Comments on Dr Varzaly's paper - Issues in enforcement

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Dr Varzaly's research in enforcement

Dr Varzaly has written several interesting articles relevant to her presentation today. In the first of those articles, she considered the scope of enforcement of directors' duties in Australia.[1] She there observed that cases against directors of public companies in the period to 2015 were more likely to be brought by the Australian Securities & Investments Commission ("ASIC") than by "private" parties and public enforcement was more likely to concern breaches of directors' duties of care or insider trading. She also there noted that cases brought against directors of proprietary companies were more likely to be initiated by "private" parties and those cases were more likely to involve misappropriation and self-dealing in breach of fiduciary duty; and that a significant amount of private enforcement action was taken by the company itself rather than by shareholders, reflecting the limits in respect of derivative actions. A review of corporations matters heard in the Federal Court of Australia and the State Supreme Courts in more recent times would disclose numerous applications for leave to bring statutory derivative actions, most of which succeed, and a significant number of oppression claims which rely on alleged breaches of directors' duties, without separately seeking leave to bring a statutory derivate action.

In a second article[2], Dr Varzaly assessed the effectiveness of disclosure law enforcement, by reference to both private and public enforcement, in compensating for shareholder losses, deterring misconduct and providing signalling information. She there rightly noted the comparatively high level of public enforcement in Australia. She rightly pointed to the significance of litigation funding and institutional investors as participants in class actions in that respect. She also noted that a significant proportion of both private actions and those brought by ASIC targeted directors and officers; intuitively, one might have expected that to be commonplace in ASIC proceedings, and less common in private actions. Dr Varzaly pointed to low net recovery amounts, compared to investor losses in such actions; however, that observation may beg the substantial question as to how those losses are to be calculated, a matter highlighted by recent case law.

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[1] J Varzaly, "The Enforcement of Directors' Duties in Australia: An Empirical Analysis" (2015) 16 *European Bus Org LR* 281.

[2] J Varzaly, "The Effectiveness of Disclosure Law Enforcement in Australia" (2021) 21 *J Corp Law Studies* 135. For earlier commentary, see M Welsh and V Morabito, "Public v Private Enforcement of Securities Laws: An Australian Empirical Study" (2014) 14 *J Corp Law Studies* 39, focussing on class actions in the period March 1991 to March 2009.

Dr Varzaly also pointed to distinctive features of the Australian class action regime which make it more friendly to plaintiffs than other international regimes, including the lack of a class certification process in advance, and the availability of third party funding arrangements; the position has now been further advanced, at least in Victoria, by the availability of contingency fee arrangements. She also recognises the difficulty, well recognised in the US academic commentary, that, at least as between diversified institutional shareholders in the Australian market, and absent additional funding from directors or their insurers, class actions tend to create a circular funds transfer between diversified shareholders, with funding costs being a wasted cost in the process. That is a matter that has perhaps received less attention than it deserves.

In a third article, Dr Varzaly examines shareholder concentration and controlling shareholders in Australia.[3] I will not focus on that area in today's commentary.

Directors' duties

I will offer several marginal notes to Dr Varzaly's paper, which I must acknowledge are impressionistic rather than empirically based. First, as Dr Varzaly's work demonstrates, claims for breach of the duty of care and diligence are regularly brought by ASIC[4], typically relying on the civil penalty regime in the *Corporations Act* 2001 (Cth) ("*Act*").[5] However, there are also

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[3] J Varzaly, "Shareholder Concentration and Control in Australia" (2023) *J Corp Law Studies* 105.

[4] Well-known examples include proceedings brought by ASIC in relation to the failures of HIH, One.Tel, the James Hardie matter and the failure of Storm Financial: *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253; [2002] NSWSC 171; *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1; (2009) 75 ACSR 1; [2009] NSWSC 1229; *Morley v Australian Securities and Investments Commission* (2010) 81 ACSR 285; [2010] NSWCA 331; *Australian Securities and Investments Commission v Hellicar* (2012) 247 CLR 345; (2012) 88 ACSR 246; [2012] HCA 17; *Cassimatis v Australian Securities and Investments Commission* (2020) 376 ALR 261; (2020) 144 ACSR 107; [2020] FCAFC 52; *Australian Securities and Investments Commission (ASIC) v Select AFSL Pty Ltd (No 3)* [2023] FCA 72; *Australian Securities and Investments Commission (ASIC) v Daly (Liability Hearing)* [2023] FCA 290; *Australian Securities and Investments Commission (ASIC) v Kaur* [2023] FCA 599; *Australian Securities and Investments Commission (ASIC) v Wilson (No 3)* [2023] FCA 1009 (where the claim failed); and see the useful review of recent case law in T Bednall and M Pedridis, "KWM Annual Digest of Judgments and Proceedings against Directors: published or commenced in 2023", King & Wood Mallesons, June 2024.

[5] There is voluminous academic literature considering the ASIC's enforcement actions and the operation of these provisions, including M Welsh, "ASIC, Civil Penalties and Compensation Orders under the Corporations Act 2001" (2003-2004) *CLQ* 13; M Welsh, "11 Years On — An Examination of ASIC's Use of an Expanding Civil Penalty Regime" (2004) 17 *AJCL* 175; M Welsh, "Adler, Whitlam & Others: Judicial Interpretation of the Civil Penalty Provisions of the Corporations Act 2001" (2005) 18 *AJCL* 243; A Rees, "Civil Penalties: Emphasising the Adjective or the Noun" (2006) 34 *ABLR* 139; V Comino, "Civil or Criminal Penalties for Corporate Misconduct: Which Way Ahead?" (2006) 34 *ABLR* 428; J Knackstredt, "The Evolution in Civil Penalties Proceedings" (2006) 24 *C&SLJ* 56; V Comino, "The Enforcement Record of ASIC since the Introduction of the Civil Penalty Regime" (2007) 20 *AJCL* 183; M Welsh, "The regulatory dilemma: The choice between overlapping criminal sanctions and civil penalties for contraventions of the directors' duty provisions" (2009) 27 *C&SLJ* 370; R M Jones and M Welsh, "Towards a Public Enforcement Model for Directors' Duty of Oversight" (2012) 95 *Vanderbilt J of Transnat'l Law* 343; M Welsh, "Rediscovering the

cases where such a claim is brought by the company, usually after a change of control or change of management or against a former director or employee or by a liquidator. Claims of this kind can also be raised directly in a statutory derivative action or indirectly in an oppression claim.

Continuous disclosure

Second, the continuous disclosure provisions will of course be very familiar to this audience. Section 674 of the *Act* provides that, if (1) a listed entity has information that a listing rule of a listed market requires it to notify to the market operator; (2) that information is not generally available; and (3) that information is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of ED securities (as defined) of the listed entity, then the entity must notify the market operator of that information in accordance with that rule: s 674(2). That section requires continuous disclosure by entities listed on ASX, where r 3.1 of the ASX Listing Rules imposed a continuous disclosure obligation on listed entities, subject to limited exceptions. Since the amendments initially made by the *Corporations (Coronavirus Economic Response) Determination (No 2)* 2020 (Cth) and broadly continued by the *Treasury Laws Amendment (2021 Measures No 1) Act* 2021 (Cth), a contravention of that section is a strict liability offence and can support an infringement notice, but the section is no longer a civil penalty provision or capable of supporting a claim for damages under s 1325 of the *Act*.

Section 674A is in similar terms, other than that it is only contravened where the entity *knows or is reckless or negligent* with respect to whether the information would, if it were generally available, have a material effect on price. That section is a civil penalty provision and allows a claim for damages under s 1325 of the *Act* where that fault requirement is satisfied. Accessorial liability is now only available in respect of a fault-based prohibition in s 674A and not for a breach of s 674 of the *Act*.[6]

Public Potential of Corporate Law" (2014) 42 *Fed L Rev* 217; M Welsh, "Realising Potential of Corporate Law: 30 Years of Civil Penalty Enforcement in Australia" (2014) 42 *Fed Law Rev* 217; A Keay and M Welsh, "Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences" (2015) 15 *J Corp Law Studies* 255; V Comino, *Australia's "Company Law Watchdog": ASIC and Corporate* Regulation, Thomson Reuters, 2015; J Hedges et al "The Policy and Practice of Enforcement of Directors' Duties by Statutory Agencies in Australia: An Empirical Analysis" (2017) 40 *Melb UL Rev* 905; I Ramsay and M Webster, "An analysis of the use of stepping stones liability against company directors and officers" (2021) 50 *Aust Bar Rev* 168; D Kingsford-Smith "Australian Directors' Duties: What does it mean to say they are Public Duties" (2021) 52 *Victoria U Wellington L Rev* 343 at 352-353, 355.

[6] These changes were noted in *Australian Securities and Investments Commission v Holista Colltech Ltd* [2024] FCA 244 at [33]-[35]. Section 1041H of the Corporations Act and s 12DA of the Australian Securities & Investment Commission Act 2001 (Cth) ("ASIC Act") were also amended by the *Treasury Laws Amendment (2021 Measures No 1) Act* 2021 so that a claim for misleading and deceptive conduct is not available where conduct would not breach the fault-based obligation in s 674A. However, claims under those sections will still be available in respect of a claim for misleading and deceptive conduct in respect of a positive statement, including a positive statement which is said to be misleading by omission, and claims are still available under s 1041E of the Corporations Act which includes a negligence standard.

There is a developing interaction in the case law between a company's continuous disclosure obligations and directors' duty of care and diligence.[7] In an early example, *Australian Securities and Investments Commission v Vocation Ltd (in liq)* (2019) 371 ALR 155; 136 ACSR 339; [2019] FCA 807, Nicholas J held that Vocation had contravened the continuous disclosure requirements under s 674 of the *Act* and had also contravened the prohibition on misleading or deceptive conduct in s 1041H of the *Act* in its answers to a diligence questionnaire in respect of the private placement. His Honour held that Vocation's chief executive officer had contravened the duty of care and diligence under s 180 of the *Act* in causing or permitting Vocation's contravention of both provisions. His Honour also held that Vocation's chair had accepted information provided by management uncritically and without challenging the correctness of the advice or the assumptions on which that advice was given, and had contravened s 180(1) of the *Act* during the period after an issue as to Vocation's government funding was identified.

A similar finding was also reached in *Australian Securities & Investments Commission v Big Star Energy Ltd (No 3)* (2020) 359 ALR 17; 148 ACSR 334; [2020] FCA 1442, where Banks-Smith J found that Big Star had contravened s 674(2) of the *Act* by failing to notify ASX of several matters, and a director had contravened s 180 of the *Act* by failing to exercise reasonable care and diligence in respect of the disclosure. An appeal from that decision was dismissed in *Cruickshank v Australian Securities and Investments Commission* (2022) 403 ALR 67; [2022] FCAFC 128. Other recent cases involving the overlap of continuous disclosure and director's duties claims include *ASIC v Australian Mines Ltd* [2023] FCA 9; *Australian Securities and Investments Commission v Australian Mines Ltd (No 2)* [2023] FCA 468; *Australian Securities and Investments Commission v Get Swift Ltd (Penalty Hearing)* (2023) 167 ACSR 178; [2023] FCA 100, involving a relatively rare case where the finding that directors had adopted an "unlawful public-relations driven approach to corporate disclosure" indicated intentionality in the contraventions; and *Australian Securities and Investments Commission v Holista Colltech Ltd* [2024] FCA 244.

There are also significant developments in continuous disclosure claims brought by private plaintiffs as funded class actions. Obviously, as this audience would know, the previous trend toward settlement of continuous disclosure actions without trial has weakened, and more of these actions now go to trial, and several have failed to establish materiality, causation or loss. Several recent continuous disclosure class actions adopt the analysis in *Re HIH Insurance Ltd (in liq)* (2016) 113 ACSR 318; [2016] NSWSC 482, where Brereton J accepted that causation could be established by a form of indirect or market-based causation, and in *TPT Patrol Pty Ltd as trustee for Amies*

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[7] For commentary, T Bednall and P Hanrahan, "Officer Liability for Mandatory Corporate Disclosure, Two Duties, Two Destinations?" (2015) 31 *C&SLJ* 474; I Ramsay, "Enforcement of Continuous Disclosure Laws by the Australian Securities and Investments Commission" (2015) 32 *C&SLJ* 196; I Ramsay and M Webster, "An Analysis of the use of Stepping Stone Liability Against Company Directors and Officers" (2021) 50 *Aust Bar Rev* 168; M Legg, *Public and Private Enforcement of Securities Laws: The Regulator and the Class Action in Australia's Continuous Disclosure Regime*, Hart, 2022.

Superannuation Fund v Myer Holdings Ltd [2019] FCA 1747, where Beach J accepted an approach based on market-based causation, although he held that no loss was established in that case where the market had approached profit and earnings guidance given by the relevant company with scepticism and the market price had reflected that scepticism.

A continuous disclosure claim subsequently failed in *Bonham v Iluka Resources Ltd* (2022) 404 ALR 15; [2022] FCA 71 ("*Iluka*"), where Jagot J held that the statements made by the company did not convey the alleged representations and held that it was not shown that the company did not have a reasonable basis for those statements. Her Honour followed the earlier decision in *ASIC v GetSwift Ltd* [2021] FCA 1384 at [1081]-[1085] in holding that, by applying the definitions of "information" and "aware" in the ASX Listing Rules, the continuous disclosure obligation can attach to an opinion that the company's officers should have formed by reference to the information available to them, even if they did not actually form that opinion.

A continuous disclosure claim directed to earnings forecasts also failed at first instance in *Crowley v Worley Ltd* [2020] FCA 1522. However, the Full Court of the Federal Court allowed an appeal from the decision in *Crowley v Worley Ltd* (2022) 293 FCR 438; (2022) 400 ALR 452; (2022) 158 ACSR 505; [2022] FCAFC 33. The Full Court's decision emphasises that whether the continuous disclosure requirements were contravened is to be determined reference to the conduct and knowledge of the company, including information known or "constructively" known to officers in the sense contemplated by the ASX Listing Rules, and not by focusing only on the board's knowledge. The majority, Jagot and Murphy JJ, there held (at [54]ff) that the trial judge had not sufficiently focused on the information known to the company and its executives, as distinct from its board, and had given insufficient weight to inferences which could be drawn where Worley Ltd had not called several of its executives . The majority again expressed the view, consistent with *GetSwift* and *Iluka*, that information can fall within the scope of the continuous disclosure obligation under s 674 of the *Act*, again applying the definitions of "information" and "aware" in the ASX Listing Rules, where company officers ought reasonably to have formed, but did not form, an opinion based on the facts known to them, and Perram J also there qualified the different view which he had previously appeared to express as to that matter in *Grant-Taylor v Babcock & Brown Ltd (in liq)* (2015) 322 ALR 723; [2015] FCA 149 at [157].

The Full Court remitted the proceedings for a limited hearing before a new trial judge, but the claim then failed again on that hearing in *Crowley v Worley Ltd (No 2)* [2023] FCA 1613. Jackman J there found that most of the steps necessary to establish liability were established, partly by the Full Court's findings, but the plaintiff had not established that disclosure should have been made of forecast profits either in the range or alternative amounts for which it contended and had not established loss arising from the alleged non-disclosure. An appeal has now been brought from Jackman J's decision.

A continuous disclosure action also failed in *McFarlane as Trustee for S McFarlane Superannuation Fund v Insignia Financial Ltd* [2023] FCA 1628,

where the materiality of the information that was not disclosed was not established. The class action brought against the Commonwealth Bank of Australia, alleging non-disclosure of non-compliance with its anti-money laundering reporting obligations in respect of deposits to automatic teller machines, failed at multiple levels in *Zonia Holdings Pty Ltd v Commonwealth Bank of Australia Ltd (No 3)* [2024] FCA 477, largely on factual findings adverse to the plaintiffs rather than by reference to any novel legal principles. An appeal has also now been brought in that matter.

Financial services regulation

Third, the area of financial services regulation arguably raises the most troubling issues for enforcement. The recent history of Australian (and international) financial services regulation demonstrates both recurrent misconduct in financial services and recurrent inquiries into the effectiveness of the regime.[8] These issues have some similarity to the history of financial services regulation in the United Kingdom, which has also seen recurrent mis-selling issues.[9] Retail investors have suffered significant losses on the failure of several entities providing products and services to the retail sector and through issues as to the quality of financial advice.[10]

We all know that conduct issues in relation to financial services were also addressed in 2019 by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ("Hayne Royal Commission"). The Interim Report of the Hayne Royal Commission observed that the source of many of the issues it identified was "greed" or "the pursuit of

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[8] I have drawn here on AJ Black & P Hanrahan, *Securities and Financial Services Law*, 10th ed, 2021, [11.2] and AJ Black, "Misconduct in Banking and Financial Services: Implications of Australia's recent Royal Commission", paper presented at the University of Oxford, 26 February 2020.

[9] For commentary, see J Black and R Nobles, "Personal Pensions Misselling: The Causes and Lessons of Regulatory Failure" (1998) 61 *Mod L Rev* 789; N Moloney "Regulating the Retail Market: Law, Policy and the Financial Crisis" (2010) 63 *Current Legal Problems* 375; E Ferran, "Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK" (2012) 13 *European Business Organization Law Review*, 247; N Moloney, "The investor model underlying the EU's investor protection regime: consumers or investors?" (2012) 13 *European Business Organization Law Review* 169, especially at 176ff; N Moloney, "EU Financial Market Governance and the Retail Investor: Reflections at an inflection point" (2015) 37 *Yearbook of European Law* 251, especially at 254ff; D Bugeja, *Reforming Corporate Retail Investor Protection: Regulating to Avert Mis-Selling* (Hart, 2019).

[10] For reviews of the issues, see Report of the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia (November 2009); D Kingsford Smith, "Regulating investment risk: Individuals and the global financial crisis" (2009) 22 UNSWLJ 514; ASIC Report 279, *Shadow shopping of retirement advice*, March 2012; ASIC Report 337, *SMSFs: Improving the quality of advice given to investors*, April 2013; P Hanrahan, "Regulating financial advice for retirement – the recent Australian reforms", 10 March 2017; G Pearson, "Failure in corporate governance: financial planning and greed" in C Mallin (ed), *Handbook on Corporate Governance in Financial Institutions* , 2016, pp 189-190; Senate Economics References Committee, *Agribusiness Managed Investment Schemes: Bitter Harvest*, 2016; ASIC Report 499, *Financial Advice: Fees for no service*, October 2016; ASIC Report 562, *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest*, January 2018; D Wishart & A Wardrop, "What can the Banking Royal Commission achieve: Regulation for good corporate culture" (2018) 43 *Alternative LJ* 81 at 82 .

short term profit at the expense of basic standards of honesty" and the Hayne Royal Commission's Final Report similarly observed that:

> "in almost every case, the conduct in issue was driven not only by the relevant entity's pursuit of profit but also by individuals' pursuit of gain, whether in the form of remuneration for the individual or profit for the individual's business. Providing a service to customers was relegated to second place. Sales became all important. Those who dealt with customers became sellers. And the confusion of roles extended well beyond frontline staff. Advisers became sellers and sellers became advisers."[11]

The Hayne Royal Commission summarised its conclusions in strong terms, observing that conduct of financial services firms over "many years" had caused substantial loss to consumers and yielded substantial profit to those firms, had often broken the law and, where it had not been unlawful, had "fallen short of the kind of behaviour the community not only expects of financial services entities but is also entitled to expect of them."[12] The Hayne Royal Commission also identified many examples of conduct that was not "fair" by any standard, or did not advance the client's interests, or involved significant conflicts of interest in dealings with retail clients and observed, in language echoing the case law as to fiduciary duties, that "experience shows that conflicts between duty and interest can seldom be managed; self-interest will almost always trump duty".[13] The Hayne Royal Commission also focussed on the commission and remuneration arrangements in respect of financial advisers, which have caused ongoing difficulties in the Australian financial services regime.

The Hayne Royal Commission also identified an incomplete transition from a "sales" culture in respect of financial products towards a "profession" of providing financial advice and doubted that financial advisers had achieved the status of a "profession"[14] but did not support the possibility of distinguishing further between sales and true advisory functions in financial services. The Hayne Royal Commission also recognised the issue of conflicts of interest arising from vertical integration of product manufacturers and financial advisory firms, where, for example, product manufacturers both provide advisory services and own advisory firms that provide such services. These matters emphasise that, obviously enough, a sophisticated legal regime is not sufficient in itself to deliver compliance, although exceptions to and failures in a statutory regime may well be sufficient in themselves to deliver non-compliance.

There have been several attempts to address these issues, including the "Future of Financial Advice" reforms which attempts to increase competency standards of advisers under the *Corporations Amendment (Professional Standards of Financial Advisers) Act* 2017 (Cth), which took effect from January 2019 and, possibly the most promising approach, the introduction of product design and distribution obligations by the *Treasury Laws Amendment*

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11 Hayne Royal Commission, Final Report, pp 1-2.
12 Hayne Royal Commission, Final Report, p 1.
13 Hayne Royal Commission, Final Report, p 3.
14 Hayne Royal Commission, Final Report, p 119.

(Design and Distribution Obligations and Product Intervention Powers) Act 2019 (Cth).

The Government is also implementing some parts of the Quality of Advice Review report (December 2022). That report recommended an expansion of the scope of "personal advice" and a narrowing of the scope of "general advice", and recommended that the existing "best interests" and priority duties and associated provisions be replaced by a duty to give "good advice" (defined by reference to the concepts of "fit for purpose" and "good" in all the circumstances) which would apply to all forms of personal advice and a best interests duty, with no safe harbour provision, which would apply to advice given by financial planners and their equivalents. The Government's response (December 2023) did not adopt that recommendation and indicates that the Government proposes to retain the best interests and priority duties and remove the present "safe harbour", which may have the consequence of reinstating a wider "best interests" duty. Several recommendations made in the Quality of Advice Review, including as to the treatment of superannuation advice and simplification of provisions for ongoing fee renewals and statements of advice, will be implemented by the *Treasury Laws Amendment (2024 Measures No 1) Bill* 2024 (Cth).

ASIC's approach to litigation, enforceable undertakings and penalties, the Banking Executive Accountability Regime and the Financial Accountability Regime

The Hayne Royal Commission recommended that ASIC should adopt an approach to enforcement that takes, as its starting point, the question of whether a Court should determine the consequences of a contravention, and emphasised that increased litigation may vindicate a legal principle and will have deterrent effect. The Government accepted that recommendation and ASIC for a time indicated that it would adopt a "why not litigate?" enforcement stance. There are, of course, some good answers to the question "why not litigate?", by reference to issues of delay, cost, uncertainty of outcome and the risk that that approach will encourage an equally litigious approach by regulated entities. In the event, ASIC now adopts a more nuanced position.

ASIC has brought numerous cases against providers of financial services, particularly relating to the duties to act efficiently, honestly and fairly and to manage conflicts (s 912A(1)(a)–(aa))[15] and the statutory best interest duty

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[15] *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)* (2012) 88 ACSR 206; [2012] FCA 414; *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* (2018) 133 ACSR 1; [2018] FCA 2078, on appeal in *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* [2019] FCAFC 187; *Australian Securities and Investments Commission* v *AGM Markets Pty Ltd (in liq) (No 3)* (2020) 380 ALR 27; 143 ACSR 140; [2020] FCA 208 at [505]-[528]; *Australian Securities and Investments Commission v MLC Nominees Pty Ltd* (2020) 147 ACSR 266; [2020] FCA 1306; *Australian Securities and Investments Commission v National Australia Bank Ltd* [2022] FCA 1324 at [354]; *Australian Securities and Investments Commission v Commonwealth Bank of Australia* [2022] FCA 1422; for recent commentary, see P Latimer, "Providing Financial Services 'Efficiently, Honestly and Fairly': Pt 2 (2020) 37 *C&SLJ* 382; J Anderson "Duties of Efficiently, Honesty and Fairness Post-Westpac: A New Beginning for Financial Services Licensees and the Courts?" (2020) 37 *C&SLJ* 450; P Latimer

requirement and associated provisions under Pt 7.7A Div 2 of the *Act*.[16] Some of the cases against providers of financial services reflect misconduct in its usual sense, but others reflect system failures. There seems to be a real prospect that these cases will now be a permanent feature of the landscape, with recurrent breaches arising from complexity in systems in financial institutions.

The penalties applicable to breach of many provisions of the *Act* have been substantially increased, and the provisions to which they apply extended, including by *The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act* 2019 (Cth), which extended the range of provisions under the *Act* to which the civil penalty regime applies and introduced civil penalties for, among other things, the obligations of an Australian financial services licensee not being carried out "efficiently, honestly and fairly" under s 912A of the *Act*, the breach reporting obligations under s 912D of the *Act* and provisions relating to the handling of client monies.

There remain substantial difficulties with greater reliance on litigation and increased penalties, at least in the case of major financial institutions, which have received substantial international attention.[17] The utility of more litigation or increased penalties is limited by the practical reality that it will generally not be possible to impose a sanction that would substantially prejudice the operation of one of the four major banks or (as is emphasised by the fact that they have traditionally been referred to as the "four pillars" of the Australian banking system) or larger superannuation or insurance companies, if that had the capacity to cause their failure. There is also a risk and indeed a likelihood (not unique to Australia) that fines imposed on financial intermediaries following successful proceedings, however large, are ultimately a cost of

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"Providing Financial Services 'Efficiently, Honestly and Fairly': Pt 3" (2022) 39 *C&SLJ* 160; I Ramsay and M Webster, "Enforcement action by the Australian Securities and Investments Commission in relation to financial adviser misconduct" (2022) 39 *C&SLJ* 225, which reviews enforcement actions brought by ASIC in respect of financial adviser misconduct between January 2017 and December 2020.

[16] *Australian Securities and Investments Commission (ASIC) v NSG Services Pty Ltd* (2017) 122 ACSR 47; [2017] FCA 345; *Australian Securities and Investments Commission v Financial Circle Pty Ltd* (2018) 123 ACSR 624; [2018] FCA 2; *Australian Securities and Investments Commission v Westpac Securities Administration Ltd* (2019) 272 FCR 170; 373 ALR 455; 141 ACSR 1; [2019] FCAFC 187, appeal dismissed in *Westpac Securities Administration Ltd v Australian Securities and Investments Commission* (2021) 270 CLR 118; (2021) 387 ALR 1; (2021) 150 ACSR 125; [2021] HCA 3; *Australian Securities and Investments Commission v Commonwealth Bank of Australia* (2023) 163 ACSR 442; [2022] FCA 1149, appeal dismissed in *Australian Securities and Investments Commission v Commonwealth Bank of Australia* [2023] FCAFC 135; for recent commentary, see H Liu et al "In Whose Best Interests? Regulating Financial Advisers, the Royal Commission and the Dilemma of Reform" (2020) 42 *Syd LR 37*; C Byrne "The Liability of Directors and Officers When AFS Licences Provide Defective Product Advice" (2022) 39 *C&SLJ* 19; I Ramsay & M Webster, "Enforcement Action by the Australian Securities & Investments Commission in Relation to Financial Adviser Misconduct" (2022) 39 *C&SLJ* 225.

[17] For example, GM Gilchrist, "The Special Problem of Banks and Crime" (2014) 85 *U Colo L Rev* (observing that the non-prosecution of banks is often justified by externalities arising from their fragility and systemic importance; that it is less clear why bank employees have not been prosecuted individually; and that the criminal law may not be the most effective tool to address bank misconduct).

business that is borne by consumers of the financial institution's services or by its shareholders.[18] Importantly, the former Banking Executive Accountability Regime ("BEAR") and now the Financial Accountability Regime ("FAR") regime largely avoid those difficulties and should incentivise executives of banks and financial institutions to assume, rather than displace, responsibility.[19]

ASIC can also accept an "enforceable undertaking" as an alternative to bringing court proceedings.[20] A breach of an enforceable undertaking exposes the party who gave it to liability to pay the amount of any financial benefit attributable to that breach to the Commonwealth, and to compensate any other person who suffered loss or damage as a result of the breach, and to any other order which the Court considered appropriate. That regime functioned similarly to the deferred prosecution regime in the United States and the United Kingdom, which is also under consideration in Australia. The Hayne Royal Commission was strongly critical of ASIC's use of that regime to resolve regulatory matters, particularly with larger financial institutions. ASIC largely did not accept enforceable undertakings in the period after the Hayne Royal Commission's report although there may now be signs of a return to a more balanced approach in that regard.

The Senate Economic References Committee's July 2024 Report – ASIC investigation and enforcement

I should also note this report, in an academic and not a judicial capacity and, of course, in a balanced way. I have several comments. First, the passage of my professional career over some 35 odd years can be measured by the cycles of largely adverse views expressed about ASIC and its predecessors. Perhaps oddly, these have typically been put while, in parallel, ASIC pursues substantial enforcement actions, often with success, and its targets generally do not share its critics' perception of its lack of effectiveness. The Committee helpfully identifies earlier criticisms of ASIC's performance in Appendix 4 to its report. Of course, one should not mistake repetition of a theme for proof of its correctness.

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[18] MR Reiff, "Punishment in the executive suite: Moral responsibility, causal responsibility and financial crime" in L Herzog (ed), *Finance in a Just Society*, 2017, p 136.

[19] For commentary, see K Manwaring & P F Hanrahan, "BEARing Responsibility for Cyber Security in Australian Financial Institutions: The Rising Tide of Directors' Personal Liability" (2019) 30 *J Banking and Finance Law and Practice*, 20-42.

[20] Section 93AA of the ASIC Act provides for ASIC to accept a written undertaken given by a person in connection with a matter in relation to which ASIC has a function or power under the Act. Section 93A of the ASIC Act allows ASIC to accept an enforceable undertaking from the responsible entity of a registered scheme in connection with the specified matters. The provision for enforceable undertakings corresponds to Australian Consumer Law s 218, which provided for enforceable undertakings in favour of the Australian Competition and Consumer Commission. For commentary, see M Nehme, "Enforceable undertakings in Australia and beyond" (2005) 18 *AJCL* 68; M Nehme, "Expansion of the powers of the Administrative Appeals Tribunal in relation to enforceable undertakings" (2007) 25 *C&SLJ 116*; M Nehme, "Enforceable undertakings and the court system" (2008) 26 *C&SLJ* 147; V Comino, "The GFC and Beyond – How do we deal with corporate misconduct" (2018) *JBL* 15. ASIC RG 69 sets out ASIC's policy in relation to accepting enforceable undertakings.

Second, it is plain that there is an expectation gap in respect of ASIC; unsurprisingly, it is blamed by consumers who suffer loss for not protecting them against misconduct; however often it points out that it cannot deliver a financial system free of a fraud and misconduct risk, the expectation that it should do so often resurfaces in response to investor losses.

Third, the approach adopted in the Committee's report is not the only possible way in which to assess ASIC's performance; others approaches include that of the Financial Regulator Assessment Authority which, as the Committee recognises, found in 2022 that ASIC was "generally effective and capable in the areas reviewed", while also making several recommendations for improvement; and the empirical studies of enforcement actions undertaken by Dr Varzaly and in much of Emeritus Professor Ramsay's work. Fourth, there is reason to be cautious of a case study methodology and the risk of hindsight; the Committee's report discusses, for example, ASIC's response to the Courtenay House matter, but Ponzi schemes are typically plain with hindsight, and the report may give too little weight to the real difficulty of identifying which matters warrant immediate regulatory action from the multitude of reports that ASIC receives and ASIC's efforts, including the use of technology to address that difficulty. Fifth, and in passing, it might seem a tad unfair to criticise ASIC for delays in judgments in civil proceedings, where it must take the litigation process as it finds it.

Sixth, so far as the Committee (or at least some of its members) supports a separation of ASIC's functions between a "companies regulator" and a "separate financial conduct authority", the width of ASIC's jurisdiction plainly gives rise to real regulatory challenges; but can we reasonably expect that two regulators with the same resources, likely greater administrative costs and real boundary issues would achieve a better result?

Seventh, there is force in several of the Government Senators' brief additional comments, which recognise the complexity of the issues; note the competing considerations that "ASIC's broad remit assists enforcement" and "some evidence suggested it leads to ASIC being spread too thin"; note the need for detail of any model to separate ASIC's several functions; and also note that dissatisfaction with ASIC's response to and information provided to complainants, combining with a "common misunderstanding that ASIC is a complaints handling body", create "a significant perception problem that ASIC must address to build confidence in its capabilities." No doubt, more could be said, but I have been conscious of the need for balance here and I also wished to spend some time highlighting the several other issues which I have addressed above.

Complexity

There are difficulties with the complexity of aspects of the *Act*, and particularly Chapter 7 of the *Act* dealing with financial services and the associated Corporations Regulations and ASIC class orders and instruments, although one should approach any claim for a direct link between complexity and misconduct with scepticism.

The Australian Law Reform Commission ("ALRC") has also made substantial recommendations for reform of the regulatory regime in respect of financial services.[21] The ALRC recommended, inter alia, the introduction of a new financial services law as a schedule to the *Act*, amendment of the definitions of "financial product" and "financial service" and the restructuring of provisions relating to consumer protection, financial advice and financial services providers. The ALRC proposed a restructuring of Chapter 7 of the *Act* and associated regulations and statutory instruments in the Financial Services Law, a scoping order and rulebooks, one of which would deal with disclosure rules, another with financial advice rules and a third with licensing rules. Recommendation 38 of the ALRC Final Report recommends grouping and consolidating provisions relating to financial advice, including requirements as to general advice and the best interests and conflicted remuneration provisions which I noted below. Recommendation 39 relates to the grouping and consolidation of general regulatory obligations of financial services providers, including licensees' obligations, the efficiently, honestly and fairly obligation and provisions relating to licensees' obligations as to conflicted remuneration. Although the ALRC's terms of reference did not extend to the review of the existing policy settings of the *Act*, the amendments that it proposed, if introduced, would likely have a significant impact upon the statutory regime.

[21] ALRC Report 141, *Confronting Complexity: Reforming Corporations and Financial Services Legislation.*