Chapter 15

Early intervention

15.1 In June 2012, ASIC's chairman stated that ASIC 'was very focused on proactive surveillance, by working with the media to call things early, to try and warn consumers and to actually engage with product manufacturers early and say, 'Is this really the right product you want to be selling to the market?". According to Mr Medcraft, ASIC is 'trying to be proactive not just being, if you want, the ambulance that arrives at the scene of the accident when it occurs'.[1]

15.2 Many witnesses to the inquiry were of the view, however, that ASIC does not deal with all the complaints it receives adequately; rather they argued ASIC ignores grassroots warnings of impending collapses and crisis.[2] The committee has already cited two cases as particular examples of where, without any effective form of early intervention, an emerging problem was allowed to develop causing harm to many retail consumers and investors. In this chapter, the committee's primary focus is on the way in which ASIC receives and investigates complaints and reports of corporate wrongdoing.

Managing complaints and receiving reports of corporate wrongdoing

15.3 As evident in this report so far, a regulator's failure to respond effectively to an emerging problem can result in significant losses incurred by consumers and investors. For example, the committee looked at the poor lending practices that were allowed to continue long after they became evident. Indeed, over a period of eight or so years the accumulation of many individual acts of irresponsible or predatory lending caused great harm to many people. According to the Banking and Finance Consumers Support Association (BFCSA), 'almost all of the consumers affected who are BFCSA members, could have avoided serious loss, had ASIC delivered detailed warnings and simultaneously took criminal action against the promoters'. It stated further that 'in particular ASIC ought to have immediately banned unsafe products'.[3]

15.4 With regard to the CFPL matter, Mr Frazer McLennan could not understand why ASIC's processes took so long. He stated:

> The length of time it took for ASIC to get Commonwealth Financial Planning to a point where it had to admit to wrongdoings was far too long.[4]

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1 Mr Greg Medcraft, Chairman, ASIC, *Parliamentary Joint Committee on Corporations and Financial Services Hansard*, Statutory Oversight of the Australian Securities and Investments Commission, 22 June 2012, p. 13.

2 *Submission*s *130, 132, 136, 140, 141, 156* and *160*.

3 Banking and Finance Consumers Support Association, *Submission 156*, p. 8.

4 Mr Frazer McLennan, *Submission 127*, p. 1.

15.5 ASIC's slow response meant that many investors suffered significant financial loss as well as emotional distress.

15.6 Unfortunately these two case studies are not isolated. It is important to place the committee's current inquiry in a broader context that takes account of recent corporate failures and subsequent inquiries, which importantly exposed familiar problems. This inquiry is only the latest to demonstrate, and further highlight, areas where ASIC needs to improve. To convey some sense of the problems associated with ASIC's slow response to warning signs, the committee briefly touches on the findings from two recent inquiries.

Liquidators inquiry

15.7 A dominant theme in the committee's 2009 report on liquidators was ASIC's unresponsiveness to the complaints it received about the conduct of some liquidators or administrators. Many submissions noted that their complaint to ASIC about the behaviour of an insolvency practitioner was either put aside, answered months later, or simply recorded on a database with no subsequent action taking place. The committee cited account after account of individuals writing to ASIC just to have, in their view, their concerns brushed away. The lack of regulatory response to the many and persistent complaints about Mr Stuart Ariff was most damning.

Storm Financial

15.8 The 2009 inquiry that examined the collapse of Storm Financial also highlighted ASIC's failure to act early to prevent further losses. Evidence before the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) highlighted the general understanding that ASIC's response was inadequate. During that inquiry, CPA Australia suggested that ASIC's approach to acting on complaints had been too reactive, possibly due to resource constraints:

> They really need to toughen up on the proactive, doing things earlier, and if that means more resources…then that is where the energies should be, because at the moment…they seem to come in either after the fact or when they go in early we do not see anything actually happen that changes the course of events that subsequently follows.[5]

15.9 A number of submitters to that inquiry suggested that a ready, willing and able regulator was needed to take the necessary steps to ensure that all the participants in the industry comply with the laws. Some of the observations included:

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5 Mr Paul Drum, CPA Australia, *Parliamentary Joint Committee on Corporations and Financial Services Hansard*, Inquiry into Financial Products and Services in Australia, 26 August 2009, p. 68.

- ASIC should strive for a primarily preventive function, through greater monitoring, supervision and enforcement of obligations imposed on AFS licensees and other entities falling within its jurisdiction;[6] and
- ASIC needs to be able to 'respond pre-emptively'.[7]

Evidence before this committee

15.10 The criticism about ASIC's slow response and its failure to join up the dots is also a recurring theme in submissions to this new inquiry. The submitters who commented on ASIC's tardiness in responding to reports of possible breaches of the law included retail investors, registered ASIC agents, licensed financial planners and liquidators.

15.11 One submitter was of the view that over many decades, ASIC's inaction has seen significant, consistent and ongoing consumer and investor losses through failed entities such as Fin Corp, Westpoint, Rothwells, Tricontinental, Opus Prime, Lift Capital, Bond Corp, HIH, Ansett, One.Tel, Quintex, Basis Capital, Great Southern, Timbercorp, Babcock & Brown and Trio Capital. He was of the view that, had ASIC analysed and understood the real causes of the historical failures of such entities, it could have either attempted to prevent the losses or have at least reduced the quantum of losses to consumers. In his opinion, ASIC could have done so by 'implementing or regulating a system that more readily identifies companies that have a much higher level of risk, having potential "red flag" issue/s and or, failure altogether'.[8]

15.12 As a specific concern, the Institute of Chartered Accountants similarly identified the amount of time that it takes ASIC to act and respond to a complaint or information. It stated that while there was no doubt that ASIC must be thorough in its investigations, questions have been raised about 'why it can sometimes take a number of years to respond to allegations made in the public arena'. The Institute contended that:

> In certain cases, a quick and timely response can have the effect of limiting the adverse consequences of any actual market misconduct that relates to the allegations. A timely and effective process of working through such allegations can also send the right signal to others who may have access to information that would be helpful to ASIC achieving the right regulatory outcomes.[9]

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6 Q Invest, *Submission 374* to the PJCCFS's Inquiry into Financial Products and Services in Australia, p. ii.

7 Mr John Brogden, Investment and Financial Services Association, *PJCCFS Hansard*, Inquiry into Financial Products and Services in Australia, 28 August 2009, p. 50.

8 Mr Bruce Keenan, *Submission 197*, p. 5.

9 Institute of Chartered Accountants Australia, *Submission 203*, p. 4.

15.13 The Australian Shareholders' Association was concerned about ASIC's complaints management policies and practices, which to the interested or affected party, appear to be reactive and not alert to potential problems. It gained the impression that overseas regulators were able to act more quickly to assess a situation, take action and reach a conclusion compared to Australia where it seemed litigation, or the threat of such, delayed these steps. In its view, actions such as 'withdrawing a product or suspending/banning an individual take too long'.[10] The Consumer Credit Legal Centre (NSW) likewise expressed concerns about the 'very long time' for ASIC to act on a complaint.[11] It noted:

> Even where consumer advocates are pleased with the ultimate outcome, the void that exists between complaint(s) and outcome is disconcerting at best and downright infuriating where consumer harm is accumulating and industry practice becoming entrenched.[12]

15.14 Mr Brody, Consumer Action Law Centre, also maintained that the time taken between raising an issue and a result was an area of consistent frustration. As an example of delay, the Consumer Action Law Centre cited the very large number of serious complaints about the debt collection firm ACM that it had referred to ASIC from 2008 requesting it to intervene.[13] The Law Centre explained that it continued to refer complaints to ASIC and, 'growing increasingly frustrated with the lack of response we took the unusual step of criticising ASIC in a 2010 media release'.[14] It noted further that ultimately ASIC commenced proceedings against ACM in May 2011 and secured 'an excellent outcome' in the Federal Court in October 2012. The Law Centre observed, however,

> …a great deal of consumer detriment may have been avoided had ASIC responded more quickly—it is notable that the 2011 proceedings concerned conduct by November 2008 and June 2010, and that the court outcome was not achieved until 2012, some four years after the issue was initially identified.[15]

15.15 Indeed, the Commonwealth Ombudsman noted that one of the most frequent complaints about ASIC lodged with his office was that the regulator had not investigated and/or taken enforcement action in relation to a report of misconduct or breach of legislation. He explained:

> Complainants typically state they have reported to ASIC what they believe to be a significant act of misconduct or breach of legislation by a director, other company official or a company itself. Following receipt of a letter

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10 Australian Shareholders' Association, *Submission 151*, p. 2.

11 See also *Submission*s *99*, *100*, *240* and *279*.

12 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 21.

13 Consumer Action Law Centre, *Submission 120*, p. 7.

14 Consumer Action Law Centre, *Submission 120*, pp. 5–6.

15 Consumer Action Law Centre, *Submission 120*, pp. 5–6.

> from ASIC responding to the complainant's report of misconduct and advising that it will not investigate, the complainant contacts the Ombudsman because they consider ASIC is not meeting its responsibility as a regulator.[16]

15.16 A number of individuals made similar complaints to the committee about ASIC not pursuing reports of serious breaches.[17] In their view, signs were present that clearly warranted ASIC's attention but simply did not register with the regulator. Submitters cited early indications of a company in trouble or company directors engaging in misconduct that went unnoticed. These examples included companies failing to lodge required returns or producing accounts; alterations to a company's registration without a director's knowledge; company name changes and turnover in board members; a history of associated entities in receivership and the issue of a stop order; and non-payment of employee superannuation entitlements.[18]

Individual experiences

15.17 Some of the evidence before the committee recounted experiences that have been raised during other parliamentary inquiries. For example, it appeared to Mr Lindsay Johnston, who reported on the activities of Mr Stuart Ariff, that:

> …law enforcement agencies and regulators perform no investigation beyond the substance of the initial complaint. In respect of my complaints if the ASC [ASIC's predecessor] had acted and made requests for documentation it would have received at an early stage the documentation that was ultimately brought before the Court. Had the ASC and ASIC performed as a regulator as expected by the community, it is highly likely that by 1999 there would have been some disciplinary action taken against Stuart Ariff and a near certainty that sufficient evidence would have existed to ensure he was never to be admitted to practice as an insolvency practitioner.[19]

15.18 Ms Anne Lampe also questioned ASIC's management of complaints. While working at ASIC's media unit, she became aware that ASIC received frequent complaints about 'dodgy and suspect investment schemes as well as lost investments in failed companies'. Ms Lompe found that the complaints were 'dutifully logged and filed'; their recording was methodical; and records well kept. Her concern was that action stalled with the recording and filing of the reports and that 'too many complaints remained buried in the archives'. She explained further:

> It was only when the volume of complaints and losses about a particular scam reached tsunami level, or investors with losses contacted a member of

16 Commonwealth Ombudsman, *Submission 188*, p. 6.

17 See for example, Mr Ben Burgess, *Submission 190* and Institute of Chartered Accountants Australia, *Submission 203*.

18 *Submissions 40, 42, 99, 223, 239, 240, 246, 260, 279, 324, 326, 330* and *376*.

19 Mr Lindsay Johnston, *Submission 130*, p. 2.

> parliament, or triggered a media inquiry that ASIC seemed to spring into action.[20]

15.19 She recalled writing articles after Storm's collapse when she learnt first-hand from other financial advisers about the lead-up to the failure. According to Ms Lampe the advisers had known what was happening at Storm and had:

> …contacted ASIC well before its demise warning that Storm was over-leveraging elderly clients and had put them in a one-product-suits-all model rather than taking into account investors' individual needs to draw up an appropriate financial plan. The advisors reported that investors were at great risk. One lot of intel came from an internal Storm source.[21]

15.20 In Ms Lampe's opinion, ASIC could have taken on board the warnings and whistleblower complaints and used its power to review client files—a random sample to see 'whether Storm advisors were drawing up appropriate individual financial plans to meet the needs of its clients'. She suggested:

> That would have shown whether each investment plan was different, or whether they were all stamped from the same template. Such an inquiry would have shown that there was a sameness and a high risk and alarmingly high borrowing component in each client file. In short it should take whistleblowers seriously, rather than shunning them as troublemakers with an axe to grind.[22]

15.21 One person in the financial services industry stated that he knew for a fact that:

> …many people in Queensland tried to warn ASIC about Storm but on all occasions these warnings were ignored. A far more pro-active approach by people who understood the true nature and risk of the Storm Financial methodology could, I believe, have saved an awful lot of time, money, anxiety for all concerned.[23]

15.22 But there were many other submitters who wrote about their experiences of ASIC's inaction that are completely removed from Storm, Mr Ariff, or CFPL. Furthermore, they are drawn from many sectors of Australia's corporate world. They recounted their own personal experiences of making a complaint or reporting a possible breach of the law, or cited cases where ASIC should have paid attention to early alarm bells. They raised concerns that ASIC ignores or fails to take corrective action on early or advanced warning signs of dubious practices. Dr Peter Brandson referred to distressed victims of banking malpractice 'being fobbed off'—getting the 'run around'. He stated:

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20 Ms Anne Lampe, *Submission 106*, p. 2.

21 Ms Anne Lampe, *Submission 106*, p. 3.

22 Ms Anne Lampe, *Submission 106*, pp. 3–4.

23 Mr Robert Bennetts, *Submission 393*, p. 2.

> The aim seems to be to let the dissatisfied victim—who has had little help in actually seeing justice done—let off some steam and then be left to pick up the pieces of their shattered life while ASIC neatly files the complaint.[24]

15.23 For example, some complained about ASIC's apparent indifference to indicators of misconduct by directors or companies in trouble, such as unpaid workers' entitlements or word of mouth intelligence about a company engaging in suspicious conduct.[25] One such witness stated that in his particular case, he believed the company was trading while insolvent:

> ASIC appear to have ignored complaints made by numerous injured individuals as well as the findings (however preliminary) of professionals such as the company's administrator and latterly its liquidator. This is despite mounting evidence in support of the original complaints made and despite the fact the evidence gathering and investigation of the companies' affairs has been the result of other parties unrelated to ASIC and submitted to them in good faith.[26]

15.24 In his view, the magnitude of losses could have been mitigated:

> …if ASIC had intervened with a more timely investigation and possibly issued an enforcement order requiring company officers to undertake action to protect the interests of the various stakeholders.[27]

15.25 Mr Peter Leech, another submitter, raised his concerns in the context of phoenix activity where four different individuals on four separate occasions complained about the same company. According to Mr Leech, his original complaint made very clear that 'if the Director as the Proprietor of the company cannot pay GST, PAYG and/or Superannuation obligations, then one could reasonably consider that the Director and the Company could not satisfy Part 1 of Sect 95A'. He stated further:

> Given past history, it is foreseeable that the alleged non-compliance will occur again. Numerous employees and creditors have been left without due entitlements. In each complaint and subsequent review after review—ASIC have 'chosen not to proceed' simply asking us, the complainants, to give them more evidence. Yet it is the Commission that has the legislative authority, resources and mandate to pursue such evidence and we, as individuals, are specifically precluded from such data. If ASIC won't investigate—who will?[28]

15.26 A submitter cited the case of Wellington Capital amending the constitution of the Premium Income Fund but, despite reports to ASIC, the regulator failed to take

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24 Dr Peter Brandson, *Submission 232*, p. 7.

25 See for example, *Submissions 40*, *94* and *132*.

26 *Submission 326* (Confidential).

27 *Submission 326* (Confidential).

28 Mr Peter Leech, *Submission 132*, p. 1.

action. According to the submitter the amendment was later overturned in the Federal Court but too late to reverse the consequences of the amendment.[29]

15.27 Another submitter lodged a detailed complaint with ASIC about a renewable energy company but, in his words, 'to no avail'. He noted that the company in question raised approximately $16 million through prospectuses but did not lodge its required returns for some time. According to the submitter, shareholders were 'certainly not kept informed'. Assets were transferred to a US entity and the submitter believes that the company was deregistered in November 2012. He also referred to a gold exploration listed company. In his view, ASIC chose to ignore the many warning signs in both cases, and 'could and should have done more to protect shareholders and question the discharge of management fiduciary responsibilities'.[30]

15.28 Mr Roger Cooper related similar experiences with ASIC's slow response to his concerns about a questionable company. He informed the committee that by the time he contacted ASIC for guidance:

> Micro Corp had become MCI Technologies Ltd who became Tomato Technologies Ltd who became Asian Pacific Ltd and they had drawn a lot of flak from disgruntled users and eventually in August 2012 they were suspended from the ASX.[31]

15.29 In Mr Cooper's words, with patience he tried 'every avenue possible to try and get some accountability happening'. At that time, Mr Cooper thought the ASX would be interested in the behaviour of Tomato Technologies, which was a listed company, and track its record with Consumer Protection Agencies. His letter to the ASX did not receive 'the dignity of a written reply but merely a wish[y] washy phone call'.[32]

15.30 Mr Cooper noted that, at an early stage in December 2000, the *Australian Financial Review* provided a revealing and scathing account of Tomato Technologies Ltd and its modus operandi. The article referred to 'the dubious pedigree and track record of its founder and Board members', which, according to Mr Cooper, raised 'serious questions about the company way back then'. He informed the committee that:

> Tomato Tech. remarkably expanded overseas into the UK, Canada and the USA. The UK Financial Services Authority and the UK Office of Fair Trading condemned the company. The BBC consumer TV program Watch Dog twice featured the company as a warning to consumers. How could all this be under the radar of ASIC?[33]

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29 Name withheld, *Submission 81*.

30 Mr Roger Cooper, *Submission 40*, p. 2.

31 Mr Roger Cooper, *Submission 94*, p. 2.

32 Mr Roger Cooper, *Submission 94*, p. 2.

33 Mr Roger Cooper, *Submission 94*, p. 4.

15.31 In his opinion, ASIC was aware of the fraudulent behaviour of the company he was dealing with and did nothing:

> If organisations like ASIC were actually businesses with competitors they would go broke. Micro Corporation/Tomato Tech. Ltd had no institutional investors and even from a layman's vantage point the company structure and behaviour was suspect but apparently under the auspice of ASIC. Corporate Watchdog indeed. They were totally indifferent, disinterested and offered no help to victims whatsoever.[34]

15.32 He wrote:

> The company name changes and the incredible turnover of board members would I thought, attract attention, but no. At what stage do alarm bells go off at ASIC?[35]

15.33 Yet another case involved LM Investment Management Limited (LMIM), the responsible entity (RE) for various registered and unregistered managed investment schemes, including the LM Managed Performance Fund (MPF). The Advisers' Committee for Investors (ACI) submitted that during the last quarter of 2012 ASIC investigated the MPF due to negative press and gave it a clean bill of health. In 2012, LMIM released MPF accounts, which had been audited in the previous June, showing an MPF asset value of $377 million with future developed value of MPF's largest asset at $1.5 billion for Maddison Estate. LMIM went into voluntary liquidation on 19 March 2013.[36]

15.34 The ACI advised that it became increasingly concerned about the sequence of events that 'failed to protect the interests of investors both on a domestic and international basis'. It questioned 'the structure, organization and fairness of Australia's regulatory system'.[37] The investors' group asked that if ASIC had concerns about LMIM in May/June 2012, why did it let it continue to accept millions of dollars from unsuspecting investors without either warning investors or placing conditions on LMIM? It also questioned why ASIC allowed LMIM to continue to accept investor funds when ASIC's enquiries into the RE in 2012 should have revealed that LMIM did not obtain any independent valuations for properties it was purchasing with investor funds. The ACI noted that the 'requirement for independent valuations for the purchase of large assets is a requirement of many major countries in the developed world'. In its view, ASIC's failure to identify this crucial mistake by LMIM 'to obtain independent valuations (not only at purchase but also during the life of that asset) indicates that there are serious questions to be asked of ASIC by this inquiry'.[38] According to the ACI:

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34 Mr Roger Cooper, *Submission 94*, p. 4.

35 Mr Roger Cooper, *Submission 94*, p. 4.

36 Advisers' Committee for Investors, *Submission 170*, p. 5.

37 Advisers' Committee for Investors, *Submission 170*, p. 1.

38 Advisers' Committee for Investors, *Submission 170*, p. 6.

> …the reports to creditors issued by the voluntary administrators of LMIM (as early as April 2013) provide details of unpaid and undocumented loans from LMIM to Drake and his related entities and possible breaches of duty and other offences under the *Corporations Act 2001* (Cth). These facts reported on by the voluntary administrators were clear grounds for an earlier intervention by the regulator.[39]

15.35 The ACI is concerned that by failing to act swiftly and decisively, ASIC has allowed further damage to occur to investors.[40] It argued that where breaches of the Corporations Act are identified, ASIC should 'act quickly to take steps to ensure those breaches are dealt with in a timely manner'. The ACI informed the committee that:

> There are approximately 10,000 LMIM investors, worldwide, and 4,500 in the MPF alone including home based and expatriate Australians. These investors, some of whom will have no ability to recover from such a devastating loss, stand to lose a significant part if not all of their investment in the funds of this Australian company which is now in liquidation. Many of these investors will lose their life savings.
>
> Although the ACI approached ASIC some months ago urging quick action, ASIC only took formal steps in the Federal Court to freeze the assets of the main director Mr Drake in September 2013 some 6 months after the company was placed into voluntary administration. Given that assets such as cash may be transferred quickly, why did the regulator in such a large corporate failure (one of the largest in Australia after the HIH collapse) fail to act immediately to obtain freezing orders of LMIM, Mr Drake and other related entities to ensure the status quo at that time was maintained and value preserved for investors?[41]

15.36 According to the ACI, ASIC's failure to take substantial, early steps to deal decisively with the causes and results of this corporate collapse contrast starkly with the quick action and early prosecutions after the Bernie Madoff scandal broke in the United States.[42]

15.37 Another group of concerned investors, the Association of ARP Unitholders Inc, reminded the committee that:

> It was the actions of an alert Industry participant who forced ASIC to take action in the Trio matter, yet any number of opportunities existed starting with the licensing of executives of Trio through to the failure to follow up serious valuation questions in conjunction with APRA.[43]

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39 Advisers' Committee for Investors, *Submission 170*, p. 6.

40 Advisers' Committee for Investors, *Submission 170*, p. 6.

41 Advisers' Committee for Investors, *Submission 170*, p. 7.

42 Advisers' Committee for Investors, *Submission 170*, p. 7.

43 Association of ARP Unitholders Inc, *Submission 173*, p. 1.

15.38 The committee received many other complaints that are too numerous to detail here about ASIC's supposedly inadequate response to complaints or reports of corporate misconduct. Some additional cases include a report from a compliance officer and internal auditor about an accounting practice providing a 'one shop' service including finance, taxation and financial planning advice. According to the submitter, ASIC took no action which has resulted in mounting client investor losses to a level of $10 million to $15 million.[44] The committee also received a confidential submission dealing with an agricultural managed investment scheme and the alleged misuse of funds. In this case, the liquidator reported the misuse of funds raised for the scheme to ASIC, alleging that funds had been used to 'prop up' previous projects operated by the responsible entity, which had significant cash flow problems. The submitter informed the committee that they had never been contacted by anyone at ASIC in relation to his complaint, 'apart from a boilerplate response, nor have I heard about any action against the directors of the company'.[45]

Reports from industry professionals

15.39 Importantly, some of the people making reports or expressing concerns to ASIC come from people within the industry, such as registered ASIC agents and financial planners.

15.40 Mr David Pemberton, a CPA who holds a public practicing certificate and whose firm is a registered ASIC agent, wrote to ASIC on 5 June 2009 on his company letterhead. He drew to ASIC's attention his misgivings about the activities of a person with a history of failed enterprises who, in his view, should be investigated for insolvent trading under the Corporations Act. Mr Pemberton informed the committee that:

> ASIC's bland & generic response of 6 July 2009 was the second and last contact I received from ASIC in this matter.[46]

15.41 He believed that any complaint from a professional should have caused ASIC to investigate. He explained:

> This complaint was very deliberately made to ASIC at its highest level because of the known issues of ASIC incompetence. ASIC Darwin has a sizeable office less than three kilometres from my office in Darwin. What is the price of a local call or for that matter an STD call?[47]

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44 Burke Bond Financial Pty Ltd, *Submission 98,* p. 2.

45 *Submission 100* (Confidential).

46 Mr David Pemberton, *Submission 279,* p. 3.

47 Mr David Pemberton, *Submission 279,* p. 3.

15.42 Mr Pemberton advised the committee that many professionals shared his views on ASIC and 'have ceased reporting suspect activity due to ASIC's chronic incompetence and inaction'.[48] In his view:

> ASIC needs to be a Kelpie as opposed to being a Bassett Hound. It's about being proactive and fearless in directing the flock. It's about knowing when to be quiet, alert and watchful; knowing when to work out wide or get in close and knowing when to run, bark and if necessary bite.[49]

15.43 One experienced financial planner, Mr Ben Burgess, took a complaint to ASIC on behalf of his client that involved an allegation that a bank had misled and coerced his client into 'investing into various high risk investments, despite requesting a much lower risk term deposit'. ASIC was provided with a complete copy of the client file as well as supporting documentation and calculations. He explained:

> Six months later I had to call ASIC myself to find out what progress had been made, only to be told 'I'm sorry but ASIC does not handle individual complaints but only systemic problems'.
>
> To date there has been no progress toward resolution of this case despite the vast amount of time; effort and expense incurred by the clients and I in fighting for this complaint and doing a large part of the work that ASIC itself should have done.[50]

15.44 Mr Burgess concluded that ASIC failed 'in a most basic way by not even bothering to keep me or my clients informed'.[51]

15.45 An area of particular note, however, involved professionals that are required under statute to make reports of possible wrongdoing. These statutory reports are a valuable source of 'front line' information about possible breaches of the corporation legislation.[52] Some such submitters commented on ASIC's tardiness in responding to reports of possible breaches of the law, including reports from auditors and liquidators.

Auditors

15.46 Under the Corporations Act, auditors are required to notify ASIC in writing of circumstances that they suspect, on reasonable grounds, amount to a contravention of the Act. They are also required, inter alia, to report circumstances that amount to an attempt by any person to unduly influence, coerce, manipulate or mislead a person

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48 Mr David Pemberton, *Submission 279*, p. 3.

49 Mr David Pemberton, *Submission 279*, p. 6.

50 Mr Ben Burgess, *Submission 190*, p. 2.

51 Mr Ben Burgess, *Submission 190*, p. 1.

52 See for example, The Auditor-General, *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001*, Audit Report No. 18 of 2006–07, pp. 13–14.

involved in an audit. The same conditions apply to lead auditors for an audit of a compliance plan. BDO Australia explained further:

> Under s311 and 601HG of the Corporations Act, an auditor is obligated to report to ASIC matters that they have reasonable grounds to suspect amount to a significant contravention of the Corporations Act or, in the case of matters that are not a significant contravention, the auditor believes that the matter will not be adequately dealt with.
>
> An auditor who fails to comply with s311, 601HG or 990K (as applicable) is guilty of an offence.[53]

15.47 BDO Australia referred to a section 311 report it produced in 2007. It stated that 'despite the extensive amount of work and costs involved in conducting the investigation, there would appear to have been no action taken by ASIC to investigate the matter' and that 'neither the audit partner who submitted the section 311 report nor any of the relevant parties have received any communication from ASIC in relation to the matter'. BDO was concerned, however, about one particular report, where the investigation involved an extensive amount of work and costs, but ASIC appeared to have taken no action.[54] This apparent lack of action, posed a number of questions for the auditor:

- Was the matter ever investigated by ASIC?
- If the matter was investigated, why were the parties who had the most knowledge of the alleged breaches of the Corporations Act not contacted by ASIC?
- If the matter was investigated, then why was there no communication to the audit partner that the matter had been investigated and finalised?

15.48 BDO Australia was of the view that, as a minimum, the whole process indicated a deficiency in communication to the underlying parties involved. Further, the audit partner questioned the ability of ASIC to assist registered company auditors to 'fulfil their supervisory roles and reporting responsibilities under existing legislation'. BDO surmised that:

> If no action is taken when reported breaches are identified, auditors should not be burdened with the responsibility and cost of complying with sections of the legislation which are not going to be enforced.[55]

15.49 In this regard, not only is ASIC failing to provide a good example for its gatekeepers but there is the potential to undermine confidence in the reporting system and act as a disincentive for reporting suspected corporate wrongdoing.

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53 BDO Australia, *Submission 163*, p. 1.

54 BDO Australia, *Submission 163*, p. 1.

55 BDO Australia, *Submission 163*, p. 2.

15.50 A number of auditors shared this concern about ASIC's response to statutory reports of suspected breaches. For example, one auditor submitted that 'as an auditor, we were required to lodge the s.311 notice within 28 days of finding a breach yet there is no timeframe imposed on ASIC for at least appearing like they are doing something about it'. In confidence, the auditor informed the committee that her firm lodged a section 311 notice with ASIC in relation to one of its audit clients. In a letter to ASIC, the auditor reported the client's reluctance to assist in the conduct of the audit and resistance to providing information pertinent to the audit. The letter also noted instances of the client providing false and misleading information to the auditor and the possibility of fraud and misappropriation.[56]

15.51 The firm issued a qualified disclaimer opinion for the year ended 2011 for the client. The client did not send the firm's opinion to ASIC with their Form 388 but instead had their solicitor, who was also an auditor, issue an unqualified opinion for the 2011 year. According to the submitter this 'was accepted by ASIC even though we were still the listed registered auditors for this client (which is a company limited by guarantee) for the 2011 year'. The submitter argued that ASIC allowed the client to 'opinion shop' and for someone who was not independent to issue an opinion. Moreover, the submitter informed the committee that this solicitor/auditor had already been accused of fraud by ASIC on another matter and yet ASIC allowed the client to utilise them.[57]

15.52 The audit firm has had no response from ASIC regarding the status of its section 311 letter. In its view, it appears that this client has been able to get away with providing false and misleading information to the auditors, not assisting the auditor in its enquiries, falsifying information and lodging an unqualified opinion to ASIC from an auditor who was not the appointed auditor for the 2011 year.[58]

15.53 Mr Peter Murray, a fellow of the Institute of Chartered Accountants, asked why ASIC's response to reported breaches was so bad. Like others, he questioned why there are rules and regulations if they are not enforced. According to Mr Murray, ASIC noted that it received 10,752 complaints, resolved 57 per cent of these and referred six per cent for formal investigation or surveillance. Further, ASIC has informed him that every complaint was 'registered on ASIC's confidential database, acknowledged, formally assessed and personally responded to'. ASIC notified him that it:

> …encourages Institute members to continue to report alleged corporate misconduct, within ASIC's jurisdiction, to us. At the very least, your information will assist us in continuing to develop a significant intelligence tool which is used, for example, as part of our campaign and surveillance

56 *Submission 328* (Confidential).

57 *Submission 328* (Confidential).

58 *Submission 328* (Confidential).

targeting, licence and professional registration approval process and in the selection of subjects for formal investigation.[59]

15.54 Mr Murray suggested that ASIC should 'classify the importance of allegations lodged with it (eg A, B, C, D) and, at a minimum, interview the submitting parties and the claims they make—before responding in a negative fashion'.[60]

External administrators

15.55 The Corporations Act also places an obligation on liquidators, receivers and voluntary administrators (external administrators) to report suspected breaches of the Corporations Act to ASIC. For example, sections 422, 438D and 533 of the Corporations Act require external administrators to report to ASIC on the activities of past and present company officers or members that involve, inter alia:

- suspected breaches of the Corporations Act;
- misapplication or retention of funds; and
- any negligence, default, breach of duty or breach of trust.[61]

15.56 Reports made pursuant to these sections are referred to as statutory reports and are an important source of information about possible breaches of the law. Section 533 applies to liquidators who must lodge a report as soon as practicable and in any event, within six months from the time it appears to the liquidator that:

(a) a past or present officer or employee, or a member or contributory, of the company may have been guilty of an offence under a law of the Commonwealth or a State or Territory in relation to the company; or

(b) a person who has taken part in the formation, promotion, administration, management or winding up of the company:

(i) may have misapplied or retained, or may have become liable or accountable for, any money or property of the company; or

(ii) may have been guilty of any negligence, default, breach of duty or breach of trust in relation to the company; or

(c) the company may be unable to pay its unsecured creditors more than 50 cents in the dollar.

15.57 Liquidators also have the discretion to lodge further reports if, in their opinion, it is desirable to draw the matter to ASIC's attention.[62]

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59 Mr Peter Murray, *Submission 164*, p. 11.

60 Mr Peter Murray, *Submission 164*, p. 5.

61 Section 533 (for liquidators); section 422 (for receivers); and section 438D (for voluntary administrators). See ASIC, *Insolvency statistics: External administrators' reports (July 2012 to June 2013)*, Report 372, October 2013, paragraph 4.

62 *Corporations Act 2001*, section 533(2).

15.58 In 2012–13, external administrators lodged 9,788 reports with ASIC. Of this number, initial external administrators accounted for 95 per cent or 9,254 reports. ASIC recorded that 81 per cent of the initial reports involved companies with fewer than 20 employees. The construction industry was subject to the highest number of reports accounting for just over 24 per cent. Of the initial external administrators' reports, receivers lodged one per cent under section 422; administrators lodged 3.8 per cent under section 438D; and 95 per cent of the reports were submitted by liquidators under section 533.[63]

15.59 Importantly, external administrators alleged misconduct in more than two-thirds of reports (6,761) involving an overall possible 16,562 breaches. Although this number accounts for an average of between two and three breaches per report, almost 30 per cent of reports or 2,493 recorded no misconduct.[64] ASIC asked the external administrator to prepare a supplementary section 422, section 438D or section 533 report for 677 of the 6,761 reports that identified possible misconduct.[65] In its analysis of the statistics, ASIC explained that its request for an additional report is a function of its assessment of risk based on a number of factors, including, but not limited to:

- the nature of the possible misconduct reported;
- the amount of liabilities;
- the deficiency suffered;
- the availability of evidence;
- prior misconduct; and
- the advice of the external administrator that the reported possible misconduct warranted further investigation.[66]

15.60 In a 2007 report, the Australian National Audit Office (ANAO) observed that given the large number of statutory reports received by ASIC each year that allege offences against the Corporations Act, it was appropriate that ASIC had systems in place to prioritise its regulatory action, through risk scoring. It found that ASIC's recording of statutory report information was accurate to a high degree.[67] The ANAO recognised that ASIC could use a wide variety of possible remedies to deal with offences identified in statutory reports or other deficiencies that warranted some sort of regulatory action. They ranged from warning letters to directors for the less serious

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63 ASIC, *Insolvency statistics: External administrators' reports (July 2012 to June 2013),* Report 372, October 2013, paragraph 32.

64 ASIC, *Insolvency Statistics*, Report 372, October 2013, paragraph 40.

65 ASIC, *Insolvency Statistics*, Report 372, October 2013, paragraph 41.

66 ASIC, *Insolvency Statistics*, Report 372, October 2013, paragraph 41.

67 The Auditor-General, *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001,* Audit Report No. 18, 2006–07, Australian National Audit Office, 2007, paragraph 23.

offences to prosecution and potentially imprisonment for more serious offences. It noted that where ASIC identified that a statutory report raised issues of regulatory significance, it sought further information about the matter from the external administrator.[68]

15.61 According to the ANAO report, ASIC did not always obtain that additional information. Based on its sample, it found that in 40 per cent of instances, ASIC did not obtain additional information that it had requested.[69] The ANAO concluded:

> …the small number of statutory reports subject to regulatory action by ASIC each year indicates that there is opportunity for greater regulatory action on these reports.[70]

15.62 Mr David Lombe, President of the Australian Restructuring Insolvency and Turnaround Association (ARITA) was of the view that ANAO's 2007 findings were still relevant and applicable.[71] He noted the thousands of reports lodged with ASIC each year but not acted upon. In Mr Lombe's view, there was a 'general perception within the business community that, if you do certain things at a certain level, there will be no effective review'.[72] He explained further:

> The difficulty that we have as official liquidators is that you get a matter off the court list and often that matter has no funds in it, so there are no available assets. Often that is a process by which directors have deliberately done that—it has been a deliberate course of action. If you report the matter to ASIC and there is no assistance from that space, there is not much you can do. If you felt really aggrieved by it or you felt that it was a matter that was of sufficient importance, you may be able to persuade a firm of solicitors to act on a pro bono basis, but that is very difficult. I found myself in that sort of situation with Babcock & Brown, where I had inadequate funds to be able to pursue a proper investigation. The only thing that was available to me was to ask creditors to fund me, which they did, which then allowed me to do a public examination, which brought out the conduct of directors and other stakeholders in that company. If you do not have funds in a matter, the courses are very limited.[73]

15.63 By way of example, Mr Lombe expanded on his concerns citing the requirement to lodge a section 533 report, which deals with offences committed by directors. He explained that for the liquidator to understand what has happened, he or she needs to 'review the books and records, determine the transactions, try to find out

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68 The Auditor-General, Audit Report No. 18, 2006–07, paragraph 24.

69 The Auditor-General, Audit Report No. 18, 2006–07, paragraph 24.

70 The Auditor-General, Audit Report No. 18, 2006–07, paragraph 26.

71 Mr David Lombe, President, Australian Restructuring Insolvency and Turnaround Association, *Proof Committee Hansard*, 2 April 2014, p. 35.

72 Mr David Lombe, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 30.

73 Mr David Lombe, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 31.

what assets are there, look at insolvent trading and look at preference payments and all those sorts of things'. The liquidator is required to file that report, which takes time. So, according to Mr Lombe, the reports involve both time and money, and often with official liquidations there are no assets at all and, if there are, creditors are effectively paying for the report. He noted that thousands of such reports are lodged with ASIC but most of them come back 'no further action'. In his view, it is frustrating for liquidators because they feel, 'Why am I bothering to do it?' Mr Lombe concluded that 'you can understand someone's frustration, where they have reported offences and nothing happens'.[74]

15.64 When asked whether liquidators, in their statutory reports, could assist ASIC to distinguish the very serious breaches from the less so, ARITA indicated that it 'might be a useful reform'. After considering the matter further, ARITA informed the committee that if it were consulted, it could assist ASIC to determine a risk scoring profile. It explained further, however:

> But we consider that the decision on how the information required by s533 is 'risk-scored' for action is ultimately one for the regulator and its decision and methods should not be publicly disclosed. For one thing, this would appear to give the 'green light' to the commission of certain offences that are deemed not serious enough to warrant action by ASIC.[75]

15.65 ARITA also stated that 'a more co-operative approach between ASIC and liquidators should also be pursued'. The committee believes that ASIC and ARITA should work closely together to develop a more effective and efficient reporting mechanism that would assist ASIC to identify the alleged serious breaches from the less so.[76]

Recommendation 17

15.66 The committee recommends that ASIC, in collaboration with the Australian Restructuring Insolvency and Turnaround Association and accounting bodies, develop a self-rating system, or similar mechanism, for statutory reports lodged by insolvency practitioners and auditors under the *Corporations Act 2001* to assist ASIC identify reports that require the most urgent attention and investigation.

15.67 Clearly, many people who lodge complaints and reports of suspected corporate wrongdoing with ASIC, including Australia's key gatekeepers, are dissatisfied with ASIC's response. ASIC has left many with the clear impression that the regulator is unresponsive and indifferent to their concerns. In the following chapter, the committee considers the likely reasons for this delay or inaction.

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74 Mr David Lombe, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 34.

75 ARITA, *Submission 202.1*, p. 2.

76 ARITA, *Submission 202.1*, p. 2.