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The Manager
Market Integrity Unit
Corporations & Financial Services Division
Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir,

Reforms to the Supervision of Australia's Financial Markets

Exposure Draft and Consultation Paper December 2009

This submission has been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia for the Business Law Section (Section) in relation to the consultation paper referred to above. This submission has been endorsed by the Section, but due to time constraints, the submission has not been reviewed by the Directors of Law Council of Australia Limited.

The Business Law Section acknowledges that this submission is being made after the submissions closing date of 24 December 2009. Accordingly, we have limited our commentary. We do, however, wish to record our concern at the limited time provided for consultation on this very important aspect of the regulation of Australian markets.

Introduction

The Business Law Section recognises that:

- it is an appropriate precursor to the granting of licenses for the operation of competitive trading platforms to have a market supervisor which is not wholly owned by one of the competitors (note that the Section makes no comment on the appropriateness of introducing additional competitive trading platforms in a jurisdiction the size of Australia); and
- whoever the market supervisor is, it must have a capacity to make rules (given the pace of change in markets both technologically and in terms of market practices), review market conduct and impose significant penalties.

However, the Section is troubled by aspects of the proposal where the market supervisor is a government instrumentality such as ASIC.

The Section is concerned by the breadth of the rule making power conferred by proposed section 798F, especially in a context where ASIC not only makes the rules but has investigative responsibility, has prosecutorial decision making and there is no clear requirement in the legislation that its delegates on the proposed Disciplinary Panel are not ASIC employees. However, we have not been able to suggest a way to limit the rule making power without unduly hampering the capacity of ASIC as the market supervisor in matters with which it should properly deal and we note that the rules will generally require Ministerial approval before they are implemented.

The Section also has a principled opposition to the use of an infringement notice regime by regulatory authorities outside the very limited scope of low level, high volume offences which require little or no investigation and are offences of strict liability. We maintain that objection but also recognise that the market supervisor must have an appropriate disciplinary system to be effective.

The Section therefore places even greater emphasis on the need for measures which mitigate the breadth of the powers being granted to a governmental instrumentality under the proposed regime. The Section sees it as essential that:

- the infringement regime be more extensively set out in the Corporations Act, rather than in delegated legislation (as has been done in Part 9.4AA of the Act with respect to continuous disclosure infringement notices); and
- the independence of the Disciplinary Panel from ASIC should be entrenched in the Corporations Act (perhaps along similar lines to the Takeovers Panel), rather than left to the appointment of the panel by ASIC on a delegated basis.

Of course, these issues would not have arisen if the new market supervisor proposed had been a non-government industry based organisation such as FINRA in the US or IIROC in Canada. Other issues which would not arise with a non-government supervisor would include easier review of the effectiveness of the supervision and less rigid pay structures and hence easier access to staff.

Infringement Notice Regime

If the market supervisor is to be a government instrumentality such as ASIC, then an infringement regime is a faster way of taking disciplinary action than initial recourse to a court. However, a person affected must still have the right not to accept the imposition of the fine, forcing ASIC to have recourse to the courts instead for compliance with the Australian Constitution.

In this regard, the Section is concerned that the details of the proposed infringement notice regime are not set out in the draft Bill, but are to be established by regulations. This is in marked contrast to the regime for continuous disclosure infringement notices under Part 9.4AA of the Corporations Act. Indeed, the draft Bill is entirely silent on the effect of someone complying with, or failing to comply with, an infringement notice under the regime proposed for market supervision. The Section is very strongly of the view that an infringement regime must conform to the central principles of Part 9.4AA. Accordingly we consider it is essential that the full details of the regime be incorporated into legislation and not be relegated to regulations.

Given the level of the penalties proposed, it is much more likely that defendants will force ASIC to prosecute actions against them in court than has been the experience with the

comparatively low level penalties which ASIC can impose under the continuous disclosure regime. This is likely to result in much more protracted proceedings (among other things, having regard to the need to explain and prove industry systems and practices to a court) than would be the case with peer review disciplinary panels such as that currently operated by ASX Market Supervision.

Specialist panel of judges

Because recourse to courts is more likely with fines at the proposed level, the Business Law Section therefore encourages the Government and the Federal Court to establish a specialist panel of judges which can develop an understanding of the systems in the context of which these cases will arise. It would also be desirable for these cases to be heard on a fast track.

It is highly undesirable that cases of this kind be allocated to judges who do not have significant experience of commercial matters. However, even judges with broad commercial experience are unlikely to have familiarity with the trading systems which underlie the market supervision cases, and greater familiarity with those systems, through exposure of a relatively small number of judges to a flow of cases, is likely to improve market confidence in the judgments of the court and expedite their administration.

Disciplinary Panel

The Business Law Section strongly supports the proposal to establish a Disciplinary Panel of market experts to act as ASIC's delegate in relation to these matters, and this may, to some extent, ameliorate recourse to the Court system, but we are sceptical that it will preclude that recourse when such large fines are in prospect.

Indeed, the Section regards this aspect of the proposal as being so important that it considers that the creation and operation of the Disciplinary Panel must be entrenched in the legislation. The Section would be concerned if this aspect of the proposal (which removes ASIC at least in part from the roles of rule maker, investigator, prosecutor and judge) were removed effectively by ASIC not appointing external people as delegates and replacing them with internal ASIC delegates for any reason in the long term administration of ASIC's new role in market supervision. We also think it will give market credibility to decisions and any reasons published by the Disciplinary Panel (which we recommend below). Indeed, it would be possible (and desirable) for the legislation to provide that the Disciplinary Panel was to be appointed by the Minister in the same way as the Takeovers Panel.

Open Hearings

The Business Law Section does not support an open hearing process for the Disciplinary Panel. The Section sees real value in the Disciplinary Panel acting as a peer review body, and we are concerned that an open hearing process will chill these proceedings. Instead, we consider that both a process integrity function and a "market education" function would be served by the reasons of the Disciplinary Panel being published following its deliberations. This follows the successful Takeover Panel model. The Disciplinary Panel members should be protected from liability arising out of the publication of the reasons.

Other matters with respect to infringement notices

When the infringement notice regime for continuous disclosure breaches was introduced, the Business Law Section expressed its concern about the likely effectiveness of that

regime. The Section indicated its principled objection and dissatisfaction with the regime again at the time of the review of the regime in the 2007. The Business Law Section notes that the outcome of the 2007 review has never been published. The Section reiterates that it does not believe that this regime has been useful in the continuous disclosure context.

One concern the Section had was that the continuous disclosure infringement notice regime would be the thin end of the wedge – a concern which now appears justified in light of the Government’s proposal in the consultation paper.

Cost recovery

The Business Law Section has some concerns about the proposal on Cost Recovery. While we recognise that industry currently carries cost associated with market supervision through ASX Market Supervision, we note ASX’s submission to the Government in which it points out that there are current vertical integration benefits which will be lost and so this proposal by the Government may add to rather than be cost neutral, for industry.


The Section has concerns about piecemeal introduction of “user pays” fees. On the Section’s understanding, revenues raised by ASIC operations would already cover its costs of operation if not for the payments to be made to the States under the agreements made to obtain their agreement to the creation of a single corporate regulator in 1989/1990. While the Wallis Inquiry may have made this recommendation, the Section holds concerns that there will be a slow creep in such proposals, rather than a systematic review of how ASIC is funded. Is this another “thin end of the wedge”?

Precedent concern

The Business Law Section would have grave concerns if this proposal (especially the aspects of a wide ranging rule making power by ASIC and the proposed penalty regime) were replicated in other contexts – it should be strictly limited to this context. The Section considers that the entrenchment in legislation of the Disciplinary Panel, with appointees who are not ASIC permanent staff, referred to above is essential both from a “separation of powers” viewpoint (which underpins our principled objection to infringement notice regimes) and for timeliness and commercial acceptability of the regime.

If you have any queries or wish to pursue any of the matters raised in this submission, please contact the Chair of the Corporations Committee, Guy Alexander on 02 - 9230 4874 or by email at Guy.Alexander@aar.com.au.

Yours sincerely



Margery Nicoll
Acting Secretary General

3 February 2010