ASIC

Australian Securities & Investments Commission

**Australian Securities and Investments Commission**
**Opening Statement**
**Senate Economics References Committee Inquiry into the performance of ASIC**
**19 February 2014**

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Good morning, Chairman. Thank you for this opportunity to address the Committee.

Representing ASIC today are all of ASIC's Commissioners—Deputy Chairman Peter Kell, and Commissioners Greg Tanzer, John Price and Cathie Armour. Also supporting the Commission are Senior Executive Leaders Greg Kirk, the head of the Strategy Group, Warren Day, the head of Stakeholder Services, Tim Mullaly and Chris Savundra, the co-heads of Enforcement, Adrian Brown, the head of our Insolvency team, Louise Macaulay and Joanna Bird, the co-heads of the Financial Advisers team, and Andrew Fawcett, the head of Strategic Policy.

We have welcomed the Inquiry into ASIC's performance. Given the breadth of the Inquiry's terms of reference, we see it as both an opportunity to hear what others think about ASIC and how ASIC can be improved, and also to provide the community with a better understanding of the results ASIC has achieved and the tools and processes we use to fulfil our regulatory role.

We are grateful to the many people who have taken the time and effort to provide submissions to the inquiry. We have closely considered all of the submissions in an effort to learn as much as we can from them.
We are committed to continually reviewing and improving the work we do and how we do it. To this end we have formulated a number of new initiatives in response to issues raised in submissions, and I will discuss these new initiatives shortly. We are also very open to other suggestions for change arising out of this inquiry.

To assist the Committee in its task we are also open to providing further factual information which would facilitate the Committee's understanding of any issues raised during the hearings.

**Submissions to the inquiry**
I would like to acknowledge at the outset that we recognise that a number of submissions have been made to the Inquiry by people who have incurred significant monetary loss and suffered serious financial hardship. We appreciate the difficult circumstances that these people face and we thank them for their contribution to the inquiry.

Individual losses are distressing. However, the settings established by Parliament for our financial system, similar to financial systems all over the world, are such that no financial regulator can prevent all losses from occurring. This is because:

- Removing losses arising from market risk from the financial system would substantially reduce economic growth, individual choice and returns to investors; and
- Preventing all losses arising from poor products, misconduct or criminal activity would involve a level of regulatory intervention that would be highly intrusive and extremely expensive.

While loss can never be entirely removed from financial markets, we work hard to enforce the law and deal with the types of misconduct that put investors at greater risk. I would like to discuss some of the ways we detect and respond to misconduct.

**ASIC's responsiveness to early warnings of market problems**

We work proactively to identify potential market problems at an early stage. We do this in a number of ways including:

- Gathering and using industry intelligence: since 2008, our teams have been structured around industry sectors, so that we can be close to the markets we regulate. We meet regularly with entities from industry and their representative bodies.
- Considering every complaint made to ASIC, and analysing them both individually and across time, along with the pattern of disputes taken to External Dispute Resolutions Schemes, to identify issues we need to act on.
- Using formal sources of intelligence to detect individual misconduct and trends: these include breach reports from licensees, liquidators' reports and other reports provided to us by people under a statutory requirement.
- Conducting proactive sectoral 'health checks': where we select a broad sector of the market to review trends and practices, which often involves a mixture of surveillance, shadow shopping and research. These 'health checks' often led to improved industry practices and better outcomes for consumers and investors.

Where we can we act quickly to prevent loss or misconduct before it occurs. For example our program to send reminders of their legal obligations to company directors that show the indications of being at high risk of engaging in phoenix activity. Inevitably such actions get little media or public attention. If we identify an illegal or ponzi fundraising scheme in the initial phase of advertising, we can shut it down and prevent loss. But because there has been no loss, any penalty is likely to be reduced and there is little media interest. Much effective work of this type can thus be below the public radar.

We acknowledge the concern expressed in some submissions about how long it takes to identify and rectify problems While our resources are inevitably finite, we are always striving to improve our processes and procedures and learn from our experience so we can identify problems as early, and address them as quickly as possible.

Some examples of where we detected significant market problems, and worked to address them, can be seen in our work in the credit and financial advice industries.

*ASIC's work in the credit industry*

One-hundred and forty-one submissions received by the inquiry relate to credit issues. Of these, 113 submissions or 80% relate to activities occurring prior to the introduction of the *National Consumer Credit Protection Act 2010* (National Credit Act) in July 2010.

Prior to July 2010, ASIC had a very narrow jurisdiction over credit. We were limited to administering broad standards of conduct, including unconscionable conduct, misleading or deceptive conduct, and undue harassment and coercion. Where we could, we used the

jurisdiction we had in the interest of consumers—for example, by going to court, guiding industry on poor practice and developing resources for consumers.
But this jurisdiction was simply too limited to address the matters described in submissions to the Inquiry because the law did not impose uniform and sufficiently robust standards on lenders and brokers.

However, despite our limited jurisdiction, we identified problems in the credit market, we conducted surveillances to understand their causes and impacts, and we published reports, from as early as 2003, bringing the issues to Government attention. Ultimately, this contribution to public debate helped lead to the credit regulation reforms of 2010, through which many of the practices described in submissions have been outlawed.

*ASIC's work in the financial advice industry*
Over the course of many years, ASIC has identified broad problems in the quality of retail financial advice, arising from embedded conflicts of interest and compounded by weaknesses in the regulatory system. We have gathered evidence of poor quality advice through a series of shadow shopping surveys, and other surveillance work.

Given the very widespread nature of the concerns we had, ASIC sought to take a strategic approach to trying to achieve change in the industry. This involved:

- liaison with, and the provision of guidance, to industry;
- risk-based surveillance with targeted work on individual firms;
- negotiated settlements, including major long-term enforceable undertakings, administrative bannings and enforcement action; and
- the provision of information for the users of financial advice.

On a number of occasions, we publicly expressed our concerns about the problems we found in the financial advice industry, including through public reports, surveillance projects, and our submission to the 2009 PJC Inquiry into Financial Products and Services in Australia. Among other things, we raised serious concerns about commission payments and the distorting impact they had on the quality of advice provided to clients. Our work contributed to the move for reform of the industry, including through the Future of Financial Advice Reforms.

In the matter of Commonwealth Financial Planning we had through the use of intelligence and intensive surveillance established that there were systemic problems with the manner and quality of advice provision in the firm and were seeking to address those systemic problems well prior to the whistleblowers coming to us with concerns about a single adviser, and long before the media purported to uncover the problem.

We will continue to use all of the regulatory tools at our disposal to detect market problems at an early stage.

**ASIC's record on enforcement**
In addition to detecting market problems at an early stage, ASIC has a strong record on enforcement after misconduct has occurred.

In the last three years, our success record in enforcement has been over 90%. In 2012–13, we were successful in 100% of civil cases, and 85% of criminal cases.

It is important to recognise that formal court-based enforcement action is only one of several regulatory tools that ASIC uses to achieve compliance with the law and positive outcomes for investors and financial consumers. Other tools that ASIC uses include education, guidance, surveillance and negotiated outcomes. The regulatory tool or tools ASIC chooses to use in response to a potential breach of the law will depend on the objectives that ASIC is seeking to achieve. These include:

- punishment;
- improving compliance;
- protecting the public;
- achieving compensation for investors; and
- deterrence.

In all cases, we need to weigh up the cost versus the regulatory benefit of taking a particular course of action and in many cases, we use a combination of regulatory tools to achieve a number of objectives.

We recognise that it may not always be clear why ASIC has taken a particular course of action in a particular matter, and we need to ensure we explain what factors we take into account when making such decisions. To this end, we have published a formal enforcement policy, Information Sheet 151 *ASIC's approach to enforcement* (INFO 151), which sets out the factors we consider. These include:

- the seriousness of the misconduct (e.g. was it dishonest or deliberate, or did it lead to widespread public harm?);
- the time since the misconduct occurred (e.g. action taken for old misconduct may have a reduced impact on the market);
- whether it was an isolated instance of misconduct or whether it is continuing; and
- whether evidence that is admissible in a court is in our possession or known to be available, to prove our allegation of misconduct.

Enforcement can be a challenging process—in taking action for breaches of the laws we administer, ASIC has to deal with complex products, complex legal structures and large volumes of material. We also face well-resourced defendants who often challenge ASIC's powers and processes, and initiate costly appeals. ASIC must ensure it has sufficient evidence to prove the alleged contraventions to the requisite standard of proof. This is often difficult due to the difficulties associated with locating willing witnesses with relevant evidence. ASIC considers the circumstances of each case. What we decide will depend on what we want to achieve and what we are able to achieve. What we are able to achieve is itself heavily influenced by the evidence that is available to establish the case; for this reason, we undertake a careful assessment of the evidence before commencing formal, court-based enforcement action.

*Enforceable undertakings*

A number of submissions have commented on our use of Enforceable Undertakings (EUs). I would like to take this opportunity to explain our approach to, and the benefits of, ASIC accepting EUs.

EUs are an important part of ASIC's enforcement toolkit as they are for a number of other Commonwealth regulators. ASIC has been given a formal power to accept and enforce EUs under the *Australian Securities and Investments Commission Act 2001*.
Some people think enforceable undertakings (EU) are a 'soft' option compared with court action, and it is better for ASIC to always pursue litigation. That is wrong.
EUs are a very effective enforcement tool. They generally require the person offering the EU to implement significant changes to the way they operate, and to provide substantial compensation, conditions that may be enforced in court.

Indeed, EUs often let ASIC achieve a more comprehensive response to systemic misconduct than court action. Compared with court action, EUs also provide ASIC with greater scope to influence future conduct and drive and monitor long lasting change to systems and culture. That was ASIC's aim in the Commonwealth Financial Planning Limited (CFPL) matter.
While a significant part of ASIC's role is to help set standards, including through the courts, ASIC needs a broad enforcement toolkit and EUs are an important part of this.
Like all Commonwealth agencies, ASIC is required to act as a model litigant, including trying wherever possible to avoid court proceedings and considering settlements where appropriate.

**ASIC's staff**
Chairman, one disappointing thing about some submissions was the inflammatory tone of criticisms made, particularly about ASIC staff.

ASIC has exceptional employees. They are men and women who work at ASIC for good reason. And that is because they believe in the public interest. They are skilled and committed to their work and, bearing in mind the difficult job they do, they should be accorded appropriate respect.

Our people have diverse backgrounds—they have experience in law, accounting, and financial services. Many have invaluable industry or consumer advocacy experience and this means they understand how markets work and the issues facing investors, consumers and the wider industry. ASIC employees also undertake ongoing internal training and have access to industry secondment programs which further develop their skills.
All of these things make our people highly sought after by the private sector and internationally by other regulators.

**Better communication**
We recognise that an underlying theme of submissions to the inquiry has been the need for ASIC to improve the transparency of its communications in all areas.

It is not enough for us to simply continue to improve the way we work and the results we achieve; we also need to ensure we communicate these things to the broad range of people we deal with.These include:

- whistleblowers;
- applicants under the various licensing and registration systems we administer;
- consumers and others who report misconduct; and
- the people who may be affected by ASIC's investigations and enforcement action including:
- potential witnesses (e.g. whether and how ASIC will use the information they provide); and

- those assisting us with our inquiries, or providing information under formal information-gathering powers.

Finally, we have a significant obligation to the broader community, to explain the decisions we take and why we work the way we do.

In my term as Chair of ASIC we have taken already taken significant steps to improve transparency and communication. Initiatives like the publication of our Enforcement Policy, the introduction of bi-annual public Enforcement Reports, our increased commitment to publicising our non Enforcement outcomes,new processes for consumers and investors reporting misconduct to us and use of new media like Twitter, YouTube and Facebook, mean that ASIC is more transparent and open than ever before.

We are now furthering that work including through providing further information for misconduct reporters on ASIC's approach to commonly reported matters, our new approach to whistleblowers, and increased transparency in how we use our enforcement powers.

*Reporters of misconduct*
Over the last two years, ASIC has sought to improve the way it communicates with people who report misconduct to us, both in terms of how to go about reporting misconduct, and keeping people informed once they do.
These improvements include:

- new training and protocols to improve ASIC officers' communication with reporters' of misconduct;
- new report handling processes, including rapid handling streams to identify matters that can be resolved quickly, so more resources can be allocated to more complex matters;
- providing clearer information on ASIC's website about how to lodge reports of misconduct; and conducting regular online and telephone based customer satisfaction surveys to monitor satisfaction with our processes and identifying areas for improvement.

We will also be providing clearer information on ASIC's website about how to make complaints about ASIC iteself, as part of a comprehensive review of our website to make it more accessible and user friendly.

*Whistleblowers*
We have decided to enhance our approach to dealing with whistleblower reports. The changes we are in the process of implementing include:

- establishing whistleblower liaison officers within all relevant ASIC teams, who, with staff from our Misconduct and Breach Reporting Team, will shortly receive new training on awareness of whistleblower protections and handling whistleblower complaints;
- implementing new processes for providing better, clearer and more regular communication to whistleblowers to the extent possible and appropriate during our investigations; and
- conducting a stocktake of any current matters involving whistleblowers, to ensure that these are being given appropriate priority.

We will also shortly be releasing an updated version of our Information Sheet 52 *Protection for Whistleblowers* (INFO 52), which outlines the legal protections for corporate whistleblowers.

Our updated approach to whistle-blowers extends to 'insiders' who seek to provide information to us but who are not corporate whistleblowers within the definition of the law—for example, because they are no longer an employee of the company involved at the time they make the disclosure, or because they do so anonymously.

*Greater transparency in enforcement*

In our enforcement role, we are conscious of the need to be as transparent as possible in the decisions we make and the actions we take. Our Enforcement teams are currently reviewing guidelines for how they communicate with witnesses, victims and persons of interest at all stages of an investigation. Once finalised, these will be rolled out with any necessary new training. Nevertheless an important point for the Committee to understand is that there is a trade off between effective enforcement and the level of public disclosure we are required to provide. We understand that there is interest in what we are doing about matters that are in the media, but a balance must be struck. Providing a running public commentary on the investigations we are undertaking, the information we have collected or our decision making process around sensitive enforcement matters would jeopardise the investigation and potentially undermine future legal proceedings or irretrievably damage the reputation of persons who may be entirely innocent. That is why the Parliament has for many years provided important safeguards to confidentiality.

**ASIC's submissions to the inquiry**

We have made four public submissions to the inquiry, as follows:

- an *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters* providing an overview of ASIC's actions on Commonwealth Financial Planning Limited (CFPL), as well as context about our work in the financial advice industry;
- a *Submission by ASIC on reforms to the credit industry and 'low doc' loans* dealing with ASIC's role in regulating consumer credit both before and after the primary responsibility for credit regulation shifted from the states to the Commonwealth in 2010;
- our *Main submission* detailing our performance track record, addressing all of the terms of reference and making a number of policy suggestions; and
- a supplementary submission in relation to *Commonwealth Financial Planning Limited* detailing the wholesale changes in the manner and culture in which financial services are now provided by CFPL

Our *main submission* covers the Inquiry's terms of reference, and includes the following topics:

- ASIC's structure and strategic priorities;
- a detailed account of how we assess complaints and take enforcement action;
- how we work with whistleblowers, and the recent changes we have made to enhance our whistleblower protection I have already outlined;
- ASIC's role addressing problems in the financial advice industry, including those seen in the CFPL matter; and
- our policy suggestions to enhance ASIC's ability to work effectively.

Importantly, we make some suggestions for policy changes and these cover four main areas:

- better regulating the *financial advice industry*, including:

raising financial adviser competence through a national exam; and
extending the public register to cover employee financial advisors to help remove bad apple advisers from the industry;

- enhancing *whistleblower* protections;
- strengthening ASIC's *licensing powers*, including providing ASIC with the ability to ban a person from managing a financial services business; and
- strengthening ASIC's *investigation and enforcement powers*, including:

streamlining search warrant powers; and
reviewing the level, consistency and availability of penalties.

To take one of those. It will come us a surprise to many that ASIC currently cannot track all individual financial advisors operating in the industry or even know the total number of advisers out in the market giving people crucial financial advice. That is because employed advisers are not on the public register. This also means that consumers can't track their advisors history and nor can a licensee who is considering employing them. This is a serious deficiency in our system.

On the topic of penalties, I would like to say a little more. There is an expectation among the public that we will take strong action against wrongdoers and, by doing this, send a message that shapes future behaviour. However, one of the barriers we face to achieving this is the current inadequacy of penalties.

We have outlined some of these inadequacies in our main submission, and they include the fact that:

- some comparable criminal offences currently attract inconsistent penalties;
- civil penalties are currently set too low, and are not available for a sufficiently wide range of misconduct; and
- we require a more graduated set of penalties to provide an effective enforcement response in a wider variety of cases, including greater availability of infringement notice powers.

To give one example where penalties for the offences we deal with are out of step with penalties available elsewhere, the maximum civil penalty in financial services is $1.7M whereas the maximum available to the ACCC for competition offences is $10M. This is despite the fact that enormous sums of money are involved in financial services where people's life savings can be at stake, and the potential gain from wrongdoing can be very great.

It is frustrating, both for us and for the public, when the penalty available to respond to misconduct is much less than the profit someone made in the process. If this is so, then rational players in the market will routinely take that risk. If the thinking of law-breakers is a tussle between fear versus greed, then we need penalties that amplify the fear and smother the greed. We need penalties that create a fear that overcomes any desire to take risks and break the law.

Mr Chairman, thank you for your time this morning, we are very happy to discuss any aspect of our submissions in more detail with you and the Committee.