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PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Oversight of the Australian Securities and Investments Commission

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FRIDAY, 24 JUNE 2011

SYDNEY

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PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES
Friday, 24 June 2011

Members in attendance: Senators Boyce and Stephens, and Mr Fletcher and Mr Ripoll

Terms of reference for the inquiry:

To inquire into and report on:
Oversight of the Australian Securities and Investments Commission

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

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

TREGILLIS, Mr Shane, Commissioner, Australian Securities and Investments Commission

Committee met at 09:32

CHAIRMAN (Mr Ripoll): I declare open this public hearing at the Parliamentary Joint Committee on Corporations and Financial Services. At the start, I congratulate Mr Medcraft on his appointment as Chairman of ASIC. I also thank him and all commissioners and officials of ASIC for allowing us to use their lovely new premises. We are very appreciative, so thank you very much.

This morning the committee is conducting a hearing into the Australian Securities and Investments Commission. Under section 243 of the Australian Securities and Investments Commission Act 2001, the corporations and financial services committee is required to oversee the functioning of ASIC. This hearing is part of that oversight. This is the second of two hearings in June for the committee's oversight of ASIC. The committee heard from Mr Richard Gilbert and Mr Charles Suttie from the Rule of Law Institute of Australia and Professor Carole Comerton-Forde from the Australian National University on 15 June. The committee now welcomes to the table the Chairman, Deputy Chair and commissioners of ASIC. I also welcome ASIC observers and other people in the gallery.

I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege, and this gives special rights and immunities to people who appear before committees. People must be able to give evidence without prejudice to themselves. Any act that disadvantages a witness as a result of the evidence given to a committee may be treated by the parliament as a contempt. It is also a contempt to give false or misleading evidence to a committee. The parliament has resolved that an officer of the Commonwealth shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions asked to superior officers or to a minister. This resolution prohibits only questions on matters of opinion on policy. It does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

If a witness objects to answering a question, the witness shall state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. A request to give a particular answer in camera may also be made at any other time. That is a long introduction but necessary for all.

Mr Medcraft: Thank you, Chair, and welcome to ASIC. I would like to make a short opening statement and will start by recognising the great contribution of ASIC's former chairman, Tony D'Aloisio. Over the past four years Mr D'Aloisio led ASIC through a period of tumult and change. Early in his term, Mr D'Aloisio implemented a major strategic review which resulted in ASIC becoming a more stakeholder oriented organisation that is better informed, I believe, about the market and much more focused on achieving civic objectives. He expanded the commission's capabilities, bringing in commissioners Peter Boxall, Michael Dwyer, Shane Tregillis and me.

During the GFC, Mr D'Aloisio managed many challenges, particularly the regulation of short selling, where we introduced measures to constrain the market in short selling, and in assisting investors in terms of investments in

frozen funds on the grounds of hardship. During his term, Mr D'Aloisio also oversaw an expansion of ASIC's role, particularly in credit licensing last year, in the transfer of market supervision from the ASX and, now, in competition and equity markets.

In the area of investor protection, Mr D'Aloisio's initiative to seek compensation for retail initiatives as part of our overall investigations has been very important. Also on investor protection, ASIC invested heavily in many education initiatives, such as our MoneySmart website, which I am sure many of you are now aware of. Since it was launched, it has had 330,000 unique visits.

We undertook major deterrence cases with Mr D'Aloisio at the helm, as you know all know. These matters were complex and not without risk, but Mr D'Aloisio showed consistently his willingness to make the tough calls and to pursue these cases in the name of public interest—cases such as Westpoint, James Hardie, Opes Prime, AWB, Fortescue and Storm, to name a few. These cases were not all wins, but Mr D'Aloisio's preparedness to take them on no matter the difficulty has without a doubt had a deterrent effect on potential wrongdoing. Finally, in the international arena, I want to mention Mr D'Aloisio's leadership, which extended well beyond Australia, with the chairmanship of the joint forum, a role that underlines the regard that ASIC enjoys in the global regulatory community.

I want to outline quickly what I see as ASIC's strategic framework for the next few years. Basically, I see it as three priorities, which are reflected in our legislation—that is, in Australia to have confident, informed investors and financial consumers and fair and efficient markets. I see that being achieved through three outcomes. The first is confident and informed investors and financial consumers. In respect of that, I see three foci: (1) education, (2) gatekeepers and, (3), consumer behaviour.

In the area of education I think it needs to be underlined that our system still relies very much on the cornerstone of investor responsibility for their own investment decisions, and that remains core—an understanding of risk, reward and diversification remains paramount. I really want to underline that in terms of the community. ASIC will continue to focus on education. We will continue to focus on things like our MoneySmart website. As I said earlier, I expect it will have over a million hits in the 12 months from its commencement. It is very important. We are seeing people spend a lot more time on the site. On the previous site they spent two minutes and now they are spending five minutes, and it is clearly having quite an impact. Helping kids to understand finance is a very important initiative in rolling out financial literacy across 10,000 schools over the next decade. It is very important that consumers and investors are empowered. Finally, what we are doing in the area of new media is also important in terms of using things like YouTube so that investors and financial consumers get direct and immediate access to information. Secondly, it is important that we hold the gatekeepers, in the widest definition of the term, to account because they are a cornerstone of the system. That includes directors, accountants, experts, advisers, product manufacturers and distributors, market operators and participants. Self-regulation is actually very important in complementing regulation.

Standards are critical. They can provide guidance in how to comply with the law and go beyond the law in setting standards, particularly in areas such as ethics. Finally, in the area of consumer behaviour, recognising how investors and consumers make decisions is actually very important. I believe that it is up to all of us to recognise that many investors do not necessarily rely only on the PDS to make their decision. Focusing on things like advertising and suitability, and, for issuers, thinking about how they can use multichannel things like new media to recognise how consumers actually make decisions, I believe is good for business.

The second priority is fair and efficient financial markets. Clearly, we will continue to focus on our efforts in market supervision and competition, and also on corporate governance guidance. The third priority is an efficient registering licensing system. I think many of you know the initiatives that we have undertaken in that area over several years with our systems et cetera. The other area I have outlined that we would like to focus on more is small business: where we touch small business and where there is perhaps an expectation gap.

The other thing that I think is very important is explaining what guides us in setting our priorities at ASIC. The first thing is clearly our legislative responsibilities, which are what we have to do. Beyond that in terms of discretionary work, we see three key things. First is the systemic or regulatory risk, which I think goes to the heart of a resilient financial system. As Benjamin Franklin once said, 'An ounce of prevention is worth a pound of cure.' Being proactive and identifying risk at an early stage is very important. To that extent, last month we established our emerging risk committee to connect the dots in ASIC and to identify thematic or emerging risks because as somebody said, 'History does not repeat itself; it rhymes.' Secondly, stakeholder expectations are very important in terms of guiding us and how we allocate resources. Thirdly, government policy is clearly an important driver.

We will continue to take on the big cases and pursue wrongdoers wherever they are and whatever they may do. But it is important that we recognise that deterrence is just one tool we have to achieve our outcomes. It is an

intensity that starts with engagement and moves into surveillance, guidance, education and then deterrence, and then if things do not work it is policy advice to government. It is important that we are not just seen as a law enforcement body but seen as a body that is focused on outcomes for consumers and investors which has a range of tools in addition to deterrents. Thank you, Chairman, I am ready to take questions.

CHAIRMAN: Thank you for the provision of the strategic framework. The committee will incorporate that as part of the evidence. We will put that on the record, if that is okay?

Mr Medcraft: Yes, that is fine. I did actually give it to you just to assist. My whole philosophy is to make sure that everyone has a consistent message and are clear.

CHAIRMAN: Thank you for that. On the first point you raised about confidence and informed investors and financial consumers, you raised new media. I would be interested to hear about the types of new media and what you are going to use them for?

Mr Medcraft: In new media, I will comment from the consumer side. We are now on Facebook in addition to Moneysmart. There are 10 million Australians on Facebook. That is how many people that we know communicate. So we are on that. We are on Twitter and we use Twitter as a tool to push out messages. We now have, I believe, have six videos on YouTube ranging from how to use a credit card to planning and budgeting and we are rolling out more on a weekly basis.

Senator BOYCE: They are spin-offs of the MoneySmart website?

Mr Medcraft: Yes, they are. But it is actually quite important, because the consumer behaviourists say that it is quite important that you can talk to somebody—it is a very effective way of reaching people. The new US consumer authority uses it a lot. I think it is a very good tool and people trust it, so we will use it more. It is a great way of reaching people. I will pass to Warren because in the real economy we are doing some interesting stuff with new media.

Mr Day: We have a Twitter account for what we call ASIC Connect, which is our registry business and our way of communicating about what is going on in our registry business. As we previously said to the committee, certainly in the next financial year there are a lot of deliverables to the public in terms of search functionality: being able to do searches online from our website and paying for those online, which will be a big step up in functionality. When those things come on stream we will be able to communicate that out. The ASIC Connect Twitter site is about trying to put more information about our registry operations—more specific focus about that—rather than the consumer angle, which is what MoneySmart is about. It really is about focusing on our company registrations. Giving them information. A lot of the people following—

Senator BOYCE: How many followings have you got?

Mr Day: I was hoping you were not going to ask me that. I do not have that information available at my fingertips.

Mr Medcraft: It would be well over 1,000, though.

Mr Day: Yes, well over 1,000. The majority of them are small businesses, accountants, lawyers and compliance professionals trying to work out the things that we are trying to push out information on, which they re-tweet to their own followers. It is a good dissemination process of the information going on in our registry function.

CHAIRMAN: Who is your target audience and how are you trying to attract them to use those particular forms of media?

Mr Day: The target audience, effectively, is small business, because they make up the large if not the full majority of the 1.7 million companies that are registered with ASIC. It will also be other groups that will come on to ASIC 's responsibilities—certainly when we take over the business names in the next 12 months. We are looking at small business, accountants, lawyers and other professionals and advisers to business about what our business operations are. That is our target audience. In terms of getting them, that, I guess, is the question everyone would like to know: how you go about getting them for Twitter. They re-tweet to their own followers and other people are coming on board as they go. It goes that way.

Mr Medcraft: The term is 'viral' isn't it?

Mr Day: Exactly.

Mr Medcraft: My view about ASIC is that the fundamental thing is how can we leveraged the resources we have to achieve the outcomes. Frankly, it is all about how we can leverage the resources the best way possible. New media provides, I think, a very good opportunity to leverage our resources. That is how I see it. Commissioner Gibson, you had some comments to make.

Ms Gibson: Yes, to round out the new media, we have also developed some apps spinning off MoneySmart. There is one for your phone where you can stand at a store and look at an instalment purchase and work out whether actually it is a good deal to buy by instalment or save your pennies and buy in cash a little bit later. It is targeted at saying to the consumer, 'We can provide you some assistance to help you make wise decisions, consistent with your budget.'

Mr Medcraft: And, Senator Stephens, you can also download it onto your iPad. In fact, our free iPad application on Apple was ranked No. 2 two or three weeks ago. We are getting 7,000 to 10,000 a week, actually. Again, it is all about leveraging resources. The young team we have are doing a great job and thinking outside of the box on this.

CHAIRMAN: Can you give us an update on MoneySmart? Obviously it has had an enormous number of unique hits, it sounds very successful and certainly it is a great looking website. How do you think its objectives are being achieved? Is there any feedback or do you have any sense of how the site is actually working?

Mr Medcraft: As I said, clearly, with the traffic that is growing, absolute numbers of unique visitors are significantly above what we were getting previously. Also, as I said before, we are getting people spending an average time that has gone from 2½ minutes to five minutes, so people are spending more time. When we drill down into that, what we see is that people are using the budget planner, the super calculator, the retirement planner and the mortgage calculator. So they are the tools that are the most popular—you can drill down to the page usage. Clearly, with the objective of providing a source of independent general advice, it is obviously working quite well. I think the next stage of MoneySmart, which is the fact that you will be able to create your budget or your plan online and save it and go back to it, creates a very interesting dynamic for people-hubbing—a source of advice but one that they can actually go back to. The early indicators to date, I think, are very positive in terms of using that information as a source. We have had 480 people come back to us with extremely positive feedback.

CHAIRMAN: Excellent. You have raised the issue of gatekeepers and accountability and a range of issues in terms of lawyers, financial advisers and financial product developers and distributors. I do not know if you can give us a brief on why you think that is important and how that currently operates.

Mr Medcraft: My view about the system is that it is really three pillars. The first pillar is the Corporations Act, which sets out people's rights and responsibilities, and that is the law. The second pillar, I believe, is ASIC. We essentially are there to enforce the law but also, as I said before, to assist and inform consumers and financial investors. The third pillar in our system is that our system is a very open system and a very light free enterprise system, and it actually relies very heavily on the people who are regulated as gatekeepers to make sure that they do the right thing. What I want to keep emphasising is that if people do the right thing in business then it actually makes our role as a regulator much easier, because we do not have to go and intervene. So the emphasis, I believe, is on good self-regulation for people to do the right thing. That also means us not standing aside; it actually means our helping gatekeepers where we can to try and achieve their outcomes, because when you are an industry it is sometimes quite hard to self-regulate. Again, to me it goes to achieving the maximum leverage we can for ASIC. If you have good self-regulation then we can allocate resources elsewhere. So it is gatekeepers doing the right thing and having good standards that guide their industry members as to how to comply with the law or even go beyond the law, and also to include things like ethics, because I think ethics is doing the right thing—that is what ethics is all about. That is where I see gatekeepers as quite important.

It relates back to a lot of the work we do with gatekeepers and where we issue guidance in the market in terms of what we do with gatekeepers. For example, what is happening at the moment with FoFA is trying to strengthen the governance of gatekeepers, being the advisers. What we are doing with surveillance of research houses at the moment is about looking at gatekeepers. So it is really broad, but I think it is really important to explain the rationale behind what we are doing. I do not know, Mr Price, if you want to comment on gatekeepers.

Mr Price: The only thing I would add is that the idea of gatekeepers is not a novel one. Certainly there is a US academic, for example, called Professor John Coffee who talks about gatekeepers. His thesis is that, to deal with things like information asymmetry and other economic problems, often regulatory systems rely on certain key individuals, and those individuals have a trusted role or an 'honest broker' role in a regulatory system. The idea is that those people are intermediaries who effectively rent their reputation to product issuers, who pay them, but because their reputation is valuable to them they are trusted to act in the interests of consumers or investors. Professor John Coffee observes that in the United States, where there have been major collapses, it is arguable that incentive problems have meant that those gatekeepers have not had due regard to their reputation or investors' interests. Two of the examples he gives are auditors, in the case of the Enron and WorldCom collapses in the

early 2000s, and then more recently, the credit rating agencies. He indicated that there were incentive problems there. This is a well-established line of academic thought that is floating around.

Mr Medcraft: I think in our system what we say is that you can have conflicts, but it is about how you manage those conflicts. You recognise that you may have a conflict but it is about how you manage that conflict.

Ms Gibson: Your risk assessment should recognise the incentives, which is where others are going. That is something we are very keen on.

CHAIRMAN: Can you give us some idea of the complexity? It is a very diverse group of people, between accountants, lawyers and advisors. They are not all specifically regulated by ASIC. ASIC does not have specific control over them through, for example, an AFSL.

Mr Medcraft: The message is that they are either regulated or they advise people who are regulated. To the people who are advisors what you are saying to them is more about doing the right thing when they are advising their client.

CHAIRMAN: I just want a detailed idea of how you manage those people. If someone holds a licence through ASIC you have direct regulatory control, but you may not have it for other people, such as lawyers who operate within the sector but who are regulated elsewhere. Can you give me some idea of how you balance those diverse groups?

Mr Medcraft: I think we can give guidance for how to comply with the law. That is what we do. We think about it and issue guidance that says, 'This is how you should comply with the law.' You have industry standards which say how you comply with the law. That is one aspect, but I will ask Belinda to comment on that.

Ms Gibson: On the lawyer point specifically, obviously we do not regulate them. They are a self-regulatory organisation through the states, but we have very extensive dialogue with the lawyers as stakeholders. We have corporate liaison meetings. Many of the industry bodies come to us with their lawyers at the front of the queue rather than at the back. We communicate with industry through the legal profession. Many of our staff are lawyers, so there is a point to talk to them about how it is that the regulated products—the reason they are there—are brought to market. Ours is more a dialogue with the lawyers than an attempt to regulate them. I know there is a little bit of concern in the industry about us seeking to regulate them in particular, but we do not seek that. We do seek a dialogue with industry, including through them, about how to deal with the market.

Mr Medcraft: That is the point. What we are saying is that if everyone does the right thing in the system, whether we regulate them directly or not, we end up with a stronger system. That is really the point I am trying to make.

CHAIRMAN: Where there is direct regulation of somebody who holds a financial services licence through ASIC, is there a control mechanism around the character of people? What limitations are there on ASIC in regulating and controlling who—

Mr Medcraft: Can become an AFSL holder?

CHAIRMAN: On who either has a licence or can hold a license?

Mr Medcraft: That is a good question. It is quite interesting who we let in to become an AFSL holder because the law says that we must give somebody a licence—it is not that we may; it says that we must, with very narrow exceptions. This is quite different to other regulatory regimes around the world, like in Singapore or in the UK, where it is a privilege rather than a right.

Mr Price: Our chairman is absolutely correct. The law basically says that ASIC must grant a licence unless there are certain areas where we have reasonable grounds to think they will not comply with the law or we have evidence that a person is not fit and proper, and various other factors have been used.

CHAIRMAN: For example, you are referring to criminal behaviour or conviction?

Mr Price: Not all criminal behaviour. It is quite specific criminal behaviour. I am just going by recollection. I have not got an act in front of me, but my recollection is that it relates primarily to issues around offences of dishonesty as the cause of a problem. Your broader question, I suppose, was not only in relation to AFSL holders but to other people we regulate as well. The answer to your question is that there is no exact standard that applies right across all people right across all the law. If I had to draw some common themes from the various regulatory regimes that apply to different people like auditors, liquidators, people who hold a financial services licence and people who hold a credit licence, things like criminal history and offences of dishonesty are often a problem for people who want to come into the regulated system.

CHAIRMAN: When you say 'a problem', it does not automatically—

Mr Price: It depends on the individual regime. That is probably the point I am trying to make. They are all slightly—

CHAIRMAN: Specifically, in terms of ASIC providing a licence it does not automatically prohibit them from having a licence?

Mr Medcraft: For example, one of the questions I had was: can a convicted murderer get an AFSL? The answer is yes, as long as they are not dishonest or have committed fraud. We do not really go to character; we go to whether you have been dishonest or not. It is actually an interesting—

Mr Price: The other common theme that appears across the various regimes is issues around competency. Obviously there are different tests for competency depending on the particular task that you are wanting to undertake.

Mr Day: The same thing goes through, say, to registration of directors. There is not a test at all for registration of directors. Again, much as Mr Price said, the only disqualification would be on grounds of dishonesty. If there was some form of conviction for an indictable offence that carried an element of dishonesty in the offence, that would be grounds for disqualification. Outside that, anyone can be a director.

Mr Medcraft: Directors are not registered per se.

Mr Day: No, but you cannot become a director—

Mr Medcraft: Becoming a director, essentially you could be a convicted murderer and you could still be a director.

Mr Day: That is right.

Ms Gibson: To make it clearer, there is no limit on being a director as long as you are an adult. We need to seek disqualification. There are certain circumstances, very limited, where someone is automatically disqualified, which means essentially that they are in jail somewhere for a protracted period. Otherwise, we need to make a decision to seek a ban under the restrictions in the act. That is not necessarily a bad thing, but it is a fact.

CHAIRMAN: Having explained that, though, does this pose a specific problem for the capacity of ASIC to regulate the market or maintain the integrity of the market? Is it related, in other words?

Mr Medcraft: It gets back to my opening statement. Our system is a very free system and it is up to investors to undertake their own due diligence very carefully as to who they deal with. That is the nature of our system. Highlighting this is quite interesting because it is important that people who are investors understand that if you are a director or an AFSL holder the only judgment we can make is if, for example, you have committed fraud or a monetary crime.

CHAIRMAN: Something related specifically to being a director.

Mr Medcraft: Yes. I think it is important that people understand that there is a control in the system. But it goes back to the fundamental, which is that people need to do their due diligence when they have commercial dealings and understand where the controls are in the system. It really does rely on individuals doing their homework when they deal.

Senator BOYCE: We have talked in the past about people who use an AFSL almost like a marketing tool to give credibility to what they are doing. Are you monitoring that? What are you doing about it?

Mr Medcraft: On AFSL holders?

Senator BOYCE: Yes.

Mr Medcraft: The use of the term AFSL?

Senator BOYCE: Yes. Some of them would want to give the impression that because they have an AFSL issued by ASIC it is a tick that says, 'This is a great scheme.'

CHAIRMAN: The stamp of approval.

Mr Medcraft: John, do you want to comment on that?

Mr Price: That is something we are aware of. We do monitor it. Whether or not a particular case of someone citing their AFSL in a particular way is a cause for concern really will depend on the individual circumstances.

Senator BOYCE: Has it caused you concern, and what have you done if it has?

Mr Price: In the past where it has caused us concern we have got people to change their advertisement.

Mr Day: We would have the odd complaint from time to time—and I do mean the odd complaint. It is a very isolated circumstance where you will have a website for a particular offer where they put the ASIC logo on their

website and say 'ASIC approved'. The easy way to deal with that is to ring them up and say, 'That is not the case and you are to remove that immediately,' and it happens.

Mr Medcraft: What you raise is quite an interesting idea, because on MoneySmart—I have not checked—perhaps one of the things we should do is explain what it means and what it does not mean to have an AFSL. That may be something that we should think about.

CHAIRMAN: There really needs to be an understood disclaimer that the holding of an AFSL does not mean that ASIC endorses products or advice. That is the real question. It is about the endorsement of products or advice.

Ms Gibson: Much as we do with prospectuses and things like that. We are very careful.

Mr Medcraft: Isn't there often something to that effect on advertising?

Mr Price: On advertising there often is. As Belinda has mentioned, prospectuses are actually required under the act, if my memory is right, to have a statement that says, 'This product is not approved by ASIC.'

Mr Medcraft: I think that is written, and I will check because perhaps we should be thinking about making sure MoneySmart makes it clear what it means and what it does not mean. One of the things we talked about is expectations, and I think perhaps there is a gap in this area between what people believe is the case and what it really is.

Senator BOYCE: And maybe what they are allowed to continue to believe.

Mr Medcraft: We have to make sure they do not continue to believe that, that they appreciate what our system is. It is about making the system work better. If people understand their rights and what they need to be careful of, it is all about making the system work better.

CHAIRMAN: I am conscious that we have a fairly broad agenda in front of us. Let's move to some questioning on regulation and particularly the stock market.

Mr FLETCHER: I have a range of questions that I would like to ask, if I may. First I would like to ask about Prime Retirement and Aged Care Property Trust and its responsible entity, Australian Property Custodian Holdings Ltd. Has ASIC received complaints from unit holders in the trust?

Mr Day: Yes, we have. We have received a considerable number of complaints. My understanding is—and I do not say this in a derogatory way—that there has been a concerted letter-writing campaign by unit holders to ASIC in regard to their concerns about Prime Trust, if I can refer to it colloquially. We have received a great number of those and we put some information on our website in relation to our monitoring and watching of the matters relating to Prime Trust. I believe the chairman is also aware of the matter. We understand an administrator has been appointed and the matter is being reviewed by the administrator at the moment. We continue to speak to the administrator and watch closely what is happening in that space.

Mr FLETCHER: I have had some serious complaints raised with me by constituents. I am aware that other parliamentarians have had complaints raised with them. Obviously we are not in a position to investigate the substance of those complaints, but I understand that one of the allegations is that the trust's responsible entity unilaterally changed the trust's constitution and, as a result, received a substantial fee. I repeat that that is simply a complaint. I have not investigated it. I just want to understand whether ASIC is presently investigating Prime Trust. You would not describe it in those terms?

Mr Day: At ASIC we are sometimes a bit specific.

Mr Medcraft: As I said, we are not in a formal investigation.

CHAIRMAN: Thank you.

Mr Medcraft: Thank you. As you have said, Mr Fletcher, the complaints have raised key issues about disclosure, related pay transactions and fees, which we are well aware of. As Mr Day said, there has been a concerted letter campaign. Prior to the appointment of administrators, our Investment Managers stakeholder team has been undertaking a comprehensive review of the compliance issues in relation to Australian Prime that are covered by the complaints. The voluntary administrators have provided us with materials and we are waiting for further materials at the present time to determine what our next steps may be.

Mr FLETCHER: So is it fair to say that you are watching it but you have not yet determined what action, if any, you might take?

Mr Medcraft: As I have said, our teams are actively looking into the complaints. We requested information. We are on to it.

Mr Day: If it further assists, we welcome the position of the administrators. Administrators per se are obliged to report any misconduct that they see in their review of the circumstances of the companies involved. So, on receipt of those, we would further review and scrutinise the reports that come to us from the administrators in due course.

Mr Medcraft: Also, as you said, we are posting information for investors on the ASIC website and we will, as appropriate, get updates on the website.

Mr FLETCHER: I would also like to ask some questions about Trio Capital, following the discussion we had of that matter at the committee hearing on 24 November 2010. At that hearing your predecessor indicated that it was unlikely that ASIC would take civil recovery action on behalf of investors, although you had not dismissed the possibility. I presume that remains the status of ASIC?

Mr Medcraft: We are talking about Opes growth funds?

Mr FLETCHER: Yes.

Mr Medcraft: In addition to that, we have actually funded out of the asset loss administration the liquidator to undertake further investigation in relation to Opes. I did actually meet with members of the Opes investors committee a few months ago and outlined to them that we would grant the money to the fund. I do feel for the investors in that fund. We really are trying to do as much as we can for that group of investors. I can assure you it has my own personal attention.

Mr FLETCHER: Terrific. Is there any update on the work of the liquidator?

Mr Medcraft: Not at this stage, no. Very recently, they were granted the money out of the asset loss administration fund. I do not know whether anybody has any information. I do not think we have had any further information. They have to report back to us. When do they have to report back to us? Is there any timing?

Mr Brown: There would be timing, I think, within the asset loss administration fund agreement.

Mr Medcraft: We will report back to you, Mr Fletcher, on the timing of that. What is important there is that, as much as anything, the investors just want to get closure as to what happened to their money. We are very cognisant of that.

Mr FLETCHER: Certainly the ones I have spoken to also want their money back.

Mr Medcraft: The first thing is to find out where it has gone and the second thing is to find out how you can get it back.

Mr FLETCHER: As ASIC thinks about the question of whether it would take action, how do you think about the various classes of parties against whom you could potentially take action—the company, the directors, the adviser?

Mr Medcraft: The adviser

Mr FLETCHER: Yes.

Mr Medcraft: We actually consider all of those parties to see whether it is going to achieve an economic outcome. We assess all of that.

Mr FLETCHER: Is that based on an assessment of, firstly, whether a case against them would succeed as a matter of law and, secondly, if it did succeed, whether there is any money there that you could claim?

Mr Medcraft: Correct. A third aspect is: is it in the public interest?

Ms Gibson: Which would include, I think, whether there are other parties who are in a position to make the recovery. The most likely person for recovery actions would, in first instance, be the administrators and, if they are in a position so to do, we would encourage them, and that is why we have the funding under the Assetless Administration Fund.

Mr FLETCHER: I want to clear up one issue of terminology which I may have got wrong previously. It is PPB, isn't it? What does that stand for? What is the name of the firm?

Ms Gibson: Prentice Parbury Barilla.

Mr FLETCHER: If I am hearing you correctly there, it is the administrator. I said 'liquidator', which is incorrect.

Mr Medcraft: The administrator.

Mr FLETCHER: Thank you. Can you just explain the thought process that ASIC has gone through here as compared to the outcome in Storm and in WestPoint. It is correct, isn't, that in both those instances ASIC either commenced legal action or secured a settlement based upon a threat of legal action. Is that correct?

Mr Medcraft: We can come back to you on that.

Ms Gibson: Storm litigation has commenced and we had commenced the Westpoint litigation. The Westpoint litigation is an action taken under section 50 of the ASIC Act, which is a representative action. The Storm litigation is, I do not believe, a section 50 litigation action. It is an action by us in the first instance as regulator. The other action where we sought to be involved was Opes Prime, and in that instance I am not sure whether the litigation was brought by the liquidator or the receiver, but we stood with them in that and got involved in negotiations. So what we do is seek the best outcome with the available resources and where the rights seem to lie.

Mr Medcraft: I agree with Belinda. It is a matter of looking at, first of all, the evidence, looking at the public interest and looking at what are the most efficient outcomes. They are all the things we weigh up.

Mr FLETCHER: Just on the question of public interest: do you generally take the view that the larger the number of investors who appear to have lost money or been victims of being defrauded or whatever the outcome is, the greater is your public interest? Do you generally apply that principle?

Ms Gibson: There is no general rule that we adopt or can adopt. If there are a large number of investors that have lost a dollar each, that is one of the issues. It depends a bit on the investors. If the investors have no resources left, you might be more inclined to act than you would for people who may have even lost large amounts but still have a lot of private resources. It really depends on the funding available. We do not have a general rule. I think the law would say that we should not have a general rule about what is public interest. We have some indications in a guide that we issued some time ago where we might intervene. We are looking at updating that guide in the next 12 or so months.

Mr FLETCHER: I am just wanting to understand, I suppose, in terms of the investors who have been affected in the case of Trio and who are not in that class who have been compensated, why it is that to date ASIC has not chosen to pursue action when it did pursue action in those other cases that we have talked about, Westpoint and Storm. I am particularly wanting to understand whether the scale of the loss, that is to say the number of investors multiplied by the average individual amount lost, is a consideration or not.

Mr Medcraft: Whether we take action or not is still under evaluation. As Commissioner Gibson said, we do not want to indicate any hard and fast rule on whether we do or we do not, because that potentially indicates the wrong thing to people, which is that we will not pursue you, and what I have said is that we will pursue you. It might be that 10,000 people have lost a dollar but we might say, 'Well, actually, this points to perhaps a weakness in the system so we're going to pursue on behalf of those 10,000 who lost a dollar because next time it might be 10,000 people who lose $100,000.' I think having a hard and fast rule on size is quite dangerous, because you might see a problem in the system. All I can underline on AAM is that I personally am focused on it. I can assure you and I have assured them—and if you talk to them I think they are well aware of how I personally feel about what has happened to them—that we will do what we can to the extent possible to assist them.

Mr FLETCHER: I will ask you about one other aspect and then I will pass to others. I just want to ask about the status in respect of a couple of key individuals. I think an Australian citizen has been charged. Has he been convicted? I think that is Mr Richard.

Mr Medcraft: He is a Canadian citizen.

Mr FLETCHER: Oh, is he?

Mr Medcraft: Yes.

Mr FLETCHER: Not an Australian.

Mr Medcraft: That is why we had to hold his passport.

Senator BOYCE: Was his residence in Australia?

Mr Medcraft: He is a resident but he is not a citizen. He is actually due for sentencing on 22 July.

Mr FLETCHER: Would you be able to provide the committee with a briefing on what you have done to date as an agency in all aspects of the Trio collapse.

Mr Medcraft: We can provide you with a briefing in relation to what we have done in the public arena but clearly not in terms of the investigation. I think we can do that.

Mr FLETCHER: One other question: according to press reports, there is a Hong Kong based lawyer, Mr Jack Flader, who is heavily involved in this. Is there any capacity for ASIC to pursue him through intergovernmental arrangements, treaties or anything else?

Mr Medcraft: I cannot really comment on that, because it is an investigation. The law related to particularly, as you know, civil matters is actually quite hard to extradite people from other jurisdictions. I do not know whether anyone wants to comment on that—Mr Price? Once they are out of our jurisdiction—I am commenting generally about people who are outside of our jurisdiction—it is quite difficult sometimes to pursue them. But I am not commenting specifically on the person you referred to.

Mr FLETCHER: I understand.

CHAIRMAN: What sort of time frame do you have for getting a brief together on all the work you have done to date on the collapse of Trio?

Mr Medcraft: We will talk to the team involved and revert back to you, because I need to get an idea. It has been going on for awhile.

CHAIRMAN: Turning to the regulation of the market in a range of areas, given that there have been a number of changes, which we have discussed—

Senator BOYCE: Before you go onto that, what I think might be an overarching question is around the emerging risk committee that you mentioned, Mr Medcraft. Emerging risk is not something new to look at.

Mr Medcraft: No, it is not.

Senator BOYCE: What has changed your focus and who is doing it, et cetera?

Mr Medcraft: I think that it is quite interesting. The IMF did a study a few years ago and looked at crises and one of the four key things they found—this gets to my point that history does not repeat itself but it rhymes—was that often financial regulators failed to keep up with the pace of financial innovation. I think we saw that come through in this last crisis. What in fact that emerging risk committee is designed to do is really look at thematic risks that may be emerging in particular industries or systemic risks and actually connect the dots across the stakeholder teams in ASIC so that, if we are doing surveillance in one sector, basically we can discuss the lessons that may be impacting. Part of it is looking at what is happening in evolving markets and making sure that we are connecting dots across ASIC. Mr Price is going to chair that committee. Do you want to comment on that?

Mr Price: Absolutely. Senator, on your question around what has changed, really one critical thing has changed—that is, there is an international organisation of securities regulators, which is called IOSCO. Arising out of the trouble that flowed from the global financial crisis, IOSCO looked at the performance of securities regulators globally. There are two principles that IOSCO came back with after considering how securities regulators across the globe handled the financial crisis. The first principle was that securities regulators should have a greater focus on systemic risk—that is, to date securities regulators have largely been focused on bodies within their regulatory remit, but there is a broader question about how what might be happening for those particular entities flows through to the macro-economy and whether that poses any particular risk. That is IOSCO principle 6, dealing with systemic risk. So that is one thing that has changed. The second thing that has changed is another IOSCO principle, which is encouraging securities regulators to look at the perimeter of regulation. Are there particular activities that are unregulated or more lightly regulated at the moment that are again posing risks to the overall financial system? In terms of your question on what has changed and what is this committee going to do, there will be a greater focus on both of those issues in the operation of this committee. It will look at issues that are pertinent to systemic risk but also have a greater focus on activities that might be on the regulatory perimeter.

Mr Medcraft: That goes back to what I said earlier about resilience. If you really want to be a good proactive regulator, it is all about having a resilient system that is forward looking and seeing what is on the horizon. I am a big supporter of using ISO 31000, the risk management framework, to really look at the probability of a risk occurring and how it might impact.

Senator BOYCE: This committee is not functioning as yet?

Mr Medcraft: It has actually just been created.

Senator BOYCE: Can we expect to get briefs from that committee when we do our oversights?

Mr Medcraft: Sure.

Senator BOYCE: It would also be good for us. I hope I have just led right into the chair's questions about indirect broking!

CHAIRMAN: Completely!

Mr Medcraft: I have actually highlighted that regulatory risk and systemic risk are the number one priority in how we allocate resources. It really does drive where we allocate.

CHAIRMAN: Perhaps just to make it easy for you, Mr Medcraft, in terms regulation of the market there are a few areas that we are interested in and have had some briefings on in the past, particularly white label indirect brokers and some of the issues that might be associated with risk in those areas and also dark pools. Maybe we can get the interpretation from ASIC of how these will operate in our market, the risks that might be involved and how you see the regulatory frameworks that currently exist in terms of managing those risks.

Mr Medcraft: I will pass over to Commissioner Tregillis.

Mr Tregillis: I will start with the first one, which is the white labellers. I think there has been some press commentary on that. This is an area consistent with the notion of trying to identify risks and get a handle on them, but we have been taking some activity. The sector consists of about 650—that is our estimate—so it is quite large but quite diverse. We have looked at that sector and have done a bit of profiling. There are around 200 that warrant further attention, in terms of size and activities. We identified them through our review of that sector. Our process has been to review across the sector and do the profiling, and now we are in the process of going out and doing a range of on-site activity. To date, we have done about 33 or 34 visits to get a better handle on what is the business model and what are the risk controls—again, consistent with the theme: 'Let's take a close look at this sector and get a better understanding of it.' We have identified a number of weaknesses, in terms of controls and other issues that we are following up on an individual level. What does cause us to think about it is: what do we need to do more generally in terms of this sector?

There is an issue that always comes up, and it came up when I was at the stockbrokers conference. I know it is a big issue. It is quite clear in terms of market regulation. We took over, if you like, the system operated by the Stock Exchange, in terms of surveillance, but we also took over the rules for market participants. That was to take it over and leave it pretty much unchanged. We embedded those in the market integrity rules and we continue to do the same style of supervision over the direct market participants under those market integrity rules. But, as I said, over the last 12 months and a little bit before, we realised there is a growing sector of indirect market participants, undertook the profiling, did a review of the top 200, and now we are doing a bit more intense work in it. We also consulted, as part of the broader competition package, about whether the market integrity rules should be extended to the indirect brokers. Again, this is not an issue for ASIC. It would require legislative change. Ultimately this is a government policy issue and a Treasury issue. Not unexpectedly, given the comments, there was a general view that there would be benefits in extending the market integrity rules to this sector. This is something that we will pass on to Treasury, plus some of the findings.

Senator BOYCE: As a result of your consultations—is that right?

Mr Tregillis: That is right. Last year—

Senator BOYCE: With?

Mr Tregillis: With the industry more generally. We put it in as a question. We knew it was an issue, because we were asking question about what the scope of the new competition regime should be. One of the questions that we kept getting in informal feedback was about the product scope—

Senator BOYCE: What about the outsiders—

Mr Tregillis: In terms of coverage and the regime we were talking about, it was about what we could cover under our market integrity rules. There were two groups outside the market integrity rules. Other jurisdictions tend to come within the regime in different ways. One was fund managers and one was indirect participants. We made it clear that this was really a legislative issue, a policy issue, but we knew it would come up, so we put it in the consultation paper. In our response we made it clear that we will collate those responses and feed that back to Treasury, because that will require a policy review. We will also, clearly, be discussing with Treasury the types of findings we are seeing as part of the more intense review of this sector.

CHAIRMAN: You have definitely identified that there are some issues. We have it here that you did an investigation of 33 brokers, and 12 of those needed either remedial action or further surveillance. Can you give us any more information on that and whether it is significant?

Senator BOYCE: Are there systems issues?

Mr Tregillis: The general finding was that for the 12 there were issues that required following up. The fact is that we said that we needed to follow up, and that could be everything around the way in which they have organised the disclosure documents to their internal controls. Our general view, based on the 33, is that there are clearly areas for improvement required in this sector, and it is an issue that we think requires continued focus. The challenge for us is that it is a very large sector. It is very resource intensive. One of the issues will be: how do we do this in a way that is effective, given the resources and the need to continue to monitor other areas?

What we intend to do is get the feedback we have from the industry—Treasury already has that—and also provide them with some of the background information on some of the issues we are seeing in the sector as they think about the policy issues, which is really about whether or not the market integrity rules should apply.

Senator BOYCE: Could we have a list of the 650?

Mr Tregillis: Do you have a list of the 650—

Senator BOYCE: Not today.

Mr Tregillis: Yes, they are all AFSL holders, so we can—again, when we say 'white labellers', these are the ones providing services to retail clients of the markets.

Senator BOYCE: What are their industry organisations? Do they have any?

Mr Tregillis: I do not think there is a specific—

Senator BOYCE: I was wondering if there was one, or two or three, that might pick up a lot of them.

Mr Medcraft: There is a brokers association.

Mr Tregillis: The Stockbrokers Association.

Mr Medcraft: Yes.

Senator BOYCE: That would be it. I was wondering what else there was.

Ms Gibson: I cannot remember its name, but there is one specifically for—

Mr Tregillis: White labellers.

Ms Gibson: I doubt that they call themselves white labellers!

Mr Tregillis: We can get that detail for you.

Senator BOYCE: Perhaps it is called Johnnie Walker or something!

Mr Tregillis: Again, they are all licence holders, so they are all on our registers. One of the issues is what the definition of a white labeller is, so we are just saying that the sector looks to us to be about 650. Some of these are engaged in other activities, of course—OTC activities.

Senator BOYCE: And there are no capital ratio holdings or anything required of any of those?

Mr Tregillis: They are required to hold the normal NTA requirement that we have for other licence holders. One of the things that is happening is that we are taking over the monitoring of the ASX's capital rules, which are much more intensive and all based on a much more detailed system than exists for AFSLs, partly because these are people trading and taking positions on the market, and over the years that regime has developed. The rest are really subject to the normal AFSL requirements, which are net tangible assets.

But I think one of the things you would have seen is that ASIC over the last 12 months—and the chairman can talk about this a little bit more—has been reviewing the capital requirements in the different sectors. It started with the responsible entities. There is currently a discussion paper, a consultation paper, out or soon to come out about OTC. Some of these participants also do OTC. So we are generally having a look at capital requirements. It is clear that there is a distinction between people like ASX direct members, because they are the ones we monitor under the ASX rules, and these other brokers who are subject to the general capital requirements just for AFSL licensees.

Senator BOYCE: You said this is a resource intensive exercise for ASIC.

Mr Tregillis: It is a large number.

Senator BOYCE: So when might we expect that you would have a sense of whether or not you would be making any recommendation to government?

Mr Tregillis: I think we will pass on the views from the market from our consultation. Again, it is not surprising—I do not have the detail, but we put it in our consultation response—that there was general support for extending the market integrity rules, but that probably came from the sectors that are already subject to those rules, so I suspect—

Senator BOYCE: I can understand that if you think you are on the level playing field you want everyone else there too.

Mr Medcraft: It is not unreasonable.

Mr Tregillis: I suspect Treasury, when thinking about this, will need to consult again a bit more broadly, specifically on the issue.

Senator BOYCE: So you do not see your investigations in this area leading to a conclusion which you might then pass to government?

Mr Tregillis: We have not got to that stage. I think we will make sure that, as we pass this information, we also pass to Treasury the types of issues we are seeing in the sector to help inform them about whether this is an area where there are emerging issues. I think we are seeing that it does need some strengthening. As to ASX, whether or not the market integrity rules are the best way to deal with this or there are other mechanisms, we will feed into that process. But ultimately this will be a policy call.

Mr Medcraft: Excuse me. Do we intend to do a health check on the sector—publish a health check—or not?

Mr Tregillis: It is one of the options. We are thinking about how to take what we have done—as I said, we have done profiling; we identified that there is a large population; we have narrowed it down to about 200 of those we think are significant—

Senator BOYCE: Those 200 are significant because they are significant players rather than—

Mr Tregillis: Yes, in terms of size and the type of clienteles—sufficiently large in terms of size and the risk profiling we do; that is right.

Ms Gibson: We should be clear that we are not suggesting that all market integrity rules would apply, but the ones about manipulation of the market and so on might be ones that we think should apply—a number of the ones about how they deal with their clients, where those rules are stricter in the MIR than they are in, say, the financial licensee space. But those suites that go to the fairness and efficiency of the market are the ones that we would be thinking might apply and might have an overall quality lift.

Mr Medcraft: The fairness question goes to the level playing field discussion we just had.

Senator BOYCE: You mentioned the fact that you are working your way through looking at revising capital ratios or updating—

Mr Medcraft: Financial resource requirements.

Senator BOYCE: Yes. Is there a schedule for that and if so is it available?

Mr Medcraft: When I first joined ASIC one of my early concerns was that the financial resource requirements we had really had no rationality in my view. I think you either have no financial resource requirements or you have ones that actually have some sort of logic and rationality behind them. We started with REs and we are now looking at the OTC. My objective is really that. Frankly what our financial resource requirements focus on is operational risk. At the end of the day they are not there necessarily to protect consumers. They are about just making sure that you have got enough. One of the interesting things with the REs is that when we went out and talked to really big businesses they said, 'Well, it is what we do anyway; it is how we allocate capital to a business.' From my background it is just commonsense. Again, it is just taking that same commonsense approach in terms of operating risk and—

Senator BOYCE: Except, when the commonsense lapses a lot of people can get hurt.

Mr Medcraft: It actually gets back to the level playing field. If a good player says that that is what we need to run the business, then if somebody is running it on the back of a postage stamp it is uneven because it is not really an equal competition. So, the general philosophy is that basically the business has sufficient resources to cover its operating risk on a one-year horizon. That is not unreasonable. They are not going to go broke in the next 12 months. The next principle is that behind that principle we are saying that entities undertake 12-month cash flow projections to demonstrate that they are not going to go broke in the next 12 months, which everyone agrees is reasonable. The directors endorse that, so they are accountable.

The other aspect of financial resource requirements is the reason you have capital, which is to cover unexpected operating risk. You have a buffer if the expected does not happen. It is then a matter of identifying a good indicator for operating risk. Generally, revenue is a good indicator of operating risk; it is pretty well recognised globally. Generally, we have come out with revenue as the activity indicator and, with the REs, we said that it was 10 per cent of the operating revenue as an indicator of what you should be in capital. Once you have got capital for a one-year horizon for unexpected risks there is no use having it in real estate because when you need it it is not there, and logically it does not make any sense. We have said that you need to have something that can be converted to cash within a short period of time.

The third principle is that businesses should also have, depending on the nature of your business structure, a minimum that you essentially need to operate the business. We have said that the minimum to be in RE is—I cannot remember the number—$250,000. The minimum for an OTC derivative provider or CFD provider I think we have discussed as probably being $1 million, because it is a different business model. It is actually just trying

to put some logic into those financial resource requirements. When you move to a different sector you have to look at that sector, but looking to apply consistent principles. That is what I was looking to.

Senator BOYCE: Where are you moving next?

Mr Medcraft: I cannot tell you because we are focused at the moment on the OTC and CFD providers. It is important to take one step at a time in terms of this and the REs. But I think it is important to understand the thinking behind it and make sure that it is consistent and that people understand it. It is important; it is people's skin in the game, as well.

Mr FLETCHER: I want to ask a couple of questions following up from the discussion we had at the last hearing about funds, particularly mortgage funds, which have frozen redemptions. I presume that is something that ASIC is continuing to track.

Mr Medcraft: We are.

Mr FLETCHER: What is the latest position in terms of the number of funds that have frozen redemptions and the total volume of investments?

Mr Medcraft: Let us go back to what happened. In November '08 we had 81 funds with 22½ billion under management that were frozen; mortgage funds, 63 schemes representing 16.8 billion; property funds, 3.7 billion; cash-in-hand funds, six at 2 billion; and one hedge fund worth 0.56 billion. That was the size of the funds that were frozen. That has now shrunk in terms of frozen funds to 18.2 billion.

Mr FLETCHER: You said 22.5 billion—

Mr Medcraft: Was what was frozen in '08 in terms of funds.

Mr FLETCHER: But 2½ years later—

Mr Medcraft: Yes, 2½ years later we have 18.2 billion that are still deemed to be frozen, which is that money cannot be taken out. I cannot tell you exactly as of what date, but I can come back to you. I believe that it is fairly recent numbers. To continue: mortgage funds, 12.3 billion; property funds, 3.6 billion; hedge funds, the one that was originally frozen, 0.6; and cash-in-hand funds, 2 billion. Of that 18.2 billion which are still technically frozen, some of them are, as you know, actually providing limited access to the money, such as quarterly withdrawal of money that has come in over time.

Senator BOYCE: It is not exactly powering down though, is it?

Mr Medcraft: I think you have to look at the models though. Within the mortgage schemes you have what are called the aggressive mortgage schemes, which were really property development mortgages. A lot of those are obviously frozen and obviously the reason they froze is generally to protect capital. They are taking a while to work their way out; a lot of them are still frozen. Then you have got, for want of a better term, the non-aggressive funds or classic ones. I think what you are seeing is some of the larger ones of those actually theoretically frozen, but they are releasing money, because generally they were lending for five-year commercial mortgages, so they are gradually releasing cash to their investors.

Senator BOYCE: And some will be in distributions as well.

Mr Medcraft: Yes. What I think we recognise is that, even though a commercial mortgage loan might have been for five years, which might be that some of them are coming to maturity, sometimes it may not be in their best interests to not necessarily roll the loan over, because you might necessarily result in that borrower defaulting. So again it is about those managers trying to protect the capital. What we are seeing is that restructuring is occurring. A large part of this sector is the non-aggressive mortgage funds. Fundamentally they want people to be in there that want to be in there because they want to reopen to accept more funds. The sector, I believe, is actually really trying to restructure because basically they want to win back the trust and confidence of investors. So there is restructuring going on. On our side in that sector we have issued, or are in the process of issuing, a new regulatory guide to really focus on PDS disclosure in terms of when you invest in a mortgage fund. We have actually written to Treasury to look at changing the way you define—

Mr FLETCHER: Are the numbers that you have quoted regularly publicly reported?

Mr Medcraft: I do not believe so, no.

Mr FLETCHER: Is that something ASIC has given consideration to—putting up on your website a three-monthly update on the number of funds that are still freezing redemptions?

Mr Medcraft: It is more a function of—I will take that on notice and come back to you. On our website we have an information sheet which explains to investors how they can get access to the money for hardship relief. The funds offering limited access, as opposed to hardship relief, we publish online, but we will come back to you

with the statistics. The underlying thing is that we are monitoring the market. I will talk to the team about how frequently we are doing it, but there is an issue about frequency because it is going back to 80 funds, a large number. Let me come back to you on that.

Mr FLETCHER: Do you think, in view of the fact that these funds are presently not redeeming money consistent with the expectations that investors had when they put money into the funds, on the grounds that these are exceptional circumstances that they are trying to recover from, that there is a case for additional regulatory scrutiny?

Ms Gibson: We have issued a number of guides as to what should be disclosed when issuing new funds and opening new funds.

Mr FLETCHER: I am more interested in the circumstances of the funds which presently are not able to redeem a unit holder's investment in circumstances where they ordinarily would be expected to, consistent with what was in the original PDS, and whether, in view of that, there is a need for some continuing closer scrutiny?

Mr Medcraft: What would have been in the original PDS—and this is the issue with this—is that the original PDS would have disclosed that, in the event there was an issue of ability to convert the funds, they had the right to freeze those funds. So they are acting within what was in their PDS. It gets back to what I said before about how these products are sold, to whom and how the risks behind the products being disclosed. That is why getting back to what Commissioner Gibson said, which I think is quite important, the PDSs are far clearer in terms of disclosing the business model going forward.

Mr FLETCHER: What you are putting is that ASIC is satisfied that, in circumstances where these funds are freezing redemptions, they are doing it consistent with the terms of their PDS.

Mr Medcraft: Yes. The law basically says that they actually have the right to freeze if they believe there is an inability to convert 80 per cent.

Mr Price: There is a percentage but the history of this goes back to the Estate Mortgage collapse many years ago. Very large consumer losses resulted from that collapse because effectively, when funds got into trouble, there was a fire sale of assets. The policy response to that particular problem was to put in place a mechanism in the law which distinguishes between what are known as liquid and illiquid managed investment schemes. The question of whether a scheme is a liquid or and an illiquid scheme is a matter to be determined in accordance with the statute. There is an actual test set out in the statute, which says when it is, but the policy concern I hear you raising is that although there may be mechanisms in place to prevent a fire sale of assets, that leaves an ongoing problem that investors may not be able to access money which they need for their own living expenses. The way ASIC and industry have sought to deal with that problem is to create the idea of hardship relief, so that in certain circumstances there is access to that money. All of that is simply to acknowledge that how to deal with situations where people have money tied up in illiquid assets when really what they should have been investing in is a more liquid type of asset is an ongoing policy issue. I think there is a broader piece of work to be done around education of consumers and also to make sure that disclosure is very clear and people understand early on what they are getting into. That is exactly the work that Ms Gibson—

Mr Medcraft: It really comes back to what I said earlier. It is about education. It is about gatekeepers—for example, advisers that put people into mortgage trusts making sure that they are an appropriate investment—and also consumer behaviour and the way that these products are sold to consumers to make sure that they actually understand what they are buying. To that end, we did a consultation paper, which is now a red guide. It is due for release in July, next month. It is called 'Debentures: strengthening disclosure benchmarks for mortgage schemes'. It focuses on liquidity; scheme borrowings; portfolio diversification; security; related parties—learning some of the issues that came from what happened; valuations in terms of independence and who is doing it—no conflicts; and loan-to-value ratios. If the scheme lends more than 70 per cent to a development on a completion basis we are asking why, because generally that is not a prudent level to lend beyond—and in other cases 80 per cent. Also, regarding withdrawal arrangements, as we were talking about, we are asking them to explain how they can pay within 90 days—that is withdrawal—and what happens if it becomes illiquid. We are trying to flesh out the key risks in the business model going forward. I think the industry has welcomed this because, at least for the good ones it fleshes out the business model more.

Ms Gibson: To answer your question about whether we are looking in an ongoing way: in the past PDSs and disclosures there may be a small handful of cases that we are looking at. It was in PDS, but you had to look hard to find it in many instances. They are long documents and you do not have an enormous amount of confidence that people read them cover to cover.

Senator BOYCE: We know for a fact from Storm that they hardly ever read them, don't we?

Mr Medcraft: The most important thing is we are monitoring the sector. We do talk to the schemes. The Challenger one has restructured. There is a commercial incentive to try and restructure it where you can, rather than lie down.

Mr FLETCHER: Mr Medcraft, I have one microquestion. I just want to check whether you received a letter from me regarding a constituent, Mr Tessararo. I am not asking you to address the merits of it but to check that it has arrived. He had some concerns about some dealings with ASIC on a particular matter. Could look at that for me in due course.

Mr Medcraft: Sure. It is noted. I will perhaps let you know afterwards.

Mr FLETCHER: I have a macroquestion. One of the metrics that gets tracked in terms of Australia's international competitiveness is how quickly somebody who wants to establish a business can do so. Generally I think Australia rates pretty well compared to other jurisdictions. Can you talk a bit about ASIC's role in that.

Mr Day: That is a very good question. Thank you, Mr Fletcher. ASIC has moved up the rankings to No. 2 in terms of the ease of starting.

Senator BOYCE: Who is No. 1?

Mr Day: Singapore, I think, off the top of my head. We have gone up, and that relates to the ease of starting a business—not of doing business but of starting a business. Of course as it stands at the moment ASIC has a large role to play in terms of registration of companies, obviously. We will have a bigger role to play when we take over the regulation of business names nationally. Obviously that measure will be more attributable to us rather than to the other state agencies, as it is at the moment. That is our role in relation to that. In relation to our activity in that space, we have given briefings and answered questions before in relation to the things we are doing to make it easier. As I said, we are moving to have full online registration. We are increasing each year the percentage of documents and business transacted with us not by paper but online, and we are moving there towards 80 per cent. That is good news for business in Australia and it shows the ease with which you can start a company in Australia.

CHAIRMAN: ASIC has done an internal review of its coercive powers and there have been a number of discussions around the extent of the use of those powers, and recommendations have come out of the internal review that you have done. There have been a number of changes, so would you give us a quick update on that.

Ms Gibson: We completed that review, details of which I think you have been provided.

CHAIRMAN: Yes.

Ms Gibson: By and large, as a result of the discussions with our stakeholders, who regularly receive these notices, and the interested party, the association, the commonly cited one, we did not identify grave concerns. As a procedural matter—I will draw a distinction between the two types. The first relates to notices seeking information for us to pursue investigations. People would prefer to have more discussion beforehand to make sure that we ask questions that are focused on what we are looking for. By and large, these are the banks and they are providing evidence of cash flow through the system. We have focused on an internal training program that causes people to give more thought to ringing up and talking beforehand where there is not a concern of tipping off the baddies, as it were. We have focused on scope of notices and not perhaps being seen as going on a fishing exercise.

The other sorts of notices we issue are industry surveillance notices and, again, we are focusing on voluntary disclosures beforehand. Many companies cannot do it voluntarily because they need a direction of law to provide us with information. But, by and large, we have a training program that looks at better interface with people about those notices and the content of them. We are doing more internal training about the strictures on the issue of those. We have a training program but we are upgrading that, and that will go with some greater consistency about who approves them internally.

We have committed to provide information in our annual reports about the exercise of our coercive powers. That will be in this upcoming annual report and it will be in the same format as the data we provide at the Senate estimates committee in October. We are close to completing a notice about transparency—that is, setting out what our powers are, the scope for those powers and so on. At the moment they appear at the bottom of our notices but we will put that on our website.

CHAIRMAN: One of the issues that was raised both by the Senate Standing Committee for the Scrutiny of Bills, which considered the use of coercive powers, and by the Rule of Law Institute of Australia was the impact of the use of coercive powers in terms of individual rights, and even human rights. How does ASIC see that in terms of the rights of an individual versus the rights of a corporation? The two do not apply in the same way.

Ms Gibson: In terms of the recipient?

CHAIRMAN: We cannot apply human rights to a corporation, as with a human being.

Ms Gibson: I am sorry, I am not sure what the focus is on human rights.

CHAIRMAN: The application, the concept, the idea that you apply due process and consider the impact of the use of coercive powers in terms of an individual versus the use of coercive powers in terms of an organisation.

Ms Gibson: Our rules would be the same for all notice issuers to have regard to the proportionality—that is, the information we seek as against what we seek against them—to talk about cost and impact—

CHAIRMAN: That is all right, if you have not really considered it. The Rule of Law Institute of Australia raised with us the matter of human rights in terms of coercive powers. My question was around how that applies when you are not talking about an individual. Normally you would apply the process: what is the impact on an individual of due process? But we are not talking about individuals. Often in terms of the work that ASIC will do you are talking about a corporation. A corporation itself has a different set of rights, not the same rights as human rights.

Ms Gibson: It is not something they have raised with us.

CHAIRMAN: If it has not been raised with ASIC—

Mr Medcraft: We will take that on notice.

CHAIRMAN: Take it on notice. I am certainly interested in the view of ASIC in terms of how the differences apply.

Mr Tregillis: Typically the notices we serve on corporations are information gathering. Usually it is a request for documents or access to documents or for material. We can take it on notice, but I cannot quite see how that raises questions of human rights.

CHAIRMAN: It was raised with us.

Mr Tregillis: That is typically what you do when we are exercising our powers for individuals—

Mr Medcraft: My personal view is that it is important that there is fairness and that information we get is information we use—incursive powers. At the end of the day, given as I said earlier about the nature of our system—that it does rely on gatekeepers and it is very open on them to do their job—

Mr FLETCHER: When you issued these notices the documents you gathered were then presumably available to be used as evidence in legal proceedings; is that right?

Ms Gibson: That is correct.

Mr FLETCHER: And if you conduct an interview with a witness presumably that is also the case—the transcript is available to be used as evidence?

Ms Gibson: It depends on whether they have claimed privilege. If they claimed privilege then we cannot use that against them. There are circumstances where we can use it against other persons—

Mr FLETCHER: In other words, there are mechanisms for individuals to protect themselves against self-incrimination, for example.

Ms Gibson: They claim privilege. Some of the information contained in those answers we can use I believe to seek that information from other sources but, yes, there are extensive powers of privilege in the verbal discussions.

Mr Medcraft: As Commissioner Gibson said, generally we will try to take a voluntary approach to asking for information where we can.

Ms Gibson: Where we can, and that would not be where we are investigating a criminal prosecution or a civil prosecution but where we are looking at industry—

Mr Medcraft: No, sorry, but in terms of surveillance we generally take a voluntary approach where possible. As Commissioner Gibson said, my experience is that sometimes industry will come back and say: 'We prefer you to just give us a notice because that will actually help protect us if there are any issues for us releasing the information.' We have actually finetuned what we do in this area.

CHAIRMAN: You have used those powers 18,000 times. I am assuming here this was in the previous year. Is that a big number or not? Is it small comparative to the size of the market?

Ms Gibson: There is no market that we can compare it to given our scope. We only collected that data in that consolidated way last year and, frankly, this year, now that we have credit and market supervision on board, it is likely to be more. It is not possible to be conclusive.

Mr Medcraft: I think it comes back to making sure that there is fairness and efficiency behind what you do with this. As Commissioner Gibson said, I think it is important that our staff are actually properly trained and we also monitor how that power is used and we actually have reviewed what we are doing there. But it does remain I think a very important tool for us as a regulator.

Ms Gibson: There is one bit of feedback, which was notices we issued to the financial services industry some time ago. We have taken on board that feedback which (1) was on the consultation before and (2) was reporting back on the outcome. We have gone back to most of those people that received those notices and had a dialogue. Interestingly, a number of them said in these meetings, 'Oh, yes, once we had read your questionnaire we did actually make these changes and we will do an annual broad report to the market about that in the next few weeks.'

CHAIRMAN: There is also the case of the principles of the Administrative Review Council regarding coercive powers. I believe there were two particular powers of ASIC which did not comply.

Ms Gibson: Yes.

CHAIRMAN: Would you expand?

Ms Gibson: Yes, that is right and the changes I have mentioned will pick that up. Those are the issues of transparency and accountability.

CHAIRMAN: So that will be taken care of now with the annual report and also with publishing on the website?

Ms Gibson: We will put on the website a statement about when we use coercive powers and some statements about rights when we use them in plain language form. I think that is desirable.

CHAIRMAN: Can I ask you this in terms of market integrity, particularly as to credit rating agencies and the payment for particular ratings. What work is ASIC doing to continue to ensure that there is integrity in terms of those ratings that are given to particular products?

Mr Medcraft: Credit rating agencies are now licensed, as you know, and the licensing requires them to comply with the IOSCO standards relating to ratings agencies. This goes back to what I said at the start about gatekeepers, because rating agencies are gatekeepers. They go back to, first of all, how they deal with conflicts of interest, one of them being about rating and getting paid. There are standards in relation to separating out carefully between those who are doing the rating and those who are actually marketing the rating. Those standards also go to the training of staff in terms of quality and getting a lesson from the actual crisis. They also go to transparency, with requirements to publish their methodologies. That is all part of the IOSCO standards, and that is what our ratings agencies here are doing. The next step is in fact us undertaking surveillance of how they are complying with those IOSCO standards. IOSCO has developed a global inspection approach which will be guiding us. We have actually published a consultation document in terms of how we expect them to report to us in respect of those guidelines. What will happen is that we will come out with a final guidance in terms of what we expect them to do with reporting. Research houses are very similar to rating agencies. We have surveillance underway at the moment on research houses, and that might perhaps inform some more work on our approach to research houses. If you think about it, they are pretty similar in terms of what they do, with investors relying on them and their responsibilities. Mr Price might want to comment on rating agencies if he has anything to add.

Mr Price: The only other thing that I would add is that there is some work underway at the moment that we are undertaking with European lawmakers that would possibly enable the recognition of credit ratings from Australian credit rating agencies, so if people were doing business in Europe they would need to get a subsequent credit rating from a European credit rating agency. Obviously, that is to facilitate and ease the cost of people in Australia who wish to do business in Europe.

Mr Medcraft: That is correct. It is taking up a lot of the time of the team at the moment trying to get that mutual with Europe.

CHAIRMAN: ASIC holds a number of information databases and I understand that there is a review currently underway of the access, use and cost associated with the databases. Perhaps you could give the committee a short verbal brief of where that is at and also, if necessary, a written brief on ASIC's work in this particular area.

Mr Day: I think also Deputy Chairman Gibson is aware of this. There are regulation restrictions on us about the ability to provide information out of our registry database, much to the annoyance I know—and probably quite rightly—of academics and others because they want to look at a lot of our data in aggregate forms so that they can opine and write articles and give guidance to the community about what they see outside of ASIC. The

regulations are quite restrictive in our ability to provide that information to other parties, in the way that we have to charge, and that works for other agencies as well—other bodies that might want access to that information.

CHAIRMAN: Including the states and territories?

Mr Day: In some cases, yes. When I say 'some cases', I mean that the states have access through arrangements, certainly under the referral of powers. They can have access to that information, but it depends on the nature of that and which agency is asking, and so on.

Mr Medcraft: I would like to add to that. At the moment, from systems perspective, we are moving to a new system at ASIC which will obviously increase our operational capacity. It is called the Star Program. That is important in terms of our effectiveness. Another aspect to this is in terms of access to information. Early in the new year or very soon we will make it a lot easier for individuals to access our portals, without having to go through third-party information brokers. You will be able to get the information yourself directly. It is important that a registry and licensing system can foster commercial dealings, rather than having intermediaries. That is another aspect of your question. I do not know whether that is what you wanted to focus on. Would you like to comment on that at all?

Mr Day: I mentioned it earlier. The search project will deliver a new direct online service to enable people to search ASIC's public registers via our website, in particular to do free searches as well as paid searches for extracts with a credit card. That project will substantially improve the search experience by providing customers with the ability to search across multiple registers for organisations or people—for example, whether they are a direct licensee, a representative, a band or a disqualified person. That is a substantial improvement from the existing service that required searches to be completed through each registry individually. Also, it will mean that the public will be able to ask for that and effect that search without the need to go to a brokerage service and without the extra charge the brokerages put on. That is not to say that the information brokers do not provide value-added services. Ours will be a relatively basic service compared to the value-added ones that some of those services can provide.

Mr FLETCHER: So the brokerage services will still be part of the picture?

Mr Day: Yes, of course. They will definitely be part of the landscape.

Mr Medcraft: With us being more efficient it will make it more user-friendly to do it yourself.

Mr FLETCHER: With the use of the brokers, I presume ASIC earns revenue from that—they pay a licence fee or the like, I presume?

Mr Day: Yes.

CHAIRMAN: Mr Medcraft, can you undertake to provide the committee with a brief on the current situation of the review and whatever you are able to provide us, so that we can better understand.

Mr Medcraft: The review of—

CHAIRMAN: Of access to the databases and what is currently happening.

Mr Medcraft: Sure. We can do that.

Mr Day: Chair, may ask whether that is a question of the type of searching for the public or is it more about access by other parties or academics, or both?

CHAIRMAN: The committee would be generally interested in what the review is about, what the databases are and what is anticipated as an outcome, so that we have a better understanding of what is held by ASIC.

Mr Day: Certainly. I understand. I just wanted clarification. We can certainly do that.

CHAIRMAN: They would be great. We would appreciate that. As there are no further questions, that concludes this hearing. We thank you for your participation. The committee has resolved for questions taken on notice to be returned by Friday, 22 July or as quickly as possible.

Mr Medcraft: Regarding the question on Trio, we said we would get back to you on that—

CHAIRMAN: That would be good.

Committee adjourned at 11:19