Q&A with Tony D'Aloisio

Zilla Efrat speaks to Tony D'Aloisio about some of the challenges he has faced as ASIC's chairman over the past four years and his views on the issues confronting company directors today.

After a busy four years at the helm of the Australian Securities and Investments Commission (ASIC), it has been widely reported that Tony D'Aloisio is not seeking another term as chairman when his term expires in May 2011.

D'Aloisio chose not to discuss this topic when *Company Director* caught up with him ahead of what was an imminent announcement on whether the Federal Government would renew his contract for another term. Unfortunately, there was no news at the time of going to press.

Whatever happens, D'Aloisio's four years so far at the corporate watchdog have certainly been littered with challenges: overseeing a massive restructure of its operations, juggling the fallout of the global financial crisis (GFC), instigating a series of high profile court cases, taking over market surveillance from the Australian Securities Exchange (ASX) and becoming the national regulator for consumer credit and finance broking, to name just a few.

Most recently, ASIC's appeal against the 2009 dismissal of its case against Fortescue Metals Group and its CEO Andrew Forrest was allowed by the Federal Court. ASIC's case relates to public statements by Fortescue in 2004 about "binding" infrastructure deals with Chinese parties that were never completed. The 2009 decision cleared the iron ore miner of misleading and deceptive conduct and of failing to comply with its continuous disclosure obligations.

Last month, D'Aloisio also announced that ASIC had reached a settlement of $67.45 million on behalf of investors in the Westpoint Group of companies and in January, that ASIC had applied to the High Court for special leave to appeal the decision of the NSW Court of Appeal in the James Hardie case.

D'Aloisio started his career in law - first in the Commonwealth Attorney-General's Department's business and consumer affairs division in Canberra before joining law firm Mallesons in 1977. There he specialised in mergers and acquisitions, taxation and restrictive trade practices, and international trade and investment. By 1992, he had risen through the firm's ranks to become its chief executive partner and had been a key partner in the merger of Mallesons with Stephen Jaques and Stephen.

In 2004, he took over the helm of the Australian Stock Exchange where he masterminded the $5.8 billion merger with the Sydney Futures Exchange (SFE). He was appointed to run the combined entity, but was "sacrificed" after major SFE institutional investors threatened to vote against the merger unless SFE boss Robert Elstone got the top job.

D'Aloisio made a quick return to business life, taking over as ASIC chairman from Jeffrey Lucy in May 2007.

He is also no stranger to the boardroom. Before joining ASIC, he had been a director of the World Federation of Stock Exchanges, Boral, Business Council of Australia (BCA), the Board of Taxation, the Australian Charities Fund and the International Legal Services Advisory Council.

D'Aloisio sat down with *Company Director* last month to discuss some of the events that have taken place at ASIC under his helm and various issues of interest to directors. An edited version of this discussion follows.

Company Director (CD): *It is four years or so since you joined ASIC. What have been the biggest changes on your watch?*

Tony D'Aloisio (TD): In my time here, there are probably five things that ASIC, thanks to its hard working staff, has achieved.

The first is that we have increased the focus and resources on improving confidence in the integrity of the financial markets. The product can be seen in convictions for insider trading and market manipulation, which work to deter misbehaviour. That's an extremely important change. The benefits are clearly coming through and are likely to continue. I accept the fact that you will never eradicate a perception of insider trading or manipulation of markets, but I believe that in the Australian market, tough enforcement action is contributing to deterring misbehaviour.

The second achievement is that we have worked hard at, and have increased ASIC's focus and resources on, assisting and protecting retail investors and financial consumers. That extends to giving greater guidance, such as "investing between the flags", through to taking action to compensate investors. We have helped to achieve settlements for them - for example, from the Westpoint and Opes Prime collapses. We have also taken action against illegally managed investment schemes to deter similar schemes.

Our guidance in helping retail investors and financial consumers extends to looking at the risks in the next upturn so that investors will be careful with the riskier products like CFDs (contracts for difference).

The third achievement is that ASIC did make timely and important judgements during the GFC, such as on short selling and frozen funds.

The fourth is that ASIC needed a cultural shift. It's still early days, but it's a cultural shift resulting in our people being more engaged with our stakeholders and being more forward looking and trying to anticipate, within our oversight role, new problems. Take, for example, our work on a new website on guidance on risky products like CFDs. This is all about trying to be a little bit further ahead and anticipating the sorts of problems that can occur. We are seeing this change within ASIC and I think that it will be important long-term.

Finally, we've demonstrated a preparedness to enforce the law at all levels, whether it concerns small business with phoenix schemes, the recovery of compensation for investors, instituting criminal proceedings for insider trading or lifting corporate governance standards by enforcing the law on directors and officers duties.

CD: *What have been the hardest challenges for you personally?*

TD: A role like this provides a tremendous opportunity and I have really been pleased that I have had the chance to lead ASIC during what has been a fairly significant period. So if you ever wanted to be a regulator, this was a good time to be one because the work has been extremely interesting and challenging. What I found really satisfying are ASIC's achievements, which I have just talked about. On a personal level, this has been harder than some other roles I have had. What is different in this role, compared to some of the other roles, is the extent of media scrutiny on everything that ASIC does and then personalised through the chairman. But you learn to manage, or should I say live, with that. It is part of a liberal democracy to have a healthy media that tackles issues and it's part of the accountability process. When you are subject to it, you do not like it when it is personal, but you accept it and remain focused on doing the job as best you can.

CD: *ASIC has applied for special leave to appeal the decision of the NSW Court of Appeal in the James Hardie case. How do you view this outcome?*

TD: The case is quite narrow in its facts, but the implications are quite far reaching for corporate governance. We are seeking special leave in the High Court, primarily on what is ASIC's responsibility in the way it conducts its cases and the so-called duty of fairness.

Now, on that, I can make these points.

First, ASIC always seeks to be fair in the way it conducts its cases, including civil penalty cases and in the James Hardie matter it judged fairness on what it understood to be the law prior to the Court of Appeal case.

You need to remember that we were criticised in the One.Tel and other cases for calling too many witnesses or having too much evidence before the court. These are all things that are balanced when these cases are run.

If the High Court says in certain circumstances we do have to call witnesses, whereas in the past we may not have had to, quite clearly we will change our processes or procedures to do that. We will do it. It is not an issue of ASIC not wanting to be fair. It is simply an issue of seeking clarification of the law.

CD: *If the High Court rejects ASIC's application, will ASIC seek an amendment to the law to make it easier for it to bring proceedings of this kind?*

TD: The Court of Appeal's decision is now clearly law. In running our current cases, we are examining what changes we need to make to ensure we can comply with it. If the High Court confirms the Court of Appeal, we will assess what further changes may be needed and make them. It will then be a matter for the Government as to whether it feels any legislative changes should be made.

It will have to assess what's in the public interest in terms of the policy behind civil penalty proceedings and whether the way the courts interpret these have now pushed them too close to the criminal spectrum.

CD: *From a directors' perspective, what do you believe are the biggest lessons from the Hardie case?*

TD: As I said, the case we ran was quite a narrow case. We focused on whether or not a market release (which has been found to be misleading) had been approved. We didn't go further to try and create new law around what directors ought to do in situations of advising the market. That is really a matter for the directors, boards and management.

> *'If the board is involved in a strategy where it is betting the farm, then we would expect that any information provided to the market needs to be very carefully reviewed'*

But I can see that broader implications will be drawn in terms of the behaviour expected of directors. No doubt the principles of that case will be discussed by boards and we expect that. The guidelines that have come out of the case so far are really very much about being careful about major statements where, if the board is involved in a strategy where it is betting the farm - that is, it's a really significant matter - then we would expect that any information that is provided to the market needs to be very carefully reviewed and boards need to have proper processes in place to ensure that it is done. That is where the major interest of the case will lie in future.

CD: *Can we expect further prosecutions by ASIC related to the fallout of the GFC?*

TD: We are working diligently through matters so that we can rule off that chapter in our history and move on. ASIC has already taken a range of actions - for example, in Storm Financial it is aiming to recover compensation for investors and is looking at taking civil penalty proceedings against the principals. ASIC has commenced civil proceedings in the Centro case in relation to misclassification in accounts of financial

information. In MFS, (now known as Octaviar), it also commenced civil penalty proceedings. We have moved quickly and for example in Trio/Astarra, we have had investigation and prosecution in very quick time.

I don't think there should be any inferences drawn from it – that ASIC is more aggressive or that it is pursuing directors more than it might have in the past. That doesn't really cross our minds. What we have to look at is the particular circumstances: What happened? Was it just a corporate failure? Does it involve wrongdoing? Is there a case that needs to be answered? And, is it in the public interest to bring such a case?

There are also a lot of investigations that ASIC has conducted where it hasn't taken proceedings. These are really case-by-case issues where you need to balance out what occurred. Simply because a company collapsed does not mean there was wrongdoing.

It's a work in progress. As you know, in a lot of cases there are also liquidator reports that are yet to be filed. We look at the liquidator reports because they provide very good information for us when assessing whether or not there has been wrongdoing. If a liquidator says there has been wrongdoing, it is then incumbent on ASIC to look at that much more closely.

CD: *There have been a few cases that ASIC did not win over the years. Have there been changes in how you approach cases?*

TD: When I became chairman in May 2007 we did a stocktake of the organisation, really, to build on the good work that Jeff Lucy and his predecessors had done. We made many changes. One of these was to introduce a Chief Legal Officer (CLO) to provide an independent review of our investigations before proceedings can be commenced.

We also broke up the enforcement division into eight (now six) separate groups to provide more seniority in the teams running cases and also greater accountability in the way that investigations and cases are run.

We made many other changes and I really believe that the benefits of these are coming through in a number of ways.

If you look at our record on insider trading and market manipulation, we've had 15 to 18 successful outcomes since January 2009. That far outnumbers anything achieved in the previous five years.

I also think that the way we are running cases, such as Fortescue, James Hardie and Centro, is very focused on the issues that are relevant. Our people spend a lot of time with internal and external counsel narrowing the issues and keeping focused. There are a lot of improvements that are leading to better results. However, that doesn't mean that we have a KPI of wins and losses.

This is where there is a mismatch in expectations between, say, the media and ASIC. The loss of a case is big news and it's dramatic, but the real judgement for us is: was there a case to answer and was it in the public interest to take that case? Win or lose, did what came out of the case improve, or is it likely to improve, corporate behaviour? I think the cases we have run, won or lost, do that.

The AWB case was lost at first instance, but then the judgement was completely reversed. But it is still reported as a loss. The HIH litigation was significant and extremely successful, but that point of view gets dropped in its importance. So we do have this mismatch. I, as the regulator, just take it as it comes. I am not complaining about the media, but when you do an objective analysis of where ASIC is going, its track record in cases is extremely good. Its overall success rate is over 90 per cent. But I qualify that. In relation to major cases, the percentage is low, but still over 60 per cent for criminal and higher for civil.

But the real test has got be the public interest and the preparedness to take cases on, because that preparedness sends a message to the market about cutting corners and potential wrongdoing, particularly in times of stress.

However, we are also very careful because the fact that you do commence a case, for example, against officers and directors can have a huge effect on their reputations. So it's not something you do lightly. You balance the public interest against individual interests and issues of fairness. We are not in the business of trying to ruin people's reputations. That's not saying any more than that's the job of a regulator after all.

Also, we spend time working with bodies such as the Australian Institute of Company Directors to assist directors with better understanding of their roles and duties.

CD: *What have been the biggest lessons for ASIC from the GFC and how has that changed your regulatory environment?*

TD: The strategic review we did in 2007 and early 2008 set us up very well to be able to handle a lot of issues that came out of the GFC – for example, the new investment management group that was set up was able to deal with the frozen funds issue and the new market operators team was able to deal with the short selling issue. We were able to handle the issues that came out of the GFC quite well with the structures we put in place. And, the international view of regulators in Australia was that they handled the GFC well. So in the sense that there are lessons, they would be that we do have a good system and we have to continue to hone and improve it.

CD: *Are some further improvements planned?*

TD: These things tend to be evolutionary. Depending on the outcome from the High Court on the James Hardie decision, as I said earlier, further changes may be made in our approach. So as cases are developed, changes will come.

Changes tend to be related to the specific set of facts and what we learn from them. From what we saw out of the GFC – for example, with Storm Financial – there are changes that the Government is making and, ASIC too, in the way that it carries out surveillance of certain industries – for example, in the finance industry.

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We have taken a much more proactive approach on things like CFDs. We are really trying to get retail investors to understand the complexity of some of these products early on before issues arise. It is part of an education program. There are a lot of things that are coming out in a very specific way that aren't big bang, but nevertheless taken together over a period in time will lead to better protection of retail investors and their ability to protect themselves and help us to continue maintaining confidence in the integrity of our markets.

CD: *What have been the challenges of taking over surveillance of the ASX?*

TD: The transfer of the surveillance occurred on 1 August 2010. Our objective was for the transition to be seamless – to ensure that the market wasn't rattled and there weren't problems. We clearly achieved that milestone.

Our second objective has been to ensure that our rate of investigation, enforcement and review is equal to and obviously improved on what ASX could do. That's not a comment on ASX standards, which have always been good, but it's about evolving and I think that we are well on our way to doing that.

We started publishing statistics in January and will do so going forward. The market can then assess how we have performed, but I am very pleased with the team. The way that staff

from the ASX have integrated into ASIC is pleasing and the blend of people from ASX and ASIC is leading to a better regulatory model than the split model between ASIC and ASX.

CD: *Would there be scope for ASIC to take on more functions like supervising listings?*

TD: I think that's really a policy matter for the Government and the normal rule is that if it is working, then let it continue to work. And, I think it is working. I think that the issue with the surveillance was that if the Government was minded to move to a competitive trading system, then having one of the competitors regulate the market did have an inherent conflict of interest. There would have to be issues like that in the listings regime, but it is working well. ASX has a good reputation.

CD: *What are your views about where directors' liability sits today?*

TD: I try to separate the law, the policy of the law and the way ASIC enforces it. At the end of the day, ASIC is a regulator. It enforces the law as it finds it. A lot of the concerns that directors have in relation to directors' duties is about the law itself - it's about directors duties, the scope and the width, the business judgement rule, reliance on advice and so on.

The question is whether the law of negligence (section 180 of the *Corporations Act* 2001) can really apply to non-executive directors (NEDs) that have to take risks. That issue in our law hasn't really been fully analysed.

If you are driving down the road and you run into someone, you've controlled all the actions pretty much leading to that event. NEDs don't have that control so at the heart of this issue is the law itself. Ultimately, the Government may need to revisit this issue.

ASIC has tried to stimulate debate on this topic at its Summer School in 2008 and again this year.

CD: *Are infringement notices an appropriate method of dealing with continuous disclosure breaches?*

TD: Infringement notices were a change subject to some discussion at the time. When I was on the board of the BCA, I argued against them. Such is life. But they have become an established part of the regulatory system. Companies are aware of them. They are part of the armoury. They don't have any special emphasis. They are there and are used. I think that in terms of disclosure, we used two last year.

What is really important about disclosure in Australia is not infringement notices or civil penalties. It is the continuous disclosure regime itself, its acceptance by CEOs, CLOs and boards and the way they live with it daily. It has proven to be a significant contributor to the confidence that exists in the integrity of our markets and has been serving Australia very well.

> *'What is really important about disclosure in Australia is not infringement notices or civil penalties. It is the continuous disclosure regime itself'*

You only need to contrast our regime with the US, which is on quarterly reporting. We have far less volatility.

CD: *ASIC was supportive of the new "assets exceeds liabilities" test for the payment of dividends. What is your view of the new dividend rules?*

TD: What we have said is this is government policy. The change has been made. Let's see how it's working in practice and do our best to deal with any issues. If we feel it necessary to clarify the law in any way, we'll approach government. So it's a bit of work in progress at the moment. I think that we are in the process of considering whether we should do a formal consultation on some of the issues across the mark.

CD: *What do you do in your spare time?*

TD: There is not a lot of spare time. I am a family man so spending time with my wife Ilana, my children and two gorgeous grandchildren (Will and Maggie) is very important to me. I also play a bit of golf.

We have a family business in a winery in the Yarra Valley and we spend a lot of time there. It's a business, not a hobby, and a wonderful contrast to ASIC and keeps us in touch with the joys of owning a medium-sized business!