Stockbrokers Association of Australia
Incorporating SDIA

MARKETS DISCIPLINARY PANEL
- *ASIC Consultation Paper 136*

Submission

Executive Summary

The Stockbrokers Association has concerns about the Infringement Notice Regime, in terms of its

- cost and complexity
- reliance on 'negotiated outcomes', and
- risk of 'internalised forum shopping' by ASIC and double jeopardy.

The **Continuous Disclosure regime** is an obvious model for the Infringement Notice Regime, but its history and context is very different.

Transitional arrangements post-Day One will cause cost and inconvenience, in terms of the **Parallel Disciplinary regimes** between ASIC and ASX/ACH/ASTC that will operate for several years.

The continuation of the ASX model of **Tiering of Penalties** may be of assistance to the Panel, but must not impede its discretion to determine the appropriate penalty in each case. The broadening of the tiers by ASIC is a positive development.

In the preparation of a disciplinary case against a broker, it is important that the broker get the opportunity to comment on a **Draft Report**. This can make the process more efficient, by identifying areas of factual error and refining matters in issue, prior to the matter going to the Panel.

Introduction

The Stockbrokers Association of Australia, formerly known as the Securities and Derivatives Industry Association (SDIA) is the peak industry body representing institutional and retail stockbroking firms and investment banks in Australasia.

The Stockbrokers Association of Australia is pleased to provide the following comments on CP136 regarding the proposed ASIC Markets Disciplinary Panel (**MDP**).

Some of the main aspects of the MDP discussed in CP136 include:

- The MDP is seen as a form of 'peer review', similar to the ASX Disciplinary Tribunal (but with a statutory basis) comprising experienced market practitioners
- The MDP will be a properly delegated division of ASIC
- MDP hearings will comprise 3 members from the Panel
- MDP Remedies available, and when they might be considered
- The factors influencing the penalties and whether fines should be graded Tier 1, 2, or 3 are outlined, including low, medium and higher penalties within each tier (which expands on the ASX predecessor)
- The 11 stages of the Infringement Notice process.

ASIC states (at CP136.11) that its aim is

> *'…to have a markets disciplinary regime which is as similar to the current ASX regime as possible.'*

We would like to comment on the following matters:

1	Infringement Notice Regime – cost and complexity	The Infringement Notice regime has the potential to increase the cost and complexity of the disciplinary process for cases which can't be resolved by agreement between the Broker and ASIC. ASX had the power to fine brokers directly under the terms of its Market Rules (which applied under the contract with the Participant). However, ASIC cannot impose a fine for constitutional reasons (judicial power of the Commonwealth[1]). Hence, if the broker does not agree – notwithstanding the proposed incentive of a 40% reduction in penalty - then if ASIC wishes to pursue the matter it will have to go to Court, or to some other properly constituted tribunal like the Takeovers Panel. This will increase litigation costs, cause delay, and it means that the matter will be heard by a judge and not an industry peer.

[1] Constitution s.71

2	Infringement Notice Regime – problems with 'negotiated outcomes'	Since ASIC does not have the power to impose fines, the Infringement Notice regime will largely rely on negotiated outcomes, including the incentive of the 40% discount to what a Court may order, to ensure that matters do not go to Court. However, such 'negotiations' would be heavily weighted towards the Commission, since it has all the regulatory remedies at its disposal, including licensing, criminal and other action outside the Infringement Notice regime. Moreover, as noted at RG000.74, there is no right of appeal of an Infringement Notice to the AAT. This flows from the Constitutional position that – minus a Court Order - ASIC does not have the power to impose one. Accordingly, there will be great pressure on the broker to accept the Infringement Notice, to reduce and/or avoid the threat of other action in relation to the Notice, or other action. While the acceptance of an Infringement Notice will <u>not</u> preclude ASIC from taking further enforcement action, the fact that a Notice has been accepted and complied with would have to weigh heavily in ASIC's decision whether to take further action.
3	Infringement Notice Regime – 'internalised forum shopping and double jeopardy'	As noted at RG000.100-106, where overlap exists between the *Market Integrity Rules* and the *Corporations Act* (and a great many overlaps exist), a variety of actions and penalties may be available to the Commission, including the usual licensing action and/or criminal action. Further, civil action by ASIC does not preclude later criminal or other action. If misconduct is found on the part of an **individual**, ASIC has the power – as it always has - to take banning order and/or criminal action against that person. Therefore, ASIC can indulge in what's been called a form of 'internalised forum shopping' between existing remedies (licensing/banning order action, criminal prosecution, etc) and the new Infringement Notice Regime, which may lead to a form of legalized double jeopardy.
4	Infringement Notice Regime – relevance of the Continuous Disclosure regime	While the ASX Disciplinary Tribunal is the obvious model for the Infringement Notice regime, the regime is also said to be based on the enforcement process for the Continuous Disclosure obligations of listed companies (RG136.8). However, it needs to be noted that the enforcement of the Continuous Disclosure rules has been rather 'light touch', and not supported by the range of penalties as those available against AFSL holders and ASX Participants. The penalties for breaches of the Continuous Disclosure rules have typically been fines in the thousands of dollars. However, penalties against AFSL holders and ASX

		Participants have included fines totalling over $1 million, suspension or termination of licenses to conduct business, the banning of individuals from the industry, and serious criminal prosecutions. Therefore, while the process of the new Infringement Notice regime may be similar to the continuous disclosure regime, the context and history is very different.
5	Transitional arrangements - Parallel Disciplinary regimes ASX/ASIC	ASX has announced that it will be handling all disciplinary matters arising prior to Day One, at which time ASIC will take over market supervision. (The figure of 20-30 remaining market manipulation matters has been mentioned by ASX, which may take 12-24 months to process.) This raises the question as to whether it is appropriate that ASX continue to finalise matters that have already commenced being investigated but are not completed. This will mean parallel disciplinary regimes for up to 2 years, in some cases considering similar sets of facts. ASIC has stated that it expects that the membership of its disciplinary panel will be drawn from a similar (if not the same) pool of industry experts as the ASX Disciplinary Tribunal. If that is the case, then consistency of views and determinations across ASX and ASIC decisions could reasonably be expected. However, even assuming that the *same* people sit on both the ASIC and ASX panels, the different processes themselves could lead to inconsistencies arising. For example, ASX matters can be taken directly to the ASX tribunal, which can levy a penalty directly on the broker, subject to a right of appeal to the Appeal Tribunal. Post-Day One, ASIC matters will require a determination or recommendation by the MDP as to penalty. However, that penalty cannot be imposed on the broker unless the broker agrees. There will be a significant incentive for the broker to do so in the form of a 40% discount to what a Court may award. If the broker does not agree, the matter would have to be taken to Court by ASIC. This would not be a quick process, and would be subject to the normal pre-trial and listing procedures of the Court. Legal costs, compared to an ASX disciplinary tribunal hearing, would be significantly higher. If the Court were to find in ASIC's favour, it may order a penalty different to that which the ASIC panel had recommended.[2] In the live market environment, time is always of the essence. The time taken to dispose of the matter in Court would be longer

[2] This casts doubt on the efficacy of the 40% discountôincentive to settle early with ASIC, since it would rely on an early assessment by the ASIC panel of what a Court would order. However, a Court would never be bound to follow such an assessment.

		than the ASX tribunal. This could give rise to two parallel hearings on similar facts, one subject to complicated legal process and costs; the other a relatively informal private administrative proceeding. The differences in timing alone could mitigate against any consistency arising in the parallel regimes during the hiatus period after the handover to ASIC, during which ASX disposes of its pre-Day One matters. Differences in penalties could also emerge, particularly at the start of the new regime. For these reasons, **we would again submit that there be a handover to ASIC of <u>all</u> incomplete matters, from Day One**.
6	Post-Day One arrangements - Parallel Disciplinary regimes ASX (ASIC) / ACH/ASTC	Post-Day One, ASX Trading Participants will be subject to the new ASIC regime including the MDP. However, if those Participants are also clearers, they will also be subject to the continuing ASX Disciplinary Process under the ACH (and ASTC) Rules. While numbers do vary from time to time, some 50 Participants will be covered by both the ASIC MDP and ASX Disciplinary Process. This will cause added cost and administrative burdens for Participants in having to operate under dual regimes. At the very least, we would again hope that there will be strict protocols around the taking of disciplinary action against 'dual participants', so that there is a nominated 'lead regulator' for the conduct of actions. The problem would be reduced if there were a clear delineation between the ASIC MI Rules and the ASX Rules. However, in areas such as organisational competencies and management and supervision requirements, ASX/ACH is maintaining rules and requirements which **cut across ASIC requirements**. As we have noted to ASX previously[3]: ***ASIC requirements sufficient***: There seems to be little acknowledgement by ASX that both organisational competencies and management and supervision requirements are adequately covered by *Corporations Act* and ASIC Licensing conditions and requirements[4]. There is no reason why the ASIC and *Corporations Act* requirements should <u>not</u> be acknowledged as being the appropriate standards for ASX Market Participants, and should be sufficient for ASX purposes. To maintain detailed management and supervision requirements in parallel would only add to the cost and inconvenience caused by **duplication** between ASX and ASIC requirements.

[3] Stockbrokers Association of Australia *Submission to ASX on draft Operating Rules* 17 June 2010

[4] See, *Corporations Act* Section 912A, ASIC Regulatory Guide 104 *Licensing: Meeting the general obligations*, ASIC Regulatory Guide 105 *Licensing: Organisational competence*, and the certifications that must be given by a financial services provider prior to obtaining an AFSL ï certifications whose breach can have criminal consequences.

		Moreover, the duplication of functions and requirements will lead to ASX requiring more resources to administer them than would otherwise be required. This would appear to be reducing the likely savings to ASX that ought to have resulted from the removal of its market supervision functions. These savings were meant to pay for the fees ASX will have to pay ASIC for carrying out these functions[5].
7	Penalties: Tier 1 - 3 grading of breaches	ASIC is adopting the ASX system of grading of matters, Tier 1 – 3. In the past with ASX, this has raised possible questions of fettering the discretion of a decision maker. We therefore commend ASIC for the removal of the 'floor' in penalties for each of the three Tiers. In any case, unless properly founded in legislation, a Court could choose to ignore the categorization of offences under the Sanction Guidelines. At RG000.111, ASIC comments that in setting penalties, *'…it would be appropriate for the courts or the MDP to have the flexibility to apply [them]'.* We agree wholeheartedly that this should be the case. We note that within Tier 1-3, ASIC is proposing three 'sub-tiers' for high, medium and low penalties (Tables 4-6). Provided these do not in any way remove the flexibility of the MDP in considering matters, it may be useful information for the Panel members. However, the Panel must not simply accept the tier/sub-tier recommended by ASIC Deterrence or it may not be fully discharging its duties.
8	Infringement Notice – Draft Report	The 11 stages of the Infringement Notice process are outlined are outlined in CP136, namely: Breach detected, Reasons & Opportunity to be heard, Whether to be Contested, MDP Panel convened, Notice of Hearing, Hearing, Infringement Notice

5 In December 2009, the Consultation Paper to the then draft legislation transferring market supervision to ASIC made the following comment, under ôCost Recoveryõ:

> 32. It is intended that the imposition of fees by ASIC on market operators [e.g. ASX] will not have a significant impact on investors. At present, investors bear the cost of the regulatory obligation for market operators to supervise their markets. This cost forms a part of the transaction cost levied on brokers by market operators for a trade, which brokers ultimately pass on to their clients. The Governmentôs decision to transfer supervisory responsibility to ASIC will remove the regulatory obligation on market operators to supervise their markets. **It is expected that this saving to operators will be offset by their need to pay the ASIC fees.** (emphasis added)

		issued by MDP, Infringement Notice served, Recipient response, Further Action if not complied with, Publication by ASIC (Table 1). We would like note the importance of *Stage 2* of the process, where the ASIC Deterrence team gives the broker a Statement of Reasons and Opportunity to be heard. Experience with the ASX disciplinary process has shown the importance of the Broker having the opportunity to comment on a draft of the case against it, prior to the matter going to the Tribunal. This gives the Broker an important opportunity to consider the matters against it. In particular, often issues of fact may arise, so that the Broker can correct the draft report, or provide further information which may bear upon the further passage of the matter. Often the correspondence that occurs at this stage changes the course of the matter, which provides a better and more efficient outcome for both parties. It is much better to identify issues and errors at this point, rather than before the Tribunal. Accordingly, we would stress the importance of *Stage 2*, and trust that ASIC Deterrence would enter into this stage with an open and transparent attitude.
9	Actions against individuals	As we have noted to Government previously[6], there is real concern at the range of persons and entities against whom the MI Rules can be enforced, which is much broader than those under the ASX rules. The ASX rules can only be enforced against the Participant. To a limited extent, pre-handover, ASX rules can also be enforced against individuals registered as Responsible Executives and Designated Trading Representatives, but only to the extent that they can be banned or suspended from these roles. Under the draft Regulations, it would appear that ASIC can enforce the MI Rules against **employees, representatives, agents and contractors** as well as the Participant itself. This substantially broadens the scope of the MI Rules, so that for example, a Responsible Executive, manager, compliance officer or adviser could be fined up to $1,000,000. The prospect that a whole new set of individuals – theoretically *anyone* working for or by arrangement with a Market Participant – could be subject to a $1,000,000 fine has sent **shockwaves** through the industry. It is doubtful whether such liability can be covered by insurance or indemnity from the Participant. Once

[6] Stockbrokers Association *Submission to Treasury on Draft Corporations Regulations* 11 June 2010

		again, we cannot see how it is fair, equitable or proportionate to have the power to levy a fine of up to $1,000,000 against a major broking firm on the one hand, and any individual within the firm on the other. We trust that – like the earlier proposal by ASX to fine RE's mentioned above – a sensible balance can be reached which recognises the weaker position of individuals vis-à-vis their firms and achieves a better degree of proportionality for offences. Having said that, and notwithstanding the expanded definition of entities that are subject to the rules, it appears that the MI Rule themselves impose obligations on the market participant, not on individuals. We would therefore query how a representative can in fact contravene a rule which is not expressed to apply to them. This matter was raised with ASIC at the 2010 Annual Stockbrokers Conference in Melbourne in June 2010 and there was a suggestion that there could be some narrowing of the rules by ASIC so that only certain rules could apply to individuals. As we have submitted to Government, rather than relying on ASIC to change its MI Rules and leaving the Regulations as they stand - imposing liability on individuals to comply with the MI Rules - we would submit that it would better to change the Regulations themselves. While we are hopeful, it remains to be seen how the Government responds.
10	Multiple Penalties (CP136.10; RG000.123)	ASIC is proposing a 'modification' to the approach taken by ASX which could result in multiple breaches of the Market Integrity Rules attracting multiple penalties. We did not believe that ASX had a strict rule or guideline requiring concurrent or aggregated rather than cumulative penalties. The discretion was always open to the Tribunal. The effect of this change in approach remains to be seen. Indeed, the Panel may decide that one penalty is appropriate for multiple breaches. For example, a case involving 100 breaches of the order record rule would probably be handled by setting a single fine of $10,000 rather than 100 separate fines. The effect of this 'modification in approach' will be monitored closely. With the Panel, ASIC is seeking to duplicate as far as possible the system of 'peer review' that existed under ASX (CP136.6). It would not be appropriate for anything stated in ASIC policy to be taken to be binding on the Panel to decide matters in a certain way.

		There should be scope for lighter regulatory touch for innocent human error e.g. 'fat finger' matters that are not accompanied by systemic/supervisory failure and that do not threaten market integrity. The existing ASX approach of routinely levying fines of at least $30,000 in such cases is unfair and unjust. The handover of supervisory functions to ASIC presents a good opportunity for the regulator to review the approach to these minor matters, which hopefully may lead to more appropriate levels of penalty.

The Stockbrokers Association is grateful for the opportunity both to discuss these proposals in meetings with us and our Members, and to provide these written submissions. We trust that we can be of further assistance to ensure the smooth transition to the new arrangements.

Stockbrokers Association of Australia
6 July 2010