ASIC - A Toothless Tiger Or Part Of The Banker's Protection Racket?

Summary:
ASIC Whistleblower James Wheeldon explains why our key corporate regulator condones and encourages unethical and unlawful behaviour. It means we are not served by the agency that is supposed to prevent white collar crime and the flow on damage to businesses and families.

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ASIC - A One-Eyed Watchdog

It seems everyone is piling on ASIC. In June, a senate committee handed down a scathing report on its failure to respond effectively to reports of fraud and forgery within the Commonwealth Bank’s financial planning division. Last Tuesday, Joe Hockey told his Coalition colleagues that the regulator had “failed miserably” in holding banks and financial planners to account.

Things are so bad, even the successful prosecutions of the Australian Securities and Investments

Commission have become a source of ridicule. Last year, Jonathan Moylan, a 26-year-old anti-coal activist based in a forest camp near Narrabri, used a fake email address and press release to con some credulous journalists and – briefly –
the sharemarket into believing ANZ bank had withdrawn funding from Whitehaven Coal's Maules Creek mine over environmental concerns.

ASIC raided the campsite and charged Moylan with a market deception offence under the Corporations Act. He pleaded guilty and now faces sentencing. His lawyers say in mitigation of punishment that he did not seek profit – he only wanted to embarrass ANZ.

But tricking the sharemarket is illegal, regardless of the motive. And since ASIC is obliged under section 1 of the ASIC Act to do whatever it can to enforce the corporations laws, it is hard to fault ASIC for charging Moylan. At least, it would be if ASIC had demonstrated similar enthusiasm for smashing the fraudsters at CBA who deliberately victimised unsuspecting investors.

If the purpose of the corporate prankster is to expose contradictions within the "system", Moylan accomplished his mission. His target was ANZ, but his martyrdom on the altar of "investor confidence" has exposed the incoherence of ASIC's approach to regulation.

Greg Medcraft, ASIC's chairman, says ASIC's "first strategic priority" is to ensure that "consumers and investors are confident and informed". A cynic might say that this ambition is contradictory: well-informed investors are, as a general rule, less confident than more ignorant investors who think they have the nous to beat the market, but I digress. Greg Tanzer, an ASIC commissioner, recently explained that a key factor in deciding whether to start enforcement action is "the effect on market integrity" and "investor confidence". It is hard to understand, then, why ASIC has set rules that encourage the duping of investors with the worst sort of marketing fluff. ASIC's tough stance against those who would prey on the credulity of investors only goes so far.

A case in point is the 2007 initial public offering of shares in the RAMS Home Loans Group. Moylan's hoax is rank amateurism compared with the prank pulled by John Kinghorn, the company's erstwhile chairman and major shareholder; Floyd Norris of The New York Times described the RAMS share offer as possibly "the worst" of the decade, anywhere in the world.

Kinghorn gave potential purchasers of his RAMS shares – the proverbial "mum and dad investors" – a glossy 107-page prospectus full of uplifting images of young couples moving into solid brick homes. Letters four centimetres tall screamed of RAMS' "STRONG FINANCIAL OUTLOOK". On the third page of the prospectus, Kinghorn assured potential investors that RAMS' business model "has been refined to continue to drive sustainable long-term growth". To ensure that punters who preferred pictures over words got the message, brightly coloured graphs featured arrows pointing ever skyward.

Only those with the stamina to grind through the fine print would find the buried hints about the truth of the situation. Section 8.2.6, on page 66, warned in small type that RAMS had "structured its funding" because of "an expectation that RMBS [residential mortgage-backed securities] and XCP margins will continue to decrease", which means that in the event of "a major liquidity disruption", RAMS may need to "replace some or all of its short-term funding".

If you find it hard to grasp the gravity of that warning, don't feel bad. The warning wasn't meant to be easily understood. The prospectus – drafted with the assistance of elite law firm Mallesons, underwritten by Swiss bank UBS and audited by PricewaterhouseCoopers – was designed to lull investors into complacency.

It worked, of course. A "major liquidity disruption" was already well under way when the prospectus went to print, and RAMS collapsed three short weeks after Kinghorn pocketed more than half a billion dollars of investors' money. The "mums and dads" who bought into the prospectus were left with near-worthless paper. ASIC never troubled Mr Kinghorn, who used his profits to build a reputation as a philanthropist, until the Independent Commission Against Corruption named him as being corruptly involved with Eddie Obeid.

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As it happens, the RAMS prospectus – unlike Moylan's fake press release – was probably perfectly legal despite being turgid, superficial and incomprehensible. ASIC is okay with the use of glamour shots in prospectuses, provided the issuer complies with hilariously loose rules: "If you include a photograph of a celebrity, you should label the photo and explain why the celebrity is relevant." Thus the private equity guys who sold their Myer shares to an unsuspecting public in 2009 had ASIC's blessing to adorn their prospectus with glossy photographs of Myer's "relevant celebrity" – Miss Universe Jennifer Hawkins. As with RAMS, everyone who bought shares under that prospectus lost money.

ASIC also endorses the use of graphs and charts in prospectuses, supposedly because they "can help present information in a way that is easy for retail investors to absorb". And ASIC permits burying the risk factors – possibly the most important part of the document – deep in the prospectus, instead of placing them front and centre.

ASIC could not go after RAMS for shoddy disclosure because the loan company and its lawyers had played by the rules ASIC itself had written. So forgive me if I find it hard to take ASIC seriously when it speaks of the importance of keeping investors confident and informed.

Since this article is about disclosure, it is only fair I point out my history with ASIC, and that its chairman, Greg Medcraft, has suggested my judgement is lacking.

In April, I gave evidence before the senate inquiry into ASIC about my experience working there as a lawyer nearly a decade ago. I spoke of ASIC's secretive "secondment" program, under which lawyers for the banks and for-profit superannuation funds were invited into the innermost sanctum of ASIC's policymaking function, the Regulatory Policy Branch. In one instance, a lawyer employed by MLC, the wealth management arm of National Australia Bank, was asked by ASIC to help prepare its response to a lobbying submission the lawyer himself had helped draft. To the best of my knowledge, the details of ASIC's bank secondment program had never been publicly disclosed – not even to parliament – until I gave my evidence.

In response, Medcraft "completely and unreservedly" rejected my evidence, although he did not deny a single fact I asserted. He also dismissed me as a "junior lawyer who worked for ASIC for just nine months". He had a point: nothing in my legal career had prepared me for working at ASIC.

After graduating from Harvard Law School in 2000, I spent four years in the merger and acquisition group in the New York offices of Skadden, Arps, Slate, Meagher & Flom. During that time, I worked on a few billion dollars' worth of transactions.

Shortly before leaving Skadden, one of the senior merger and acquisition partners gave me a small and routine assignment. The client was an investment bank famous for its wealth and influence. One of the client's investment funds sought to take an action that might technically violate regulations made by the US corporate regulator, the Securities and Exchange Commission. The client proposed asking the SEC for a "no action" letter: an assurance from the regulator that no enforcement action would be taken over the technical breach.

I could see a solid argument for the SEC giving the client what it sought. But I could also see reasons why the SEC shouldn't give any relief, and the rule was that we would have to clearly explain to the SEC all of the arguments against our client's position. The partner told me to forget it. He wasn't going to submit a weak application on the firm's letterhead, and he certainly wasn't going to withhold information from the SEC. The fact that our client had vast resources and political influence was irrelevant. That was the end of the matter; I assume he told the client they could not do what they had proposed to do.

Some weeks later, I arrived back in my home town of Sydney, and started work in ASIC's Regulatory Policy Branch. One of my first assignments was to respond to a relief application submitted by a top Sydney law firm on behalf of a prestigious and well-known Australian investment bank. The application was about a page and a half long and full of typos. The law firm argued that ASIC should relieve the bank from certain legal obligations because investors were already sufficiently protected under established Victorian law.

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A few hours of research revealed that the application egregiously misrepresented the true position – the state protection wasn't there, and granting the relief would leave investors hopelessly exposed.

There was nothing to do other than to tell the law firm the application was denied. I put this to my supervisor. Discomfort at the notion of saying "no" to that law firm and that bank was written all over his face. ASIC did eventually reject the application, but only after weeks of hand-wringing and consternation. A few years later, the forestry investment fund that was the subject of the application collapsed, leading to many tens of millions of dollars of investor losses.

Shortly thereafter, the head of the Regulatory Policy Branch instructed me to start working under the supervision of that MLC lawyer, preparing a response to the lobbying application the lawyer had helped draft. Instead, I walked out on the commission and got a job with – yes – a corporate law firm.

Medcraft is correct when he says I only worked at ASIC briefly. But I can honestly say that the only time in my legal career I was given instructions I considered unlawful and unethical was during that brief period.

The outlook for Australian retail investors is not good. The government has successfully rolled back many of the new investor protections under the Future of Financial Advice (FOFA) reforms, and ASIC's budget has been slashed. The lobbyists for the banks have the ear of the treasurer – they pay for the privilege of delivering him "in-touch policy dialogue" through Joe Hockey's North Sydney Forum. Despite Hockey's tough words, we can expect many more miserable failures from ASIC

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