COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Oversight of the Australian Securities and Investments Commission

FRIDAY, 11 MARCH 2011

SYDNEY

BY AUTHORITY OF THE PARLIAMENT

THIS TRANSCRIPT HAS BEEN PREPARED BY AN EXTERNAL PROVIDER

INTERNET

Hansard transcripts of public hearings are made available on the internet when authorised by the committee.

The internet address is:

http://www.aph.gov.au/hansard

To search the parliamentary database, go to:
http://parlinfo.aph.gov.au

JOINT STATUTORY COMMITTEE

ON CORPORATIONS AND FINANCIAL SERVICES

Friday, 11 March 2011

Members: Mr Ripoll (Chair), Senator Boyce (Deputy Chair), Senators Cormann, Hurley and Stephens and Mr Fletcher, Mr Griffin, Mr Anthony Smith and Ms Smyth

Members in attendance: Senators Stephens and Mr Griffin, Mr Anthony Smith and Mr Ripoll

Terms of reference for the inquiry:

To inquire into and report on:

Oversight of the Australian Securities and Investments Commission

WITNESSES

ADAMS, Mr Mark, Senior Executive Leader, Australian Securities and Investments Commission 19

D'ALOISIO, Mr Tony, Chairman, Australian Securities and Investments Commission 19

DAY, Mr Warren, Regional Commissioner, Australian Securities and Investments Commission 19

DINES, Mrs Janette Evelyn, Assistant Secretary, Civil Law Division, Attorney-General's Department 11

LEWIS, Mr Kevin, Group Executive and Chief Compliance Officer, Australian Securities Exchange 1

MEDCRAFT, Mr Greg, Commissioner, Australian Securities and Investments Commission 19

PRICE, Mr John, Senior Executive Leader, Australian Securities and Investments Commission 19

STARR, Mr Malcolm, Executive General Manager, Regulatory and Public Policy, Australian Securities Exchange 1

YANCO, Mr John, Regional Commissioner for New South Wales, Australian Securities and Investments Commission 19

Committee met at 9.00 am

LEWIS, Mr Kevin, Group Executive and Chief Compliance Officer, Australian Securities Exchange

STARR, Mr Malcolm, Executive General Manager, Regulatory and Public Policy, Australian Securities Exchange

CHAIRMAN (Mr Ripoll)—I welcome everyone to the hearing on oversight of the Australian Securities and Investments Commission. I welcome Mr Kevin Lewis and Mr Malcolm Starr from the Australian Securities Exchange and invite each of you to make an opening statement.

Mr Starr—The ASX Group appears before this committee at the committee's request. We conduct a number of regulated businesses in respect of which ASIC has responsibilities for monitoring our compliance with licence obligations. These include listing, trade execution, clearing and settlement businesses. It is the trade execution business, the business of providing systems for matching orders from buyers and sellers of shares and other financial products, that is at the heart of ASIC's responsibility for overseeing what the relevant legislation calls 'market operators'. In this context the relevant legislation is using the term 'market' in the narrow sense of transactions facilitated by a single computer system, operated in this instance by us, rather than in the wider economic sense of all transactions in a financial product irrespective of how many venues are involved.

The regulatory framework governing licensed market operators does not allow anyone with a market licence to conduct this match-making business in a systematic way without also incurring certain responsibilities. This includes a responsibility to do everything practical and necessary to ensure that the market is fair, orderly and transparent. Until 1 August 2010 licensed market operators also had to have adequate arrangements to supervise the market including monitoring the conduct of the brokers that used that facility. ASIC meanwhile already had overlapping powers and obligations relating to both oversight of the market through enforcement of market manipulation, insider trading and other market misconduct laws and oversight of brokers through the enforcement of their obligations as licensed financial services businesses.

A similar structure applied and continues to apply to the conduct of the related but separate businesses of clearing and settling trades that result from matching of orders whether on a licensed market or otherwise. Operators of those facilities have obligations directed at a different set of regulatory objectives and continue to be subject to both ASIC and Reserve Bank oversight. This clearing and settlement regulatory structure was not affected by the changes to the trade execution regulatory structure made on 1 August 2010.

The 1 August 2010 regulatory amendments involved two fundamental changes. Firstly, responsibility was transferred from licensed market operators to ASIC for supervising brokers in relation to their use of a market operator's order-matching system. Secondly, ASIC acquired new rule-making powers which it could use not only to start supervising brokers in relation to their use of exchange facilities but also to extend its long-established function of supervising market operators to encompass issues of market microstructure and competition. These two changes, of course, were made to facilitate competition in the order-matching business and specifically to

accommodate the granting of market licences to operators wishing to establish trade execution facilities in competition with ASX.

Perhaps because the conferral on ASIC of rule-making powers, which could be used to impose obligations on competing market operators, occurred at the same time as market operators were relieved of their broker supervision responsibilities, the government's decision to transfer broker supervision responsibilities is sometimes referred to in a shorthand way as being a decision to transfer responsibilities for supervising the market. That description is potentially misleading in two respects: first, it suggests that the function of supervising not only brokers but also ASX itself was a function that ASX rather than ASIC had previously undertaken. We have even seen the rationale for the government's decision to transfer broker supervision responsibilities explicitly misdescribed as having been necessary in order to avoid the prospect of ASX regulating itself. The fact of the matter is that ASIC has always had the statutory responsibility to regulate the activities of ASX, both as a licensed market operator and as a licensed operator of clearing and settlement facilities. Secondly, it ignores the very important role that ASX performs through its listings function of monitoring the activities of entities that seek to access capital through the market. That role was not affected by the 1 August 2010 regulatory changes. There are approximately 2,200 listed entities that ASX continues to supervise within the framework of its listing rules.

Perhaps this committee might want to consider the scope for using the regulatory objectives that underpin regulation of the market, in its wider meaning, to guide its own assessment of ASIC's performance. ASIC has itself made useful contributions to articulating what it sees as the regulatory objectives which should in turn drive ASIC's exercise of its new rule-making powers. It has highlighted the importance of regulating like activities in like ways. This is important to avoid creating market distortions and opportunities for regulatory arbitrage.

ASIC has also recently highlighted its objective of ensuring that its rules are consistent with protecting the price formation function of markets in financial products. Both the relevant minister and this committee presumably have some role to play in satisfying themselves that these important objectives are being met through the exercise over time of ASIC's rule-making powers. With that scene setting, we will attempt to answer any questions you may have about either the transfer of responsibilities or other matters you consider relevant to your oversight responsibilities.

CHAIRMAN—As a follow-on from your introduction, our understanding is that while there has been a regulatory transfer of market supervision powers and a new responsibility that ASIC has taken on, ASX still monitor, manage and self-regulate in terms of the market performance brokers and all other activities. Could you describe to us how that overlays and sits with what ASIC does and if there are any conflicts or any issues that arise out of that layer of oversight that you have of the market.

Mr Starr—The essential distinction that was drawn as to what matters in relation to supervision of brokers stay with ASX and other operators in time versus what goes to ASIC is a distinction between market integrity and operating market facilities. The matters that ASX used to have primary responsibility for and now are ASIC's issues are things like insider trading, market manipulation, and broker-client relationship issues—the possibility that a broker is acting in its own interests rather than the interests of the client. So ASIC is responsible for anything to

do with market integrity, manipulation of the market, anything to do with the broker-client relationship et cetera.

At ASX, by contrast, the key word used is that we have to have rules relating to the operation of the market. Since, by definition, in order to operate a market you have to have a capacity to bind your immediate customers, your brokers, to a set of rules in order to make the market work, the distinction that is drawn is: we have got to have the rules that in fact you would expect to be in place to enable the market to do its core function of matching trades. A good example of the area where we will still be involved is that we will still set rules around cancelling trades in circumstances where the traded price might have been a long way away from fair value. We will necessarily have rules about the circumstances in which orders can be put into the system to make sure that they do not in fact disrupt the system for other participants. It is really a regulatory versus non-regulatory distinction.

Mr Lewis—Perhaps if I could also pick up on some issues you raised about potential for overlap. The regulatory change that occurred on 1 August 2010 was focused in particular on, as Malcolm said in his opening remarks, the trade execution side of our business. We also have a clearing and settlement side to our business. Some of our brokers are trading participants only that work in the trade execution side of our business, some of our brokers are clearing participants only that work in that side of the business and some do both. The clearing part of our business is still very much regulated within our operating rule framework. It was not affected by the transfer of market supervision responsibility that occurred on 1 August 2010. So there is some scope for overlap between the rules that we apply to our clearing participants and the rules that ASIC applies to trading participants in the new regulatory framework. There is also potential for overlap between rules that go to market integrity that also go to the operation of the market. A typical case of that would be disorderly markets, which Malcolm mentioned. That forms part of the ASIC rule framework and also part of our operating rule framework on the trade execution side of things. So there is scope for overlap there, to pick up your point, Chairman.

CHAIRMAN—Thanks. Does the ASX see any potential for conflict to arise between the sharing of powers—I understand the distinction; you have described that very well—in terms of rules that you might set in an operational sense that may conflict with rules that exist under ASIC's powers in terms of integrity of the market?

Mr Lewis—We think there is limited scope for that. Our rule framework of course is subject to a ministerial disallowance framework. So, if we were to implement a rule that conflicted with ASIC's market integrity rules, that could be dealt with by the government fairly readily. I should also add that we have gone to great lengths, working cooperatively with ASIC, to ensure that those types of issues do not become an issue for the market.

Mr ANTHONY SMITH—Can you just enlarge on how that plays out on a day-to-day basis?

Mr Lewis—I am happy to do so. In August last year we implemented a committee that we refer to as the ASIC-ASX compliance liaison committee. It comprises senior representatives from the ASX business and also from ASIC's market supervision area. It meets approximately fortnightly, depending on schedules. It has a standard agenda that addresses issues of rule overlap. It addresses rule conflict issues. It addresses participant coordination issues. I will perhaps elaborate on that last point on participant coordination.

One of the concerns that I think the industry had and certainly ASIC and ASX had around the time of the 1 August 2010 transfer was the fact that we would have two regulators effectively operating in the space of the broking industry in a different way than those two regulators had operated prior to 1 August 2010. There was a concern that, for example, ASIC with its responsibilities for supervising brokers might come in and conduct an on-site review at the same time as ASX, for the purposes of monitoring and enforcing its operating rules, was conducting an on-site review as well. We were concerned that we not end up with brokers being burdened by having two regulators in at the same time. So we have put in place a process for coordinating what we refer to as a participant coordination protocol with ASIC, to make sure that we coordinate our enforcement activities and our monitoring activities so that this type of event does not occur. This falls within the bailiwick of that committee and is something that gets discussed on an approximately fortnightly basis.

CHAIRMAN—How large is the committee? How many members does it have?

Mr Lewis—It varies from meeting to meeting, but it is usually between 10 and 15 members. It is a broad cross-section. All of my general managers who operate the different parts of the compliance function at ASX participate in it. I participate in it. A representative from our legal function participates in it as well. Various representatives from, as I say, the market supervision areas within ASIC are present as well.

Senator STEPHENS—Since the shift on 1 August last year have you actually had to act on that protocol?

Mr Lewis—The protocol is actually about coordinating activities. So we have an exchange of information with ASIC about what their schedule of participant review activities might be and what our schedule might be, and we make sure that the two do not clash.

CHAIRMAN—So it is a permanent committee and it meets every fortnight. Is that going to be an ongoing—

Mr Lewis—Correct. In fact, one of the things that we are doing is we are renegotiating the ASIC-ASX memorandum of understanding, which is now a little dated. It goes back to 2004 in relation to ASX. I think the one in relation to the SFE, as it used to be known, goes back to the 1990s. So they are well and truly mature for replacement. We are in the final stages of negotiating changes to that memorandum of understanding. The protocols I referred to will, when finalised, be signed under that memorandum of understanding.

CHAIRMAN—Wonderful. What do you generate out of these meetings? Is there a set agenda? Is there a particular course of action? Is it just sharing information? I am just trying to understand what you do.

Mr Lewis—As I say, we have a standing agenda. The products of that agenda are usually some action items. I circulate after each meeting a list of action items from the meeting, assigning responsibilities for the things that we have discussed at the meeting. That gets reviewed at the next subsequent meeting. We tick off those action items from meeting to meeting.

CHAIRMAN—Just give us an example, without breaching any confidential actions that might be taking place in the market. What is it that means so much activity between the two bodies?

Mr Lewis—It is the coordination of our separate regulatory responsibilities, for want of a better expression. As part of the handover of responsibilities we had to pass across a significant amount of information to ASIC. That has come through in the form of a reasonable assistance request under the Corporations Act. So the provision of that information is something that we coordinate through that committee. If, for example, we are having practical problems generating that information we will discuss that at the committee and work out how we will tackle ASIC's request. I mentioned the participant coordination activities previously. That involves primarily an exchange of information so we each understand what the other is doing. From time to time we or ASIC will spot an issue with a participant that we think the other should know about and we exchange that type of information at the meeting.

CHAIRMAN—So these meetings are more around the market integrity than market operation? What is the focus?

Mr Lewis—I think it is fair to say that they cover both. It is really a case of ASX in its capacity as the operator of the market and in its role of monitoring and enforcing compliance with its operating rules coordinating its activities with ASIC's responsibility of supervising the market and monitoring and enforcing its market integrity rules and the Corporations Act.

CHAIRMAN—Do you generate a report from these meetings? Are they internal reports? Are they reports back to ASIC?

Mr Lewis—No. We try to keep them as informal and productive as we can, and the primary product of these meetings is a set of action items that we review on an ongoing basis at each meeting.

CHAIRMAN—ASIC did a report on market supervision from August to December last year. Are you aware of that report?

Mr Lewis—I am aware of it, but I have to confess that I have not read it.

CHAIRMAN—Mr Starr, do you know anything about that particular report?

Mr Starr—I think you are referring to the annual assessment that is done. No? A different one?

CHAIRMAN—ASIC did a report last year on market supervision called REP 227: *ASIC supervision of markets and participants*. In there they refer to trading alerts, referrals on investigations and similar activities, including a whole range of other issues.

Mr Lewis—As I said, I have not read the report in detail. I am aware of it. I recently saw the press reports and some of the press releases on that.

CHAIRMAN—Can you take that on notice. I would be interested to hear the ASX's view on that particular report, whether there are any issues that come out of that and whether it is something that the ASX wants to comment on. I am happy for you to take that on notice. Just write back to the committee with your assessment or your opinion of the particular report.

Mr ANTHONY SMITH—Just on the question that the chair raises, if there is some sort of comparative analysis that you are able to do on what that report showed compared to the period prior to the handover that would be good. On notice is fine.

Mr Lewis—Yes. I certainly do remember reading the summaries in the press of the market surveillance activities that have been undertaken and the number of alerts that they were generating and noting that the volume of alerts in their market monitoring system, which is known as SMARTS, was generating was in fact consistent with the volume of alerts that we were generating.

CHAIRMAN—In terms of alerts and any issues that arise out of the market, has there been any difference at all from pre-ASIC supervision to now? Is there a difference in the number of alerts? Are there any operational differences? Is there anything you can point to or is it exactly what you would expect? Is it exactly the same?

Mr Lewis—From the headline numbers that I saw in the press reports, the numbers that were reported for the period of ASIC supervision are consistent with the numbers of alerts that our system was generating prior to that. That should not come as a surprise because we are both using the same computer software system to supervise the market. We continue to use that system for the purposes of our continuous disclosure monitoring.

CHAIRMAN—So there has been no improvement.

Mr Lewis—The standard was high previously. As I said, that software is referred to as the SMARTS system. It monitors real-time trading. It takes a dump of data from our market and looks for anomalies in trading. It will generate quite a lot of alerts. In fact, we have seen a huge volume of alerts over the last two or three years because of the volatility in the market. One of the things it monitors is rapid movements in price that might be an indication of somebody insider trading, pushing the price up, or a breach of continuous disclosure, those types of things.

CHAIRMAN—Should we expect some improvement?

Mr Starr—At the risk of stating the obvious, not necessarily, because it was not a decision prompted by a view of poor performance on the part of the ASX; it was a decision prompted by the competition imperative and it made sense for those reasons.

Mr ANTHONY SMITH—It has a forward-looking oversight, air traffic control, you would say, to maintain that high standard.

Mr Starr—We would say that the real test comes when you have additional market operators, because we clearly could not have done the task that only ASIC can do of doing the supervision of competing venues. So it was with a view to that rather than this transitional period that we are now in.

Mr Lewis—The point I was going to make is that there is a lot of focus on the number of alerts being generated by the SMARTS system. That is, frankly, a function of market activity. The system generates thousands of alerts that need to be investigated. Those thousands will diminish to a very small number of issues that warrant further investigation. So the focus on the headline number of alerts is not really meaningful.

CHAIRMAN—Given that there is some overlap in supervision, even though the responsibilities have changed, should we see some sort of further improvement, even on the very high benchmark that currently exists? Is there something that we can look forward to in the future to say that we can make it even better than it currently is?

Mr Lewis—One of the points that ASIC has made is that, because it is now doing the market monitoring itself and able to investigate straightaway, that certainly speeds up the process of taking enforcement action. I think that is unquestionably correct. Previously we would need to do an investigation to form a view that there might be a breach of, for example, a market manipulation law or an insider trading law, and that required a period of time for us to gather raw data, talk to participants, get them to respond and formulate a case which we would then present to ASIC. It would then have to go through its investigation processes from there. So in a sense there was double handling involved. Unquestionably, the fact that ASIC now undertakes that responsibility directly will speed up the investigation process.

CHAIRMAN—Are there any technology issues, in terms of potential problems with different types of trading and trading mechanisms that are available today, now or around the corner in automated trades, microtrading and those types of matters?

Mr Lewis—I think there is no doubt that high-frequency trading and algorithmic trading have made the job of market supervision more difficult just because of the sheer volume of orders, trades, that need to be sifted through to detect potential market abuse. Unquestionably it has made that job harder.

CHAIRMAN—How are you dealing with it? How is the ASX applying either rules or technology to ensure that there is no manipulation of the market?

Mr Lewis—Our role has ceased to be ensuring that there is no manipulation in the market, because of the transfer of responsibility. Our area of focus in our market supervision is very much around continuous disclosure rules, which continue to be part of our rules framework.

CHAIRMAN—Is it not an operational matter, though, in how the market operates?

Mr Starr—We certainly have technology issues to deal with in making sure that we can handle the increased number of trades that come with high-frequency trading, and the opening-up of additional markets will in fact increase the amount of high-frequency trading because of the increased opportunities that are available. Our challenges are challenges as the operator of a business that is trying to match the orders of trades involved, whereas ASIC's challenge is increasing because of the increasing numbers in doing the market integrity monitoring.

CHAIRMAN—Yes. What I want to try and understand in that field, though, from an operational sense is: do you currently have, are you planning to have or are you looking at

setting rules around how that operates within the market to ensure that the market has integrity, in the sense that it is operational as a business, so that there is not a halt in trading or an unbalancing of the market?

Mr Lewis—I think perhaps the area that you are pointing to is around disorderly markets.

CHAIRMAN—Yes.

Mr Lewis—We have always, for as long as I have been involved in financial markets, had rules around disorderly markets. ASIC also has rules around disorderly markets in its market integrity rules. So there is potential for overlap there, as I mentioned previously. Disorderly markets tend to be things that you can look at only after the event. It is very hard to anticipate a disorderly market and try and prevent it occurring. Most of our powers in that area are focused around error or trade cancellation—reversing positions and so on.

CHAIRMAN—You do not currently have any mechanisms to automatically cease operation of a particular segment of the market or the market hanging on structures that happen.

Mr Lewis—Yes, we do. We can always turn the switch off. If we saw something horrendous happening in the market we could turn the switch off.

CHAIRMAN—But there is nothing that is automated? There are no specific rules at this point in time—a set of rules around a particular disorder taking place? Given that we already know the technologies that are out there and the types of trading that go on, I am trying to better understand how the ASX deals with potential.

Mr Starr—We have and will continue to have rules that give as much precision as possible to the circumstances in which we will cancel a trade.

Mr ANTHONY SMITH—What sort of time frame are you operating in typically?

Mr Lewis—The decision to cancel a trade occurs relatively quickly, usually within hours—certainly no longer than a day.

Mr ANTHONY SMITH—So typically within an hour or so?

Mr Lewis—Yes, absolutely.

Mr Starr—That is one area where we determine our rules in the first instance, but in order to determine our rules we have to get ASIC and the minister's approval; and, secondly, the 1 August conferral of a rule-making power on ASIC gave it the capacity, if it wanted to in effect give a direction as to the sorts of issues we should take into account in formulating our policy, to have an additional lever by virtue of that rule-making power to also get into that space. Because of the timeliness with which those trade cancellation decisions must be made—notwithstanding that they have some bearing on integrity—it is recognised that the operators have got to have that decision-making power but subject to oversight.

Mr Lewis—Let me pick up one further point. The area that you may be thinking about is volatility controls. That was something that the exchange was already looking at prior to the 1 August 2010 regulatory changes and it is something that ASIC, of course, has picked up in its consultation paper on market integrity rules. I think it is fair to say it is something that we have supported—anomalous order entry controls that prevent an order that is a long way away from market being entered. If you then had a rapid movement in market price, it could cause market prices to gyrate outside acceptable boundaries. It was something that we were already looking at prior to 1 August 2010. It is something that ASIC is focused on very closely in its market integrity rules and something that we are supportive of.

CHAIRMAN—ASIC has undertaken some market rule reform in two phases: firstly, by looking at market competition this year and then addressing the more complex issues after that. Have you got any views on that in terms of the two phases and what that means?

Mr Starr—We have commented that we thought ASIC produced an excellent consultation paper last November in the area that you are talking about. We have similarly expressed some views that we would have preferred if it were possible for solutions to nearly all of the issues that were raised in the November consultation paper to have been put in place rather than bifurcated the way they have been. If you take, for example, the area of what rules are going to apply to dark pools then we have commented that that is clearly an equally important issue as competition between lit markets. So we have said, 'Yes, it is all very well to have a few rules dealing with issues that will arise when you have got two markets, ASX and Chi-X. It is equally important to ensure that there are appropriate rules to make sure that the activity is not drained from either of those two venues into internalised trades.

There are difficult technology issues involved for everyone involved in changing a set of rules. We understand those pressures but we do think that is an area where we would be hopeful of seeing some movement. We, as the market operator, have up until now been the one that set any rules in that space as to what our participants can do off market. That is one of those classic areas where we could not go too far in regulating our direct customers as to what they do off market, without being accused of acting in our own interests. So that is the very area where we are very pleased that ASIC has the task of deciding those competition issues between lit and dark markets. That is an area where we have indicated in our submissions to ASIC on its November consultation paper that we thought the direction of their rules were better than the direction of our existing rules and, therefore, bringing rules in along the lines of those that they promoted in their November paper and doing so quickly was something which we were very supportive of.

ASIC has said two things in respect of that: (a) they are not quite so sure that they are still going proceed with the proposals that they initiated in November; and (b) they will not be in the first batch whatever resolution it comes to. Our only comment is that we hope that is done as expeditiously as possible, because if we are correct in our view that the issue of trades leaking away from the public markets to the non-public markets will potentially occur to such an extent that the quality of our public markets deteriorates then it is the quality of our public market that is in fact the core reason ASIC is oversighting us in the first place. We think it is an extremely important issue. We recognise the considerations as to why some of the views put to ASIC, including by the operators of dark pools, have caused it to go a little slower.

CHAIRMAN—Have you got any particular concerns around market rules in dark pool trades?

Mr Starr—We have expressed our views on that subject in our submission to ASIC's Consultation Paper 145 released in November. So our views are very much on the public record.

CHAIRMAN—But do you think that the rule settings around that are appropriate settings?

Mr Starr—ASIC's current position is that they need a bit more time to sort out the ideal set of replacement rules. For a while longer, it will not hurt if they just incorporate into their rules exactly the same concepts as ASX have had for quite some time. You can see that there is some logic to that proposition, that the world will not end if one is just continuing for a while longer with rules that have been in place for a while. You can also see from looking at international experience that, once you open up lots of public markets, the way that trades are put into those public markets has the potential for discouraging fund managers from using the public markets as much as they previously had. If in turn those fund managers decide to put more of their trades in the dark pools compared to the lit markets then you have a problem that is probably a bit too hard to deal with after the switch has occurred, because you are never going to be able to put in place a new set of rules that causes the fund managers to say, 'Well, liquidity has gone from the public markets but we're still going to go back there in the hope that every other fund manager goes back there at the same time.' That is just not going to happen. That is why it is reasonably important that the optimal set of rules as to what size trade can go into non-transparent trading are sorted out as soon as possible.

CHAIRMAN—So you see some fairly serious downside to not getting the settings right in terms of how these things operate and the rules around competition, as it were, with other entrants in the market?

Mr Starr—The international experience, which is easy to look to in Europe and the US, is that increasing the number of lit markets occurs at the same time as increasing the proportion of trading occurring in dark markets. That mere statistical fact is enough to cause any regulator and all regulators to make sure that they get right whatever controls they choose to put in place on what trades can be affected in dark venues.

Mr Lewis—I would make one further observation. There is, in fact, a third tranche of reforms. It tends to drop off the radar screen because there is a lot of focus on market competition and market structure issues. That third set of reforms is having a uniform set of participant client rules that operate across all of our markets. We currently have market integrity rules that apply to the ASX, the SFE and other markets and impose effectively the old market rules that each of those individual markets applied. There is, I think, a need for those to be rationalised and to have one set of common rules that apply to the broker community across all of the different markets given that they can operate on those different markets. That is something that tends not to be focused on because, as I have said, there is so much attention being put on market structure issues and competition issues.

CHAIRMAN—As there are no further questions from the committee, I thank you for your statements and, as well, for the submission that you have made.

[9.43 am]

DINES, Mrs Janette Evelyn, Assistant Secretary, Civil Law Division, Attorney-General's Department

CHAIRMAN—Welcome. I invite you to make an opening statement.

Mrs Dines—I thank the committee for the opportunity to appear. Section 55Z of the Judiciary Act gives the Attorney-General the power to issue directions to Australian government agencies in relation to the provision of legal services to the Commonwealth. The directions are intended to ensure that legal services are delivered in a consistent and coordinated manner so as to protect the Commonwealth's legal and financial position. The directions apply to all FMA Act agencies and most Commonwealth Authorities and Corporations Act 1977 bodies. Specifically, the directions establish requirements covering the engagement of legal service providers and counsel by the Commonwealth; the conduct of constitutional, public, international, national security and cabinet legal work which is tied to certain providers; the reporting of significant legal issues; the sharing of legal advice within government; the provision of legal assistance to Commonwealth employees; the conduct of litigation by in-house practices; and the handling of claims and litigation by or against the Commonwealth and which includes the Commonwealth's obligation to act as a model litigant.

The model litigant obligation is set out in appendix B to the directions. A central theme of the obligation is that the Commonwealth and its agencies must act honestly and fairly and with complete propriety in handling claims and litigation brought by or against them. Some examples of what model litigant obligation requires are keeping the cost of litigation to a minimum by not requiring proof of a matter that the Commonwealth knows to be true; not contesting liability if the dispute is about quantum; considering alternative dispute resolution at the outset of any legal proceedings and throughout the course of a matter; not appealing unless there are reasonable prospects for success or the appeal is otherwise in the public interest; apologising where the Commonwealth or its lawyers have acted wrongfully or improperly; and not relying on technical defences unless the Commonwealth would be prejudiced by the failure to comply with a particular requirement. The obligation does not prohibit the Commonwealth from properly testing claims, defending unmeritorious or vexatious litigation or running test cases. It does not prevent agencies from acting firmly to protect the Commonwealth's interests including proceeding with litigation in order to clarify a significant point of law, even where the other party may wish to settle the dispute, and enforcing cost orders.

The model litigant obligation also applies to tribunal proceedings where the obligation requires an agency to use its best endeavours to assist the tribunal to make its decision. The obligation falls on agencies and not their legal service providers directly, but agencies are required to include clauses requiring compliance with the directions when engaging a legal services provider.

There are a range of reporting requirements under the Legal Services Directions. The directions require FMA Act agencies to report as soon as practicable to the Attorney-General or to the Office of Legal Services Coordination on any possible or apparent breaches or alleged

breaches of the directions and any corrective action undertaken or proposed to be undertaken. FMA Act agencies are also required to provide the Office of legal Services Coordination with certificates signed by their chief executive confirming compliance with the directions within 60 days of the end of each financial year. That certificate is required to disclose any apparent or possible breaches that have not previously been reported and detailed action taken to address the cause of any breaches in the previous financial year.

FMA Act agencies are also required to report to the Attorney-General or the Office of Legal Services Coordination on any significant legal issues being handled by the agency. In any cases where exemptions from compliance with aspects of the directions have been granted, agencies are typically required to provide quarterly reports in relation to compliance with any conditions imposed. Finally, FMA Act agencies and non-FMA Act agencies are required to report on their legal services expenditure within 60 days of the end of each financial year.

The primary role of the Office of Legal Services Coordination is to facilitate compliance with the directions predominantly through education and outreach. OLSC officers visit agencies and conduct training on the directions. We maintain a website that sets out information, including guidance notes and other information to assist agencies and members of the public who may have concerns about an agency's conduct. Where we become aware of possible noncompliance with the directions, we initially consider whether there are sufficient grounds to proceed to an investigation of the possible breach. If we form the view that the alleged or apparent conduct would on its face amount to a breach of the directions, then the affected agencies are invited to respond to the alleged or apparent breach.

We consider any response received, and the head of the office will write to the agency complainant in writing advising them of our preliminary determination and the reasons for that determination. The parties will typically be asked to provide further information within 28 days if they wish, failing which the determination will become final. Where appropriate, we can recommend that the Attorney-General direct agencies in the conduct of litigation or to undertake remedial action where appropriate.

CHAIRMAN—Thank you very much. We would be very interested in your view from the Office of Legal Services Coordination in terms of the relationship between different agencies and the office and, in particular, that relationship with ASIC, the Australian Securities and Investments Commission, as the largest spender or user of legal services?

Mrs Dines—We have got, I think, a very good relationship with ASIC in that ASIC is very aware of what its obligations are under the directions. It makes a very determined effort to talk to us about what certain aspects of the directions might require and inform us, fairly promptly, when they believe that either there is an issue in the way the directions might apply to them or they believe that they may have breached one of the directions.

I think ASIC would be probably our highest self-reporter of potential or alleged complaints against it, including, quite regularly, advising us of any adverse judicial comment, which often is not necessarily something that results in a complaint or an alleged breach of the directions. I think we feel that ASIC works quite diligently to try and ensure that we understand its business and its operations. We are fairly confident that it usually informs us pretty promptly of any issues that it sees. ASIC has a couple of exemptions under the directions.

CHAIRMAN—That was going to be the next question.

Mr ANTHONY SMITH—You could go through those.

Mrs Dines—Sure. When an agency does have an exemption it signifies that we feel that they have a level of maturity in the way they operate their legal services and, by the same token, it brings a closer relationship between us and the agency because we move to a higher level of information sharing and understanding of the business. ASIC has an exemption from paragraph 5 of the directions. Paragraph 5 requires that an agency not be its own solicitor on the record in litigation unless the Attorney-General has approved that. In March 2006 the Attorney granted ASIC an exemption. That allows ASIC to use its in-house lawyers as solicitors on the record in the regulatory and enforcement activities.

Mr ANTHONY SMITH—What happened prior to 2006? I assume they had in-house solicitors, but—

Mrs Dines—They would have always engaged external—

Mr ANTHONY SMITH—sought—

Mrs Dines—Yes.

Mr ANTHONY SMITH—So after 2006, it really formalised what they were doing before?

Mrs Dines—ASIC has not always been subject to the directions, but once it did become subject to the directions it required an exemption to actually use its in-house lawyers instead of engaging an external solicitor to instruct counsel in proceedings. Part of the rationale as to the benefits of that exemption which led to the Attorney's decision to grant the exemption was an attempt to conduct legal services and litigation in a more cost-effective way and a recognition that, for many of the aspects or types of litigation that ASIC may undertake, the level of technical knowledge that an in-house lawyer can bring gives you a better result.

CHAIRMAN—Has that exemption been granted on a permanent basis?

Mrs Dines—The exemptions are reviewed. Most of the exemptions that the Attorney has granted recently have been only for a period of one or two years, and that is because the Attorney has been considering a range of reforms to how the Commonwealth purchases and conducts legal services generally. I do not have the end date of ASIC's exemption in front of me, but I believe it may have been the end of June this year. That was not because the Attorney had any concerns but more because, if the government did decide to significantly change how it purchased legal services, he wanted the flexibility. There are regular reporting requirements throughout the term of an exemption, but they would always be regularly reviewed—generally on a three-year basis; that would be the maximum term of the exemption.

CHAIRMAN—You said there was another exemption as well?

Mrs Dines—There is another exemption. ASIC also has an exemption from paragraph 9 of appendix D to the directions, and that gives it a bit more flexibility in the rates that it can

actually pay to counsel. That followed a significant period, over a couple of years, where ASIC consistently had difficulty in being able to engage counsel of a suitable stature and experience within the ceilings within the Legal Services Directions. So in May 2010 the Attorney granted ASIC what is really only a partial exemption in that ASIC is required to obtain the approval of its relevant portfolio minister before it agrees to pay counsel at a rate above $5,000—that is per day—and there is a ceiling of $10,000. So between $5,000 and $10,000 ASIC can actually brief counsel with the approval of their relevant portfolio minister, whereas previously they would have needed to seek the Attorney's approval each time they wanted to engage over $5,000. And, again, that is subject to—

Mr ANTHONY SMITH—That has just shifted it from the Attorney on every occasion to the portfolio minister on every occasion.

Mrs Dines—Yes. It is seen that the portfolio minister is in a good position to determine that the interests at a particular time do support the need to go above, because it was often very difficult for the Attorney to make that decision in a quick time frame without the benefit of all of that information.

Mr ANTHONY SMITH—Quite naturally, they would have been automatically liaising with the portfolio minister anyway.

Mrs Dines—Yes, so there is a bit of a streamlining intention.

CHAIRMAN—This committee over a long period of time has consistently raised questions, as it should, of ASIC in terms of its litigation, its processes and its methodology in terms of how it litigates, why it litigates and so forth. We have had a variety of responses. Would you say that ASIC adheres closely to the model litigant rules and complies across all of its litigation with those model litigant rules?

Mrs Dines—I do not have any evidence to suggest that it does not. The impression can be created by the odd judicial comment or a complaint from a plaintive. When you consider the actual volume and extent of litigation that ASIC conducts, there is proportionately a small amount of criticism or allegations that it has not complied with the model litigant obligations. From everything we see, ASIC does take quite seriously the requirements and attempts to ensure that it complies with the kinds standards of fairness that the model litigant obligation requires. As I said, the majority of the model litigant complaints that the Office of Legal Services Coordination have looked at have been ones where ASIC has drawn the complaint to our attention, and we have generally not found a breach in those cases.

CHAIRMAN—Does the Office of Legal Services Coordination conduct its own review of ASIC in terms of all its litigation? Is there some sort of annual review?

Mrs Dines—No. Unfortunately, we are fairly small. We are a smaller regulator. The Legal Services Directions are made under the Judiciary Act and so they are a legislative instrument. The general kind of staffing profile in the office would be about 14 people, who work on a broad range of functions. In terms of the way we approach compliance with the directions, we have to very much be selective in our approach.

CHAIRMAN—Is it more up to ASIC to refer complaints?

Mrs Dines—Yes.

CHAIRMAN—They choose what they would refer obviously. Have any of the complaints they have brought forward been upheld?

Mrs Dines—Just to clarify: I would not say that they 'choose'. They do need to tell us every time they have potentially breached or there has been an allegation.

CHAIRMAN—And you are satisfied that that is the case—that they do?

Mrs Dines—Yes. I do not have people monitoring judicial comments—

CHAIRMAN—I just want to get your impression of it rather than absolutes.

Mrs Dines—Also, it is not really that productive for us to scan newspapers and then ring agencies. I think they are a good reporter and certainly there have been times in the last few years where they have even—

Mr ANTHONY SMITH—Just on that, the onus is not on you, to be saying, 'We saw paragraph 68 in the *Financial Review*'; the onus is more the other way round?

Mrs Dines—It is more about needing to be with the volume of legal services activity across the Commonwealth.

Mr ANTHONY SMITH—Absolutely.

Mrs Dines—We kind of put our efforts into the front end of trying to help people understand how to comply rather than—

CHAIRMAN—A question that has come up for us in this committee in terms of ASIC is whether or not to litigate. It is easy enough if there is some form of litigation going on to make some judgment about its appropriateness or outcomes, but what about where an agency chooses not to litigate? Is there any review or judgment made about that particular process? It is a process of choice: whether a case which was not brought forward should have been brought forward.

Mrs Dines—Again, we do not go back and look retrospectively at whether it was a good idea. We would often become involved more from the perspective if a particular piece of litigation had been notified to us as a significant legal issue under directions, which the agency then gives you quite regular reporting on. Often in that context our office may, based on reports it has received, say, 'This is starting to look as though it is really in the Commonwealth's interest to settle it,' and not pursue the matter. I cannot think of an instance with ASIC where we have had to proactively say, 'You need to actively pursue ADR in this.' There have been instances where ASIC has come to us because, once the matter is notified as significant, the Attorney has to approve any settlement in the matter. There have not been any significant pieces of litigation brought to our

attention that have resulted in us actually unpicking the question of whether litigation should have commenced in the first place.

CHAIRMAN—Is there any requirement for an agency or ASIC to take a particular path, say, in terms of model litigant rules and how that works? There have been some issues in the past, certainly where there are differing views around whether ASIC should pursue a settlement or continue through with a case to determine an outcome and set a precedent or an example for the market or whatever, because it is perhaps larger than just that one issue or that case—it really is more about a better understanding of the market or the law around particular issues.

Mrs Dines—Yes, say, you have a public interest—

CHAIRMAN—There is a public interest case around a particular outcome where you would be better off—and this is where the question comes in and I want your view on this. Technically, in terms of a model litigant, you may be better off settling or you may be just more effective, more efficient, it is cheaper for the Commonwealth and achieves a better outcome for everybody involved. But in terms of a public interest to actually follow a case through to have a determination made—

Mrs Dines—It is very explicitly recognised that there will be circumstances where, whilst technical legal advice would actually say that the Commonwealth's prospects of success were limited, it would actually be appropriate because of those broader factors for an agency to initiate or pursue litigation. Sometimes that arises in other contexts for agencies as well when the claim is being brought against the agency rather than vice versa. The Commonwealth will not always just settle on commercial terms.

CHAIRMAN—Is there any requirement around that for agencies to notify the OLS and put their case forward?

Mrs Dines—When they have decided that it probably does not have sufficient prospects but there is another reason. There is not a requirement in itself, although often that sort of piece of litigation will be something that is reportable under the requirement to report significant legal issues because it will be sensitive, complex, test a new area of law or attract significant media attention. So it is quite often the case that we would be notified because of that requirement and then one of the nuances through the reporting would be that tension between the fact that perhaps legal principle and practice would not support the litigation and that there were other good reasons why the agency wished to pursue it.

CHAIRMAN—Does it follow on then, though, with this reporting that is collated in some sort of broader report that the legal services office re-examines those or makes some judgment or assessment as to whether this in fact is in the public interest?

Mrs Dines—We would usually hope to be able to have that conversation, give that guidance or assert that view a little bit in real time, which is why once you have a significant legal issue it is reported to us and you then have ongoing reporting requirements. One of the things that we have as well is that the secretary of our department has set up a significant issues coordination committee. So on a monthly basis there is a committee that involves the secretary of our department, the Solicitor-General, the head of the Australian Government Solicitor and some

representatives from the Department of Finance and Deregulation, and they review everything that is on our significant issues register. That is an additional safeguard where we would it to bring to their attention or they might separately say, 'What is the background to this case that is on there? Why has it been pursued?' It would not be impossible at the end of a piece of litigation if an agency was criticised for having pursued the litigation improperly that we would be required to look back. But, again, that would probably be more a matter of practical resourcing issues. We do not spend a lot of time doing that.

CHAIRMAN—Whether it is ASIC or any other agency, there often many more cases than it can possibly deal with in its own capacity to litigate. Therefore, it must choose between particular cases, which poses a bit of a problem or conundrum in terms of which ones are chosen. Is there any particular work that OLSC does in looking at that? Are there particular rules around this? Is there a particular set of guides to ensure that the choosing of something either being done or not being done does not then pose a jeopardy later?

Mrs Dines—It is easier for us to give that guidance in a general sense by trying to educate agencies to understand the meaning of 'reasonable prospects of success' in the rules around settlement and at what point you would decide that there are sufficient grounds to settle. There are a few different legal concepts that operate throughout the directions and it is difficult. People would always like a percentage requirement that says you have to be 90 per cent sure before you pursue or what the level should be before the Commonwealth should settle. We have guidance and training that we do through guidance notes, seminars or even just discussions. In many instances the agency will ring up and talk through with us those kinds of issues. It tends to be more on a general level. I think, just being specific around ASIC, there is a recognised difficulty in how in the additional layer that a regulator has to apply to those decisions because of the nature of its regulatory functions it is not necessarily always clear-cut because you may have other regulatory objectives or specific things in your enforcement strategy for a particular period that you have indicated are a real focus for the agency. So we accept there is an additional level of sophistication that leaves it a little bit up to the judgment of the agency as to how you would make a decision in a particular circumstance.

Having said that, the Attorney-General is very much of the mind that there is not a limitation in how the alternative dispute resolution policy applies to regulators and he believes that alternative dispute resolution is something every agency can pursue regardless of the nature of their business.

CHAIRMAN—Does your office receive complaints from outside of agencies, from the general public?

Mrs Dines—Yes. It is quite routine for a member of the public to write to the Attorney-General or sometimes for the legal representatives of a plaintiff in a matter to write to us. What would usually happen is that we would apply the triage I mentioned in my opening statement. Just as a matter of course we cannot investigate everything in a meaningful way, so we do try to apply judgments as to whether it is worth commencing an investigation.

CHAIRMAN—So the agencies have been pursuing everything.

Mrs Dines—Absolutely.

CHAIRMAN—Thank you very much. Mrs Dines, we thank you for your submission as well as for your time here today.

Mrs Dines—You are welcome.

Proceedings suspended from 10.11 am to 10.22 am

ADAMS, Mr Mark, Senior Executive Leader, Australian Securities and Investments Commission

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

DAY, Mr Warren, Regional Commissioner, Australian Securities and Investments Commission

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

PRICE, Mr John, Senior Executive Leader, Australian Securities and Investments Commission

YANCO, Mr John, Regional Commissioner for New South Wales, Australian Securities and Investments Commission

CHAIRMAN—I welcome officers from ASIC. Mr D'Aloisio, I invite you to make some opening remarks, after which we will go to questions.

Mr D'Aloisio—I do want to make some quick points today, really to pick up developments since we last met in November. You will recall that at that meeting that we foreshadowed an announcement concerning where we were at in commencing proceedings in the Storm Financial matter. Those announcements were in due course made. We have commenced proceedings to seek to recover compensation for investment and commenced an enforcement of civil penalty proceedings. Since we last met we have also banned one financial adviser.

Next, we have settled the Westpoint litigation. The main action in relation to that concerned the auditors and the directors. All up, when you take into account financial advisers, recovery from those proceedings and recovery from the liquidations themselves, we think the Westpoint investors will receive in the order of $160 million to $170 million, in relation to a total loss of about $388 million. We also commenced proceedings through the CDPP, the Commonwealth Director of Public Prosecutions, in relation to ABC Learning's two former executives. We received a decision on Fortescue which was handed down by the Court of Appeal, which was in ASIC's favour. The defendants in that case have foreshadowed special leave to appeal to the High Court. We also received a judgment from the Court of Appeal in relation to James Hardie. The action against the company was confirmed in ASIC's favour but the decision in relation to the non-executive directors was reversed by the Court of Appeal, and we are seeking special leave to appeal to the High Court in relation to that case.

Talking about enforcement activities, since we last met we have had some 45 cases that have been resolved of which we have been successful in 41. We have had successful outcomes in 14 criminal cases, eight civil, 12 administrative and seven enforceable undertakings and negotiated settlement.

Another significant case that has been resolved more recently is Sonray with regard to the CFDs. Scott Murray entered a guilty plea in relation to aspects of misleading and deceptive

conduct. We have also had a guilty plea from Mr Shawn Richards in relation to an Astarra-Trio matter. I think our record in continuing to run successful litigation and outcomes in a timely matter continues.

Another significant development since we last met—or update, if you like—is the continuation of the takeover of the licensing and credit regime. That is going extremely well. I think in my last report we said that we had had something in the order of 14,700 registrants. We have been in the process of converting those to licences. We have now received some 6,882 applications for licences, and so far we have granted 4,387 and we are in the process of granting 1,044.

Another major project for us is the transfer of ASX market supervision—we talked about that at the last meeting. As I said at the time, the transfer went well; continues to go well. We are pleased that we have achieved a seamless transition and we are now monitoring the market daily of course and proceeding with enforcement and compliance activities. Greg Yanco, who is here today, can provide the committee with more direct input in relation to that transfer.

We have moved from the transfer of ASX market supervision to the rules enabling competition for trading services to occur, if the government decides to grant final licences. Last week, in relation to that, we issued a timetable. It is important to note here, as I said previously to the committee: we set a program once the government had made the decision that it wished to introduce competition for trading services. We set a program first of all of achieving a seamless transmission of ASX supervision on 1 August as a precondition. That was achieved. We then said we would consult with the market in relation to rules that are necessary for the competition and trading services to occur because you have got new players in the market. Clearly, the integrity of the market and continued confidence in the integrity of the market is of utmost importance to us and to the markets.

In relation to that, that consultation process has been going on and the outline of the new rules that we are thinking about were announced to the market as part of the timetable that we released. We are on track to continue to complete that work and clear the way for the competition for trading services to occur if the government makes its final decision later this year or in the third or fourth quarter of this year.

Finally, briefly to other things: since we last met we had a very successful ASIC summer school. The ASIC summer school is now in its 14th consecutive year. We had over 400 participants to that. It is a paying event, so it pays for itself so to speak. Again, it is an important even for ASIC in not only being seen to be at the leading edge of opinions in key issues but also hearing from its stakeholders across a wide range of their views on those issues.

Next Tuesday we will be announcing and launching with the government our new website that will replace the FIDO website. It is not just, I might add, another website; it is a significant development for ASIC. Our FIDO website has achieved up to date this year in excess of 2 million hits. We see this website replacing that and upgrading and providing interactive assistance to investors and financial consumers in relation to superannuation and loans in a number of areas. It is very much part and parcel of our drive to improve our financial literacy in Australia. That launch will occur next week. The site will have a new name, but I am instructed that I am not to disclose that name until next Tuesday. That completes my opening address.

CHAIRMAN—Thank you very much, Mr D'Aloisio. We might go in camera so that we know what it is! No, we will not do that today. Thank you for your submission and for appearing before us. Also, congratulations on the success of the summer school. I think you are right that it is a great event every year and the number of participants highlights just how important it is and its success. Can I start you on the ASX and the transition that has taken place. We understand that by all accounts it has been a very successful and seamless transition. We had the ASX in this morning as a witness and had some discussions around the differences between what ASIC does as a regulator and what the ASX continues to do in terms of operation of the market. I would be interested in your view of how the two work. Is it side by side or is there overlap between your broad role as market supervisor looking after the integrity of the market and the ASX's role as the operator of the market and the rules that it sets? I would be interested in your view as to how those two work together.

Mr D'Aloisio—I will ask Greg Yanco, who led the team in the transfer and is responsible for the day-to-day operations, to answer that question.

Mr Yanco—If you look at the system and what was transferred, ASX previously handled the market supervision area for the whole of the market. What has transferred over is essentially the responsibility for supervising insider trading, market manipulation and market abuse and also a focus on disruptive orders. Algorithmic trading is where we find a lot of the disruption occurs. So that has transferred over and our market supervision team focus on those areas. What is retained at ASIC is the primary frontline responsibility for monitoring the market for potential breaches of continuous disclosure requirements and also a fair, orderly and transparent market obligation. Mark's team supervises ASX for those remaining responsibilities. In functional terms, on a day-to-day basis the two teams, the ASX market surveillance team and the ASIC's market surveillance team, work pretty closely together. We have an interest in continuous disclosure and we discuss issues we see. If there are potential breaches we might raise that with ASX or we might speak to a company ourselves.

What also transferred over was supervision of market participants in relation to the market integrity rules. These are rules around interaction with clients and requirements around order entry and also around automated order processing control—that is, the controls that are about making sure that we do not have a flash crash. We have inherited a fairly robust system in Australia that ASX has put in place to prevent something like a flash crash. It could still happen because we do see a lot of algorithms that do not work. Since we have taken over supervision we have intervened with a broker 23 times where we thought that their algorithm needed attention. On a continuing basis we have a liaison—

Mr ANTHONY SMITH—Just to refresh my memory, that is 23 times in how long?

Mr Yanco—It is 23 times in seven months. We have seen a spike or other activity or a looping algorithm where we have intervened with a broker. It has been detected by our systems. We have gone to the broker and said, 'We think that algorithm needs attention.'

CHAIRMAN—Same broker?

Mr Yanco—No, different brokers.

Mr ANTHONY SMITH—Any lumpiness in the period of time over that seven months?

Mr Yanco—No. They come up fairly regularly. I actually have an education campaign on this with brokers. The way that works is, apart from being visible in discussing the problems with them, sending a clear message that we are now moving some of those matters through to the deterrence teams where we are not happy with how the activity occurred. That may lead to a—

CHAIRMAN—Sorry, do you see that more as a market operational issue or a market integrity issue in terms of whether it is the conduct of the broker or more of a structural problem?

Mr Yanco—It is both, so ASX will also have an interest. They have an interest in maintaining a fair, orderly and transparent market, so they will be concerned that the brokers have the right connections. They will also be concerned about these spikes. We are taking the lead role in dealing with the brokers in getting remediation plans in place if they have problems. As I said, there are some matters where we have felt that either the way the problem manifested itself, as in it might have too far or might have happened too often, will cause us to refer something through to the deterrence team to consider whether brokers have breached their requirement to make sure that their orders do not disrupt the market.

Going back to the participant side, we now supervise brokers for compliance with the market integrity rules. My team, which was in place before the transition, also supervised brokers for compliance with their licensing obligations in the Corporations Act. Now we have a program which brings those two pieces together. We work closely with ASX to make sure that we minimise any overlap. We make sure that we share information about who we are visiting and when and what we are visiting brokers about. We also discuss the individual brokers that might be causing problems, so we both know and we share that information under the ASIC Act. So, we are both aware of where issues are happening and where the trends are going.

CHAIRMAN—That process that you have just described, it is more by agreement and consent between the two regulatory authorities in this area?

Mr Yanco—We worked very closely with ASX during the transition period to put in place these sorts of controls about working with each other on a continuing basis. We have formal meetings every fortnight as well as the day-to-day interactions we have with the ASX compliance team. We also have a set of protocols that we are developing to really govern those interactions. I guess a good example of that is the protocol we are developing around continuous disclosure and, with ASX having frontline responsibility, what ASIC would do and how it would go about doing something if it wanted to intervene. That is the sort of protocol we have in place as well as the protocols about dealing with participants.

Mr D'Aloisio—That is generally under the overall umbrella of the memorandum of understanding between us and ASX.

CHAIRMAN—In respect of that relationship you have a memorandum of understanding, you have your official role and then there is a separate function which is by understanding. Have you a similar mechanism being developed for any other entrants into the market; Chi-X for example?

Mr Adams—We will have arrangements with every operator. Sometimes that is formalised in an MOU as it certainly is with ASX. With the new applicant, Chi-X, we would have an MOU with them too.

Mr D'Aloisio—And licence conditions.

Mr Adams—Yes.

Mr D'Aloisio—There would be a range of tools you would have to ensure that you feel that you have overall proper supervision of the market operator.

CHAIRMAN—Do you have any concerns over the competition issues or over the way that the rules operate in view of a new entrant possibly coming later this year?

Mr D'Aloisio—It will probably be useful if I ask Mark Adams to spend a little bit of time giving you a bit of background of how we have approached competition and approached consultation. I think Mark will also cover our consultations with ASX, the input we have had from ASX and how we have responded to that. Then you will get the feel. Basically at the heart of we have been driven by the issue of making sure that we maintain confidence in the integrity of the markets in the way that competition would work and focused on the additional rules that are needed to facilitate that.

Mr Adams—The first step was, with the transfer of supervision, as Greg Yanco has informed you, we put in place market integrity rules, which took over from some of the operating rules that ASX had on the conduct of business matters that Greg described. However, with a multimarket environment, it is our view and I think the market's view that there need to be additional rules to accommodate the fact that now trading can occur on more than one market in relation to stocks that are quoted on the ASX. That is what we have been putting a lot of attention into.

It was highlighted by a consultation paper that we put out in November last year, which proposed a whole range of rules in addition to those existing market integrity rules to deal with a number of regulatory issues. It proposed a set of rules which we felt were necessary for the introduction of competition and, in addition to that, it noted a number of developments and trends in our markets which exist already. It noted that on some of those things we think there should be additional rules—but not necessarily linked to the introduction of competition. That is what the consultation paper covered.

We had over 40 submissions. We met with over 60 entities over the period between November and early this year getting feedback on those. In addition to that we have had dialogue with overseas industry participants as well as overseas regulators. With all that brought to bear, it came to a head with the announcement we put out last week about the intended framework for competition. The responses we received almost universally said, 'You've picked the right subject matter for maintaining integrity with the introduction of competition, as you proposed in your rules.' So what we intend to put in place is all the subject matter that we originally covered, with some minor variations. In addition, the response was: 'All the broader issues that you have identified, which are trends in the marketplace, are deserving as matters of priority to be looked

at with further consultation and additional rules.' So that is what we announced as well. That is probably the broad brush of where we are at.

I will give you an idea of some of the rules for the introduction of competition. A key one is called best execution. It concerns a market participant who is faced with the obligation or the duty of 'where do I put my trade?' when the instruction comes from a client. Potentially that could be governed by conflicts or it could lead to inefficiencies in the market if there are not adequate rules in place. So to supplement the existing rules is an obligation to achieve the best overall outcome for the client, which called the best execution rule. It is a key rule that we have put in place. It has different application in relation to wholesale and retail clients. I am happy to give more details if you would like me to.

Another key rule is a lot of consistency across the place. We are putting in place the pre-trade transparency rules, which say what can be non-displayed orders or displayed orders on a consistent basis across all markets. When it comes to some of the controls that Greg Yanco referred to, we are also proposing consistent controls across markets to deal with potential issues such as a flash crash. Every market operator will be required to have order entry controls which can deal with aberrant orders and, in addition to that, at the end of it to have consistent cancellation rules to deal with extreme price movements.

To give you a flavour of another one, obviously market operators need to cooperate. An important rule that we are putting in place is that, where the listing market—in this case ASX—puts a trading halt on a stock, that is immediately halted across all market operators. That gives you a flavour of some of the rules. There are more.

CHAIRMAN—Specifically on the consistent rules—and obviously it would make sense to have consistency right across the board—are we talking about the same markets, though? Chi-X is a different type of market, and you might need to look at some specific rules that would apply to the way they operate. Do you not see that as an issue at all?

Mr Adams—Not fundamentally. Chi-X is going to be a trading platform. It is all displayed liquidity, so it is not operating any 'dark pool', for want of a better description. It will have a central order book, just as the ASX does. Across those markets we will have universal rules on pre- and post-trade transparency, controls at the entry level and cancellation, cooperation between the markets around halts. The core rules will be common across both markets. Both ASX and Chi-X will have specific market integrity rules similar to the ones that Greg Yanco described earlier on. Fundamentally they too will be similar. However, it may be that a market operator will wish to innovate and be different and it may mean that we will need to respond with specific rules for that market. But at present that is not the case.

Mr Yanco—One issue is the tick size.

Mr Adams—The tick size—

Mr ANTHONY SMITH—I think you had better take us through it.

Mr Adams—The tick size is a rule which says: what is the increment between what you can bid an offer on the market. For instance, for BHP that is at a cent. That is where the tick size is.

So we are starting with a rule proposition that all operators have the same tick size across markets. That is an example of an issue that operators may wish to differentiate themselves between. At present that is not the intent, but they may well come to us and say, 'We would like to compete on tick sizes.' But that has not been proposed to us to date.

Mr D'Aloisio—I think what Mark is saying is that if you get that sort of proposal you would look at it, make an assessment, consult with the market and decide whether you would agree to a difference. If you feel that there are integrity issues that would cut across agreeing to a change, you would not change the rule.

Mr ANTHONY SMITH—I suppose I am interested in that process, not just on that issue but on other related issues.

Mr D'Aloisio—It is worthwhile—

Mr ANTHONY SMITH—Why don't you take us through, theoretically, where we are today, and then that is one example of where people may wish to differentiate.

Mr Adams—There are two kinds of rules. There are market integrity rules which are made by ASIC and approved by the minister. There are operating rules that a market may have and the minister has a power of disallowance on those rules. They are the two forms of rules. For instance, if an operator chose to differentiate itself in some way, it would be proposing an amendment to its operating rules. We would ordinarily advise the minister on those changes, just as my chairman described.

Mr ANTHONY SMITH—So it would come to you—

Mr Adams—Exactly. And we would engage with it and depending on the nature of it—

Mr ANTHONY SMITH—And typically—I hate to dwell on this but I think it is important—this would happen over some weeks—

Mr Adams—Absolutely. Depending on the materiality of the rule proposition, we would have already expected the operator to have undertaken consultation with the industry. We are likely to do our own as well. As my chairman pointed out, it may be that the proposition suggests that our own market integrity rules need to be adjusted as well. Therefore, if that was the case, we would consult, as we are obliged to do, on any proposed change in our rules. No operating rule, you would imagine, would be operative without the full package being considered adequately.

Mr ANTHONY SMITH—Not just by yourselves but through the consultation process so that others could say here is what we see as a strength or a weakness being proposed. We have been thinking that ourselves.

Mr Adams—Indeed.

Mr D'Aloisio—The others would include the market operators themselves, who would no doubt talk to us and discuss with us and discuss with the market. The consultation process is open and transparent.

CHAIRMAN—Is there a legislative requirement for a market operator, a platform, to seek the view or permission of ASIC before it changes an operational rule, or can they go straight to the minister?

Mr Adams—There is a requirement. Market operators have to submit their operating rules for disallowance by the minister. In that process we would normally advise. As for our market integrity rules, they are legislative instruments. The minister has an approval role and, under the Legislative Instruments Act, there is an obligation that consultation occur, and they are subject to parliamentary disallowance.

CHAIRMAN—There is obviously a very close working relationship. We heard from the ASX about the fortnightly meetings and their view on how that operates. That generates a range of activities and action items that need to be acted upon regularly. Can you give us some sense of the pre and post ASIC supervision in terms of the level activity on trading alerts, referrals and investigations? Has there been any difference at all pre supervision and post supervision?

Mr Yanco—I note from your recent report that you looked at our report that came out in January, which covered the first five-month period. But I do have some up-to-date numbers. Up to the end of February, we have received 37,500 alerts, which is about 5,300 a month, which is consistent with the number that ASX were getting. They were getting between 5,000 and 6,000 alerts a month. That has led to 24 referrals to the deterrence team. On an average per month, that is probably a little bit higher but then, again, it is only a seven-month period.

The one difference that we flagged is what we thought would be a benefit in bringing the market surveillance to ASIC was that we are closer to the deterrence function, not in the sense that we are thinking constantly about deterrence because we are also about sending matters over to deterrence, because we really are monitoring the orderliness of the market as our first role. But we actually have something called triage, which is meeting that we have every week or sometimes more than once a week with the deterrence people, where they review matters very early on and give us advice as to whether they think this is a matter that should be worked up fairly quickly to come through or something that they are willing to take on.

Mr ANTHONY SMITH—I do not want to stop you in your tracks. I just want you to enlarge on that point. In relation to this triage, are there set times that you meet—weekly or more than weekly? Do you meet twice a week or a couple of times a week?

Mr Yanco—We generally meet once a week. But depending on a matter, if there is—

Mr ANTHONY SMITH—You are demand driven is what you are saying.

Mr Yanco—Yes. The surveillance people will be looking at alerts. They will flag something for further inquiry and they will do some preliminary work.

Mr ANTHONY SMITH—Just so that we are clear: as a matter of course you are meeting weekly to have that ongoing weekly analysis and then when there is more activity that requires you to meet more than weekly, at your weekly meeting you say, ‘I think we’d better meet in a few days time.’

Mr Yanco—Yes.

Mr ANTHONY SMITH—How do you do that? Is it face to face?

Mr Yanco—Yes, it is quite a formal process because we are leading to a decision to make an investigation, and that is a legislative type phase; it is not that we have just called it an investigation.

Mr D'Aloisio—The teams are physically located in a way that that just happens—on the same floor.

Mr Yanco—There is almost daily interaction between the investigators and the analysts. So they are talking about these matters. The triage will be the formal process where we consider a matter. There is a paper produced about what the matter is about, what the indications are of what offence it might be, and then there is a discussion with the senior managers from deterrence and surveillance about whether this matter needs more work done by one of my teams or it satisfies the requirements for a formal investigation, in which case it is taken on. In terms of that process previously, ASX would produce a referral. They would make a call on whether a matter should be referred to ASIC. They were restricted in that they were not able to interview clients. If they could find information from the broker, they would know who the client was.

Mr ANTHONY SMITH—So they could get to a certain point.

Mr Yanco—That is right. Then they would do a referral and that would go to a team in my area—market analysis team—who would then do some more work, maybe do some interviews with clients, and refer that on to deterrence. So we did start the triage process—

Mr ANTHONY SMITH—Or not take any further action.

Mr Yanco—Sure. By cutting out that extra process and bringing in a deterrence team closer to the analysis, out of our 24 matters that we have now sent through that have been approved for investigation 10 were taken on by deterrence teams within 30 days of the trading activity. Previously, ASIC would not really have seen a matter for maybe four to six weeks.

Mr ANTHONY SMITH—At the first instance.

Mr Yanco—That is right. And that is getting to the analysis team. What is significant about that—and I am not trying to say that we are going to make a massive change to how long an investigation takes—and what is important to the deterrence team is that the evidence is a lot fresher. The interviews that they conduct are a lot fresher and, hence, they believe they are getting a heads-up, I guess.

Mr ANTHONY SMITH—What you are saying is now, as distinct from the past, you are able to talk about matters, deal with matters and conduct interviews should you need to within days.

Mr Yanco—Essentially.

Mr D'Aloisio—Under the previous arrangement, ASX had to operate within its rules and it did its best, and we did within ours. It is the change of structure that has led to the additional efficiency and time that Greg is talking about.

CHAIRMAN—There is obviously a lot more activity. Would I be right in saying that? Could we use just the simple term of 'more'?

Mr Yanco—There is more activity because of the interaction between the investigators and the analysis team about evidence. It is really focusing in on the elements of any particular offence and what evidence we are seeing and what work we need to do either to bring the matter up to investigation ready or to write the matter off. It is important that we are getting a feedback loop from the deterrence people about what are good matters for them and what are matters that we need not really waste time working on.

CHAIRMAN—The ASX had a view—and I think you have confirmed it in terms of trading alerts and the work you have been doing—that there is no discernible difference between pre and post.

Mr Yanco—Kevin Lewis facilitated some parallel runs and we looked at the alerts over a period in November last year. There were some little differences both ways—looking at matters that they would have liked to have seen but did not in our alerts and ones that they had—

CHAIRMAN—I know it is a high benchmark as well in terms of the market integrity, but would it be unfair if I said that, given all of this activity—and it has been only a short period of time—there has been no improvement?

Mr D'Aloisio—The word 'unfair' is a little emotive. I think what we are saying in a very measured way is that all the signs we are seeing are that the improvements are there, and Greg has just gone through the improvements in relation to the deterrence and activity. We are not at this stage, because it has only been seven months, about to say to you that there has been a gigantic improvement. I think saying 'no improvement' is unfair, but I agree that it is your call.

CHAIRMAN—That is why asked that.

Mr D'Aloisio—I think the improvements starting to come through are quite clear. I think it is a good move for the market and for the teams that are operating.

CHAIRMAN—So we can expect to see some level of market integrity improvement, something that can be measured and reported on. Would it be fair to expect that?

Mr Yanco—With Mark's team we are doing some work around developing those measures. The answer to that is a clear yes, and we are looking at how we will measure that and report.

Mr D'Aloisio—As I have said on previous occasions, this is additional surveillance work that we are doing but, as you will recall from previous meetings, there has been a significant uplift in the work and the resources we have put into insider trading and market manipulation. A lot of the work that has been done over the last few years in relation to that is now coming through in the number of convictions you are seeing in the court and in the number of guilty pleas you are

seeing in the court in relation to these offences, which indicates that our evidence collection and investigation are very robust and the work of the DPP in working with us on those things is very robust. It is building on what we think is already an improvement that should be translating into improved confidence in the integrity of the markets.

CHAIRMAN—The ASX this morning raised some concerns on competition issues, particularly between lit markets and dark markets, with the number of players there are in the market. There is evidence that in other markets overseas where there were more than two operators it became an issue in terms of liquidity in terms of activity. Competition in that sense was not necessarily a good thing. Do you have any comments or views on that?

Mr D'Aloisio—Let us deal with dark pools first. What you are seeking to do here is identify whether dark pools in a competitive environment in the way they are regulated are different to a monopoly environment. Our conclusion is that, with proper rules, dark pools can operate in a monopoly environment and they can operate in a competitive trading environment, as we are seeing in places like Canada and so on.

It is important to give you that background and then to pass to Mark to talk about what currently happens with dark pools and how they are regulated, what will happen with dark pools and how they will be regulated post competition and the further ideas and thoughts we have in mind in relation to monitoring dark pool activity. We share with the ASX the basic concern that at the heart of everything else is the integrity of the markets and if there is behaviour or conduct that needs to be regulated and dealt with we will deal with it, and we think we can deal with it much faster and with absence of any potential conflict than the market operators themselves. With that I will pass to Mark to give you more detail about dark pools. There are other issues I think you may want to raise but let us just deal with dark pools first.

Mr Adams—What is dark pool? My layman definition of that is that it is a trading facility typically operated by a market participant, such as UBS or Credit Suisse, which enables the matching of orders either between themselves and clients or between clients of that same participant. That is sort of a dark pool. What happens in there is that the orders are non-displayed to the lit market, so that is the darkness feature of it. They already exist in Australia today. There are a number of them which exist under the rules that ASX has had for some time. The ASX has rules today on what is displayed and non-displayed liquidity. They are called 'off-book' and 'on-book' dark trades. These dark pools operate in that environment. They are also, as market participants, Australian Financial Services licensees and are subject to the operating rules of ASX and our market integrity rules. That is the current environment that they exist in.

As I mentioned before, one of the consistent rules we want to put in place in a multimarket environment is: what kind of orders can be dark, or lit, or displayed or non-displayed? What we are intending is to put in place, at first instance, consistent rules across all market platforms which are based on the current ASX rules. So that is the current environment.

There is debate going on globally and here about what is the appropriate regulatory treatment of these operators. As I say, they are sort of working under the franchise or auspices of the ASX market today and our rules. In other jurisdictions, such as in Europe, some of these dark pools are treated as a regulated trading platform. In Europe they call them 'multi-lateral trading facilities' and in the USA they call them 'alternative trading systems', which is a half-way house

between being a market operator and being simply a market participant. That is, I think, an issue which is deserving of attention and it is one that we understand that Treasury have in mind to undertake a review on. In light of that through this process we did not intend any rule changes which would pre-empt that review process.

My chairman referred to an important issue which is the debate about displayed and non-displayed liquidity. What matters to us is whether there will be flows into dark liquidity which may undermine the price discovery process on the lit market. This has been in our minds and in the minds of a number of entities in this jurisdiction and certainly the ASX as well. Our intent is to take forward the discussion on that with a view to consulting later this year and with a view to settling, perhaps, rules on that early next year. We do that on a concurrent basis because all those major jurisdictions I mentioned are all discussing the same issue right now.

Mr ANTHONY SMITH—On the same timetable?

Mr Adams—Their timetables are all slightly different.

Mr ANTHONY SMITH—Of course, but take the US, for instance.

Mr Adams—They put out a concept paper last year so they are broadly working on dealing with that during this coming year. Canada put out a paper at the end of last year, similarly, and Europe as well. So the overall topic about what is the right balance between displayed and non-displayed liquidity is being debated globally. That is what we propose to consult further on. In the consultation paper we put out in November we did have propositions on this. I will touch on two thresholds. One is called the block-trade threshold. Currently the ASX rule sets that at $1 million. An order over that can be done off-market at any price and then it is executed on-market. So the match happens off-market and is executed on and reported to ASX.

Then there are what are called priority crossings. They can be of any size and they need to occur at or better than the bid-ask spread. They are then executed also on the ASX market. What we put forward was a proposition that there should be a threshold of $20,000 on those priority crossings and that orders less than that should be displayed on the market. Orders above that could go through this priority crossing process and be non-displayed, as long as there was price improvement. That was the proposition. It was hotly debated through the consultation. I think there is universal agreement that we should be concerned about the price discovery proposition. But just how to respond to that is the issue that we wish to consult further on.

Mr ANTHONY SMITH—When you say it was hotly contested, what were some of the criticisms of it?

Mr Adams—One level—

Mr ANTHONY SMITH—Appreciating that you may not wish to advertise—

Mr Adams—The same issues globally—at one level, some entities do not accept that this borderline issue is an issue at all.

Mr ANTHONY SMITH—That is what I am trying to get to, the range—

Mr Adams—At one level, it is not an issue

Mr ANTHONY SMITH—(*inaudible*) don't know what you're going on about,' and another said, 'We know what you're going on about, but you're not going to achieve what you want to achieve or there will be some unintended consequences.'

Mr Adams—That is right. You have the flavour of the response.

Mr ANTHONY SMITH—Can you take us through the second—

Mr Adams—The second response was, 'We need to think carefully about the proposition to put in place.' There were all sorts of ideas. Some people thought that our threshold notion was a good idea. In fact, the ASX said that and suggested that the threshold should be increased to $50,000. Some people said that any threshold proposition similar to the Canadian rule, which they are proposing, should only apply to certain kinds of orders—the kind of order that is a limit order where someone actually displays, 'Here's my bid and order; here's a price that I put out there.' So they should be incentivised to do that by putting on these thresholds. Market orders would not be subject to that threshold; they would just go straight in. That is another option.

Another idea that people put to us is similar to the USA model: if a certain volume occurs in transactions, particular stock in the non-displayed platform, then once that volume is hit all the orders should become pre-trade transparent. That is an idea that the USA is discussing. All those options are ones that we need to take—

Mr ANTHONY SMITH—That suggestion is really a timing issue?

Mr Adams—In that case, in a sense, once a platform reaches a certain dimension in its size, that should go on to the display market. We plan to further consider all those things, in dialogue with the industry, and to put forward a further consultation paper later this year.

My chairman has explained the relationship with competition. As I outlined earlier, the existing regime already has market participants with these doubtful operations. They exist today, whether or not there is competition. With competition, will there be more of these? That is a difficult one to answer. I would not necessarily suggest to you that competition will be the progenitor of many other dark platforms. You can imagine there has been a growth of people wishing to offer dark platforms. That trend, whether or not there is competition, is likely to continue.

CHAIRMAN—Before moving off the market and moving to other things, ASIC made a decision to undertake market rule reform in two phases and to specifically look at it in two parts—market competition this year and then addressing more complex issues later. Maybe you can give us a quick brief on that.

Mr D'Aloisio—Again I will introduce it and pass it to Mark but, fundamentally, we have had to look at these rules and make the judgment of saying, 'Do we tidy everything up and then give the final recommendation on competition or can we break these up, introduce those rules that really matter for competition now and allow competition to operate and continue consulting the

industry in relation to the other issues and bring those changes in when we can?' I think this is probably a point of difference with the ASX.

Our view is that, if the market can operate with integrity, you allow that and you give the advice to the government to allow competition at the earliest possible time and that is what we have done. We have made the judgment that we can introduce competition and then look at these other rules in due course. That is the position we have taken after very careful consideration and a review of all the views that have been put to us, particularly by the ASX and the market. We have had to make that judgment balancing the interests of all parties, but particularly market integrity. That is the background to it and Mark might want to fill in some of the details about those rules.

Mr Adams—I have little to add in fact because I touched on it earlier, so I might just confirm some of the things that I said at the outset. When we took forward our consultation we identified a range of proposals that we felt were necessary for competition and others that were responding to trends in the marketplace. We thought carefully about the responses we received. As I indicated earlier, almost universally people said that we picked the right patch where they were necessary for competition, the other issues do not need to be dealt with, do not undermine market integrity, so proceed with that and continue the dialogue and settle those other issues sooner rather than later. No-one was suggesting that we do not carry forward that momentum but that two phases was an appropriate outcome. We took on board the consultation and our own analysis of those issues plus dialogue with overseas regulators that we were making the right call on what needed to be dealt with at the outset or not.

CHAIRMAN—That satisfies my question. I am happy with that. I want to move on to an issue that the committee has discussed on many occasions with ASIC. It is the issue of litigation and the processes around ASIC's decisions to litigate or not to litigate. This morning we heard from the Office of Legal Services Coordination, particularly in terms of model litigant rules. I am trying to better understand ASIC's process in how it takes on board a particular case. And as you, Mr Chairman, earlier highlighted some of the successes that ASIC has had, we appreciate those, and obviously there have been, at times, others that have not been successful. I am certainly interested in how you apply the model litigant rules internally within ASIC.

Mr D'Aloisio—I will not go through the actual specifics of the model litigant rules but I am happy to do so if need be. Basically, the Legal Services Directions that you would have heard from the Attorney-General's Department that apply to ASIC as they do to other agencies are very closely followed by us in what we do. We provide and, indeed, I as chairman certify compliance with those directions on a regular basis to the Attorney-General's Department. We provide those reports on a regular basis. We have processes within ASIC operated through the chief legal office area and the commission's general counsel to track through complaints or issues that may have been raised in relation to our compliance with those directions. We report and improve our processes where we need to.

Those directions and Legal Services Directions extend to, for example, if we think that we should seek special leave to the High Court, there is a process by which we need to consult and speak with the Solicitor-General and we would follow that process. There are requirements in there that the standard you reach in relation to your prospects of success has to be at a particular level before you take it to the next gate as to whether you consider proceedings. The directions

around model litigant rules that the Commonwealth government has are part and parcel of all of our procedures. We comply and where there might be an issue we certify that compliance and draw the attention of the Attorney-General's Department if there has been some issue or complaint.

Going to the more substantive issue of how we actually decide to commence litigation, you will be aware from previous discussions we have had on major matters that there is a process. Clearly, we need to reach a point where we think that the investigation is one that warrants a particular type of remedy. It might be criminal or civil wrongdoing or forceful—

CHAIRMAN—Just on that, is that done for every single case that comes in to ASIC? Every single one is looked at and the determination is made ruling it in or out.

Mr D'Aloisio—Every single case, before legal proceedings are commenced, is looked at and reviewed in the process. Clearly, if we are talking about a breach of a lodgement of a report, that is not done at a commission level. There is a sort of gradation. The major investigations, major matters, will generally be decisions that will be taken finally either by a commissioner, with a senior executive leader, or by the commission itself. From there, the senior leaders can take a range of decisions and so on. So we have a delegated process. At the heart of it, at the end of the day, is the issue that, in undertaking any form of litigation you have to ask: is it a case where you have reasonable prospects of success as a matter of law? Secondly, is it in the public interest that you take that case on in that way? Those decisions are case by case decisions that the agency makes.

CHAIRMAN—Can I take you to the process and how it escalates. You receive a complaint of some description—and I assume all of them would warrant some investigation, at whatever level it might be—and then you process it to a particular point. I understand that you do not have limitless resources at your disposal. Is there ever a situation where a resource decision has to be made as to whether a case does not warrant further investigation on the basis that resources mean that you cannot investigate every single case? Are there any resource issues in that particular area?

Mr D'Aloisio—I might ask Warren to talk about the complaints area, how we deal with a number of those and how they get sifted. I think that is what you are referring to. We can start the process from there and I can perhaps pick it up in relation to some of the bigger cases. But, clearly, resources and balancing of priorities are part and parcel of any agency's work. We do not have limitless resources, as you know. They are quite finite and we have a huge amount of work, so there is a prioritisation that you need to go through.

CHAIRMAN—I am only seeking a better understanding of this area, to really understand the rules around the processes and guides that ASIC uses and whether they need more work in the future.

Mr Day—As you know, ASIC receives around 14,000 reports of misconduct, or complaints, a year. Of those, I think it is important to note that about 21 per cent are not in the jurisdiction. They relate to other things and there is no actual information there that gives grounds for an offence. So 21 per cent are not something that ASIC would ever be able to action, for those reasons. We count the 14,000 as everything that comes through the door. We register and

acknowledge everything that comes through the door and everything gets considered, initially, in that space. We aim to do 70 per cent of that initial assessment within 28 days. So 70 per cent of those who put in a complaint will get a response within 28 days.

In terms of the criteria and the matrix of issues that will apply to that, our formal assessment takes into account the information that the report contains. We will look at other antecedents. Have we been told about that individual party before? We match up previous information out of our database. We will take into account other sources of information that we might have received from other agencies or from other parts of ASIC. We match all those up, so it is not just taken in isolation without the context of other things. It is an important component of what we do.

Mr ANTHONY SMITH—You said 14,000.

Mr Day—Yes.

Mr ANTHONY SMITH—You might want to take this on notice, but what proportion of that would be repeat business, where you have multiple complaints in an area? Would it be 50 per cent?

Mr Day—We refer to them internally as duplicates. Those are ones that are about the same thing. Or are you talking about a person who has come back more than once?

Mr ANTHONY SMITH—No—the same issue.

Mr Day—We could probably tell you that.

Mr ANTHONY SMITH—Do you want to take it on notice?

Mr Day—I am happy to take it on notice. The thing you need to be careful about with that, as Mr Ripoll would know, is in relation to a matter like Storm it is in the hundreds. The commission said some time ago that they put a threshold that anything that has a certain number, like a hundred complaints, needs to go to the commission. I can tell you that what we would call a high-volume matter is something that has something like eight complaints. That is not to say that we do not get matters that have 50 to 100 complaints. That happens occasionally, although in the last 12 months there has been less of that.

CHAIRMAN—But there is no minimum requirement?

Mr Day—No.

CHAIRMAN—If there was just one complaint, if it was significant—

Mr Day—I would not be able to mention the details of them but I could point to a number of things in the last three months that have been accepted for further investigation by our deterrence teams that have been on the basis of one complaint and no other information. In terms of the threshold, it does not need more than one. But if you like, Mr Smith, I can still take on notice the question about—

Mr ANTHONY SMITH—I do not want you to create a bureaucracy. I am not going to hold you to precise percentages.

Mr Day—We will see what we can provide.

Mr ANTHONY SMITH—What I was really getting at is that, at any given point in time, 10 or 20 per cent—you tell us—might be an ongoing matter. For instance, there was one that was public last year dealing with some telecommunications and small business matters. There was a crossover with the relevant ombudsman, for instance. At any given point in time, I imagine, you would have a certain percentage that are ongoing and then you would have new complaints coming in. What you are saying is that the substance of just a single complaint is sufficient. That is really what I was getting at.

Mr Day—Rest assured, if the information is there that supports the allegations and they are of a type that the agency takes on then they will. As I said, in the last six months I could point to a number of occasions where that has been the case. I talked about 21 per cent. That does not mean we just say, 'Sorry, not us.' We do what we can to assist them to find the right place. It might be another government agency. We assist them with that by either letting them know that, with their permission, we will refer that or giving them further information. We do not just abandon them. Outside of that, there will be a certain component where an issue is in our jurisdiction but it is not one where we can identify any real breach or any real offence. So if there is an allegation that is of a type that is within ASIC's purview but there is not enough evidence to support the breach or offence in that respect, through that process we will consult with specialist teams such as Greg Yanco's or our credit area to see what they think about that. We will also consult with the deterrence teams about that, if need be. For some of them we will work up an assessment of those things and speak to the deterrence teams and say, 'We have issues about the A, B and C evidence. We don't think that will come up to scratch.'

Mr ANTHONY SMITH—Just to take you back a bit, when you say that 70 per cent of people making a complaint will get an answer within four weeks—28 days—that obviously covers the field from, 'Thanks, we can understand why you have written to us but we are high profile and this is really not for us; it is for the ACCC or someone else,' or 'This is an ongoing matter and we refer you to what we are doing.' Then for the 30 per cent that are not responded to within four weeks, is that principally because you really have to delve into it?

Mr Day—Exactly. I would use the example of Storm. Complaints or reports of misconduct are still coming in now about Storm from members of the public. I can tell you, it is not necessary—

Mr ANTHONY SMITH—You are replying to them?

Mr Day—We are registering them and replying to them and reviewing those matters. We are referring those matters to the existing investigation team for them to consider whether there is anything new. By and large, there is not.

Mr ANTHONY SMITH—But you are writing back attaching the chairman's press release and—

Mr Day—Yes, and pointing them to what actions we are taking.

Mr D'Aloisio—In the case of Storm and Westpoint, in addition to writing back we have established a website specifically for Storm and specifically for Westpoint, which is linked to our main website. That keeps them up to date on what we are doing. In the case of Storm we have also provided individual confidential websites within that to investors so that correspondence with us and what they do can be monitored in that way. That is the big matter end. By and large, that would happen in the big cases. It does not happen in all cases. To pick up your point, it is the efforts that we go to to keep people advised of the progress of their investigation. We understand people do get frustrated. They would like to see quicker results. Sometimes they do not hear from us for a period of time and they get frustrated with us. It is not through lack of effort from Warren and his team; it is just that some things take time.

Mr Day—But everyone will get a response. As I said, it is 70 per cent within 28 days, but 100 per cent will get a response. There are circumstances where, with 14,000 of them, they come in from all around the country. There will be something so that at the time—administrative error, human error—a response is not sent. When we become aware of that we rectify that immediately. That is the rarest of circumstances.

CHAIRMAN—That is fine, thank you. Mr D'Aloisio, a complaint we often get into our offices or from people who write to us is that ASIC 'isn't doing anything about X, Y and Z', that there is no response or that you are not acting on what, on the surface, might appear to some people to be 'a case'—

Mr ANTHONY SMITH—It is still happening.

CHAIRMAN—Or it is still happening. A fund that has had some issues—perhaps fraud, and I could go through a number of specific ones. Generally speaking, we do get regular complaints. I want to give you the opportunity to satisfy us about this process of dealing with not just a complaint but with the matter, whether it is through litigation or through a particular action, that ASIC follows through on every single one as it were. That leads on from my question about the resourcing issue, but really I want to be confident—I am sure all the committee members want to be confident—that ASIC fulfils all of that to some satisfactory level, and hopefully that would then in turn satisfy people who complain about this view that either nothing or not enough is being done.

Mr D'Aloisio—It is a big question, Chairman. What I would like to do is not so much take it on notice but think about it a bit more and come back to you and give you an answer today as well. It is a problem that worries me, that worries the commission, in the sense that we want to make sure that we are not seen to be dropping the ball in any cases and that we do discharge our responsibilities as a regulator. It is a balancing issue between the rights of individuals who might be subject to an investigation and the right of the public or the complainants to know what is going on day to day. Typically, once ASIC makes public that it is investigating an individual, for example, that has a huge impact on that individual's reputation. So, clearly, ASIC is very careful about maintaining as confidential its proper inquiries until such time as it can make a decision as to whether or not it would institute proceedings.

With a lot of investigations ASIC gets to the point of saying that there is no case to answer and that is the end of it. You are balancing up in that regard the rights of individuals against the right of those involved in the public to know what is going on. That line traditionally has been drawn, that once the investigation is complete, if ASIC decides to take action, it is announced and that then gives the public the right to know. The difficulty with that line has been that where ASIC decides not to take any action, that has not generally been announced or made known. We are looking at what we can do to better improve that aspect of communication, of reassuring people that the matter is not dead or has not been lost sight of but at the same time balancing the rights of individuals.

The other area that we have concerns about and are trying to grapple with is where you come to the view that ultimately a matter does not have the merit to proceed and how you then communicate that back to the individual. I am conscious of the problem, and we are trying to work it out. But at the moment the default, if you like, is that the balance is in favour of individual rights and preserving those until such time as we feel there is a case to answer and it is going to court. We are trying to explore other ways of keeping people informed and we will continue to do that. We could default back to say, 'Look, we've taken your case on. We have commenced an investigation. This is where we are at. This is what we are looking at.' It is very media friendly material—and that is fair enough—but it could do a lot of damage to individuals. Indeed, as you know, the mere commencement of a court action does a huge amount of damage to reputation, so we have got to be very careful in discharging that responsibility. I am mindful of the problem, we are mindful as a commission and we are trying to find other ways to keep people better informed. Indeed, as you know from some of the inquiries with you, the discussions we have with you and the confidential briefings to this group from time to time, we do go into it to give you comfort that we are not sitting on things and not letting things slide by the wayside.

CHAIRMAN—Thanks for that. I appreciate that. So in terms of some follow-up that you said you would provide, maybe there are two particular areas of focus. One is that method of communication—while fully understanding what you have explained about what you can and cannot communicate, for all the right reasons—and maybe looking at how that is actually taken on board so that people, organisations or whoever it might be can feel satisfied that ASIC is undertaking its duties fully. So it is more of an opportunity for the commission to be able to give people some comfort that whatever it is that you are doing is satisfactory. The other one is around the idea or concept, certainly given what is portrayed to us as members of parliament, that a case might not be of interest to ASIC and there is a perception sometimes that, as has been explained to me, ASIC thinks it is too small, insignificant, not important enough, does not have enough public interest or whatever it might be. The complaint that is around is, 'Look, there is a case that exists but it's just not important to ASIC,' whereas it is important to the particular person that is raising the issue. So on those two themes there is maybe an opportunity to satisfy not only this committee but the public as well.

Mr D'Aloisio—Let me take both of those and we will give you a response. In giving you a response we will also do some internal spot reviews to illustrate our answer, to explain why our answer is what it is, so that it gives you a bit more meat—without naming individuals—about the issues that concern us when we balance individual rights against those of the public interest, the community interest, in trying to strike the right balance between keeping people informed and at the same time protecting those rights.

CHAIRMAN—Thanks for that. The Office of Legal Services Coordination relies on agencies like ASIC to provide them with details as to self-regulation in terms of any litigation that you are going to take on. Could you give us some idea of the level at which you do that?

Mr D'Aloisio—In addition to the certificate I give on compliance with Legal Services Directions, we report the cases we take on, the costs of counsel that we brief and the time. There is a range of reports that we provide back through—

CHAIRMAN—Does that include the cases that you do not take on? Does it go to the positive and the negative in terms of reporting?

Mr D'Aloisio—I will check that. I will take that one. I do not think it does go to the negative.

CHAIRMAN—I will explain why I am asking the question. I am assuming there is 100 per cent compliance and I am certainly satisfied that it is the case that ASIC does report to the OLSC in terms of any potential breaches that ASIC might have and in terms of following the model litigant rules et cetera. But they are for all the cases that you do take on. What I am interested in is the decisions in the cases that you decide not to take on. So if there is a decision made, do you report that as well?

Mr D'Aloisio—If there is no case to answer or if a matter is a 'no further action'—or an NFA—I do not think we report that to the Attorney-General's Department. I will check. But in any event that material is available to us, to the commission and internally, and I can give those statistics to the commission. In other words, we can look at a 12-month period or whatever it is and outline the number of actions. We already report the investigations we take on—those where we are successful and those where we are not successful—and in that process we can also extract those where we decide that the evidence might be of a nature that requires no further action or where the public interest considerations are not met. We can give those numbers as well.

CHAIRMAN—Still on the theme of the model litigant rules, they are quite specific about how it all operates and the role that ASIC and other agencies need to play in adhering to those rules. Do you believe ASIC has a special case in the sense that there might be times when, rather than follow a settlement path, you have a higher public interest case because of giving examples to the market or setting a legal precedent or doing something which might have a further benefit?

Mr D'Aloisio—Do you mean outside the Legal Services Directions?

CHAIRMAN—Yes, where ASIC does make, or has the capacity to make, a decision not to follow model litigant rules on the basis that there is a higher public interest.

Mr D'Aloisio—I am not aware of any example where I have been involved or this commission has been involved in making that decision, that we would make a decision irrespective of the model litigant rules. Is there an example, Chairman?

CHAIRMAN—No.

Mr D'Aloisio—Our interests and the Attorney-General's interests are entirely consistent. At the end of the day we are a law enforcement agency and we work within law enforcement

agency rules. There are some differences. For example, we can brief barristers probably more easily than some other agencies can in terms of some of the rules that are in place, but they are generally procedural rules. But on the substantive points of how we conduct litigation and judgments about what is in the public interest, I am not aware that we would say, 'Notwithstanding what the model litigant rules provide, we will go in this direction and then report it to the Attorney.' I have not had this question before—so it is not one that I have thought through—because the default always is that you are a Commonwealth agency and you comply with the agency rules. I do not see a circumstance right off. I am happy to think about it, Chairman.

CHAIRMAN—Okay. I will pursue it at some other point in time. I thought there might be a special case for ASIC where I think it would be a positive for ASIC to particularly go down a path which might not be entirely consistent with the model litigant rules because there is a higher public interest case.

Mr D'Aloisio—We will have a look at it. As for the most recent example, special leave to the High Court on James Hardie on an important point of law, when we looked at it we saw it affected ASIC and other agencies—probably ASIC more so—and the model litigant rules have provision for that. I will take it on notice.

CHAIRMAN—The question really revolves around this issue of whether you seek a settlement in a particular case or you decide that there is a public interest that you not seek settlement and you actually follow a case through regardless perhaps of the percentage that would be assigned to that case as to whether you would win or lose.

Mr D'Aloisio—That sort of process is also—

CHAIRMAN—Contained within the model litigant rules.

Mr D'Aloisio—Yes, it is within the rules.

CHAIRMAN—You have to meet those.

Mr D'Aloisio—Yes, as a Commonwealth agency your job is to act in the public interest and if settlement is the better way to go the rules will accommodate that.

CHAIRMAN—Okay. I will move off that particular one and ask you this. I know a fair bit has happened recently with the case of Storm Financial. Perhaps you could give us a brief update on where that is at.

Mr D'Aloisio—As you know we commenced proceedings for unregistered management investment scheme, MIS, against three major institutions and commenced also unconscionable conduct, under breach of section 73 of the Trade Practices Act, proceedings in relation to another three, as well as several penalty proceedings against directors of Storm. Those cases are proceeding through the courts. The indications are that parties will have put out statements to contest those cases and contest them in detail and in substance. That is their right to do. We will continue to progress them through the courts. They are going through various directions hearings at the moment. The commercial resolution processes that we were following have now ceased

and the matters will work their way through the courts. ASIC remains committed to proceed with those cases in the quickest possible time that it can given the court program and given the rights of the defendants to contest the various issues.

CHAIRMAN—Thank you for that. Could you give us an update on the progress of frozen funds? Mr Medcraft, I think it might be your area.

Mr Medcraft—As you know, they have been frozen since the GFC. What is happening at the moment is that there are three things. One is that there is an asset liability mismatch—a lot of five-year loans for commercial property development is a sort of classic—and then there are others, which are development loans, which were even more locked. That is the nature of the problem. In terms of releasing those funds there have been ASIC measures in hardship relief to allow people to get their money out. We put those measures in place. I have some statistics on those which may give you an idea. In terms of the hardship relief to the end of January we had had 6,500 applications representing $223 million, of which 4,300 representing $114 had actually been paid out, which represents about 0.6 of the funds under management. As you know there are various hardship criteria relating to release of the funds.

The third aspect of frozen funds is in terms of releasing money back. As the money is coming in there are two ways in which the fund managers are releasing those funds. One is by offering an option, once the fund is accumulated, to offer it back in a single offer and then allocate pro rata given the number of people who actually want their money back. There are others that are releasing a set percentage back every quarter. So, basically, the situation is that the frozen funds are working their way through as the cash is flowing out.

If you want a last option that is available to investors, if they are still not happy with moneys coming back, they can look to replace the RE or they can look to wind up the funds. Really what we have in the situation with the frozen funds is that you had a classic asset liability mismatch that is being wound up over time.

CHAIRMAN—Is ASIC satisfied that the process and the time frame around the release of funds, the hardship provisions and the other mechanisms that exist are as satisfactory as possible given the circumstances?

Mr Medcraft—I believe so. Where, in fact, we do get complaints from individuals, which is not that often, we try and work with a fund. If somebody has a hardship relief problem and they are not getting the response they need back from the fund we have got involved in trying to facilitate that to make sure that they get a proper consideration.

I think it is working through. At the end of the day that industry do not really want to have frozen funds because their problem is they cannot raise new money. It is actually not good for the industry to have frozen funds. As you also know, a number of the groups have tried to restructure, have tried to essentially unfreeze the whole fund through various options.

The other big thing that is constraining it is clearly they do not want to undertake fire sales of the assets, which would result in investors losing the principal amount of their money. The real underlying logic of this is: do not have distressed sales that actually result in trashing value to those investors. It has to be passed in over time.

The other aspect of this is we have been consulting on benchmarks for the future of the mortgage trust sector. The hope is that in the future we will have benchmarks that will highlight the nature and liquidity of the underlying fund. Again it is what we always do: we look at what we have done in the past and what we can do today. We are trying to have a more robust sector for the future.

CHAIRMAN—Is ASIC satisfied that all the requirements of these funds are being met and they are operating under the current conditions in the proper manner and dealing with their investors and clients in the proper manner?

Mr Medcraft—Yes, as I said, where we get complaints we follow up. We did see some abuse to a fund a few months ago—it was a frozen fund trying to raise money—and we jumped on that very quickly. The prospectus was withdrawn and the moneys were refunded to the investors. We have a team surveilling. In our surveillance activities it is a high priority. As I said, from intelligence either coming indirectly or what we hear or see, we attempt to react.

CHAIRMAN—To follow up on the complaints area: can you give is an idea of the level of complaints and what they revolve around at the moment.

Mr Day—In relation to frozen funds?

CHAIRMAN—Yes.

Mr Day—I do not have that information in front of me, but we can provide that on notice.

CHAIRMAN—I would be interested to see. I assume there would be fewer complaints today.

Mr Day—Yes, without a doubt. As Commissioner Medcraft said, when we get those we are speaking to the relevant stakeholder team investment managers so we can facilitate and foster a discussion with the fund.

CHAIRMAN—Perhaps you could take on notice to provide the committee with a short brief on where it is today in terms of complaints, what the complaints are and if they are being resolved satisfactorily.

Mr Day—Sure.

Mr Medcraft—We have an information sheet that we publish online for investors in frozen funds. It advises them of their rights.

Mr Day—A lot of those in those circumstances we push back to the service that assists with that and gives them the information that Commissioner Medcraft referred to.

CHAIRMAN—I want to take you to the Financial Reporting Panel. Thank you for the letter you provided to the committee. We appreciate that. Maybe you could give us an idea of how the relationship between ASIC and the Financial Reporting Panel works.

Mr D'Aloisio—They are a panel and, as the letter indicates, we refer cases to them. I have met with the panel myself in terms of looking at these issues. You raised why there have not been more referrals and we explained the reasons for that in the letter.

Overall we think, as the letter indicates, that having this form of resolution of issues that arise under the accounting rules which can be resolved through that process is sound. The take-up on it has not been significant but, as I think we said in the letter, it should not be assumed that it is not playing a valuable role. In some examples, parties seek to resolve it with ASIC more quickly than they perhaps otherwise would. I think the four matters that have gone to them in more recent times—two resolved and two in the process have been withdrawn—are probably an indicator that things are changing a bit and parties are prepared to take some of these issues to the panel.

Given that we have changed to IFRS, the changes going on and where we are in the market, it is probably something, from your point of view and from ours, which we should keep under review, to see if there is something which may raise concerns. From where I sit—and I have discussed it with the chairman of the panel—I do not see it as fundamentally wrong within ASIC or within the broader accounting community in relation to these issues.

CHAIRMAN—Turning quickly to recent announcements you have made on prosecutions, the number of directors who have been prosecuted on a range of offences, there are some interesting numbers from that but particularly some very high numbers from New South Wales—47, I believe, but only three prosecutions from Victoria. There are a variety of prosecutions from different states. What assumptions could we draw from the fact that there are so many from New South Wales?

Mr D'Aloisio—I am not going to be drawn on that, in relation to New South Wales and Victoria.

CHAIRMAN—It appears on paper that there are only three. Is New South Wales better behaved?

Mr D'Aloisio—I will ask Warren to comment because he is closer to the issues. From a commission point of view, we are not drawing any inferences from those numbers. That is a statistic from a point in time. It will vary depending on where the levels of activity are in the organisation.

Mr Day—That is a recent announcement in relation to the Liquidator Assistance Program and the prosecutions of directors for failing to provide reports as to affairs to liquidators. In relation to the state-by-state breakdown, I will follow my chairman's reluctance to state observations. It is a result for only a quarter. I am sure Queensland and Victoria will be back up there in the next quarter.

CHAIRMAN—You think they will catch up?

Mr Day—They will catch up. That is mere speculation. It is an important program for us in assisting the SME sector and assisting liquidators to get the proper information out of directors in relation to their affairs, effectively in small companies. We are having real success there in

getting compliance. They are prosecutions but there is broad activity behind those where we address directors ahead of that, getting 40 per cent complying before we have to go to the trouble of prosecuting. We do a large body of work. That is just the pointy end of that compliance activity.

CHAIRMAN—Certainly, we would be interested as a committee to keep an eye on that and to take note of it. In time we would also be interested to see whether there are only significant issues, there may be some state based issues or state laws, or some reason, if a pattern develops in future, as to why there are breaches in a particular area. We would be interested in keeping an eye on any developments coming out of those particular numbers. I agree that not much can be drawn from that statistic today but if there were a continuing trend it would probably warrant more attention from ASIC.

Senator STEPHENS—We cannot go past the 100th anniversary this week of International Women's Day and the discussion on women on boards and women as directors without talking about the gender breakdown of people who are being prosecuted, whether there is, as Pru Goward said this morning, an incredible risks to shareholders to try to increase the number of women on boards by taking some quite specific measures. How does the gender issue play out in terms of ASIC's compliance regime?

Mr D'Aloisio—It is certainly not an issue that has been raised with me. Obviously, as an agency, issues of gender do not really come into consideration in prosecutions and so on. But I am happy to look back at the statistics over 12 months—

Senator STEPHENS—That would be helpful.

Mr D'Aloisio—and just extract it for you on a statistical basis and provide it to you. It is an interesting point that has been raised.

Senator STEPHENS—On the issue of the more public debate about increasing the number of women on boards and proposals for specific measures such as quotas, does ASIC have any development strategies around increasing the number of women on boards or supporting women in that?

Mr D'Aloisio—No. In ASIC's role as a regulator, our regulatory remit would not extend to board diversity. These are broader social and economic issues for government and the community more generally. While we may have personal views, these are not ASIC issues. We participate on things like the work with the ASX corporate governance board and working with AICD. If there is an opportunity to support the AICD's mentoring program for women directors at a personal level then clearly we would support that and, similarly, the work that the ASX corporate governance group is doing. In that sense, we would be involved, but it is not a policy matter for ASIC as such.

CHAIRMAN—I will take this opportunity to thank ASIC, Mr Day and everyone else who came with us on our visit to Traralgon sometime ago. That was a most informative and enjoyable visit. I still think that was the first time this committee has gone to the complaint centre, so it was much appreciated. Complaints are always going to be a major feature of the work that this committee does. I am interested in whether you can provide us today with some idea of whether

there are any particular trends that you are watching within the complaint area or if there are any particular new developments or anything that stands out as unusual, or is it just a case of business as usual with the normal operations of the broad market?

Mr Day—It is a good question. The short answer is that it is business as usual. In fact, as I said in relation to some questions earlier, there are a lack of big issues because we have not had in this financial year issues such as the collapse of something like Storm, Timbercorp or Great Southern. We have not had those issues this year, thankfully. That said, our volumes are still maintained, if not up a little bit. It is not like there are not issues to complain about. That is still occurring. That is the good news! In terms of where complaints are going, certainly after the GFC, as you would expect, there was a slight increase in relation to complaints about corporate governance, solvency and those sorts of things. Now, a couple of years out from that, it has returned to the more normal distribution that we have seen over a longer period of time, moving back towards a balance between those types of issues and financial services issues of planners, products, frozen funds and those types of things. If you are asking what we are watching, our new area is credit and we are looking at developing our skills and expertise on credit issues that are arising in relation to unregistered and unlicensed people now operating credit services. We are watching that and giving some priority to that so that our compliance programs that we have developed through our—

CHAIRMAN—So you are watching the complaints that are coming in?

Mr Day—Yes, very closely. That is because, again, the legislation is new and it is the first time they have been subject to as extensive a national regime as this. So we are learning as well about that. We have set up special committees and groups so that we can ensure that, as those things come through, they will get pushed through our groups of senior staff from the relevant stakeholder teams and the deterrence teams. It is also important, given that this is a new regime, to ensure we get as close to 100 per cent compliance as we can early so we set that industry up for better compliance into the future. If you are asking what we are looking at and what the big things are at the moment that we are focusing on, that is something we are giving a lot of focus to.

CHAIRMAN—The ATO has been particularly successful over a long period of time in communicating areas of interest to the general public. For example, at the moment the ATO has made it very clear that people not paying GST and the cash economy in general is on their radar, I would think successfully in terms of communicating that. Does ASIC have a similar program of communicating to the community in particular focus areas?

Mr D'Aloisio—Yes, it does. ASIC through the FIDO website, and next Tuesday through the new website, does communicate. When we are alerted to potential scams, potential dishonest activity or whatever the team really looks at that very quickly and sends out warnings and contacts other consumer groups, so there is a program that sits behind what we do to try to be more forward in picking up these sorts of issues as they arise. It is similar to, as you say, the tax office and indeed other agencies that try to alert the public. The ACCC is another agency we work closely with when there are issues in the financial services area. There is an active program. Again we can easily extract a list of those for the committee out of the FIDO website over a period of 12 months to give you a feel for what they are.

Mr Medcraft—On our surveillances when we talk to industry groups we very clearly telegraph what we are going to focus on in the next 12 months which actually sends another message, which is that you need to be careful. In fact we have something coming out in the next few days on our surveillance activity in the financial advice space, for example, and what we intend to focus on in the next 12 months. So we do try and it is important to telegraph.

Mr D'Aloisio—The examples Greg and I have just used are more in the consumer retail investor area where you would expect us to be, but John has just pointed out to me the more formal programs we have such as in the accounting area where we do the surveillance of the accounts on a regular basis of a number of entities and tell the market what we think is coming out of those issues that the accounting bodies should be thinking about. That is if you like at the other end of town so to speak. There are a range of programs that we do run.

Mr Yanco—We do that with market participants as well. We flag that audit record keeping and trust accounts will be the themes that we are looking at this year.

Mr Day—In relation to our core business in terms of the registry function, the registry incorporations, our latest initiative is that we have put an ASIC Connect account on Twitter. The people I work with would be unhappy with me if I missed the opportunity to promote that.

CHAIRMAN—I will send you a tweet! I am sure you have many followers.

Mr Day—That gives us an opportunity to identify especially for a lot of Pty Ltd company directors the requirements for compliance, certain fees have to be paid those types of things in a channel that they might actually pay attention to.

CHAIRMAN—There has been a lot of work done in the last couple of years in terms of financial services and you have just highlighted communicating more broadly and trying to improve the integrity of financial services advice and so forth. Is there any measurable way either through complaints or anecdotally to measure whether there is an improvement in the quality of services that are provided or at the other end a better community understanding, better community knowledge, around the issue of financial services provision? Often there is a mismatch between people's expectations and understanding and service delivery. Is there anything around that that ASIC can particularly shed some light on?

Mr Day—I think complaints are a difficult way to measure that or draw conclusions from. In fact, I would say the reverse is true. As people become more informed, more financially literate, they are more likely to complain because they know who the players are, they know we exist, they know what our remit is; therefore they complain. That is always the view I and my group have taken that more complaints shows an increase in financial literacy more than anything else.

CHAIRMAN—And you were saying before that you actually are receiving more complaints?

Mr Day—It is trending up at generally about three to five per cent per year. I just think that is more and more people becoming aware of ASIC. It does not necessarily reflect that things are worse; it is probably just more people investing than ever before and more people becoming aware of ASIC than ever before, and we think that that is a good thing, not a bad thing. At the risk of being kicked under the table by my chairman, I would think that, in relation to financial

advice, statistics put out by the Financial Ombudsman Service in relation to the level of disputes they deal with—given that they are the primary dispute resolution scheme in relation to financial advice, financial planners, financial products—and the report they have recently put out would probably give a better indication of how those things are going.

CHAIRMAN—It would be an interesting issue to follow, of course fully understanding that legislation is yet to come in most of those areas and there is still a bit of work to be done—but my assessment would have been, and it may be the case, that just the work that has been done to date is enough to have some measurable improvement in the way that people participate in that market.

Mr D'Aloisio—I think you are right, in the sense that, if you go back to the example that I used earlier of our focused efforts on insider trading market manipulation, it is always difficult to get statistics about how market integrity is improving, but intuitively you know that those efforts do contribute to improved behaviour. I think what has happened over the last couple of years, coming out of the GFC or as part of the GFC, particularly in the financial advice industry, is that you have had a very intensive focus on that sector, whether through the work of this committee, through our work or through government policy, and indeed you are seeing quite a significant positive response from everybody involved in that industry really taking stock and saying, 'Hey, irrespective of whatever, we've got to improve here, because the community expects it.' I think the signs are all quite positive, but we cannot give you actual statistical information. I think it is the sort of thing you probably want to allow another year or two for. You want to allow the new training programs to take effect, and the new rules that the government is proposing in relation to commissions and so on and the work that we are doing through the websites and so on to alert people to ask questions, to go to advisers they can trust and so on. I think all that will lead to incremental and good improvement, but it probably needs another two or three years to run.

CHAIRMAN—Maybe just an early flag ahead of time as something that could be measured in some way—whatever way that might be. It would certainly be of interest, to see whether our collective efforts are improving integrity.

Mr Yanco—I agree with the chairman. The industry is reshaping already. You are seeing that conflicted remuneration is already changing, which is obviously an important driver in terms of people's motivations. I think there is a whole swag of things actually happening at the moment, even pre the industry's reshaping. We are already seeing those big changes coming through.

Senator STEPHENS—Mr D'Aloisio, could I also flag the committee's interest in the government's agenda around reform of the not-for-profit regulatory space. Can you provide the committee with some information about the number of not-for-profits that fall into ASIC's regulatory environment?

Mr D'Aloisio—John will answer that.

Mr Price—A Productivity Commission report was released recently, and their estimate was that, of the not-for-profit sector that is regulated, ASIC would regulate approximately five per cent of that sector, which is mainly in the form of companies limited by guarantee, so it is quite a small proportion of the sector.

Senator STEPHENS—The interesting issue for us is to what extent those organisations that are regulated by ASIC would have more or fewer complaints or compliance issues than any other organisations.

Mr Day—I can say off the top of my head that we occasionally get the odd complaint about a not-for-profit, but in terms of what level it is as a percentage of the population that we regulate, as John Price has pointed out, I would not be able to say now. I could take that away and come back to you about that.

Senator STEPHENS—It would be very helpful for us to understand the extent to which there are compliance issues within the ASIC regulatory framework. The other issue I was interested in pursuing with you was whether or not you participated in the development of the consultation paper that Treasury released.

Mr Medcraft—Yes, we did, a few months ago. What we provided to Treasury was what our costing would be if, in fact, the functions that were considered by the Productivity Commission were to be taken over by ASIC. Obviously it would cover a stakeholder group, the deterrence aspect, the complaints—so, essentially, that type of infrastructure and what it would cost. That is basically how we interacted.

Senator STEPHENS—Are you able to share those costings with the committee?

Mr D'Aloisio—No, that would be advice to Treasury.

Mr Medcraft—It was advice to Treasury, yes.

Mr D'Aloisio—It would be up to Treasury to release that.

Mr Medcraft—But we did actually provide them with that information.

Senator STEPHENS—Given that it is only an estimated five per cent of your work—

Mr D'Aloisio—Not of our work.

Senator STEPHENS—No, I know; I meant that five per cent of the number of not-for-profits are within your environment. That does seem to be a pretty small fraction of the overarching $43 billion that the Productivity Commission has registered is that kind of activity. Have you seen any of the submissions that have responded to the Treasury paper that are actually saying the regulator should be in ASIC? Are you part of an ongoing discussion about that within government?

Mr Price—I have briefly perused some of the submissions that have come back. Indeed, my recollection is that at our summer school recently there was a question from the floor to our chairman about what our view is. But, in the end, where that regulatory role ends up is really a matter for government.

Senator STEPHENS—Yes.

Mr Price—My recollection is that the eventual recommendation—and whether it is in the Productivity Commission report or the Treasury report I cannot clearly remember—seemed to be around setting up a stand-alone regulator, but there was a question about how the sector might be regulated in the interim until any stand-alone regulator might be set up. The two regulatory bodies that were mentioned in the report I am recalling were the ATO, which obviously would typically have purview across the whole sector because many of these bodies want to have a charitable status for taxation purposes, and ASIC. There were a range of arguments that were canvassed in that paper that I thought were quite balanced and reasonably well set out.

CHAIRMAN—In reference to the not-for-profit sector, are there any particular issues for ASIC in terms of its oversight of what is really just a small percentage of the whole sector in terms of their level of compliance as compared to the rest of the licensees that ASIC has?

Mr Price—It sort of goes back to Mr Day's comments a little earlier. I am certainly not aware of anything.

Mr Medcraft—I can probably comment, Mr Chairman, because I attended a session with you last year or the year before and I got some statistics on it, in terms of complaints, about two years ago. Most of the complaints were about governance coming from the not-for-profit sector, and we can come back with that. For the number of corporations that we have in this sector, the number of complaints was actually relatively high, but, as I said, the nature of them related to governance. That is my recollection, but we can come back with more detail.

Senator STEPHENS—It would be helpful if you could look at it again.

Mr Day—We can refresh the information about that. But, from my recollection, I would have to concur with Commissioner Medcraft that that is what those types of complaints centre on. These are volunteers who are on the boards of these things who effectively are in dispute over certain decisions and so on, and it is that type of governance complaint that comes through more than anything else. We will pull that data together for you.

CHAIRMAN—Is the large number an issue for ASIC? There are something like 600,000 registered not-for-profit type organisations but only a small percentage—11,000 companies limited by guarantee—are covered by ASIC. Does that sector pose an issue for ASIC—

Mr D'Aloisio—No.

CHAIRMAN—in the sense of compliance.

Mr D'Aloisio—No.

Mr Medcraft—We have 1.8 million corporations.

Mr D'Aloisio—Chairman, as John and Greg commented, the issue of the further oversight or supervision of the not-for-profit sector is a policy issue for government. The issue of whether ASIC is given additional resources and responsibilities, again, is a matter for government. We have at the moment a lot on our plate. We have business names coming up. We have surveillance. We competition for market services. In the end we will do as government wishes,

but the not-for-profit sector is not really a core ASIC function right now. It is a matter for government how it wants to deal with it. If it is going to deal with it and give it to ASIC, we have said—and I am sure government understands—that we would need to be adequately resourced to do that, to add to our registries. It is something that would take some time and some resources to put in place.

Mr Medcraft—It is the registries, it is stakeholders and it is deterrence—it is resources.

Senator STEPHENS—Is ASIC planning to formally respond to the Treasury paper?

Mr D'Aloisio—Probably not, in the sense that we will assist Treasury now, and if it needs further assistance and advice from us we will provide it. But it is a Treasury consultation paper. It is running the policy. We will help Treasury, as we normally do in any of these situations. We would not be putting in a separate submission in the sense of taking a different position because the policy is not within our role; it is within Treasury's role.

CHAIRMAN—I understand what you are saying about that: it is a matter for government to make the policy on those types of determinations. But I am seeking to better understand it. Obviously, the 11,000 that are registered you would supervise like any other registered, licensed organisation, so there is no difference there. Of all the others that are not—589,000, give or take one or two—do you see any issues that either do or could exist in terms of their behaviour?

Mr D'Aloisio—We have not done the work, Chairman.

CHAIRMAN—That is fair enough. I just wanted to understand whether ASIC had done anything.

Mr D'Aloisio—No.

CHAIRMAN—I think that rounds up all of our questions. I thank ASIC, as always, for your submissions and your time. I thank all of you gentlemen for appearing before the committee and giving us your answers.

Committee adjourned at 12.18 pm