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Comments on some issues regarding financial services regulation in Australia

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Introduction 1

- 4 core elements to the presentation:

- 1. Importance of normative factors including tradition in constructing regulatory praxis;
- 2. Strategic Importance of the contemporary financial sector and associated limits on the scope of regulatory action;
- 3. Allied effect of the “beauty parade” of competitive national regulatory regimes in a competitive sector; and
- 4. Financial crime issues

Introduction 2

- Recurring presence of scandals and crises prompting concerns re adequacy of regulatory infrastructures, e.g. Great Depression, Railway Mania in England in the 1840s, South Sea Bubble in 1720.
- Are contemporary investors actually less likely to suffer fraud than their mid-Victorian counterparts?
- 3 key enduring characteristics of fraud:
- 1. Availability of appropriate victims;
- 2. Motivated offenders; and
- 3. Problems with levels of guardianship.

Introduction 3

- Is ever-increasing financial services regulation inevitable?
- How much regulation is the “right” amount of regulation?
- Regulatory actors constrained by political realities.
- Difficulty and importance of nurturing entrepreneurialism, then balancing that with other notions of the public interest in regulatory praxis.
- Central importance of legitimacy in the discourse and practice of regulation.
- Given the influence of self-interest, jurisdictional limitations, scope of regulatory resources and scale of the territory and actors to be regulated, are popular expectations for regulatory enforcement simply too high?

Historical perspectives

- The importance of the relative autonomy of financial sector actors (especially under the Anglo model).
- The inter-twining of the polis and the market as a continuing tension in how societies organise themselves and this tension is played out on an ongoing basis especially in crisis conditions
- This ambiguity still present today and predominant normative/cultural standards still present as enormous regulatory challenges.
- How can a regulator protect all investors from what may be their own: greed/naivety/stupidity?
- The “Mind The GAP” analogy.

Regulating the City of London

- **The evolution of the UK's system of financial self-regulation and the relative autonomy of the financial sector were a direct result of the post-medieval financial dependence of the Crown upon the City of London.**
- **The City as the "Square Mile" – a village.**
- **A small, relatively insular community.**
- **Trading arrangements were controlled through the hierarchical livery companies.**
- **The *dictum meum pactum* - 'my word is my bond' approach to the conduct and regulation of business.**
- **These traditions exported to jurisdictions such as Australia and the US**

The enduring importance of sociologies of trust and influence in the financial sector

- **Parallels with contemporary capital markets and their influential actors.**
- **Despite increasing disintermediation and the safety nets of due diligence and contractual obligation, sociologies of trust are still immensely important and vulnerable in deal-making in capital markets.**
- **Are these dangers exacerbated under increasing levels of high-frequency trading and growing "dark pools" of capital?**
- **GFC, (as the US Savings and Loans crisis did in the 1980s), saw these sociologies of trust abused and traditional sociologies of influence facilitated and exacerbated their impact (e.g. reliance on views of ratings agencies, despite potential conflicts of interest contexts).**

Moral Issues in Financial Services Regulation

- Mazes of multiple moral codes influential in the financial services sector
- Reflexive interrelationship between regulation and morality
- Moral evaluations inherent re choice and discretion in regulatory practice
- Power relations will impact upon the exercise of discretionary authority in regulatory praxis at both higher and field officer levels

Strategic importance of financial sector 1

- Australia is the world's 13th largest economy with an estimated 2.1% of global GDP at US$1.4 trillion (IMF 2011)
- The financial sector is the largest contributor to Australia's national output and is estimated to contribute 11% or A$135 billion of Australia's Real Gross Value Added by Industry in year to June 2011 (Australian Bureau of Statistics 2011)
- Almost 420,000 people employed in Australia's finance sector (Australian Bureau of Statistics 2011)
- Australia ranked as the 2nd fastest place in the world to start a business (IFC & World Bank 2011)
- Australia ranked 6th globally for good corporate governance by Governance Metrics International (2010)

Strategic importance of financial sector 2

- The World Economic Forum ranks Australia 5th in its Financial Development Index 2010
- Australia's financial markets turnover in 2009-2010 was almost A$102 trillion, more than 250% higher than 1999-2000 (Austrade 2010)
- The Australian stock market ranked in July 2011 as the 6th largest in the world at US$1,136 billion (Standard & Poor's 2011)
- Australia's Funds Under Management at US$1,500 billion, ranked in 2011 as the 4th largest in the world (Investment Companies Institute 2011)
- Australia ranks 4th in the world in terms of superannuation (pension funds) assets at US$1,261 billion (Towers Watson 2011)

Dilemmas for financial regulators as they compete in regulatory beauty parades 1

- The International Organisation of Securities Commissions (IOSCO) sets out thirty principles of regulation that are based on three core objectives (2003:i):
- 1. The protection of investors;
- 2. Ensuring that markets are fair, efficient and transparent; and
- 3. The reduction of systemic risk.
- These three core objectives lie at the heart of the approach that virtually all national securities regulators adopt in respect of their home markets.

Dilemmas for financial regulators as they compete in regulatory beauty parades 2

- **The OECD's Policy Framework for Effective and Efficient Financial Regulation (2010) sets out structural templates under 5 key headings for regulating national and international finance sectors:**
- **Financial Landscape;**
- **Policy Objectives;**
- **Policy Instruments;**
- **System Design and Implementation; and**
- **Review.**
- **ASIC and Australia's other financial regulators seem to meet the OECD's general guidance criteria.**

Dilemmas for financial regulators as they compete in regulatory beauty parades 3

- ASIC's Annual Reports attest to significant levels of achievement across its strategic priorities.
- Is ASIC able to provide a proportional figure for how much of its resources are applied to its 6 strategic priorities of: engagement; surveillance; guidance; education; deterrence; and policy advice or is this not possible?
- ASIC's education and other normative-oriented strategies seem to receive less acknowledgement than its deterrence activities through prosecutions etc, if "harder" numbers available would this change?
- Regular regulatory innovation likely to be seen as normal, indeed essential, for competitive survival - this is the competitive environment in which conflicts must be managed, both nationally and internationally, and capital attracted to national finance centres.
- The GFC has seen a reduced emphasis on "light touch regulation" by some national regulators as their finance centres compete internationally

ASIC: FSA Scale of Operations

Table 8: Some Key Performance Indicators for 1998 to 2011

	KPI's FSA			KPI's ASIC	
Year (FY)	Cases investigated/ Opened	Convicted/Dis ciplinary Action	No. of Employe es	Investigati ons Commence d	No. of Employees
1998 /99	159	14	1,768	233	1,225
1999 /00	159	1	1,961	234	1,219
2000 /01	241	27	Not Available	214	1,221
2001 /02	519	593	2,196	246	1,284
2002 /03	315	260	2,288	302	1,396
2003 /04	213	210	2,303	347	1,531
2004 /05	352	200	2,356	215	1,570
2005 /06	418	227	2,610	195	1,471
2006 /07	235	103	2,659	148	1,610
2007 /08	276	90	2,489	154	1,669
2008 /09	352	154	2,643	140	1,698
2009 /10	287	114	2,952	180	1,932
2010 /11	258	103	3,291	175	1,893

Figures Derived From the Financial Services Authority UK (FSA) and the Australian Securities and Investments Commission (ASIC) Annual Reports

ASIC: FSA Regulatory Activity

Table 7: Regulatory Activity and Expenditure, FSA & ASIC– 1998 to 2011

	Regulatory Activity and Expenditure 1998 to 2011			
	UK (£ Mil's)		Australian ($AUD Mil's)	
	Net Expenditure	Total Fees Received	Net Expenditure (incl Gov Revenues)	Total Administered Revenues
Year (FY)	FSA - Annual Total Expenditure	FSA - Annual Regulatory Activity	ASIC - Annual Total Expenditure	ASIC - Annual Regulatory Activity
1998/99	145.1	168.3	145.5	338.9
1999/00	158	170.7	142.9	362.8
2000/01	157.8	168.8	143.3	403.8
2001/02	179.7	194.4	159.9	413.2
2002/03	193.3	202.7	172.6	431.3
2003/04	192.9	210.9	207.9	493.2
2004/05	193.3	240.5	208.4	568.4
2005/06	267.4	270.6	217.9	585.8
2006/07	269.3	282.1	255.7	558.5
2007/08	298.1	303.3	273.8	589.8
2008/09	335	324.4	294.8	603.9
2009/10	391.7	435.5	386.6	639.9
2010/11	450.8	464.2	385.4	684.9

Figures Derived From the Financial Services Authority UK (FSA) and the Australian Securities and Investments Commission (ASIC) Annual Reports

Trying to count fraud in Australia 1

- Can determine the number of fraud offences recorded by state police forces, from the various state police crime statistics (although there are definitional discrepancies as to what constitutes a fraud offence). Also, difficulty obtaining fraud statistics for the ACT and NT.
- Difficulties with trying to analyse prosecution and conviction data.
- Not standardised across state courts/sentencing advisory councils.
- For example, Victoria doesn't publish prosecution or conviction data broken down by offence in this way for the Magistrates Court, but provides conviction data for certain (but not all) fraud based offences (Obtain Property by Deception and Obtain Financial Advantage by Deception) for the higher courts.
- NSW does publish data on prosecutions broken down by category of offence, but doesn't break down conviction rates by offence.
- South Australia does not seem to aggregate fraud related data to the same extent as some of the other states as they seem to categorise some fraud offences under a broad "theft" category (e.g. limited categories regarding *obtaining financial advantage by deception* and *obtaining property by deception*).

Trying to count fraud in Australia 2

Fraud statistics

	Australia		United Kingdom
	Recorded fraud offences	[redacted]	Recorded fraud offences
Year (FY)			
1998/99	112, 209		304, 877
1999/00	112, 264		362, 252
2000/01	106, 141		346, 375
2001/02	109, 080		340, 477
2002/03	108, 940		355, 001
2003/04	102, 863		340, 872
2004/05	89, 198		303, 218
2005/06	101, 222		248, 616
2006/07	95, 606		213, 147
2007/08	92, 193		166, 470
2008/09	92, 134		175, 062
2009/10	85, 210		163, 961
2010/11	Not available		Not available

Trying to count fraud in Australia 3

Fraud statistics by state, 2007-2010

	New South Wales	Victoria	Queensland	South Australia	Western Australia	Tasmania
Year (FY)						
2007/08	33, 249 (2007) 38, 856 (2008)	23, 623	19, 293	2, 973	9, 564	688
2008/09	38, 856 (2008) 35, 478 (2009)	22, 834	17, 857	2, 589	11, 140	547
2009/10	35, 478 (2009) 35, 774 (2010)	19, 318	18, 182	2, 381	9, 231	472

The problem of defining financial crime

- **Justice Potter Stewart of the US Supreme Court once famously said of obscene material that he might not know precisely what it was, but:**
- **"..I know it when I see it."**
  (*Jacobellis v Ohio*, 84 S. Ct. 1676 [1964])

- **There are similar issues regarding financial crime when individuals and agencies are faced with the problem of defining such activity.**

- **Financial crime is a slippery concept, notably resistant to precise definition due to its blurring of activities and structures.**

- **Over the years there have been many definitions put forward by government agencies and other commentators, but finding a universally acceptable definition has been difficult.**

- **“Financial crime can refer to any non-violent crime that generally results in a financial loss, including financial fraud. It also a range of illegal activities such as money laundering and tax evasion.”**
- **(International Monetary Fund, *Financial System Abuse, Financial Crime and Money Laundering – Background Paper*, 2001, p.3)**
- **“The use of deception for illegal gain, normally involving breach of trust and some concealment of the true nature of the activities.”**
- **(Pickett, K.H.S. & Pickett, J.M., Financial Crime, Investigation and Control, Wiley, New York, 2002)**

- **“There is no generally valid definition of financial crime. At a minimum, it includes money laundering, organized crime, and the financing of terrorism.”**
- **(Portal of the Principality of Liechtenstein, *What is financial crime*, 2007)**

- **The UK's Financial Services Authority (FSA) states that financial crime includes any offence involving money laundering, fraud or dishonesty, or market abuse. This is obviously a pretty broad church.**

- **The reduction of financial crime has been one of the FSA's four statutory objectives: section 6 of the Financial Services and Markets Act 2000 requires the FSA to aim to reduce the extent to which regulated persons and unauthorised businesses can be 'used for a purpose connected with financial crime'. The objective interacts with the FSA's three other objectives – protecting consumers; market confidence; and public awareness. In pursuing its financial crime objective, the FSA's main focus is on firms' risk management, systems and controls.**
- **(FSA, *About the FSA, Financial Crime*, 2007, http://www.fsa.gov.uk/Pages/About/Teams/Crime/index.shtml**

- So there is underlying uncertainty regarding what financial crime is.

- This lack of specificity is a problem with respect to establishing baselines about scale of activity and evaluation of law enforcement responses to such activity.

- These problems appear to be true for approaches towards financial crime by various regulatory actors and across a range of jurisdictions.

Initial Pilot Study re Defining and Measuring Financial Crime

- **1. Does your agency use an operational definition of financial crime, and if so what is it?**

  2. What is the extent of financial crime in your jurisdiction?

- **3. If your agency does not use an operational definition of financial crime, what behaviours/offences that your agency seeks to counter could be categorised as financial crime?**
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  4. If your agency does not use an operational definition of financial crime, what is the extent in your jurisdiction of the behaviours/offences that could be categorised as financial crime?

- **Agencies approached in Australia and the UK**
- **Agencies approached (n = 59)**
- **Agencies responded (n = 35)**
- **Police forces approached (n = 44)**
- **Police forces responded (n = 25)**
- **Non-police forces approached (n = 15)**
- **Non-police forces responded (n = 10)**

Responses from agencies in Australia

- Agencies approached (n = 20)
- Agencies responded (n = 14)
- Police forces approached (n = 8)
- Police forces responded (n = 5)
- Non-police forces approached (n = 12)
- Non-police forces responded (n = 9)

Some Australian sample responses

- **“Not aware of any use of term in department. Uses other bodies’ definitions: Australian Bureau of Statistics for Court statistics; NSW Police definitions for crime statistics (around 70 groups, none are *financial crime*)”.**
- **[New South Wales Attorney General’s Office]**

- **1. No, however a working definition could be 'Any activity of a financial nature which might constitute an offence against the Criminal Code 1899 or an offence of money laundering against the Criminal Proceeds Confiscation Act 2002.**
  2. Unable to quantify the extent of 'financial crime'.
- **3.Public sector corruption and fraud**
  Fraud conducted in the context of organised criminal activity ie major organised fraud or fraud committed in the context of other organized criminal activity eg fraud on financial institutions using false identities, fraudulent misrepresentations etc, money laundering.
  4. See Q2 above.
- **[Queensland Crime and Misconduct Commission]**

- **No operational definition. Commercial Crime Division investigate serious crimes in business transactions (fraud, stock stealing, gold stealing, computer-aided crime). It has 4 sections (Computer Crime, Gold, Rural, Major Fraud). Major Fraud squad investigates crimes related to fraud, stealing as a servant, identity fraud, special commodities.**
- **[Western Australia Police]**

Responses from agencies in the UK

- Agencies approached (n = 39)
- Agencies responded (n = 21)
- Police forces approached (n = 36)
- Police forces responded (n = 20)
- Non-police forces approached (n = 3)
- Non-police forces responded (n = 1)

Some UK sample responses

- Question 1. No there is no definition of financial crime per se as the financial investigation unit work primarily to the provisions of the Proceeds of Crime Act 2002 which have a bearing on the terms of reference for the department.
  Question 2. The extent of financial crime is not measured as arguably there is a dimension of financial crime in all acquisitive crime which accounts for about 70% recorded crime.
  Question 3. Distinct from a general heading of all acquisitive crime, financial crime is investigated predominantly to counter Money Laundering and Fraud.
  Question 4. There is no known extent of financial l crime let alone the behaviours that could be so categorised. This is not peculiar to Cheshire but a national issue.
- [Cheshire Police]

- **The FSA confirmed that (under section 6(3) of the Financial Services and Markets Act 2000) uses the term "financial crime" to include:**
  (a) fraud or dishonesty;
  (b) misconduct in, or misuse of information relating to, a financial
  market; or
  (c) handling the proceeds of crime.
- **However, the FSA was unable to supply data regarding the scale and incidence of financial crime in the UK.**

- **No operational definition**
- **Not applicable**
- **Deals with financial crime as fraud cases**

- **[Suffolk Constabulary]**

- Question 1: Dyfed-Powys Police does not have an operational definition of the term ‘financial crime’. Under the Proceeds of Crime Act 2002 any crime committed whereby the perpetrator has benefited financially could be construed as ‘financial crime’.
- Question 2: Dyfed-Powys Police is unable to state the extent of financial crime within our jurisdiction as the Force does not have an operational definition for the term ‘financial crime’ (as per response to question 1).
- Question 3: Under the Proceeds of Crime Act 2002, Dyfed-Powys Police would look at all crimes where the perpetrator has benefited financially from his/her criminal acts eg through money laundering per se or through confiscation of assets post charge.
- Question 4: See response to question 3
- [Dyfed-Powys Police]

Trying to categorise financial crime

- Gottschalk & Solli-Saether (2011) suggest 28 categories of financial crime ranked by perceived vulnerability by large business organisations in Norway:
- Loan Fraud; Credit Fraud; Fee Fraud; Theft of Cash; Insurance Fraud; Health Insurance Fraud; Identity Theft; Money Laundering; Bankruptcy Fraud; Credit Card Fraud; Investment Fraud; Subsidy Fraud; Public Offer Manipulation; Stock Fraud; Extortion; Copyright Fraud; Currency Manipulation; Data Manipulation; Customs Fraud; Invoice Manipulation; Theft of Goods; Accounting Fraud; Insider Trading; Embezzlement; Art Theft; Forgery; Cartel Activity; Tax Fraud.
- What prospects are there in Australia for categorising and recording financial crime – does ASIC have a position on this?

Conclusions

- **The financial services sector is an especially complex, diffused and rapidly evolving environment .**
- **The sensible management of risk (and obviously that can be interpreted in a multitude of ways) lies at the heart of much of the ongoing financial regulation re-engineering.**
- **The absolutely crucial issue of the political context and how vested interests play out in regulatory praxis.**
- **Successful regulation is at heart an issue of balance and nurturing broad normative commitment is crucial for the development and any ultimate success of regulatory initiatives (Crime Control vs Due Process Model?).**