Chapter 2

Issues raised with ASIC

2.1 The committee discussed a number of issues with ASIC at its oversight hearings on 23 June and 24 November 2010. These included:

- Expansion of ASIC's responsibilities;
- ASIC's response to the collapse of Storm Financial;
- Issues arising from the Global Financial Crisis (GFC):
    - Potential for a unique client identifier system
    - Freezing of investor funds
    - Regulatory reform;
- Complaints handling; and
- Financial literacy.

Expansion of ASIC's responsibilities

2.2 ASIC's regulatory responsibilities have increased over time. Recently, ASIC has assumed responsibility for the following functions:

- Market supervision;
- Regulation of consumer credit; and
- National Business Names Register.

Market supervision

2.3 On 1 August 2010 ASIC took over responsibility from the ASX for supervision of real-time trading on Australia's domestic licensed markets. The ASX has retained the 'issuers function, the listings function and the continuous disclosure function'.[1] To enable real-time trading supervision, ASIC has an integrated market surveillance system (SMARTS) in place, which mirrors the system used by the ASX. A number of ASX surveillance staff moved across to ASIC on 1 August:

> ...23 or about that number came from the ASX. We already had a number at ASIC who had been at ASX in the past and we have others with market experience.[2]

2.4 As noted in an earlier committee report, it was considered that the new arrangement would 'counter perceptions of conflict of interest faced by the ASX' in its

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1 Ms Belinda Gibson, Deputy Chairman, ASIC, *Committee Hansard*, 24 November 2010, p. 24.

2 Ms Gibson, *Committee Hansard*, 24 November 2010, p. 24.

dual role of market operator and watchdog. It was noted that the perception could be exacerbated when competition for domestic trading markets services is opened up. Had the change not been made, ASX would have had oversight of its competitors.[3]

2.5 Ms Belinda Gibson, Deputy Chair, ASIC, informed the committee that the transition from the ASX to ASIC went according to plan. She reflected positively on the process to-date:

> The integration process has gone well over the last four months and we are now at the position where we are monitoring the market real-time. We are assessing an average of about 300 alerts a day where there is some questionable activity or questionable conduct that requires greater analysis.[4]

2.6 Ms Gibson noted that, with respect to monitoring of broker conduct, 'the time from identification of a problem through to formal investigation has decreased' since ASIC took on this supervisory function. As she observed:

> That is a benefit of the change in supervision program. It is telescoping the analysis ASX did and the analysis we did into the one exercise.[5]

2.7 While it is expected that further efficiencies will be achieved, Mr Tony D'Aloisio, Chairman, ASIC, commented that it would take another six to twelve months before the benefits of the new arrangements can be fully assessed.[6]

2.8 The committee has noted that ASIC is consulting on reforms to market structure and surveillance; this was foreshadowed in one of the oversight hearings.[7] The consultation paper was released in November 2010. The media release for the consultation paper lists the following proposals for reform:

> **new controls to curb extreme price movements and to require transparent cancellation arrangements** – [ASIC's] response to the 'flash crash'
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> **enhanced controls for direct electronic access and algorithmic trading** – in response to the increasingly pervasive role of technology
>
> **formal obligations on market participants** – to deliver best execution to clients
>
> **minimum disclosure about order and trade information** – to promote efficient price formation on markets and reduce incentives for trading to shift to ‘dark pools’

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3 Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, June 2010, p. 3.

4 Ms Gibson, *Committee Hansard*, 24 November 2010, pp 22–23.

5 Ms Gibson, *Committee Hansard*, 24 November 2010, p. 23.

6 Mr Tony D'Aloisio, Chairman, ASIC, *Committee Hansard*, 24 November 2010, p. 24.

7 Ms Gibson, *Proof Committee Hansard*, 23 June 2010, p. 11.

consolidation of market data across all execution venues – to ensure whole of market transparency

market operator cooperation on trading halts and related matters

better regulatory data on orders and trades – to ensure ASIC's market supervision keeps pace with market developments.[8]

2.9 The committee understands that discussions with stakeholders are continuing, but that there may be resistance to aspects of ASIC's proposals in some areas such as the regulation of dark pools.[9] Dark pool regulation is an important emerging policy issue, which is causing concern for regulators internationally,[10] and which the committee understands is also currently being examined by the International Organization of Securities Commissions (IOSCO), of which ASIC is a member.[11]

2.10 The committee has also noted the first market supervision report issued by ASIC since taking on market supervision responsibilities. The report states that the pattern of trade surveillance alerts is consistent with that received by the ASX prior to the handover of responsibilities.[12] The report does not indicate whether there have been changes in the number of cases that are subject to initial investigation (91) or referral to a Deterrence team (17), but states that the turnaround time has improved.[13]

Regulation of consumer credit

2.11 In 2008 the Council of Australian Governments agreed that the regulation of consumer credit would be transferred from the states to the Commonwealth. Dr Peter Boxall AO, Commissioner, ASIC, explained that:

> The states and territories have been operating under the Uniform Credit Code, and this has been enforced with varying degrees of rigour in terms of licensing and surveillance...[T]his is moving across to the Commonwealth,

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8 ASIC, 'ASIC consults on equity market structure regulatory framework', Media release 10-227, 4 November 2010.

9 Eg. Patrick Durkin, 'ASIC presses brokers to report suspect clients', *Weekend Australian Financial Review*, 22–23 January 2011, p. 13.

10 Eg. Jacob Bunge, '2nd update: CBOE's Brodsky Seeks Review Of Dark-Pool Trading', *Wall Street Journal Business* online, 20 January 2011, http://online.wsj.com/article/BT-CO-20110120-716694.html (accessed 24 January 2011).

11 Technical Committee of IOSCO, *Issues Raised by Dark Liquidity – Consultation Report*, CR05/10, October 2010, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD336.pdf (accessed 24 January 2011).

12 ASIC, *Report 227: ASIC supervision of markets and participants: August to December 2010*, January 2011, p. 4.

13 ASIC, *Report 227: ASIC supervision of markets and participants: August to December 2010*, January 2011, pp 8–9.

> and ASIC will be responsible for the licensing and monitoring of credit providers.[14]

2.12 In October 2009 the National Consumer Credit Protection Bill 2009 was passed. It established a new single, federal regulatory framework for the regulation of consumer credit and finance broking. This function requires ASIC to licence credit providers and monitor compliance with the *National Consumer Credit Protection Act 2009*.

2.13 ASIC explained that in order to make the changes known and understood by stakeholders it conducted 'Australia-wide roadshows' in regional areas as well as capital cities. Along with this ASIC has released several regulatory guides to assist industry in compliance with the new requirements.[15]

2.14 Mr D'Aloisio provided the committee with an update of registration and licence applications and further reported that:

> the team in the next 12 months will be looking at the margins to see if there are areas where people should have applied that did not and whether they need to take any action. We can get a fuller answer on this, but I tend to think it is very much at the margins, by and large, when you look at the number of registrations, we are not expecting that all those registrations are going to convert to licences. The take-up rate of the licences is probably going to be much less, which will give us a clearer picture of the number of real providers in the market going forward.[16]

National Business Names Register

2.15 From April 2011, ASIC will be responsible for the National Business Names Register, in effect taking over responsibility from the states and territories. The register will be an online service, hosted by the Australian Business Register, for registration of Australian Business Numbers and business names.[17]

2.16 ASIC informed the committee that the register is a 'significant project' that will increase ASIC's registered and related transactions.[18] The overall resource implications are being assessed:

> We are working on a workforce plan to identify the resource requirements that are going to be needed for the delivery of the business name service in the first three years post commencement with ASIC.[19]

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14 Dr Peter Boxall AO, Commissioner, ASIC, *Proof Committee Hansard*, 23 June 2010, p. 3.

15 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 25.

16 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 25.

17 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 27.

18 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, pp 27–28.

19 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 28.

2.17 ASIC advised that implementation of the register is on track for April 2011.[20]

Consumer protection – additional powers

2.18 From 1 July 2010—as part of the new Australian Consumer Law—ASIC took on responsibility for administering laws to deal with unfair terms in consumer contracts for financial products and financial services.[21] ASIC was also given additional enforcement powers to deal with conduct that contravenes the consumer protection provisions of the ASIC Act.[22]

Committee view

2.19 At this stage, ASIC's adoption of the additional functions discussed above appears to have occurred relatively smoothly. The committee commends ASIC on its planning and management of these new arrangements.

2.20 The committee recognises that there are synergies between some of ASIC's functions, which give some room for re-directing internal expertise across functions on a needs basis. In the case of market supervision, expertise has also been transferred from the ASX to ASIC. At the same time, the committee notes that an expanding portfolio of responsibilities carries with it risk—in particular, the potential dilution of resources and expertise.[23] The committee will continue to track the progress of these new functions and their impact on the overall performance and resourcing of ASIC. It will talk to ASIC in 2011 about the equity market structure regulatory framework.

ASIC's response to Storm Financial

2.21 Since its 2009 report *Inquiry into financial products and services in Australia*, in which the committee considered the collapse of Storm Financial Ltd, the committee has followed ASIC's investigation into the collapse with considerable interest. Consequently, the committee asked ASIC to provide an update on this matter at the public hearing.

2.22 With an announcement pending on the Friday following the hearing and ASIC Board discussions still in progress prior to the announcement, ASIC was unable to provide the committee with a detailed update. However Mr D'Aloisio did assure the committee that Friday's announcement would be a 'definitive statement' on whether a

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20 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, pp 27–28.

21 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 17.

22 Schedule 3 of the *Trade Practices Amendment (Australian Consumer Law) Act 2010* amends the *ASIC Act 2001* to provide ASIC additional infringement notice powers and power to issue public warnings notices. The new enforcement powers commenced on 15 April 2010.

23 A further potential risk is the re-direction of resources from one function to another in order, for example, to be seen to be achieving results by focusing on the softer target or to satisfy political priorities.

commercial resolution has been achieved or whether there would be further investigation or litigation.[24]

2.23 The committee notes that ASIC duly announced on 26 November that it would bring civil penalty proceedings against directors of Storm Financial Ltd and would commence legal proceedings against various parties, including Commonwealth Bank of Australia Limited, Bank of Queensland Limited and Macquarie Bank Limited 'seeking compensation for investors arising out of the collapse of Storm', unless a settlement could be reached in a final three-week period.[25] No resolution was reached, so on 22 December 2010 ASIC announced that legal action had commenced.[26]

Issues arising from the Global Financial Crisis

Unique client identifier system

2.24 At the April 2010 hearings, the committee sought ASIC's view regarding the feasibility of a unique client identification system for the Australian market. ASIC advised that the issue is 'very, very significant', and undertook to provide further information at the June 2010 hearings.[27]

2.25 ASIC outlined the client, or broker, identification systems in Canada, the United Kingdom and the United States. Ms Gibson advised:

> There is no country in the world that has a unique client identifier system at the moment, in the sense that every time client A trades they have to tell their broker, whichever broker or intermediary it is: ‘My number is 572’, and that tracks through the market.[28]

2.26 Ms Gibson reported that the US Securities and Exchange Commission has estimated that implementing such a system in the United States would cost US$4 billion upfront, with annual ongoing costs in excess of US$2.1 billion. Under the US proposal, the main costs would fall to brokers and clients.[29]

2.27 ASIC informed the committee that preliminary discussions about implementing the system in the Australian market have occurred,[30] however additional consultation and analysis is required:

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24 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 3.

25 ASIC, 'ASIC announces intention to commence legal action', Media release 10-250, 26 November 2010.

26 ASIC, 'ASIC has commenced Storm legal proceedings', Media release 10-281, 22 December 2010.

27 Mr D'Aloisio, *Proof Committee Hansard*, 29 April 2010, p. 41.

28 Ms Gibson, *Proof Committee Hansard*, 23 June 2010, p. 7.

29 Ms Gibson, *Proof Committee Hansard*, 23 June 2010, p. 8.

30 Ms Gibson, *Proof Committee Hansard*, 23 June 2010, p. 9.

> The greater opportunity for us to talk to the market on this issue will be as we move into the consultations around competition for trading services. That would be the time to probably talk about this issue more. We need to be careful here. Our markets are operating well, have been operating well and, if we are going to introduce a change such as this it needs quite a lot of thought and a lot of discussion.[31]

Freezing of investors' funds

2.28 In late 2008, in light of the GFC, a significant number of investors' funds were frozen. Under the *Corporations Act 2001*, managed investment schemes are required to freeze redemptions if the scheme ceases to be liquid. Therefore, the capacity for investors, who ordinarily have an ongoing or periodic right to redeem their investments, is suspended.

2.29 At its November 2010 hearing, the committee sought an update on this issue. Mr D'Aloisio explained that mechanisms were put in place to ease the burden on the unit holders:

> We allowed what we called hardship relief—that is, in certain circumstances, unit holders could withdraw their money ahead of other unit holders, otherwise, under an illiquid scheme you can only take it out in equal amounts...The funds themselves are trying to work through a way of, over time, rolling out these investments so that the unit holders get their money back dollar for dollar, but we think that is going to take two to five years to work its way through.[32]

2.30 Mr Greg Medcraft, Commissioner, ASIC, observed:

> Commercially, I think, it is in the industry’s best interests to try to get money back to those people who want their money as soon as possible, because otherwise investors basically are not investing in those mortgage funds. So there is quite a commercial driver there as well to try to win back confidence from investors.[33]

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31 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p. 10.

32 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 14.

33 Mr Medcraft, *Committee Hansard*, 24 November 2010, p. 14.

2.31 ASIC provided the committee with a table containing statistics on the number of schemes that were frozen and hardship relief, including the number of hardship applications:[34]

Summary – All frozen Funds	**Statistics**
Estimated total number of schemes that were frozen	93
"Unfrozen" schemes – restructured, in the process of being wound down or wound up and/or deregistered	20
Remain frozen but offers periodic withdrawal	32
Remain frozen and offers no withdrawal (primarily comprised of frozen property schemes)	23
Number of schemes applied for hardship relief	83
Hardship Relief – total number of applications received as at Dec 2010	6452
Hardship Relief – total number of application paid as at Dec 2010	4726
Hardship Relief– total amount paid under hardship relief as at Dec 2010 ($ million)	155
Total amount paid under hardship relief as a % to total assets under management (AUM)	0.7%

Regulatory reform

2.32 Mr D'Aloisio summarised the reforms, which followed from the GFC, noting that on a domestic level the government has:

- Reformed the margin lending provision;
- Introduced the national credit regime; and
- Is in the process of reforming the financial advice area.[35]

2.33 Mr D'Aloisio noted that because of Australia's relatively robust systems, international reforms have had less of an impact on Australia. Nonetheless, reform has occurred in the following areas:

- 'Changes to short-selling and improved disclosure'; and
- Changes to the credit rating agencies.

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34 ASIC Answer to Question on Notice #3, 24 November 2010.

35 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 13.

2.34 Along with this, there are currently proposals concerning improved disclosure, hedge funds and improved regulation of securitisation.[36]

2.35 Mr D'Aloisio observed that the areas of reform adequately capture or respond to the issues arising from the GFC:

> From an ASIC perspective, I think those two streams are addressing the sorts of issues that we have seen emerge. From our point of view, we have not at this stage made other suggestions to government outside those two streams on what is needed or what additional reform is needed.[37]

Complaints-handling

2.36 ASIC's complaints-handling responsibilities and processes were considered at the committee's oversight hearing on 25 November 2009. The committee noted that it would seek further information about ASIC's capacity to receive and resolve complaints.[38]

2.37 ASIC advised that it receives approximately 13,000 to 15,000 complaints per year. Following the commencement of ASIC's role in monitoring compliance with the National Consumer Credit Protection Act, from July – November 2010 ASIC received 999 credit complaints from both consumers and industry. The committee noted the general trend, reported in ASIC's 2009-10 Annual Report, for the number of complaints to increase per year. ASIC agreed that a future annual report will comment on the trends in complaints received.[39]

2.38 The committee sought information about whether ASIC has in place measures to continuously improve its complaints handling processes. Dr Boxall informed the committee that additional resources have been allocated to the complaints area in response to ASIC's new consumer credit responsibilities.[40] ASIC is continuing to monitor the resources required to respond to consumer credit complaints.[41] The committee was also informed that ASIC has opened a new, small call centre in Adelaide.[42]

2.39 ASIC also advised that new procedures to track and report complaints have been introduced, including revised call centre scripts in the market participant area. The committee was advised that the ASIC's analysis of the kinds of complaints

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36 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 13.

37 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 13.

38 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission: February 2010*, p. 5.

39 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 26.

40 Dr Boxall, *Proof Committee Hansard*, 23 June 2010, pp 16–17.

41 Mr D'Aloisio, *Committee Hansard*, 24 November 2010, p. 25.

42 Dr Boxall, *Proof Committee Hansard*, 23 June 2010, p. 16.

received informs other areas of practice, including retail investor education and feedback provided at stakeholder meetings.[43] Dr D'Aloisio explained:

> the learning, development and experience are occurring both in the handling and in the output about how that information is used to try and improve the market and the market players.[44]

Committee view

2.40 It is essential that complaints continue to be appropriately addressed and accurately recorded. The committee notes with approval ASIC's commitment to continuously improve its complaints-handling process, and to use the information gained through the process to improve other areas of responsibility and service delivery. The committee notes the general trend for the number of complaints to increase per year. The committee would welcome explanation of the underlying cause of the trend.

Financial literacy

2.41 ASIC provides resources to help improve financial literacy. The committee was informed that ASIC's financial literacy program, which is developed in consultation with the Australian Government Financial Literacy Board (FLB), contains four streams:

> We have a number of targeted education initiatives which use the existing educational pathways. We have a number of tools, access to useful and independent tools that investors could use. We look at other ways to enhance the financial understanding, and finally we work with other groups like consumer groups to better educate.[45]

2.42 ASIC's financial literacy program are funded from within ASIC's general budget.[46] The direct cost of the financial literacy programs in 2009-10 was $4 897 915. This does not include associated support costs, such as IT, finance, corporate affairs and human resources.[47]

2.43 ASIC is 'the secretariat and facilitator' of the FLB.[48] The committee raised with ASIC the question of what populations need attention when targeting financial literacy activities. The committee notes that ASIC has undertaken to raise this for

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43 Dr Boxall, Mr D'Aloisio, Ms Gibson, *Proof Committee Hansard*, 23 June 2010, pp. 16–17.

44 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p. 15.

45 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p. 26.

46 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p. 27.

47 ASIC Answer to Question on Notice #6, 23 June 2010.

48 ASIC Answer to Question on Notice #8, 23 June 2010

discussion at the next meeting of the FLB on 31 March 2011.[49] The committee was also informed that ASIC plans to expand the financial literacy program.[50]

2.44 ASIC coordinates its financial literacy work with a range of other bodies, particularly 'FaHCSIA, Centrelink, NICRI, Departments of Education, the Australian Defence Force, the ATO, ACCC and community and industry associations'. The committee was particularly interested in financial literacy amongst retirees, who may be investing large sums. ASIC has indicated that it is 'currently planning a guide to retirement, on which we are working closely with FaHCSIA and NICRI and may co-brand the publication'.[51]

2.45 Mr D'Aloisio explained that the services are reviewed, including through focus groups and feedback sessions, to determine their effectiveness in promoting financial literacy.[52] For example, monitoring of the FIDO website indicates that the service is an 'extremely well-used tool', with the website receiving approximately 1.5 million hits in 2008-09.[53] This grew by 50 percent to nearly 2.2 million hits in 2009-10. Beginning in March 2010, ASIC began to measure how many of the hits on FIDO pages were from new visitors. In March-June 2010, around three-quarters of visitors to the site were new.[54]

Mr Bernie Ripoll MP
Chairman

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49 ASIC Answer to Question on Notice #7, 23 June 2010.

50 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p. 30.

51 ASIC Answer to Question on Notice #9, 23 June 2010.

52 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p 27–28.

53 Mr D'Aloisio, *Proof Committee Hansard*, 23 June 2010, p. 26.

54 ASIC Answer to Question on Notice #9, 23 June 2010.