Submission to Senate Enquiry into ASIC Investigation and Enforcement

From Mark Allen – Lawyer

Introduction

I thank the Committee for giving the opportunity to present this submission to its enquiry into ASIC Investigation and Enforcement

I was the lawyer who, on instructions from a client, wrote an initial and then two follow-up letters to ASIC raising concerns about the prospectus issued by Nuix Pty Ltd as it then was in relation to its IPO.

My client was a whistleblower, having worked in Nuix in the lead up to the planned IPO and wanted to maintain his anonymity due to fear of (primarily economic) reprisals.

I subsequently assisted my client when he first engaged with ASIC after ASIC decided to investigate the Nuix float – some 8 months later.

I am a commercial and corporate lawyer but focus on providing services to entrepreneurs. These clients aspire to growing their companies with a view accessing the stock exchange as a means of realising the value of what they have built and/or to gain access to capital.

My expertise does not lie in taking companies through the listing process so the submissions I make are as an interested observer who has an understanding of the applicable law and who believes that the law should be applied without fear or favour by a respected regulator.

My personal experience both in relation to the Nuix IPO and from what I have heard from my colleagues or observed in the media and law reports - about ASIC's management of its responsibilities - leads me to support the call for a broader enquiry into the effectiveness of the current ASIC structure and processes.

The outcome of such an enquiry should provide the foundations for a structure and processes that, among other things:

- promotes confident and informed participation by investors and consumers in the Australian financial system.
- results in there being a respected regulator to which lawyers aspire to join for at least part of their career and which is free from any perception of favouritism.

As the creation and promotion of financial and investment products become more complex (including through the application and use of technology) and as more individuals invest to provide for their retirement, I am not satisfied that enough is being done to ensure the consistent application of rules relating to the publication of information on which investors can rely to participate.

I submit there have now been enough reported cases where ASIC has either failed to succeed in enforcement action it has taken or chosen not to get involved in enforcement action with adverse outcomes for the very investors and consumers who are entitled to rely on it to police the corporate laws in Australia.

Such an enquiry will enable the causes of ASIC's performance record to be understood and recommendations made to address those causes, whether they be a lack of direction, a lack of resources or poor culture.

Such an enquiry is necessary because the conduct of ASIC Commissioners at Parliamentary committee meetings has demonstrated that the organisation does not have enough insight into its own conduct to be relied upon to do this job itself.

I have assumed that the Committee has copies of the correspondence that passed between myself and ASIC.

Role of ASIC

As members of the Committee will be aware, ASIC's role is to:

- maintain, facilitate and improve the performance of the financial system and entities in it
- **promote confident and informed participation by investors and consumers in the financial system**
- administer the law effectively and with minimal procedural requirements
- **receive, process and store, efficiently and quickly, information it receives**
- make information about companies and other bodies available to the public as soon as practicable
- **take whatever action it can, and which is necessary, to enforce and give effect to the law.**

Prospectus

As members of the Committee will be aware, the general requirements for a prospectus are that:

- it must contain all the information in relation to the listing company that investors and their professional advisers would reasonably expect and require to make an informed assessment about …. the financial position and performance, the profits and losses and the prospects of the listing company.
- it must be worded and presented in a clear, concise and effective manner.

Further, there is no specific legal requirement for a prospectus to include forecast financial information. However, ASIC expects a forecast to be disclosed in a prospectus if reasonable grounds exist for making such forecasts given the statutory disclosure test requires disclosure of an entity's prospects. If there are not reasonable grounds for making a forecast, the forecast is deemed to be misleading.

In other words, those promoting the listing of a company cannot guess or close their eyes and hope everything will be ok.

Within four months of the IPO, significant earnings downgrades were notified to the ASX. For earnings downgrades to occur so soon after listing suggests there were no reasonable grounds for making the forecasts in the prospectus with the result that Nuix should have been asked for its explanation as to why the prospectus was not misleading.

The fact that ASIC had not previously intervened to stop the production of long and complex prospectus documents, resulted in Nuix's advisers believing it was entirely appropriate to publish a document of over 300 pages of small print. This contributes to the belief that companies and their advisers are given free reign when it comes to interpreting the legal requirements of a prospectus.

I do not believe that any investor would be able to attest that a document of this length enabled them to make an informed decision. This does not lead to an efficient market for newly issued shares.

ASIC Conduct on IPO and Subsequently

From my observations, in respect of the Nuix matter, ASIC did not perform its role adequately.

ASIC:

- should have, in respect of what was touted as the largest float of 2020, earmarked the Nuix prospectus for review even without any complaint being made – it appears it had not done so;
- should have on receipt of my first letter:
    - responded immediately (given available time) to verify that the concerns articulated in the letters were genuine (and not initiated because of a petty grievance);
    - (having taken the first step) taken steps to qualify my client as a whistleblower;
    - afforded my client the protections and support that ASIC exhorts companies, under its supervision, to provide those reporting misconduct within their organisation[1];
    - caused a proper investigation to be conducted by senior officers into the concerns raised about the risk relating to the offer being made to investors by Nuix[2];
    - should have extended the period, in which it had to review the prospectus, to give it more time to conduct such investigation[3].

When it did respond to my letters, on the day of listing, ASIC chose to take issue with the 'smoke' of the disclaimer to which we had drawn its attention rather than addressing whether there was an underlying 'fire' underneath that smoke.

ASIC appears to have relied on the reputations of the major shareholder promoting the float and those advising it and the listing company, as a basis for not going harder and more quickly when the claims were made.

There is a perception that ASIC affords different treatment to the biggest law firms, accounting firms and investment banks. This perception may not be correct but financial disasters like the Nuix float do give it credence.

It is assumed that, if this perception is indeed correct, ASIC's approach is based on its belief that those organisations are more trustworthy and partners or executives within them would not do or omit to do anything to harm their reputation. Recent revelations about the conduct of the big four accounting firms should be enough to dispel this assumption. At the end of the day a firm hand is needed to manage self-interest.

When ASIC did start to investigate the Nuix IPO and only after questions were raised in the Australian Parliament, it did not take advantage of my client's offer to assist with an analysis of the financial information that had been available to ASIC and appeared to go through the motions of investigating the IPO deciding, some 8 months later, not to take any further action.

Given the immediate post-IPO earnings downgrades and the use in the prospectus of a disclaimer that ASIC conceded was unusual, this decision is hard to fathom as is the decision was not to prosecute Nuix's CFO for insider trading.

Whistleblowers

[1] See: https://download.asic.gov.au/media/pnkbtzpp/letter-to-ceos-on-whistleblower-policies-published-13-october-2021.pdf

[2] It appears from material disclosed under FOI requests that the prospectus was given to an intern to review and reliance placed on a response provided to ASIC by Nuix's lawyer.

[3] This, in all likelihood, would have prevented the IPO occurring in 2020 which would have upset the promoters of the IPO.

While not directly related to ASIC's conduct as corporate regulator, the other matter that could be ventilated in an enquiry is the treatment of those reporting misconduct, as a whistleblower, to ASIC.

As ASIC's workload has increased and as supervision of the financial markets become more complex, ASIC needs to rely for assistance, on the enforcement front, from those who decide to report corporate misconduct regardless of the identity of those involved in the alleged misconduct and investigate all such reports without fear or favour.

Prior scrutiny of ASIC

ASIC has come under scrutiny before on its laissez faire approach.

In the final report of the Banking Royal Commission, Commissioner Hayne emphasised the potential such an approach creates:

"Financial services entities are not ASIC's 'clients'. ASIC does not perform its functions as a service to those entities.

And it is well-established that 'an unconditional preference for negotiated compliance renders an agency susceptible to capture' by those whom it is bound to regulate.

As one leading American scholar has written:

'*corporate behavior moves quickly to take advantage of any perceived softening. Social norms act less upon complex organizations than upon individuals*'."

This culture creates the sense that compliance with the law is optional, Hayne says:

"All of these considerations show that improving compliance with financial services laws cannot be achieved by focusing only on negotiation and persuasion.

Compliance with the law is not a matter of choice. The law is, in that sense, coercive and its coercive character can be neither hidden nor ignored. Negotiation and persuasion, without enforcement, all too readily leads to the perception that compliance is voluntary. It is not.

All financial services entities must obey the law, not just those who are willing to do so.

And all financial services entities must comply with all the laws that apply to them, not just with those bits of the law that they find to be commercially acceptable."

The fact that ASIC has failed to be there to intervene, on behalf of those the Corporate Law is designed to protect in the case of Nuix and others, demonstrates that it has not paid heed to this part of the Commissioner's report and those who have lost money can have grounds for asserting that ASIC has indeed been captured by those it is meant to be regulating.

Shareholder Remedies

ASIC might respond by asserting that there is now, in Australia, a well-established ability (through litigation funding providers and law firms) for investors - who are adversely affected by a company's actions - to pursue their own remedies by bringing a class action.

However, the costs of such proceedings and the associated funding arrangements are very high. This generally results in the lawyers and litigation funders being remunerated for the work they do and the risk thy take - but leaves the plaintiffs in the proceedings (ie those that have lost money) short changed – even if their claim is successful.

As the Honourable Mr Justice Stevenson of the Supreme Court of NSW stated emphasis added) in his judgment in the litigation that followed the collapse of electronics retailer Dick Smith[4]:

[4] Findlay v DSHE Holdings Ltd; Mastoris v DSHE Holdings Ltd; Mastoris v Allianz Australia Insurance Ltd [2021] NSWSC 249.

"10 The figure of $25 million is a disappointing result for the group members as the total of the losses they contend has arisen from the conduct complained of is in the order of hundreds of millions of dollars.

11 However, I am persuaded that the inter partes settlement achieved is the best that could reasonably be expected and that the inter se settlement, although involving group members sharing only around 20% of the Settlement Sum, is in all the circumstances fair and reasonable."

It would have been far better, for the investors in Nuix, if ASIC had intervened when it was given the opportunity to do so.

Further, having not done so, it should have taken a more aggressive position when deciding whether, after the event, it should have taken action in respect of the forecasts in the prospectus and Nuix's CFO.

Solutions

It will, of course, be the remit of any more formal enquiry to canvass solutions.

However, such enquiry could consider among other things:

- whether the policy and administration arms of ASIC and its enforcement arm should be separated into two organisations thus allowing each to establish a culture and direction that is fit for the role it is serving and in turn enables it to attract and retain staff of the highest calibre.
- the extent to which ASIC's decisions not to enforce the law by prosecuting actions is a result of in sufficient funding.
- the process by which those leading ASIC are selected and whether there is sufficient diversity, not just in terms of gender but also in terms of qualifications and professional experience.
- the extent to which ASIC should take a more assertive approach in relation to the content of prospectuses so that free reign is not given to the creative drafting of disclaimers
- the use of alternate processes for corporate law matters requiring specific expertise – such as occurred with the establishment of the Australian Takeovers Panel. For example, the task of reviewing prospectuses lodged with ASIC could be delegated to a similar expert panel.

Mark Allen
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