



ASIC

Australian Securities &
Investments Commission

LAW INSTITUTE OF VICTORIA
ANNUAL COMMERCIAL LAW
CONFERENCE

*Session : A knock on the door in the middle of the
night, is it ASIC, ACCC or ATO?*

ASIC's Enforcement Powers and Activities

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Commissioner
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ASIC's enforcement powers and activities

Good morning everyone, and thank you for inviting me to speak here today.

I must admit that the topic of today's session startled me slightly. We tend not to go around "knocking on doors in the middle of the night". Such a claim implies sinister covert dealings, horrifying occurrences when the "victim" is at its most vulnerable, and frankly, that is not the way ASIC operates. It is interesting however that we – and other regulators – are perceived as coming "knocking on the door". I saw that expression used only last week in the Sydney Morning Herald ("Heavy load of compliance made lighter" Jan Eakin *SMH* 29/9/03 page 33). The imagery is obviously appealing.

While we are a law enforcement agency, with the necessity to conduct investigations and undertake litigation (with all necessary confidentiality) as appropriate, we nonetheless endeavour to be transparent in our priorities and policies. And so for the purposes of my presentation today, I thought it would be useful to concentrate on a few issues relevant to our approach to taking enforcement action. To that extent, I am hoping to demystify some of our processes, while giving you a brief indication of the way in which we operate.

I have structured my paper to address the following issues:

- what we do;
- a brief look at the civil penalty/criminal proceeding issue, which has attracted some attention of late;
- a look at when we might come to you, and a brief review of some of our powers including inspection of books and search warrants;
- an example of a current surveillance programme;
- and finally - an example of when we *won't* be coming around

What do we do, then?

So, if we are not out there doing a bad imitation of the big bad wolf frightening the poor little pigs, what do we do?

To start with, we are responsible for the regulation of:

- 1.3 million companies in Australia;
- The Australian Stock Exchange, the Sydney Futures Exchange, and other financial markets authorised by the Minister;
- Financial services businesses, including fund managers, stock brokers, financial advisers and insurance brokers;
- Superannuation funds, life and general insurance companies, and deposit taking institutions;
- Registered managed investments schemes; and
- Credit providers (but only in our consumer protection jurisdiction – credit remains primarily a matter for the States under the *Credit Code*).

We have a statutory mandate, found within section 1 (2) *Australian Securities and Investments Commission Act 2000*, which requires us to exercise our powers and perform our duties in order to, *inter alia*:

- maintain, facilitate and improve the financial system;
- promote the confident and informed participation of investors and consumers in the financial system; and
- at the end of the day - take whatever action we can and is necessary in order to enforce and give effect to the laws that confer functions and powers on us by Parliament.

Accordingly, it will come as no surprise to you for me to say that we are a fairly active litigant. In exercising our powers we have a range of enforcement powers or remedies to compel compliance with the law, address misconduct or protect the market or consumers from misconduct. These powers or remedies can be broadly categorised as:

- **Criminal action.** We prosecute serious offences primarily through the Commonwealth Director of Public Prosecutions. We will sometimes prosecute minor regulatory infractions of the law directly. Section 1317P Corporations Act permits the commencement of criminal proceedings notwithstanding that ASIC has already obtained a civil penalty outcome in respect of conduct which is the same or substantially the same.
- **Civil action.** This includes civil penalties, injunctive relief, corrective action (for example, seeking orders for corrective advertising), and compensatory action. We will sometimes take civil action where immediate protective action is warranted while investigation of possible criminal matters is ongoing.
- **Administrative action.** A topical example is banning from holding a financial services licence following an administrative hearing.
- **Enforceable undertakings.** Under section 93AA *Corporations Act*, ASIC may accept an enforceable undertaking in connection with a matter in relation to which ASIC has a function or power under the *ASIC Act*.

The factors we consider when deciding whether to take enforcement action include

- an examination of ASIC's jurisdiction in the matter,
- the level of evidence,
- whether an achievable or appropriate remedy exists for ASIC to pursue,
- whether the matter involves serious corporate wrongdoing or serious risk or detriment to consumers and the market, and
- whether the matter satisfies ASIC's regulatory and enforcement priorities.

Civil penalty vs criminal proceeding

You may be aware that ASIC has actively brought civil penalty proceedings over the last few years. Well known examples include our actions in respect of the collapse of Water Wheel, decided in the Supreme Court of Victoria earlier this year; and our cases against directors of HIH in relation to the funnelling of \$10 million of shareholders' funds to Pacific Eagle Equities. To my knowledge we currently have two civil penalty matters before the courts.

Does this mean that there is a trend in our regulation of the corporate and financial services sectors, so that miscreants should expect an approach by ASIC taking civil action rather than criminal?

The answer to that is no. First, let me note our statistics in relation to the types of actions we bring. Before the end of the year we have 32 matters in court -

- 5 civil matters, including civil penalty and injunctive relief applications.
- 20 criminal matters, and
- 7 administrative matters (including AAT and CALDB).

We have a total of 209 defendants at the receiving end of ASIC regulatory action –

- 104 criminal defendants on a total of 2679 charges, and
- 105 defendants before the courts on civil proceedings.

Our statistics tell the story – we continue to be active in pursuing criminal breaches of the law.

But in any event, it is a key part of ASIC's enforcement policy that we do not bring civil proceedings in substitution for criminal proceedings in matters involving serious corporate crime. This is a cornerstone of our memorandum of understanding with the Commonwealth Director of Public Prosecutions. Indeed, it was the subject of a direction by the Commonwealth Attorney-General in 1992 when the Minister directed the then ASC and the DPP that in every case where there is a reasonable prospect that an investigation may disclose evidence of the commission of a serious offence, such assessment should involve the fullest consultation and co-operation between the ASC and the DPP. This is a direction we take very seriously.

When do we come to you?

The mild paranoia suggested by the session title invites the regulator to say when you *can* expect us to turn up at your door.

The answer is – not too often.

Informal and formal investigations

We may come to you because we are conducting an investigation.

An example of an informal investigation is where we conduct a surveillance of a corporation because we believe there may be a breach of the law occurring, such as insolvent trading. I'll come back to that in a moment.

ASIC's formal investigation powers stem primarily from sections 13, 14 and 15 of the *ASIC Act*. We have power to conduct such investigations as we think expedient for the due administration of the corporations legislation where, *inter alia*, we have reason to believe that a contravention of the law has been committed (section 13). Further, we may conduct an investigation where we are directed by the Minister (which to my knowledge has never occurred) (section 14) or on the basis of a liquidator's report lodged under section 422 or 533 *Corporations Act* (section 15).

Four powers we may use in the context of an investigation are:

- inspection of books under section 29 *ASIC Act*;
- a section 30 notice to produce books [can also use other sections such as 31, 32A, 33, and require disclosure of info in relation to financial products under s41]
- a search warrant (this definitely involves a knock at the door) and
- a section 19 examination.

I'll look at each of these powers briefly.

Inspection of books : section 29 ASIC Act

In this case we are likely to turn up "knock on the door" and inspect books which the law requires corporations to keep. Failure by a person who has possession of a book, to comply with a request by an authorised person to make the book available for inspection, is an offence (section 63 (3) *ASIC Act*, penalty 10 penalty units or imprisonment for 3 months, or both).

“Books” are defined by section 5 (1) *ASIC Act* to include a register, financial reports or records, a document, banker’s books and any other record of information.

Like the section 30 notice, powers under section 29 are exercisable for the purposes of the performance or exercise of any of ASIC's functions and powers under the corporations legislation. So, we can inspect books (section 28)

- for the purposes of ensuring compliance with the corporations legislation; or
- in relation to:
 - an alleged or suspected contravention of the corporations legislation; or
 - an alleged or suspected contravention of a law of the Commonwealth, or of a State or Territory in this jurisdiction, being a contravention that concerns the management or affairs of a body corporate, or involves fraud or dishonesty and relates to a body corporate or financial products; or
- for the purposes of an investigation under Division 1.

This is a power upon which we rely when we engage in some of our informal investigation and surveillance work

Notice to produce books

Section 30 *ASIC Act* provides

(1) ASIC may give to

(a) a body corporate that is not an exempt public authority; or

(b) an eligible person in relation to such a body corporate ;

a written notice requiring the production to a specified member or staff member, at a specified place and time, of specific books relating to affairs of the body.

Note : Failure to comply with a requirement made under this subsection is an offence (see section 63)

Section 30 (2) is an equivalent provision which applies to registered managed investment schemes.

This is a power we use frequently – indeed in about 90% of matters we investigate.

The penalty for failing to produce a book is serious. Anyone who conceals, destroys, mutilates or alters a book where ASIC is investigating or about to investigate a matter, commits an offence for which the penalty is 200 penalty units or 5 years imprisonment (or both) (section 67). Generally speaking, the power of ASIC to require production of books exists notwithstanding the general rules concerning self-

incrimination, although information provided cannot be used in a criminal proceeding against the person or a proceeding to impose a penalty on the person (section 68).

Warrants

The ability of ASIC to apply for a warrant to search premises for books and records can be found in a number of places.

So far as presently relevant, section 35 *ASIC Act* provides as follows :

(1) [**Procedure**] Where a member or staff member has reasonable grounds to suspect that there are, or may be within the next 3 days, on particular premises in Australia, books

- (a) whose production has been required under this Division; and
- (b) that have not been produced in compliance with that requirement;

he or she may:

- (c) lay before a magistrate an information on oath setting out those grounds; and
- (d) apply for the issue of a warrant to search the premises for those books.

A magistrate may issue a search warrant under section 36.

In essence, ASIC may apply for a warrant where there are reasonable grounds to suspect that a person has failed to comply with a notice to produce books (and has failed, therefore, to comply with section 30).

Alternatively, section 3E of the *Crimes Act 1914* (Cth) permits an issuing officer (a magistrate or a justice of the peace : section 3C) to issue a warrant to search premises if the officer is satisfied by information on oath that there are reasonable grounds for suspecting that there is, or there will be within the next 72 hours, any evidential material (that is, a thing relevant to an indictable offence or a thing relevant to a summary offence) at the premises (section 3E (1)). ASIC may apply for a search warrant under the *Crimes Act* pursuant to our general power of investigation in section 13 *ASIC Act*. The warrants are executed by officers of the Australian Federal Police.

Section 3L *Crimes Act* also permits evidential material on computer hard disks to be seized by the executing officer seizing the equipment or copying the material on to disks, tapes or other storage devices.

A well-known example in this context arose in our investigation into Pacific Eagle Equity Ltd, where search warrants were issued to seize documents from the homes of Messrs Ray Williams and Rodney Adler and the business premises of Mr Williams' accountant. ASIC's power to seek the issue of warrants to search for and seize documents in relation to possible criminal breaches of section 184 *Corporations Act* was upheld by the Federal Court in *Williams v Keelty* (2001) 19 ACLC 1,535 on 13 September 2001. This included obtaining evidentiary material from Mr Williams' accountant and stored on the accountant's computers.

Section 19 notices

The fourth power which may be of interest to you is the power of ASIC to require a person to appear for examination. Section 19 *ASIC Act* provides:

- (1) **[Application]** This section applies where ASIC, on reasonable grounds, suspects or believes that a person can give information relevant to a matter that it is investigating, or is to investigate, under Division 1.
- (2) **[Reasonable assistance and appearance]** ASIC may, by written notice in the prescribed form given to the person, require the person :
 - (a) to give to ASIC all reasonable assistance in connection with the investigation; and
 - (b) to appear before a specified member or staff member for examination on oath and to answer questions.

Note : Failure to comply with a requirement made under this subsection is an offence (see section 63)

- (3) **[Content]** A notice given under subsection (2) must :
 - (a) state the general nature of the matter referred to in subsection (1); and
 - (b) set out the effect of subsection 23 (1) and section 68.

Examinations must take place in private (section 22) although the examinee's lawyer may attend (section 23). The person conducting the examination (the "inspector") may cause a record to be made of the examination, and must do so if the examinee requests (section 24). An examinee is not entitled to refuse to give information on the basis that doing so might incriminate the examinee, although this information may not be used in a criminal prosecution, or proceeding to impose a penalty (section 68); nor is ASIC required to tell the examinee in advance the questions he or she will be asked.

When ASIC examines a person under section 19, ASIC has power to release the transcript of the examination to the lawyer of another person, if the lawyer satisfies ASIC that the person is carrying on, or is contemplating in good faith, a proceeding in respect of a matter to which the examination related (section 25). We have a Policy Statement on this issue (Policy Statement 103 *Confidentiality and Release of Information*). This may be of assistance to insolvency practitioners who are contemplating actions against persons we examine under section 19.

Surveillances – current insolvency initiative

As I mentioned earlier, one group who could receive a call from ASIC consists of companies who are in financial distress. This is an initiative of the Commission to deal at the front end with small to medium size corporate insolvency issues. While we continue to take both civil and criminal action in relation to insolvent trading, we have developed an alternative strategy to take proactive steps to "nip in the bud" potential insolvent trading, where it comes to our attention.

Last year we established a new unit, the National Insolvency Co-ordination Unit ("NICU"), which is active in surveilling companies that come to our attention as being in clear financial difficulties, and at risk of insolvent trading. We have recently enlarged this unit through recruitment, and secondments from accounting firms.

Companies we surveil in the context of this project are selected on the basis of factors such as:

- complaints we receive about the company
- information we receive within ASIC from our accounting surveillance programme
- information from liquidators and

- referrals from elsewhere in the agency.

A key power exercised by this group is inspection of books and records, as permitted by section 28 and 29 of the *ASIC Act*.

During the first six months of this programme, the unit :

- undertook 219 insolvency assessments,
- visited 74 directors, and
- reviewed 222 company books and records,

As a result, 49 companies reassessed their financial situation, 19 companies appointed insolvency practitioners and 8 matters were referred to ASIC's Enforcement Directorate.

We welcome intelligence about companies which appear to be at risk of insolvent trading. On the other hand, if this is your client you may wish to alert them that ASIC could indeed be knocking on their door, and that perhaps it is beyond time to get their financial affairs, including books and records, into order.

Where you won't see us...

Lastly, one area you won't see us at the moment is where we actually don't have jurisdiction. No regulator is all-powerful – it is our job to have discrete areas as defined by Parliament in the laws of this land. So, for example, in relation to get-rich-quick schemes, the jurisdiction is a combination of ASIC's, the ACCC's and the State fair trading authorities. As a general rule we have no jurisdiction over these matters, and the only way we can take any court action is where the conduct of the company strays into our territory. An example of this occurring was in the case of Henry Kaye's National Investment Institute Pty Ltd. In summary :

- strategies of these operators in the "wealth creation industry" which involve direct investment in property are not in its face "financial products", and therefore **not** within ASIC's jurisdiction. This would include information like the value of properties and the performance of property investment.
- It would also include information such as the success of an organisation or a particular person, skills that can be acquired from particular courses – ASIC does **not** have jurisdiction

- where the strategies involve making comparisons between products or strategies that are not financial products and those which are, **ASIC has jurisdiction**
- where the strategies involve promoting strategies like "mezzanine mortgages" **ASIC has jurisdiction**, because this appears to fit the general definition of a "financial investment" (the investor gives the money to another person to use the contribution to generate the return for the investor and the investor does not have day to day control over the use of the contribution.) (Mezzanine mortgages appear essentially to be a version of a second mortgage). Statements by Kaye and others in promotional material and seminars, which contained recommendations and statements of opinion which could reasonably be regarded as being intended to influence a person making a decision in relation to those products appears to be "financial product advice" (and therefore providing a financial service).

This issue is currently the subject of a joint working party set up by the States, chaired by Queensland, of which ASIC is a member. The working party is due to report in March 2004 – we await their report.

Conclusion

ASIC is not interested in pursuing legitimate businesses, licensees, corporations or others who comply with the law. Our task is made easier in the corporate sector by the fact that we believe standards of corporate governance are high. The likelihood of our "knocking on your door," in the middle of the night, or in broad daylight for that matter, is low. However we will not hesitate to take action in appropriate cases, be they involving high profile individuals or less-well known personalities or entities. Like, no doubt, my fellow regulators here to day, we take our job seriously and will continue to do so in fulfilment of our statutory mandate. Parliament, and the community, expects no less.

Thank you for your time today.