COMMONWEALTH OF AUSTRALIA

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Oversight of the Australian Securities and Investments Commission

THURSDAY, 29 APRIL 2010

SYDNEY

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JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Thursday, 29 April 2010

Members: Mr Ripoll *(Chair)*, Senator Mason *(Deputy Chair)*, Senators Boyce, Farrell and McLucas and Ms Grierson, Mr Hartsuyker, Ms Owens and Mr Robert

Members in attendance: Senators Boyce, Farrell and Mason and Mr Hartsuyker, Mr Ripoll,

Terms of reference for the inquiry:

To inquire into and report on:

Oversight of the Australian Securities and Investments Commission

WITNESSES

Committee met at 1.31 pm

CHAIR (Mr Ripoll)—I declare open this public hearing of the Parliamentary Joint Committee on Corporations and Financial Services. This afternoon the committee is conducting a hearing into the Australian Securities and Investments Commission under section 243 of the Australian Securities and Investments Commission Act 2001. The Corporations and Financial Services Committee is required to oversee the functioning of ASIC and this hearing is part of that oversight. I welcome to the table the chairman and commissioners of ASIC and welcome other ASIC observers. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. This gives special rights and immunities to people who appear before committees. People must be able to give evidence without prejudice to themselves. Any act that disadvantages a witness as a result of the evidence given to a committee may be treated by the parliament as a contempt. It is also a contempt to give false and misleading evidence to a committee.

The parliament has resolved that an officer of the Commonwealth shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy. It does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. A request to give a particular answer in camera may also be made at any other time.

[1.33 pm]

D'ALOISIO, Mr Tony, Chairman, Australian Securities and Investments Commission

GIBSON, Ms Belinda, Commissioner, Australian Securities and Investments Commission

KIRK, Mr Greg, Senior Executive Leader, Deposit Takers and Insurers, Australian Securities and Investments Commission

MEDCRAFT, Mr Greg, Commissioner, Australian Securities and Investments Commission

CHAIR—Welcome. In terms of the process for this afternoon, there is a fair bit to go through. As always, we are limited by time. I suggest that perhaps we just deal with each of the themes that the committee has proposed to ASIC. If you give the committee an opening statement on those themes, we can deal with some issues and questions and progress it through in that manner.

Mr D'Aloisio—Thank you, Chairman. We have something we want to say about national consumer credit, market surveillance and some of the major cases. I am in your hands. I thought we might do a short opening statement, taking each one in turn. If the committee wants to probe those issues, we will go into that. Or I can give you all three opening statements and we can go to questions. I thought it might be a better use of time if we take each of them. So I am in your hands, I think, Chairman.

CHAIR—I think we will take each one. Give us an opening remark on those themes and then we can have a discussion about them and go on from there.

Mr D'Aloisio—Well, clearly, the three important things are national consumer credit and its transition, the transition of market surveillance and the announcements the government has made on competition for trading services. Of course, since we last met, there have been some major cases that ASIC has lost and won, which we thought we would comment on.

So in relation to the first of those—national consumer credit and its transition to ASIC—we have with us today Greg Kirk, the senior executive leader of credit, who will make a short statement. That work has been under the direction of Dr Peter Boxall, Commissioner, but Dr Boxall could not make it because of other commitments today. So he sends his apologies. But Greg has been the team leader in charge of this project, so he is more than qualified to answer questions and to assist us with this. So I will ask Greg to make some opening remarks.

Mr Kirk—I might start by setting out the broad timetable for the transition to the Commonwealth regulation of consumer credit. Firstly, there is the registration of all lenders and intermediaries. That commenced on 1 April, with all participants in the industry required to be registered by 30 June. Registration is a relatively simple and quick process; it takes less than an hour. For us, it really identifies the regulator population and gets them into the system and is the first step towards the licensing process. To date, registration has been very smooth. There were over 700 registrations on the first day. As of a few days ago, there were just over 4,500 in total. That is registration of entities rather than individuals.

The next step commences on 1 July. Between 1 July and 30 December, all entities will have to apply to be licensed under the scheme. Subject to some minor exceptions, the substantive regulatory provisions of the new national credit code also commence on 1 July. From that date, ASIC will be the single national regulator of consumer credit.

Looking at that roadmap ahead, I want to note a few of the highlights of ASIC's preparations for this regime and some of the efforts we have been making to help industry prepare. ASIC has been funded for its new role. We have a phased process to recruit and train new staff. Credit staff numbers will peak at something just over 200 during the height of the licensing process and then drop back to something between 150 and 160 ongoing staff regulating credit. In the process so far, we have put out regulatory guidance for industry on all of the key elements of the new regime, with a total of 16 regulatory guides and information sheets already released and a further six publications planned prior to July. Each of those guides has been prepared after a consultation process involving all of the relevant stakeholders. They cover such things as credit registration and transition, whether a licence is needed, general conduct obligations and the new responsible lending requirements.

We have also been active in communicating with industry about the new regime and, in particular, the registration and licensing processes, which are their first steps into this regime. We conducted a national roadshow with a total of 54 presentations in capital cities and regional centres. In a first for ASIC, we also did a live podcast of that same presentation, which is now available for download and which has been a very popular way for industry to access information about the regime. Given the success of that process, we are going to conduct a further roadshow and podcast in June, just as industry is preparing for the licensing process.

We are also helping consumers prepare and have developed new information and educational resources for consumers on credit and a range of new tools, particularly calculators, which will be available on the credit portal of our website. We are also conducting a national roadshow for financial counsellors and community workers to bring them up to speed with the new credit laws. That roadshow is one of the first initiatives of our credit outreach team, which has been established to ensure that we cover the needs and identify the problems of consumers in remote and regional areas across the country.

Obviously the states and territories, as the current regulators of credit, play a key role in the smooth transition to a national regime. We have been working closely with them in the process. To the extent they have existing prosecutions and other litigation that they have already commenced, prior to 1 July, that will be carried on by the states. Where court action has not been commenced, we have processes in place to transfer existing state investigations to ASIC, where that is appropriate. The states and territories are also providing us with access to their records on complaints, bannings and prosecutions to assist with our licensing decision-making processes.

They are just a few of the highlights in terms of preparations. Broadly, I conclude that we are well on track for the commencement of the new regime in July.

CHAIR—The only question I had in that regard was the practicalities of supervision and enforcement across a very wide market area. Perhaps you could make a few comments in practical terms on how ASIC will actually deal with it. How many people has it assigned to it?

What is the structure it has in place to actually deal with that supervision and then enforcement capacity in that area?

Mr Kirk—I guess there are a couple of key points there. In the background it is compulsory for all participants in the industry to be members of an external dispute resolution scheme. That is a first for credit, so that is coming in. That is one of the mechanisms—those external dispute resolution schemes—through which we identify problems. Internally, we will have new complaint staff dealing with complaints specifically around credit. They have been trained in recent weeks on the new regime. Again, that will be one of the key processes for identifying problems. In terms of going out and looking at ongoing compliance with the regime and addressing problems, it is structured into two teams. One team is an existing team dealing with deposit taking institutions. It is because we have already had regulatory responsibility for some of their activities now. That will continue to be responsible for the broad range of activities of deposit taking institutions, including credit. So one team, which will be about 40 people, will look at banks, building societies and credit unions and the full suite of their activities, including credit. There will be a team of similar size—I think possibly slightly smaller—which will be looking at the lending practices of non-ADIs, which will be all of the smaller lenders, finance companies and the like, plus all of the activities of mortgage brokers. So the broad jurisdiction is split into those two teams.

In addition to those, there is an outreach team. Because we want to make sure we do cover all the regions and the like, there is an outreach team of 12 people. It will be specifically targeted to not only making contact with the regions and bringing information and resources to consumers but also identifying problems for us and bringing them back. For the first year, we have decided to have a specialist credit enforcement team as well. It is a group dealing specifically and only with enforcement in relation to credit matters. That is partly because we want to build up the skills of that group and it is best to do it with them all together. Longer term, we would expect that those staff will merge with our broad financial services enforcement teams. They will go back and take those skills back into the three financial services enforcement teams that we do have. That will become part of our overall enforcement activity.

Senator BOYCE—Are they state based staff?

Mr Kirk—We have staff in each state.

Senator BOYCE—But I am talking about consumer credit.

Mr Kirk—Yes. There are staff in each state specifically for consumer credit.

Senator BOYCE—Are they people who come over from the state government bodies?

Mr Kirk—Some of them are. We had a merit based selection process that was open to anyone. Quite a few, in fact, came from existing state agencies that were regulating credit. Others came from industry. There were also some transfers internally with staff who were interested in doing work on credit.

Senator MASON—Mr Kirk, how is the industry accepting the changes? What is the feedback from industry thus far?

Mr Kirk—The feedback is generally good. For industry, the core of the new regulations is the existing provisions of the uniform consumer credit code. The lenders are used to having to deal with that and having to comply with that. The big group that was not previously regulated is the intermediaries, particularly mortgage brokers. Both of the national organisations that represent mortgage brokers had been calling for this legislation for some years. They wanted to be regulated. They had been involved in the process of the development of the legislation, so generally there is a good acceptance of the regulation in industry. People are actively and positively preparing for it.

Senator MASON—We have wonderful secretariat staff here on this committee. They have put in our folders an article from the *Financial Review* of 31 March. You are right. It quotes Aussie Home Loans executive chairman John Symond. He thinks it will in fact assist the industry and assist his business because it has the imprimatur of ASIC and, therefore, that is a good thing. Generally, it has been well accepted, has it, among the key players?

Mr Kirk—Yes. That is certainly our experience. As I said, we have had a lot of contact with industry through those roadshows. Generally, it has been very positive feedback.

Senator MASON—There is a picture here of Gerard Fitzpatrick. That is not you, Mr Kirk, clearly.

Mr D'Aloisio—That is correct, Senator.

Senator MASON—Where is he? Is he gone?

Mr Kirk—No. There are going to be two ongoing teams dealing with credit. There are the existing deposit takers and insurers team and the new credit team. Gerard Fitzpatrick is coming in to manage that credit stakeholder team. I have been there since the beginning of the process. I have been managing the preparations and transition. When I am finished that, I will go back to the deposit takers and insurers team. Between those two teams, we will have responsibility for the whole lot.

Senator MASON—I just thought there might have been a palace coup, Mr Kirk.

Mr Kirk—No.

Mr HARTSUYKER—What sanctions are going to be imposed with regard to people who miss the deadlines under the process?

Mr Kirk—Essentially, if people do not register by 30 June, they cannot continue to operate in the industry until they obtain a licence. Come July, they would have to start applying for a licence and go through that process, which will be open to them, but it might delay their business for a short time. Beyond 30 December, when the licensing application period closes, again, they will not be able to continue operating the business if they have not at least by that stage applied for a licence. There might be still a few applications pending in terms of being processed, but they cannot operate in the industry without that licence application being in.

Mr D'Aloisio—It is worth stressing that the registration requirement, which enables them to go beyond practise from 1 July, is very, very simple. It is online. With the take-up that we have had—I think, as Greg has said, it is about 4½ thousand so far—we think all up there will be about 10,000. There is still quite a lot of time to go.

Mr HARTSUYKER—Yes.

Mr D'Aloisio—So we expect that, by and large, people are not going to be disadvantaged because of some last-minute technical problem or problem that ASIC could not process or whatever. So we are quite confident that, come 1 July, those that have wanted to continue in practice will be able to do so. The way that the licensing regime is being put in and phased in over the next six months or so should give people adequate time. We will obviously keep it under review. If we need to reassess that for some reason—something that might occur in the market—we will obviously do so. But, at the moment, with the team and the way that it is running and the way that it is coming together, we do not anticipate any sort of draconian problem for people going out of business inadvertently, for example.

Senator MASON—You said the process was very quick, did you not?

Mr Kirk—Yes.

Mr D'Aloisio—I think the first registration came in at 12:11 am.

Mr Kirk—Yes. It opened at midnight, and the first person had completed and was registered by 11 minutes past 12.

Mr D'Aloisio—And it was not either of us that was sitting there on the computer.

CHAIR—Do you want to make a few comments about the scrutiny of contracts for difference?

Mr D'Aloisio—Yes. We can do that. I was going to go on to market surveillance, but we can do that. I will get Greg to speak on contracts for difference.

Mr Medcraft—First of all, what is a CFD? Basically, it is a leveraged derivative product that is offered in the retail market that can be listed or unlisted. The buyer and the seller agree to exchange the difference in value of a contract in relation to an instrument. Basically, it is the contract.

Senator MASON—Can you give us an example, Mr Medcraft?

Mr Medcraft—Basically, I am interested in taking a position on BHP shares. I want to go long, so I believe the price of BHP is going to rise. I will enter into a contract for difference with you, for example, for, say, 100 shares of BHP at $100, for example. That is basically the reference security. I will lodge a small deposit in respect of the position that I am taking—the long position. If the price of BHP actually goes down, potentially it means that I will have to probably pay you money in the future because it has actually gone down; it has not gone up. The contract for difference may have a requirement for a small margin deposit to be made so that

there is a coverage for that risk. So that is covering it during the period the contract is outstanding. At the end of the contract, basically whatever the price of BHP is on the day, if it actually has gone up from where we agreed we took the bet, you will have to pay me money. If it has gone the other way, I will have to pay you the difference in the price. Basically, it works the same in relation to any referenced security. Basically, as the name implies, it is a contract for difference. Equally, if you go short, expecting that the prices are going to fall, it is basically the same thing in the opposite direction. It is basically a way of taking out a leveraged bet on the movement of a referenced asset, be it a commodity, foreign exchange, index or a share.

Senator MASON—And it could even be insurance, in effect, too, could it not?

Mr Medcraft—You could be using it if you own the underlying physical stock. You could use it as a way of hedging your position; that is correct. For a period of time, if you expected that there was going to be volatility in the market for three months and you are holding a big portfolio, you might be using it as a hedging instrument, correct. As I said, investors can be long or short. As I said, the investor is only required to lodge a small deposit. Therefore, it is obviously a pretty attractive instrument if you really want to take leveraged bets on an underlying financial instrument. So that is pretty well what a CFD is; it is a retail derivative.

What are our concerns about it? I guess what prompted our interest is that it is a market that is growing rapidly. The number of active participants in the market currently is over 35,000. The number of participants grew by 23 per cent last year, which is a phenomenal growth rate. We have basically two sets of concerns. One is protecting retail investors—so potentially investor trading losses in respect of those investors who are using these instruments. Basically, they do not understand what they are investing in. So often there is an issue that people believe they may be investing in the underlying security rather than in the derivative, for example. There are some issues around realising that the losses potentially are unlimited in relation to these instruments. Trading losses are potentially a concern.

Senator FARRELL—How are the losses unlimited? Surely it cannot be greater than the amount of the risk?

Mr Medcraft—If you take a short position and the stock goes the wrong way, however high that price goes compared to you taking the short price—

Senator FARRELL—If you are taking $100, the maximum you can lose is $100, surely.

Mr Medcraft—If the price goes to $500 or $1,000 and you have said it is $100, then your losses can be whatever that price can rise to.

Senator FARRELL—Yes. You are right.

Mr Medcraft—If you are taking the long, you are correct. But if you are taking the short, then the price can vary, as always when you go short.

Senator MASON—It is limited by going to zero the other way.

Mr Medcraft—At least, in a way, there is a physical cap on it. It cannot go lower than zero. Whereas whenever you short anything, you are taking a risk on it going up. Yes, the risks on shorting are unlimited.

Senator FARRELL—I was thinking of the risk side of it rather than the potential investment side of it.

Mr Medcraft—On the other side of the risk, there are the trading losses that potentially an investor can have, which can be significant. Basically, the deposit you are required to lodge is actually quite minimal. So it is a very good way of taking a leveraged bet. The other area that concerns us in this is basically the sector that is not exchange listed. That is the OTC market, where basically as long as you have an AFSL, you can set up and take bets on these. The concern we have clearly on that is two things. One is client moneys, because you have to put that deposit on when you make the bet. At the moment, our estimate is currently there is around $350 million sitting in that non-listed sector. That is client moneys sitting with these unregulated entities that are taking bets. The second area of risk that we are concerned about is really the counterparty risk in respect of this untraded sector. There is not just the issue of client moneys. Let us say that your bet does go the right way and you win. Basically, if you go to a bookie and you break the bookie, you do not collect your bet. Essentially, trading losses and, if you like, counterparty risk for client moneys are the two areas of concern to us.

What have we done about the areas that we are concerned about? Basically, there are three areas. One is conduct, two is disclosure and three is education. In relation to conduct, we have been advertising surveillance. As you may know, with groups like the major participants in the market—CMC Markets, IG; you will see them on television and you will see them in the papers—we have been doing surveillance of that to make sure that the advertising is not misleading or deceptive. We have achieved some corrective action in respect of advertising. Secondly, in respect of conduct, we have undertaken shadow shopping of seminars. A lot of the seminars on these are conducted in the guise of education when in fact they are often more about promotion. Again, in response to that, we have taken corrective action in relation to those seminars.

Thirdly, in relation to conduct, we have engaged with the major issuers in the market and basically been out discussing with them. As they have to be AFSL holders—Australian financial service licence holders—they have a requirement to have in place appropriate compliance procedures and risk management procedures. Basically, we have been engaging with them to try to understand what their procedures are to manage the risk and, where necessary, seek corrective action. So that is what we have done in conduct.

In relation to disclosure, basically we have had a surveillance underway in terms of the PDSs of the issuers of those contracts for difference. Basically, of the ones on which we have conducted surveillance, where we have seen areas where we believe there is a need to correct the disclosure in relation to things like the product features or the counterparty risk disclosure, we have sought change. That is an ongoing surveillance program in terms of those PDSs, where we are looking to get corrective action.

Also in relation to disclosure is client moneys, which I mentioned is an issue. We issued a paper in August last year in relation to client moneys. We had responses back in September. We

recently had a review at the commission on it. We intend to come out with probably a regulatory guide in the near future in relation to the handling of client moneys. Obviously the CFD area is one where it is quite relevant.

The third area is education. We have been running focus groups with investors in the market to gain an understanding of what they do understand and what they do not understand and how they use CFDs to try to get a better understanding as to where potentially the problems are in this market for investors. What we intend to do, based on that and based on a lot of the other things we are doing in the various other groups of ASIC, is look at producing an investor guide to better explain to investors that are going into CFDs. Hopefully, that gives you an outline of what we are doing in the area. I remind you that these are an execution only product. Basically, they are relying on general advice, and that is what the education is all about.

CHAIR—I read with interest the other day that ASIC has an agreement or understanding with Centrebet in terms of a type of CFD in relation to bets taken on the possibility of an interest rate rise. I am interested in the view of ASIC. I am interested in what that means and whether that is a financial product and where that might go.

Mr D'Aloisio—We are going to regulate all gambling.

CHAIR—That would be very interesting.

Ms Gibson—More to be done in that department. We have had some discussions with Centrebet about some products. One of them is like a CFD. It is a bet against where the ASX200 may go. The other one relates, I gather, to interest rates. That correspondence has been made public. Centrebet, as it has said, has withdrawn from those products. It needs to take its own advice as to whether that does or does not comply with the law, as do others. It is a difficult area. The definition of a derivative is wide and potentially could get many things—probably not a football game or a horse coming over a line, but many things. Yes, we are certainly looking where there is a clear payment based on what is a financial instrument, such as a stock share price.

Mr D'Aloisio—We are not prohibiting it, as Belinda says. There are licensing requirements. If the licensing requirements apply, we apply it across the board, irrespective of what the products are.

CHAIR—It is obviously an interesting scenario, because it has an impact on how you define what a product might be, depending on what somebody does with that particular widget, if we can call it that.

Mr D'Aloisio—Well, the Corporations Act does have the definition of a derivative, so that is the guide that we choose.

CHAIR—You are working through—

Mr D'Aloisio—We work through those.

CHAIR—What have you got as an agreement with Centrebet?

Mr D'Aloisio—Well, we do not have an agreement, as such.

CHAIR—There is no lawful undertaking?

Mr D'Aloisio—We are still in discussions with them.

CHAIR—So you have voluntarily decided to—

Mr D'Aloisio—Well, at the end of the day, the law is self-executing. People know. If it is a licensing requirement, the law is there and definitions are there. It is a matter for them to get legal advice and make their own call.

CHAIR—And this would apply to everybody in the sector?

Ms Gibson—We have done some analysis of the sector. There does not seem to be the widespread taking of bets against the stock market and stock prices and so on. It is perhaps more common that people want to bet about what the Reserve Bank might do next week. I am sure any number of lawyers around town could have a go at whether that can be structured in a way that does not walk into a derivative.

CHAIR—So there are obviously some complex issues around whether it is a derivative product or contract for difference and how you define them?

Mr D'Aloisio—I think derivatives has a definition of products because they derive from other products. They are necessarily quite complex instruments and the definitions are complex.

Ms Gibson—A contract for difference is clearly a derivative. The providers of contracts for difference all have AFSL licences. That is the legal requirement. With the licence goes certain constraints about how you conduct your business and so on, which is what Greg's surveillance is undertaking.

CHAIR—With the complexities in mind, I will come back to the CFDs. There are two different environments now with ASIC's ongoing role in terms of corporate regulation and surveillance and so forth. In that particular area, is there any difference now with your new powers in terms of market surveillance with the Australian Stock Exchange and how those two link together? Is there a massive change or a new challenge that did not exist in the past in terms of the way you are dealing with them?

Mr D'Aloisio—Not in relation to this area of the CFDs. I think later on we will talk more fully about the transfer of surveillance and what that has meant for ASIC. But certainly not in the contract for difference space. I think as Greg has outlined, the main concerns we have is once products that typically have been used much more in the wholesale sector of the market get into the retail sector, there are issues around the understanding of risk and loss, how certain sorts of insurances might work or not work with these products and whether people are properly advised. The sorts of issues Greg has talked about clearly become much more important and have our focus. CFDs have been growing. In response to that, we have put additional resources into the surveillance of those markets. As Greg has pointed out, we are concentrating particularly on the non-ASX traded derivatives because we have got derivatives that are traded on the stock

exchange. There is another set of protections, if you like, that exist on that market that are not available over the counter or the non-exchange traded market. Having said all that, this is one that is on pretty close watch for us because of the degree of risk that an unsophisticated player can get involved in. Thinking that they might have only had an exposure of $10,000 on a bet, it compounds into $100,000 or $200,000 depending on what the underlying arrangements were with that particular instrument.

Senator FARRELL—Who are you trying to protect there?

Mr D'Aloisio—The investor.

Senator FARRELL—But we get back to that question earlier about the maximum loss the investor can make if the price goes down to zero.

Mr Medcraft—It depends whether it is short or long, though.

Mr D'Aloisio—It also depends on the number of the securities. For example, you will recall with BrisConnect, people thought that a one-cent one unit compounded into $100,000, thinking it was only $1. So it is not as simple as just one share on one instrument or one bet. It is the complexity of the way it is placed.

Senator FARRELL—Why do you think it is now more popular?

Mr Medcraft—If you think about it, if you want to trade on the market, you do not have to put up much money and you can take a very significant leveraged position. So it is attractive to somebody who wants to trade in the market.

Mr D'Aloisio—You need less capital.

Mr Medcraft—Yes. It is like why people do margin loans or whatever. It is a way of actually taking leveraged bets. The thing that concerns us more is as the market recovers and people become more comfortable about maybe the direction of the market—

Senator BOYCE—It will always go up.

Mr Medcraft—I think being proactive on this is actually quite important. As the economy recovers and people become more comfortable, they can also enter it in a whole range of markets. It is why we just have to make sure that people understand what they are doing.

Senator MASON—Should we enhance regulation, Mr Medcraft?

Mr Medcraft—I think that is a policy issue, Senator.

Senator MASON—That is all right. I am asking those questions. You do not have to answer it. You can answer it if you like.

Mr Medcraft—As I say, I think it is a policy issue. I have given you what our feedback is. We will share with you and with the market the results of our surveillance and what we are doing. I

think it is clearly a market to watch. I do not think we have seen at this stage any real horror stories emanating from that market, but I think we just need to be careful.

Mr D'Aloisio—I think also the instruments in the form of insurance are used for all sorts of different purposes. So if you are going to intervene with regulation, you need to be quite targeted as to what you are doing and why and what the implications for the market are. We just do not have at this point sufficient evidence to go to government and say, 'We think the current regime is deficient.' The extra resources are going to give us that information. If we need to, we definitely will give advice to the government.

Mr Medcraft—I think another answer to that is that the market operators themselves are really starting to put a lot more resources into education. Think about it from a business perspective. Basically, they do not really want people who have lost money saying, 'Well, I had no idea what I was doing.' So our engagement with the sector is actually showing that a lot of the bigger operators are basically trying to change their model to really make sure that the investors that are being taken on board are properly educated. So there is a market response to the growth in making sure that there is the appropriate investor in there as well.

CHAIR—I will briefly move on to short selling. I have one question. Can you give us an explanation for the basis of the delayed start of the new reporting obligations?

Mr D'Aloisio—As you know, Chairman, gross reporting on short selling on a daily basis has continued throughout and continues. It is reported the next morning. The reporting by investors of their short sale positions, which was to take effect on 1 April, has been delayed to 1 June to enable systems changes and other changes so that when they do come in, the market is better prepared. We do not see the delay as significant. The third form of reporting that applies in relation to short selling goes to the securities lending transactions under the financial stability standard that is administered by the Reserve Bank. That is in place. The gross sale reporting is the next day. The short sale position—the one that will be in on 1 June—is two plus three. While I think there has been a short delay, we do not believe that that should be a problem for the market.

CHAIR—I want to get to the transfer of market supervision and so forth and the ASX, but we might just finish off this particular section and then spend some time in that area. You have a number of investigations and prosecutions ongoing. Some are completed. I am particularly interested in getting some feedback on the closure of Project Mint. I want to talk about Storm Financial as well.

Mr D'Aloisio—Yes. So far as Storm Financial is concerned, the short answer is that there is nothing further to add to what we put out in our release recently, which was that our investigations had reached a stage where we felt it would merit us engaging in commercial confidential discussions with a number of the parties who could, if we decided, be the subject of legal proceedings for compensation. We indicated at that time that we would report to the market at the end of May, depending on where those discussions were at. That is where we are with Storm so far as ASIC is concerned. So its investigations are continuing. We have, as part of the case preparation, set up a website which provides information to Storm investors in terms of what and how our investigation is unfolding. It also provides each investor with their own confidential user name and password in relation to their own individual position. Through that

process, we are able to collect, correct and confirm a substantial amount of information that would otherwise take quite a long time to do because, as you would understand, we are dealing with some 3,000 investors who in one way or another may have made losses in the Storm Financial matter.

So that is where we are. The CBA resolution scheme that has been in place that has lawyers acting for the investors is continuing. My understanding is that offers are being made and considered by investors. That is consistent with the confidentiality undertaking and the nature of these discussions. That is about as far as I can go, Chairman.

CHAIR—Sure. Are you satisfied with the Commonwealth Bank's regulatory scheme in broad terms?

Mr D'Aloisio—I think any financier in the situation that they are in—and there are other financiers as well—should be commended for taking action to see if they can resolve these issues commercially. So to that extent, yes, that is a good development. So far as the adequacy of the scheme is concerned or otherwise, that is really a matter for us to discuss in confidence with the investors and with the CBA.

CHAIR—I was not asking about the adequacy. That is a personal issue for each individual investor, and they can make their own determination as to how they feel about the resolution scheme. As a process, though, as a way forward for those aggrieved investors, from ASIC's perspective, is this a satisfactory process?

Mr D'Aloisio—I think there are two things. One is that the CBA resolution scheme is subject to a carve-out. So if ASIC is able to recover additional for the investors, they will get the benefit of that, notwithstanding that they may have accepted the CBA resolution scheme offer. Speaking generally, any alternative dispute resolution system that can provide results is, from an ASIC point of view, welcome because it avoids costly litigation. Beyond that, I am not really in a position to say any more about this scheme.

Senator MASON—You would not rule out, then, litigation against any bank or credit provider just because they have entered into some negotiations or, indeed, payments to people who have suffered through Storm Financial, would you?

Mr D'Aloisio—No. We have said that we expected carve-out provisions in those deeds and in those forms of settlement. The parties have agreed to those carve-outs. So from our point of view, what we would do is over and above. To be clear, we have not made final decisions on commencing any proceedings at this point.

Senator MASON—Sure.

Mr D'Aloisio—We are entering into confidential discussions bona fide and with a view to seeing if these issues can be resolved without the expense and the time that litigation involves. Indeed, in doing that, we have taken a similar approach as we took in Opus Prime. That, in the end, did get resolved. With Westpoint we have also tried global mediation, but that has had mixed success and legal proceedings are still continuing there. So you take each situation. But we have been very pleased with the response we have had and the approaches we have made to

enter into these discussions. In a broad sense, everyone is working to try to see if there can be a resolution to what is a very unfortunate set of circumstances, as the committee knows.

Senator MASON—Do you still have arrows left in your quiver?

Mr D'Aloisio—Thank you, Senator. You also, I think, asked about Project Mint.

CHAIR—Before we move on to that, the Storm matter is ongoing. We will discuss it further at other hearings. We have another oversight hearing in June, so we will look forward to having some more information at that point. Certainly of interest to the committee has been, and through the inquiry process as well, what learnings can come out of a whole range of unfortunate circumstances, but particularly from ASIC's perspective, from a regulatory perspective, about how to better manage the likes of other Storm type organisations. Certainly the model they use, while it might have been a bit exaggerated in areas, is not an uncommon model in a range of other organisations. I wonder what view ASIC has in terms of the future in trying to deal with Storm like organisations. I am pre-empting, in a way, the full failure.

Mr D'Aloisio—In a sense, one will do that. In the fullness of time there should be lessons. I do not necessarily agree that these are common. This was a very unusual set of circumstances. I think we need to let the legal process and the process in place take their course before you draw that these were really common across the whole of the industry. This was a very unusual set of circumstances.

CHAIR—I probably was not referring to common in the sense of what Storm actually did. While it might have been exaggerated, the model is not an uncommon model. Investing in the ASX top 300 is not uncommon.

Mr D'Aloisio—They are simple things. Investing in—

CHAIR—Or leveraging or anything else.

Mr D'Aloisio—If you take each component—

CHAIR—It is the exaggeration which was distinctive.

Mr D'Aloisio—If you take each component, no, it is not uncommon to invest in shares; it is not uncommon to invest in indexed funds; it is not uncommon to have a margin loan; and it is not uncommon to borrow against your home. You could take each of those elements. What really matters is how it was all put together and who was involved.

CHAIR—That is exactly my question.

Mr D'Aloisio—But that is what is unusual.

CHAIR—But that is exactly my question. My question is: what can ASIC take out of this? Now that we have established that it was unusual, what learnings can ASIC have in the sense that its individual bits are common? The unusual nature of Storm must give rise to some

learnings about how we can identify in the future other like organisations who may have similar qualities.

Mr D'Aloisio—Well, I think what you have seen in the response has not simply been an ASIC response. What you have seen is the retail investor losses that really have come out of the related GFC issues of a year or so ago. You have seen concerted action from ASIC in terms of its surveillance programs and its approach to these issues. It is being more proactive on such things as Greg talked about—CFDs. You have indeed seen the response from this committee and the recommendations of this committee. You have seen the responses from government to the issues that were involved particularly with the financial advice industry. So I think, in the government itself, everyone is really seeking to take lessons to improve performance in going forward. But it is the same story for the next crisis, if it occurs. Can you actually pick it? That, of course, is extremely difficult. We are working hard to try to foresee in the next upturn what could be the sort of stresses and strains that could come in that would require us to look at if the market heats. So we are doing all we can to do that. Hopefully, we will pick some of these better in the future than we may have in the past.

CHAIR—You were going to talk about the closure of Project Mint.

Mr D'Aloisio—I want to make some quick comments about Project Mint. Project Mint is a name given to looking at the rumours and what followed in relation to short selling. It was one of a number of actions we took at the time, including the short selling ban. Project Mint, for us, had at least two significant benefits. The first is what you would call in enforcement terms disruptive activity. The fact that we took that action, we went into the various groups and had a look at what was going on and testing the rumours, I think, was very important in reassuring the market that, if you like, ASIC was on the beat. I think it had quite an impact at the time. It has not led to a lot of direct enforcement actions. Sometimes these things do and sometimes they do not. It is an ongoing monitoring, review and surveillance of the market. It is not just one project.

The second thing it has done is enabled us, with the benefit of the work that was done during that project, to have a look at how false rumours, or rumours, or rumours that could be price sensitive are handled. Following that, we issued a consultation paper to assist and discuss with industry how these rumours could be better handled in the future. We are in the process of issuing a regulatory guide in relation to that. So I think the project as a whole has been successful in helping deal with false rumours or, at least, in a market rumours that could be price sensitive used in the wrong way that could affect the integrity of the market.

It was part of the market integrity group which Belinda heads and her team. I think they were, and are continuing to be, quite vigilant in handling these issues. But at the same time we recognise that markets work on information, and the free flow of information is extremely important to the market. So it is a judgement that has to be made about what is unacceptable and what is acceptable.

Ms Gibson—We might have taskforce meetings, but business as usual for now certainly includes rumours. In the rising market we are seeing some rumours that are clearly false coming out. Our deterrence teams and our market watch teams are looking at them. They report through the usual way.

CHAIR—So the rumours that the unit was shut down are wrong?

Mr D'Aloisio—You will recall it was around May to September 2008 before we put the full ban on short selling. There were concerns. It was necessary to have a focused unit within ASIC on it. But I think now it has fallen back to being part of business of usual for the surveillance team.

CHAIR—Can you see any advantage in looking at both ends of that market, with market supervision in your new role in terms of movements, insider trader and other activities and then the work of this particular unit looking at information and rumours?

Ms Gibson—Yes, indeed. It very much is folded in. Our Mint work was done in conjunction with the ASX because at that time they had the day-to-day monitoring of the markets. People who thought there must have been rumours would contact one or other of them or us. So the supervision side of it is an integral part of it. If you see a price moving strangely or unexpectedly or volume moving, the immediate thing you do is to try to say, 'Well, what's out there? Why might it be going?' The first thing often our people will do is call some of the broking houses that are doing the big deals and say, 'Well, why are you doing that? What's happening?'

Mr HARTSUYKER—How do you define a rumour for the purpose of this exercise?

Senator BOYCE—Am I right in remembering, Ms Gibson, that part of what you were planning on setting out to do was to define rumourtrage?

Ms Gibson—We started our consultation paper with a definition of rumours. There are a couple of elements that go with the definition of rumour. One is that it is unverified. Clearly, a false rumour is illegal. A false rumour is a story and information. But the key thing is rumours are purported facts that are unverified that someone is just spinning out there. It is also important that it is market sensitive. So you could put a story out. In a volatile market it is hard to tell just what might be price sensitive or otherwise. But the key elements are unverified, market sensitive and not generally available or not widely circulated. I guess by the time something has got so widely known in the market that everyone knows it is on, it becomes not so much a rumour as a fact underlying. What you have to do is to try to stop these things before they have just got such a run that they are influencing the market and there is no validity to them at all.

Mr HARTSUYKER—You said put a story out there. What does that mean, put a story out there?

Ms Gibson—Well, it is true that at times people who want to sell shares will make something up.

Senator BOYCE—Whether it is an embellished truth—

Ms Gibson—Yes. Sometimes.

Senator BOYCE—or a lie is—

Mr D'Aloisio—A classic example is where you could say in company X there is going to be a profit downgrade tomorrow. Or you could say that company X is going to be taken over by company Y. They can affect the market in those shares very quickly. In a takeover situation, typically the target will rise. If you are astute and you are trading quickly, you can make money in a very short period of time.

Mr HARTSUYKER—Quite clearly, that is true. But we are operating in an area where it is very hard to gain a prosecution. You are spending a lot of money on this rumourtrage issue. I would be interested in how much that is. You could also say that some are saying A, B or C. Some may well be saying that. Would you ever turn that into an offence or something under which the government could—

Senator BOYCE—It could be market manipulation.

Mr HARTSUYKER—Some are saying that.

Mr D'Aloisio—Well, in terms of the way that our system works, our system and the markets work on ensuring that there is confidence in the integrity of those markets—that they are fair and they are clean. That is what gives the investors assurance. If you have markets that do not police false rumours or attempt to police them, then you run a risk that your markets will be perceived as being less clean and that there are insiders that can make money and outsiders. And that can affect the level of investment in that market. So even if you may not be successful all the time in being able to get to the root of the unverified rumour that has affected a price movement, the fact is that you need to be in there and you need to be diligent about it. You need to ensure that the market players—the licensees and the market participants—understand that you are serious and have systems and processes in place to manage that so that their people do not put our false rumours or rumours that could affect the integrity of the market. So it is not an issue of cost-benefit analysis. This goes to the fundamentals of how a clean market works and the integrity of the market in Australia. I think in the work of the ASX in this area, our work and the future surveillance work, issues around insider trader, market manipulation, false rumours and misleading conduct will always remain at the core of everything we do.

Mr HARTSUYKER—So what is your process in relation to rooting out this false rumour? What is the organisational process you are talking about?

Mr D'Aloisio—In the scale of things, there might be suspicions in a week around 30 things. They might all turn out to be no problem; there was no issue in it. Occasionally, there are things that could have an issue in it. They will then be subjected to a further review and checking in the market. It might go to a full investigation. That investigation may lead to prosecution. It may not. So there are processes that you would follow depending on what the impact of that has been and what you are able to prove. It just depends.

Senator MASON—Mr D'Aloisio, you and I had a chat about this a while ago and you will recall my scepticism about this. It really is just simply as a matter of proof, as Mr Hartsuyker has touched on. We know how difficult it is to prove insider trading. I am not much of a lawyer, but I know how hard it is to prove conspiracies. This is like a conspiracy of Chinese whispers. You are trying to get back to the source of rumours. I am not saying it is not important for market

integrity; I suspect it is. But trying to prove that—I said this at the time—is so difficult, as it has proved.

Mr D'Aloisio—Senator, the converse of that—

Senator MASON—It has a deterrent effect, perhaps. But I wonder.

Mr D'Aloisio—I will put the converse of that. I come before you and say that false rumours are really difficult to prove so we are putting no resources into it. The fact is that no matter how hard it is, ASIC has to be in the space of maintaining and protecting the confidence and the integrity of the markets. And with false rumours and rumours that can affect the price of shares, we have to be in there. I think what you are underestimating in your comment is the fact that we are vigilant and in there and are talking to the major players. The major players do want to do the right thing because they have large concerns. They have reputation issues. They do not want people in their midst that could do the wrong thing. So in improving their compliance processes and the way that they approach these things—talking to them and in the work we do—that all works towards assisting in keeping this sort of behaviour to a minimum. Indeed, the criticism of ASIC was back in 2008 that we were not doing enough on the rumours when the short selling was occurring.

Senator MASON—I recall that. This is not my area of law. I know very little about it. I am just thinking conceptually for a second. You have false rumours being illegal. If the rumour is incorrect, that might be insider trading. I do not know where you start to pull apart rumours from simply market information. I really find that conceptually it is very, very difficult.

Mr D'Aloisio—We agree that it is difficult. If you could have simple definitions that got you there, that would be great, but this is the regulatory regime we have. It is similar to those that operate in the US and the UK and other parts of the world. With other regulators, we are all trying to grapple with the issue, at the heart of which is the need to maintain these markets fair and clean.

Senator MASON—Could you suggest to the committee a way that the legislature could reform the law to make it easier for you to look at false rumours?

Mr D'Aloisio—We could take that on notice. We think—

Senator MASON—I think the committee would be interested in whether there is a better way to do it.

Mr D'Aloisio—We are not suggesting that the current regime is deficient. Our emphasis has been on enforcement, deterrence and working with the current regime. There are a number of prohibitions on false rumours, misleading conduct, insider trader and market manipulation. The regulatory framework is quite clear that it wants this practice outlawed, if you like. Our emphasis is on the surveillance and enforcement. I think we need a bit more experience. Again, as I have often said to this committee, we want to push these regimes to the limit before we seek legislative change.

Senator BOYCE—You mentioned that some of the players had changed their internal compliance regimes as a result of Project Mint, for want of a better word, or the taskforce. Can you give us some examples or can you talk some more about that, please?

Ms Gibson—Certainly. I was going to add to the Chairman's comments that a lot of this is about professional judgement and establishing the correct standards for behaviour. If we model ourselves on where they have gone in the US, the UK and Hong Kong, there are some standards. It is left to the brokers concerned to be responsible about how they deal with things. So, anecdotally, I can say to you that the big broking houses—the investment bank broking houses—did change the manner in which expressions of opinion or circulation of facts went into the market on a daily basis. Every morning the selling houses at brokers put out a sheet that says, 'Rumour reported in the paper' or, 'Rumour is X, Y, Z'. Often there will be a headline on it that says, 'Sell this', or there will be research reports that will take a little fact and turn it into, 'On this basis you should sell.' It is a long bow to take it from there to there, but it was effectively for them to sell more stocks. The hedge funds said to us, and the brokers that we spoke to about their practices said, that they were managing their policies. Many of them, because they are international houses, have extensive policies already. They have perhaps fallen to the bottom of the drawer and down the back. When we started—

Senator BOYCE—Well, there was money to be made, Ms Gibson.

Ms Gibson—But certainly they said to us when we started consulting on our paper on handling rumours that they had been looking at these and that there are elements of them that they found onerous. I think you will find that when we do issue our paper, the most onerous of them, which is the log, will disappear. But they said, 'Yes, we have rules that seem to do what you think the rules should do in the broadest of terms, and that is all we seek—some standards, and some elevation of the responsibility for how these stories and when these stories going to the market go at a more senior level where there is more overall responsibility for the overall status of the market', I suppose, is the best way to put it.

CHAIR—Given the importance of dealing with misleading information and misconduct in the market and so forth, ASIC would have obviously done a report from Project Mint or some sort of guide or some outcomes in terms of the program itself. Can you give us an up-to-date brief on where that is at and whether there is a report?

Mr D'Aloisio—We would not ordinarily, and we have not here, from memory. It is really what we have learnt from it and in discussions internally and are passing on to our people. It tends to be by discussion.

Ms Gibson—There have been updates along the way, but I do not recall there was a formal closure because things stopped happening as we went on as we have shifted our focus.

CHAIR—I would be interested to have some sort of report from ASIC—

Mr D'Aloisio—Yes. We can take that on notice.

CHAIR—as to its successes, learnings and otherwise in terms of Project Mint. I certainly think it is important and something that needs to be ongoing, so I think it would be very helpful

for us. Have there been any specific changes in terms of guidelines or anything in relation to company reporting or any particular outcomes that you can identify at this stage?

Ms Gibson—The other thing that we have been consulting about is how companies keep their information confidential. A number of the rumours that were told to us in that period of turmoil just did not meet that first base test of false, to be honest with you. They actually were true but were supposed to be secret. The real complaint was about the true fact. The most telling was one that said, 'Note X to the account says A, B, C, D. Therefore, you should sell.' The stretch was between note X and sell. It was not between whether note X said that or whether note X was false. So we have a dialogue with the business community about how they keep their information secret. They have disclosure obligations to report unless a deal is still secret or a position, say, on accounts is still internal. But if it does leak and the market starts to run, they need to announce then. So we think there is room again to lift Australian standards to overseas standards about how they manage information. It is a small market here. The CBD here and in Melbourne is pretty small so the deals zip around pretty quickly. We want to encourage people to be a bit more responsible.

Mr HARTSUYKER—I would just like to hark back to my other question about what you have spent on the project so far.

Mr D'Aloisio—I would have to take that on notice. It is part of our normal business, so we would not segment and cost. It is important work, so we would not have a separate cost on it.

Senator MASON—It is part of the enforcement, is it?

Mr D'Aloisio—It is part of surveillance and enforcement and stakeholder teams. So it involves a significant group.

Senator MASON—It is core.

Mr D'Aloisio—It is core business for ASIC.

CHAIR—Could you look at that anyway in terms of cost outcomes? It is obviously a project, so it is a defined task and undertaking that ASIC does. Certainly I think it is a very important one. It is something that needs to be ongoing. But I am very interested as well in terms of the resources that ASIC devotes to it and how it deals with that and whether the organisation has a view to continue those as a project other than ongoing work. Does it warrant at some future time to undertake another special exercise like Project Mint? I would certainly be very interested in that.

I am also interested in reviewing investigation strategies and where your plans are in the future in terms of taking on some new work. I am obviously not asking you to divulge to the market or anyone else any particular inquiries you have. But are there any new strategies or are there any particular areas that you feel are important that you can inform the committee about?

Mr D'Aloisio—Can you be a bit more specific?

Senator BOYCE—Targeted behaviours.

CHAIR—If there is anything new that is happening in the market—

Senator BOYCE—Of concern.

CHAIR—of concern. Any areas that you feel warrant more attention? We have already discussed CFDs and derivatives. They are areas that are obviously of concern to ASIC that you are doing more work on. We would be interested in having a sense from the regulator where it sees future work in investigations or particular areas, be it future rumourtrage investigations and particular areas that are coming onto its radar as areas that we should also devote more time to.

Mr D'Aloisio—In terms of where we are in the current cycle that we are in and where we are with workloads and the state of the markets, very much our work is driven by the state of the market at any particular time. At the moment, the priorities remain pretty much as I outlined before to the committee. The areas of insider trading and market manipulation clearly remain important. We have a number of ongoing investigations and, indeed, new investigations commencing in those areas. In the area of retail investor protection, clearly, that is another key priority of ours. Again, the sorts of issues there are around our projects of investing between the flags and the retail investor protection that Greg spoke about earlier. Monitoring new product areas that may be emerging as we move into the next stage of the cycle and protecting retail investors remain key priorities. So I think in that sense there is no new market misbehaviour that has suddenly come onto our radar. It is still essentially maintaining a focus around the key core business—insider trading, market manipulation and retail investor protection. In addition to that, of course, there are the sorts of issues we have been discussing with the transfer of surveillance and the transfer of credit and other areas that we have at any particular time.

In terms of caseload and workloads, certainly the major investigations and the major court actions do continue to take a lot of our time. It is probably a more general answer that you were looking for, Chairman, but I am happy to delve further if we can help. Basically for us—

CHAIR—I am just thinking along the lines that markets are not static. You have your finger on the pulse as an organisation on it every day in terms of what corporations are doing. There is a huge variety of different activities. Certainly the market changes. We are seeing a resurgent market. Corporations and companies and other people are becoming more active again as economies speed up. Are there any particular areas that you can point us to in terms of saying, 'We have concerns in any specific areas', or is it really just business as usual and nothing is changing?

Mr D'Aloisio—I think it is business as usual, though clearly we have an eye on whether, as markets do recover, they heat and whether new areas or new forms of investment may come along and how we can assist investors to understand them. But we cannot point to any area that we are really concerned about. Clearly, we are keeping an eye on all the segments of the markets through our stakeholder teams, but we are not at the moment seeing a group of products that are going to lead to tears or things of that nature. I am hoping that certainly this time around we are much more active in being in the market and picking those things up. But at this point we do not have those sorts of issues. But I am more than happy to take it on board, Chairman. When we meet in June, perhaps we can give you a more specific answer section by section or area by area rather than perhaps the general answer that I have given you today.

Senator BOYCE—In your view, is there any potential for the development of products to attempt to circumvent the consumer credit regulatory system?

Mr D'Aloisio—Perhaps not at this stage as such. It is just a bit early.

Senator BOYCE—Products or organisations, I suppose.

Mr Kirk—To some extent, the history of credit regulation has involved the history of attempting to, on the fringes, avoid being regulated and to come up with ways to avoid being regulated. Overall—

Senator BOYCE—I notice that some pawnbrokers appear to be setting themselves up as providers of consumer credit these days or reframing their business, so to speak.

Mr Kirk—Yes. It may be that the flow is in the opposite direction. Pawnbroking will not be regulated under this regime, so there may be an effort by fringe providers to become pawnbrokers or to appear to be pawnbrokers to try to avoid regulation and licensing and the like. Yes, there is that history of efforts to avoid regulation, but it is largely on the fringe. They are small players and they can have an impact on the consumers that they deal with. So we will certainly be vigilant looking out for that. Again, in the transfer in the cooperation with the states, we are getting information from them about what they have seen in the marketplace to try to make sure that we are ready for what might already exist or what might be developed.

Senator BOYCE—In what is quite a fragmented market anyway, is it not?

Mr Kirk—In terms of the whole, the vast majority of credit is provided by only a small number of institutions.

Senator BOYCE—I realise that.

Mr Kirk—But when you get right out on the fringes, there can be very small players who are only operating in relatively local—

Senator BOYCE—In one city or whatever, yes.

Mr Kirk—Local circumstances, yes. Again, part of the need for us to have an outreach team is to make sure that we are conscious not just of what is happening in the capital cities but what is going on in the suburbs or in regional centres or smaller places.

Senator MASON—It would be interesting, Mr D'Aloisio, if you could update us on emerging scams as well. Markets never sleep. You know that.

Mr D'Aloisio—Markets never sleep. Spruikers always make money. But certainly we would regard that as just part of core business.

Senator MASON—Sure.

Mr D'Aloisio—Indeed, I did mention earlier that in each of the stakeholder teams, particularly the teams run by the two Gregs, there is a lot of what we call risk based surveillance going on. We are really trying to be earlier in the game of seeing what is going on to see if it gets our attention and it could involve something larger than a one-off thing. But we do regard that pretty much as our core business.

Mr Medcraft—And I think that is quite important in terms of what you were talking about regarding emerging trends. It is looking to identify risk, evaluate it and then determine whether we should take action. It is a dynamic process. I think that is very important.

CHAIR—I want to ask you where your internal reviews are at with the OneTel, AWB and Fortescue Metals cases.

Mr D'Aloisio—I want to spend a bit of time on this because I think we actually have a good story to tell. Although the reality is that the OneTel, AWB and Fortescue decisions came within a short space of time, I want to reassure the committee that we continue to act responsibly in the way that we select and run litigation. We are very focused and only take litigation on after considerable due diligence. Just to put it in context, we lost the OneTel decision and our decision was not to appeal it. We lost the AWB at first instance but won it on appeal on all points. The Fortescue decision, which we lost at first instance, is currently the subject of appeal.

In terms of putting that in context, the first point I would make is that ASIC has maintained and continues to maintain deterrence or enforcement as a significant part of its work. You will see in our 2008-09 annual report that we completed 186 pieces of litigation. We had over a 90 per cent success rate. We achieved 19 jailings and eight suspended sentences. I accept that our percentage of success in major cases is not as high, but it is quite acceptable. In 2008-09, in contrast to the three recent decisions I talked about, we won James Hardie, which is now on appeal. We resolved a number of Westpoint recovery matters in the financial advice area, the Panchal case on insider trading, the Somerville case, the Ariff case and Opus Prime, where we worked to get successful settlements. We had considerable success in HIH with the prosecutions and convictions. So both in terms of the medium matters and the large matters we think we are acting responsibly. Litigation by its nature is adversarial and cases are always going to be won and lost. But in our case, even if cases are lost, they still provide very important guidance to the market on, for example, market integrity. The deterrence impact of ASIC being prepared to take on large and complex cases should not be underestimated. The deterrence impact of ASIC taking a whole host of smaller cases should not be underestimated for the small to medium size area of the market.

When we do take large cases on, we do not do that lightly. We clearly comply with the model litigation rules from the Attorney-General. In the case of Fortescue and James Hardie, we used not only experienced senior counsel from the bar but also external experienced solicitors who acted for ASIC. So, from our point of view, to lump those three cases together and draw the sorts of inferences that you may have seen in the media is unfair.

CHAIR—I assure you that we are not drawing any inferences. We are just asking about the internal review.

Mr D'Aloisio—I will add that since those cases were commenced prior to ASIC's strategic review, ASIC's strategic review and its outcome and what we have implemented have made a significant number of changes which we see as improvements in being able to handle major litigation. For example, we have created the office of Chief Legal Officer. An experienced lawyer and former barrister has been appointed with a strong team of, I think, 23 lawyers to assist us in the preparation and running of, and act as a point of reference for, the more difficult cases.

Senator MASON—You can never have too many good lawyers.

Mr D'Aloisio—The enforcement division was too large. We broke it up into eight deterrence teams. The objective was to make them smaller with an increased focus and have more leaders and more senior people than we may have had. Those senior leaders were appointed both from internal promotions and from the market. We also recommended to government, and the government approved, the expansion of the commission, including Commissioner Medcraft, who is here today, with a view to enabling commission members to take a more direct involvement in the running of major cases. We have instituted a number of training and development programs for our lawyers and people handling these cases.

So I think both in terms of the track record and what we have done, it is to give you assurance that we are acting responsibly and achieving good results for the community. I think there are a number of examples that are emerging that those new arrangements are working, not the least of which has been the success rate we have had in more recent times in relation to the insider trading and market manipulation matters. Since January 2009, we have had three insider trading convictions, five market manipulation convictions and three false and misleading conduct convictions. In all, that is 11 significant results. That number of results from 1 January 2009 far outweighs the results we achieved in the previous five or six years in the organisation. So it is an example of, I think, the results of the strategic review and the changes we have made at ASIC working better. That is not to say that it was not working better before. It is just part of the improvement that organisations need to go through.

Finally, however, we accept that because of the nature of those three cases we should in addition to all that do a further review of those cases, which we have done and are in the process of completing with our senior leaders. So we have all the deterrence leaders in the commission. We have had a number of workshops, where we have workshopped each of those matters, looked at what was done and where we could improve. What is coming out of that is a series of, if you like, matters where it can improve our performance going forward. That will be implemented. We have left open the issue as to whether at the end of that process we do not seek additional external assistance in some of the reviews. At the moment I do not think we will need that. But we have an open mind. As I have said before, if we need to involve, for example, perhaps someone retired from the bar or a retired judge to help us look at some of our conclusions and whether we could do even better, we will do that as well. So I trust, Chairman, that those comments will enable the committee, I think, to better assess the track record.

As chairman of the organisation—and I am sure I speak on behalf of our commissioners—we are committed to discharging our functions in the enforcement area in the way that you and the community would expect us to. That is, we approach it with rigour and fairness but at the same time we do not shy away from the difficult cases because they might be high profile or there

might be consequences if they are lost. If we feel that the matter needs to be taken on because it is a market integrity or public interest issue and it has more than reasonable prospects of success based on proper advice, as an organisation we will take that action, notwithstanding that the community tends to favour more wins. But you have to be prepared for risks in litigation by its nature and take those cases on.

Indeed, a case like Storm Financial is a very good example of the complexity and the issues we are talking about. On the one hand, you have the complexity and risk that any actions in that sort of environment will be fraught with, with the risk of winning or losing. On the other hand, you have the public interest issues. You have a group of investors who believe that they should not have lost the money that they lost in those circumstances. You have to make a judgement about that and be prepared to take that action notwithstanding that there is a risk that you may not succeed.

CHAIR—I agree with you absolutely about the importance of taking on cases win or lose. Can you briefly describe to us how important it is that you take on high-profile cases and the value judgement you make about whether you can win those cases or not win those cases? What is the importance of actually taking them on?

Mr D'Aloisio—It is always hard because simply the question of what is high profile is an interesting question in itself.

CHAIR—An important case rather than just high profile.

Mr D'Aloisio—What you do is clearly you look at the case and you look at what happened. The general proposition you start from, quite frankly, is the proposition that in our system there will be failures of corporations. It is just the way that the markets work and free enterprise works with risk. So it does not mean that every failure has a wrongdoing in it. When crashes occur et cetera, what you are seeking to look for is, 'Well, is this one that was in the ordinary course bad business judgement?', and these things happen, 'Or is it one that has involved wrongdoing?' Fraud—the sort of HIH type issues—is a clear example of where there is wrongdoing, and you then get your investigation team going. So there is a lot of work that goes on initially in assessing whether there is the level of wrongdoing or a message that needs to be given to the market about behaviour that you would take on. Then the investigation process takes over. The judgement we make on resourcing the investigation process will be obviously what we have available and how we should run that. We try to keep it focused because of resources. But you have to give your investigation team a degree of freedom. You cannot simply say, 'You will run this and you will only invest $10 in it.' You have to really give them the ability to assess and reach a considered view. If they then conclude that there are reasonable prospects of success—in other words, that there is wrongdoing with a reasonable prospect of success—we then subject that to a number of filters. We subject it to external legal advice in some cases, internal advice and internal review by the CLO before it gets to a recommendation to the commission. The commission then subjects it to review from a strategic point of view from a number of angles to form a judgement as to whether it will take that action on.

So we do go through a very considered and rigorous process in reaching a decision as to whether or not we do take a matter on. There are many cases that just do not get to a stage where you take it on. There are cases that do. We do not then differentiate the cases between the small

end, middle end and big end of town. There is a lot around that. Clearly, when you look at our cases and the statistics I gave you earlier, you can see that it is across a wide range. I think today we put out a release where we have fined something in the order of 313 directors over a three-month period. They tended to be fines around the smaller end of town, if you like, or companies. More recently, we put out advisories in relation to insider trading, market manipulation and bannings in addition to the sorts of actions we may have taken with AWB or with OneTel and Fortescue et cetera.

CHAIR—Would you say there is a tension that exists between civil proceedings that you might undertake and criminal proceedings that the DPP might undertake?

Mr D'Aloisio—There is not a tension in the sense that we work very well with the DPP. I think in broad terms, you know—

CHAIR—Sorry, that is not my question. It is not in the relationship. The tension I speak of is between the differences between pursuing civil rather than perhaps pursuing criminal and the tension that might exist in making a determination as to which path you would take initially and where it might end up.

Mr D'Aloisio—It is an issue that is assessed. Clearly, there are a lot of factors you will weigh up in forming a view. Generally, those decisions are taken in consultation with the DPP as well. Go back to 1994, which was a time when the civil penalty proceeding was brought into the Corporations Act. I think that is right; I look to Belinda. It was around the mid-1990s. I think there was an expectation at that time that the civil penalty process would be a simpler process and a process where ASIC could get cases to court more quickly and so on.

I think with the interpretation by the courts in relation to the test and the procedures, it has got closer. The civil has moved probably closer. It is still civil. It is no issue. I think that causes us to wonder if all the effort you go to for civil is better. You may as well go the full way and look at the criminal. So we are judging that ourselves at the moment as to—

CHAIR—There is a cost difference and a time difference. There is an issue about—

Mr D'Aloisio—Because the cases have to be investigated and researched—

CHAIR—To a different standard.

Mr D'Aloisio—The actual time and cost and degree of preparation is very marginal. It is really marginal. In my experience, it is very marginal.

Ms Gibson—It is also a matter of weighing up the outcomes. Civil carries with it some banning and some cost recovery proceedings. So if you go criminal, the cost recovery does not follow automatically. In fact, it usually does not follow. So you—

CHAIR—There is also a higher, different threshold in terms of evidence as well, though, which is pretty significant.

Ms Gibson—It is marginal the way the courts have—

CHAIR—I am asking the question.

Ms Gibson—The way the courts have gone, the balance of probabilities in a civil case brought by ASIC, because there is a penalty component, is pushed much higher to beyond reasonable doubt. It is not there totally. But I think for our internal assessment measures, you are pushing well into beyond reasonable doubt before you—

Senator BOYCE—So you are almost feeling you need to develop a criminal case before you pursue civil?

Ms Gibson—Yes. Before you think it is a proper thing to bring a case, you have to be fairly assured of the outcome.

Mr D'Aloisio—It is an interesting and a live area in our assessment. It is one of the things that we are obviously looking at closely about the merits. Certainly in the cases of insider trading and market manipulation, on the statistics I gave you earlier we have generally defaulted to criminal. We feel that the threat of imprisonment is the market focus and the market discipline. But on breaches of directors duties and other things that you can get involved in, you are a bit more careful about that.

CHAIR—You have a memorandum of understanding with the DPP?

Mr D'Aloisio—Yes, we do.

CHAIR—Can you tell us what that involves?

Mr D'Aloisio—Well, the memorandum of understanding, I think, is a public document, from memory.

Ms Gibson—I think it is.

Mr D'Aloisio—It sets the protocols between us about how we talk, how we brief them, what we brief them with, how they appoint counsel, how they review our cases and how we make decisions about civil and criminal. In a number of areas, it delegates to us, for example, some of the more routine, smaller end of offences. They tend to be delegated back to ASIC to run as the 'prosecutor'. So it covers a range of procedures between the two of us. Part of the memorandum of understanding is that there are what are known as regional liaison meetings between ASIC and the DPP at national meetings. Interposed above that is a meeting that takes place between the secretary of the Attorney-General's Department, myself and the DPP. So we meet on a regular basis and see how our cases are going with the DPP and the DPP's views.

CHAIR—Earlier you gave us a figure that I think you have quoted a number of times. It is a 90 per cent success rate with cases. Is that contested or uncontested cases? Is there a difference?

Mr D'Aloisio—They range—

CHAIR—Is that the totality of all cases?

Mr D'Aloisio—I think the definition is in the annual report. From memory, it covers the positive outcomes that are achieved. Some are achieved through court. Most are achieved through court. Some are achieved through enforceable undertakings. Some are achieved through negotiated settlement. So there is a range of what we call positive outcomes in relation to the process.

CHAIR—Is there a figure of contested cases in the annual report?

Mr D'Aloisio—I will take that on notice and get that for you. Yes, I will get that for you. I just do not have it.

CHAIR—That is fine. No problem.

Senator MASON—I just want to make a comment, Mr D'Aloisio, and then ask a couple of questions following from that. I suppose I am like most people; I was disappointed that ASIC was not more successful in some of the more recent high-profile prosecutions. But I have to give you this: you have been very consistent in what you have said about this. Not only to this committee on a previous occasion and again today but also I note to the economics committee in February, you said in relation to these cases—it is very similar to what you said today, sir:

But even if cases are lost—

this is an important point—

they still provide important guidance to the market on, for example, such issues as market integrity. The deterrence impact of ASIC being prepared to take on large and complex cases cannot be underestimated.

I think I can say that in a private briefing earlier today we were discussing these issues. It was said by prominent legal academics that it was very good that ASIC took these cases on for issues of legal certainty. The public and often, indeed, our good friends in the press do not understand the importance of you taking on these cases. So I just wanted to put that on the record.

Mr D'Aloisio—Thank you.

Senator MASON—I perhaps in the past have downplayed that. In retrospect, upon reflection, they are very important points. You are quite right to raise them, and you have consistently.

Mr D'Aloisio—Thank you.

Senator MASON—But, having said that, have you changed your approach? Has ASIC learned anything from this? Will it change its approach to these prosecutions? Do you think you just have to soldier on? You have justified why you would soldier on. Have you reflected upon this? Has it perhaps changed the way in which you might pursue these matters in the future?

Mr D'Aloisio—As I said earlier, in the strategic review we undertook when we looked at how we could improve ASIC, we identified our ability to mount and run major cases as a very important part of the enforcement function of ASIC. Indeed, the changes that I talked about earlier were made with that in mind. So we have not made those changes because we lost

OneTel, for example, and that had been completed and we were awaiting judgement. I think when that decision came down, it reinforced to us the need to continue with these changes of our leadership team, the training of that team, using external counsel much more selectively and the need for a really independent critical review within ASIC of the cases from a pushing point of view. So if a team is going down a particular direction, they are given a 180-degree view of the whole thing rather than getting a too narrow view. So we think the benefits of those changes that we have been putting in place in the last two or three years are starting to come through.

But, over and above that, we recognise the importance of these cases, first, for the individuals that are involved. To be involved in a major case where ASIC is on the other side has a huge impact on reputation. For the community and for the individuals it is incumbent on us to continually see how we can improve the running of these cases to be clear with the market why we are taking them on and why we think the case is one of wrongdoing that should be subject to a court process of punishment if you win or further guidance at least as a minimum, even if ASIC may not be successful, or as vindication for the individuals that may be involved.

At the moment, as we do that review, we are looking at getting down to a lot of detailed issues about the investigative process—the document collection, the review of those documents and the way that our case is put together. We have moved from the more general, bigger picture reforms that I talked about earlier to really detailed work. In that way, I think we can continue to improve. As I said earlier, litigation by its nature is a fifty-fifty proposition. It is not because your case is not well prepared and not because you do not feel you have reasonable prospects. It is just when it is subject to that cross-examination and review and the evidence in a court of law with a judge, things emerge that parties had not anticipated.

Senator MASON—Sure. But it is terrible public relations, is it not? Cases like the high-profile cases that we have discussed—

CHAIR—The public would like to see you win every case, obviously.

Ms Gibson—So would we.

Mr D'Aloisio—There is a perception, and I will—

CHAIR—It is not really a criticism. It is more a reflection.

Mr D'Aloisio—What I guess I would be looking for in assistance is also from the committee. I think this is a very important process in terms of us at least being able to put to you our side of it. There is no doubt. For example, you had the media coverage on the three cases early on. The subsequent winning of the AWB case did not really get that much profile.

Senator MASON—No, it did not. I agree.

Mr D'Aloisio—And people still talk about it. You will see things written and said: 'They lost three cases.' In fact, at the moment it is two-two. But it is not a football game.

Senator MASON—No. I take your point.

Mr D'Aloisio—We just have to deal with that, that is all.

CHAIR—Hence why we are giving you this opportunity, by asking you these questions, to tell us exactly.

Mr D'Aloisio—We thank you for the opportunity.

CHAIR—I hesitate to cut it off there, but it is a very positive note. We really appreciate what you have given us so far. I will call a short break for the committee and everybody. When we come back, we can focus on the transfer of market supervision responsibility from the ASX. I trust that is okay with the committee and everyone. We will take a short break.

Proceedings suspended from 3.13 pm to 3.26 pm

CHAIR—We will resume proceedings. Mr D'Aloisio, can you give us some opening remarks in terms of the process and where we are at with the transfer of market supervision from the ASX?

Mr D'Aloisio—I am going to ask Commissioner Gibson to make the opening remarks. She and the team of two senior leaders, Greg Yanco and Mark Adams, have been leading this project. We will give you a bit of a roadmap about where we are going and what the issues are. She will also cover the competition for trading services, which was recently announced by the government.

Ms Gibson—Thank you, Chairman. I will start with the roadmap. In August last year, the minister announced that we would move to ASIC assuming responsibility for market supervision some time in Q3 this year, which would be some time between 1 July and 30 September. We are on track to be ready for that when that should come forward. I will come back to that.

The next announcement was in March, when the minister indicated support for competition for market services, which really broadly means competition with the ASX and some of the other markets. Perhaps they will not be competed with. He said that he would look further at that. We need to settle in the transition of market supervision. I will give a little roadmap on what we are thinking that means.

There will need to be a fairly extensive consultation about the rule framework that would apply where there is competition for market services. We think there would be a consultation. We have been working towards that. We think that would be released shortly after the transition. We would leave people working with the rules with just the markets we have to start with. After that consultation, there would need to be some new rules. Once those rules are established, particularly in relation to best execution, the markets that would be competing would need to set up their rules. The ASX would need to make some changes. Chi-X will then need to announce what its operating rules will be. It is against that that we would assess for recommendation to the minister whether particular licensees would be suitable. Chi-X obviously is the party that has got approval in principle, as it were, but they would need to do a lot more work with us with our rules to get to the point of approvals. So that is probably a few more months after our consultation.

The market participants have a very high degree of engagement in the process during the consultation and afterwards. With the new rules will come some IT systems that will need to be developed to enable them to give effect to best execution obligations and to give effect to reporting to the markets about those obligations. We will touch on them later. But the roadmap, I guess, is Q3 transition to supervision and the start of consultation on the competition framework. Towards the end of the year would be the time when you would be seeing what the new rules would be for the competing markets. We estimate it would be some months before someone could actually go online and trade on Chi-X in competition with the ASX.

I will start with where we have gone since we were directed to assume responsibility for market supervision. We have two areas of responsibility. One is the markets itself—the real-time supervision of trading. Those markets are the ASX and the SFE. They are the major markets, but there are three substantially smaller equity markets. There are also a number of more professional derivative type markets that are licensed. But we will also take over a lot more responsibility for supervision of the brokers. We have had a market participant and stockbrokers group, which comprises about 30 people. It has had some responsibility for the supervision of brokers. The term of art is perhaps white label brokers—people who are not in fact market participants on the exchange but act as though they are brokers in terms of interface.

Greg Yanco is the head of that project team. Greg has worked with the ASX for some years and more recently was with one of the potential applicants for a market licence. We have also set up a supervision advisory panel involving people from industry, from the big broking houses and the smaller broking houses, to assist us in working out a supervision regime that works or should work.

I will run fairly quickly through our work program. We have had to develop a set of market integrity rules, which are the rules that we have had to develop just related to integrity. We need to work with the ASX about, if you like, the carve-out of their rules that go to integrity and which ones remain. We have completed the purchase of an integrated market surveillance system. That is the SMARTS system. It is the real-time supervision—the thing that sets up the computer alerts that tell us if there is a trade that is out of the ordinary, which could be an indication of insider trading or market manipulation.

We plan to increase our team by about 40 people. We have completed offers and have had accepted offers from 26 people who work at the ASX. They will have hands-on supervision responsibility. We have advertised and are in the process of interviewing for another 12 places externally. As I said, we had a team of 30 market participants. We have had another 50 already in market deterrence. And 12 of those have got extensive experience in the Australian or, particularly, the European markets on market supervision.

We have done a lot of work defining the processes for the supervision model. We have had a lot of discussions with the ASX, both in terms of the fact that it is their market that we are first and foremost focused on supervising and the fact that they have been doing that frontline supervision for some time, albeit with us monitoring that.

I guess the final aspect is that we have had to develop a disciplinary model. The ASX runs a disciplinary tribunal. We are going to have a panel of people from outside. We have had to take bits of the infringement notice regime. We have taken bits of the enforceable undertaking regime

to try and replicate the global model for disciplinary arrangements, particularly for broker conduct.

There are some things that are still in the queue to come out for people to see that are not in our control. I guess that would be the regulations that are going to follow from the act under which we make our rules. The ASX has recently released its rules to apply once we have carved out our integrity rules. They are proposing some fairly substantial changes to the structure of their rules. That is still a matter in consultation.

We are close to finalising our broker supervision model and working out how that will interface with the ASX. The ASX, of course, will still have some broker supervision responsibilities, particularly in clearing and settlement. So we are close to finalising that with the supervisory panel. Then we will release that. We too are planning roadshows and podcasts. July will be our roadshows to all of the capital cities where there are ASX markets to speak particularly to brokers but also others about what may be there.

Competition is an overlay in that, as it were. As I said earlier, it requires more consultation. In 2008, ASIC had a consultation with the market about competition. It resulted in a confidential paper to the then minister about the fact that competition could work in certain parameters. Since then we have been monitoring the issues that came up there. It is fair to say that I think in the last six months there has been a lot more thinking in Europe and the US about the structure of markets and the quality of supervision where things have been exposed by the GFC, including their ability to keep close to who is doing what trading wise. If you have time to read it, I commend to you the SEC's paper. It is an issues paper. They are concept issues. It just talks about how you measure whether a market is efficient and what the balance is between an efficient market and a market with integrity. Are we more concerned with raising capital and looking after long-term investors, which is why stock markets were set up originally? Now you have a model where in the US up to 70 per cent of trades are by the so-called professional traders who are looking for anomalies in the market and seizing a profit opportunity. They are playing the market rather than playing the stock, as it were. What are the settings for monitoring that? If you are interested, we can send you those papers. They are interesting. It does need to inform the discussion that we have with the market on the competition structures.

What are we going to do in terms of competition? As the chairman said, we have established a project team. Mark Adams is going to head that. Mark Adams is currently the senior executive leader in charge of our exchange market operators, so he has supervision responsibility for that. He has had carriage of the competition model. We will need dialogue with the markets that are concerned themselves. To get competition working, there needs to be a close working dialogue between each of the markets and us. If you are going to have a trading halt on that market, where will you have a trading market on that market? Who will correct it? How do you relay your information about whether a particular insider trader is playing in both or a manipulator is playing in both?

We need to talk with the market players—the brokers and the investors—because they need to understand the new technology and the new rules. We also need to talk to the affected companies because it is ultimately their stock that is in play, as it were, and will be more in play as competition happens. I think we expect the outcome will be multiples of the level of orders and

sales that go through. You might expect the professional traders will come in and see arbitrage opportunities, which is their profit opportunity.

I will briefly touch on some of the things that we will be consulting on. We have a list of 25 things that we think are important. But the key ones will be best execution policies. What do you require of a broker to look for the best prices between markets? There is trade reporting. What do you have to tell the market? How open do you have to be about your pre-trade reporting? When and how do you tell the market about your post-trade reporting? In the US there is a consolidated tape so that all markets are required to disclose all their trades on a consolidated tape so everyone can see what is going through on a post-trade basis anyway. In Europe, they adopted a model three years ago—that soon ago—which said that you will rely on the information vendors. So the markets will sell the information to the vendors and the vendors have an interest in collecting it. Now, one is compulsory and one relies on the market. Which one is better? We need to talk with people. There is also a differentiation on best execution between those. I will not go into that.

There is the issue of how you deal with the crossings market, which is these sophisticated markets system that the investment banks run now. They are so-called dark pools. At the moment, they are all required to report through to the ASX at some point their crossings. How does that work where there are a number of markets you can report to? Then there is the question of supervision.

I guess the other question one does have to talk to is the fees for the supervision and where those fees are levied. Are they levied at the exchange level? Are they levied at the market participant level? Ultimately, the investor wears it somewhere. What is a fair divvying up of those fees is a matter for discussion in the market.

Senator BOYCE—Could you give us on notice the list of 25, just from interest?

Ms Gibson—I could. I could write that and get that done for you, yes. It is some 25. It is in an order of priority. It is those six that are the main ones, yes, certainly. And there is the change process that obviously is going to have to be managed for everyone as you move to quite a different market.

CHAIR—Obviously there is a lot on the agenda and it is a massive undertaking and a big change. I am very interested in that critical changeover period from the ASX with those responsibilities going across to ASIC. I know you have already touched on it. Just give us a better idea in terms of that changeover process, the redundancy that is in place and the overlap. What period will that be managed over so we have a sense of the overlap period? What is the time and process and what are your expectations over that period?

Ms Gibson—In some respect, the overlap period has started now in that the ASX has a SMARTS system that is operating and monitoring the market. They are still sending referrals to us, as they always have. We talk with them about what you can cite on SMARTS. It is public that we have appointed SMARTS to build our system. That build is underway. We are looking to trial and set up our alerts, which is the baseline. So there is a lot of dialogue going on about the transition. The people who have agreed to come to us when the changeover happens are in close dialogue with us. They have started doing some training with us. The ASX has been very

amenable to that. We are talking with the ASX about how we continue to provide some resources for them to continue, in particular, to run off their cases that they will have that are incomplete. There is also a dialogue about how the two of us are going to surveil—it is an awful word—the brokers, which is how we will talk to them and review them. There is a possibility and a concern in the market that there will be a lot of duplication. We do not want to generate more work by virtue of this.

CHAIR—Is there a particular redundancy system that you have in place? I have a lot of confidence in a very smooth and seamless transition. I think there is plenty of overlap and overlay and time to get all this done. But with any transition there is always the potential for some risk. Are there any particular redundancy strategies you have in place?

Ms Gibson—If our system does not switch on on the due date—and there is plenty of lapse time there—we have a back-up system in place. We are talking about another one. So in terms of people, I do not think you need redundancy because the ASX people are there and will come to us when it happens.

CHAIR—Is it fair to say also that even though there is a transition, a start date and a period, the reality is the ASX will continue really to do what it is doing today? There is a fair overlap in that supervision, even though you will have the legislative carriage.

Ms Gibson—I think there would be an ongoing dialogue. They will keep their SMARTS system because they still have responsibility for monitoring continuous disclosure. They are still the listing authority, as it were. Their system will also be switched on. The people have worked together forever. I do not imagine that there is going to be a situation because market integrity is fundamental to their business too.

CHAIR—Certainly.

Ms Gibson—It is not going to be a situation where they say, 'Well, that's your problem and don't bother me', I imagine.

Mr D'Aloisio—There are three components. There is the ASX, there is ourselves and there is the market itself. Clearly, we are conscious of the fact that this needs to be done in a staged way. We would hope that ultimately the switch-off by the ASX, if you like, and us is just done seamlessly—the market does not really realise that one has moved over to the other. That is the objective. When you talk about market surveillance, of course, the alert system is one aspect. There is the actual work that the people do in following the market and making the calls, as Belinda is saying, which is probably just as critical, if not more critical. So we would not expect that you would have a situation if what you have in mind is that surveillance comes across and then there is some sort of major drama and there is no surveillance. It just is not possible.

CHAIR—We also take note that there is a transfer of people who are currently performing those roles. Quite number of them in the ASX are coming across to ASIC. We can assume that. There is the transfer of skills and experience, and any other necessary strategies and so forth are all in place now.

Ms Gibson—And a transfer of arrangements that the market has so that brokers have understandings about what happens in certain circumstances. They are embodied in guidance notes. We have indicated that we would expect to apply the same construction to the rules that we have picked up as the ASX has. With time, we might change that, but that would be a matter of separate consultation. We are not rewriting the book for day one; that is the plan.

CHAIR—Have there been any concerns raised by the ASX in terms of the transition period itself, not in the overall context of the change but just the transition period? Are there any issues that you are working with the ASX to resolve?

Ms Gibson—There is certainly an ongoing dialogue with them about some of the details.

Mr D'Aloisio—There is no issue. The ASX has been supportive of the changes. It has said that on a number of occasions. We are working well to change the systems over. The protocols around making the offers of employment were agreed and so on. So below Belinda, I guess, at the commission level there are two taskforces—one in our place and one in the ASX—that are working together. I think it is worth going back to the issues of the market itself and the brokers and market participants. One of the key things in this will be, from their point of view, particularly around June and July, that they understand what the change involves when they go to the ASX and when they come to us and what practically they need to do to ensure that they understand the changes that have occurred. I think the roadshows and the work that we will do there will take away any of the concerns they may have that this might be moving too fast for them.

CHAIR—I appreciate and understand that you are using the same system, so there is certainly no question about, I think, that seamless transition. It will be exactly the same system. At what point is that system contracted? I will rephrase that. I understand it is a third party technology platform that is currently used by the ASX. You are going to be using the same platform. At what point will you either review that technology or assess whether that technology is still the most appropriate technology on the market?

Ms Gibson—We have been public about the contract. It is a two-year contract with some options for renewal. I should say that this is the technology that is used by many, if not all, of the brokers for their own internal compliance. The provider is well aware of the Australian system. We have built into our contract some capacity for supervision in a competitive market, but with competition it will be important at the end of the term to reconsider what is the right technology. The world is moving on in technology. I think that provider is one of the major providers in the world now. Whether it is in three years is something to examine, I suppose.

Mr D'Aloisio—I think like all other technology, you refresh things that you do, and you do in most industries. The process of review really is ongoing. That work has already commenced, if you like, even though the contract is yet to start. You have always got to be ahead of what is happening and review your systems. As Belinda says, we subjected this to a competitive tender process. On fairly exhaustive criteria, it came out as the preferred party. We will continue to work with them and develop and develop what is needed for the competitive market when that eventuates.

CHAIR—Sticking with the technology issue, are there any integration matters in terms of further competition and other entrants into the market, like Chi-X, for example?

Ms Gibson—The system that we have designed would enable the supervision of a number of markets. We know that they will feed off the same system that also feeds through a number of the other information sources.

CHAIR—So does everyone use the same platform? There is the issue of the platform they use for their own internal compliance. There is also the issue of how they will interact with the market in terms of either settlements and clearances and so on.

Ms Gibson—Their clearing will need to go through. At this stage there is just the one market for clearing and settlement. For the trading, I am reluctant to mention trade names, I suppose, in some respects. All of them connect and provide information through IRIS and Bloomberg. The SMARTS system sits over the top of all of that network. All of them will be capable of being monitored, as it were, by that technology that sits over the top.

Senator BOYCE—Where are the new rules that you are developing at at the moment? They have been out for consultation, and what now?

Ms Gibson—We finished our consultation and we are writing up, as it were. We are not planning significant issues and changes from what has been there. There will be a number of refinements. The rules are made pursuant to regulations. The regulations are due shortly for public consultation. Timing wise, when we release the rules publicly is a matter for some discussion in conjunction with Treasury on the rules. But we would certainly expect them to be available, if 1 July were to be the start date, by the end of May. The ASX's rules are under consultation. Again, I am not sure if they are final dates, but I would have thought by the end of May also.

Senator BOYCE—Do the rules allow for competition?

Ms Gibson—No.

Mr D'Aloisio—No. What the first stage—

Senator BOYCE—They are looking at for now?

Ms Gibson—These are rules that apply to trading just on the ASX. There is a separate set of rules for trading on the NSX and the BSX and the—

Senator BOYCE—But the SFE is covered by—

Ms Gibson—We have a separate set of rules for the SFE.

Senator BOYCE—You have?

Ms Gibson—So these will be separate rules for each of those markets only.

Mr D'Aloisio—In simple terms, the ASX had a bunch of rules that covered market integrity, conduct and operating rules and systems and the relationship with brokers. What in actual fact you are doing is carving out the ASX's rules—the integrity rules. That is the first stage. Then subsequently you will look at the competition rules over and above that, which ASX do not have because we were not in a competitive market.

Senator BOYCE—Well, because there is not any, yes.

Ms Gibson—There is another stage which we foreshadowed in our consultation paper, which would be consolidating the rules for all of the equity market so that the same rules apply for APX and so on as for the ASX. Whether we could do that in conjunction with competition without confusing things too much we just need to look at. I imagine the ASX ones would be the dominant ones in that competitive world, but we will just have to decide how much change is suitable in the market, which is partly a measure of who is trading on those other markets.

Senator BOYCE—Thank you.

Mr HARTSUYKER—In relation to overseas operators—Chi-X or whatever—where the rules are in a foreign jurisdiction and where a potential competitor in our market may be based, that overseas jurisdiction may changes its rules. Are there any formal procedures in place to anticipate that a foreign jurisdiction may change its rules under which one of these competitors is now working in our markets?

Ms Gibson—They will have to have rules for our market. Those rules are approved or disallowed by the minister on our recommendation. So the current framework is that they will have their own rules for this market. They will not be the same ones as overseas. So it is not a matter of just picking up overseas rules.

Mr D'Aloisio—In each of the markets that they operate, there will be rules that will govern the trading on those markets, as there will be in Australia. So if the UK changes its rules, it is not relevant. What matters is the rules that operate in our market at any particular time, which are under the direct control of ultimately the minister.

Senator BOYCE—I am not quite sure how you might address this question. There is the possibility of black holes developing between the ASX and yourself during this changeover. Where are those areas and what have you done about them?

Mr D'Aloisio—I do not think there will be. These are not markets that are unknown. They have been in operation for a long time. The way that the ASX has supervised them—

Senator BOYCE—I am thinking more in terms of where you have interlocking or complementary responsibilities. There might end up being areas where no-one is truly responsible.

Mr D'Aloisio—I do not see a risk of that. The markets and the way they trade and the way they have been operating and the rules have been there for a long time. What you are doing is taking a bunch of those rules and passing them from the ASX to ASIC in a process where the people who will continue to administer those rules are the people who were administering in

large part before. The experience that was being brought to bear in the way the surveillance in the market worked both at ASX and ASIC has remained the same. So the first stage of the process, the changeover from ASX to ASIC, should not involve a 'black hole' or a gap that has not been foreseen.

The more difficult issues, as Belinda has said, will be in the area of competition. On that, as she has outlined, we are very mindful of the market understanding what is happening with the rules, the changes and the experience overseas. Once the transition from ASX to ASIC in this first phase has settled in, and the minister has said it is after the arrangements have settled in, we would move to the difficult issues of competition. Again, we are very cognisant of the fact that if indeed there are issues that brokers or the market are concerned about—speed or some of the issues—clearly, we will be alive to them. The overriding issue here has to be, and indeed has been, as I spoke earlier, fair and efficient markets and the integrity of the markets. They are what really matter to Australia. Our job is to get this transition in place with no negative impact on market integrity.

Mr HARTSUYKER—I want to revisit my earlier question. Chi-X or a foreign operator is granted a licence to operate on the basis that the supervisory regime is comparable with Australia's. My question really is: should that supervisory regime in that foreign country change? What is the impact or what procedures have you got in place?

Mr D'Aloisio—I will use an example. At the moment, if you are an investor, you go to a broker. You want to place an order to buy a particular stock. That broker at the moment takes your order and puts it through to the ASX, trades, clears and settles it for you. In a competitive environment, you go to your broker and you say you want to buy a particular stock. The broker says, 'Well, I'll go to the ASX market or I'll go to the Chi-X market. I might put the order on one or the other or both.' Again, the trade will occur. It will be settled and you will get your stock. But what has happened is in between, instead of having the option of one market, there are two markets. Because there are two markets, price discovery is critical. We say we need rules around best execution and proper reporting. So those rules regulate the ASX and Chi-X markets, if you like. They are Australian rules. They are about our market. If Chi-X or another market operator is operating in the UK, similarly, it is operating in a system where the London stock exchange may trade through that or trade through Chi-X. Say I am the client. Let us assume that the UK changes its rules on best execution to something else. That is what will govern that market.

Mr HARTSUYKER—Yes. It will not hit here.

Mr D'Aloisio—That will have no impact back in Australia. But what you are seeing globally, though, is that the regulators and the operators of these markets are talking all the time. So you are seeing models, as Belinda mentioned earlier, developing about best execution and how you would approach it. So indirectly when those changes occur in those markets, we would obviously look at them and see if indeed our rules should be changed. But until those rules are changed, we would continue with that, notwithstanding that someone else may have changed its rules. But as the markets become more and more global and trading and technology allows messaging speed in trade, clearly, you will see and are seeing trading venues moving with similar rules in similar directions. But that is just a function of the global markets. It is not anything we are doing.

Ms Gibson—There is another sort of foreign entity that has an exemption from a licence where they essentially do operate what they have overseas here. But we provide an exemption for a very small market that is targeted at the professional wholesale market. Essentially, they are no more than a computer terminal here. We issued a release about two weeks ago on that. That is where you provide an exemption because of a comparable market. But there is no way that the competition for the ASX is in that zone of an exemption. It is much lesser markets, so a different regime.

CHAIR—There is currently no unique client identifier within the market. Obviously that poses some issues in terms of identifying who is acting on whose behalf and who the clients actually are, particularly in terms of insider trading and so forth. Does ASIC have any view in terms of having unique client identifiers?

Ms Gibson—In my dream world—I would not say my fantasy—

CHAIR—I will take that as a yes.

Ms Gibson—That is a very important thing.

Mr HARTSUYKER—Speaking on a personal level.

CHAIR—Yes. Absolutely, sure.

Ms Gibson—We went to the US, Canada and Europe to look at where we are in supervision and competition. The thing that has most vexed the mind of those regulators overseas is what they call a clear auditable audit trail. The best solution to that is the same client identifier in every market. Technology wise, that is doable.

Senator BOYCE—Are you talking about a global identifier?

Ms Gibson—That would be even better.

Senator BOYCE—That does sound like a fantasy, Ms Gibson.

Ms Gibson—Goldman Sachs, wherever it trades anywhere in the world, will have that identifier number. In the US, what they have found really is not having that number even when, say, Goldman Sachs is on the New York Stock Exchange and when it is on NASDAQ and the competing markets is something that is a hamper. It is interesting that the SEC put out a paper very recently which requires the large traders to lodge statements with the SEC of all their trades when they reach a stipulated barrier. The barrier does not strike me as very high. So to get over the fact that they cannot see through to all of the different clients, they are making those big clients tell them about everything.

Senator BOYCE—Does that mean a daily report or a weekly report?

Ms Gibson—I think it is still in consultation. I cannot remember the details, to be honest.

Senator BOYCE—It is the time lag in having to ask the broker who the client was that is one of the issues, is it not? It is one of them.

Ms Gibson—Yes. It is what we have now, because we only have the broker ID. Then you have to ask for the computer thing. Dare I hark back to Project Mint. One of the things we did is work with all the brokers so that now when we say, 'Tell us who your clients were when you traded in that period', we have a system—

CHAIR—Do they respond positively to all your requests?

Senator BOYCE—You have a system now for that?

Ms Gibson—Positively and electronically, so it is searchable and efficient. They all want to cooperate. So that works well. In the US, it is a system called blue sheeting and they trail it back. Now it is all that much harder, where the broker takes the order from the investment manager. The investment manager is placing an order for a custodian. There are three or four behind there until you get to the end client, so it takes a long time to build it.

CHAIR—Are there technology issues in terms of creating it? Let us make it simple, for argument's sake, just within Australian markets.

Mr D'Aloisio—I think you have a tall order of cost-benefit analysis in the sort of change and what the benefit is you are trying to achieve. Clearly, information is good, but why do you need it? What is the problem with the system at the moment that you are not able to get that information for your surveillance and so on? I think as Belinda has said, the wish is different to the reality. I think there would have to be quite extensive discussion with the market to identify the concerns before you would embark on something like that at a time when we are making a lot of changes to this market. We want to continue to operate efficiently.

Ms Gibson—Technology, in particular, would be at the broker level with their clients.

CHAIR—I know the committee has agreed that we could have a photographer, but I have not asked Mr D'Aloisio or Mr Medcraft.

Mr D'Aloisio—Where is the photographer from?

CHAIR—The photographer is from the *Financial Review*.

Mr D'Aloisio—Can we caucus?

CHAIR—I will take that as an agreement.

Mr D'Aloisio—That is fine. Absolutely. No problem at all.

CHAIR—It is not a technology issue. You are saying it is a cost-benefit analysis. I am just making a very rough assessment that having a unique identification number per client would not be some technical challenge. Upon registration, you would just have that one unique number and

that is it. The information it would provide, which currently does not exist and you really cannot tell, is who is in the market.

Ms Gibson—I think the technology capacity is more substantial than that because people have been trading in those markets for a long time with certain identifier numbers. Those numbers trigger back so that—

CHAIR—It would not be much different, though, from the registration of credit providers, where it is, as you have described it, a very simple, easy registration process. I could not imagine it was more difficult.

Senator BOYCE—Do you have a knowledge of how many clients there currently are in the share market in a year?

Mr D'Aloisio—I think rather than try to guess this—I understand where you are coming from; it is a very, very significant issue—I am happy to take it on. We can pick it up in June.

CHAIR—Yes. That would be great.

Mr D'Aloisio—We can give you more information about the market rather than try to guess. It is an opportunity for us to also talk to AFMA and the Stockbrokers Association to see what their views are on these sorts of issues. It would be a very, very significant issue.

CHAIR—Are there any other jurisdictions that you know of that currently have unique client identifiers?

Senator BOYCE—But you are saying that they are thinking about it?

Ms Gibson—They would all like it. I think the Canadian system is certainly moving towards that, if it is not there. They are doing it in conjunction with the SMARTS system that they have there.

CHAIR—You have undertaken to come back and give us some more fuller information.

Ms Gibson—Will do.

CHAIR—We are certainly interested in where that might lead, so that would be good.

Mr D'Aloisio—Okay.

CHAIR—Unless there is anything in particular you want to add to it, I do not want to cut you off either.

Senator BOYCE—You cannot imagine it being more difficult than bank customer numbers, for instance, can you, or ABNs?

Ms Gibson—I think the problem when I was with the Canadians and the Americans was not so much assuming you cannot start a whole new registration and identification system but the conversion capacity.

Senator BOYCE—Thank you.

CHAIR—Have you purchased the new SMARTS system? It has been purchased?

Mr D'Aloisio—Yes.

CHAIR—Is it being installed as we speak, or is it installed?

Ms Gibson—It is being installed.

CHAIR—It is being installed. I know technology always goes perfectly well. Will there be a testing period?

Mr D'Aloisio—Yes.

CHAIR—There is no risk there?

Mr D'Aloisio—We have done a risk assessment and so on. ASIC has had extensive experience in changeover programs on technology and so on, so all that will be used.

CHAIR—Are there any general questions? I think we have dealt with all the issues that we certainly had themed and programmed to speak to you about. I am not sure if there is anything that ASIC want to add in relation to anything we have discussed—

Senator BOYCE—On a point of clarification, Ms Gibson, you said that as a result of Project Mint you had set up some sort of a communication or disclosure system with brokers around clients. Can you explain that a bit better?

Ms Gibson—It is more protocols. In the past, I do not think ASIC previously had inquired as to who was particularly trading. That was mainly the ASX. We would work with the ASX and the ASX would ask for the client records. With Mint, we ourselves went direct to the brokers and said, 'Can we have the records?'

Senator BOYCE—And that was in terms of suspicious activities?

Ms Gibson—Yes. Part of our notice process was to say, 'Well, we need to see who the clients were.' So there is just a manner of delivery that is efficient. There is another manner which sends hardcopy paper delivered, but that is not effective for anyone.

Senator BOYCE—Well, as we understood it, ASX writes to brokers and asks for client information, which seems an interesting way of going about it. But please go on, Ms Gibson.

Ms Gibson—We started with that and spoke to them and said, 'Look, it's harder for you to print everything else out and deliver it. Why don't you deliver it electronically?' That by and large now happens, I gather. It is just more efficient for everyone to do it. The notices are valid to do it. Then you can scan them much more efficiently.

Mr HARTSUYKER—I have a totally different subject, if I can wander.

CHAIR—I would prefer not to wander too far, but if it is specifically in relation to something, try to avoid the wandering. Please ask your question.

Mr HARTSUYKER—On the FIDO website in relation to super fees, there is a disclaimer on the site that says they do not represent all of the additional fees and costs being incurred by a particular fund. Some of them go to that FIDO website.

Mr D'Aloisio—Is this on the calculator?

Mr HARTSUYKER—Yes.

Mr D'Aloisio—And the assumptions around the calculator?

Mr HARTSUYKER—Yes. Really, the question is: what are these fees and costs that are not disclosed? If so, why not? What is the rationale of all of that? How effective is it if you have a range of costs that are not disclosed?

Mr D'Aloisio—I will take that on notice. I suspect that the disclaimer or the comment is really to say that the calculators are there to give you a guide and that we do not necessarily have all of the fees that could apply but this gives you a way of testing and looking at things. But I am happy to take that on notice and give you a more specific answer.

Senator BOYCE—Because it is a generic calculator.

Mr D'Aloisio—It is a generic calculator. I suspect it is to protect to say that you cannot get everything. But it should not be inferred from that that there are secret fees that we do not know about or anything of that nature. But I am happy to take it on and have a look at it for you.

Mr HARTSUYKER—When you have looked at that, I would be really interested in any comments on the quantum—perhaps take a couple of examples—of the different fees disclosed and undisclosed.

Mr D'Aloisio—I should mention, as you have given us the opportunity to mention the FIDO website, that it enjoys a tremendous number of hits. It was featured on the *Neighbours* program on television the other night. So there you go. Our people are very pleased.

Senator BOYCE—My daughter would have seen that.

CHAIR—In that case, I thank the commissioners and chairman and everyone from ASIC. Thank you very much. I also thank Hansard and the committee members and the public. That concludes today's hearings. Thank you very much.

Committee adjourned at 4.12 pm