ASIC

Australian Securities & Investments Commission

Future directions for ASIC

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Australian Securities and Investments Commission

To

Committee for Economic Development of Australia (CEDA)

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Good afternoon. I am delighted to be here to speak with you today.

I'd like to thank CEDA for organising today's event - and other events like it. CEDA plays an important role in Australian society, by providing a valuable forum for Australia's thought leaders to come together and discuss the economic and public policy agenda. Even more than that, it often leads debate on important issues affecting Australia's economic development and sustainability. ASIC is a member of CEDA and our staff regularly participate in CEDA functions around the country.

For my part, I'd like to add to the public policy discussion by speaking to you today about ASIC's contribution to market confidence and the economic development of this country. And in particular, I'd like to focus on a few of the major challenges that we currently have facing us as the corporate regulator, including:

- the introduction of Super Choice on 1 July
- the future of audit regulation, and lastly
- current trends in ASIC enforcement.

Of course, with today's sentencing of Ray Williams and yesterday's of Rodney Adler, ASIC's enforcement role is very topical at the moment. Today, I would like to discuss with you some issues that have recently received much media speculation – specifically pre-trial guilty pleas and the way ASIC has dealt with those pleas.

Before we go there, however, let's focus for a moment on ASIC's contribution to Australia's economic prosperity and consider ASIC's role in maintaining the architecture, integrity and confidence of Australia's financial markets.

ASIC has a broad remit. We regulate the conduct of all financial service providers and market operators, we register companies, auditors, liquidators and managed investment schemes. We review fundraising, merger and acquisition proposals, we maintain databases providing crucial corporate information to the public, we keep Australia's investors and consumers informed through various consumer protection programs, and we enforce all 1400 pages of the Corporations Act (as well as several other pieces of legislation).

We do all of this with the ultimate objective of achieving fair and efficient markets, upheld by confident, informed consumers and businesses. And there is no doubt in my mind that a **strong**, **fair** and **progressive** regulator is crucial in bringing about such confidence.

Currently, market confidence is supported by more than 14 years of unprecedented domestic economic growth. Market confidence has been further enhanced by the CLERP reforms. In these healthy economic circumstances, one might be forgiven for asking "what is ASIC's role in today's market?". At least at the present time, we are not seeing the high rates of insolvency that one would usually associate with a recession or a major downturn in the economy. Nor are we currently seeing major

decreases in the value of stocks and shares and the resulting consumer and industry reactions that might accompany an economic downturn.

On the contrary, the RBA's recently published "Financial Stability Review" estimates that 'in 2004, growth in world economic activity was around 5 per cent, well above the average of recent decades'.[1] 'In Australia, the economic and financial environment also remains favourable from a financial stability perspective … and the prospects are that demand conditions will remain broadly supportive of overall growth in the period ahead'.[2]

In this economic environment, we are seeing a growing interest in the negative impacts of over-regulation, with the BCA and the media more generally giving this issue some attention. I remain of the view, however, that corporate and securities regulation in Australia is finely, but well balanced; And that even in the current economy, there has never been a more important time for the regulator to work on maintaining confidence in the market. Let me explain what I mean.

According to the RBA, high rates of economic growth combined with low interest rates has had significant 'effects on financial markets and the borrowing decisions of Australian investors, contributing to risk being perceived as low (and/or priced very cheaply) and to an increase in leverage in both financial markets and household balance sheets'.[3] That is, the current risk profile of investors and consumers is being influenced by apparent economic stability, such that there is a willingness of some investors to 'take on more debt and, apparently, accept less compensation for holding risk'.[4]

The current positive economic conditions also mean that Australian consumers and investors are increasingly involved in Australia's financial markets and are therefore increasingly dependent on the products sold to them and the conduct and advice of their advisers.

Combining the current low risk perceptions of Australian investors with their increased participation in our financial markets necessarily raises opportunities for fraud or misconduct by those seeking to take advantage of new or less experienced investors. This can occur through the selling of complex and inappropriate financial products, cunning investor scams or plain old-fashioned corporate fraud.

While this type of activity does not come and go with the economic cycle, opportunities abound in times of a growing economy. It is in these circumstances that ASIC's regulatory antennae are all the more alert - our role in raising standards of conduct and disclosure is all the more important - and our enforcement successes are all the more satisfying.

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1 RBA Financial Stability Review, March 2005 p.3
2 RBA Financial Stability Review, March 2005 p.7
3 RBA Financial Stability Review, March 2005 p.3
4 RBA Financial Stability Review, March 2005 p.4

ASIC is, and will continue to be, attuned to the risk areas facing investors, and we will continue to take action against illegal activity.

At the same time, the positive economic conditions we have been experiencing can cause consumers to become complacent, over-confident and make poor financial decisions. In this respect, ASIC seeks to legitimise market confidence by encouraging investors to play an active part in finding out their rights, investigating their prospective investments, and taking responsibility for their own financial decisions.

Today's economic climate has also had positive impacts the value of our listed 1700-odd entities such that at 31 December 2004, their total market capitalisation was at $991 billion[5]. In 2004, the ASX 200 increased by 23% which was the largest increase amongst the major industrial countries.[6]

At the same time, our licensed exchanges face competitive commercial pressure from overseas markets, from new entrants to Australia and from Australian companies moving offshore.

In these circumstances we cannot afford to take the integrity of our markets for granted, and ASIC must ensure that responsibilities for market supervision, regulation and enforcement in this area are effectively carried out.

It is often the case that positive market conditions also place extra pressure on companies to maintain high profit growth. When a company is unable to perform to these expectations, the market reaction can put extra pressure on the company's share price. The markets react badly to "bad news" and therefore this is a natural encouragement for business to continue to provide results that the market expects. In these circumstances, all kinds of bad commercial decisions can be made. Sometimes this is played out through inadequate or incomplete disclosure or deliberately mis-stating financial results.

Good corporate conduct and reliability of financial reporting and disclosure are the foundation-stones for building a confident market and they are particular responsibilities for ASIC. Time and again we have seen the importance of maintaining high standards in these areas, regardless of the economic cycle. As our market continues to increase in size and complexity, ASIC needs to keep a strong regulatory presence in these areas.

The international and domestic corporate failures that occurred only a few years ago happened at a time of generally positive economic conditions. The failures of those companies were typically *not* the result of external market pressures. And yet we saw directors behaving dishonestly and failing to discharge their duties as senior company officers properly.

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5 http://www.asx.com.au/about/asx/index.htm, 12 April 2005.

6 RBA Financial Stability Review, March 2005. p.16

Following the last round of significant corporate failures, new and more demanding standards of financial reporting, audit, disclosure and corporate conduct were introduced in Australia and many other countries, including those where there are close financial links to Australia (for example the US and UK). ASIC must and will enforce these standards, recognising that 'the maintenance of faith in the due performance of the duty [of corporate controllers] is of vital importance to the economy.'[7]

Superannuation choice

Let me now turn to discuss a specific area in which ASIC has, along with the ATO, Treasury and APRA, a major and immediate regulatory role – the implementation of the super choice legislation.

As you would all know, this new legislation ensures that, for the first time, many Australian workers will be able to decide who manages their hard earned retirement savings. Employees will be able to switch funds, thereby exercising their own buying power and choosing the super fund that best suits their needs. Of course, employees already have a choice of fund in relation to their non-compulsory contributions.

There are some in the media who have been getting a little worked-up about the impending introduction of super choice. The fact is, however, that there is no urgency for consumers to make hasty decisions about their retirement savings. There is no decision 'time bomb' waiting to go off on 1 July. People can take their time.

In the meantime, ASIC is working on ensuring that both consumer and industry confidence is maintained by:

- demanding appropriate standards of advisers and fund managers; and
- helping consumers make informed decisions.

ASIC expects that industry will act responsibly and we are actively policing the marketplace to identify, weed out and deter any isolated bad practices we find that might be inappropriate.

We will see that consumers are provided with appropriate disclosures about the implications of changing or switching super funds. Financial advisers generally need to find out about their client's current superannuation arrangements and to consider any potential lost benefits or transfer costs before recommending a change.

We are monitoring financial services providers and we will take action if they fail to meet their significant obligations under the law. These obligations include the need to provide good professional advice supported by appropriate documentation. However where there are new provisions and if people are making a genuine attempt to comply, we will be balanced in our approach. Where the provisions are not new, where the

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[7] Wood CJ, R v Williams [2005] NSWSC 315, paragraph 34.

legislature has deliberately imposed strict liability, or where people are disregarding the law, we will adopt our usual strong approach to enforcement.

Not providing a Statement of Advice (SOA) is clearly in the latter category. SOAs are a primary consumer protection tool under the Financial Services Reform Act and all the more relevant where switching of super is concerned because of the long-term implications of a switching decision and the important provisions covering the costs and benefits of switching someone's retirement savings.

For consumers, the best way to ensure they make the right decisions about switching funds is to be properly informed and to do their homework – there is plenty of information available and consumers should take their time to think through what they need and want.

Those thinking about changing should always take time to carefully compare the funds they are considering. Consumers should also carefully evaluate benefits that may be included in their existing fund, particularly life insurance.

ASIC will also undertake a 'shadow shopping' exercise to monitor the advice that financial advisers give their clients around the start of super choice in July. The shadow shopping technique gives strong insights into the consumer's real life experience of getting advice, and we will be seeking to check whether the financial advice they receive complies with the law, including whether advisers have met their legal obligations related to switching.

The future of audit regulation

The future of audit regulation deserves some discussion this afternoon, and not just because I used to be an auditor. Rather, I come back to one of the issues I raised previously - the challenges we face in forestalling failures in financial reporting and promoting a vigorous, independent audit profession.

It is fair to say that this is not just a domestic focus. With the major corporate collapses of recent years, integrity of financial reporting has become an international preoccupation.

In Australia, we started ahead of most other countries with a robust framework comprising well-regarded accounting standards and a co-regulatory framework for audit regulation. While our previous regime had not produced the type of problems seen in the US, market confidence is an international goal and the Australian Parliament considered it best to address the issue by introducing a considered and measured response in the form of CLERP 9.

Justice Wood has today emphasised the importance of the CLERP 9 reforms in his sentencing of Mr Ray Williams, former CEO of HIH. Justice Wood recognised that the integrity of financial reports is essential in

maintaining market confidence. Specifically, he stated "the Annual Report of a corporation is a most important document from which prospective and existing shareholders, and those who engage in financial dealings with it glean information as to its current financial state and prospects… a failure to properly discharge the duties owed in respect of the preparation and release of annual reports involves serious criminality, which risks undermining the public confidence in published accounts, that is essential for the orderly conduct of financial markets."[8]

Looking forward from here, the next challenge for Australia is to consider audit regulation in an international context and work towards an internationally consistent approach to audit regulation. In my view, international cooperation amongst audit regulators is vital to ensure the effective regulation of auditors and audit firms, particularly in this time of increasing globalisation.

Those of you who are familiar with the industry will know that the audit profession is incredibly well organised on a global scale. Further to that, there is a strong global dominance by a small number of auditing firms. The "Big 4" for instance, exert enormous influence over the audit world and collectively account for around 70-80% of listed company audits.

Their firm culture is an interesting one. For marketing purposes these firms are for all intents and purposes global firms – they share information, experiences and a common culture. However, when it comes to regulatory compliance, these same firms are worryingly regional. We are also seeing instances where New York is directing the professional decision-making of the Australian firms, notwithstanding the differences between applicable US and Australian law.

The challenge faced by ASIC and other global audit regulators is to help shape the culture and practices of these audit firms through cooperative regulation. In my view, there is no doubt that regulators need to engage with each other and with the profession on a global basis in order to see this cultural change occur – it is not enough to engage on a jurisdiction-by-jurisdiction basis.

We are now at the point of crossing into new territory in audit regulation. If we are to ensure an effective response to this global issue, we must pioneer a new path on audit regulation that will enable the regulators to share information and work together. In this respect, ASIC has already taken steps to build effective and cooperative relationships with other international regulators including in the US. We are also active participants in a roundtable of international audit regulators.

Our continued successful participation in this work is key to maintaining open access for Australian companies to international markets and vice-versa.

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[8] Wood CJ, R v Williams [2005] NSWSC 315, paragraphs 26 & 27

Current trends in ASIC enforcement

I'd now like to turn your attention to some current issues associated with ASIC enforcement activity.

This week has been a busy one, to say the least. It marks the end of proceedings in relation to two of the most senior figures associated with the HIH group of companies - Mr Ray Williams, the former Chief Executive Officer of HIH and Mr Rodney Alder, a former director of HIH.

It is also an important milestone for ASIC's HIH Taskforce. Tomorrow marks the two-year anniversary of Justice Owen handing down the HIH Royal Commission findings and I believe that a lot has been accomplished during this period.

Mr Williams was today sentenced to four-and-a-half years' jail with a non-parole period of two-years and nine months in relation to three criminal charges associated with his management of the HIH group of companies in the three-year period 1998 to 2000.

His sentencing follows the sentencing of Rodney Adler yesterday to four-and-a-half years' jail, with a non-parole period of two-and-a-half years.

The charges against Mr Williams go to the heart of the issues with HIH. The charges relate to a series of transactions where the true financial position of HIH was hidden from HIH shareholders and the regulators for many years.

The offences of Mr Adler were characterised by the Court as showing 'an appalling lack of commercial morality' and designed for Mr Adler's personal benefit. Indeed, the sentences handed down to these men send the clearest, most unequivocal message to the corporate community that dishonest and reckless conduct will not be tolerated.

The judges made some very interesting and important comments in their judgements that give a clear message to corporate Australia and the community. In sentencing Mr Adler, Justice Dunford noted that, "directors are not appointed to advance their own interests but to manage the company for the benefit of its shareholders…They were not stupid errors of judgement but deliberate lies, criminal and in breach of his fiduciary duties to HIH as a Director."[9]

In sentencing Mr Williams, Justice Wood said "the three offences were objectively serious and involved a considerable abandonment of duty on the part of the Defendant, who as the Chief Executive Officer of HIH was in a significant position of trust and responsibility."[10] "...the individual responsibility of Directors in not engaging in corporate conduct that

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9 Dunford J, R v Adler [2005] NSWSC 274, paragraph 39.

10 Wood CJ, R v Williams [2005] NSWSC 315, paragraph 13.

involves dishonesty, or the making of false statements, cannot be overemphasised."[11]

Indeed, this week's outcomes demonstrate the serious consequences for directors and company officers who place their own interests above those of shareholders, or seek to mislead others about the true financial position of the company or for their own financial gain. More than 50 per cent of Australians have direct or indirect investments in the financial markets and they have a right to expect companies and their officers to act honestly, and to serve the interests of shareholders.

As you would all know, Mr Adler and Mr Williams pleaded guilty to the charges brought against them. Since their pleas, there has been much speculation about how and why the guilty pleas came about, and more specifically about whether ASIC had done 'deals' with them.

Let me address this last point first. Anyone who knows ASIC knows it does not do 'deals'. And anyone who knows me knows this policy won't change.

In other words, we don't engage in the process of making concessions in return for guilty pleas, whether it is by way of dropping charges, or going soft on penalty.

Why then, you might ask, did ASIC accept the pleas in the respective HIH cases? The answer to that question is multi-faceted.

Firstly, it is important to consider ASIC's approach to the investigation. The collapse of HIH was the biggest corporate collapse in Australia's history, causing significant damage to the Australian economy, and to public confidence more generally.

In response to the collapse, the Federal Government established the HIH Royal Commission, which over a period of 18 months, exposed some of the worst aspects of corporate failings. As a result of the Royal Commission, the Government funded ASIC to establish a taskforce to investigate referrals from the Royal Commission.

I can assure you that **all** matters identified by ASIC through its independent investigations, and all referrals from the HIH Royal Commission, have been thoroughly investigated. As you will appreciate, not all of our investigations resulted in sufficient evidence to sustain criminal charges. But those that did were referred to the Commonwealth DPP.

In the cases of Adler and Williams, both individuals approached the authorities to plead to various charges that had or were being laid. We can only speculate why these individuals pleaded guilty, which is a very serious step on their behalf to face the prospect of going to jail.

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[11] Wood CJ, R v Williams [2005] NSWSC 315, paragraph 48

I will say though, that guilty pleas clearly reflect the strength of ASICs criminal cases, based on the admissible evidence. ASIC was able to obtain this week's outcomes primarily because of the strength of the briefs of evidence we assembled against these individuals and because we did not compromise at any stage of the investigation. The pleas represent a remarkable success and their significance should not be understated.

The prosecution of white-collar crime is notoriously difficult. The issues are frequently complex and a jury is forced to listen to a multitude of witnesses and examine thousands of documents. The trials are inevitably very long, which makes a favourable outcome even more difficult.

In his judgment regarding The Crown v Howard in December 2003, Justice Kirby said "those who commit such crimes are usually intelligent, and well able to afford expensive lawyers. Their crimes are often obscure. They depend upon subtle inferences arising from documentation, the so-called "paper trail". The paper is usually buried in a mass of other paper. Even where it can be uncovered, proof is usually difficult. Crucial documents are often missing. Motivation will sometimes remain obscure. Prosecution is therefore difficult. Successful prosecution even more difficult."[12] I agree with these comments entirely.

Another factor that might impact on a person's decision to plead guilty is the Court's recognition of a guilty plea. The law in this area has recently come to recognise, in the judgments of both the High Court and State Courts of Appeal, that it is in the public interest to encourage people to plead guilty in clear cases of criminal conduct.

To provide the necessary encouragement, the Courts have recognised that someone entering a plea of guilty is entitled to a discount from the sentence they would have got if they had pleaded not guilty and allowed the trial to run its full course. The rationale for the discount is that it is in the public interest to plead guilty because, by doing so, long and expensive trials are avoided.

Of course, there are many other factors that might also affect a person's decision to plead, including the cost of the trial or multiple trials and the personal desire to rule a line under a period in their lives and their families' lives, and get on with the future, recognising that the trial process could take many years. Perhaps they also consider an admission of guilt might mitigate against reputational damage.

This leads us back to the question of why ASIC accepted the guilty pleas.

Ultimately, ASIC must take into account the fact that the law encourages a person to come forward and acknowledge their criminality for the reasons I have just mentioned. When a person does approach ASIC wanting to plead guilty to criminal conduct, we have an obligation to hear them out. If the plea, in our view, adequately represents their criminal culpability based on the admissible evidence we have assembled, it is in

[12] Kirby J, R v Howard [2003] NSWSC 1248, paragraph 59.

the public interest that the cost of the court case, together with all the associated risk and potential appeals, are saved.

In this case, both ASIC and the Commonwealth Director of Public Prosecutions, who is the final decision-maker as to whether it is in the public interest to accept a guilty plea, were satisfied that the relevant charges adequately reflected the criminality of Mr Williams' and Mr Adler's conduct, and their culpability.

Recognising the HIH trend of guilty pleas and taking into account the Court's position of encouraging such pleas, ASIC will continue to facilitate the early resolution of matters in this way, if appropriate circumstances exist.

In recent times ASIC has seen more people coming to us to plead on matters, reflecting the strength of our cases after detailed investigation and our determination to see justice done. We see this as an important development and consider it in the interests of the community generally that these sorts of alternative outcomes are achieved. This has particular synergies in NSW where, I understand, a process of compulsory mediation in criminal cases is to be trialed in the near future with these principles in mind.

This kind of approach to criminal and civil cases is not unusual, with regulators around the world incorporating cooperation policies into their enforcement methods. The regulatory rationale is that a greater good can be achieved when the regulator is able to deal quickly, effectively and adequately with individual criminal activity and subsequently divert scarce resources to major fraud or criminal activity in the broader industry.

ASIC shares this view. We believe that by encouraging appropriate guilty pleas, we are able to get better enforcement results. It is about being faster, more effective, stronger and focusing our resources in the right places.

We want to encourage criminals to plead guilty and to do it early. We want them to do this because they know we run strong cases and that we will not compromise. ASIC will not be deterred, even with all the challenges we face. We are a law enforcement agency and we will continue be a strong enforcer of the law. For only in doing so, will we see the confidence in our markets maintained.

Before I leave this point I would like to mention that, in all of our investigations, we encourage cooperation and dialogue. When we start a matter, it is serious – clearly - for both us and the person who is the subject of that investigation.

Companies may think that we encourage cooperation to make our own job easier. I do not deny that our job can be made easier, but my point is broader than this. What I am talking about is the approach taken by, for example, a potential accused to action taken by the regulator. A blanket refusal to cooperate or talk to us, by an accused or sometimes a potential

witness, might sound like a good strategy from a legal adviser's perspective. But the lawyer is not the one who might end up on the wrong end of a jail sentence when ASIC sees the matter through to an inevitable conclusion.

I strongly urge everyone in this room to consider carefully their approach to ASIC if we come to you as part of an investigation.

Indeed the Court recognises circumstances where an offender supplies information and is willing to give evidence against other offenders. This is known as the "Cartwright" discount. This discount is particularly important in white-collar crimes. In the Howard case, the sentencing judge, Justice Kirby, determined that Howard was entitled to such a discount and if it was not for his promise of future assistance, the judge would not have suspended the sentence which he imposed.

Conclusion

I have endeavoured to give you a flavour of some of the external issues we are currently facing at ASIC. However, the issues I have discussed today by no means cover the full breadth of our work.

Time permitting, I would be happy to discuss ASIC's other areas of regulatory focus. Likewise, I would love to have the opportunity of talking about some of ASIC's internal priorities, including the importance of our people and the ongoing need to continually review the way we manage our activities. Unfortunately, time will not allow us to cover these today, and in any case they are outside the realms of our topic.

The themes discussed today: of regulation and enforcement demonstrate how ASIC will continue to work towards providing a clean, fair market, to protect investors and consumers and to provide a confident financial environment in which legitimate businesses will flourish. We will encourage company directors to meet their legal responsibilities, deter them from going beyond what is acceptable and ensure they are punished fairly, but firmly, for any transgressions. I believe this will materially assist in the global market retaining confidence in the Australian financial markets.

Thank you for inviting me to speak with you today.

