Parliamentary Joint Committee on Corporations and Financial Services

Statutory Oversight of the Australian Securities and Investments Commission

February 2009

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978-1-74229-061-4

Printed by the Senate Printing Unit, Parliament House, Canberra

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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).

1.3 In undertaking this oversight function, the committee has inevitably focused on matters of a controversial nature or areas where there may be scope for ASIC to improve the way in which it carries out its responsibilities. Despite this, the committee remains satisfied that ASIC continues to carry out its functions in accordance with the provisions of the corporations legislation.

Public hearing

1.4 The committee held a public hearing on 28 November 2008 to examine matters falling within ASIC's regulatory jurisdiction. Evidence was provided by Mr Tony D'Aloisio, Chairman of ASIC; Mr Jeremy Cooper, Deputy Chairman of ASIC; and Ms Belinda Gibson, ASIC Commissioner (Appendix 1).

1.5 A copy of the Hansard transcript from the hearing has been tabled for the information of the Parliament. It is also available online at http://www.aph.gov.au/hansard/joint/commttee/J11473.pdf.

Additional information

1.6 A number of questions were placed on notice at the hearing. Those questions and ASIC's responses are at Appendix 2.

Chapter 2

Issues raised with ASIC

2.1 The committee's hearing with the Australian Securities and Investment Commission (ASIC) officials on 28 November 2008 raised a number of issues relating to ASIC's regulatory responsibilities. These included a number of issues stemming directly from the global financial crisis that escalated in the second half of 2008:

- ASIC's decision to ban short selling to reduce market volatility;
- hardship exemptions for frozen mortgage fund redemptions; and
- new licensing and reporting arrangements for credit rating agencies.

2.2 The committee also discussed with ASIC a number of issues that were of interest at previous oversight hearings. These included:

- the regulation of insider trading, false rumours and market manipulation;
- ASIC's strategic review;
- workload and budgetary issues;
- superannuation projections and shadow shopping;
- financial literacy; and
- professional indemnity insurance for financial planners.

Short selling

2.3 On 19 September 2008 ASIC announced a package of measures to regulate short selling. This included a ban on naked short sales and the requirement to disclose covered short sales to the Australian Securities Exchange (ASX) via brokers.[1] Two days later ASIC announced that all short selling would be temporarily banned, to be reviewed in 30 days.[2] Following the market confusion that ensued, ASIC made a number of announcements clarifying the operation of the prohibition, particularly with respect to existing hedging positions.[3] On 21 October the ban on covered short selling was extended for a further 30 days (until 19 November) and until 27 January 2009 for

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1 ASIC, 'Naked short selling not permitted and covered short selling to be disclosed', *Press release*, 19 September 2008; ASIC, *Class order [CO 08/751]*

2 ASIC, 'Covered short selling not permitted', *Press release*, 21 September 2008; ASIC, *Class order [CO 08/752]*

3 ASIC, 'ASIC advice to ASX market participants regarding hedging existing transactions', *Press release*, 22 September 2008; ASIC, 'Update on ASIC's response to short selling', *Press release*, 23 September 2008; ASIC, 'No action position for owners selling from stock lending portfolios', *Press release*, 24 September 2008

financial stocks.[4] This ban on short selling financial securities was subsequently further extended to 6 March 2009.[5] The ban on naked short selling remains in place following the passage through parliament of the Corporations Amendment (Short Selling) Bill in December 2008.

2.4 In anticipation of the lifting of the covered short selling ban on 19 November, on 28 October ASIC announced the disclosure requirements that would apply to covered short sales. Sellers are required to inform brokers whether a sale is a short sale, and brokers in turn are required to inform the ASX. The regulator then provides a daily report at 9.00am each day of short sales executed for the 24 hours up to 7.00pm the previous day.[6]

2.5 The passage of the Corporations Amendment (Short Selling) Bill legislated to set up a disclosure regime for covered short selling that broadly reflects ASIC's previous announcement. Details of the disclosure of short selling data will be dealt with by regulation following consultation with the industry.[7]

2.6 The committee was interested in why such strong measures had been taken to curtail short selling activities since the previous ASIC oversight hearing. While noting that 'liquidity and price discovery are important contributions that short selling can make', ASIC indicated that circumstances had changed since its meeting with the committee in June:

> In the period leading up to our last meeting we had taken the view that the way that short selling was operating in the market was not showing disorderly aspects that concerned us, hence we left the short selling to play out, although we and the ASX did say to government that there should be better disclosure of so-called covered short selling.[8]

2.7 ASIC told the committee that global financial market turmoil and regulatory moves in other jurisdictions led to ASIC implementing what it described as a 'circuit breaker':

> The issues that were concerning us were the lack of confidence in the market, with buyers staying out and short sellers using strategies to push down prices, and also allegations of false market rumours. We felt that we

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4 ASIC, 'ASIC extends ban on covered short selling', *Press release*, 21 October 2008

5 ASIC, 'ASIC extends ban on covered short selling of financial securities', *Press release*, 21 January 2009

6 ASIC, 'Requirements for disclosure and reporting of short sales from 19 November 2008', *Press release*, 28 October 2008

7 Senator The Hon. Nick Sherry, 'Government to legislate for better regulation of short selling', *Media release*, 13 November 2008

8 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 2

> needed a circuit-breaker to come into line with what was happening internationally.[9]

2.8 ASIC also explained the reason why financial stocks continued to be subject to the short selling ban:

> …short selling coupled with rumours can actually depress prices further. In the case of financials, that is an extremely worrying issue. If the stock price of a financial gets to a particular level it runs a risk of being rerated for credit purposes, so it might drop from AA to something else. That, of course, is your worst nightmare because that then precipitates a further decline, and, of course if you are the short seller, you keep shorting the stock.[10]

2.9 In response to a question on notice about the effect the ban had had on market liquidity, ASIC stated that trading had decreased following the ban but that it was difficult to attribute a causal relationship between the ban and reduced trading:

> ASX's monthly activity report released for the November period revealed a decrease (9%) in trades during the period of the short selling ban when compared to the period from 1 July to the commencement of the ban on 22 September. Given the volatility in market activity internationally, we are unable to assess whether that decrease is directly related to the short selling ban.
>
> An examination of price levels, volatility and liquidity does not provide a clear view about the effect of the ban in Australia. However, none of these indicators suggest that ASIC should not have placed the bans. ASIC's action to ban covered short selling of all quoted stock was necessary when considering the aims it set out to achieve, that is, to act as a circuit breaker to assist in maintaining confidence in Australia's financial markets; as a response to bans imposed overseas; and to deal with high levels of rumourtrage.[11]

2.10 With the passage of the Corporations Amendment (Short Selling) Bill through the parliament in December 2008, there has also been considerable debate about the disclosure regime for covered short sales. As referred to above in paragraph 2.4, under ASIC's applicable class order clients are required to advise brokers whether a sell order is a short sale, with brokers required to advise the ASX daily of gross short sales executed on the previous day. Whether this system will be retained under the regulations to the *Corporations Amendment (Short Selling) Act 2008* has yet to be determined by the government.[12]

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9 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 2

10 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 16

11 Appendix 2, question 12

12 Appendix 2, question 16. See also ASIC, *Class Order CO 08/752*

2.11 ASIC informed the committee that it would be consulting with industry about the disclosure regime until the end of January 2009, when the ban on covered short sales of financial stocks is likely to be lifted:

> …there are issues around whether reporting should be net or gross and whether daily reporting is needed, but we will talk to industry and the ASX over the next couple of months and particularly to the industry associations. We will also continue to talk to our fellow regulators, the RBA, APRA and Treasury in particular, and we hope through that to improve the disclosure regime for the market.[13]

2.12 Acknowledging that there would be different views on how the disclosure regime might operate, particularly from traders who do not want their short positions disclosed, ASIC indicated that its preference is for the market to have all the information ASIC has received:

> …is the market better by not having it disclosed or having it disclosed? We are saying that it is better to disclose it and let the traders sort it out rather than holding the information and then the market is not aware of how much of the trading that has gone on is covered by borrowed stock.
>
> … … …
>
> At the moment the disequilibrium is that covered short selling goes on in the market but the rest of the market does not know the extent of the short selling of a particular stock or what percentage of its capital is being shorted. We think that the best place to put that information is in the market, not for it to be held by ASIC and then for ASIC to decide when it will choose to release that data.[14]

2.13 Officials emphasised that the steps they have taken were not perfect and would continue to be refined but were a 'significant move in the right direction'.[15]

2.14 ASIC also told the committee of its involvement with international regulators in better co-ordinating regulatory responses:

> …it has become more fundamental for ASIC through its good international credentials and its role on IOSCO, which comprises 95 per cent of the world's capital markets regulators, to be part of the reform agenda. At present our work on IOSCO will essentially be to advise government here and have input where we can on the reform agenda, which will necessarily unfold as we look back on what precipitated the crisis and what has occurred. We are involved in some specifics around that such as the short selling task force. We think it is important that short selling be treated as a

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13 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 2. The foreshadowed January lifting of the ban on shorting financial stocks did not ultimately occur. At the time of writing this report, the ban on covered short sales of financial stocks had been extended to 6 March 2009.

14 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, pp 18-19

15 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 19

> global issue. Because different jurisdictions have different systems, different disclosure regimes and different prohibitions, in the heat of mid-September and in October the leading capital markets were taking different positions, which made it much more difficult for Australia to position its short selling regime.[16]

2.15 Officials emphasised the importance of understanding the broader international regulatory environment:

> For Australia it is quite important that we are there, because we have a small market, and what you do not want is not to know what the settings are so that government can assess whether it will take those settings into account when it formulates policy.[17]

2.16 In response to a question on notice, ASIC indicated that 'the common international principles that will be developed as a result of the IOSCO Technical committee task force will inform [the content of the disclosure regime]'.[18]

Committee comment

2.17 The committee is of the view that short selling serves an important function in assisting with liquidity and price discovery in the market. The rationale for banning short selling seems to be underpinned at least in part by the regulators' inability to prevent unlawful profiting from short selling during volatile periods via spreading false market rumours (for instance, on impending margin calls) or insider trading. The committee will monitor the effectiveness of the new disclosure regime closely to ensure that improved transparency assists in identifying and prosecuting such practices and removes the need for such drastic action in the future.

2.18 With respect to using the regime to inform the market, the committee's preference is for more transparency about short selling in the market rather than less, in line with the view expressed by ASIC at the committee's hearing. Market participants should be able to identify the extent of shorted stock without undue delay, and traders can manage their short positions accordingly.

2.19 The committee also welcomes ASIC's involvement with other regulators at the international level. It is important that Australia understands the global regulatory environment when formulating its own capital market regulation and that Australia contributes to a more consistent global approach to issues such as short selling. For a small yet interconnected market such as Australia's, such consistency is important when establishing our own regulatory settings.

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16 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 4

17 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 10

18 Appendix 2, question 16

Freeze on redemptions from mortgage funds and cash management trusts

2.20 On 12 October 2008 the government moved to provide an unlimited guarantee for all bank deposits in Australian accounts. This was introduced to support confidence in Australian banks in an environment where stressed banks in other jurisdictions had been given similar protection. However, the guarantee does not cover cash management trusts and mortgage funds, prompting investors to shift their money to government-backed bank deposit accounts. In order to maintain stability, many of the affected (non-guaranteed) funds responded by putting a freeze on redemptions. On 24 October the government applied a fee for deposits above $1 million to reduce the distorting effects of investors accessing the guarantee, and on 31 October ASIC announced that it would provide regulatory relief to enable withdrawals from frozen funds on hardship grounds.[19]

2.21 The operators of the frozen schemes apply the hardship provisions where a request is made by a member of their scheme. Trustees may provide hardship payments only where the hardship criteria are met, and they are required to comply with their statutory duty to act in the best interests of the members of the scheme as a whole.[20]

2.22 ASIC reported that the freeze on mortgage trust redemptions had been widespread: 'something in the order of 52 or so mortgage trusts have frozen redemptions, which affects about $30 billion of the $32 billion of that market'.[21] ASIC officials indicated that it was too early to collect accurate information on the extent of applications for allowing partial redemption on hardship grounds. However, in evidence ASIC suggested that, as of 28 November, around 100 to 110 applications had been made across three or four funds.[22]

2.23 ASIC declined to comment on the policy merits of the government's bank deposit guarantee. Officials told the committee that their role in this area relates to the following:

> We see our role as being, now that it is in place, first in the broad area of misleading and deceptive conduct and making sure that the products that have the guarantee and those that do not are clearly differentiated, for example, so that there is no misleading conduct in the market in the way that the guarantee may be administered. Secondly, we are looking…at the mortgage trust area to see where we can assist with hardship relief if areas of those markets have their assets frozen for a period. So our work is very

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19 ASIC, 'ASIC facilitates withdrawals from frozen funds', *Press release*, 31 October 2008. Hardship grounds include inability to meet immediate living expenses; compassionate grounds such as medical costs or pending foreclosure; and permanent incapacity.

20 See Appendix 2, question 5

21 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 2

22 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, pp 28-29

> much centred on looking at how the market is handling the guarantee and responding.[23]

Committee comment

2.24 The committee understands that ASIC's responsibility is for administering the hardship provisions applying to frozen funds, rather than for the bank deposit guarantee that led to this occurring. The committee will seek further information about the application of this relief at its next oversight hearing, when events relating to the guarantee have unfolded.

Credit rating agencies

2.25 Investor reliance on credit rating agencies' (CRAs') positive assessments of complex securitised debt products that subsequently failed was a contributor to the financial crisis spreading as widely as it did. The complexities of the products and CRAs' conflicts of interest in rating them have been suggested as reasons for their inaccurate ratings.

2.26 In August ASIC announced that it was working with Treasury on a review of how CRAs operate.[24] This review included investor reliance on CRAs' assessments, the diligence taken in making assessments, and possible conflicts of interest. On 13 November Minister Sherry announced that the regulation of CRAs is to be reformed. This includes removing the exemption from holding an Australian Financial Services Licence and requiring CRAs to issue an annual compliance report, which includes reporting on rating processes and managing conflicts of interest.[25]

2.27 ASIC told the committee that it would be responsible for administering the new arrangements:

> …credit rating agencies is a priority of the government that will occupy us. We agree with that priority and will be moving to remove the current exemptions of mid-CRAs not to hold AFSL licences. We will be also moving on requiring credit rating agencies to produce to ASIC annual compliance reports outlining in detail how the credit rating agencies have complied with the IOSCO code of conduct, which is a fundamental underpinning to the licensing regime.[26]

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23 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 9

24 ASIC, 'ASIC outlines market turmoil response to financial services industry', Press release, 7 August 2008

25 Senator The Hon. Nick Sherry, 'Improved Australian controls for credit rating agencies and research houses', Media release, 13 November 2008

26 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 4

Committee comment

2.28 The assessments of CRAs contributed to the ill-founded market confidence in securitised debt products that triggered the current financial and economic crisis. The committee therefore commends any action taken to address deficiencies in the way CRAs perform their functions. It will seek further information from ASIC at future oversight hearings to determine the effectiveness of these proposed measures.

Market regulation

2.29 ASIC's responsibility for investigating and prosecuting instances of insider trading, false rumours and market manipulation continues to be of interest to the committee. In its August 2008 oversight report, the committee called on ASIC to improve the way it cooperates with the ASX to act against these practices, to ensure investors have confidence in the market.

2.30 Strategies for cracking down on insider trading and market manipulation are currently being considered as part of a review being conducted by the Corporations and Markets Advisory Committee (CAMAC). One of the matters referred to CAMAC by the Minister for Corporate Law and Superannuation, Senator Nick Sherry, is the spreading of false and misleading information to benefit from artificial movements in price.[27] CAMAC has been asked to look at the way overseas jurisdictions regulate this practice and propose regulatory change if necessary.[28]

2.31 This follows ASIC's Project Mint investigation into the effect of false rumours and collusion on market integrity, launched in March 2008. Although not complete, ASIC told the committee that the project had established that the burden of proof required and the elusive nature of rumours made prosecutions difficult. ASIC officials suggested that the most useful leads come from direct complaints and that some brokers could do better in preventing the circulation of rumours.[29]

2.32 ASIC stated that dealing with insider trading and market manipulation had been given high priority by the regulator:

> We have worked hard in cooperation with ASX to deal with the referrals that we get … in addition to added resources within ASIC to that sector, principally headed by Commissioner Belinda Gibson. The benefits of that work are coming through with the prosecutions and the referrals to the DPP … and I think you will see more of the benefits of that going forward.[30]

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27 Senator The Hon. Nick Sherry, 'Action to further enhance market integrity', *Media release*, 19 November 2008

28 Senator The Hon. Nick Sherry, *Letter to CAMAC Convenor*, 19 November 2008. CAMAC is due to report on its findings by 30 June 2009.

29 Appendix 2, question 24

30 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 5

2.33 ASIC reported that:

> Since January this year the ASX has referred to us some 90 instances of insider trading, market manipulation and market conduct. All of them have been actioned. Currently we have 12 of those matters before the court—two insider trading matters, five market manipulation matters, two on continuous disclosure, one on directors' duties, one on misleading statements and one on short selling—and another 11 matters before the Commonwealth Director of Public Prosecutions. Our work on rumourtrage, in the sense of coming down as hard as we can on false rumours in the market has continued, and our so-called Project Mint has extended its inquiries to deal with those investigations and those issues.[31]

2.34 The committee heard that ASIC had systems in place to identify unusual trading activities that may indicate rumourtrage and market manipulation:

> The ASX has a technological system that oversees the market and alerts us to odd activities or things that are outside the projected normal bands, and that will lead us to look into what might be manipulative, which is more often a course of trades over a time frame that look to be odd and out of the ordinary course. We also look for spikes in trading, which tends more to suggest inside trading or an inside deal. What we then have to do on the rumourtrage is tie back where we hear of a rumour or believe that there is a rumour in circulation and look at what happened to the course of trading, so that it is a matter of linking fact of rumour to course of trading and, if at all possible and ultimately if prosecution is to proceed, linking the party doing the trading to the rumour.[32]

2.35 In response to a question on notice ASIC advised that referrals for insider trading and market manipulation in the calendar year 2008 were more than double that of the 2005/2006 financial year.[33]

2.36 There have been suggestions that some of the ASX's market supervision responsibilities may be shifted to ASIC. These are a result of criticism that the ASX is conflicted in its dual role of market operator, where there is an incentive to maximise trading volumes, and market regulator.[34] The possibility of the government ending the ASX's monopoly on market services would also have implications for its regulatory role, given the conflicts associated with regulating its competitors.

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31 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 3

32 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 22

33 Exact figures are contained in Appendix 2, question 2.

34 See for example Gray, J. 'Pressure grows to strip ASX of its regulatory power', *Australian Financial Review*, 22 May 2008, p. 1

2.37 ASIC informed the committee that it had advised the government on market competition licensing and that the matter is now with the government for their decision.[35]

Committee comment

2.38 It is critical that investors have confidence in the regulators' ability to identify and prosecute insider trading, false rumours and market manipulation. The committee recognises that the complex and elusive nature of these activities makes it a difficult task for ASIC. Project Mint and the recently announced CAMAC review are welcome initiatives designed to better tackle the problem, and the committee encourages ASIC to continue to work closely with the ASX in identifying these practices.

ASIC strategic review

2.39 At the committee's previous oversight hearing ASIC outlined a number of changes within the organisation following its strategic review. This included additional investment in market research and analysis, the planned appointment of an external advisory panel, a major staffing restructure and improved staff development. In August, ASIC announced its senior executive appointments within the new stakeholder and deterrence teams.[36] In response to a question on notice, ASIC indicated that since the restructure there had been only a slight increase in staff turnover from the corresponding period last year, but that ASIC had 'not experienced any significant increase in exits from the organisation'.[37]

2.40 The strategic review followed a survey of the regulator's stakeholders in April 2008, which highlighted mixed opinions about ASIC's performance. There was a view that ASIC is process-driven and concentrates on prosecuting easy targets. Only 21 per cent of respondents agreed with the proposition that ASIC was good at identifying emerging problems, while the survey results also indicated a lack of confidence in ASIC's ability to identify and prosecute instances of dishonesty and misconduct, and insider trading and market abuse.[38]

2.41 ASIC told the committee that the stakeholder survey was an important basis for the strategic review:

> Feedback is important if you are going to make changes. We did a strategic review of the organisation and made changes that we felt were needed but

35 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 10

36 ASIC, 'ASIC announces executive appointments', *Press release*, 22 August 2008

37 Appendix 2, question 40

38 Allen Consulting Group, *ASIC Stakeholder Survey*, April 2008, pp. 13-24. For some discussion of the results of this survey, see also *A year of change: ASIC Annual Report 07-08*, ASIC, 1 August 2008.

> we felt that we needed a base, and the best base is to talk to your customers or to your stakeholders.[39]

2.42 The response has been to better develop skills within the organisation and improve technological efficiencies:

> Firstly, it is essentially about training to develop skills and the development of people so that they are much more in tune with the market and understand what is happening so they can give a quick response. Secondly, in terms of systems and processes, ASIC registers 1.3 million companies a year and licenses 11,000 people, and we are using technology to allow people to deal with us more efficiently.[40]

2.43 The committee sought information about the progress of the changes in ASIC following the review.[41] ASIC told the committee that its recruitment had been assisted by instability in the financial markets:

> We were very pleased with the external recruitment process and now that we are filling other positions below the senior positions pleased with the applications we are getting. The number of applications are significant. We accept the fact that that is also to do with the current state of the financial markets, but we are going to take it as an opportunity to add skills and talent within ASIC as we fill vacant positions going forward.[42]

2.44 The committee also heard of the need to bring a cultural change to the organisation through a 're-education program':

> We have had to turn our staff from processors to thinking about the market first. We are doing a lot of leadership training of staff at the most senior level and trailing that through the organisation so they can look at something and say: 'Does this matter? Why does it matter? What can we do to make a difference?' That is going to take time, but certainly less than the two years. There is a mindset to change.[43]

2.45 However, ASIC emphasised that the benefits would take some time to become apparent:

> That training and development and improvement in technology will take place over the next two, three, four or five years. If we did a survey tomorrow I do not suggest that you would see much of a change in the score, but in two years time, when we intend to do another survey, I would

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39 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 11

40 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 12

41 These were outlined in the committee's previous report. See Joint Parliamentary Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, August 2008, p. 5.

42 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 6

43 Ms Belinda Gibson, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, pp 13-14

> expect to see the sorts of things that I have just spoken about pushing up satisfaction quite significantly.[44]

2.46 ASIC also told the committee that its external advisory panel had not yet been appointed. Officials indicated that the current regulatory issues facing ASIC have confirmed the panel's potential benefits.[45]

2.47 From a strategic perspective, ASIC suggested that the success of its new approach is still to be proven:

> The way we responded to the mortgage trust issue, the way we dealt with the hardship issue and with short selling, I think it is fair to say…are steps that ASIC has not taken in the past. So we are seeing the benefits of what we are talking about, but we are the first to concede that with a new structure, a new approach, we are still to prove that it will all work…[46]

Committee comment

2.48 The committee supports the changes arising from ASIC's strategic review and commends the regulator's honesty in publishing the disappointing findings from its stakeholder survey. The timing of the financial crisis has assisted with recruitment and ASIC should work hard to retain the expertise as a consequence. The committee can also see the potential benefits of ASIC receiving guidance from its external advisory panel and encourages ASIC to appoint this panel as soon as possible.

Budgetary issues

2.49 Issues stemming from the global financial crisis and the shifting of credit regulation from the states to the Commonwealth have increased demands on ASIC considerably. The committee was interested to ascertain whether ASIC's budget was adequate to effectively handle the increased workload. The committee was told that ASIC's work on short selling, mortgage trust redemptions, additional credit regulation from the states, credit rating agencies and the Financial Literacy Foundation were significant responsibilities that they were dealing with. ASIC officials outlined the budgetary implications for the agency as such:

> The current position with our budgets is that we said to government that for the 2008-09 year we felt confident that we could work within the existing budget settings. Recently, through the Prime Minister's allocation for this financial year, we were allocated an additional $10 million for the crisis work.
>
> …

44 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 12

45 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 7

46 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 7

> For this financial year we have enough resources to do what we want to do, and our NPP proposal for the next three to four years is currently with government. In addition to that, again through the Prime Minister's allocation, or the Treasurer's allocation, an additional $20 million has been set aside for next year, even before we go through that NPP process. As a commission, we feel that we have the resources at this point to be able to do what we are doing.[47]

2.50 In response to a question taken on notice, ASIC advised the committee that the government had provided ASIC with $66 million to regulate consumer credit nationally.[48]

Superannuation

2.51 In July ASIC released a consultation paper on the best way for superannuation funds to facilitate calculations for members seeking to estimate their necessary contribution levels.[49] It is difficult for members to decide on contribution levels without some guidance as to how much will be required to meet retirement income needs. However, there are presently difficulties for superannuation funds wishing to provide members with projections because they are deemed to constitute personal advice under section 766B of the Corporations Act. Offering personal financial advice requires an Australian Financial Services Licence.

2.52 The committee heard that superannuation projections were an important element of getting people to engage with the task of managing their retirement income. However, ASIC cautioned that work would need to be done to ensure that the projections offered do not constitute ironclad representations about retirement income:

> …whatever you call it, you are almost representing to people what they are going to have in retirement. As we have seen, this year equity markets have fallen by round about 50 per cent. So in making these kinds of predictions to the entire superannuation population of 10 million-odd people, some very deep issues are going to have to be worked through. We think it is a very worthwhile project and that people should have this snapshot, this picture, but one has to be very careful that it is not an ironclad representation. After all, these are accumulation funds.
>
> …
>
> …ultimately there will be pretty ironclad assumptions, and inflation rates, earnings rates and those kinds of things are all going to have to be very carefully looked through, probably through the Australian Government Actuary.[50]

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47 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 14

48 See Appendix 2, question 1

49 ASIC, 'ASIC advocates super snapshots – a wake-up call on super', *Press release*, 28 July 2008; ASIC, 'Superannuation forecasts', *Consultation Paper 101*, July 2008

50 Mr Jeremy Cooper, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 24

2.53 As well as making sure the assumptions used by superannuation account holders are appropriate, ASIC indicated that liability issues where projections have been wildly inaccurate would also need to be addressed.[51]

2.54 ASIC's shadow shopping exercise was again raised by the committee. In its last ASIC oversight report the committee criticised the regulator for not yet repeating its successful superannuation shadow shopping survey. In response, ASIC told the committee that it would maintain its planned timetable:

> At the moment we think there are a lot of issues in the market that we need to deal with and we are not sure that in the current crisis situation that accelerating the shadow shopping is the way to go, but certainly it is for us to do.[52]

Committee comment

2.55 Superannuation projections are crucial in assisting people in assessing the level of contributions they need to make towards their retirement income. The fact that the law does not facilitate superannuation funds offering projections to individual fund members hampers the likelihood of them making informed decisions about their superannuation contributions. This has clear implications for Australia's aged pension liabilities in the future. The committee recognises the risks associated with superannuation funds using calculators as a potentially misleading advertising device, but a solution to this problem is overdue. The committee therefore suggests that, despite its other pressing responsibilities, ASIC pursues further work in this area as a matter of urgency.

Financial literacy

2.56 ASIC is also responsible for improving financial literacy amongst Australians to better equip investors to make appropriate investment decisions, mitigating the extent of the harm caused by investment scheme collapses, low-ball share offers and other disreputable investment products. In the context of banking and credit regulation, in particular the risks associated with reverse mortgages, the committee previously suggested that ASIC make greater efforts to gain mainstream press coverage about risky credit products.[53]

2.57 ASIC responded to this suggestion in evidence at the hearing:

> Within the retail investor consumer area ASIC now has dedicated teams on financial literacy and a dedicated team on investor education. We think that through those teams we will do more to educate investors, and clearly things like seniors' magazines and the press will be part of the focus on

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51 Mr Jeremy Cooper, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 24

52 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 5

53 See Joint Parliamentary Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, August 2008, p. 11

> getting across the message on what really are some fairly fundamental and simple principles about asset allocation, diversity of portfolio, understanding price reward premiums on products and the risk profile.[54]

2.58 The committee notes that the collapse of Storm Financial Limited occurred after its hearing with ASIC in November. ASIC's investigation into this matter will be dealt with at the committee's next oversight hearing.

Committee comment

2.59 The committee acknowledges the ongoing work being done by ASIC and government to improve standards of financial literary amongst Australians, including through the publication of ASIC's 'fido' website outlining financial tips and safety checks for consumers.[55] However, the committee reiterates its position that mainstream press coverage is the most effective way of educating Australians about important investment principles. In particular, ASIC should be more visible in promoting these messages when stories about investment scheme collapses are broadcast in the mainstream media.

Professional indemnity insurance

2.60 The committee's previous ASIC oversight report addressed the new compulsory professional indemnity arrangements for financial planners.[56] The committee was again interested to know whether the regime was operating effectively, particularly with respect to the availability of adequate insurance cover. ASIC told the committee that it was assessing whether the new scheme is working:

> The stresses on that are the availability of professional indemnity insurance, its cost and its adequacy in the event of issues occurring. When we implemented the regime we told the market that we would look at it over a two-year period and give government feedback whether the professional indemnity approach to protecting those who get advice from financial planners is adequate or not. We are about 12 to 15 months into that, I think, so we are going to look pretty carefully over the next six months at what issues are unfolding…

2.61 The committee will welcome further information from ASIC on the adequacy of professional indemnity insurance cover at its next oversight hearing.

Mr Bernie Ripoll MP
Chairman

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54 Mr Tony D'Aloisio, ASIC, *Proof Committee Hansard*, Canberra, 28 November 2008, p. 5-6

55 See http://www.fido.gov.au/fido/fido.nsf

56 Joint Parliamentary Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, August 2008, p. 9

Appendix 1

Public hearings

Friday 28 November 2008 — Canberra

Australian Securities and Investments Commission

Mr Tony D'Aloisio, Chairman

Mr Jeremy Cooper, Deputy Chairman

Ms Belinda Gibson, Commissioner

Appendix 2

Answers to questions on notice

Question on Notice 1

Credit regulation takeover funding (Senator Boyce, Hansard p. 15)

Senator BOYCE—And how much is that?

Mr D'Aloisio—I think the government has announced it but I will need to check it for you, Senator. I think it is of the order of $70 million, but we might check that.

Response:

The Government has provided $66 million to nationally regulate consumer credit. (Taken from the Hon Nick Sherry's Media Release, New Commissioners Appointed to the Australian Securities and Investments Commission)

Question on Notice 2

Referrals from the ASX (Senator Boyce, Hansard p. 22)

Senator BOYCE—But has the number of companies that you are being alerted about changed?

Ms Gibson—We have received a lot more referrals from ASX this year than in prior years. I do not have the exact figures with me, but certainly—

Senator BOYCE—Can you give some sort of sense of the number?

Ms Gibson—I would be inclined to say double but I think that is overstating it. But it is—

Senator BOYCE—So we are talking about a hundred companies or a thousand companies?

Ms Gibson—We have had 86 referrals from the ASX this year on continuous disclosure, market manipulation and insider trading. My sense of it is that market manipulation has been significantly more, but, Senator, I would need to come back to you with the exact figures on past referrals on those.

Senator BOYCE—I would be interested in any more information you can give me on that.

Response:

ASIC becomes aware of potential breaches of market rules through ASX referrals, complaints made directly to ASIC and initiating its own surveillances. ASX referrals to ASIC during recent years are as follows:

	ASX REFERRALS		
Misconduct	**2005/2006 (financial year)**	**2006/2007 (financial year)**	**2008 (from 1 January to 24 November)**
Continuous Disclosure	7	22	20
Insider Trading	17	20	28
Market Manipulation	5	9	19

Question on Notice 3

Dodrill matter (Mr Ripoll MP, Hansard p. 30)

CHAIRMAN—I also put on the record that at our last meeting I raised the issue of the Dodrill matter out of Queensland, so could we again pursue not only that situation but also the related issue of where we draw the line in the sand in dealing with specific issues that are raised with ASIC?

Response:

As previously advised (QON 11, August 2008 ASIC Oversight Report), Mr Dodrill has raised a number of complaints against JMD Queensland (ACN 097 200 381), The Irish Restaurant and Bar Pty Ltd (ACN 073 727 205) and American Pie Restaurant Pty Ltd (ACN 098 180 011). On each occasion ASIC has assessed the matter and determined not to take any action. There is no ongoing action in relation to this complainant.

Question on Notice 4

Freeze on redemptions (additional Question on Notice, Senator Boyce)

How many written, phone and email complaints has ASIC received from investors related to the freezing of redemptions? Please outline the types and grounds for the complaints made? Are the hardship provisions adequate to meet the needs of investors?

Response:

Since our announcement on 31 October 2008 to 12 December 2008, we have received 137 calls and 28 complaints specifically relating to the hardship relief and/or frozen funds.

For the period 1 January 2008 to 12 December 2008, we have received 142 calls and 58 complaints specifically relating to the hardship relief and/or frozen funds.

The relief which ASIC has stated it is prepared to provide allows members of frozen funds suffering hardship to access the lesser of:

- the specific amount the subject of a member's hardship withdrawal request; and

- $20,000 plus 50% of the balance of the member's interest in the scheme.

ASIC is not aware of the needs of each member within a frozen fund, however the funds available under the cap would provide a significant injection of money to members suffering hardship. ASIC decided to cap the amount of hardship withdrawals to minimise the disadvantage experienced by other members of the fund who are not permitted to withdraw their investments.

Question on Notice 5

Freeze on redemptions (additional Question on Notice, Senator Boyce)

What process is used to decide if an applicant meets the hardship criteria? Could ASIC outline the process for an individual seeking redemption?

Response:

The relief to facilitate hardship withdrawals does not mandate a process by which the operator of a frozen scheme administers requests for hardship withdrawals. Individual operators, who have a better understanding of the needs of their members, are responsible for determining the hardship withdrawal process. However, the relief does require operators to only permit hardship withdrawals under three specific criteria:

- where the member is unable to meet reasonable and immediate family living expenses;

- on compassionate grounds (e.g. medical costs for serious illness, funeral expenses, to prevent foreclosure); and

- in the case of permanent incapacity.

The operator of the frozen fund has the responsibility of deciding whether an application for a hardship withdrawal meets, or does not meet, the hardship criteria. The operator must exercise its discretion in considering hardship applications in a reasonable manner and must maintain appropriate documentation of the decisions it makes.

In deciding hardship applications, the operator must comply with its general statutory duties including the duty to act in the best interests of the members of the scheme, to act honestly and to exercise the degree of care and diligence that a reasonable person would exercise.

Question on Notice 6

Freeze on redemptions (additional Question on Notice, Senator Boyce)

Does ASIC investigate the validity of hardship claims or simply accept the information provided?

Response:

The responsibility of deciding whether to permit a hardship withdrawal lies with the operator of the frozen scheme. The operator must be satisfied the hardship claim is valid before permitting a withdrawal. The relief ASIC provides to operators is conditional on operators only permitting hardship withdrawals where one (or more) of the criteria is met.

Question on Notice 7

Lifting of bank guarantee (additional Question on Notice, Senator Boyce)

What consideration has ASIC given to the consequences of the eventual lifting of the bank-based guarantee is lifted?

Response:

The bank-based deposit guarantee is a policy matter for the Government. ASIC's role, as part of the Council of Financial Regulators, is to administer the arrangements that are in place.

Question on Notice 8

Credit rating agencies (CRAs) (additional Question on Notice, Senator Boyce)

What will be contained in the annual compliance report?

Response:

The annual compliance statement will report on CRAs' compliance with the revised IOSCO Code of Conduct Fundamentals for CRAs (May 2008) (IOSCO Code). The annual compliance statement will emphasise the quality and integrity of ratings processes and arrangements to adequately manage conflicts of interest. For example, CRAs would report on whether they have adopted measures so information underlying ratings is of sufficient quality and from reliable sources and that there are systems and adequate resources to update ratings periodically and in light of new market intelligence.

Question on Notice 9

Credit rating agencies (CRAs) (additional Question on Notice, Senator Boyce)

What is the process that ASIC will take to determine whether the reports are satisfactory? Will ASIC take action if a report is deemed to be unsatisfactory and if so, how

Response:

ASIC will review the annual compliance reports against the IOSCO Code. If necessary following review of the report, ASIC may undertake monitoring and surveillance work (for example compliance visits) to verify that CRAs are displaying the behaviours needed to restore confidence in their activities and are complying with their Australian Financial Service licence obligations, conditions of their licence and the IOSCO Code.

Question on Notice 10

Credit rating agencies (CRAs) (additional Question on Notice, Senator Boyce)

What is the procedure for holding CRA's accountable for corporate misinformation and disinformation or for unanticipated movements in a volatile market?

Response:

Following the sub-prime crisis, concerns were raised about the failure of CRAs to identify particular market risks associated with structured financial products. The IOSCO Code was revised to address these concerns. CRAs will be required to report on their compliance with the revised IOSCO Code in their annual compliance statement. CRAs will also be required to obtain a licence with specific licence

conditions dealing with disclosure of CRAs' procedures, methodologies and assumptions and processes for keeping ratings current.

Question on Notice 11

Short selling (additional Question on Notice, Senator Boyce)

Will investors be less likely to short sell under the new disclosure requirements? Would ASIC like to see the amount of short sales lowed, and if so, why?

Response:

The policy embodied in the Corporations Act (as newly amended by the short selling legislation) is that naked short selling is banned but covered short selling is permitted subject to disclosure. ASIC is responsible for administering that policy.

Question on Notice 12

Short selling (additional Question on Notice, Senator Boyce)

Did the ban on short selling have an adverse effect on market liquidity? How would the market have benefited from the liquidity created by short selling whilst investment funds were being frozen?

Response:

ASX's monthly activity report released for the November period revealed a decrease (9%) in trades during the period of the short selling ban when compared to the period from 1 July to the commencement of the ban on 22 September. Given the volatility in market activity internationally, we are unable to assess whether that decrease is directly related to the short selling ban.

An examination of price levels, volatility and liquidity does not provide a clear view about the effect of the ban in Australia. However, none of these indicators suggest that ASIC should not have placed the bans. ASIC's action to ban covered short selling of all quoted stock was necessary when considering the aims it set out to achieve, that is, to act as a circuit breaker to assist in maintaining confidence in Australia's financial markets; as a response to bans imposed overseas; and to deal with high levels of rumourtrage.

Question on Notice 13

Short selling (additional Question on Notice, Senator Boyce)

What type of measure will be used to disclose information about short sales to the market? Who would be responsible for reporting short sales?

Response:

The Corporations Amendment (Short Selling) Act 2008 sets out the framework for disclosure and reporting of covered short sales. It requires a seller to inform the broker if a sale is a covered short sales, and for the broker to inform the market operator. The market operator must publicly disclose the reported short sale information.

Further details of the disclosure regime (including timing and manner) are yet to be determined by government. It may be the government decides to continue with the disclosure and reporting regime imposed under ASIC class orders or otherwise.

ASIC's current disclosure regime for short selling requires reporting by brokers to the ASX of each day's short sales for a security (ie gross short sales). The ASX releases to the market aggregate daily short sales by security the next trading day.

Question on Notice 14

Short selling (additional Question on Notice, Senator Boyce)

What type of reporting exemption would be taken to take small trades into account?

Response:

A small trade exemption would allow small traders to avoid compliance costs, however, such an exemption would also compromise the accuracy of reported figures and may be inconsistent with the desire to capture data reflecting actual levels of short sales executed in a stock. The current interim disclosure regime imposed by ASIC's Class Order does not provide such an exemption.

It is open to the government providing a small trade exemption in the regulations to the Corporations Amendment (Short Selling) Act 2008.

We are aware of reporting exemptions provided in overseas reporting regimes to take small trades into account. For example, in the jurisdictions of the other regulators contributing to the IOSCO Task Force for short selling, the disclosure regime is only triggered for short positions above certain thresholds. These disclosure regimes differ on thresholds as well as other aspects. The government will be informed by the outcomes of the IOSCO Task Force on short selling.

Question on Notice 15

Short selling (additional Question on Notice, Senator Boyce)

What is world best practice for the release on short sales to the market?

Response:

There is currently no consensus on this point. Given the integrated and international nature of financial markets, it is important for international regulators to co-ordinate ways to deal with short selling. An International Organisation of Securities Commission (IOSCO) Technical Committee Task Force has been formed to develop common international principles for the regulation of short selling to eliminate gaps in various regulatory approaches to naked short selling, and to examine how to minimise adverse impacts on certain transactions that are critical to capital formation and reducing market volatility.

Question on Notice 16

Short selling (additional Question on Notice, Senator Boyce)

What other developed countries use the short selling regime being adopted for Australia? If no other country has used this system, why is Australia adopting the system?

Response:

We assume this question relates to reporting. Under ASIC's class order, clients must advise their brokers at the time of placing a sell order whether it is for a short sale. Brokers are required to advise the ASX of the gross short sales executed on the previous day. ASX consolidates and publishes this data for the public.

Measures implemented by both ASIC and the Securities and Exchange Commission (SEC) in the United States now require real time recording of short sales. Some jurisdictions, such as the UK and Japan, require daily reporting by clients of gross short positions exceeding 0.25% of total issued stock, while other jurisdictions do not provide a threshold for reporting.

ASIC believes it is important that covered short sales only occur with appropriate disclosure in place. It was an important factor contributing to ASIC's decision to lift its ban on covered short selling without being confident that market participants were able to disclose levels of short sales occurring.

It is a matter for government to determine whether the disclosure regime currently imposed under ASIC's class order continues under the regulations to the Corporations Amendment (Short Selling) Act 2008. To this end, the common international principles that will be developed as a result of the IOSCO Technical Committee Task Force on short selling will inform this process.

Question on Notice 17

Short selling (additional Question on Notice, Senator Boyce)

What will be the lead times for brokers to make changes to their systems?

Response:

All brokers are currently reporting in accordance with the reporting regime required by ASIC. We have been and continue to work closely with industry and technology providers on systems issues associated with the disclosure regime.

We understand Treasury has been and will continue to consult industry with a view to inform the technical aspects of the regulations and consequent adjustments to reporting systems.

Question on Notice 18

Market manipulation (additional Question on Notice, Senator Boyce)

How will ASIC ensure that it and the ASX's role in detecting market manipulation will not overlap?

Response:

ASIC and ASX will continue to work closely in detecting issues. Under existing arrangements, where ASX detects unlawful market conduct, such as, market manipulation, ASX refers the matter to ASIC for further investigation. Both ASX and ASIC may initiate investigations.

Question on Notice 19

Short selling (additional Question on Notice, Senator Boyce)

How will the new reporting regime be a long-term solution to what ASIC sees as the problems caused by short-selling?

Response:

The new reporting regime meets a few aims. It assists market transparency of pricing pressures, for example, by providing an early signal that individual securities may be overvalued or that high levels of short selling may cause high stock lending utilisation. Reporting will also help to provide additional market confidence that regulators have access to data allowing it to detect market manipulation or other market abuse, and identify persons engaged in such activity. Reporting will also enable the regulator to identify transactions (and relevant parties) carrying potential settlement risks arising from short selling and stock lending positions.

Question on Notice 20

Short selling (additional Question on Notice, Senator Boyce)

How will the proposed rules enhance or prejudice the competitiveness of the Australian financial markets in comparison to other major foreign markets?

Response:

As mentioned, the technical aspects of the regime are yet to be decided by government. However, we note that other jurisdictions similarly require or have taken steps to require reporting and disclosure of short sales. The principles to be established by the IOSCO Technical Committee task force on short selling may inform the content of the proposed regulations.

An important factor to ensuring that Australian financial markets remain competitive is stability and confidence in the market. The proposed disclosure rules will provide a comprehensive set of short selling data to investors and regulators, thereby promoting confident and informed participation in a transparent market.

Question on Notice 21

Short selling (additional Question on Notice, Senator Boyce)

How do the proposed arrangements for the regulation of short selling ensure that investors are protected and not misled?

Response:

Although the Corporations Act required a level of disclosure for short selling, over time, the market developed a view that those obligations were only directed at naked short sales.

The arrangements under the Corporations Amendment (Short Selling) Act 2008 clarifies that these obligations also apply to covered short sales. These measures give investors access to information about levels of short selling activity occurring in the Australian markets (that is, transparency). Accurate information about levels of short selling will also enable ASIC to identify and address market manipulation and settlement risks, in that way, protect investors by enhancing the integrity of the market.

Question on Notice 22

Short selling (additional Question on Notice, Senator Boyce)

What is the procedure for protecting the confidentiality of hedged positions?

Response:

There is some concern that advising brokers in real time of short sales executed may comprise asset managers' proprietary research and could lead to front running by those brokers.

We note that these are risks already borne by traders in the market and some traders use techniques, such as using multiple brokers and splitting transactions, to mask their intentions if they have concerns.

Brokers have a fiduciary duty to their clients not to misuse confidential information.

Question on Notice 23

Stock lending for vote renting (additional Question on Notice, Senator Boyce)

How is ASIC regulating stock lending for vote renting purposes? Can ASIC outline how widespread the practice of vote renting is in the market?

Response:

Under stock lending arrangements, vote renting can occur where an investor 'borrows' shares in order to secure voting rights to influence the outcome of a company vote. ASIC regulates the following provisions that may apply in particular cases of vote renting:

- Section 671B of the Corporations Act requires a person to publicly disclose if they have voting rights over at least 5% of a listed company's shares. Therefore, significant acquisitions of voting rights must be disclosed to the market.

- Section 606 of the Corporations Act prohibits a person from obtaining voting rights over more than 20% of a company's shares unless an exception applies (such as approval by the company's shareholders).

We do not have precise data on how widespread the practice of vote renting is. But ASIC's regulatory experience over recent years does not suggest that there is widespread abuse of vote renting. Vote renting was also recently discussed in the PJC Report Better Shareholders – Better Company.

Question on Notice 24

Insider trading and market manipulation (additional Question on Notice, Senator Boyce)

What were the findings from Project Mint? Is the investigation ongoing? Can ASIC provide the precise terms of reference to Project Mint?

Response:

Findings

The project has yet to be completed. We are not in a position to comment on ongoing matters of investigation. However, general findings to date have included:

- The burden of proof for market misconduct cases and the 'transient' nature of market rumours makes prosecution challenging. There are evidentiary issues in establishing the rumour – source and flow. There is then an issue of materiality.

- The most useful leads to ASIC on rumours and market misconduct have come so far from direct complaints made to ASIC.

- The practices of brokers in terms of the prevention of the circulation of rumours differ significantly and can be improved.

Terms of reference

The project's objectives are broadly:

- Review allegations of market misconduct to assess whether enforcement action is required in particular cases

- Increase market compliance with section 1041A and 1041E of the Corporations Act.

- Improve brokers' and other market participants' practices in the handling of rumours.

- Increase ASIC's role in being a credible deterrent for market misconduct.

- Be responsive to complaints/whistleblowers.

Question on Notice 25

Insider trading and market manipulation (additional Question on Notice, Senator Boyce)

What information has Project Mint provided concerning the extent of the spreading of false and misleading information? Do you have the numbers of any prosecutions or investigations that have resulted from the project?

Response:

Project Mint has resulted in a number of parties expressing concerns about false and misleading information and has also resulted in ASIC obtaining documents that in some cases suggest information has been circulated in the market that may not be completely accurate. Our investigations into these matters are ongoing.

Question on Notice 26

Insider trading and market manipulation (additional Question on Notice, Senator Boyce)

What is the process that ASIC follows to prove the origin of false rumours?

Response:

Typically ASIC would seek to prove the origin of false rumours by:

- Gathering evidence. For example, we would gather information by communicating with parties who may have reported a rumour; reviewing trading data of certain stocks during specific trading periods; preparing and serving ASIC notices on market participants to gather documentary information or voice recordings they hold about particular stocks; interviewing market participants and entities the subject of rumours; and working with ASX and other regulators in reviewing data they have obtained.

- Undertaking Surveillance. For example, this can include on-site surveillance and interviews about trading activities with particular market participants (e.g. hedge funds and major brokers).

Question on Notice 27

Insider trading and market manipulation (additional Question on Notice, Senator Boyce)

What were the main findings of the review ASIC conducted last year on the regulations governing day traders on internet forums? How is ASIC cracking down on people using multiple online identities to manipulate share prices?

Response:

ASIC's review of internet forums, or internet discussion sites (IDS), is ongoing.

IDSs have been a source of concern in relation to their possible use for the purposes of market manipulation. Our current policy, set out in Regulatory Guide 162 Internet discussion sites (RG 162), was developed prior to the implementation of the financial services reforms in the Financial Services Reform Act 2001. It allows a limited kind of IDS operator to operate without a licence, provided that they comply with certain conditions set out in RG 162. These conditions require the giving of certain warnings and disclosures to IDS users.

ASIC will shortly be releasing a consultation paper, which will revisit our current policy on IDS, including through dealing with some recently raised concerns (e.g. ensuring warnings are given to users of these sites, looking at the potential for misconduct via discussion sites and the need for appropriate identification of users of these sites).

We intend to release the consultation paper in early January, with a 6--8 week consultation period. We will likely re-release RG 162 in updated form as soon as possible after consultation is completed.

Question on Notice 28

Market supervision responsibilities (additional Question on Notice, Senator Boyce)

How does the ASX's conflict of interest jeopardise the market? Can ASIC give examples?

Response:

As the holder of an Australian market license ASX is required to manage conflicts between its commercial interests and the need to ensure that the ASX market operates in a fair, orderly and transparent manner (section 792A(c)(i) of the Corporations Act 2001).

In ASIC's most recent Market Assessment Report about the ASX group dated 31 July 2008 which ASIC prepared pursuant to section 794C(3) of the Corporations Act, ASIC concluded that ASX adequately managed its commercial conflicts of interest over the period covered by the assessment.

Details of ASIC's most recent assessment of ASX's conflicts handling arrangements are set out in the Market Assessment Report, which is available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_135.pdf/$file/REP_135.pdf.

Question on Notice 29

Market supervision responsibilities (additional Question on Notice, Senator Boyce)

How does ASIC see the ASX's conflict of interest best managed?

Response:

As an Australian financial market licensee ASX is required to ensure that it satisfies its obligations under section 792A(c)(i) of the Corporations Act to adequately manage conflicts between its commercial interests and its obligation to take all necessary steps to ensure that the ASX market operates in a fair, orderly and transparent manner.

ASIC does not consider that there is any particular method that ASX should adopt to ensure it complies with its obligations under section 792A(c)(i) of the Corporations Act.

ASX has made a number of changes to the way it manages its conflicts of interest over the years, some of which were made in response to past ASIC's recommendations. ASIC anticipates that ASX's approach to managing its commercial conflicts of interest will continue to evolve in response to internal and external changes.

Details of ASIC's most recent assessment of ASX's conflicts handling arrangements are set out in the Market Assessment Report, which is available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/REP_135.pdf/$file/REP_135.pdf.

Question on Notice 30

Market supervision responsibilities (additional Question on Notice, Senator Boyce)

Would competing listing agencies have helped prevent the recent turmoil in the share market caused by the financial crisis? If so, how?

Response:

ASIC understands this question to be asking whether the existence of competing markets upon which securities quoted on ASX can be traded would have helped prevent the significant market volatility and price declines in ASX listed securities.

In light of the experience in various overseas jurisdictions where securities can be traded on more than one platform or market, including in the USA and Europe, it is not obvious that the existence of competing markets upon which ASX quoted securities can be traded would have had any impact in reducing recent market volatility and price declines due to the global financial crisis.

Question on Notice 31

Market supervision responsibilities (additional Question on Notice, Senator Boyce)

31 In what circumstances would it be appropriate for the ASX to maintain any regulatory activities if market competition is implemented?

Response:

ASIC provided confidential advice to the Government in March 2008 on the issues it considers important in constructing a supervisory framework if competition for market services is implemented.

ASIC's primary concern is that market supervision arrangements work effectively across the whole market, as well as at each market individually, if market competition is implemented.

It is a question for the Government as to the circumstances in which ASX continues with its supervisory activities in the event that competition for market services is implemented.

Question on Notice 32

Market supervision responsibilities (additional Question on Notice, Senator Boyce)

How will ASIC undertake more detailed market surveillance in the absence of the ASX performing the role?

Response:

ASIC is not aware of any existing Government decision that would result in a change to the supervisory framework for ASX listed securities.

Question on Notice 33

Blackout trading (additional Question on Notice, Senator Boyce)

To what extent is blackout trading occurring in the market? How many investigations or prosecutions has ASIC initiated over the past six and twelve months with relation to blackout trading? Have the amount of investigations and prosecutions risen or fallen over the past five years?

Response:

In 2008 ASX conducted two reviews of directors trading during 'blackout' periods. A 'blackout' period is period set under a company's trading policy during which trading in the company's securities by its directors and employees is restricted. The periods from year or half-year end leading up to the announcement of the company's results are usually declared 'blackout' periods. Under the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, companies should establish and publish its policy in relation to trading in its securities.

ASX's most recent review of 'blackout' trading (Review of directors' trading during the "blackout period" – Q3 2008, released 11 December 2008) found that during the period from 1 July to 30 September 2008 there were:

- 718 active trades by directors during a 'blackout' period; and

- Of these, 95 trades potentially contravened the trading policies of the relevant company concerned; and

- After inquiry, 15 did contravene the relevant company's trading policy. 2 of those were in securities of companies in the All Ordinaries Index, including one in the ASX/ASX 200 Index.

This compares with 795 trades during a 'blackout' period and 57 trades that potentially contravened the company's trading policy for the earlier period of 1 January to 31 March 2008.

ASIC has not conducted any investigations specifically into 'blackout' trading during the past 6 or 12 months. This is primarily because trading during 'blackout' periods does not, in itself, contravene the Corporations Act. This is explained further under the next question.

ASIC does review referrals (from ASX and otherwise) alleging directors traded with insider information, some of which do occur in the blackout period.

Question on Notice 34

Blackout trading (additional Question on Notice, Senator Boyce)

Is there any ambiguity in the Corporations Act with respect to blackout trading, and if so, what is it? Under what circumstances could directors trading shares in their company not be considered a breach of the Act?

Response:

The Corporations Act does not directly regulate trading during 'blackout' periods. Directors and others who trade whilst in the possession of information that is not generally available are subject to the insider trading prohibitions under Part 7.10 of the Corporations Act. Directors are also subject to the obligations not to misuse company information for personal gain (ss183 & 184(3) Corporations Act), and to notify the market when they trade in the company's securities (s205G Corporations Act).

We note that on 19 November 2008 the Minister for Superannuation and Corporate Law requested that the Corporations and Markets Advisory Committee (CAMAC) consider whether any changes are required to the Australian regulatory framework in relation to trading by directors during 'blackout' periods.

Question on Notice 35

Market disclosure (additional Question on Notice, Senator Boyce)

What improvements have been made over the past 12 months to disclosure and shareholder communication? How is ASIC continuing to address and improve this issue?

Response:

Since June 2007, companies and shareholders have been able to take advantage of amendments to s314 of the Corporations Act, which allow shareholders to choose whether they wish to receive a hard copy of an annual report, an electronic copy of the report or to download the report from a website.

In addition, ASIC has recently published the following Regulatory Guides that aim to improve disclosure in particular industry sectors:

- Regulatory Guide 69 Debentures – improving disclosure for retail investors (published in October 2007, updated in August 2008);

- Regulatory Guide 45 Mortgage schemes – improving disclosure for retail investors (published in September 2008); and

- Regulatory Guide 46 Unlisted property schemes – improving disclosure for retail investors (published in September 2008).

ASIC continues to be mindful of the need to improve disclosure and shareholder communication in light of relevant market conditions. ASIC and ASX presented a joint seminar focussed on disclosure for listed entities in Perth, Brisbane, Sydney and Melbourne in 2008. That series will be continued in 2009, and extended to Adelaide. Commissioner Belinda Gibson has made a number of presentations in 2008 (including most recently a speech on 27 November 2008) addressing various disclosure related issues, including the need for good disclosure in a volatile market, together with some suggestions for how companies might deal with market rumours.

Question on Notice 36

Market disclosure (additional Question on Notice, Senator Boyce)

What are the observance rates of margin loan disclosure of directors? Has ASIC examined instances where materially significant margin loan exposure has not been disclosed?

Response:

On 29 February 2008 ASIC and ASX jointly published a reminder of obligations of a listed entity to disclose market sensitive information about margin loans. Following that publication a number of entities announced directors margin loan exposure (eg Asciano, Fairfax, United Group) or that no such exposure existed (eg CSL). Other entities announced that they would be undertaking a review of their margin loan policy (eg Brambles).

Question on Notice 37

Market disclosure (additional Question on Notice, Senator Boyce)

What kind of feedback has ASIC had concerning whether directors understand whether or not their margin loan exposure needs to be disclosed?

Response:

The ASX/ASIC Update on margin loans mentioned above advised:

- Where a director has entered into margin loan or similar funding arrangements for a material number of securities, the continuous disclosure obligations, in

appropriate circumstances, may operate to require the entity to disclose the key terms of the arrangements.

- Whether a margin loan arrangement is material is a matter which the company must decide having regard to the nature of its operations and the particular circumstances of the company.

There are some differing views on the circumstances in which margin loan exposure needs to be disclosed to the company, and in turn to the market and whether the existing regulatory regime is sufficiently certain in this regard. Industry guidance has also been produced. For example,

- The Australian Institute of Company Directors published a position paper in June 2008 setting out its views on directors and margin loans. The paper states that to give effect to the ASX/ASIC Update, boards must possess all relevant information about the funding arrangements so that an assessment of materiality can be made. It recommends boards adopt a policy requiring disclosure of this information. The paper also states that materiality and whether market disclosure is required are best judged by boards and companies with reference to the company's particular circumstances at a particular time.

- Chartered Secretaries Australia has recommended mandatory disclosure to the company and the market if a director holds more than five per cent of the company's issued securities subject to security interests or other third party rights.

We note that on 19 November 2008 Minister Sherry referred this issue to CAMAC.

Question on Notice 38

Market disclosure (additional Question on Notice, Senator Boyce)

What have been the difficulties of seeking disclosure of margin loans? What is the process for managing disclosure without flagging trigger prices to the market?

Response:

ASIC considers that, to the extent that companies permit their directors to enter into margin loan arrangements, the manner of disclosure is a matter for the companies and their directors to manage. If the trigger price is material price sensitive information (as it often will be for significant holdings) ASIC would expect companies to restrict their directors from taking margin loans, as it places the directors in a position of potential conflict.

Question on Notice 39

Market disclosure (additional Question on Notice, Senator Boyce)

How does ASIC intend to improve disclosure of other types of director's debt?

Response:

ASIC does not seek to require all director's debt to be disclosed to the market. It does require material price sensitive information to be disclosed by a company. Margin loans over significant shareholdings can be in this category. Simple unsecured debt is less likely to be in this category.

Question on Notice 40

ASIC strategic review (additional Question on Notice, Senator Boyce)

The new structure became operational on 1 September. What have been the movements in staffing levels since this date?

Response:

The turnover experienced in the 3-month period 1 Sep - 30 Nov 2008 was a slight increase on the turnover for the same period last year (1.3 percentage points). However, this is a decline on turnover we have experienced in other quarters. We have not experienced any significant increase in exits from the organisation.

Question on Notice 41

Managed investment scheme prosecutions (additional Question on Notice, Senator Boyce)

Have the levels of illegal managed investment scheme prosecutions continued to fall during the last 6 months? What are the numbers? What is the reason for the rise or fall?

Response:

In the period 1 July 2008 – 23 December 2008, ASIC has resourced for enforcement activity matters in relation to 20 illegal managed investment schemes involving 449 investors and funds totalling $177 million.

Set out below is a table of action taken in relation to illegal investment schemes over the last four financial years. The table covers civil actions taken by ASIC and does not include other actions, such as criminal proceedings.

Financial Year	No. of Schemes	Investors	Funds involved
04/05	76	2150	$220M
05/06	102	5000*	$788M*
06/07	105	2550	$202M
07/08	80	2069	$174M

*Westpoint has impacted on these figures, involving 4300 investors and about $360M in funds.

Question on Notice 42

ASIC strategic review (additional Question on Notice, Senator Boyce)

How is ASIC managing the danger that an increase in ‘stakeholder teams’ and increased supervision will result in extra bureaucracy and less efficiency?

Response:

Following its recent strategic review ASIC replaced its previous structure of four functionally-based directorates with smaller, externally focused financial economy and real economy teams, including 20 financial economy stakeholder and deterrence teams.

The previous directorate structure had unclear and overlapping roles and accountabilities, which inhibited effective decision making and gave rise to a 'silo' mentality, and an inflexible resourcing model which limited ASIC's responsiveness to external issues.

ASIC has now moved to an externally oriented structure focused on achieving stakeholder outcomes, with a leadership group employed for its market knowledge, judgment and decision making ability, and inbuilt resource flexibility to identify and respond to new issues.

Stakeholder team leaders understand the market sectors for which each leader is responsible, are alive to emerging trends and risks, and can apply their knowledge practically and commercially and act without unnecessary escalation. The new team structure also enables resources to be moved to suit changing needs, with project teams formed as needed and disbanded when work is completed.

Finally, in the new structure a member of the Commission takes overall responsibility for the work done by teams across specific sectors of the market, and is closely involved in and externally accountable for the work carried out by each team. The

recently announced increase in the size of the Commission will further broaden its skill base, improve responsiveness and enable ASIC to cover in greater depth all the market and industry sectors that the new structure contemplates.

Question on Notice 43

Financial Services Compensation (additional Question on Notice, Senator Boyce)

43 What is the distinction between monetary limits and compensation caps? What advice is provided to investors from ASIC before they waive their right to claim for the excess amount elsewhere?

Response:

Where monetary limits operate, a complaint will not fall within the EDR scheme's jurisdiction if the claim exceeds the monetary limit. This existing model can require EDR schemes to spend significant time and resources determining whether a complaint falls within the EDR scheme's monetary limits before they consider the actual merits of the complaint.

In contrast, if monetary limits were replaced with compensation caps, a consumer or investor with a complaint involving an amount that is higher than the compensation cap would be permitted to waive the excess and still have the complaint heard by the EDR scheme. The scheme would then be able to make an award up to its compensation cap.

The question of whether or not consumers and investors would be required to waive their right to claim for the excess amount elsewhere is still open. In the UK, for instance, complainants must not be bound by an EDR scheme decision at any stage. The UK system is however different to the Australian system: it is statutory and has a right of appeal.

If complainants are required to waive their rights to pursue the balance of the claim elsewhere, the next question becomes when they should be required to do so. If complainants are only required to waive their rights at the end of the process (that is if they accept the outcome), then they will be in a good position to make an informed decision about the outcome, and their remaining rights.

If they are required to waive their rights at start of the process, then the issue of ensuring that complainants are properly informed of the rights they are giving up becomes very significant, because the outcome of the process is unknown so complainants will not necessarily be aware of what they are giving up. If this last option is implemented, it is not yet clear whether ASIC's policy would include requirements about what advice must be provided to complainants, or whether this issue would be left to EDR schemes to determine.

Question on Notice 44

Financial Services Compensation (additional Question on Notice, Senator Boyce)

To what extent will these charges apply retrospectively, such as for Westpoint investors?

Response:

It is not intended that changes to ASIC's policy would apply retrospectively.

Question on Notice 45

Financial Services Compensation (additional Question on Notice, Senator Boyce)

What sort of feedback has ASIC received so far? Why are different limits for different dispute resolution bodies appropriate?

Response:

We have received 24 submissions to Consultation Paper 10, Dispute resolution – Review of RG 139 and RG 165 (CP102), including submissions from most retail financial services industry associations and a joint submission on behalf of nine consumer groups (including CHOICE and Consumers' Federation Australia).

As a general observation, the submissions were often polarised as between industry and consumer representatives on key issues including:

1. whether or not ASIC-approved EDR schemes should be required to operate compensation caps rather than hard monetary limits and, if so, when a complainant should be required to waive their rights to recover the excess in court;

2. whether or not a minimum dollar figure for compensation caps (or monetary limits) of $280,000 should be stipulated;

3. if monetary caps/limits are increased, whether there should be a transitional period; and

4. whether interest should be awarded in addition to – or as part of – an EDR scheme award for compensation.

In CP102, ASIC proposed to set $280,000 as a minimum for compensation caps – subject to very limited exceptions.

ASIC considers it important that all EDR schemes operate a consistent minimum compensation cap to ensure that there is an equal minimum level of protection for consumers and investors and to prevent forum shopping. For example, a consumer or investor should have access to the same compensation cap whether or not they buy an insurance product through a broker or directly from an insurer.

The approach also provides some flexibility and allows EDR schemes to tailor the compensation cap for different industry sectors where appropriate. The Productivity Commission has recognised that tailored limits for different types of disputes may be appropriate because "[t]he ceilings set for any particular scheme should reflect the underlying distribution of risks facing consumers for the relevant financial services".

For instance, there are currently much lower limits ($6,000 and $3,000 respectively) in the Investments, superannuation and life insurance division of FOS for income stream products and in the General insurance division for complaints about third party general insurance claims. ASIC will consider where these limits should be set, but the very significant difference from the $280,000 limit reflects the facts that income stream risk products generally provide coverage for 75% of income, and third party general insurance claims depend on the cost of repairing a vehicle.

Question on Notice 46

Financial Services Compensation (additional Question on Notice, Senator Boyce)

Would any legislative amendments be required to give effect to these changes? If so, what?

Response:

Our intention at this stage is to implement any changes through amendments to our Regulatory Guides 139 Approval of external dispute resolution schemes and 165 Licensing: Internal and external dispute resolution. Depending on the likely costs of each change, we may issue a Regulatory Impact Statement.

Several of our proposals about internal dispute resolution (including the adoption of the definition of complaint and the Guiding Principles in AS ISO 10002 as well as other specific elements of the new standard) reflect the fact that Australian Standard AS 4629-1995 Complaints Handling has been superseded by AS ISO 10002 Customer satisfaction – Guidelines for complaints handling in organisations.

We understand that the Government intends to update the Corporations Regulations to reflect the introduction of AS ISO 10002 and it is for this reason that RG 165 must also be updated. One option is that amendments to ASIC's regulatory guides only take effect once the Corporations Regulations have been updated.