts for most of the enforcement outcomes within ‘small business compliance and deterrence’. The small business ‘action against directors’ category (1,454) accounts for well over half of all ASIC’s enforcement outcomes (2,407). ASIC’s 2013-2014 Annual Report indicates that misconduct, compliance with licensing and registration requirements and illegal phoenix activity are some of the matters addressed within the area of ‘small business compliance and deterrence’. ASIC’s work in this area also includes the Liquidator Assistance Program, which is one of the measures it utilises to combat illegal phoenix activity.

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Figure 2: Aggregate ASIC Enforcement Outcomes by Regulatory Area from 1 July 2011 to 31 December 2014

Figure 3 shows the aggregate enforcement outcomes for each specific wrongdoing type from 1 July 2011 to 31 December 2014. The colour coding in Figure 2 has been maintained in Figures 3 and 4 to represent the different regulatory areas. Figure 3 emphasises the point made above that ‘action against directors’ within ‘small business compliance and deterrence’ dominates ASIC’s enforcement activity (in terms of the sheer number of enforcement outcomes). The next most commonly enforced wrongdoing types are within the ‘financial services’ regulatory area, including wrongdoing in relation to ‘dishonest conduct, misleading statements, unconscionable conduct,’ ‘credit’ and ‘other financial services misconduct.’

Figure 3: Aggregate ASIC Enforcement Outcomes by Wrongdoing Type from 1 July 2011 to 31 December 2014

Figure 4 is a variant on Figure 3, which excludes the data for ‘small business compliance and deterrence’. By excluding the ‘small business’ data, it is possible to see which other wrongdoing types are most commonly enforced. Again, ‘action against directors’ within the ‘corporate governance’ area is a significant category, yet it is not clear what specific types of wrongdoing this category includes.
Turning now to focus on enforcement methods, Figure 5 displays the aggregate enforcement outcomes reached via each enforcement method. This Figure shows that criminal enforcement methods are by far the most common, although this is due to the large number of criminal enforcement outcomes in the ‘action against directors’ category within ‘small business compliance and deterrence’. It can be seen from Figure 6 below that, once the ‘small business’ data is excluded, administrative enforcement methods are the most common and enforceable undertakings are almost as numerous as criminal methods. It is interesting to note the limited role that civil enforcement methods play in ASIC’s overall enforcement activity. This will be a key issue to explore as the research project progresses, subject to the availability of relevant data.
Figure 6: Aggregate ASIC Enforcement Outcomes by Enforcement Method from 1 July 2011 to 31 December 2014 (excluding small business compliance and deterrence)

Figure 7 adds further detail to the picture of which enforcement methods ASIC is choosing to adopt. This Figure shows the number of enforcement outcomes reached via particular enforcement methods as a percentage of the total enforcement outcomes within each regulatory area. For example, it can be seen that about 45% of enforcement outcomes within ‘market integrity’ are reached via administrative enforcement methods, while only about 6% are reached via civil enforcement methods. Administrative enforcement methods are particularly dominant in relation to ‘financial services’ (46%) and criminal enforcement is overwhelmingly used in ‘small business compliance and deterrence’ (87%) and also the most common enforcement method in the ‘corporate governance’ area (39%).

Figure 7: Aggregate ASIC Enforcement Methods as Percentages of Regulatory Areas from 1 July 2011 to 31 December 2014 (see corresponding table in Appendix 1)
Focussing on trends in ASIC’s enforcement activity over time, Figure 8 displays the number of enforcement outcomes within each regulatory area over the 3.5 years that ASIC has published the Enforcement Reports. Overall, there has been a moderate downward trend in ‘small business’ activity and a slight upward trend in the other areas since July 2012. Figure 9 is a variant on Figure 8, which excludes the ‘small business compliance and deterrence’ data.

Figure 8: Trends in ASIC Regulatory Areas from 1 July 2011 to 31 December 2014 *(see corresponding table in Appendix 1)*

![Figure 8: Trends in ASIC Regulatory Areas from 1 July 2011 to 31 December 2014](image)

Figure 9: Trends in ASIC Regulatory Areas from 1 July 2011 to 31 December 2014 (excluding small business compliance and deterrence) *(see corresponding table in Appendix 1)*

![Figure 9: Trends in ASIC Regulatory Areas from 1 July 2011 to 31 December 2014 (excluding small business compliance and deterrence)](image)

Figure 10 shows the number of enforcement outcomes reached via each enforcement method over the 3.5 years that ASIC has published the Enforcement Reports. Figure 11 is a variant on Figure 10 that excludes the ‘small business compliance and deterrence’ data. Figure 10 shows a moderate downward trend in criminal methods of enforcement since July 2012, which corresponds to the aforementioned downward trend in enforcement outcomes within ‘small business compliance and deterrence’ due to the large number of criminal ‘small business’ matters. Figure 11 shows a moderate upward trend in the use of administrative methods of enforcement across the whole 3.5 year period, particularly in the final 6 months.
Overall, it is not possible to discern any significant trends over time in the data extracted from the ASIC Enforcement Reports, primarily because of the limited 3.5 year duration of the data sample. The research project will seek to collect data over a 10 year period, from 1 January 2005 to 31 December 2014, and therefore may further illuminate whether there are any important trends over time in relation to particular regulatory areas, types of wrongdoing or methods of enforcement.
PART VI – FINANCIAL MARKET REGULATORS IN OTHER JURISDICTIONS

There are a proliferation of regulatory agencies and other law enforcement actors that operate in most countries and regulators identical to ASIC do not exist in other jurisdictions. In Report 387 and its submission to the FSI, ASIC drew comparisons with the following regulators: \(^90\) Canada - Ontario Securities Commission (OSC); Hong Kong – Securities and Futures Commission (SFC); New Zealand – Financial Market Authority (FMA); Singapore – Monetary Authority of Singapore (MAS); UK – Financial Conduct Authority (FCA); and US – Securities and Exchange Commission (SEC). ASIC selected these regulators on the basis that these jurisdictions have comparable legal systems; \(^91\) that is, they are common law jurisdictions derived from English legal traditions and conventions. Of course, these regulators have different regulatory remits and supervisory responsibilities for organisations and markets. For example, while the FMA and SEC have regulatory functions roughly analogous to ASIC, the OSC and SFC are predominantly concerned with market integrity, the FCA also has responsibility for competition and consumer protection, and the MAS is Singapore’s central bank but in addition supervises financial services. \(^92\) These regulators also operate under different political regimes and function within varying cultural and economic environments.

The regulators selected by ASIC are the main public regulators of the financial markets within their jurisdictions, as acknowledged by the international Organisation for Economic Cooperation and Development (OECD). \(^93\) How these key regulators are structured, funded and organised will have important implications for all facets of their enforcement activities, including their approach to and application of penalties regimes. Using data drawn from the 2015 OECD Corporate Governance Factbook, \(^94\) Table 3 offers some insights into the structural dynamics that shape ASIC and comparable regulators.

Table 3: Financial market regulators

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Regulator</th>
<th>Form of Funding</th>
<th>Main Funding Resource</th>
<th>Ruling Body</th>
<th>Members (current)</th>
<th>Term of Members</th>
<th>Members appointed by</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>ASIC</td>
<td>Public</td>
<td>National budget</td>
<td>Commission</td>
<td>3-8 (5)</td>
<td>3-5</td>
<td>Governor General</td>
</tr>
<tr>
<td>Canada</td>
<td>OSC</td>
<td>Self</td>
<td>Fees from regulated entities</td>
<td>Commission</td>
<td>9-15 (14)</td>
<td>Fixed</td>
<td>Lieutenant Governor in Council</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>SFC</td>
<td>Self</td>
<td>Fees from regulated entities</td>
<td>Board of Directors</td>
<td>14</td>
<td>Fixed</td>
<td>HKSAR Chief Executive</td>
</tr>
<tr>
<td>New Zealand</td>
<td>FMA</td>
<td>Public</td>
<td>National budget</td>
<td>Commission</td>
<td>5-11</td>
<td>5</td>
<td>Governor General</td>
</tr>
<tr>
<td>Singapore</td>
<td>MAS</td>
<td>Self</td>
<td>Fees from regulated entities</td>
<td>Board of Directors</td>
<td>10</td>
<td>3</td>
<td>President</td>
</tr>
<tr>
<td>UK</td>
<td>FCA</td>
<td>Self</td>
<td>Fees from regulated entities</td>
<td>Board</td>
<td>12</td>
<td>3</td>
<td>Treasurer</td>
</tr>
<tr>
<td>US</td>
<td>SEC</td>
<td>Self</td>
<td>National Budget &amp; Fees from regulated entities</td>
<td>Commission</td>
<td>5</td>
<td>5</td>
<td>President</td>
</tr>
</tbody>
</table>


\(^92\) Information extracted from regulators’ websites.


Among the factors that shape these regulators, funding and other resource realities are critical, not only in terms of the applied intensity of their penalties regimes but also across their entire range of activities. Table 3 shows that the OSC, SFC, MAS and FCA are self-funded with their main funding source being fees from regulated entities, ASIC and the FMA are publicly funded from the national budget, and the SEC receives fees from the regulated entities, but the US Congress determines the SEC's funding and the amount of funding received is offset by fees collected. In an era of increasing fiscal pressure on public budgets, there is a heightened focus on the subject of funding models for regulatory agencies. Whether ASIC should move more towards a user-pays approach is an especially live issue in Australia given ASIC’s recent lobbying for such an approach. For example, ASIC Chair Greg Medcraft stated in his opening address to the ASIC Annual Forum in March 2015:

‘Those who participate in our markets should have a price signal for the cost of ASIC's oversight to incentivise them to meet the outcomes the Australian Government expects.

To provide this, ASIC should have a user-pays funding model, as recommended by the Financial System Inquiry. Under a user-pays system, those industries needing the most attention would pay the most.’

Drawing on data available on the regulators’ websites, Table 4 provides a snapshot of the regulatory resources available to ASIC and comparable regulators.

Table 4: A snapshot of regulatory resources (2014)

<table>
<thead>
<tr>
<th>Regulator</th>
<th>Total Budget</th>
<th>Total personnel</th>
<th>Enforcement (% operational budget)</th>
<th>Surveillance operational budget (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASIC</td>
<td>Aus$405 million</td>
<td>1,785</td>
<td>35</td>
<td>20</td>
</tr>
<tr>
<td>OSC</td>
<td>Can$98.7 million</td>
<td>Data not available</td>
<td>Data not available</td>
<td>Data not available</td>
</tr>
<tr>
<td>SFC</td>
<td>HK$1,200 million</td>
<td>753</td>
<td>Data not available</td>
<td>Data not available</td>
</tr>
<tr>
<td>FMA</td>
<td>NZ$31.2 million</td>
<td>164</td>
<td>25 (investigation and enforcement functions)</td>
<td>42 (licencing and compliance monitoring functions)</td>
</tr>
</tbody>
</table>

---


While Table 4 provides a general indication of the resources available to each of the regulators, it is very difficult to compare funding and budget allocations with any precision based on the publicly available information. ASIC allocates proportions of its budget across seven categories (2014 percentage allocations in parentheses): education (4%); enforcement (35%); engagement (9%); guidance (3%); policy advice (4%); registry (25%); and surveillance (20%).97 However, comparable regulators to ASIC in the other jurisdictions do not use the same categories. For example, the FMA’s budget category for enforcement, ‘Investigation and Enforcement Functions’, may include some functions that would fall within the ‘surveillance’ category in ASIC’s budget. Similarly, the FMA’s budget category ‘Licensing and compliance monitoring functions’ is likely to include registry functions in addition to surveillance. Nevertheless, Table 4 suffices to show that there are significant differences in resources available to each of the regulators.

VII CONCLUSION

The issue of penalties regimes for corporate wrongdoing is a problematic and often controversial one. A particular debate is whether parliamentary and public expectations about the levels of investor and consumer protection that regulatory agencies such as ASIC and comparable regulators overseas are expected to deliver are realistic given the funding levels such regulatory actors actually receive. As Table 1 of the working paper indicates, ASIC is expected to regulate a very large number and wide range of entities with limited staffing and surveillance capabilities. There will of course be other intervening variables such as the ways in which laws have been drafted and broader macro-economic priorities. Nevertheless ASIC has been very open in recent years about what it believes it is able to achieve in terms of its enforcement outcomes given its operating budget and its extensive administrative remit.98 In an interview related to its 2012 Enforcement Report, ASIC Chair Greg Medcraft emphasised that ‘You get what you pay for.’99

Significant cuts to ASIC’s budget announced by Treasurer Joe Hockey in the 2014 Federal Budget will inevitably impact on ASIC enforcement and surveillance. When appearing before a Senate Estimates Committee in June 2014 Mr Medcraft stressed the fact that ASIC’s budget would be reduced by 12 per cent for the 2014-15 financial year under cuts flagged in the Federal Budget. This means that ASIC had to reduce its staff by 209 staff to

approximately 1,570. In monetary terms ASIC’s budget will be reduced by $120 million over a four year period. Mr Medcraft said these cuts meant that ASIC would have to increase its reliance on the Australian public to act as whistle-blowers on corporate crime, because the budgetary reductions would compel reduced ASIC surveillance of certain sectors. ‘We will not undertake the same level of proactive surveillance that we did previously and will have to be more careful in selecting those matters we pursue,’ he said. At the end of the day...where people see white-collar crime occurring, it becomes more important for people to report that.’

Given this difficult budgetary outlook and the absolutely central strategic regulatory role that ASIC plays in the economic good health of the nation, it is important for ASIC as a regulatory agency, for the Australian Federal Government that funds that agency, for business and for the Australian community who depend on that agency, that penalties regimes under ASIC administered legislation create the appropriate incentives for compliance by those whose activities are regulated by ASIC.

The adequacy of its penalties regime is crucial for ASIC to achieve its statutory objectives of promoting the confident and informed participation of investors and consumers in the financial system and maintaining, facilitating and improving the performance of those in the financial system. As discussed in Part III of this paper, the last significant review of the penalty regimes operated by ASIC was in 2007 by Treasury. There should be regular evaluation of the principles and practices of ASIC’s penalties system in order to contribute to ASIC’s regulatory objectives. The motivation for the research project is to add empirical information to facilitate regulatory evaluation and related policy development regarding penalties for corporate wrongdoing in Australia.


Appendix 1

Table corresponding to Figure 7

<table>
<thead>
<tr>
<th>Regulatory Area</th>
<th>Criminal</th>
<th>Civil</th>
<th>Administrative Remedies</th>
<th>Enforceable undertakings/negotiated outcome</th>
<th>Public warning notice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market integrity</td>
<td>41%</td>
<td>6%</td>
<td>45%</td>
<td>8%</td>
<td>0%</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>39%</td>
<td>18%</td>
<td>27%</td>
<td>15%</td>
<td>1%</td>
</tr>
<tr>
<td>Financial services</td>
<td>14%</td>
<td>15%</td>
<td>46%</td>
<td>24%</td>
<td>1%</td>
</tr>
<tr>
<td>Small business compliance and deterrence</td>
<td>87%</td>
<td>0%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Table corresponding to Figure 8 and Figure 9

<table>
<thead>
<tr>
<th>Regulatory Area</th>
<th>July-Dec 2011</th>
<th>Jan-June 2012</th>
<th>July-Dec 2012</th>
<th>Jan-June 2013</th>
<th>July-Dec 2013</th>
<th>Jan-June 2014</th>
<th>July-Dec 2014</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market integrity</td>
<td>11</td>
<td>9</td>
<td>18</td>
<td>9</td>
<td>21</td>
<td>18</td>
<td>20</td>
<td>106</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>36</td>
<td>12</td>
<td>13</td>
<td>6</td>
<td>13</td>
<td>17</td>
<td>34</td>
<td>131</td>
</tr>
<tr>
<td>Financial services</td>
<td>59</td>
<td>57</td>
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