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Dr Kathleen Dermody
Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

ASA SUBMISSION – SENATE COMMITTEE INQUIRY INTO PENALTIES FOR WHITE COLLAR CRIME

Dear Dr Dermody

The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors, self-managed superannuation fund (SMSF) trustees and investors generally seeking ASA's representation and support. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

We refer to the invitation to make a submission in relation to the Senate Economics References Committee inquiry into penalties for white collar crime.

In summary, our view is that the penalties for white collar crime in Australia in recent years have generally been inadequate. The civil and administrative penalties which are currently available and actually imposed are not strong enough to deter offenders and criminal convictions, where available, are pursued only in limited cases. ASA believes that there is a need for more criminal prosecutions and increased civil and administrative penalties for white-collar crime.

As we are particularly concerned with matters falling within the scope of ASIC's supervision and regulation of financial markets, our response will focus primarily on the penalties in those areas. We do not comment on the terms of reference as they relate to other regulated sectors such as credit, insurance and other aspects of the Australian Consumer Law, or matters regulated by the ACCC, APRA, ATO and others bodies.

In preparing this response, we have had regard to ASIC Report 387 *Penalties for corporate wrongdoing* published in March 2014, the Committee's Final Report on the performance of ASIC published in June 2014 as well as the findings of the Financial System Inquiry.

Current maximum criminal penalties

We accept that the current maximum terms of imprisonment and fines available in Australia are broadly consistent with those in overseas jurisdictions. However, our concern is that there appears to be a reluctance to pursue and/or impose custodial sentences other than in very exceptional cases. In some cases, even where a custodial sentence is imposed, it is wholly or partially suspended. What we have seen is a penchant for weak punishments such as good behaviour bonds or community service orders even when the admitted wrongdoing has been serious, deliberate and systematic (for example, fraud). There is also a lack of clear consistency in the sentencing of offenders.

Thus, whilst there is a framework in Australia that might be considered comparable to overseas jurisdictions in terms of criminal penalties, the fact that the actual penalties imposed are towards the lower end of the spectrum produces an outcome that is both inadequate to deter offenders and encourage proper compliance by individuals. It also attacks public confidence and the integrity of markets and the financial system as a whole.

Availability and adequacy of non-criminal penalties

We are concerned that non-criminal penalties are not as widely available and are lower in Australia when compared with overseas jurisdictions. In particular:

- The maximum civil and administrative penalties for corporate and individual wrongdoing are too low. In our view, these penalties should at a minimum be at least the amount of the wrongful gain, and have the potential to be proportionately higher (for example, up to 10 times the financial benefit). Where there is no clear quantifiable wrongful gain, ASIC should have the power to order that the wrongdoer pay a penalty, for example up to $5 million for a body corporate and $1 million for an individual.

- ASIC does not have a disgorgement power other than under the Proceeds of Crime Act (POCA) in connection with criminal proceedings. Action under POCA is not always appropriate as the monies go into a confiscated assets account rather than to directly compensate victims. We believe that in all cases of white collar crime where a financial benefit is gained by the wrongdoer, including in non-criminal proceedings, any profits made or losses avoided should at a minimum be disgorged. This should be in addition to any other penalties imposed and the payment of costs.

- ASIC reports that there are legal and practical barriers that prevent the pursuit of both criminal and civil penalties for the same contravention. We believe that there should be sufficient scope for ASIC to pursue both criminal and non-criminal penalties in relation to a particular wrongdoing as appropriate. In this regard, we are of the view that the burden of proof for criminal proceedings is potentially too onerous and must play a role in reducing the number of actions brought under the criminal jurisdiction.

Separately, we understand (but have not investigated in detail) that there are inconsistencies between the various legislation between the fixed and maximum penalties for almost identical

offences. We see no reason for this to be the case and believe that these inconsistencies should be addressed. There is also no reason why penalties available to ASIC should be significantly lower than those available to the ACCC for offences of comparable seriousness.

Actual penalties imposed have been inadequate

As mentioned earlier, our view is that the actual penalties imposed for white collar crime in Australia have been too weak. Criminal penalties are rare and, in many civil cases, negotiated settlements take place which although provide greater certainty regarding the outcome, could lead to lower penalty than would otherwise have been imposed if the penalty was not pre-agreed (of course, it is still up to the court to determine that the settlement is appropriate). This is particularly concerning as the High Court recently confirmed that regulators can negotiate civil penalties and that this should be encouraged in the interests of efficiency and avoiding lengthy and complex litigation. We believe there is a need for more criminal prosecutions rather than civil or negotiated settlements.

We provide brief comments relating to insider trading, continuous disclosure breaches, the giving of false/misleading statements and conduct relating to the provision of financial services. We note there are other areas where similar findings can be observed, such as fraud and conduct relating to market manipulation offences, however we do not comment specifically on those areas.

Insider trading

While there have been a number of recent prominent cases where custodial sentences have been imposed (for example, Lukas Kamay/Christopher Hill and Hanlong managing director Hui Xiao), our view is that in the majority of cases, the penalty is relatively weak and insufficient to deter other offenders. Even in the recent cases referred to above, which were viewed to involve a high degree of seriousness, the penalties were not the maximum penalty available in legislation. All of this is discouraging for regulators and market confidence, especially as insider trading cases are often hard to successfully prosecute.

For example, the following cases all involve directors of companies:

- John O'Reilly, a former director, bought shares whilst privy to confidential information. He made a profit of $29,045 from his purchase and sale of the shares. The court imposed a jail sentence of 10 months and then suspended the term because he pleaded guilty. Ultimately, Mr O'Reilly was given a good behaviour bond for 18 months. The court also imposed a $30,000 pecuniary penalty on top of the $61,600 that he was required to forfeit under the Proceeds of Crime Act.

- John Gay, former Chairman and CEO of collapsed Tasmanian timber company Gunns, faced a maximum penalty of five years in prison, after admitting to insider trading. He was convicted and was required only to pay a $500,000 fine (initially a $50,000 fine). The judge in this case accepted that Mr Gay was in poor health and that he was a person of "exemplary character ... with a reputation of honesty and integrity." At the time of sentencing, ASIC commented that Mr Gay was the most senior Australian executive to have

been convicted of insider trading. Yet, that he was able to avoid any sort of custodial sentence is very telling of the weaknesses of the system.

- Peter Farris, former director of Northern Star Resources, was convicted and sentenced to two years and nine months imprisonment for insider trading but the sentence was fully suspended. He avoided a loss of $123,975 as a result of the trades. In addition to his suspended sentence, he was fined $65,000 by way of a pecuniary penalty order and he also consented to forfeiting the amount of the loss avoided.

Continuous disclosure and false/misleading statements to the market

Penalties to date have been lower than those imposed overseas. Most companies pay a $33,000 penalty after being served with an ASIC infringement notice for an alleged breach of the continuous disclosure provisions. These cases are deemed to be a less serious contravention and it is acknowledged that the penalty specified in an infringement notice may be materially less than a court-imposed penalty for a contravention of the same provision. Cases involving larger penalties such as Newcrest Mining ($1.2 million penalty), Leighton Holdings ($300,000 penalty) and Chemeq ($500,000 penalty) are rare. Our view is that the penalties for continuous disclosure breaches should be increased.

As ASIC reports, criminal prosecutions under section 1041E of the Corporations Act for misleading statements are rare and there are no non-criminal penalties for breaches. In the James Hardie case, action was taken under the directors' duties provisions of the Corporations Act and the directors were ordered to pay a penalty of between $20,000 to $75,000 each. Arguably these penalties should have been much higher. However, the use of banning orders as well was appropriate and we believe they should be used more often (including in cases of less seriousness) and for longer periods.

In the Centro case which related to errors in the company's financial statements, ASIC alleged that the directors had breached their duty of care and diligence and their duty to ensure compliance with financial reporting laws. The CEO, CFO and non-executive directors were found to have contravened the law however in terms of penalties, the CEO was ordered to pay a $30,000 whilst the CFO was banned from managing corporations for two years. The non-executive directors avoided any penalty other than court declarations and orders for payment of costs.

It is concerning that the court in the Centro case determined that the aforementioned penalties "satisfied the requirements of the principle of general deterrence" and that additional penalties were not necessary "to facilitate future adherence to the standard of corporate behaviour". In particular, it is concerning that widespread publicity of the case and the subsequent reputational damage was a consideration in determining penalties.

The maximum civil penalty for directors and officers who breach their directors' duties is $200,000. This is not a large amount considering the amounts CEOs and non-executive directors are paid. Yet, in the Centro case, the judge did not think any additional penalties would bring about a greater benefit for society or the corporate world, and would otherwise be "unfair or inappropriate".

We believe that unless the $200,000 penalty is increased to reflect the potential gravity of the offence, courts will continue to be reluctant to impose anything more than a nominal penalty (if any) on directors breaching their duties, even though shareholders may have suffered severely as a result.

Financial services advice

In 2015, executives from Macquarie, ANZ, NAB and CBA faced a Senate inquiry into problems in their financial planning and wealth divisions. This concerned misconduct (including systemic dishonesty and fraud) by some financial advisers over many years and a large number of people have suffered immensely as a result. Yet to date, whilst compensation schemes have been established and some enforceable undertakings given, we are not aware of any action being taken against any of Macquarie, ANZ, NAB and CBA or their executives.

In the CBA case, we understand some of the financial advisers provided enforceable undertakings, under which they agreed not to provide financial services for a period of time and in the more serious end of the scale, permanently. Yet, we are not aware of any other penalties (monetary or otherwise) being imposed on those advisers.

The penalties available for inappropriate advice in Australia appear to be up to $1 million for a corporation and $200,000 for individuals. It is not clear to us why penalties were not pursued against those advisers, especially given the seriousness of the conduct in some cases.

In some overseas jurisdictions, namely Canada, UK and the US, a disgorgement power is available for the giving of inappropriate advice. We believe the same should be available and pursued in Australia in these cases.

Role of ASIC

We believe ASIC does not have sufficient funding and resources to do the preliminary investigation work in all cases of suspected wrongdoing. Even where it has conducted the relevant investigations, it is incentivised to pursue certain penalties over others in the interests of time and efficiency. For example, negotiated settlements are attractive but are only available for civil proceedings (as opposed to criminal proceedings) and enforceable undertakings would be more attractive than taking any court action at all.

An analysis of ASIC's enforcement record as set out in the Committee's Final Report on the performance of ASIC shows that over the period from 2006/7 to 2012/13:

- the number of completed criminal proceedings completed, persons convicted and jailed each year has steadily decreased;
- the number of civil proceedings completed each year has decreased; and
- the number of people/companies banned from engaging in financial services or consumer credit activities has increased significantly.

The number of enforceable undertakings has also increased and in some cases, have produced an outcome where the actual penalty does not correlate to nature of the misconduct. For example, UBS, BNP Paribas and Royal Bank of Scotland were fined only $1 million in conjunction with their enforceable undertakings when they were found to have influenced the swap index rate in Australia. That penalty is miniscule compared to amounts banks paid overseas in respect of similar conduct. When UBS settled charges regarding Libor, the fine was US$1.5 billion. We believe any possible deterrent effect is also significantly reduced since enforceable undertakings typically allow companies to avoid any admission of liability.

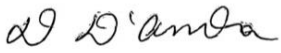
We support the following finding of the Committee at paragraph 17.48 of its Final Report referred to above:

> *"Nevertheless, the committee is of the view that the public interest would be better served if ASIC was more willing to litigate complex matters involving large entities. There appears to be either a disinclination to initiate court proceedings, or a penchant within ASIC for negotiating settlements and enforceable undertakings. The end result is that there is little evidence to suggest that large entities fear the threat of litigation brought by ASIC. Other remedies such as enforceable undertakings may correct behaviour within a particular organisation, but they do not yield the wider and more significant regulatory benefits that are associated with successful court action."*

Further, the length of time it takes ASIC to investigate matters and initiate proceedings is too long, although we note that its success rate has been reasonably high. We would support an increase to ASIC's funding and resources to enable it to investigate and pursue more cases in a timely manner. Unless ASIC has the appropriate powers and funding to pursue action through the courts, there is little to be achieved by having a stronger penalty regime.

Please do not hesitate to contact me if you have any queries.

Yours faithfully,



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