ARTICLES

REGULATION OF SECURITIES INDUSTRY INTERMEDIARIES — AUSTRALIAN PROPOSALS

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1. INTRODUCTION

In its one hundred ninety-eight page A Review of the Licensing Provisions of the Securities Industry Act and Codes (Review) published in October 1985, the Australian National Companies and Securities Commission, upon reviewing the licensing provisions of the Securities Industry Act of 1980 Commonwealth and Codes, stated what many had long felt, that "the present licensing system is not working adequately to provide adequate investor protection." The Review considers, instead, a move to the United States/Canadian model of supervised self-regulation by self-regulatory organizations (SROs) in combination with the maintenance of the existing method of regulation by the Commission.

This article endeavors to address the Australian proposals and to compare them with the North American experience. In particular, the article will initially review the various theories of occupational licensure. Next, it will discuss the ramifications of self-regulation by

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1 NATIONAL COMPANIES AND SECURITIES COMMISSION, A REVIEW OF THE LICENSING PROVISIONS OF THE SECURITIES INDUSTRY ACT AND CODES (1985) (A discussion document with proposals for the reform of Part IV and other provisions, and regulations of the Securities Industry Act and Codes relating to licensing of securities industry participants) [hereinafter REVIEW].

2 Id. para. 2.1.
3 Id. paras. 10.1 - .66.
4 See infra notes 37-56 and accompanying text.
SROs. The article will conclude with an examination of several economic theories of regulation and their implications for the proposals in the Review.

2. BACKGROUND

2.1. Australian Company Law

There is no nationwide control by the Australian Canberra-based Federal Parliament of company and securities law in Australia's six states and two territories. Uncertainties created by the High Court of Australia's interpretation of the scope of the "corporation's power" under the Australian Federal Constitution has resulted in the evolution of a cooperative scheme of state- and territory-based regulation. The system is comprised of the six states and the two territories (the Australian Capital Territory and the Northern Territory, which joined the scheme on July 1, 1986). By the "Formal Agreement" of December 22, 1978, the six states and the federal government (which also administers the Australian Capital Territory) bound themselves into a decision-making structure for the establishment and implementation of the cooperative scheme, based upon coordinated regulation of the existing state and territory infrastructures. Such regulation would be undertaken by two bodies, the Ministerial Council for Companies and Securities, and the National Companies and Securities Commission.

The Ministerial Council, the political master of the cooperative scheme, includes the Attorney General of each of the six states and the

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* See infra notes 57-109 and accompanying text.
* See infra notes 110-18 and accompanying text.
* "The Parliament shall, subject to this Constitution, have power to make laws for the peace, order and good government of the Commonwealth with respect to . . . Foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth." AUSTL. CONST. § 51.

* See, e.g., Companies Act, 1981, AUSTL. ACTS P. No. 89, § 3(1) (act intended to provide for the formation, regulation, and registration of companies within the Australian Capital Territory); Companies and Securities (Interpretation and Miscellaneous Provisions) Act, 1980, AUSTL. ACTS P. No. 68, § 3(1) (act intended to regulate the securities industry in the Australian Capital Territory); Companies (Acquisition of Shares) Act, 1980, AUSTL. ACTS P. No. 65, § 3 (act intended to regulate acquisition of shares of companies incorporated in the Australian Capital Territory); National Companies and Securities Commission Act, 1979, AUSTL. ACTS P. No. 173, § 6(3) (act creating commission with power to recommend adoption of new laws or changes in existing laws relating to the securities industry within the Australian Capital Territory).

* REVIEW, supra note 1, at viii-ix (Preface). The "Formal Agreement" is a Schedule to the National Companies and Securities Commission Act, 1979, AUSTL. ACTS P. No. 173 (statute outlining basic powers of Ministerial Council created pursuant to Formal Agreement of December 22, 1978).

* REVIEW, supra note 1, at viii-ix (Preface).
federal government. It has the overall responsibility for the operation and administration of the regulatory plan.\textsuperscript{11}

The National Companies and Securities Commission (Commission), the Australian equivalent of the Securities and Exchange Commission (SEC), is largely responsible for policy development through securities legislation and for the administration of the companies and securities legislation. Based in Melbourne, it encompasses only a staff of about eighty, a large number of whom are professionally qualified in areas such as accounting, economics, and law. The legislation confers on the Commission wide discretion and power over takeovers, company administration, and legislative and administrative development. In essence, the Australian legislation requires the licensing of all market actors, subject to the exemptions set out hereunder, so that their activities can be supervised by the Commission and its delegates. Under the Securities Industry Act of 1980 and Codes,\textsuperscript{12} licenses are divided into four categories: 1) Dealer's license;\textsuperscript{13} 2) Dealer's representative;\textsuperscript{14} 3) Investment adviser;\textsuperscript{15} and 4) Investment representative.\textsuperscript{16} Application forms and procedures are set out in the Securities Industry Act and Codes and Regulations and include specific grounds upon which registration may be denied,\textsuperscript{17} subject to the right to a hearing.\textsuperscript{18} In addition, the Commission can establish minimum fraud requirements for dealers.\textsuperscript{19}

This standard mirrors the U. S. provisions in the Securities Exchange Act of 1934.\textsuperscript{20}

At present the Australian securities legislation exempts several securities market actors or products from regulation: life insurance company bonds, monies going to indirect personal investment (such as portfolio management, equity trustees, life insurance), new insurance products (such as cash management trusts), and the investment advisory industry.\textsuperscript{21} Technical advances and the erosion of investment product segmentation have led to diversification, as has internationalization of the securities market through dealing in Australian shares on the


\textsuperscript{12} Securities Industry Act, 1980, \textit{Austl. Acts P. No. 66}.

\textsuperscript{13} Id. § 43.

\textsuperscript{14} Id. § 44.

\textsuperscript{15} Id. § 45.

\textsuperscript{16} Id. § 46.


\textsuperscript{18} Id. § 62.

\textsuperscript{19} Id. § 51(3).


London Stock Exchange and quoting Australian stock on NASDAQ and the U.S. over-the-counter market.

Moreover, under the Securities Industry Act and Codes, external surveillance occurs in various forms. The Commission has the power to require information to be furnished, to receive accounts and annual statements, and to revoke and suspend licenses. The Commission can also apply to the court for various orders in the event of a violation of the legislation, including an order for the observance or enforcement of either the business rules or listing rules of the stock exchange.

The preexisting Corporate Affairs Commissions of each of the six states and the two territories continue under the cooperative scheme as decentralized delegates of the National Companies and Securities Commission.

2.2. Licensing of Securities Industry Participants

The licensing of those dealing in securities, as well as those merchandizing related information, is the basic mechanism of control used in common law jurisdictions such as the United States, Canada, the United Kingdom (U.K.), and Australia.

In the United States, licensing requirements for those dealing in securities is provided by the Securities Exchange Act of 1934, 15 U.S.C. § 78(a) (1982). Section 15(a)(1) requires the registration of any securities broker or dealer falling within the constitutional scope of the Act. Section 15(b) details specific grounds upon which such registration may be denied. Similarly, Section 203(c)(2), (e) of the Investment Advisers Act provides for denial of registration as an adviser. Section 80b-3(c)(2), 3(c). Section 15(c)(3) of the Securities Exchange Act of 1934 directs that the Commission establish minimum financial requirements for brokers and dealers. Exempted are banks, persons who do not qualify as a “broker” or a “dealer”, and investment advisers, though the latter require registration under The Investment Advisers Act.

External surveillance takes various forms, including authorizing the SEC to set licensing standards, to prescribe tests of competency. Additionally, willful violation of SEC rules is a felony under Section 78ff(a).

In Canada, Manitoba was the first province to impose a licensing requirement for the sale of securities. Sale of Shares Act, 1912, 2 Geo. 5, ch. 75 (Man.).

In the United Kingdom, there is the Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, ch. 45, § 1.

In Australia, the origins of the regulation of dealers and investment advisers and their representatives goes back to the Securities Industry Act, 1970/71 (N.S.W., Victoria, Queensland and Western Australia), drafted in response to securities industry abuses that occurred during the 1960's and were later documented in Senate Select

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22 Id. § 53.
23 Id. § 56; Part IV.
24 Id. § 59.
25 Id. § 14.
26 Id. § 42.
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29 In the United Kingdom, there is the Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, ch. 45, § 1.
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The goals of licensing include the need to ensure the adequacy of dealer capitalization, to exclude the untrained and unqualified from the industry, to provide for and strengthen those rules in the public interest, and to enforce compliance with ethical standards. Underlying these goals is the recognition that the quality of the service provided cannot be judged by the consumer at the time of consumption, thus potentially providing serious financial harm to the unknowing customer.

The view is widely held, and is recognized in the Review, that Australia's current system of dealer-investment adviser licensing does not achieve these goals. Initially, the volume of licenses issued, increasing from some 4,000 in 1981 to some 14,000 in 1985, appears to be beyond the regulatory capability of the current personnel. Moreover, licensing is sometimes recognized as achieving only one purpose, that of raising revenue for the regulator.

The conflict at the core of any licensing scheme is how to maintain equilibrium, that is, how to make the distinction between financial stability, knowledge, and so forth, while recognizing licensing as an interference with freedom, a barrier to entry of an occupation, and an anticompetitive creation of exclusivity by legislative decree. Any licensing system must recognize that all have a right to earn a living, and that the grounds on which registration is to be denied should be specific, clearly defined in advance, and void of generalized and often unchallengeable "public interest" requirements.

The Australian proposals are based on the premise that the present system of licensing dealers, investment advisers, and their representatives provides inadequate protection to investors. In particular, the proposals seek to examine and resolve the following issues:

1. Are investors in securities adequately protected by...
present licensing arrangements? Is the reasonably well-informed investor acting with reasonable caution apt to suffer serious losses as a result of dishonesty or incompetence by operators in the securities industry?

(2) Is continued occupational regulation of participants in the securities industry justified? If so, what type of regulation is appropriate — registration, certification, or licensing?

(3) If licensing is to be retained — who should be licensed — principals, or representatives, or both? What categories of license holders are appropriate? What criteria are relevant in determining licensing categories? What exceptions, if any, should apply to licensing? Should restricted or conditional licenses be granted?

(4) Who should perform the licensing function — a government instrumentality or a self-regulatory organization? If self-regulatory organizations do undertake a licensing function, what checks and balances should be applied to them?

(5) What criteria should apply to the grant of various categories of licenses?

(6) Is it possible to justify prudential controls on license holders? If so, on what basis should they be applied?

(7) What provisions should be made for monitoring and enforcing the conduct of license holders and their compliance with licensing provisions? Who should perform the enforcement function?

(8) What types of misconduct would give rise to disciplinary action against a license holder? What disciplinary actions are appropriate for specific types of misconduct? What criteria should be used to determine whether a license is to be suspended or revoked?6

Designed to ensure efficiency, the Australian recommendations suggest that their main achievement is to redistribute the existing regulatory burden away from the Commission regulators and toward the SROs.

2.3. The Drafting of the Regulation

The preparation of the regulation proposed in the Review raises
significant questions. Economic and social theory, as well as practical experience, show that legislation and administrative rules, once drafted, often unintentionally favor the regulated. At the drafting stage, expert evidence, input, and experience is required. This is normally available only from the regulators, and the existing professional associations and their members, based upon their own experience as sellers of the service.

Any legislative action based on the Review should attempt to ensure the representation of all who may be interested. These unintentional biases need to be counterbalanced by groups other than the providers of these services, such as consumer/user groups and commissioned experts such as economists, academics, and others with different and sometimes wider perspectives. Yet, consumer/user groups generally lack the numbers, authority, and experience to get involved, especially in the area of technical and specialized legislative development. Nor can one expect the biases to be corrected by politicians or by the advisers responsible for drafting the legislation or administrative action, as they, like most experts, are not trained to recognize the ramifications of the legislation. Politicians will not intervene to correct the proregulation bias if no opposition is perceived.

3. THEORIES OF OCCUPATIONAL LICENSURE IGNORED

Although the Review sets out the strengths and weaknesses of self-regulation, it overlooks the wealth of recent studies of the effects of self-regulation. These studies conclude that self-regulation may lead to cartelization for existing members of the regulated group by raising incomes of the regulated, both by reducing their supply and, if consumers perceive licensing as raising competence, by increasing the demand for their services.

Occupational licensing generally results in barriers to entry in the form of requirements of qualifications and apprenticeship. It also restricts advertising, pricing, and client relations. It may further result in

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37 Id. paras. 10.8-10.
38 M. Friedman, supra note 34, at 136-60; W. Gellhorn, supra note 35, at 105-51; G. Stigler, The Citizen and the State (1975); Benham & Benham, Regulating through the Professions: A Perspective on Information Control, 18 J.L. & Econ. 421 (1975); Maurizi, Occupational Licensing and the Public Interest, 82 J. Pol. Econ. 399 (1974); Duggan, Occupational Licensing and the Consumer Interest, in A. Duggan & L. Darvell, Consumer Protection Law and Theory 163, 168-70 (1980); Moore, The Purpose of Licensing, 4 J.L. & Econ. 93 (1961).
39 See generally M. Friedman, supra note 34, at 137-60 (discussion of social effects of licensure); W. Gellhorn, supra note 35, at 112-18 (comparing U.S. licensure system with medieval guilds).
the creation of a fund to compensate clients affected by dealing with members of the licensed group. In short:

The thrust of occupational licensing, like that of the guilds, is toward decreasing competition by restricting access to the occupation; toward a definition of occupational prerogatives that will debar others from sharing in them; toward attaching legal consequences to essentially private determinations of what are ethically or economically permissible practices.

Occupational licensing authorities exercise considerable control over licensees through the power to delicense, the power to enforce adherence to often anticompetitive codes of ethics, and the power to suppress information, new products, and new services.

3.1. Types of Occupational Licensure

The Review outlines the four forms of occupational regulation,

40 See generally Review, supra note 1, paras. 1.0-38 (general discussion of objectives of licensing participants in the Australian securities market); Connelly, supra note 31, at 1269-76 (discussing goals of licensing of securities market actors); Benham & Benham, supra note 38, at 421 (discussing effects of regulation of professions generally); Duggan, supra note 38, at 178-80 (evaluating role of compensation scheme with licensure system).

41 W. Gellhorn, supra note 35, at 114.

42 Why target securities professionals?


(i). . . to maintain, facilitate and improve the performance of the capital market in the interests of economic development, efficiency and stability.

(ii). . . to ensure adequate protection of those who invest in the securities of public companies and in the securities market.


More searching justifications for the imposition of legal liabilities on market transactors have been set out in Lodge & McAuley, Walking the Tightrope: The Comprehensive Liabilities of Securities Professionals in the United States, 5 J. Comp. Bus. & Cap. Mkt. L. 267, 268-70 (1980). The justifications are: (1)"Access" or "Passkey" theory, by which securities markets constitute a valuable resource which if disrupted will affect investor confidence. Pressure for enforcement of securities regulation accordingly should fall on the securities professionals who control access to the market and who are obliged to ensure that the market remains fair and orderly. (2) "Super Fiduciary" theory, by which, because of the disparity in expertise between clients and securities professionals, the professionals owe fiduciary duties which predominate over their
but nowhere does it consider the option of no action or no regulation. Unfortunately for the consumer/user sovereignty case, governments, commissions, and regulators do not receive credit for doing nothing. These options are discussed hereunder.

3.1.1. Registration

When widespread noncompliance and the subsequent failure of a privately operated Registry resulted in the abolition in the early 1980s of the Registry of Business Names in the U.K., and thus the disclosure of the names of natural persons behind the business name, the question was raised whether such registration had ever been to anyone's benefit. If there is no provision surrounding the denial of the right to engage in the registered activity, competitive forces are unaffected, although in practice qualifying conditions are usually required for registration.

3.1.2. Certification

Certification by a tribunal, government, industry, or private body indicates possession of certain skills but does not or should not prevent access to the market by uncertified persons. Hence, a registered builder or licensed contractor can coexist with any other builder or contractor, as can an accountant (Certified Public or Chartered Accountant) alongside any other accountant. At a certain level barriers to entry and the resulting expense would be ignored by those in the industry.

Certification without licensure has the advantages of protection against monopolization or cartelization by the industry; satisfying the licensure paternalism arguments; providing information to users; evidencing compliance with declared standards of skill and training as some proof of expertise; and not foreclosing the development of skills by newcomers, nor leaving "the door of opportunity open for [persons]
who are occupationally gifted though not conventionally schooled.\footnote{W. GELLHORN, supra note 35, at 148.} Of the four options considered, certification is most consistent with a competitive market and a consumer sovereignty.\footnote{Cf. M. FRIEDMAN, supra note 34, at 145 (registration is most consistent with liberalism).} As such, certification warrants further consideration in the \textit{Review} rather than the cursory dismissal received.

\subsection*{3.1.3. Licensing\footnote{\textit{Review, supra note 1, para. 5.7.}}\footnote{Id. para. 5.28.} \footnote{Id. para. 3.31 (discussing burgeoning growth leading to "a flood of paper," a breakdown in the ability of the NCSC (National Companies and Securities Commission) to monitor licensing provisions, and other administrative difficulties). The \textit{Review} reports that "[t]he Commission noted with interest that many of the submissions expressed concern about the conduct of license holders rather than the licensing system itself." \textit{See also id.} paras. 5.9-28 (discussing factors which lead the NCSC to recommend licensing in spite of the fact that it is typically anticompetitive).}}

Any scheme of licensing must return to first principles and be a preventive measure to guard users from victimization rather than an economic weapon intended to strengthen the licensees.\footnote{M. FRIEDMAN, supra note 34, at 148.} It must not affect consumer sovereignty. The very weakly presented case against licensing\footnote{W. GELLHORN, supra note 35, at 145.} does not address Friedman's paternalism argument:

Individuals, it is said, are incapable of choosing their own servants adequately, their own physician or plumber or barber. In order for a man to choose a physician intelligently, he would have to be a physician himself. Most of us, it is said, are therefore incompetent and we must be protected against our own ignorance. This amounts to saying that we in our capacity as voters must protect ourselves in our capacity as consumers against our own ignorance, by seeing to it that people are not served by incompetent physicians or plumbers or barbers.\footnote{M. FRIEDMAN, supra note 34, at 148.}

Nor does the \textit{Review} draw a distinction between instances where licensing may be justified, namely, in the "special case which arises when an occupation of critical public importance has been overrun, and not merely occasionally infected, by persons insensitive to their responsibilities."\footnote{W. GELLHORN, supra note 35, at 145.} There is no evidence of widespread failure of Australian securities professionals beyond the failures in the 1960s reported in the
Australian Rae Report.66 Where user choice is wide, the argument for licensing — whether by external regulation or by self-regulation — is weak.67

The argument for licensing is stronger where the user cannot choose who will serve him, or arguably where the user is too distant to know the facts about his servant (such as dealing with a securities professional). However, the existence of such evils must be demonstrated and proved, rather than being based on the suppositions underlying the Review.

3.1.4. Negative Licensing

The jurisdiction of an authority such as the Commission or a licensing tribunal to issue or to obtain an order prohibiting a person from engaging in an occupation for breach of a rule or for unacceptable conduct is an option that deserves consideration. Such power would be compatible with the consumer sovereignty theme of this paper, and need not involve the entrenchment of the SROs or other industry groups as proposed in the Review.68

4. Ramifications of Regulation by Self-Regulatory Organizations

The U.S. Congress has placed great emphasis on the self-regulation of market actors in the securities industry, through both administrative and judicial supervision of stock exchanges and of securities industry professional associations.69

In contrast to the self-regulation in the U.K., where compliance is voluntary and where there is not really the possibility of U.K. government intervention by statute,60 the U.S. and Canadian schemes, as well as the proposed Australian self-regulation scheme, are not independent of some external accountability and outside supervision.61 Such inter-

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66 See supra note 30.
67 See id., para. 5.10-.13.
69 Section 78o of the Securities Exchange Act of 1934 contains the primary provisions regarding broker-dealer registration and administration. In particular, Section 78o(b)(4) authorizes the SEC to censure, to place limitations on the activities, or to suspend or revoke registration of any broker or dealer, especially in subsection (A) where there has been a willful violation of the securities legislation or regulations. Sec-
vention is arguably very important in order to ensure that self-regulation works, as government must be assured that the SROs actually perform their regulatory functions. Regulation also must replace impairment of competition, and supervision of a quasi-public utility is necessary for efficiency.

Self-regulation is perceived as having the benefit of "the expertise and intimate familiarity with complex securities operations which members of the industry can bring to bear on regulatory problems, and the informality and flexibility of self-regulatory procedures." The

Section 78o-3(b) of the SEC Act sets the criteria which the SEC must consider prior to approval of a national securities association of an association of brokers and dealers.

(1) The association must have the organization and capacity to carry out the purposes of the Act, and must be able to comply with, and to enforce compliance with, the Act by its members and persons associated with its members. § 78o-3(b)(1).

(2) The rules of the association must provide that any registered broker or dealer may become a member. § 78o-3(b)(3) (subject to subsection (g) of this section).

(3) The rules of the association assure a fair representation of its members in selection of directors and administration of its affairs. § 78o-3(b)(4).

(4) The rules of the association provide for the equitable allocation of dues, fees, etc., among members. § 78o-3(b)(5).

(5) The rules of the association foster equitable principles of trade, and are designed to prevent fraudulent and manipulative acts and practices. § 78o-3(b)(6).

(6) The rules of the association provide for appropriate disciplining of members and accounted persons, § 78o-3(b)(7), and provide a fair procedure for such discipline. § 78o-3(b)(8).

(7) The rules of the association do not impose any burden on competition. § 78o-3(b)(9).

Self-regulation of stock exchanges is built into the Australian securities industry by the Securities Industry Act, 1980, AUSTL. ACTS P. No. 66 and Codes. This legislation allows for the continuation of stock exchange rules and procedures, subject to overriding Court and/or Commission sanction under sections 14, 42. Securities Industries Act, AUSTL. ACTS P. No. 66, §§ 14, 42. However, the SRO proposal, subject to overriding Ministerial Council and/or Commission supervision, does not fully address the cartelization issue and the potential windfall of the self-regulated. The REVIEW gives no consideration to alternatives to licensing — why regulate or self-regulate at all? — why not ensure the market works competitively and regulates itself? See REVIEW, supra note 1. Nor does the REVIEW stress that membership of an SRO is not proposed as a precondition to the holding of a proposed Securities Industry License or that regulation by the Commission (as a kind of SRO) would continue alongside the proposed SROs.

Cf. id. at 1442-43.


Id. at 1442-43.

transfer of the administrative workload from a government agency to the SRO itself can save money for the public sector and thereby enable more effective use of government resources.

Several questions arise, however, especially with respect to external surveillance of the adequacy of self-regulation. These questions have not been fully addressed in the Review, yet they highlight dangers to be borne in mind when considering the effectiveness of self-regulation. In the Report of the Windfall Royal Commission, Justice Kelly observed that self-regulation on the Toronto Stock Exchange prior to the introduction of external supervision of the Exchange displayed the following three weaknesses: (1) the rulemaking did not keep pace with loopholing deficiencies in the rules; (2) there was widespread aberration from strict observance of the spirit of the rules; and (3) there was "woeful lack of any effective surveillance to ensure the adherence to rule."65

Because of these weaknesses, any review of SROs must ensure disclosure of information on the SRO internal operations. In particular, because of the public utility function of SROs, there must be public accountability. The question is, to whom? The Commission? The public? The legislature? With the legislated status of an SRO goes public accountability and responsibility.

The Australian proposal to pass management of the SRO legislation/administrative action to the industry requires careful consideration. The justification for handing over administration to the recognized experts, if the industry so qualifies, has immediate appeal in that it avoids political patronage and partisanship and ensures expert and informed administration.66 However, this inevitably leads to control by the regulators. For example, in 1956, Professor Walter Gellhorn stated that seventy-five percent of U.S. occupational licensing boards were composed exclusively of licensed practitioners of the respective occupations who, by definition, had an economic interest in many of the decisions they made concerning admission requirements and standards to be observed by licensees.67 As with the SRO plan, the licensing boards directly represented organized groups within the occupation and were often nominated by the industry for self-regulation.68

Even if the industry experts do not have a majority of places on

65 Ontario Royal Commission, The Windfall Report 100 (1965), cited in Dey & Makuch, supra note 62, at 1428. The Windfall Report was the result of an inquiry into the trading of Windfall Oils and Mines limited shares, with an eye towards evaluating the role of the government in supervising the operation of SROs.


67 W. Gellhorn, supra note 35, at 140.

68 Id.
the regulatory board, representatives of other related professional groups such as accountants and lawyers tend to outnumber any lay or consumer representatives who often lack sufficient knowledge or confidence to provide a view to balance that of the experts.

The legislation/administrative action proposed appears to fit the pattern of this model with the expected biases towards the industry and its regulators. Indeed, the Australian Commission regularly boasts of its close and satisfactory relationship with the securities industry.69

The Review contains no view opposing that of the regulators (the Commission proposal and the proposed SROs), and the "checks and balances"70 provide only limited control over the naturally self-seeking operation of the proposed SROs.

Any review of SROs must address the powers of the government, through the Commission, to regulate SROs in the public interest. In particular, the following anticompetitive and jurisdictional issues must be considered.

4.1. Anticompetitive Factors

Section 15A(b)(9) of the Securities Exchange Act of 1934 requires for SEC approval as an SRO evidence, *inter alia*, that the rules of the association do not impose an inappropriate burden on competition.71 In a similar vein, the Review lists the following criteria to be satisfied before an SRO may be approved by the Australian Commission:

(a) demonstrating that it would be capable of properly exercising its functions as a securities industry SRO, being the functions of regulating its affairs in the interests of the public and of administering and enforcing its business rules;

(b) that, if it will operate other than an approved securities industry SRO —

(i) its operations will not interfere with its operation as a securities industry SRO; and

(ii) its business rules provide for a separate class of membership for a person to whom its operation as a securities industry SRO relates whether or not such a person may be a member within another class of membership;

(c) that its business rules make satisfactory provision —

69 See Review, supra note 1, paras. 10.3, 10.42.
70 See, e.g., id. paras. 1.6, 2.1, 10.43–46.
(i) for the admission as members of persons licensed or proposing to apply to be licensed under the Act, or a specified class of such persons;

(ii) for the standards of training and experience, and other qualifications, for membership;

(iii) for the manner in which members are to conduct their business of dealing in or advising on securities so as to ensure efficient and honest practices in relation to that business;

(iv) for the exclusion of a body corporate from membership where a director of the body corporate, a person concerned in the management of the body corporate or a person who has control, or substantial control, of the body corporate would himself be excluded from membership (except where that exclusion would be based upon an educational requirement);

(v) for the exclusion from membership of a person who is not of good character and high business integrity;

(vi) for the expulsion, suspension or disciplining of members for conduct inconsistent with just and equitable principles in the transaction of business or for a contravention of or failure to comply with the business rules of the proposed securities industry SRO or the provisions of this Act;

(vii) for an appropriate mechanism whereby a person aggrieved by the refusal of an application for membership or by any of the actions referred to in subparagraphs (iv), (v) and (vi) may appeal to an independent body in respect of the refusal or action;

(viii) for the inspection and audit of the accounting records of members required to be kept by the Act.\textsuperscript{72}

Comprehensive as they appear, it remains to be seen whether these criteria accord with the U.S. experience, and, in particular, whether regard has been paid to the following competitive criteria set forth directly below.

4.1.2. Restrictions on Entry

Will the proposed self-regulation readily allow a qualified or ex-
experienced person (such as a dealer qualified and/or experienced overseas) to be granted a securities industry license?

Economic theory suggests that occupational regulation favors existing members to the detriment of aspiring members. New regulation tends to entrench existing members, restrict numbers, and raise incomes and costs to users whether or not the users gain any benefit from the regulation.73 Existing members benefit further because they do not pay for the new regulations and the extra requirements.

The extra requirements proposed for aspiring securities industry licensees fit this anticompetitive model by erecting barriers to entry. The existing members qualify for a license on two years experience in the industry; aspiring members will be required at least to attend a course involving 100-120 teaching contract hours provided by institutions yet to be determined.74 While there is some merit in the proposed requirement of formal studies in law and economics, what safeguard is proposed to ensure that this course does not serve anticompetitive purposes?

4.1.3. Code of Behavior/Code of Ethics

Will the proposed code of behavior/code of ethics to be promulgated75 allow for free play of market forces?

Economic theory shows that such codes are usually anticompetitive and paternalistic in that they (1) prevent elaborate and attention-seeking advertising; (2) prevent poaching by competitors; (3) disadvantage new entrants to the industry who cannot advertise; (4) restrict information for users; and (5) deny consumer sovereignty by denying the consumer the option to decide just what the consumer wants.71

The Review proposes to give the SRO the right to regulate the conduct of its members, but no user benefit is stated.77 Only if SRO membership is not a prerequisite to carrying on business as a securities professional could these powers be given to an SRO. Market forces would then operate to maintain competition. The user must retain the freedom to choose based upon relevant full information and knowledge of the options.

73 See Duggan, supra note 38, at 172.
74 See REVIEW, supra note 1, paras. 7.5, 7.12. But see id. para. 7.18 (acknowledging that experience requirements should take account of “barrier to entry” considerations).
75 Id. paras. 10.43(c)(iii), 10.52.
76 See, e.g., Duggan, supra note 38, at 174-75.
77 REVIEW, supra note 1, para. 10.53; see also id. para. 10.56 (recommending that SROs monitor and review the financial position and reports of their members).
4.1.4. Quality and Price of Service

The Review does not promote the development of new products and services. Are these to be encouraged, or are they to be restricted and regulated by the business rules of the proposed SROs presumably to the advantage of the existing suppliers and their products? Are the SROs to have control of prices, commissions, and so forth, so as to maintain a "reasonable" return to members in times of economic downturn? Are recommended prices to be permitted insofar as they are permitted under competition legislation? An effective and competitive system of self-regulation must address these questions.

4.1.5. Compensation Fund

The proposed national fidelity fund would appear to provide a certain and fairly complete protection for investors. It must, however, be remembered that contributions to the fund will have a social cost if not related to the risk of default or other fraudulent practices. To be fair to contributors, the fund must be regulated by the market test of similar "insurance" schemes.

4.2. Commission Must Have Sufficient Regulatory Powers Over SROs

Theories of regulation indicate the ease with which regulation comes to the benefit of the regulated. Attention must be paid to ensure control is beyond that of the industry/interest groups which will form SROs.

Has the Commission and/or the Ministerial Council sufficient power to regulate SROs? Has thought been given to how best to gauge and enforce the interests of the public generally and users specifically? Have class action/representative actions been considered for their usefulness as an enfranchising device?

The Review goes some way towards articulating the proposition that it is important, for reasons of competition and control, that SROs answer not to themselves but to the external Commission as some bal-

78 See id. paras. 3.22-.29.
79 See id. paras. 8.107(c), -111, -.112.
80 See supra notes 37-56 and accompanying text (analyzing the four types of occupational licensure discussed in the REVIEW and their tendency to increase the monopoly position of existing members); see also infra notes 110-18 and accompanying text (discussing the REVIEW's failure to address the central aspects of economic theories of regulation).
ance to the natural gravitation towards self-gratification. Nonetheless, serious lacunae are evident in the proposed regulatory scheme.

4.2.1. Commission Must Be Assured That SROs Actually Perform Their Regulatory Functions

In the absence of performance of regulatory functions by the SROs, the facade of self-regulation will be worse than no public protection at all. Hence, regulation should revert in such instances to the government or the Commission. The Review, cognizant of this issue, proposes to endow the Ministerial Council with the power to cancel SRO approval.82

While Section 42 of the Securities Industry Act and Codes,83 empowering the court to order observance or enforcement of stock exchange business rules or listing rules, provides the model for Commission oversight of SROs, U.S. law gives significantly greater powers to the SEC to supervise SROs. SRO administrative disciplinary proceedings are subject to SEC oversight.84 Written conclusions of an SRO must be filed with the SEC, which may review the matter on its own motion or on the motion of an aggrieved party.85 The SEC can then affirm or modify an SRO sanction, or remand to the SRO for further consideration.86

4.2.2. Power to Suspend or Cancel SRO Approval

The Australian Commission should have the power to suspend or cancel SRO approval in line with the power of the Ministerial Council to approve and therefore to disapprove a stock exchange under the Securities Industry Act and Codes Section 38. Similarly, the power to suspend or revoke registration, to censure, or to impose limitations on SRO activities, when after notice and opportunity for a hearing an SRO has been found to have violated the law, could be strengthened in line with Securities Exchange Act Section 19(h)(1).87

81 Review, supra note 1, para. 10.44 (discussing the structure of a statutory framework for governing SROs); see, e.g., id. para. 10.34 (summarizing several positions opposing self-regulation by SROs).
82 Id. para. 10.44(a).
83 Securities Industry Act, 1980, AUSTL. ACTS P. No. 66, § 42.
85 Id. § 78s(d)(1), (2).
4.2.3. Publication of SRO Particulars

Information is required for an informed market, and the proposal to notify officially and publicly details of SRO approval, suspension, and cancellation is an important means of informing the market.88

4.2.4. Appeal to the Court by SRO Members

Persons whose membership in an SRO is denied or otherwise affected should have the right of appeal to an outside body such as the Commission or the courts. This principle is important to ensure outside redress, and as another balance to the natural gravitation of the regulated to self-gratification.

Securities Exchange Act Section 25 gives a person aggrieved by a final order of the SEC recourse to the U.S. Court of Appeals.89 Similarly, in Canada, the Toronto Stock Exchange (TSE) is supervised by the Ontario Securities Commission (OSC).90 The Australian scheme should make available such an outside appeal.

4.2.5. Notification to Commission of Amendments to SRO Business Rules

The proposed procedure for notification of amendments to SRO business rules parallels in part the existing procedure for notification of amendments to stock exchange business rules.91 The proposal, however, contains no public interest requirement as a basis for amendment,92 and the apparently arbitrary but very short period of twelve days is recommended.93 The public interest requirement and more manageable

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88 REVIEW, supra note 1, paras. 10.57-.58; see also id. para. 10.44(b) (outlining the notification requirement as part of the overall statutory framework).
89 See, e.g., Sorrell v. SEC, 679 F.2d 1284 (9th Cir. 1982); Sirianni v. SEC, 677 F.2d 1323 (9th Cir. 1982).
90 The Ontario Securities Commission (OSC) must recognize the Toronto Stock Exchange (TSE) in writing before the TSE can operate as an exchange. Regarding governance, the OSC can make any directive, etc., on the activities of the TSE, or relating to the internal rules of the TSE. As a review procedure, the OSC can hear appeals from TSE decisions by any person affected. Securities Act, Ont. Rev. Stat. ch. 466, § 9.1(22) (1980), amended by Ont. Rev. Stat. ch. 59 (1984); Dey & Makuch, supra note 62, at 1443.
92 See, e.g., id. § 38(2)(d).
93 Compare id. § 38(2)(d) with id. § 39(3) (allows 21 days for publication of amendments to exchange rules before the amendment ceases to have effect for failure of public notice).
twenty-one day notice period of the Securities Industry Act and Codes should both be included in the proposed scheme.

4.2.6. *Power of Investigation*

The power of investigation by the Commission into SROs and their activities would be an important factor in its administration of SROs and their self-regulation. Presumably, the Securities Industry Act Codes would authorize such investigation.\(^{84}\)

The powers of the SEC provide a useful comparison and a model for development of the powers of the Commission. The SEC is empowered, under Section 21 of the Securities Exchange Act, to investigate possible violations of securities laws.\(^{85}\) If the investigation discloses violations by brokers/dealers or investment advisers, the SEC can proceed under Section 15(b)(4) of the Securities Exchange Act to invoke disciplinary measures, such as censure, limitation of activities, suspension for up to one year, and revocation of registration.\(^{86}\) To so proceed, the SEC must show that the firm or individual willfully made a material misstatement to the SEC, willfully violated the securities acts, or willfully aided or abetted the violation of such statutes.\(^{87}\)

4.2.7. *Power to Discipline Related Persons*

Does the Commission’s power of discipline over SROs extend to persons associated with a member of an SRO? In the U.S., the SEC can discipline persons associated with an SRO member firm by suspending or barring such persons from association with members of the organization.\(^{88}\)

The paragraphs in the *Review* addressed to discipline of securities professionals do not consider whether those once removed, such as lawyers, investment bankers, and spouses, should also fall within the Commission’s disciplinary net. Presumably, they could be subject to such discipline under other legislative sources, such as the penalty provisions of the Securities Industry Act and Codes.\(^{89}\) The *Review* also fails to

\(^{84}\) Id. §§ 15-36 (Investigations).

\(^{85}\) 15 U.S.C. § 78u(a) (1975) (broad authority and discretion given to SEC to investigate violations).

\(^{86}\) Id. § 78o(b)(4). The SEC can also bring suit in the district court to enjoin behavior “[w]herever it shall appear . . . that any person is engaged or is about to engage in acts . . . constituting a violation of exchange rules . . . .” Id. § 78u(d).

\(^{87}\) Id. § 78s(e)(4)(A), (D), (E).

\(^{88}\) Id. § 78s(h)(3).

\(^{89}\) See, e.g., Securities Industry Act, 1980, AUSTL. ACTS P. No. 66, § 42 (1980) (giving the court power to enforce rule of the exchange against “any person under an obligation to comply with, observe, enforce or give effect to . . . the rules of . . . [the

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consider the question of persons associated for various breaches specified.\textsuperscript{100} The discipline of related persons must be further addressed by any comprehensive regulatory scheme.

4.2.8. Power to Ensure That SRO Rules Are Just And Equitable

The \textit{Review} recommends that the business rules of a proposed SRO require the "just and equitable" conduct of SRO members and the carrying on of business "with due regard for the interests and protection of the public."\textsuperscript{101}

Are these requirements stated with sufficient strength or is "satisfactory provision" too elusive a standard? Section 15A(b)(6) of the Securities Exchange Act states the U.S. equivalent more boldly when it says that "[a]n association . . . shall not be registered . . . unless the [SEC] determines that . . . (6) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade."\textsuperscript{102} Similarly, the U.S. exchanges are under the same obligations to establish rules to further "just and equitable principles of trade"\textsuperscript{103} and to enforce compliance with such rules.\textsuperscript{104}

4.3. Commission Must Have Power to Suspend/Revoke Securities Industry License

The \textit{Review} proposes the granting of power to the Commission to revoke a Securities Industry License.\textsuperscript{105} It also proposes the legislation be drafted so as to impose no obligation on the Commission to divulge information on request.\textsuperscript{108} This seems unduly authoritarian in these days of administrative law and freedom of information, and no case for such heavy-handed secrecy has been advanced.

Comparison can be made with Securities Exchange Act Section 19(h)(2) which retains for the SEC — regardless of the position of the SRO — the upper hand of license suspension if in the public interest,

\begin{footnotesize}
\begin{enumerate}
\item See, e.g., \textit{REVIEW}, \textit{supra} note 1, paras. 9.28-.30 (discipline provisions limited to representatives or employees of representatives within the securities industry); \textit{id.} paras. 10.59-.60 (disciplinary action by the associations only considered in relation to members).
\item \textit{REVIEW}, \textit{supra} note 1, para. 10.43(c)(vi), (x).
\item \textit{id.} § 78f(b)(5).
\item \textit{id.} §§ 78f(b)(1), (6), 78s(h)(1).
\item \textit{REVIEW}, \textit{supra} note 1, para. 9.6 (Recommendation 9.1).
\item \textit{id.} para. 9.32 (Recommendation 9.7).
\end{enumerate}
\end{footnotesize}
for the protection of investors, and/or for the purposes of the legislation.\textsuperscript{107}

4.4. \textit{SROs Must Have Sufficient Powers to Regulate their Members (Subject to Commission Oversight)}

The \textit{Review} proposes that SROs share with the Commission in the administration of discipline of their members, and touches upon the scope of SRO regulation.\textsuperscript{108}

The level of SRO obligation of enforcement is not specified, however,\textsuperscript{108} and it is suggested that attention be paid to the following two questions on the scope of the SRO authority. (1) Must SRO rules provide for discipline of members? Securities Exchange Act Section 15A(b)(7) requires that SRO rules provide that members, and persons associated with members, be disciplined for violation of securities law "by expulsion, suspension, limitation of activities, functions and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction."\textsuperscript{110} (2) Must SROs enforce compliance by members with securities law? Again, Securities Exchange Act Section 15A(b)(2) requires that the association have the capacity "to enforce compliance by its members and persons associated with its members" with securities legislation.\textsuperscript{111}

5. \textbf{ECONOMIC THEORIES OF REGULATION}

The \textit{Review} proposes new initiatives. Delegation of the administration of broker-dealers who are SRO members to the SRO qualified self-regulation, and inclusion of previously "exempt" dealers (banks, insurance companies) warrant further study. As presented in this article, the ramifications of many of the issues, especially those with lengthy track records in North America, have been inadequately assessed. Nowhere does the \textit{Review} consider whether the proposed qualified self-regulation could provide any improvement over the current system of licensing, with minor supervision by Australia’s eight Corpo-

\textsuperscript{108} \textit{Review, supra} note 1, para. 10.61 (Recommendation 10.7).
\textsuperscript{109} See id. para. 10.43(c)(iii), (v), (vi) (Recommendation 10.1).
\textsuperscript{111} Id. § 78o-3(b)(2); see also id. § 78s(g)(1)(A); (a registered national securities exchange must enforce compliance with its rules by its members and their associates unless there is a reasonable justification or excuse for non-enforcement); \textit{cf. Baird v. Franklin}, 141 F.2d 238 (2d Cir. 1944) (stating that New York Stock Exchange "violated a duty when it failed to take disciplinary action against [partner in a Stock Exchange firm] after there was reason to believe that the latter had converted the plaintiffs' securities.").
rate Affairs Commissions (as delegates of the National Companies and Securities Commission). Nor does it consider the alternative of no licensing at all.\textsuperscript{112} Certainly the \textit{Review} fails to address the breadth of economic theory and literature dealing with the costs, effects, and benefits of regulation and self-regulation.\textsuperscript{113} Accordingly, it reads in parts like the rather narrow-minded, black-letter consumerism reports characteristic of the 1960s and 1970s.

Presumably, the \textit{Review} does agree with the basic proposition of economic theory that voluntary exchange is mutually advantageous; that is why the buyer buys and the seller sells. The \textit{Review} does not articulate and does not seek to reinforce, advance, or confirm the assumptions underlying this proposition. These assumptions are that: (1) ignorance must be dispelled so that both buyer and seller are well-informed about the things exchanged; (2) there must be a perfect and efficient market, with no market imperfections impeding the flow of resources into or out of the industry; (3) both parties know what they prefer; and (4) individuals are the best judge of their own self-interest.\textsuperscript{114}

The \textit{Review}, therefore, fails to address the central tasks of the theory of economic regulation, and does not explain who will receive the benefits or burdens of the proposed regulation; nor does it explain the details, if any, on the maintenance of competitive forces and freedom of entry in the proposed system of regulation. Its explanation is lacking as well as to the effects of the proposed regulation on the allocation of resources.\textsuperscript{115}

By ignoring consideration of economic theories of regulation,\textsuperscript{116} the

\textsuperscript{112} This alternative was in practice before the first Securities Industry Act was passed. \textit{See, e.g.}, Securities Industry Act, 1970 N.S.W. STAT. No. 35.

\textsuperscript{113} \textit{See, e.g.}, AUSTL. LAW REFORM COMM’N, REPORT No. 16, INSURANCE AGENTS AND BROKERS paras. 124-126, at 78-80 (1980).

\textsuperscript{114} \textit{See, e.g.}, Parish, \textit{Industrial Censorship}, 22 QUADRANT 12, 12 (1978).

\textsuperscript{115} \textit{See} Fels, \textit{The Political Economy of Regulation}, 5 U. N. S.W. L.J. 29, 32 (1982).

\textsuperscript{116} Several hypotheses concerning the effects of regulation are set out in Fels, \textit{supra} note 115, at 32-38.

(a) \textit{The Consumer Protection Hypothesis}. Under this hypothesis, regulation is passed in response to the actual or potential failure of the market to protect consumer interests. Traditionally, unquestioned areas of regulation included the legal profession, health care, and drug and product safety.

(b) \textit{The Perversion Hypothesis}. This hypothesis states that, although the intended purpose of regulation is to protect consumers, the regulated industries ultimately "pervert" their regulators. The result of this perversion is that the regulators come to identify with the regulated and become the protectors of the regulated. \textit{But see} Posner, \textit{Theories of Economic Regulation}, 5 BELL J. ECON. & MGMT. SCI. 335, 341-42 (1974) (finding the "Capture Theory" unsatisfactory).

(c) \textit{The No-Effect Hypothesis}. This hypothesis states that regulation achieves no
Review fails to recognize that intervention allegedly made in the consumer interest is often perverse in its effects. It can be ineffective, or inefficient in achieving its purpose at high cost. Such failure can often be traced to the following factors: 1) inattention to basic economic principles, and especially neglect or underestimation of the responses of the economic person who rationally pursues self-interest and reacts to incentives and disincentives; 2) failure to explore the full consequences, including the incidental and remote consequences of the proposed regulation; and 3) disregard or underestimation of the cost of the proposed regulation. 11

The Review does not articulate these economic assumptions, and fails to pay regard to the principle of consumer sovereignty characteristic of a democratic society. 118 The state, through its regulatory agencies, does not know better than consumers themselves about what is good for consumers. Both parties — buyer and seller, government and governed — know what they prefer, and individuals are the best judges of their own self-interest. Regulation in accordance with consumer sovereignty can be justified only in certain instances, through well-tailored mechanisms. For example, it is appropriate to dispel ignorance so that the balance is redressed to ensure that buyer and seller are well-informed about the things exchanged. In brief, the intervention should be to subsidize not the regulation but the provision of information. 119 Interven-
tion is also appropriate to correct market imperfections. For example, as the Review recognizes, the high cost of litigation discourages buyer redress for fraud or deception. In such a case, the solution is to reduce litigation costs to enable ready legal redress at the lower end of the market, such as by establishment of a securities tribunal or the like, or by redefining the jurisdiction of the existing consumer-oriented Small Claims Tribunals. Finally, where a group such as stockbrokers achieves a natural monopoly, a comprehensive regulatory scheme must ensure that the competitive provisions of trade practices law apply and continue to apply to the group and to new groups in the industry.

6. CONCLUSION
The National Companies and Securities Commission’s review of Australia’s licensing provisions in the securities industry is a detailed document covering many issues. It borrows many initiatives from North American models, but sometimes fails to address basic policy issues such as the likelihood of cartelization for SRO members, the need for external constraints on SRO activities, and the necessity of maintaining and promoting Commission registration as a quasi-SRO in its own right (as an alternative to dealing through an SRO). Thus, nowhere are the actual benefits and advantages of any registration stated; in this light, the proposals in the Review should be given less authority than they have assumed.

120 See, e.g., O’Connor, Repatriation Appeals Made Easier, 59 LAW INST. J. 58 (1985) (Repatriation Legislation Amendment simplifies review procedures and streamlines handling of veterans’ pension claims, thereby alleviating claim backlog and expediting appeals).