Parliamentary Joint Committee on Corporations and Financial Services

Statutory oversight of the Australian Securities and Investments Commission

August 2011

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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Abbreviations

ACCC	Australian Competition and Consumer Commission
AFSL	Australian financial services licence
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ASX	Australian Securities Exchange
FSA	Financial Services Authority (UK)
OCIE	Office of Compliance and Inspections (USA)
PDS	Product disclosure statements
RoLIA	Rule of Law Institute of Australia
SEC	Securities Exchange Commission (USA)

Recommendation

Recommendation 1

2.39 The committee recommends that ASIC amend its website to include an explanation of the meaning and significance of holding an Australian financial services licence. The information could also be usefully included on the MoneySmart website.

Chapter 1

Statutory oversight

1.1 The Parliamentary Joint Committee on Corporations and Financial Services was established by the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). Section 243 of the ASIC Act specifies the committee's duties, which include:

> (a) to inquire into, and report to both Houses on:
>
> > (i) the activities of the Australian Securities and Investments Commission (ASIC) … or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed …

1.2 This report is presented in execution of the committee's duty under paragraph 243(a)(i).

1.3 As the regulator of Australia's corporate sector, markets and financial services, ASIC is responsible for monitoring the integrity of Australia's financial system. Areas within the Commission's purview include regulation of corporations, financial advisors and consumer credit providers, and supervision of trading on Australia's licensed equity, derivatives and futures markets. The Commission may also advise the Minister about changes required to address concerns with the operation of the corporations legislation or the financial products or financial services industry, or to improve the efficiency of the financial markets.[1]

1.4 In inquiring into ASIC's activities, the committee sought to determine whether ASIC is fulfilling its statutory responsibilities as the corporate, markets and financial services regulator. In considering ASIC's performance the committee had regard to section 1 of the ASIC Act, which directs ASIC to:

- maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy;
- promote the confident and informed participation of investors and consumers in the financial system;
- administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements;
- receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it;

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1 *Australian Securities and Investments Commission Act 2001*, para 11(2)(b); ss.11(3).

- ensure that information is available as soon as practicable for access by the public; and
- take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.

Gathering evidence

1.5 The committee held public hearings on 15 June 2011 in Canberra and 24 June 2011 in Sydney. The committee invited the Rule of Law Institute of Australia and Dr Carole Comerton-Forde, Professor of Finance, Australian National University, to give evidence at the hearing on 15 June. The committee appreciates the assistance provided by the Institute and Dr Comerton-Forde, and thanks the witnesses for their contribution to the oversight process. The committee also acknowledges ASIC's ongoing cooperation, and extends its thanks to ASIC for providing facilities for the hearing on 24 June.

1.6 This report reflects evidence taken at the hearings. The witnesses who gave evidence are listed in Appendix 1. Copies of the Hansard transcripts from the hearings have been tabled for the information of the Parliament, and are available on the committee's website.[2]

Additional information

1.7 A number of questions were placed on notice at the hearings. Those questions, and responses to them, are published in Appendix 2.

2 www.aph.gov.au/Senate/committee/corporations_ctte/asic/index.htm

Chapter 2

Matters considered at oversight hearing

2.1 The committee inquired into several matters relating to ASIC's activities. These included:

- ASIC's strategic framework;
- supervision of the stock market;
- ASIC's coercive powers;
- Australian financial services licences; and
- freezing of investors' funds.

ASIC's strategic framework

2.2 The committee was informed that ASIC has adopted a strategic framework to guide the Commission's activities. The strategic framework establishes three priorities; confident and informed investors and financial markets, fair and efficient financial markets, and efficient registration and licensing.[1]

2.3 Mr Greg Medcraft, Chairman, ASIC, advised that the first priority covers three 'foci', namely, education, gatekeepers and consumer behaviour. This priority will drive ASIC's use of new media to promote financial literacy, and the dissemination of standards and guidance material for gatekeepers and consumers. Under the second priority ASIC will 'continue to focus...efforts in market supervision and competition, and also on corporate governance guidance.' The committee was further informed that under the third priority, ASIC will give particular attention to 'small business...where there is perhaps an expectation gap.'[2]

2.4 It was apparent that an emphasis on self-regulation and 'empowerment' underlies ASIC's approach to corporate, markets and financial services regulation. Mr Medcraft advised that ASIC considers that '[i]t is very important that consumers and investors are empowered.' Mr Medcraft further stated:

> 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.[3]

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1 Mr Greg Medcraft, Chairman, ASIC, *Committee Hansard*, 24 June 2011, p. 2; ASIC, *Draft Strategic Framework*, 8 June 2011.

2 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 2.

3 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 2.

2.5 With regards to gatekeepers, it was noted that ASIC considers that '[s]elf-regulation has an important role to play, with the support of ASIC where needed.'[4] Mr Medcraft elaborated on the concept of self-regulation:

> [I]t is important that we hold 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.[5]

2.6 It was explained that there are four factors guiding the development of the strategic framework, namely, 'legislative responsibilities, systemic or regulatory risk, stakeholder expectations and government policy.'[6]

2.7 It was noted that the Commission's focus on managing systemic or regulatory risk prompted the formation within ASIC of an 'emerging risks' committee.[7] Mr Medcraft explained that the committee:

> 'is designed to...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.[8]

2.8 Mr Medcraft further explained that the formation of the committee is in response to ASIC's view that '[i]f 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.'[9]

Committee view

2.9 The committee notes with approval ASIC's strategic framework, which appears to cover ASIC's legislative objectives as contained in the ASIC Act. The committee agrees with ASIC's understanding of its role and responsibilities as the corporate, markets and financial services regulator, and particularly approves ASIC's commitment to identifying areas of potential risk. On the basis of the information provided to the committee, it is apparent that ASIC recognises the importance of the Commission's educative role in promoting prudent and fully-informed self-regulation by market participants. The committee considers that the financial literacy tools,

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4 ASIC, *Draft Strategic Framework*, 8 June 2011.

5 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 2.

6 ASIC, *Draft Strategic Framework*, 8 June 2011.

7 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, pp 2, 10.

8 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 10.

9 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 10.

standards and guidance material that ASIC provides are a necessary part of promoting confident and informed market participation and are a key tool to assist gatekeepers and investors to self-manage their activities.

2.10 The committee notes with approval the formation of ASIC's emerging risks committee. The committee sees merit in the continual analysis of the system to identify areas of potential risk. Such analysis is a core element of maintaining and improving Australia's financial system that, the committee notes, is part of ASIC's legislative objectives. The committee will seek advice from ASIC's emerging risks committee at subsequent oversight hearings.

Supervision of the stock market

2.11 The committee has continued to track the transfer of responsibility for supervision of real-time trading on Australia's domestic licensed markets from the Australian Securities Exchange to ASIC. ASIC has previously advised, and the committee has noted, that since the transfer of responsibility, the time from problem identification to formal investigation has decreased.[10] The committee notes that this trend continues, 'with approximately 40% of all referrals progressing to investigation in under 30 days from identification of the misconduct.'[11] The committee further notes ASIC's advice that from January to June 2011:

> [t]here were 23,494 trading alerts, with 121 matters requiring further consideration. Some 34 matters were referred for further investigation. These matters involved potential insider trading (17), market manipulation (6), possible breaches of the market integrity rules (10) and of continuous disclosure obligations (2).[12]

2.12 As has been noted, ASIC advised that 'fair and efficient markets' is one of the three priorities under ASIC's strategic framework. ASIC's report *ASIC supervision of markets and participants: January to June 2011*, provides further details of the activities undertaken to achieve this priority:

> A core outcome for ASIC is investor confidence that our markets are fair and efficient. This requires our market infrastructure to be robust; trading, clearing and settlement of transactions to be orderly and efficient; and market misconduct to be minimised. We do this through engagement with stakeholders, surveillance of markets and market participants, education, guidance and our deterrence activities.

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10 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, February 2011, p. 4; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, May 2011, p. 4.

11 ASIC, 'ASIC releases second market supervision report', Media release 11-141MR, 13 July 2011.

12 ASIC, 'ASIC releases second market supervision report', Media release 11-141MR, 13 July 2011.

ASIC is committed to reducing the incidence of market misconduct by:

- ensuring that market participants have better controls in accordance with required standards;
- supervising markets and market participants to detect market misconduct quickly; and
- conducting timely investigations of market and market participant misconduct, resulting in significant penalties where appropriate.[13]

Emerging issues

2.13 The committee's attention was drawn to a number of emerging issues that may affect the performance of Australia's domestic licensed markets, including 'dark pools', high frequency trading and 'white label/indirect brokers'. Areas of potential risk were identified by ASIC and Dr Carole Comerton-Forde, Professor of Finance, Australian National University.

2.14 The committee was informed that, consistent with its policy of seeking to identify emerging issues, ASIC has reviewed indirect brokering, also known as 'white labellers'. Mr Shane Tregillis, Commissioner, ASIC, provided an overview of indirect brokering in the Australian market, noting that ASIC has 'identified a number of weaknesses, in terms of controls and other issues'.[14] However, while commenting that 'there are clearly areas for improvement required in this sector, and it is an issue that we think requires continued focus', ASIC noted that regulation of indirect brokers is a policy matter for Treasury.[15] The committee was informed that ASIC is advising Treasury of the need for policy development in this area.[16]

2.15 The committee was also informed that in the overseas market, internalised/non-transparent trading, known as 'dark pools' have caused 'concerns about both price discovery and liquidity'.[17] Dr Comerton-Forde explained that their increased availability as a result of advances in technology and, therefore, increased use, 'creates more risks, both because there is no longer a strong motivation for why that sort of trading is allowed and because there is no longer a lever for ensuring that sufficient transparency and liquidity are going to the main market.'[18]

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13 ASIC, *ASIC supervision of markets and participants: January to June 2011*, Report 243, July 2011, p. 4.

14 Mr Shane Tregillis, Commissioner, ASIC, *Committee Hansard*, 24 June 2011, p. 11.

15 Mr Tregillis, ASIC, *Committee Hansard*, 24 June 2011, p. 11.

16 Mr Tregillis, ASIC, *Committee Hansard*, 24 June 2011, pp 11–12.

17 Dr Carole Comerton-Forde, Professor of Finance, Australian National University, *Committee Hansard*, 15 June 2011, p. 10.

18 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 10.

2.16 Dr Comerton-Forde explained that 'the current Australian regulatory environment does not provide for a dark-pool class of markets. They are operating currently under the rules of the ASX.' Dr Comerton-Forde advised that it is 'very important...that they [dark pools] are regulated in their own right'.[19] However, Dr Comerton-Forde questioned whether ASIC has the capacity to regulate non-transparent trading:

> ASIC regulates the brokers who are operating these venues, but they are not regulating the venue per se. So the brokers have an obligation to the market and to their clients...but they are not regulated as a trading venue. And they probably should be.[20]

2.17 The committee was also provided with an analysis of the risks posed by high frequency trading, which Dr Comerton-Forde predicted will increase with the introduction of competition in the Australian market. While reporting that high frequency trading can add value to the market, Dr Comerton-Forde advised that the trading can increase technology costs and 'create a more complex environment for traders'.[21] Dr Comerton-Forde recommended consideration be given to ensuring that the increased costs 'are borne by those that create the costs rather than by the market as a whole',[22] and further stated 'I think one sensible approach is to charge a fee when the ratio of orders being placed to cancelled orders becomes excessive'.[23]

2.18 Dr Comerton-Forde also noted that risks may be posed by market competition and new forms of trading services. While advising that 'competition in equity markets is very good and very important for the development of the markets', Dr Comerton-Forde stated that competition entails 'risks and issues that need to be managed'. These include 'issues in terms of the fragmentation of the market and being able to access liquidity'.[24] Drawing on experiences of overseas markets, Dr Comerton-Forde further advised:

> [t]he new entrants have come into the market with superior and much faster technology and have innovated significantly in the way they offer trading services to the market. Generally this has been good, but there have been some risks along the way. There has been a massive change in the types of orders that are available to investors in the market: hidden orders, pegged orders, flash orders. They have generally been good, but there have been some instances, such as with the flash orders in the US, which have been

19 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 11.

20 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 12.

21 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 11.

22 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 11.

23 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 12.

24 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 8.

> problematic. It is important that the regulator is on top of those sorts of things and can step in and make changes quickly if needed.[25]

2.19 Regarding ASIC's oversight of the Australian market, Dr Comerton-Forde stated that the challenges facing the market should influence ASIC's resources and approach to market regulation:

> Again, the regulators need additional tools, technology and understanding of the market in order to monitor the market effectively. In general, the trends with high-frequency trading, dark pools and competition increase the need for better understanding of the markets and better access to data. It is important as we go forward that ASIC are able to obtain that information and that data to ensure they keep abreast of the market and abreast of developments in the market, and that they are able to be proactive and change quickly in response to the market dynamics.[26]

Committee view

2.20 The committee is particularly interested in areas of potential risk that may threaten the performance of Australia's domestic licensed markets and, therefore, the financial system. In this regard, the committee notes Dr Comerton-Forde's advice that the 'two most important qualities that...we need to keep in mind, as we look at how markets are evolving, are the liquidity and the price discovery process'.[27] The committee draws ASIC's attention to the areas of potential risk to market liquidity and the price discovery process that Dr Comerton-Forde identified.

2.21 The committee has previously noted that ASIC is consulting on whether additional market integrity rules are required to address broader market developments, including non-transparent trading.[28] The committee will seek ASIC's advice regarding whether prudent regulation of non-transparent trading and the other matters identified requires additional transfer of responsibilities to ASIC.

2.22 The committee also notes ASIC's view of the risks posed by white labellers/indirect brokering. The committee approves ASIC's role in proactively screening the market for potential risks and, consistent with its responsibilities under the ASIC Act, alerting the Government to this risk. At subsequent oversight hearings, the committee will seek an update on the progress of measures to respond to the risks posed by indirect brokering.

2.23 The committee will continue to seek ASIC's estimation of emerging risks, and the development of regulations to address the risks. To assist with monitoring risks to

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25 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 9.

26 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 11.

27 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 9.

28 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, May 2011, p. 6.

the market, the committee considers it appropriate for ASIC to continue to publish six monthly reports regarding the Commission's supervision of markets and participants.

ASIC's coercive powers

2.24 ASIC has been granted facilitative, regulatory and enforcement powers consistent with its responsibility to enforce and give effect to relevant Commonwealth law. These include the power to enter premises and seize documents pursuant to a warrant, and to compel persons to provide ASIC all reasonable assistance in connection with an investigation and to appear before ASIC to answer questions on oath.[29] A person may commit an offence if he or she refuses to comply with ASIC's directions or otherwise hinders ASIC in exercising its powers.[30]

2.25 The Rule of Law Institute of Australia commented that such coercive powers are 'intense and broad ranging' and 'diminish fundamental human rights'.[31] The Institute suggested that such powers require transparent and accountable use:

> Given the gravity of the powers which we give our regulators, including ASIC, we say we need to question first of all whether they are really needed. We need to question whether they have due process around them, whether there are checks and balances, whether there is transparency both in process and in outcome and, finally, [whether] there is accountability on the regulator about how they use those powers.[32]

2.26 It was noted that the accountable use of coercive powers is consistent with the Administrative Review Council's 20 best-practice principles regarding the use of coercive power by Commonwealth agencies. [33] The principles are based on administrative law values of fairness, lawfulness, rationality, transparency and efficiency, and seek to balance agencies' objectives and individual rights.[34]

2.27 The Institute reported that compared with other Commonwealth regulators, 'ASIC does not exactly come up as the model disclosure regulator'.[35] The Institute argued that, where appropriate, ASIC should attempt to obtain information from third parties on a voluntary rather than a compulsory basis,[36] and also recommended that:

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29 *Australian Securities and Investments Commission Act 2001*, s.19, s. 35.

30 *Australian Securities and Investments Commission Act 2001*, s. 63–67.

31 Mr Richard Gilbert, Chief Executive Officer, Rule of Law Institute of Australia, *Committee Hansard*, 15 June 2011, pp 1–2.

32 Mr Gilbert, Rule of Law Institute of Australia, *Committee Hansard*, 15 June 2011, p. 2.

33 Mr Gilbert, Rule of Law Institute of Australia, *Committee Hansard*, 15 June 2011, p. 3.

34 Administrative Review Council, Report 48: The coercive information-gathering powers of Government agencies, p. ix.

35 Mr Gilbert, Rule of Law Institute of Australia, *Committee Hansard*, 15 June 2011, p. 3.

36 Mr Gilbert, Rule of Law Institute of Australia, *Committee Hansard*, 15 June 2011, p. 3.

- ASIC publish in its annual reports 'detailed statistics on its use of coercive powers, along with a discursive statement that notes their use and key trends'
- ASIC's website contain 'a policy statement on how it uses its coercive powers', and
- ASIC's use of its coercive powers be reviewed against the Administrative Review Council's best-practice principles.[37]

2.28 ASIC advised that the Commission has recently reviewed its procedures and policies regarding coercive powers. The committee was informed that '[o]verall, the review concluded that ASIC's policies and procedures are appropriate, and subject to a number of internal controls'.[38] Ms Belinda Gibson, Deputy Chairman, ASIC, elaborated, stating '[b]y and large, as a result of the discussions with our stakeholders...we did not identify grave concerns.'[39] Regarding ASIC's adherence to the Administrative Review Council's 20 best-practice principles, the committee was advised that ASIC complies with all bar the two principles concerning transparency and accountability.[40]

2.29 However, the committee was informed that the review has prompted ASIC to undertake several measures to improve the Commission's use of its coercive powers. The measures appear to address the Administrative Review Council's best-practice principles and the Institute's recommendations, and include additional training for relevant ASIC staff, amendments to ASIC's internal policies to include additional guidance regarding appropriate use of the powers, and publication of guidance material and statistics.[41] As Ms Gibson further explained:

> [w]e have committed to provide information in our annual reports about the exercise of our coercive powers. That will be in this upcoming annual report...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

37 Mr Gilbert, Rule of Law Institute of Australia, *Committee Hansard*, 15 June 2011, p. 3.

38 Ms Belinda Gibson, Deputy Chairman, ASIC, Letter to Mr Bernie Ripoll MP, Chair, Parliamentary Joint Committee on Corporations and Financial Services, 15 June 2011, p. 1, http://www.aph.gov.au/senate/committee/corporations_ctte/asic/Additional_Information/ASIC_110615_Coercive_Powers.pdf.

39 Ms Gibson, ASIC, *Committee Hansard*, 24 June 2011, p. 16.

40 Ms Gibson, ASIC, Letter to Mr Bernie Ripoll MP, Chair, Parliamentary Joint Committee on Corporations and Financial Services, 15 June 2011, p. 1, http://www.aph.gov.au/senate/committee/corporations_ctte/asic/Additional_Information/ASIC_110615_Coercive_Powers.pdf.

41 Ms Gibson, ASIC, Letter to Mr Bernie Ripoll MP, Chair, Parliamentary Joint Committee on Corporations and Financial Services, 15 June 2011, pp 4–5, http://www.aph.gov.au/senate/committee/corporations_ctte/asic/Additional_Information/ASIC_110615_Coercive_Powers.pdf.

> the moment they appear at the bottom of our notices but we will put that on our website.[42]

2.30 With regards to seeking information on a voluntary, rather than a coercive, basis, ASIC stated that 'in terms of surveillance we generally take a voluntary approach where possible'.[43] However, it was noted that a voluntary approach could not be taken where ASIC is 'investigating a criminal prosecution or a civil prosecution', or in circumstances where 'companies cannot do it voluntarily because they need a direction of law to provide...information'.[44]

Committee view

2.31 The committee considers that it is best practice for regulators to exercise powers necessary to fulfil their regulatory responsibilities in a transparent and accountable manner. The committee also considers that regulators should exercise powers cautiously, giving due regard to individual rights and ensuring that the most appropriate power is utilised.

2.32 The transparent and accountable use of coercive powers is consistent not only with the Administrative Review Council's best-practice principles but also with the requirement, under section 1 of the ASIC Act, for ASIC to ensure that information is available as soon as practicable for access by the public. The committee encourages ASIC to disclose appropriate information regarding its use of coercive powers without compromising its activities as a regulator. The committee considers that it is appropriate for ASIC to make available, for example through its annual reports, data regarding the incidence of ASIC's use of its coercive powers, the kinds of powers used and the outcomes of the use of those uses of power.

2.33 The committee notes ASIC's advice that the Commission is currently implementing measures to significantly improve the transparency of its use of coercive powers. The committee approves these measures, and will routinely revisit this matter in future oversight hearings following the release of ASIC's annual reports.

Australian financial services licences

2.34 The committee was informed that the Corporations Act contains a presumption in favour of granting applicants an Australian financial services licence (AFSL). Mr Price stated:

> [t]he law basically says that ASIC must grant a licence unless there are certain areas where we have reasonable grounds to think they will not

42 Ms Gibson, ASIC, *Committee Hansard*, 24 June 2011, p. 16.

43 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 17.

44 Ms Gibson, ASIC, *Committee Hansard*, 24 June 2011, pp 16, 17.

> comply with the law or we have evidence that the a person is not fit and proper...[45]

2.35 However, on the basis of evidence provided to the committee, it was not clear that the presumption in favour of granting a licence undermines market integrity. Mr Medcraft informed the committee that stakeholder due diligence should be taken into account when considering risk:

> 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 judgement we can make is if, for example, you have committed fraud or a monetary crime.[46]

2.36 The committee was further informed of misperceptions amongst investors and consumers of the significance of an AFSL, which may result from licensees claiming their product or advice is 'ASIC approved'.[47]

Committee view

2.37 The committee is concerned with any confusion regarding the significance of Australian financial services licences. Consistent with the Commission's legislative responsibility to promote informed participation in the financial market, the committee considers that it would be appropriate for ASIC to publish information to address any such confusion.

2.38 The committee also notes ASIC's advice regarding the preconditions for obtaining an Australian financial services licence. The committee will subsequently raise this matter with ASIC to determine if the preconditions are appropriate and adequate to promote the confident and informed participation of investors and consumers in the financial system.

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45 Mr John Price, Senior Executive Leader, ASIC, *Committee Hansard*, 24 June 2011, p. 5. The committee notes that under section 913B of the Corporations Act the matters that ASIC may take into account when considering whether an applicant is not of good fame and character are any convictions, in the past 10 years, for serious fraud, whether the applicant has previously held an AFSL that was suspended or cancelled, whether a banning order or disqualification order has previously been made against the applicant and any other matters ASIC considers relevant.

46 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 6.

47 Mr Warren Day, Victorian Commissioner, ASIC, *Committee Hansard*, 24 June 2011, pp 6–7.

Recommendation 1

2.39 The committee recommends that ASIC amend its website to include an explanation of the meaning and significance of holding an Australian financial services licence. The information could also be usefully included on the MoneySmart website.

Freezing of investors' funds

2.40 The committee has continued to track the outcomes of the global financial crisis on Australia's economy and financial markets. This includes developments regarding the significant number of illiquid managed investment schemes frozen in accordance with requirements under the *Corporations Act 2001*.[48]

2.41 Mr Medcraft advised that as of November 2008, the value of funds frozen totalled $22.5 billion. As of June 2011, the value of frozen funds totalled $18.2 billion. The committee was further advised that, while the funds are frozen, 'some of them are...actually providing limited access to the money, such as quarterly withdrawal of money that has come in over time'.[49]

2.42 The committee was informed that the significant increase in illiquid funds, along with a resulting increase in the number of frozen funds, has affected market behaviour. Mr Medcraft stated '[t]he sector...is actually really trying to restructure because they basically want to win back the trust and confidence of investors.'[50] The committee was also informed that the lessons of the global financial crisis regarding freezing of investors' funds are informing market regulation. In March 2011, ASIC advised that the Commission is 'consulting on benchmarks for the future of the mortgage trust sector' to determine measures that can be taken to promote 'a more robust sector for the future'.[51] At the hearing on 24 June, ASIC confirmed that the Commission is 'in the process of issuing a new regulatory guide to really focus on PDS [product disclosure statements] disclosure in terms of when you invest in a mortgage fund.'[52]

Committee view

2.43 The committee considers that, consistent with the legislative requirement to promote the confident and informed participation of investors and consumers in the

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48 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, February 2011, pp 9–11; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, May 2011, pp 16–17.

49 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 14.

50 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 14.

51 Mr Medcraft, ASIC, *Committee Hansard*, 11 March 2011, p. 41.

52 Mr Medcraft, ASIC, *Committee Hansard*, 24 June 2011, p. 14.

financial system, ASIC's functions must include disseminating information regarding the possibility of funds being frozen and what options are open to investors should this occur.

2.44 The committee notes that in May 2010 ASIC released an information sheet for investors in frozen funds, which particularly included information for investors in funds frozen as a result of the global financial crisis.[53] While this is a significant step in ensuring investors are appropriately informed, the committee considers that such information should be given to potential investors as an aid to making fully informed investment decisions. The committee therefore approves the measures ASIC is taking to improve disclosure regarding frozen funds.

2.45 The committee considers that the significant volume of funds frozen as a result of the global financial crisis provides a substantial opportunity to assess whether the rules regarding frozen funds in the Corporations Act are operating effectively. The committee will continue to raise this matter with ASIC, to determine if improvements can be made to the operation of the Corporations Act.[54]

Mr Bernie Ripoll MP

Chair

53 ASIC, *Information sheet 111: Information for investors in frozen funds*, May 2010, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/info111-information-for-investors-in-frozen-funds.pdf/$file/info111-information-for-investors-in-frozen-funds.pdf (accessed 11 July 2011).

54 Section 243 of the ASIC Act authorises the committee to inquiry into the operation of the Corporations Act.

Appendix 1

Public Hearings

Wednesday 15 June 2011

Mr Richard Gilbert, Chief Executive Officer, Rule of Law Institute

Mr Charles Suttie, Advisor, Rule of Law Institute

Professor Carole Comerton-Forde, Professor of Finance, Australian National University

Friday 24 June 2011

Mr Greg Medcraft, Chair, ASIC

Ms Belinda Gibson, Deputy Chair, ASIC

Mr Adrian Brown, Senior Executive Leader, ASIC

Mr Warren Day, Regional Commissioner Victoria, ASIC

Mr Greg Kirk, Senior Executive Leader, ASIC

Mr John Price, Senior Executive Leader, ASIC

Mr Shane Tregillis, Commissioner, ASIC

Appendix 2

Answers to questions on notice

ASIC Oversight hearing, 15 June 2011

Question on notice to Mr Gilbert, RoLIA

(Hansard, p. 5)

Topic: Comparison with overseas regulators

Mr TONY SMITH: Could you give us an appreciation, as best you can, on how ASIC would compare not so much with the other Australian regulators, but with—how can I put it?—cousin regulators in similar jurisdictions? Do you have an appreciation of that—assuming that you have not done any work in that regard? Perhaps the United States and the UK.

Mr Gilbert: I would like to go away and work on that if I could. If I were to say one thing or another now, it might mislead you, and I do not want to do that...

Mr Gilbert: Maybe we will go and have a look at some of the data.

Mr TONY SMITH: If you are able to appreciate it—we would not have expected you to have done that work, but you have done a lot of work on the Australian scene—I think the committee members would just be interested to get an appreciation from you on some of the jurisdictions--not just the US and UK but also whether there is a similar trend, I suppose.

<u>Response</u>

USA – SEC

The US Securities Exchange Commission is the primary overseer and regulator of the U.S. securities markets. In addition to its annual Performance and Accountability Report the SEC also publishes annual data on:

- The number of SEC-related criminal cases filed;
- An Enforcement Act Summary chart, including the number of enforcement actions initiated with a breakdown by classification (e.g. insider trading, market manipulation) and by type (Civil Actions or Administrative Proceedings);
- The number of investigations of possible violations of the Acts the SEC administers, including the figures on investigations which were pending, closed and opened

- The number of 'Formal Orders of Investigation' which were issued - with a formal order of investigation, the SEC's Enforcement Division's may compel witnesses by subpoena to testify and produce books, records, and other relevant documents.
- The number of times the SEC used its statutory powers to obtain customer financial records.

Copies of this data for the last 2 years is attached. [See Parliamentary Joint Committee on Corporations and Financial Services webpage for copies of these attachments: http://www.aph.gov.au/senate/committee/corporations_ctte/asic/index.htm]

I also alert the Committee to a recent news item published by Leonard Street and Deinard in relation to the SEC's filing of its report to Congress on the use of its regulatory powers. In that report is a link http://www.sec.gov/about/internalcontrols961.pdf to the actual report which details the certification and internal supervisory controls applicable to the exercise of power conferred on the SEC. The Article is as follows:

> **SEC Gets a Taste of Its Own Medicine While Preparing Report for Congress**
>
> by Steve Quinlivan | January 6, 2011
>
> Section 961 of the Dodd-Frank Act requires that the SEC provide the Senate Committee on Banking, Housing, and Urban Affairs, and the House Committee on Financial Services, a report on the "supervisory controls" over the conduct by the SEC of examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings. The report is required to be provided not later than 90 days after the end of each fiscal year. The SEC has delivered the first such report for the fiscal year ending September 30, 2010.
>
> Perhaps not surprisingly, the SEC concluded no significant deficiencies in internal supervisory controls were identified as of September 30, 2010. Based on the results of the evaluation, the report also concluded the internal supervisory controls of the SEC with respect to examinations of the Office of Compliance and Inspections, or OCIE, enforcement investigations, and Corporation Finance filing reviews are effective, and the procedures of the SEC applicable to the OCIE, enforcement, and Corporation Finance staff who perform examinations of registered entities, enforcement investigations, and reviews of corporate financial securities filings, respectively, are effective.
>
> We'll see if the Comptroller General agrees when it reviews the adequacy of the SEC's internal supervisory control structure and procedures once every three years, as required by the Dodd-Frank Act. After all, the SEC left itself plenty of wiggle room. For instance, the report states "there may be instances where judgments made in good faith are, in hindsight, deemed inappropriate." A reference to the Madoff investigations perhaps?
>
> The report describes some of the procedures used. For instance, the OCIE assessment team identified the key parties responsible for execution of the

controls and created a "process flow narrative" that is, a step-by-step description of how the controls apply to the examination and investigative processes. There will probably not be a lot of sympathy from corporate America that has been grappling with the costs of Sarbanes-Oxley Section 404 compliance for the last several years.

UK FSA

The FSA is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. The FSA regulates the financial services industry in the UK. In 2010 the FSA was given new statutory powers to enable it to require a person to provide information and documents that the FSA considers are or might be relevant to the stability of the UK financial system. The new powers were granted in the wake of the Global Financial Crisis and appear in s 165A of the Act. The grant of these new powers was accompanied by statutory safeguards which appear in s 165B of the Act. Relevantly, the statutory safeguards:

- Require the FSA to prepare a statement of its policy with respect to the exercise of the new powers for approval by the Treasury; and
- Once approved, the FSA must publish the policy statement.

The safeguards also provide that the FSA may not exercise the new powers until the approved policy statement has been published.

The FSA has published the approved policy statement and included it in the FSA Handbook, which is available through its website. A copy of the statement is attached.

[See Parliamentary Joint Committee on Corporations and Financial Services webpage for copies of the FSA statement and the Financial Services and Markets Act 2000 s 165A and s 165B.
http://www.aph.gov.au/senate/committee/corporations_ctte/asic/index.htm]

ASIC Oversight hearing, 24 June 2011

Questions on notice to ASIC

Question on Notice 1, (Hansard, pp 11–12)

Topic: White label broker sectors

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.

....

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.

Response

The Australasian Securities Dealers Association (ASDA), formerly known as ASSFDA, claims to represent the interests of approximately 650 indirect participants. According to its website, the ASDA maintains that it is the peak body representing the interests of securities and derivatives oriented Australian Financial Services License holders in Australia.

ASIC is not privy to ASDA's member list.

Question on Notice 2, (Hansard, pp 14–15)

Topic:

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.

Response

ASIC has prepared an information sheet providing an update on frozen funds that is scheduled to be available on our website mid August 2011. We will continue to monitor the status of frozen funds and provide further updates when appropriate.

Question on Notice 3, (Hansard, pp 16–17)

Topic: Coercive powers and human rights

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.

Response

Use of coercive powers by regulators such as ASIC can be intrusive. However, these powers are subject to a range of legal limitations which determine when and how they can be used. The purpose of the limitations is to ensure that an appropriate balance is struck between the goal of fulfilling regulatory objectives and the legitimate rights and interests of parties who may be the recipients of compulsory notices.

ASIC's own internal policies are also designed to strike an appropriate balance between these goals. These policies have been recently refined as part of ASIC's general review of its use of compulsory information gathering powers. ASIC's refined internal policy sets out a number of guiding principles including that information gathering powers should only be used when warranted.

In practice, ASIC ensures that the rights of the recipient, including the human rights of any individual, are taken into account through compliance with legal limitations on powers and adherence to internal policies.

Question on Notice 4, (Hansard, p. 19)

Topic: Review of access to databases

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.

Response

Under the ASIC Act (2001) we are required to receive, process and store, efficiently and quickly, the information given to us, and to ensure this information is available as soon as practicable for access by the public. This information is contained in prescribed registers specified under the Corporations Regulation 2001 and National Consumer Credit Protection Regulations 2010. These registers are collectively known as the 'public register' (or ASIC's database).

The public register contains the details of companies and various professionals that operate within the Australia economy such as company officeholders, auditors, liquidators, financial services and credit licensees and their representatives. These parties most commonly lodge information to the public register to:

- Support their application for registration or licensing, such as a new company; and
- Meet ongoing compliance requirements under the law, such as lodgement of financial accounts, notifications of a change in company details, and filing copies of minutes of creditor meetings.

In 2010/11, 2.13 million lodgements of information were received. Our public register was searched 68.5 million times, up 13.1 % from the previous year, reflecting the increasing demand for information we hold. The majority of these searches were free, with 6.1 million searches requiring a fee to be paid. The types of ASIC searches available, and the fees payable are outlined in ASIC information sheet 12, available

from our website. As a guide, a current company extract costs $9 and a copy of a document less than 10 pages in length costs $18. Fees are charged in accordance with the Corporations (Fees) Regulations 2001 ('the fee regulations') Fees are collected on behalf of the Commonwealth and are not retained by ASIC.

Our registers are accessed by a range of external organisations, including businesses, the general public and government agencies. The information is used for a range of purposes that include supporting business and investment decisions, research, investigation and law enforcement activities.

The most frequently used service to search the public register is via the ASIC website. This service has been available for about 10 years and has provided customers with the ability to search and retrieve free information from our registers. Where customers want to purchase more detailed information from the registers (e.g. copy of document) they may currently do so with ASIC via mail or over the counter services. Alternatively they can purchase information online through a third party provider Information Broker (who generally will add a service charge). Searchers are referred to information brokers via direct links on our website. Brokers are charged fees for searches in accordance with the fee regulations. The fees are generally $3 less than the fee for searches provided over-the-counter.