



11th August 2005 – Past, Present & Future IM

*Legal Developments
in the
Financial Management Industry*

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1



Australian corporate bodies

- > Constitutional uncertainty with pre-1990 was State based **Companies Code**
 - **Corporations Law** (mixture of pseudo Commonwealth by States/Territory)
 - post-15 July 2001 **Corporations Act 2001 (Cth)** clearly Federal
- > **Australian companies = 1,362,962**
- > **1,344,209** proprietary (private) limited
 - **9,955** public limited by shares
 - 1,709 quoted on ASX

2

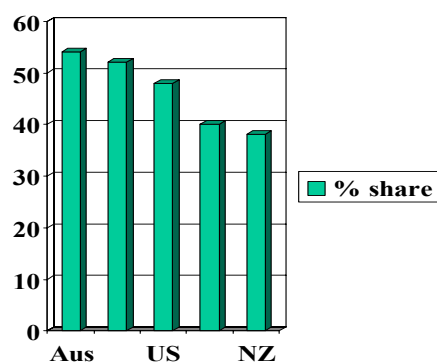
Australian case law

- > By July 2005 (starting with federal corporate system – 1 Jan 1991)
 - 4,403 superior court cases
 - 37 High Court of Australia (**HCA**)
 - 1,022 Federal Court of Australia
 - 3,344 state supreme courts
 - Halsbury's classification 120

3

Share (equity/stock) ownership

- Direct & indirect share ownership by adult population
- > **Australia 54%**
 - > Canada 52%
 - > USA 48%
 - > UK 40%
 - > New Zealand 38%
 - Source: **ASX** 2000



4

Superannuation example

> Super Law Sources:

- Constitution of Trustee
- Trust deed and governing rules of each RSE
- Super trustees' internal policies
- Directors and Officers insurance
 - Professional Indemnity insurance policies

7

Super Safety - RSE Licensing

>Licensing of Trustees

>Registration of funds

8

APRA Licensing Requirements

- > Material Outsourcing Agreements
- > Adequacy of human, technological and financial resources
- > Capital Requirements – Net Tangible Assets
- > Risk Management Strategy
- > Risk Management Plan
- > Fit & Proper Standard

9

The Fit & Proper Standard

- > **The prudential operating standard:**

".....an RSE licensee meets the Fit & Proper standard if the RSE licensee possesses relevant attributes that enable the RSE licensee to properly discharge the duties and responsibilities of an RSE licensee in a prudent manner."

10

Fit & Proper Standard – Responsible Officers


- > AFSL Nominated
- > RSE Licensee Defined
 - Director includes Alternate Directors
 - Executive officer "concerned or takes part in the
management of the RSE
Licensee e.g. Executive Directors
 - Company secretary

11

What is the distinction between the types of responsible officers?

- | ASIC | APRA |
|---|--|
| <ul style="list-style-type: none"> > Part of the AFS licensing process > Definition in Corporations Act 2001 and ASIC application confusing > RO nominated by RSE to cover the areas of authorisation contained in the AFS license. | <ul style="list-style-type: none"> > Part of the RSE licensing process > Definition in SIS Act 1993 and APRA application clear/consistent > All staff who meet the SIS Act definition will be an RO (limited scope to nominate or select them) |

12




The Standard of Fitness - Individual

Fit and Proper Policy reflecting the nature, scale and complexity of the RSE Licensee

	INDIVIDUAL	COLLECTIVE
FITNESS	<p>Minimum Requirements</p> <ul style="list-style-type: none"> >The RSE Licensee possesses the relevant attributes that enable the RSE Licensee to properly discharge the duties and responsibilities of an RSE Licensee in a prudent manner. >Responsible Officers need to be able to quickly acquire sufficient knowledge regarding the duties and responsibilities of an RSE Licensee to make informed decisions based on the advice of technical experts. >Key Persons 	<p>Minimum Requirements</p> <ul style="list-style-type: none"> >Educational qualifications >Technical qualifications >Knowledge and skills relevant to duties and responsibilities >An understanding of an ability to effectively implement the principles outlined in section 52 of the SIS Act >A working knowledge of the SIS Legislation and other prudential requirements and their application >Basic investment knowledge >Basic knowledge of the elements and application of other RSE Licensee law

13



The Standard of Propriety

Fit and Proper Policy reflecting the nature, scale and complexity of the RSE Licensee (cont'd)

	INDIVIDUAL	COLLECTIVE
PROPRIETY	<ul style="list-style-type: none"> >Character >Competence >Diligence >Experience >Honesty >Integrity >Judgment 	

14

Ongoing compliance procedures

- > To continue to satisfy **the** Fit & Proper Standard
 - Ongoing monitoring and review
 - Renewed Statements of Personal Information, AFP, Bankruptcy, Business Reference, Character Reference, Disqualified Persons checks
 - Reporting including breach reporting
 - Policy review

15

Effect of APRA Licensing

- > Compliance
- > Risk Management
- > Governance

16



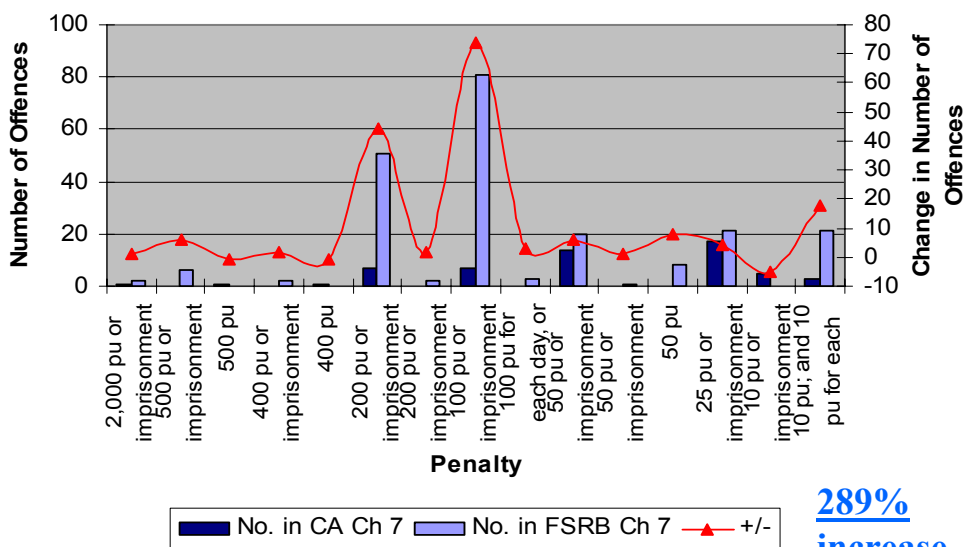
Regulators' developments

Lifecycle of the regulators

- > Do not underestimate change:
 - Tony Hartnell
 - Alan Cameron
 - David Knott
 - Jeffrey Lucy
- > ASC regulator changed its powers 1 July 1998 to
 - **Australian Securities & Investment Commission**
 - Fall out of the role of the ACCC (Competition & Consumers)

17

Offences in Ch 7 Corps Act v Ch 7 FSRB



289% increase

Question

Do officers of
corporations actually
go to jail in Australia?

19

Question

How long do they
spend in jail?

20

What does corporate governance mean?

“An umbrella term that includes specific issues arising from interactions among senior management, shareholders, boards of directors and other corporate stakeholders”

Cochran & Wartick (1988)

21

Corporate Failure in Australia & USA

- > Clear cycles of “boom” & “bust”
- > **1980s**
 - QINTEX (1989; A\$1.5 billion)
 - WA Inc (Rothwells Bank; A\$600 million & Bond Corp; A\$2.3 billion)
- > **1990s**
 - Ansett Airlines (2001; A\$2.8 billion); One.Tel (2001; A\$1.8 billion)
 - HIH Insurance (2001; **A\$5.3 billion**)

22

Background to HIH Insurance: Final Report

- > **Final report 3 volumes & over 500 pages**
- > **Volume 1 has 11 chapters covering a post-mortem; the life & times of HIH; directions for the future**
- > **Volumes 2 & 3 are “Reasons, circumstances & responsibilities” covering 13 chapters**
- > **61 policy recommendations**
- > **Many referrals to ASIC & APRA to investigate**

23

HIH Royal Commission

- > **Operational statistics:**
 - **52 parties involved**
 - **126 witnesses by oral evidence**
 - **75 written only evidence**
 - **228 hearing days**
 - **19,771 pages of transcript**
 - **25,966 exhibits**
 - **44 million documents (130 million pages)**

24

HIH Commission - Policy recommendations

- > **Corporate governance – TWO**
 - Up-dating the CA2001 & accounting standards & ASX rules for directors' pay
 - New definition of “officer” by function
 - Clarify duties for employees
- > **Financial reporting & assurance – FIFTEEN**
 - Broaden AASB; adopt international standards; review independence auditors ²⁵

What did the Commissioner find?

- > **Chapter Six “Corporate Governance”**
- > **“Corporate governance is not a term of art”**
 - **“At its broadest, the governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations”**

– Page 101 of Final Report

26

Corporate Governance comments

- > **“Obviously, primary governance responsibility lies with the board of directors.”**
- > **“Another danger with an overly prescriptive approach to systems and structures is that it may unwittingly encourage a superficial or ‘tick the box’ approach to the achievement of governance objectives.”**

27

Corporate Governance comments

- > **“Systems and structures can provide an environment conducive to good corporate governance practices, but at the end of the day it is the acts or omissions of the people charged with relevant responsibilities that will determine whether governance objectives are in fact achieved.”**

28



Adler – Round No 1

- > HIH Royal Commission investigates one of Australia’s largest corporate collapses
- > ASIC independently investigates civil and criminal contraventions of the law
- > ASIC isolates a single \$10 million transaction to bring a civil penalty litigation focusing on “officers’ duties”
 - > *ASIC & HIH v Adler, Williams & Fodera*

30

Adler – Round No 1

ASIC & HIH v Adler, Williams & Fodera

- > Ray Williams – chairman of HIH
- > Dominic Fodera – chief financial officer
- > Rodney Adler – previous CEO of FAI Insurance which was taken over by HIH
 - Adler becomes a non-executive director of HIH Insurance
- > \$10 million is transferred from HIH to a number of companies which are controlled by Adler

31

Adler – Round No 1

- > The majority of the funds are used to acquire HIH shares
- > The NSW Supreme Court (and subsequent Court of Appeal) held that:
 - Adler 101 contraventions
 - Adler Corporation 84 contraventions
 - Williams 7 contraventions
 - Fodera 5 contraventions
- > But what about the penalties?

32

Adler – Round No 1

> **Williams** has:

- Pecuniary penalty of \$250,000
 - Paid to the Commonwealth Government consolidated revenue
- Disqualified from taking part in the management of a company for the next ten years??
- Ordered to pay A\$8 million compensation with Adler to HIH Insurance (in liquidation)

33

Adler – Round No 1

> **Fodera** has:

- Pecuniary penalty of A\$5,000
 - Paid to the Commonwealth Government consolidated revenue
- No disqualification
- No compensation/damages order

34

Adler – Round No 1

> **Adler** has:

- Pecuniary penalty of A\$900,000
 - Split between \$450,000 personally and \$450,000 by Adler Corporation Pty Ltd (private company involved in the contraventions)
 - Paid to the Commonwealth Government consolidated revenue
- Disqualification from management for 20 years
- Ordered to pay A\$8 million compensation with Adler to HIH Insurance (in liquidation) with Ray Williams

35

When is a Civil Action – not very civil?

- > As discussed previously, contraventions of the Corporations Act may be:
 - Civil actions
 - Civil penalty actions
 - Criminal actions
- > In 2004 the HCA rules that a civil penalty could be interpreted as akin to a criminal punishment *Rich v ASIC* [2004] HCA 42

36

Adler – Round No 2

- > It can be assumed that Rodney Adler, after being found liable for breaches and contraventions of the Corporations Act for mostly officers' duties provisions;
 - that was that...
- > A criminal prosecution, brought after an ASIC investigation and proceedings brought by the Commonwealth DPP, for the same events (the A\$10 million share transaction) could not occur?

37

Adler – Round No 2

- > **Why could it not occur, you ask?**
 - double jeopardy, of course.
- > Adler had already been tried for this action
- > Off to court, to challenge the criminal proceedings!
- > NSW Supreme Court looked at the actual charges that had been laid.
- > **Market manipulation claims – very different to officers' duties actions**

38

Adler – Round No 2

- > The officers' duties are owed to the company (HIH Insurance)
 - Possibly a duty may be owed to the shareholders in the company
- > Where there is a liquidation, then the action can be brought for recovery for the benefit of creditors – the A\$8 million
- > But what about for market manipulation?

39

Adler – Round No 2

- > Market manipulation is about protecting the community
- > Market fairness and integrity
 - Reputation is important
- > The court has held that the criminal case against Adler can proceed and that there is no double jeopardy – **HCA** ruled 10 December 2004
- > The trial started February 2005.....

40

Adler – Round No 2

- > **R v Adler** [2005] NSWSC 274
 - four and a half years imprisonment
 - Mixture of State Crimes & Cth crimes
 - 10% discount for pleading guilty
- > **R v Williams** [2005] NSWSC 315
 - Four and a half years imprisonment
 - Mixture of State crimes & Cth offences
 - 25% discount for pleading guilty early

41

Recent Case Law: Steve Vizard (July 2005)

- Telstra director between September 1996 and November 2000
- Was found to have received and acted on insider information in regards of Sausage Software, Computershare Limited and Keycorp, dotcom companies which earned him over \$200,000 in profits at the time
- Pleaded guilty to the civil crime of breaching his duties as a director under the Corporations Act
- Recent evidence given by Vizard would have allowed him to be found guilty under the Crimes Act and as such be liable for a prison term for Insider Trading

42



Steve Vizard case (2005)

- > Vizard has been found guilty of breaching his duties as a company director
- > 10 years ban from managing any corporation
- > Pecuniary penalties of \$390,000
- > ASIC criticised for their 'soft' behaviour in relation to Vizard's actions as compared to Rivkins.

43

Conclusions.....



Conclusion – a concept model

- > ***Ethics – organisational level***
- > Corporate governance
- > Due diligence – external
- > Due diligence – internal
- > Compliance programme
- > **Ethics – personal level**