Parliamentary Joint Committee on Corporations and Financial Services

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Statutory Oversight of the Australian Securities and Investments Commission

December 2005

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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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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. Section 243 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 s.243(a)(i).

Overall assessment

1.3 This Committee exists as an oversight Committee. In fulfilling this function, and in writing these reports, it is inevitable that the Committee will focus on areas for improvement, or areas of controversy. This may give an impression that the Committee is more critical of ASIC than is in fact the case.

1.4 The Committee wishes to state that it is satisfied that in the period since the last ASIC oversight report was tabled, the Commission, its leaders and officers have continued to apply both the letter and the spirit of the corporations legislation in the specific matters considered by the Committee within this oversight hearing.

1.5 Consideration of a number of issues raised by the Committee with ASIC during this oversight hearing will however continue at future hearings.

Public and other hearings

1.6 The Committee held two public hearings, on 13 September 2005 and 9 November 2005. The second was held at the request of the Committee due to the extensive range of issues that needed to be considered and ASIC is thanked for its co-operation in this regard. The hearings were attended by the Chairman of ASIC Mr Jeffrey Lucy, Deputy Chairman Mr Jeremy Cooper, and Commissioner, Professor Berna Collier. They were supported by Ms Jan Redfern, Executive Director, Enforcement.

1.7 In addition, the Committee received a private briefing from officers of the Commonwealth Director of Public Prosecutions and the Commonwealth Treasury, relating to insider trading and in particular the case of Mr Stephen Vizard. This briefing was held *in camera*, though a letter tabled by Mr Damian Bugg QC, was published by a resolution of the Committee. The letter appears at **Appendix 3**.

1.8 A copy of each of the Hansard transcripts from the public hearings has been tabled for the information of the Parliament. The transcript is also available online at http://www.aph.gov.au/hansard/joint/commttee/j-corps-fs.htm

Additional Information

1.9 A number of questions were placed on notice at the hearing. Those questions and responses are at **Appendix 2**.

Chapter 2

Issues raised during the hearings

2.1 The hearing held on 13 September 2005 had as its primary focus ASIC's performance in relation to offences against the Corporations Act by Mr Stephen Vizard. The Committee's focus was not on the Vizard case specifically, but rather on the public policy issues which arose from the Vizard case. These include:

- the use of s.19 of the ASIC Act as an investigative tool;
- the operating relationship between ASIC and the DPP; and
- the appropriateness of current civil penalties for insider trading.

2.2 In addition, during the hearings the Committee considered other issues including:

- ASIC action against Lifecare Services Australia;
- appropriateness of advice under financial services reform and the superannuation choice scheme;
- the listing of persons banned from managing companies; and
- the Government's response to the Committee's report *Corporate Insolvency Laws: A Stocktake*

2.3 This chapter considers those issues in turn.

Matters relating to Mr Stephen Vizard

Background

2.4 Mr Stephen Vizard, a businessman and formerly a television presenter of public note, was appointed as a non-executive director of Telstra Corporation in 1996. As a member of the Telstra board, Mr Vizard was privy to market-sensitive information relating to Telstra, prior to Telstra disclosing that information to the market. This is, of course, perfectly normal and in fact a necessary element of corporate governance.

2.5 On three occasions[1] Mr Vizard improperly acted on information which he obtained as a director of Telstra. In the first instance he used his prior knowledge of a likely merger between Telstra and a company named Sausage Software, to buy

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1 This paragraph summarises facts found by Finkelstein J in *ASIC v Vizard* [2005] FCA 1037. His Honour notes (at [4]) that he in turn is drawing on a statement of facts agreed by plaintiff and defendant.

Sausage Software shares just before news of the merger drove the value of the shares up. In the second instance he became aware that Telstra was to divest itself of a large shareholding in a company called Computershare Limited. Acting on this knowledge, he sold his own Computershare shares before the Telstra sale became public and the share price dropped as a result. In the final transaction, Mr Vizard used his knowledge of a proposed merger between Telstra and a company called Keycorp to purchase Keycorp shares before the merger announcement lifted the price.

2.6 When these matters came to ASIC's attention, ASIC undertook an investigation and announced on 4 July 2005 that it had commenced civil penalty proceedings against Mr Vizard. Finkelstein J of the Federal Court of Australia handed down his judgment on 28 July 2005. Mr Vizard was fined $390,000 (being $130,000 for each offence) and was disqualified from managing a corporation for ten years.

2.7 In his sentencing remarks, Finkelstein J expressed two notes of dissatisfaction relating to penalties. In the first instance, he noted that he would have preferred a higher pecuniary penalty:

> The cases, including decisions of the Federal Court … hold that I should not depart from the penalty recommended by the parties unless it is clearly out of bounds. The proposed penalty is certainly low. Left uninstructed I would have imposed a higher penalty, but not substantially different from that suggested. If this penalty is insufficient, Parliament should increase the maximum. The current amount has been in place for more than 13 years and may require review.[2]

2.8 In the second instance, his Honour stated:

> … it is my view that a disqualification for five years is not sufficient … a message must be sent to the business community that for white collar crime "the game is not worth the candle" … In my view the appropriate period of disqualification is ten years. But for the factors requiring a "discount", a much longer period would have been in order.[3]

2.9 The announcement of the penalties gave rise to extensive public comment, much of which was critical of both ASIC and the DPP. The main criticisms were, first, that ASIC should have brought criminal charges against Mr Vizard[4], not just civil charges; second, that in the civil case ASIC should have sought higher penalties[5]; and finally there was a suggestion that there may have been political pressure on ASIC

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2 *ASIC v Vizard* [2005] FCA 1037 at [45]

3 *ASIC v Vizard* [2005] FCA 1037 at [47]-[49]

4 See, for instance, McCrann "Humiliation for ASIC" *Herald Sun*, 29/7/2005

5 See, for instance, Gluyas "Hanging judge did our crime-deaf watchdog's job" *Australian*, 29/7/2005 p. 4

and the DPP to treat Mr Vizard mildly[6]. The Committee discusses a number of these issues below.

2.10 In the Committee's view, public confidence in the performance of ASIC as regulator and enforcer of Corporations law is of the highest importance. Despite significant public disquiet about the level of penalties sought by ASIC, the Committee notes ASIC's evidence that the ten year disqualification handed down by Finkelstein J was higher than in preceding cases. The Committee welcomes indications by ASIC that the court's decision in relation to Mr Vizard will be taken into account in future.

2.11 It should also be emphasised that the Committee's task is to consider ASIC's performance and such public policy issues as arise from that performance. It is not the Committee's role to revisit the court's decision in relation to Mr Vizard or to sit in purported judgment of individual cases.

Suggestions of interference

2.12 The Committee can quickly dismiss any lingering suggestions that pressure was brought to bear on ASIC or the DPP to treat Mr Vizard leniently, and that this pressure resulted in criminal charges not being pursued. The Committee pursued this question very directly, as follows:

> **Mr Lucy**—The commission would categorically state that there has been no influence from any state or federal government or from any business interests in respect of the Vizard matter.
>
> **Senator BRANDIS**—Nor any individual politician?
>
> **Mr Lucy**—Nor any individual politician.
>
> **Senator BRANDIS**—Any suggestion to that effect is either ignorant or dishonest?
>
> **Mr Lucy**—Correct.[7]

2.13 The Committee put a similar question to the Director of Public Prosecutions, Mr Damian Bugg QC, and received a response to the same effect:

> Neither I nor any person in my Office was approached by any Parliamentarian, Political Officer/Activist or any person on their behalf either directly or indirectly in an attempt to influence the decision my Office made concerning the possible prosecution of Stephen Vizard.[8]

2.14 The Committee is satisfied that there was no political interference in decisions made by the DPP and ASIC in relation to Mr Vizard.

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6 See, for instance, Eckermann "Big fish still slip through the net" *Independent Weekly*, 31/7/2005 p. 8

7 Mr Jeffrey Lucy, Senator George Brandis, *Transcript of Evidence*, 13 September 2005, pp. 23-24.

8 Mr Damian Bugg QC, Correspondence to the Committee, 2 December 2005.

Use of s.19 of the ASIC Act

2.15 In its evidence, ASIC advised that the reason criminal charges were not brought against Mr Vizard was as follows:

> In this case, criminal charges were not pursued against Mr Vizard because the DPP was not satisfied that there was admissible, substantial and reliable evidence of the offence and therefore there were not reasonable prospects of securing a conviction.[9]

2.16 This evidence was consistent with a press release issued by Mr Bugg on 28 July 2005, which stated:

> The policy which my Office follows does not permit the laying of charges on what we, or others, hope that a witness might say if and when called to give evidence but rather on the evidence which is available and admissible. To do otherwise would undermine confidence in the integrity of our system. Charges should not be laid without evidence which is available and admissible to prove the essential elements of the offence. A prosecution should not commence in the hope that critical evidence will later become available.[10]

2.17 In the same press release, Mr Bugg noted that the "missing link" in the evidential chain was the evidence of Mr Vizard's accountant, Mr Gregory Lay, who could have directly implicated Mr Vizard in the trades. Mr Bugg stated:

> Evidence from this witness was crucial, for a criminal prosecution, as it would connect Mr Vizard to … the trades and the timing of the trades.[11]

2.18 Mr Lay was interviewed by ASIC several times but declined to provide a signed statement without first receiving an indemnity from prosecution for offences arising from that statement:

> The main issue with Mr Lay was not so much about being prepared to cooperate with us and provide the necessary information we needed but rather that he was not prepared to sign a witness statement because of concerns about his own position. He indicated that for the first time when it came to the crunch in November 2004. I think it was really a period of six months, from November 2004 through to May, when we had a number of discussions with Mr Lay, his advisers and the DPP about satisfying him in relation to his own position.[12]

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9 Mr Jeffrey Lucy *Transcript of Evidence*, 13 September 2005, p. 2.

10 Press Release, *Stephen Vizard*, Commonwealth Director of Public Prosecutions, 28 July 2005, pp. 2-3.

11 Press Release, *Stephen Vizard*, Commonwealth Director of Public Prosecutions, 28 July 2005, p. 2.

12 Mr Jeffrey Lucy *Transcript of Evidence*, 13 September 2005, p. 2.

2.19 The DPP provided a statement to Mr Lay to the effect that "what was contained in [Lay's] draft statement did not expose Mr Lay to the jeopardy of being prosecuted for any possible offence."[13] This was insufficient to obtain Mr Lay's signature.

2.20 This left ASIC and Mr Lay at an impasse, because the prosecution could not be completed without Mr Lay's evidence, and Mr Lay would not sign a statement affirming what evidence he would give.

2.21 The Committee considered whether this impasse could have been overcome by the use of ASIC's powers under s.19 of the ASIC Act, which gives ASIC the power to require persons to attend an ASIC office to be cross-examined under oath. The section reads in part:

19 Notice requiring appearance for examination

(1) This section applies where ASIC, on reasonable grounds, suspects or believes that a person can give information relevant to a matter that it is investigating, or is to investigate, under Division 1.

(2) ASIC may, by written notice in the prescribed form given to the person, require the person:

(a) to give to ASIC all reasonable assistance in connection with the investigation; and

(b) to appear before a specified member or staff member for examination on oath and to answer questions.

2.22 Effectively s.19 would allow ASIC to compel Mr Lay to be subject to cross-examination under oath, just as if he were before the court. He would be compelled by his oath to give true and full evidence, without the need for an indemnity and regardless of his willingness to cooperate. The Committee asked officers of ASIC why it did not use its powers under s.19 to compel Mr Lay to give evidence. Ms Jan Redfern, Executive Director, Enforcement, stated:

> Obviously a signed witness statement is far more cogent and reliable than a section 19 which is a question and answer session. What we do in those situations is try to bring a witness along and deal with the issues of concern. In this case one of the obvious mechanisms that we would employ would be an induced statement through the DPP. That was rejected on a number of occasions and particularly by May 2005. So the issue for us at that stage was what would have been the utility in May 2005 of 'section 19ing' Mr Lay in circumstances where he was not prepared to provide a signed statement, where there were real issues being raised about his credibility as a witness and where we had spoken to the DPP and they had indicated that

13 Press Release, *Stephen Vizard*, Commonwealth Director of Public Prosecutions, 28 July 2005, p. 2.

> without a signed statement from Mr Lay it would be very unlikely that charges could be laid in the matter? That was the difficulty. There really would have been no point in 'section 19ing' Mr Lay at that point.[14]

2.23 Ms Redfern reiterated her point, stating that evidence obtained under s.19 "could not have been and would not have been used by the DPP as the foundation for laying a prosecution."[15]

2.24 Ms Redfern's evidence was contradicted by the letter from the DPP to the Committee, which the Committee has published at **Appendix 3**. While that letter agrees that a signed statement obtained from a cooperative witness is far more useful to prosecutors than is evidence obtained under s.19, Mr Bugg concludes:

> Where a professional witness is unwilling to provide a statement but otherwise willing to tell the truth in a section 19 examination the process may be useful in determining what the witness will say when called to give evidence in court. In this case the DPP would be confident that even though the witness has not cooperated in providing a statement, that witness would give relevant and truthful evidence in court.[16]

2.25 In answer to questions on notice arising from the September hearing, ASIC recast the issue slightly, stating that "having provided ASIC investigators with his evidence voluntarily and on tape, [Lay's] refusal to verify the truth of those statements made his credibility – as opposed to the means by which that evidence could be secured – the critical issue."[17]

2.26 In relation to the decision not to obtain evidence under section 19 to support a criminal prosecution, the Committee makes the following comments. Committee members take the view that there appears to have been a lack of clear communication between the DPP and ASIC on the use of section 19 in order to obtain evidence from Mr. Lay. The Committee also considers that there is a difference of view between the DPP and ASIC as to the utility of section 19 for preparing criminal prosecutions. The Committee suggests that it would be constructive for these issues to be considered in the flagged revision of the operational relationship between the DPP and ASIC as defined by their Memorandum of Understanding. This is discussed further at paragraph 2.36.

2.27 In answer to questions on notice from the Committee, ASIC suggested that one way to overcome the impasse exemplified in the Vizard case was to amend s.49 of the ASIC Act "to enable ASIC to require certain witnesses to provide a statement in

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14 Ms Jan Redfern *Transcript of Evidence*, 13 September 2005, p. 11.

15 Ms Jan Redfern *Transcript of Evidence*, 13 September 2005, p. 12.

16 Mr Damian Bugg QC, Appendix 3 to this report.

17 ASIC, answer to question on notice no. 3.

an admissible form."[18] The result of such an amendment would be that ASIC could compel a witness such as Mr Lay, following a s.19 interview, to provide a statement.

2.28 The Committee has two concerns about this: a practical concern, and a concern of principle. The practical concern is that such an amendment to s.49 may not in fact have resolved the dilemma of Mr Lay's evidence. If Mr Lay were interviewed under s.19, then compelled to provide a statement under an amended s.49, he would still have been able to limit that statement to include only the evidence he was willing to give in court. He could, in other words, still have refrained from including in his statement any of the evidence which he felt would incriminate himself. Consequently, the amendment to s.49 may not have advanced ASIC's position.

2.29 The concern of principle is that an amendment such as that proposed to s.49 would be a substantial increase in ASIC's powers over a person (and not even an accused person) without any real accountability measures in place. It is doubtful that such an incursion into personal liberties is justified under these circumstances. During the 9 November hearing, Senator Murray suggested that ASIC be required to seek the Court's permission to require a statement to be made under s.49. This may well resolve the issue of principle, but the practical issue would remain.

2.30 The Committee has considered another option which may resolve the practical difficulties of using s.19 interviews in evidence, without increasing ASIC's powers unduly. The Committee's proposal is in two parts:

- First, s.19 of the ASIC Act should be amended so that ASIC can require a witness to provide, following a s.19 interview, a notice to the effect that they are willing to repeat the evidence given under s.19 in evidence in a court; and

- Second, s.19 of the ASIC Act should be amended to give the court discretion to allow limited portions of a s.19 transcript to be given in evidence, but only where there is a substantial difference between the evidence given under s.19 and the evidence given in court. The purpose of admitting portions of the s.19 transcript would be limited to questioning the witness about the inconsistencies in evidence.

2.31 This process would allow ASIC and the DPP to more confidently rely on information obtained under s.19 when considering the decision to prosecute.

Recommendation

2.32 The Committee's view is that the Government should consider both the option raised by Senator Murray – a compulsory statement subject to a court order – and the option raised in paragraph 2.30 of this report.

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18 ASIC, answer to question on notice no. 6.

Operating relationship between ASIC and the DPP

2.33 The Vizard case, and the confusion noted above in relation to the use of evidence obtained under s.19 of the ASIC Act, led the Committee to consider the wider relationship between ASIC and the DPP.

2.34 The ASIC Act gives ASIC very broad powers, including a slate of investigative powers (see, particularly, Part 3 of the ASIC Act). The Act also gives ASIC the capacity to act as a prosecutor. Section 49(2) of the ASIC Act states that if, after an investigation, ASIC consider that an offence against corporations legislation has been committed, then "ASIC may cause a prosecution of the person for the offence to be begun and carried on." Section 50 of the Act gives ASIC the capacity to commence civil actions.

2.35 The office of the Director of Public Prosecutions was established by the *Director of Public Prosecutions Act 1983*, with the intention of providing a central, independent agency specialising in just prosecutions. While the power to commence prosecutions is not exclusive to the DPP, the DPP is able to take over prosecutions wherever it considers this appropriate. The DPP, and any other person or agency conducting prosecutions on behalf of the Commonwealth, is bound by the *Prosecution Policy of the Commonwealth*.

2.36 There is obviously an important and ongoing relationship between ASIC as (primarily) an investigator, and the DPP as the Commonwealth's specialist prosecutor. This relationship was formalised in a 1992 Memorandum of Understanding (MOU).

2.37 Mr Peter Wood, a former executive director of enforcement with ASIC and a former deputy director of the DPP, is uniquely placed to give an account of the MOU. Writing in the *Australian Financial Review*, he outlined the circumstances of the MOU's genesis:

> There is a lot of history between ASIC and the DPP in relation to choice of remedies. Feelings ran so high in the early 1990s that the attorney-general at the time, Michael Duffy, was forced to intervene and give a written direction to Tony Hartnell, chairman of the then Australian Securities Commission (now ASIC) and Michael Rozenes, who was the DPP. At issue was the question of civil or corporate sanctions for corporate misconduct.
>
> The direction made it clear that serious criminal misconduct in relation to corporations should be addressed by criminal prosecution. Moreover the ASC and DPP were directed to co-operate with each other in carrying out their respective roles in corporate regulation. It was a traumatic episode for both agencies which largely framed their present working relationship.[19]

19 Wood, P, "Independence must be seen" *Australian Financial Review* 20 July 2005, p. 63.

2.38 In the letter published at **Appendix 3**, the current DPP Mr Damian Bugg QC described the MOU in the following terms:

> The MOU between the DPP and ASIC was first agreed in September 1992. Understandably some of the procedural concepts in the MOU are now dated. For example ASIC's investigatory techniques have changed and developed. However, many of the fundamental concepts contained in the MOU are still relevant to the relationship between ASIC and the DPP. The DPP regards it as important that there be full and early consultation between the regulator and the prosecutor as to potential criminal cases. We recognise that ASIC is the investigator and the decision to investigate and carriage of the investigation are matters for ASIC. However, where the DPP can assist ASIC by advising as to potential evidentiary difficulties or areas of potential criminality, we feel that we can add value to the process to assist in focussing the investigation and assist ASIC in producing a brief of evidence that is able to be successfully prosecuted.
>
> The DPP and ASIC have recognised that the MOU requires updating and have commenced work on a project to produce a new MOU that both recognises the roles and responsibilities of each organisation as well as the principles of cooperation to be employed in achieving a proper and appropriate outcome in the area of corporate criminal enforcement.[20]

2.39 In the Committee's view, it is disappointing that the relationship between ASIC and the DPP continues to occur in the context of an MOU concluded more than a decade ago to head off what was then imminent conflict between the two institutions. The Committee supports current moves to update the MOU. This should be a high priority task for both agencies and the Committee expects to learn of progress at the next oversight hearing.

Appropriateness of penalties for insider trading

2.40 As noted above, in sentencing Mr Vizard, Finkelstein J stated:

> The proposed penalty is certainly low. Left uninstructed I would have imposed a higher penalty, but not substantially different from that suggested. If this penalty is insufficient, Parliament should increase the maximum. The current amount has been in place for more than 13 years and may require review .[21]

2.41 Although Justice Finkelstein's sentencing remarks clearly state that the penalty he would have imposed would be "not substantially different from that suggested", His Honour's invitation to the Parliament to consider the appropriateness of the penalties after 13 years was an entirely appropriate suggestion from the bench.

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20 Mr Damian Bugg QC, Appendix 3 to this report.

21 *ASIC v Vizard* [2005] FCA 1037 at [45]

2.42 It is necessary for parliament to review penalties on a regular basis in order to ensure that they remain appropriate. Indeed, in the view of some Committee members, the entire body of law relating to insider trading is ready for review. The Government appears to have shared this view at some point: the Corporations and Markets Advisory Committee, which advises the Treasurer, was commissioned in 2001 to undertake a review of insider trading law. Its report, with 38 recommendations for change, was released in November 2003. Two years later, the Government has not responded to the CAMAC report with proposed changes to insider trading laws.

2.43 During the hearing on 13 September 2005, Committee members asked Mr Lucy to review the CAMAC report, and to consider whether in the light of that report and Finkelstein J's comments, changes to insider trading law are warranted. After such consideration, ASIC stated that it "does not believe the Vizard case has exposed a systemic weakness in the enforcement of either the insider trading prohibition or breaches of directors' duties."[22]

ASIC Investigation of disclosure of information by Telstra Executives

2.44 During the September 13 hearing, the Committee raised with ASIC its investigation of Telstra and its continuous disclosure obligations. Mr Lucy stated that ASIC commenced its investigation following public comments about the performance of Telstra by Mr Phil Burgess, a senior executive of Telstra, and an announcement by Telstra with regard to an expectation of reduced future earnings.

2.45 Mr Lucy indicated that because the matter was the subject of ongoing investigation ASIC was constrained in its ability to discuss the progress of its investigation.

2.46 The Committee pursued questioning to determine whether ASIC's investigation would include consideration of all public statements by Telstra executives, Government Ministers and the Prime Minister in relation to Telstra's performance, as follows:

> **Senator SHERRY**—And are you aware of the comments by the Prime Minister in parliamentary question time about talking up the share price?
>
> **Mr Lucy**—I read them.
>
> **Senator BRANDIS**—On a point of order, Mr Chairman, that is a false statement. The Prime Minster did not use the expression 'talking up the share price'.
>
> **Senator WONG**—It was: 'talking up the interests of the company'.

22 ASIC, answer to question on notice no. 6.

Senator BRANDIS—He used the expression 'talking up the interests of the company', which is quite a different thing.

Senator SHERRY—Mr Lucy, have you checked to verify what the Prime Minister said in relation to this matter in question time?

Mr Lucy—All matters to do with this investigation are before us. We are looking at all areas, and at this stage we cannot comment any further.

2.47 The day after the oversight hearing, Mr. Lucy sought to clarify his evidence as it related specifically to public statements made by the Prime Minister and released a public statement in relation to the investigation. It said:

> This morning I have spoken with our investigation team specifically in relation to those comments made by the Prime Minister. They have advised me that they are not relevant to our ongoing investigation of Telstra ...
>
> I can categorically state that ASIC is not undertaking any investigation of the Prime Minister ...

2.48 The Committee will explore the progress of ASIC's investigation of Telstra and its continuous disclosure obligations in subsequent oversight hearings.

ASIC Action against Lifecare Australia

2.49 During the 13 September hearing, the Committee raised with ASIC its actions in relation to a company called Lifecare Services Australia Pty Ltd ("Lifecare Australia"). The Lifecare matter arises from four 2002 schemes which (purportedly) intended to develop aged care facilities in the Brisbane area. The schemes were allegedly promoted by Mr Brian Maher, Mrs Marie Maher and Mr Paul Rodda. As Mr Maher is an undischarged bankrupt, Mrs Maher and Mr Rodda were the directors of the schemes. They raised some $7.25 million from investors.

2.50 ASIC alleges that Mrs Maher and Mr Rodda, as directors of the companies, loaned money to another company of which they were the directors ("Partnering Dynamics"); and that this company in turn loaned the money to "other companies and entities associated with Mr Maher, Mrs Maher and Mr Rodda". Partnering Dynamics is now in liquidation.

2.51 Lifecare Services Australia directors Mr Colin Francis and Mr David Stoyakovich have since taken over management of the four trusts in an effort to see the projects to completion and realise the investment of the investors. However, given that much of the investment proceeds were removed from the trusts, their effort faces obvious difficulties.

2.52 It is the view of ASIC that the four schemes are managed investments, and that as such they are not constituted lawfully. Deputy Chairman Mr Jeremy Cooper explained ASIC's involvement in the following terms:

> It is a complex matter and I will, in very general terms, just explain why ASIC is here. The fact is that the scheme is wholly illegal. It is an unregistered scheme. It is a managed investment scheme that is not registered. None of the relevant parties have licences from us to deal in financial products, which these investments are. The funds have been raised without any formal product disclosure statement whatsoever. We also believe that a number of the statements that have been made in relation to this project are misleading or deceptive.
>
> It is harsh on the current participants that they see the regulator intervening in a way that they might think is inconsistent with their interests but we do not have discretion to ignore very serious breaches of the law.[23]

2.53 Mr Jan Redfern, Executive Director, Enforcement, stated that it is not ASIC's intention to cause further loss to investors:

> It is hard to predict these things, but our stated position—and we spent a lot of time talking with the investors so that they understand the position—is that we do not want to cause difficulties for the project itself but simply have to make sure that the schemes, which are illegal, are regularised in some way that gives the investors protection. Investors may say now, 'We are happy for these things to proceed,' but the issue for us is that, in two years time, if there are problems they would be entitled to complain.[24]

2.54 On 27 October, between the two oversight hearings held for this report, the Supreme Court of Queensland made orders following agreement between ASIC and Lifecare. The court ordered the schemes to be wound up, but deferred this winding up until the completion of construction. Investors will receive the return of their principal plus interest. Until winding up, the schemes will operate subject to supervision.

2.55 The Committee is pleased with the orders, which appear to be eminently sensible. They allow for the allegedly illegal schemes to be wound up, but do not leave innocent investors to carry massive losses. ASIC should be congratulated for this outcome.

2.56 However the Lifecare matter should emphasise to all potential investors the importance of ensuring that, before they invest in a project, they are certain that it is a lawful project within the framework of financial services legislation. The Parliament, and this Committee in particular, has spent recent years working towards a legal framework which provides investors with protection and confidence. However if investors place their money in schemes outside this legal framework, they place themselves outside the protection of ASIC and the laws it administers. Investors should seek advice from a licensed financial adviser before proceeding with any substantial investment.

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23 Mr Jeremy Cooper *Transcript of Evidence*, 13 September 2005, p. 30.

24 Ms Jan Redfern *Transcript of Evidence*, 13 September 2005, p. 32.

Super Choice and Financial Services Reform (FSR)

2.57 The Super Choice regime commenced on 1 July 2005. During the hearing of 13 September 2005, ASIC gave the following assessment of progress during the early months of implementation:

> I will now turn to super choice. ASIC is continuing to monitor compliance with this major policy initiative. As the committee would know, we have already conducted a review of advice given in late 2004 and early 2005 by financial advisers to more than 260 people—out of a sample of over 7,000 pieces of advice—thinking of switching superannuation funds. The super switching surveillance sought to test the readiness of advisers to give complying super-switching advice ahead of the implementation of super choice on 1 July this year. The findings highlighted some areas where licensees and advisers needed to lift their game. In particular, we identified instances of misconduct during the surveillance, some of which have already led to enforcement action. Various industry organisations, including the Financial Planning Association of Australia, have, without basis, criticised the methodology and timing of this review, perhaps because they do not like the surveillance results. The fact is, however, that some worrying patterns of misconduct were found that go beyond any fine judgment of the law as they involve cases of blatant misselling and flagrant disregard for the interests of the clients involved.[25]

2.58 During the second hearing, officers of ASIC tabled at the Committee's request a report entitled *Report to the Parliamentary Joint Committee on late 2004 (and early 2005) superannuation switching advice surveillance*. The report, which appears as **Appendix 4** of this report, is a more detailed outcome including case studies of the surveillance mentioned above. The main findings were as follows:

- **Limited investigation of the 'from' fund.** Most advisers recommending a switch had made limited or no investigation of the fund that they advised the client to switch from (i.e. the 'from' fund);

- **Poor disclosure of the costs, loss of benefits and other significant consequences if the advice is followed.** As a result of limited or no investigation of the 'from' fund, most advisers in our surveillance did not comply with the specific obligations to disclose the costs, loss of benefits and other significant consequences of the recommended switch. In the [statements of advice] we reviewed, disclosure about the basis for the recommendation to switch was generally poor.

- **A tendency to recommend a fund related to the licensee.** Based on the statistics provided by licensees, there is a strong tendency among advisers to recommend switching to a fund related to the licensee. In these cases, there is a conflict of interest that must be carefully managed in order to avoid the

25 Mr Jeffrey Lucy *Transcript of Evidence*, 13 September 2005, p. 3.

perception that advice is inappropriate or is not given on a reasonable basis, or that the interests of the licensee are placed above those of the client.

- **A tendency to oversell life insurance.** There were a number of examples where advisers seemed to recommend life insurance to clients where there did not seem to be a reasonable basis for doing so.

2.59 The Committee is concerned at these findings, which indicate some advisers engaging in mis-selling and having insufficient regard for the interests of their clients. In particular and of great concern to the Committee is, as noted by Mr Cooper, that targeted groups of mis-selling appear to be low to middle income consumers. The Report includes seven real life examples of poor advice uncovered by ASIC, all of which should be considered carefully by both financial advisers and superannuation policy holders considering switching

2.60 The Committee continues to endorse the super surveillance policy. However, in light of suggestions that some of the examples were not factually correct, for the policy to work effectively, ASIC must ensure that its research is high quality, impartial, relevant, transparent and comprehensive. Without this approach, the credibility of super switching advice may be seriously undermined causing consumers to lose faith in the system. However, it is also important not to over-react to the results of ASIC's surveillance. The Committee is generally pleased with the professional improvements made by the industry in the face of a major program of regulatory change and notes ASIC's relatively optimistic view that the quality of super switching advice is likely to continue to rise:

> … in many ways a lot of financial planners were moved, by legislation, effectively out of a sales culture into an advice one. That is why we call this a journey. We have not arrived yet. We are hoping to maintain some balance so this work is not all about fear. We do receive a lot of pressure to produce enforcement outcomes so we have to keep a balance between the educative and the prescriptive and the enforcement, and that is the exercise we are on.[26]

2.61 Second, the fact that ASIC has undertaken this surveillance, that shadow shopping exercises are underway, and that ASIC is investigating with a view to taking action where necessary, demonstrates that the regulator is performing its required functions. If ASIC can maintain the balance noted by Mr Cooper above, then there is every reason to be confident that super switching can minimise the existing shortcomings evident in advice on superannuation choice.

2.62 The Commission provided detail on simplification of reporting requirements particularly documentation to be issued by product providers to consumers under FSR. This follows the announcements by the Parliamentary Secretary to the Treasurer,

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26 Mr Jeremy Cooper *Transcript of Evidence*, 9 November 2005, p. 28.

the Hon Chris Pearce MP, on the need for provision of simpler documentation.[27] The Committee is generally satisfied that this will be of greater assistance to both consumers and industry. However it believes ASIC should maintain ongoing assessment to reduce documentation size wherever possible, consistent with the need to adequately inform. Further in the case of consumers this should be "tested" before finalisation.

Listing of persons banned from managing companies

2.63 On 18 October 2005, the *Age* newspaper reported that Mr Stephen O'Neill, jailed in 2001 for fraud and other offences, had managed the failed *Money for Living* company while banned from corporate activity. Mr O'Neill claims not to have understood that the ban was in effect, as he made a search on ASIC's register of barred persons and found that he was not listed.

2.64 This case raised the Committee's concerns. There are a number of ways in which people may be banned from corporate activity. They may be banned by ASIC itself or by court proceedings to which ASIC is party. In such cases, obviously, ASIC is aware of the ban and so the name of the banned person is registered. However, in addition, a person can become banned as a result of section 206B of the Corporations Act, after being convicted of indictable offences relating to their corporate activity, and in particular offences involving dishonesty.

2.65 The list maintained by ASIC does not generally include the names of people banned in accordance with s.206B. In evidence, ASIC stated:

> The people that are on our register are people that we ban, or where we have taken proceedings against people. That enables us to administer a very accurate register of who, by our action, has been disqualified. The difficulty with the automatic banning under section 206B, is that not only does it apply when the person is released, but it also even applies to overseas convictions. Our internal view is that we do not have the power to create such a register but, even if we did, it would be a sizeable task to administer such a register.[28]

2.66 The Committee recognises that the maintenance of a register would be complex, and may require either co-operative arrangements between ASIC, courts, and prison authorities; or alternatively detailed surveillance by ASIC. However in the absence of such a register, it may be impossible for investors, advisors and other market participants to find out whether companies in which they are investing, are led by proper people. If a person is banned by virtue of s.206B, but nobody can find out that this is the case, then they may as well not be banned at all.

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27 The Treasury, *Refinements to Financial Services Regulation*, May 2005.

28 Mr Jeremy Cooper *Transcript of Evidence*, 9 November 2005, p. 11.

2.67 The Committee considers that the government should investigate a cost-effective means of enhancing the register of banned persons to include as many as possible of those persons banned under s.206B of the Corporations Act.

Government response to *Corporate Insolvency Laws: A Stocktake*

2.68 On 13 October 2005, the Government tabled its response to the Committee's 2004 report *Corporate Insolvency Laws: A Stocktake.* The government supported a substantial number of recommendations. Others it declined to support. There was a third category, however, which the government neither supported nor declined, but rather passed to ASIC, indicating in each case that "this recommendation is a matter for ASIC."

2.69 Such responses are somewhat troubling to the Committee. A Committee, when it tables a report, is entitled to a government response to each recommendation. ASIC, as a government agency, briefs the Treasurer and the Parliamentary Secretary, and could have been included in Treasury's process of formulating responses to the report. This did not occur.

2.70 Instead, by responding that some recommendations are "a matter for ASIC" the Government placed these recommendations in limbo. Formally, they received a response – that they were a matter for ASIC. However a response of this kind is of little utility. The Committee hopes that in future, similar cases, the Government might include ASIC's responses in its own response document.

2.71 In the final stages of preparing this report, the Committee received a response from ASIC in relation to the Insolvency report. This response will be discussed at the next oversight hearing, and reported upon in the next report.

Adverse comment by ASIC Official

2.72 On 25 August 2005, *Money Management* magazine reported that an ASIC official said of financial planners 'I just don't trust them'.

2.73 This raised the Committee's concerns. ASIC informed the Committee that it was aware of this comment, that it was made at a technical industry-arranged session designed for open dialogue between industry and the regulator, and that it had made considerable efforts to see off any potential long-term damage to its relationship with the financial planning industry. ASIC agreed with the Committee that these comments were an unfortunate reflection on ASIC's view of the financial planning industry and encouraged a view inconsistent with the public views expressed by it.

2.74 The Committee accepts ASIC's explanation that the reporting of these comments were taken partly out of context by the media, that they are confident comments of this nature will not be repeated, and that overall, ASIC and the financial planning industry enjoy a productive working relationship.

2.75 However, the Committee retains some concern that comments of this nature reflect a poor perception of financial planners on the part of ASIC and have the capacity to undermine public confidence in the financial planning industry. The Committee considers that ASIC should always approach the industry with its concerns first before voicing them in a public forum. ASIC should also set appropriate standards to be followed by its officials where they are required to comment publicly on ASIC's activities.

Senator Grant Chapman

Chairman

Appendix 1

Public Hearings and Briefing

PUBLIC HEARINGS

TUESDAY 13 SEPTEMBER 2005—CANBERRA

Australian Securities and Investments Commission

COLLIER, Professor Berna, Commissioner

COOPER, Mr Jeremy, Deputy Chairman

LUCY, Mr Jeffrey, Chairman

REDFERN, Ms Jan, Executive Director, Enforcement

WEDNESDAY 9 NOVEMBER 2005- CANBERRA

Australian Securities and Investments Commission

COLLIER, Professor Berna, Commissioner

COOPER, Mr Jeremy, Deputy Chairman

LUCY, Mr Jeffrey, Chairman

PRIVATE BRIEFING

TUESDAY 13 SEPTEMBER 2005—CANBERRA

Director of Public Prosecutions

BUGG, Mr Damian John QC, Director

DAVIDSON, Mr Graeme Scott, Acting Deputy Director

THORNTON, Mr John Edward, First Deputy Director

Department of the Treasury

MURPHY, Mr James Andrew, Executive Director, Markets Group

Appendix 2

Answers to Questions on Notice

Questions asked on 13 September 2005

Question 1
When was the formal notification of the decision not to prosecute?

Answer:
There was formal notification on 2 May 2005.

This view was expressly confirmed by the DPP at a liaison meeting with senior ASIC enforcement staff on 15 June 2005 and in writing on 29 June 2005 prior to ASIC commencing its civil penalty proceeding against Mr Vizard.

Question 2
(in relation to privileged advice from the DPP-should the public have a right to see it)

Mr Lucy—My point was that I would like to take the question on notice so that we can consider our situation.

Answer:
ASIC respectfully asks that the Committee not press its request for release of this privileged correspondence.

Advice and correspondence between ASIC and the DPP attracts both legal and professional privilege and public interest immunity. Accordingly, there is no public right in favour of disclosure of DPP advice.

The Committee will appreciate that it is essential that the DPP should be able to correspond frankly and confidentially with Commonwealth law enforcement agencies such as ASIC. The production of such correspondence, even "in camera", would be inconsistent with the on-going need for such frankness and confidentiality.

ASIC respectfully requests that the Committee observe its usual circumspection in calling for material the production of which might prejudice current or future law enforcement.

Question 3
Would you take on notice and provide to the committee—if you are able to—the dates on which any discussions between ASIC and the DPP about the use and non-utility of section 19 were had in relation to this matter?

Answer:
The issue of Greg Lay's evidence was discussed in detail between ASIC investigators and the DPP on several occasions after ASIC referred a brief of evidence to the DPP in November 2004.

The tenor of these discussions was that the DPP required Greg Lay to sign a voluntary witness statement rather than attend a s19 examination and this was the only way to progress

the DPP's decision-making. The critical issue was that the s19 transcript of a witness is not admissible in evidence and while there have always been provisions to subpoena reluctant witnesses after the laying of charges, the DPP was and has not been willing to rely on s19 transcripts in lieu of a signed statement in respect of the evidence of key witnesses when making decisions to prosecute.

ASIC and the DPP specifically discussed the issue of a section 19 notice in respect to Greg Lay at a liaison meeting of senior ASIC and DPP staff held on 15 June 2005. The substance of that discussion concerned whether a s19 examination would assist the DPP in resolving concerns about the credibility of Greg Lay given his refusal to provide a statement and his request for indemnification.

The view was that a s19 would not overcome the credibility issue created by his refusal to sign a statement.

Having provided ASIC investigators with his evidence voluntarily and on tape, his refusal to verify the truth of those statements made his credibility – as opposed to the means by which that evidence could be secured – the critical issue.

Question 4
Prior to the Vizard matter being made public, I want to know whether you had raised any concerns about the operation of the MOU or the content of the MOU, either with the DPP or with the relevant minister.

Answer:
ASIC and the DPP had been in discussions about updating the MOU for some months prior to the announcement of the Vizard matter.

The Vizard case itself did not raise any new issues relating to the MOU that had not already been identified.

Question 5
(in relation to the MOU with the DPP)

Chairman, I would like to take that on notice for my own knowledge. I do not know what Ms Redfern has responded. On the basis that what she said is correct, which I am sure that it is, I would have no difficulty, but since the question is directed to me I would need to satisfy myself.

Answer:
Yes, the document is now public.

Question 6
Could I ask you on notice, unless you have a ready answer, to take a look at the CAMAC report, take a look at the DPP's remarks, integrate it with other things you know and give the committee a view as to whether there are any areas in the law covering directors' duties, insider trading, penalties and even corporate governance matters which, in your opinion, could be brushed up or improved arising out of the circumstances of this case?

Answer:
ASIC does not believe the Vizard case has exposed a systemic weakness in the enforcement of either the insider trading prohibition or breaches of directors duties. The case highlights that credible enforcement action always depends on at least one reliable witness being prepared to give evidence. The DPP statement reinforces this position.

The case also highlights the difficulties and complexities involved in investigating and prosecuting insider trading to a criminal standard. In each case it is necessary to establish beyond a reasonable doubt a defendant possessed inside information and the inside information was material to the price or value of the shares and was not generally known. An additional difficulty in this case was establishing that Vizard was the person who instigated the trading. This required evidence from Greg Lay and this was the reason he was a critical witness.

As the Explanatory Memorandum to the Financial Services Reform Bill 2001 stated, the difficulties in proving insider trading beyond reasonable doubt (i.e. the criminal standard of proof)

"…may result in cases not being pursued even where there has been a breach of the provisions. This difficulty may result in cases not being pursued even where there has been a breach of the provisions. This is undesirable as it casts the law into disrepute, and also threatens the integrity of financial markets…It is therefore proposed to make the market misconduct and insider trading provisions civil penalty provisions. The application of the civil burden of proof (balance of probabilities) will facilitate the bringing of actions for breaches of the provisions. The application of civil penalties is likely to act as a deterrent to market misconduct. " (Ex. Mem. Para 2.78-2.79)

The addition of insider trading as a civil penalty obviated the need to amend further the insider trading prohibition however the Vizard share trades predated this amendment and hence this route was not available in the Vizard case.

ASIC v Petsas & Miot (2005) 23 ACLC 269, was also a case that in the DPP's view could not have been the subject of a successful criminal prosecution and hence the insider trading civil penalty provisions were used in that case.

There is one possible reform issue that would alleviate the DPP's difficulties in dealing with reluctant witnesses. An amendment to s49 of the ASIC Act to enable ASIC to require certain witnesses to provide a statement in an admissible form would achieve this, and is supported by the DPP. Under the ASIC Act, a s19 examination transcript of a witness is not admissible unless the witness is dead or absent. However, currently a witness may choose whether to provide a statement in a criminal prosecution. Without a statement, the DPP is unable to properly assess the evidence to make a prosecution decision, and in some states, a committal cannot proceed.

An alternative, which is not as useful, is to allow a transcript of a witness' examination to be admitted into evidence where the court or the rules of procedure, such as in criminal committal proceedings, require a written statement to be relied on as a record of the witness' evidence in chief. This may allow the DPP to place greater reliance on s19 transcripts as a basis for decisions to prosecute than is presently the case.

This may allow the DPP to place greater reliance on s19 transcripts as a basis for decisions to prosecute than is presently the case.

Question 7

I would not have thought that being able to tell me whether or not the two former directors had been interviewed or not, as a matter of fact, is a particular problem.

Answer:

Three former directors were interviewed prior to the commencement of ASIC's civil proceedings.

Question 8

Subsequent to the decision to investigate the Telstra matter that Ms Burke brought up, what discussions have there been with either ministers or ministerial officers and yourself, Mr Cooper, Professor Collier or, to your knowledge, other officers of ASIC? …

Answer:

The decision to investigate Telstra was made on Tuesday 6 September 2005 and the first part of the PJC hearing was 13 September 2005. In that time there was no contact with Ministers or Ministerial officers by the Deputy Chairman, Commissioner Collier any Executive Director or any person associated with the Telstra investigation.

The ASIC Chairman had contact with Minister Brough and the Treasurer at an FSAC dinner on the evening of 12 September at which the issue of Telstra was not referred to be neither Minister nor Mr Lucy.

Question 9

That leads in part to my next question. You referred earlier to an example about insurance et cetera. As a consequence of this exercise, are you able to provide the committee with a case-by-case list - but not going to names - of the mis-selling and the disregard for the interests of clients that you identified? Please take it on notice.

Answer: See Appendix 4 of this report

Question 10

I would also like you to take on notice how many identified cases of mis-selling or disregard of clients' interests you have 'settled'—cases that have reached a successful conclusion, cases where you believed you had to take action and a response has occurred. I would like the details, not necessarily names but the quantum of money and the type of case. Could you take that on notice?

Answer: See Appendix 4 of this report

Question 11

I would be interested in some detail of how you regulate the license dealers in the companies under the new regime as far as your investigations are concerned and in percentages of investigations that occur and the abnormalities that you detect.

Answer: See Appendix 4 of this report

Question 12
There is some detail in this press release that I will go into next time, but can I ask you to check something. The press release went out on 1 April. The *Financial Review* article on 2 April was obviously off the back of the press release. However, one of the issues that concerns me is that the *Financial Review* article of 2 April, which was based on your press release, contains detailed information of a monetary size—specifically, $140,000—that was not in the press release. The question is: are ASIC aware or have they investigated whether or not a leak occurred from the organisation that provided to the *AFR* that monetary detail, which was not in the press release that was released the day before?

Answer:
ASIC did not leak any information to the AFR or any other media outlet about the prosecution of Mr Moore. After the media release was issued, the AFR asked ASIC what ASIC alleged to be the total of superannuation money involved in the transactions that are the subject of the charges.

ASIC supplied that information to the AFR.

Questions asked on 9 November 2005

Question One
Are you aware of any ASX trading irregularities in relation to Sausage software?

Answer:
In 1996 ASIC received a referral from the ASX in relation to trading irregularities in Sausage Software shares but has not received any referral from the ASX in relation to Sausage Software since this time. ASIC has spoken to the ASX about trading irregularities in Sausage Software in March 2000. During this time there were 2 price alerts generated by the ASX's market surveillance system.

One was for an unusual price increase. This was reviewed and assessed by the ASX as trading within normal range. The other price alert was for a closing price fall over a 15 day period. This was reviewed and assessed as price returning to previous levels. No alerts for unusual volumes in relation to trading in Sausage Software shares were generated by the ASX systems during this period. These matters were not referred to ASIC.

Question Two
How many trading irregularities have been referred from the ASX to ASIC over:
The financial year to date;
Financial year 2004/05;
Financial year 2003/04;
Financial year 2002/03;
Of these referrals, how many became investigations?

Answer:
ASIC received the following numbers of referrals from the ASX For the following financial years. The numbers of these referrals that have resulted in an investigation are also listed:

	ASX Referrals	Number of these investigated
Financial year to date:	16	5
Financial Year 2004/05:	73	27
Financial Year 2003/04:	48	36
Financial Year 2002/03:	53	45

There is a significant change in the proportion of referrals that resulted in an investigation between the 2003/04 financial years and the 2004/05 financial years. This is because ASIC changed the way it treated ASX referrals in May 2004. Prior to May 2004, ASX referrals routinely went to ASIC's enforcement directorate to be assessed in that directorate.

It was common practise for investigations to be commenced as part of this assessment process. In May 2004, ASIC's procedures were changed so that the referrals were assessed in what was then ASIC's policy and markets regulation directorate without a formal investigation being commenced. The referrals are now assessed in ASIC's compliance directorate without a formal investigation being commenced.

One of the reasons this change was because ASIC found that a relatively small proportion of investigations following ASX referrals resulted in enforcement action.

Therefore, it was considered more efficient for referrals to be assessed before they went to the enforcement directorate with only those that were more likely to result in an enforcement action or matters of strategic significance being referred to the enforcement directorate for investigation.

The enforcement directorate has not changed the number of resources it devotes to investigating markets matters but this change has allowed it to focus more investigative resources on matters that are more likely to result in enforcement outcomes or have strategic significance.

ASIC believes that this change has facilitated better outcomes in the investigation of market matters over the last 2 years.

Question Three
The MOU and protocol documentation between ASIC and the ASX, can this be made available to the committee.

Answer:
The MOU is a public document and is available on ASIC's website. There are no other current protocol documents between ASX and ASIC.

Question Four
In relation to insider trading, is there documentation outlining how and what you investigate and do you determine your procedures in relation to these investigations?

Answer:
ASIC does not have specific documentation that sets out procedures for investigating insider trading but does have documentation providing procedures in relation to the conduct of investigations generally.

However, ASIC has staff who specialise in insider trading investigations are in the process of preparing documentation outlining various methodologies for conducting insider trading investigations. These staff also provide assistance to ASIC's investigation staff on the methodologies that can be used to investigate particular insider trading investigations.

Of course, any methodology must recognise that each investigation will be different depending on the facts and circumstances of the suspected offence and the investigations need to be tailored accordingly.

Question Five
What is the final cost of the switching survey?

Answer:
Fully loaded staff costs including salaries, an allowance for salary on-costs, property and overheads is $0.320.7M. Direct salary costs were $0.238.7M. Travel costs amount to $600.00.

Question Six
What is the final cost of the shadow shopping exercise?

Answer:
ASIC's shadow shopping exercise is in progress and is yet not complete. We therefore cannot respond to this question at this point in time. When the exercise is complete a list of costings can be made available to the committee.

Question Seven
Were any accountants included in the switching surveillance?

Answer:
Yes.

1. Some of the authorised representatives of AFSLees are accountants and in some cases the surveillance looked beyond their conduct as authorised representatives into their conduct as accountants outside the scope of their AFSL authorisation.

   One particular issue that arose is whether proper disclosure was being made to clients about which 'hat' the adviser was wearing, particularly when advising on SMSFs. Another issue was the risk management procedures of AFSLees in relation to their liability when an authorised representative acted outside the scope of their authority.

2. Three discrete surveillances were conducted on accounting firms providing advice and administration services for SMSFs. One is ongoing.

Question Eight
Super calculators – do you take actuarial advice here about what is ok?

Answer:
Yes, ASIC takes actuarial advice in relation to superannuation calculators.

Question Nine
Audit independence, what have been the issues raised across the sector?

Answer:

The suggested areas for improvement in our report were:

- Firms had remained more focused on Sarbanes-Oxley than CLERP9;
- Firm's own testing of independence systems revealed unsatisfactory results;
- All firms' partners are required to be financially independent of clients, but firms had varying policies on professional staff prohibitions;
- Some firms took narrow and legalistic view of independence when considering non-audit services and did not appear to consider a reasonable person's perception test;
- All firms had inadequate documentation and varying processes for audit engagement team independence confirmation;
- Firms had a wide variety of documentation supporting decisions for approving non-audit services;
- Some firms levels of attendance and completion of independence training was inadequate; and
- Firms did not clearly communicate consequences of non compliance to staff.

Most firms did not have a central register of independence queries and breaches

Question Ten

Does ASIC share the view of the Financial Reporting Council, that Audit Independence guidelines in Australia may be overly prescriptive?

Answer:

The findings in our report were that all firms had generally adequate systems and processes in place and we did not identify any breaches of the Corporations Act.

We did suggest areas for improvement and our approach was to articulate to the firms where they could improve but we were not prescriptive about how they achieve these improvements - this is a matter for each firm to consider in the context of its own local and global systems, structure, and resources.

Appendix 3

Letter from Mr Damian Bugg QC

Following is the text of a letter tabled by Mr Damian Bugg QC at the private briefing held on 13 September 2005. The Committee agreed by resolution to publish the letter with the Subject line of the letter obscured. In this case it has been removed.

13 September, 2005

The Secretary
Joint Committee on Corporations and Financial Services
Parliament House

CANBERRA ACT

Dear Sir

Subject line removed by order of the Committee

In order to assist the Committee's deliberations on the above matter the following comments are provided in relation to the specific questions posed by the Committee.

How the Commonwealth Prosecution Policy is applied to Criminal Charges brought under the Corporations Act 2001

The *Corporations Act 2001* is a Commonwealth Act. The Prosecutions Policy of the Commonwealth is applied to prosecutions under this Act in the same way that is applied to prosecutions under any other Commonwealth Act.

In practical terms the Prosecution Policy requires that for a prosecution to be instituted:

- there is admissible, substantial and reliable evidence that a criminal offence known to the law has been committed by the alleged offender;
- there is a reasonable prospect of conviction; and,
- it is in the public interest to prosecute.

The decision requires an evaluation of how strong the case is likely to be when presented in court. It requires the prosecutor to take into account matters such as the availability, competence and credibility of witnesses and their likely impression on the court as well as the admissibility of other evidence such as any confession by the offender. The prosecutor must have regard to any likely defences open to the offender.

Under what circumstances, if any, the DPP would be prepared to rely on the evidence of potentially hostile witnesses

The DPP has a duty to call all witnesses who are credible and can give relevant evidence. This is the case even though the witness's evidence may not assist the prosecution case. However, if the DPP forms the view that the witness is not telling the truth or will not give truthful evidence when called the DPP may decline to call that person to give evidence. In some cases as a matter of fairness and, if requested by the defence, the DPP may call that witness to be made available for cross examination by the defence.

In other cases a potential witness may not be willing to cooperate with the investigatory agency and provide a statement which sets out truthfully and accurately the evidence that the person is able to give in court if called as a witness. In these cases an inquiry must be made as to the reason why the person is not willing to cooperate. In some cases it may be clear that the witness is concerned as to their own position and is fearful of being prosecuted for an offence. In these cases the witness may be invited to provide to the investigators an induced statement which sets out the evidence the person can give in the matter which will be used for the purpose of assessing whether that witness is suitable to receive an indemnity from the DPP. The induced statement cannot be used against the witness in court. There is close liaison between the investigatory agency and the DPP prior to inviting a witness to give an induced statement to ensure that it is appropriate. Under the Prosecution Policy an indemnity, or more correctly an undertaking under section 9(6) or section 9(6D) of the DPP Act, is given as a last resort to secure a witness's testimony and only where the witness can be regarded as significantly less culpable than the defendant. Generally the Prosecution Policy requires that the witness be dealt with in relation to their criminality and that their cooperation be taken into account as a mitigatory factor in their sentencing.

In other cases the witness may not be willing to cooperate for a reason other than self incrimination. Examples of this might be professional advisers who may regard such cooperation as a potential breach of their duty of confidentiality. Generally where there is sufficient evidence to justify a prosecution even without that witness's evidence, and the DPP is confident that if called the witness will give truthful and relevant evidence, the DPP may subpoena the person to give evidence even if that person has failed to cooperate with the investigation.

Whether evidence obtained in accordance with notices issued under section 19 of the ASIC Act assist the DPP to undertake successful prosecutions

Section 19 is a powerful investigatory tool that is of great utility in ASIC investigations. In the context of investigations with a view to establishing a criminal offence section 19 can be used to examine potential defendants with a view to establishing what those persons would say in relation to the allegations. It provides an insight into likely defences and may assist in avoiding unwarranted prosecutions.

Section 19 is also a useful tool in establishing what a potential witness might be able to say. However, because it is an investigatory tool section 19 examinations may not have the required degree of focus to always be of use in a prosecution. For example a section 19 examination may be wide ranging and be at an early stage in the investigation, it may not explore areas of criminality as fully as required to bring criminal charges and if the examiners are not precise in their questions may give rise to ambiguities and uncertainties. Further because such examinations are conducted in a relatively formal atmosphere some witnesses may not be at ease and ready to volunteer information as distinct from a willing cooperation with the investigation.

Accordingly there will still be a need for investigators to focus a witness's attention to the specific matters required to be proved to establish the elements of an offence. Practical experience has shown that if a person is approached as a potential witness with a view to taking a statement they may be more willing to cooperate than if required to attend a compulsory examination under section 19.

Where a professional witness is unwilling to provide a statement but otherwise willing to tell the truth in a section 19 examination the process may be useful in determining what the witness will say when called to give evidence in court. In this case the DPP would be confident that even though the witness has not cooperated in providing a statement, that witness would give relevant and truthful evidence in court.

Whether the MOU between the DPP and ASIC remains an appropriate instrument to facilitate successful criminal prosecutions

The MOU between the DPP and ASIC was first agreed in September 1992. Understandably some of the procedural concepts in the MOU are now dated. For example ASIC's investigatory techniques have changed and developed. However, many of the fundamental concepts contained in the MOU are still relevant to the relationship between ASIC and the DPP. The DPP regards it as important that there be full and early consultation between the regulator and the prosecutor as to potential criminal cases. We recognise that ASIC is the investigator and the decision to investigate and carriage of the investigation are matters for ASIC. However, where the DPP can assist ASIC by advising as to potential evidentiary difficulties or areas of potential criminality, we feel that we can add value to the process to assist in focussing the investigation and assist ASIC in producing a brief of evidence that is able to be successfully prosecuted.

The DPP and ASIC have recognised that the MOU requires updating and have commenced work on a project to produce a new MOU that both recognises the roles and responsibilities of each organisation as well as the principles of cooperation to be employed in achieving a proper and appropriate outcome in the area of corporate criminal enforcement.

Whether the DPP would recommend any amendments to the Corporations Act in order to remove obstacles to just prosecutions

There are 3 areas of law reform that the DPP has suggested or supported in the past.

The DPP has for some time suggested that consideration be given to inserting a general fraud provision in the Corporations Act. In our 2000 – 2001 Annual Report we noted that if a case that has been investigated by ASIC involves a fraud on a company, or a fraud using a company structure, it is often necessary for the DPP to lay charges under the fraud or theft provisions of State Acts. In some case the DPP has laid only State offences and this has led to challenges to the DPP's power to prosecute or appeal inadequate sentences imposed in those cases. Further Commonwealth criminal law has developed over the years and now differs in marked respect to State law. The introduction of the Commonwealth Criminal Code has meant that different principles of criminal responsibility apply to Commonwealth offences than State offences. In some case it may not be possible to prosecute State offences on the same indictment. All these developments have created the need to consider the enactment of more general fraud offences in the Corporations Act.

The second area of reform concerns section 184(1) of the Corporations Act 2001 and was referred to in the DPP's 2001 – 2002 Annual Report. This provision relates to conduct which involves a breach by a director or officer of a corporation of duties they owe to that corporation. Section 184(1) makes it an offence if a director is reckless and fails to exercise his or her powers in good faith in the best interests of the corporation for a proper purpose.

The general principles of criminal responsibility in Chapter 2 of the Criminal Code now apply to offences against the Corporations Act, including offences against section 184. However, the effect of applying these general principles to section 184 is that there is uncertainty as to how the concept of recklessness can apply as drafted. The DPP has suggested it would be appropriate to amend the law to provide some certainty.

The final area of law reform that the DPP supported was a proposal put by ASIC to enable ASIC to require a person who is examined under section 19 and who can give relevant evidence in a prosecution to provide ASIC with a statement of the evidence for the purposes of a criminal prosecution. As currently framed it is not certain that the power in section 49 of the ASIC Act will enable ASIC to require a person to give such a statement.

Yours sincerely

Damian Bugg AM QC

Appendix 4

ASIC Report on late 2004 (and early 2005) Superannuation Switching Advice Surveillance

INTRODUCTION

In late 2004 and early 2005, ASIC undertook a surveillance looking at whether advisers were complying with their obligations to disclose, in the Statement of Advice (**SOA**) given to clients, the costs, possible loss of benefits and other significant consequences of following advice to switch super funds.

During this surveillance, ASIC uncovered some cases where the interests of clients were harmed by poor advice.

PURPOSE OF THIS REPORT

The purpose of this report is twofold:

- to explain the methodology behind the surveillance; and
- to illustrate the results of the surveillance in simple language.

PROJECT METHODOLOGY

ASIC started surveillance on superannuation switching advice in December 2004 to assess how financial advisers were, at that time, complying with new legal obligations relating to advice to switch superannuation products.

ASIC's surveillance sample included 19 AFS licensees and 93 representatives of those licensees. Initially, ASIC reviewed 101 client files in which personal advice was given to switch superannuation funds in the second half of 2004. In the process of making further inquiries, ASIC reviewed the compliance procedures of some licensees and over 160 further advice files (ie a total of 261 files from 93 people representing 19 licensees).

Licensees were selected from the retail, industry fund, corporate and government sectors. Some advice was from independently-owned advisers. ASIC also reviewed advice given in relation to self-managed superannuation funds (**SMSFs**).

ASIC required all licensees the subject of the surveillance to provide information about the switching advice they had provided during a 3 month period. ASIC received information on around 7,500 pieces of switching advice. 4,900 of those were from advisers whose licensee was a related entity to the trustee of the superannuation fund they recommended (see table below for break-up of conflicted advice per licensee).

ASIC used a number of tools to determine whether the licensee was a related entity to the trustee of the super fund recommended. This included review of the Financial Services Guide provided by the adviser, and also use of ASIC's ASCOT database to ascertain related entity status.

ASIC required each licensee to produce on average 5 client files for full review (totalling approximately 100 files). Typical selection for a retail adviser included one consolidation advice, one switch recommendation from an industry fund to a retail fund, one retail fund to another retail fund, one corporate fund to a retail fund, and one public sector to a retail fund. These files were taken from a selection of switching advice given over a specified three-month period for each licensee. For one very large licensee, however, ASIC reduced the scope of the notice to only include information about switching advice provided by representatives with surnames (or company names) beginning with A-D over a one month period.

Further files were also requested from advisers and licensees where concerns were detected after review of the first batch of client files – an additional 160 files in this category, totalling 261 files overall.

SUMMARY OF FINDINGS

There were three main findings:

- **Limited investigation of the 'from' fund.** Most advisers recommending a switch had made limited or no investigation of the fund that they advised the client to switch from (ie the 'from' fund).
- **Poor disclosure of the costs, loss of benefits and other significant consequences if the advice is followed.** As a result of limited or no investigation of the 'from' fund, most advisers in our surveillance did not comply with the specific obligations to disclose the costs, loss of benefits and other significant consequences of the recommended switch. In the SOAs we reviewed, disclosure about the basis for the recommendation to switch was generally poor.
- **A tendency to recommend a fund related to the licensee.**

  Based on the statistics provided by licensees, there is a strong tendency among advisers to recommend switching to a fund related to the licensee. In these cases, there is a conflict of interest that must be carefully managed in order to avoid the perception that advice is inappropriate or is not given on a reasonable basis, or that the interests of the licensee are placed above those of the client.
- **A tendency to oversell life insurance**. There were a number of examples where advisers seemed to recommend life insurance to clients where there did not seem to be a reasonable basis for doing so.

ASIC ACTION

ASIC has taken, and proposes to take, a wide range of actions in relation to the findings of the surveillance.

At the extreme end was the case of Superannuation Retrieval Services (see ASIC media release [MR 05-205]) which involved an unlicensed adviser giving misleading advice to consumers about rolling over their superannuation entitlements into self-managed superannuation funds (**SMSFs**). One victim with only $8,000 in super savings was sold an SMSF and charged $1,500 in fees. In that case, ASIC obtained orders in the Federal Court restraining the relevant parties and compelling them to repay all client money. This matter is ongoing.

ASIC has also issued a direction to national financial planning and stockbroking firm, Bridges Financial Services Pty Ltd, requiring it to provide an audited opinion that it has changed its procedures and is complying with its switching advice obligations (see ASIC media release [MR 05-318]. ASIC had discovered that Bridges had failed to provide clients with information in statements of advice about charges incurred and benefits lost as a result of super switching recommendations.

ASIC has also initiated a detailed and more wide-ranging surveillance of one of the major financial planning groups involved. This could result in a range of outcomes; ranging from a 'clean bill of health' to enforcement action. It is too early to make any comment at this stage.

Other action includes a number of enforcement referrals in relation to the behaviour of individual advisers summarised in the examples set out later in this report, together with proposed Federal Court action in relation to the conduct described in Example 7. Compliance action[1], along the lines of the Bridges matter is also proposed for a number of licensees.

ASIC believes that the disclosure, at this time, of more details of proposed enforcement and compliance action, by identifying particular conduct and the proposed response, would have the potential to compromise our work in this area. It has the potential to be misused by participants in the industry to argue that certain types of conduct result in a certain level of response from ASIC. It also has the potential to be misleading in that ASIC might decide not to take enforcement action based on certain information and then take a different decision based on subsequent information. It must also be remembered that all of these matters are ongoing, even where compliance action has already been undertaken, under investigation or the subject of preparation for enforcement action (either judicial or administrative). For all of those reasons, ASIC is not in a position to provide further information at this stage.

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[1] 'Compliance action' is a tool used by ASIC, particularly in the financial services industry, to improve the standard of compliance with the law. It has the benefit of being more wide ranging, timely and less costly (for ASIC and the licensee) than traditional enforcement action. In this case, it includes formal directions requiring licensees to take steps to address the compliance findings set out in the 6th column of this table. Licensees who receive such directions are required to provide an audited report to ASIC in early December 2005 detailing the steps taken and changes made. Where monitoring of specific advisers is required, the licensee must review, train and supervise that adviser over the course of one year.

TABLE OF DATA

Below is a table indicating the level of conflicted advice per licensee based on the statistical review of switching information provided by licensees under notice. It also summarises the compliance findings across all licensees.

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
1	Yes (Retail)	98% of 709 recommendations	12	55 (15 then a further 40)	1. Advice - failure to investigate the client's existing fund 2. Disclosure - inadequate switching disclosure. 3. No advisers nominated for specific monitoring due to enforcement referral.	
2	Yes (Retail)	69% of 78 recommendations	5	5	1. Advice - failure to investigate the client's existing fund. 2. Disclosure - inadequate switching disclosure 3. Monitoring required – 3 advisers	1. Some instances of pre-FSR language being used.
3	Yes (Retail)	75% of 257 recommendations	8	28 (9 then a further 19)	No findings letter will be issued because the AFSLee is with Enforcement. Their compliance manuals mislead advisers as to their obligations.	

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
4	Yes (Retail)	75% of 360 recommendations	10	20 (11 then a further 9)	1. Advice - failure to make adequate investigation of the client's existing fund. 2. Advice - setting scope of advice (insurance) 3. Risk management - licensee liability for representatives acting outside authority 4. Disclosure - inadequate switching disclosure (insurance) 5. Monitoring required - 3 advisers.	1. Presentation of SOA - some advice not CC&E. 2. Advice on SMSF - SOA should outline ongoing obligations & costs.
5	Yes (Retail)	99% of 1,320 recommendations	9	10	1. Advice - failure to investigate the client's existing fund (insurance) 2. Advice - setting scope of advice (insurance & fund comparison) 3. Advice - licensee business structure may preclude compliant switching advice. 4.Disclosure - general switching disclosure inappropriate 5. Monitoring required – 3 advisers	1. Advice - use of templates may lead to misleading representations about comparative benefits.

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
6	Yes (Public Sector)	100% of 3 recommendations	1	1	1. Advice - failure to investigate the client's existing fund leading to misleading advice. 2. Disclosure - inadequate switching disclosure	
7	No	(Note a strong leaning to XX products - likely conflict based on remuneration structures OR narrow product list.	6	8	1. Advice - failure to investigate the client's existing fund leading to misleading advice. 2. Disclosure - inadequate switching disclosure 3. Not supervising risk of accountant / representatives giving SMSF advice under acc. Exemption but ostensibly as representative.	
8	Yes (Retail)	55% of 58 recommendations	6	8	1. Advice - failure to adequately investigate the client's existing fund. 2. Disclosure - inadequate switching disclosure. 3. Monitoring required - 1 adviser	

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
9	Yes (Industry funds)	89% of 766 recommendations	9	33	1. Advice - failure to adequately investigate the client's existing fund. - if there is investigation beyond costs and insurance, a recommendation to switch cannot be made under s945A. 2. Disclosure - inadequate switching disclosure - general statement that there may be other lost benefits not available to XXX adviser because more information cannot be reasonably found out.	

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
10	Yes (Retail)	61% of 343 recommendations	6	35 (7 + a further 28)	1. Advice - failure to make adequate investigation of the client's existing fund. 2. Advice - inappropriate scope of advice (insurance) 3. Disclosure - inadequate switching disclosure 4. Disclosure - inappropriate use of general switching disclosure 5. Disclosure - templated statements about benefits of a recommended fund may be misleading. 6. Disclosure - SOAs must be given before other financial services are provided. 7. Monitoring required – 3 advisers	1. Some terminology needs to be updated to reflect Australian financial services license regime (white) 2. Comparison of funds should include ongoing costs. 3. Recommendations of consolidation into an entirely new fund should clearly disclose the basis of this advice. 4. Presentation - inclusion of lengthy research reports and lack of structure makes SOAs less clear, concise & effective.

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
11	Yes (Retail)	86% of 129 recommendations	5	14 (5 + a further 9 files)	1. Advice - failure to make adequate investigation of the client's existing fund. 2. Disclosure - inadequate switching disclosure. 3. Monitoring required – 2 advisers	1. Disclosure - non-compliant disclosure of interests by link to website
12	Yes (Retail)	85% of 330 recommendations	6	14 (7 + a further 7)		1. Disclosure - isolated instance of late SOA. 2. Disclosure - inadequate switching disclosure (ongoing costs of corporate / public sector funds)
13	Yes (Retail)	100% of 123 recommendations	5	5	1. Advice - failure to make adequate investigation of the client's existing fund. 2. Disclosure - inadequate switching disclosure. 3. Monitoring required – 3 advisers	1. Disclosure - strategies raised by an adviser but presented as a client direction may be misleading.

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
14	Yes (Public Sector)	100% of 151 recommendations	2	4	1. Advice - failure to make adequate investigation of the client's existing fund. 2. Advice - inappropriate scoping of switching advice. 3. Monitoring required – 1 adviser	1. Advice - strategies raised by an adviser but presented as a client direction may be misleading. 2. Advisers tied to specific superannuation funds must have strong conflicts management processes.
15	Yes (Public Sector)	100% of 14 recommendations	1	1	1. Disclosure - failure to disclose conflicts of interest (relationship with product provider)	1. Review templates for pre-FSR language

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
17	No	(This adviser was the only one selected from complaints data)	1	1	1. Advice - failure to make adequate investigation of the client's existing fund. 2. Advice - failure to make adequate enquiries about the client. 3. Disclosure - inadequate switching disclosure. 4. Disclosure - holding out. (Further surveillance on other AFSL related compliance issues)	
18	Yes (Corporate / Public sector)	100% of 40 recommendations	3	5	1. Advice - failure to make adequate investigation of the client's existing fund (even name) 2. Disclosure - inadequate switching disclosure.	1. Disclosure - templated comparisons on fees may be misleading in particular circumstances.

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
19	Yes (Retail)	98% of 178 recommendations	5	5	1. Advice - recommendations of insurance may not be appropriate 2. Disclosure - inadequate switching disclosure (espec. Comparative costs) 3. Monitoring - use of 'product replacement statement' in template. 4. Report - misleading advice on co-contributions 1 adviser 5. Monitoring required – 2 advisers	1. Consolidation advice - reasonable basis for consolidating into a new fund where one of the existing funds suits the client's needs.
20	Yes (Public Sector)	100% 93 recommendations	5	35 (5 + a further 30 files)	1. Advice - failure to investigate the from fund. 2.Disclosure - failure to make switching disclosure 3. Disclosure - general switching disclosure used improperly	

EXAMPLES OF POOR ADVICE

The following scenarios are taken from some of the 261 files actually retrieved during the surveillance. The names of the clients and other parties involved have been changed, but the factual information is unaltered.

Example 1: Jane Adams[1]

Jane Adams had existing super with $92k worth of death & TPD cover in Fund 1. She earns approximately $10k per annum and her husband has an income of $36k per annum. They have no dependants. She is not in good health and would like to give up work because of this.

She was given advice to roll over her balance into Fund 2. Fund 2 required her to pass health checks in order to get equivalent cover. She was rejected for TPD (total & permanent disablement) cover and now only has death cover. The wording in the SOA relating to the loss of benefits from the switch are as follows "*There will be a $91,905 Death and TPD benefit replaced with the rollover of (Fund 1) to (Fund 2). However, the increased cover under (Fund 2) is more appropriate to your situation.*" The adviser did not disclose that health checks would be necessary to get TPD cover in Fund 2 or that she could potentially lose her TPD.

ASIC's conclusion so far – We doubt whether there is a reasonable basis for this advice. There is clearly client detriment suffered if there is a loss of TPD cover. There is a breach of disclosure obligations in respect of the potential loss of benefits, due to the health check required.

Example 2: John Smith

John Smith was a labourer. He received advice to roll over from his existing industry super fund (Fund 1) to Fund 2. Fund 1 provided Death & TPD cover regardless of occupation, while Fund 2 did not provide TPD cover to labourers. The loss of the cover is disclosed in the SOA with the comment *"There is a loss of $55,000 Death and TPD, however the FLS plan compensates for this with a higher cover of $250,000 for Death."* What the SOA fails to say is that the higher death cover in Fund 2 was at a significantly greater cost. The client was 25 years old, not married, had no dependents, and as a labourer was at much greater risk of requiring TPD than someone with an office job. The death cover was far less suited to his situation than TPD cover and arguably of no benefit. He was separately advised to get trauma cover that was considerably more expensive than the TPD available in Fund 1 and less suitable as it is not as connected to his capacity to work.

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[1] All names have been changed to protect the identity of the parties

John Smith could have kept his TPD cover by remaining in Fund 1, which had lower administration fees and nil establishment and contribution fees. He would also have saved himself the 4.5% entry fee into Fund 2.

ASIC's conclusion so far - $250k is very large life cover for a 25-year old labourer with no family – it is questionable whether this person needed this death cover at all and certainly not at the cost of losing TPD cover. There is a marked increase in fees payable which will have a significant impact on the client's end retirement payout. We doubt whether there is a reasonable basis for this advice.

Example 3: Anne and Michael Stevens

Anne and Michael Stevens are a married couple. Anne was recommended to roll the $6,110 she had in Fund 1 into Fund 2. The termination cost was $882.37 and the entry fee for Fund 2 was $274.95, so the total cost of the rollover was $1,157.32 or 19% of the value of her fund. These entry/exit fees were disclosed.

The rationale for the switch was stated in the SOA as *"[Fund 2] performs better and gives more flexibility as far as insurance benefits and ongoing premiums are concerned. Any new funds going into this policy over and above the contracted level incur excessive fees and so it has remained frozen for some time."*

This statement was misleading because it indicates the client should leave Fund 1 due to excessive fees on her contributions. However, in reality Fund 1 charged 5% on all contributions *in excess* of her agreed premium, whereas in Fund 2 she would pay 4.5% on the *entirety* of *all* contributions.

As it turns out, Fund 1 had no less flexibility than Fund 2 in relation to insurance options available.

Michael was recommended to rollover funds from Fund 1 to Fund 2. However, important details about Fund 1 were not ascertained by the adviser who instead *referred the client to Fund 1 to find these details out for himself.*

Anne and Michael were also advised to buy insurance totalling $5,719 in annual premiums. This was excessive given their combined gross annual income was $45,000.

ASIC's conclusion so far – This advice is incorrect on cost issues that adversely affect the financial circumstances of the client. There is a significant cost associated with switching between these products and the financial benefits of such a switch are not apparent. We doubt whether there is a reasonable basis for this advice.

Example 4: Jim Barlow

Jim Barlow was in a so-called 'old' employer Fund 1 plan. He was recommended to switch to a 'new' employer Fund 1 plan, but was given no details about the difference between the old and the new. The client was to be charged a 3% entry fee for going

into the 'new' fund. ASIC spoke with the product manager of Fund 1 who said that there is no such thing as an 'old' and a 'new' plan. She could not think of any instance where a new entry fee could be charged unless one account was closed and a new one opened up some time later.

ASIC's conclusion so far – this advice may have been given solely to secure the transfer of trail commissions from a previous adviser.

Example 5: Ruth Taylor

Ruth Taylor had $26,000 super with an industry fund (Fund 1). The SOA recommended that the client switch to Fund 2 and get extra death cover.

A review of the file discloses that the adviser did not get any details of the client's income. There is inadequate information about the client's circumstances and financial objectives. The client was charged $782 to switch her funds. The client is a 45-year-old divorcee with no dependants, and as such the need for additional death cover is not apparent. She is on a low income, working 12 hours per week as a shop assistant. The additional costs have had a significant impact on her financial position.

ASIC's conclusion so far – There is a marked increase in fees payable which will have a significant impact on the client's end retirement payout. We doubt whether there is a reasonable basis for this advice.

Example 6: Douglas Kant

Douglas Kant earns $38,000 per year and owes $46,500 in personal debts. He visited an adviser to get advice on how to restructure his finances to pay off his debts. He was not seeking advice about super and had $22,533 worth of super with a low cost fund (Fund 1).

The adviser recommended in the SOA that he switch into Fund 2. Fund 2 has an entry fee of $977 and an ongoing fee of 0.4%.

The adviser did not do any research about Fund 1, nor discuss the advantages or disadvantages of the switch in the SOA. There appears to be no reasonable basis for the advice given in the SOA. The reason for the switch is said in the SOA to be "ability to choose different fund managers and to fit those fund managers within your investment profile."

In considering the reason given for the switch, it is hard to see how "the ability to choose different fund managers" is relevant to a person who owes more than their annual salary in personal debts.

Further, there is a concern as to whether the adviser should have given any advice at all in these circumstances, given they have not researched the fund of which this client is a member, before providing advice which adversely affects the client's financial situation. We doubt whether there is a reasonable basis for this advice.

Example 7: Adviser 1

Adviser 1 recommended six of his clients move from industry superannuation funds (Funds1) to Fund 2. The clients were all low-to-middle income earners and were significantly worse off as a result of Adviser 1's advice to switch. The fees and charges associated with Fund 2 were significantly higher.

Using the ASIC super calculator, we estimate the clients' retirement payouts will be reduced by between 22% and 44% as a result of the advice to switch. There is some evidence that Adviser 1 deliberately lied by saying that Fund 2 was cheaper. In one instance, the SOA does not disclose important costs in Fund 2.

In addition, Adviser 1 recommended three clients (all single with no dependants and little debt) take out life insurance of $250-$300,000, which was far more than they were likely to need.

The SOAs also failed to disclose that clients will generally lose their insurance as a result of the switch and that Fund 2's insurance premiums were generally more expensive than Funds 1.

In each case, Adviser 1 distorted the client's financial circumstances to justify his advice to switch funds. In several cases, the summary of the client's circumstances in the SOA was directly contradicted by the client's evidence about their instructions to Adviser 1.

Adviser 1 also failed to investigate Funds 1 and had no knowledge of the exit fees or cap on insurance offered by Funds 1. Adviser 1 even failed to investigate Fund 2 as evidenced by the fact that he was ignorant of the fact that it was possible to get TPD insurance without getting an equivalent amount of life cover.

The incentive for Adviser 1 to advise clients to switch is that he would be entitled to a commission equal to:

- 104% of the insurance premiums paid in the first year (plus 11% every year thereafter);
- 4.5% of all funds paid into Fund 2; and
- an annual ongoing fee (ie 'trail') of 1% of the value of his clients' share of the assets in Fund 2.

In light of the conduct of Adviser 1, ASIC intends to take enforcement action against this adviser in the Federal Court.

Australian Securities and Investments Commission

9 November 2005