Question No: **QON 1**
Topic: **Market Cleanliness**

Question:

1. The ASIC annual report mentions a new measure of market cleanliness [page 3]. Could you inform the committee:

a. What is a satisfactory level of market cleanliness?

b. How do markets within Australia compare?

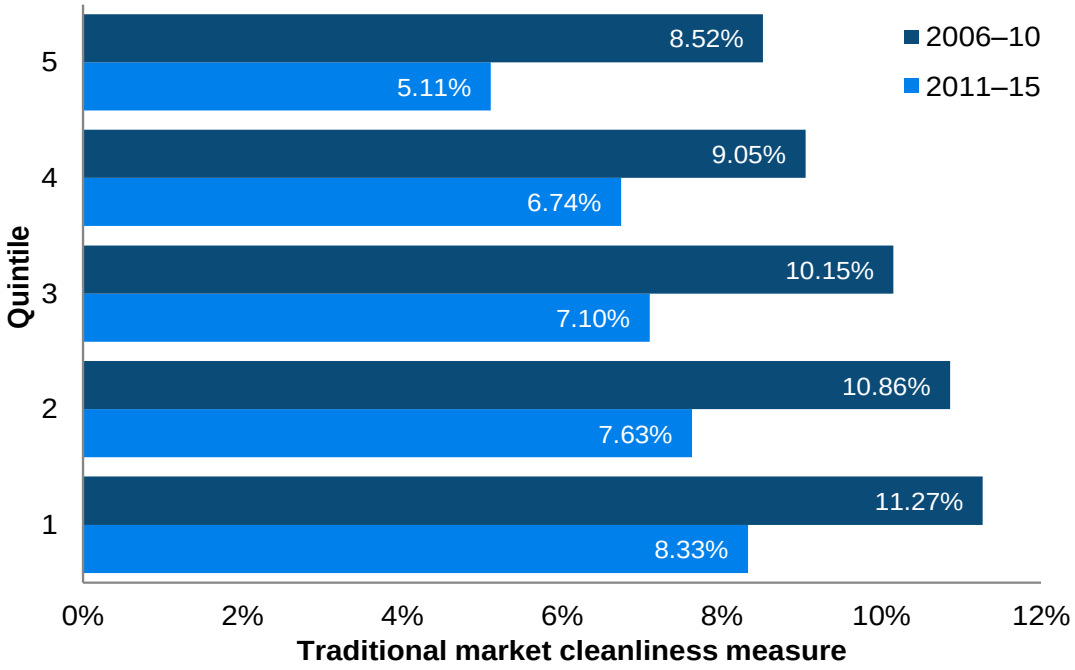
c. How do Australian markets compare to international markets?

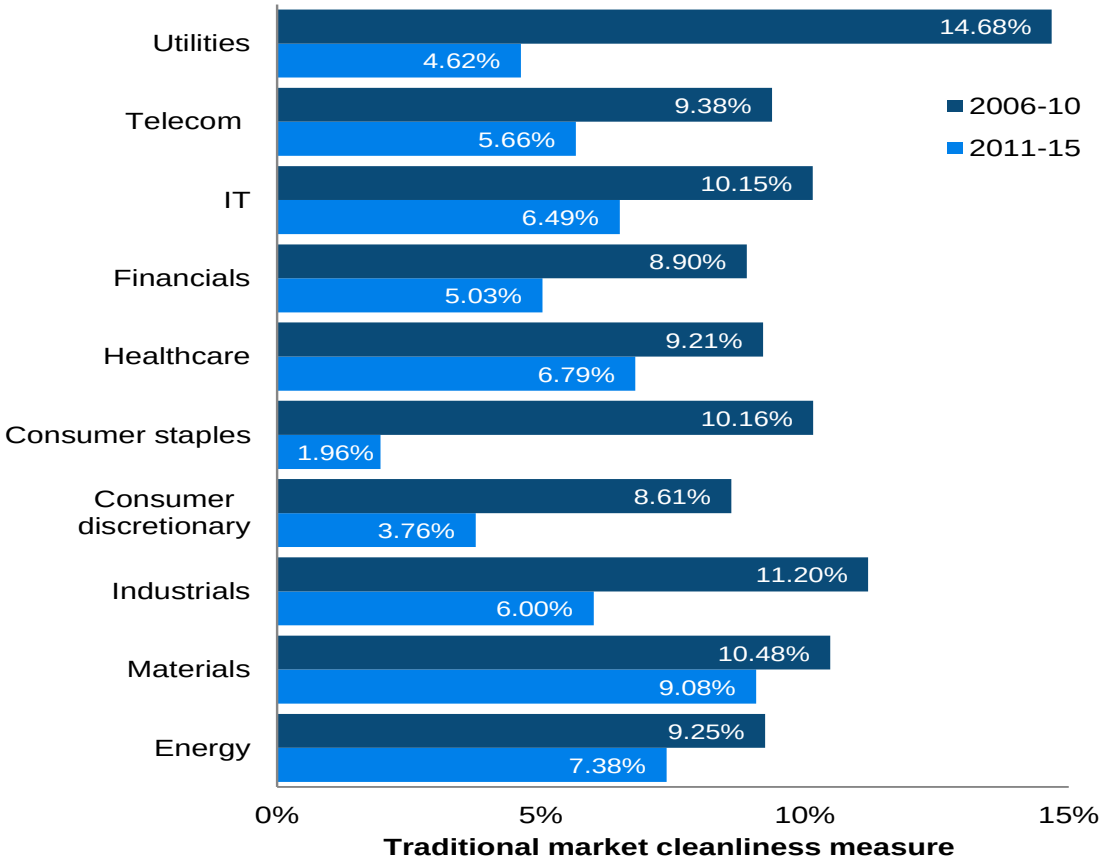
d. Could similar indicators be developed for other areas such as loans, insurance, and financial advice?

Answer:

a. ASIC has constructed two independent but complimentary measures of market cleanliness. They are based on summary statistics indicative of possible insider trading, information leakage, or both, by quantitatively identifying abnormal trading patterns ahead of material company announcements. They provide a high level overview of market cleanliness and give insights into how market cleanliness varies across different segments of the market to inform our regulatory work. Such measures do not necessarily translate to prosecutable offences, nor can it be concluded that all price movements ahead of material price sensitive announcements are instances of insider trading. In the vast majority of instances the share price movements can be attributed to a range of factors such as media speculation or broader macro-economic issues impacting particular stocks or sectors. It is impossible to define a satisfactory level of market cleanliness given not all abnormalities flagged by the measure are a result of market misconduct, as noted above. When applied consistently, the measures allow ASIC (or other regulators) to gauge changes in relative levels of market cleanliness across time and market segments.

b. The project focused only on companies listed on the ASX and examined different segments of the market. As per the below charts, which use traditional measures, we found that larger companies (Quintile 5) exhibited better market cleanliness than smaller companies (Quintile 1), and industry sectors exhibited varying degrees of market cleanliness. However, all segments of the market experienced a decrease in abnormal trading patterns ahead of material company announcements, indicating an improvement in general market cleanliness over time.


Quintile
5
4
3
2
1
8.52%
5.11%
9.05%
6.74%
10.15%
7.10%
10.86%
7.63%
11.27%
8.33%
2006–10
2011–15
0%
2%
4%
6%
8%
10%
12%
Traditional market cleanliness measure


Utilities
Telecom
IT
Financials
Healthcare
Consumer staples
Consumer discretionary
Industrials
Materials
Energy
14.68%
4.62%
9.38%
5.66%
10.15%
6.49%
8.90%
5.03%
9.21%
6.79%
10.16%
1.96%
8.61%
3.76%
11.20%
6.00%
10.48%
9.08%
9.25%
7.38%
2006-10
2011-15
0%
5%
10%
15%
Traditional market cleanliness measure

c. Independent international studies have ranked Australian equity market cleanliness favourably compared to other major developed markets. Commissioned by Intralinks and conducted by the M&A Research Centre at Cass Business School, the Intralinks report examined more than 4,475 mergers and acquisitions from 2009–14 for evidence of information leakage about the deals before their public announcement. The study found a general improvement in market cleanliness over the six year sample period, with Australia having one of the lowest indicators of information leakage ahead of mergers and acquisitions compared to other international jurisdictions. Intralinks and Cass Business School have suggested the global improvement is due to stronger regulatory enforcement, tighter internal governance, and increased risks to a transaction when leaking a deal. See link for Intralinks Report (https://www.intralinks.com/platform-solutions/solutions/dealspace/cass-leaks-report).

d. Trends such as changes in loan delinquency or broad failures of various classes of insurance to respond could be developed to measure the cleanliness and integrity of other financial services sectors. Such measures would be contingent upon the ability to acquire and interrogate data specific to those sectors. We were advantaged in the markets area in producing the report on market cleanliness because we hold rich equity market trading data extending back some 10 years. Similarly rich data is not available in relation to other sectors.

Consumer Credit
ASIC is considering potential cleanliness indicators for the retail credit markets within its jurisdiction.

ASIC regularly undertakes thematic reviews in respect to consumer credit products and publishes reports of its findings (including for example, a review of mortgage broker remuneration and reviews of compliance with responsible lending obligations for small amount credit contracts, leases, interest only home loans and low doc home loans). These reports identify broad industry trends (e.g. reduced numbers of interest only home loans) as well as observed instances of good and bad practice. These industry reports give an indication of levels of compliance in the various sectors of the consumer credit market.

ASIC is also considering measures such as the proportion of loans in default or in arrears and other loan characteristics (e.g. loan amounts, LVR). There is high level loan data available on loan default from a variety of sources. It should be noted that

some of this information may not be in itself an indicator of "cleanliness". For example, in the context of responsible lending, defaults may arise for various reasons which were not reasonably foreseeable (e.g. loss of employment, relationship breakdown) at the time the loan was advanced.

Life insurance

In relation to life insurance, ASIC recently undertook a review of life insurance claims, and issued Report 498 Life insurance claims: An industry review (REP 498) in October 2016. In REP 498 we identified that to improve public trust, there is a clear need for better quality, more transparent and more consistent data on life insurance claims.

ASIC has already commenced work with APRA to establish a consistent public reporting regime for claims data and claims outcomes, including claims handling timeframes and dispute levels across all policy types. Data will be made available on an industry and individual insurer basis.

Financial advice

In relation to financial advice, we note that ASIC already conducts broad thematic surveillances and publishes the results of those surveillances. The reports of these surveillances give an indication of levels of compliance in certain sectors of the financial advice market. For example, Report 413 Review of retail life insurance advice provides an indication of the level of compliance of life insurance advice. We are about to commence a major shadow shop and surveillance of SMSF advice which will indicate the level of compliance with legal requirements and the impact of the FOFA reforms.

We are also receiving data from life insurance companies about churn by financial advisers. This data will enable us to monitor overall levels of churn in the life insurance advice industry. However, it is important to note that churn is not in itself a breach of the law because it may well be in the client's best interests to change life insurance policies. Therefore, data on churn is not a direct indicator of the level of compliance in the life insurance advice industry. At this point, ASIC is primarily using this data to identify advisers who may be providing non-compliant advice and should be subject to surveillance. Finally, we note as part of the Government's reforms to the remuneration arrangements in the life insurance advice industry, we will be conducting a review on the success of the reforms in 2021. In order to inform the review, we will collect data from life insurers periodically over the next few years. We have worked with APRA and industry to ensure we collect good quality, consistent, and useful data.

Question No: QON 2
Topic: The regulatory sandbox/ Fintech licensing exemption

Question:

The annual report mentions a regulatory sandbox for fintech start-ups on pages 6 and 80. Could you inform the committee about the nature of these fintech start-ups, the regulatory sandbox licensing exemption and how ASIC is ensuring that consumer protection is built from the beginning, rather than being retrofitted after an issue is identified?

Answer:

ASIC's 'regulatory sandbox' framework, which was released in final form on 15 December, was created to facilitate innovation in financial services and credit. Our regulatory sandbox framework is comprised of three components:

1. application of the existing flexibility in the regulatory provisions or exemptions provided by the law which mean that a licence is not required;
2. a 'fintech licensing exemption', where ASIC has provided a class waiver to eligible fintech businesses to test certain specified financial and credit services for up to 12 months without holding a licence; and
3. tailored, individual licensing exemptions from ASIC to a particular business to facilitate product or service testing—individual exemptions of this nature are similar to the 'regulatory sandbox' frameworks established by financial services regulators in other jurisdictions.

The fintech licensing exemption has been designed to allow fintech businesses to validate the concepts and viability of their services. With this in mind, ASIC has limited the types of services and products covered by the licensing exemption.

New, innovative Australian businesses are able to rely on the fintech licensing exemption. Businesses that already hold a licence from ASIC are not eligible. Under the exemption businesses are able to:

1. give financial product advice or deal in specified classes products that are simple, liquid, or otherwise pose limited risks to consumers;
2. act as an intermediary, or provide credit assistance in relation to certain types of credit contracts.

In creating the fintech licensing exemption, ASIC has balanced the need to promote financial innovation with the objective limiting the risk of poor consumer outcomes. To minimise the risks to consumers of services provided by entities that rely on the fintech licensing exemption, the following consumer protection measures have been included:

1. the exemption is limited in duration to 12 months;

2. The limitations on the services that can be provided by exempted entities. Services relating to complex or long-term products, or arrangements incompatible with a short test have been excluded;
3. client and exposure caps. Testing businesses are limited to 100 retail clients and all services covered by the exemption have exposure limits that are designed to allow concept validation while minimising risks to consumers;
4. the requirement for testing businesses to have adequate compensation arrangements. This requirement replicates the normal obligations that apply to AFS and credit licensees. Businesses usually comply with the requirement by holding professional indemnity insurance cover; and
5. requiring internal dispute resolution processes to be established and membership of an external dispute resolution scheme. This requirement replicates the normal obligations that apply to AFS and credit licensees.

Question No: **QON 3**
Topic: **Applications for relief**

Question:

3. The annual report indicates on page 7 that 1251 of 1982 applications or waivers for regulatory relief were granted, because compliance savings outweigh the regulatory risks to investors and consumers.

a. How many waivers have accumulated over time?

b. What proportion of the waivers are for individual businesses versus classes of business?

c. Are such waivers subject to the parliamentary disallowance process for legislative instruments?

d. How long do such waivers last for?

e. Are the waivers ever reviewed individually or collectively?

f. Have any such waivers been provided to banks?

g. Could you provide the committee on notice with a list of the types of regulations that have been waivered over the past five years and what types of business the waivers have been given to?

h. How are consumers able to access transparent information on their rights and protections in areas where waivers have been provided?

i. How does ASIC ensure that such a large collection of waivers does not lead to erosion of consumer protections?

j. The waivers are given when compliance savings outweigh regulatory risks to investors and consumers. Why is there not an equivalent relief function for consumers and investors where obligations on business may be increased if the regulatory risks to investors and consumers outweigh the compliance savings?

Answer:

a. As many relief instruments are for a specific event or transaction or otherwise apply only for a limited time, it is not possible to say how many waivers are currently in effect.

b. The 1,982 applications for relief referred to are all for individual entities. A waiver for a class of business is implemented through a legislative instrument.

c. No.

d. The period for which a relief instrument applies depends on the particular circumstances of the matter.

e. There is no formal requirement for review of relief instruments after they have been issued.

f. Yes.

g. Since 2003, ASIC has published regular reports which provide an overview of situations where ASIC has exercised, or refused to exercise, our exemption and modification powers from the financial reporting, managed investment, takeovers, fundraising or financial services provisions of the *Corporations Act 2001* and *National Consumer Credit Protection Act 2009*.

h. Individual relief instruments are published in the ASIC Gazette, available via www.asic.gov.au/gazettes, or under 'credit relief' on our website (for credit instruments). A register of waivers, including class rule waivers, granted under ASIC market integrity rules is published on our website via www.asic.gov.au/markets under 'market integrity rules'.

i. ASIC provides guidance on when we will exercise our powers to modify the law, for example Regulatory Guide 51 *Applications for relief* as well as other regulatory guidance on specific topics. RG 51 guides ASIC in making consistent decisions as well as guiding applicants for relief. We will generally only grant relief where there is a net regulatory benefit (including taking into account consumer interests), or any regulatory detriment is minimal and is clearly outweighed by the commercial benefit.

j. ASIC's relief powers must be exercised in a manner that is consistent with the scope, context and purpose of the law.

Question No: QON 4
Topic: ASIC legislative instruments

Question:

3. The annual report indicates on page 7 that there were over 300 ASIC legislative instruments in operation at 30 June 2016:

a. Can ASIC provide a summary of its instruments that indicates:

i. categories of instruments;
ii. who is affected;
iii. whether the instruments are providing some form of regulatory relief;
iv. whether any of the instruments provide consumer protections;
v. whether any of the instruments relate to banks; and
vi. how consumers are able to access transparent information on their rights and protections in areas where instruments have been provided?

Answer:

i. ASIC issues legislative instruments to:

- give relief to classes of people from certain provisions of the *Corporations Act 2001* or other Acts administered by us;
- clarify the operation of certain provisions of those Acts;
- impose obligations on particular classes of people; or
- make rules about the conduct of people engaging in particular activities.

ASIC instruments may deal with, amongst others, the following:

(a) financial services;
(b) managed investment schemes;
(c) financial reporting;
(d) credit;
(e) superannuation;
(f) corporate governance;
(g) fundraising;
(h) takeovers and reconstructions;
(i) financial markets;
(j) clearing and settlement; and
(k) auditing.

ii. Who is affected by a legislative instrument will vary significantly from instrument to instrument depending on its purpose and content. The range of people includes those who

engage in conduct in relation to the areas mentioned in response to point i; and consumers/investors in relation to those areas.

iii. The majority of ASIC's instruments provide regulatory relief. Often this is by way of exempting classes of entities from compliance with the law where they meet certain conditions. Typically relief is provided where the law, as enacted, does not regulate a particular activity in an appropriate way or the burden of requiring strict compliance with the law is out of proportion with the regulatory benefit.

iv. Many of ASIC instruments enhance consumer protection, for example, by requiring people who operate managed investment schemes to have particular levels of financial resources.

v. A small number of instruments relate to deposit taking and lending activities and would apply to banks to the extent that they engage in those activities. This includes *ASIC Class Order [CO 14/1262]*. This gave relief to enable 31-day notice term deposits of up to five years to be given concessional regulatory treatment as basic deposit products under the *Corporations Act*.

vi. Where ASIC makes a legislative instrument we will generally issue related regulatory guidance. This guidance is freely available on ASIC's website. It will generally explain the effect of the instrument and the rationale for making it.

Question No: QON 5
Topic: **Surveillance of responsible entities and superannuation trustees**

Question:

5. The annual report on page 22 describes ASIC's surveillance of responsible entities and superannuation trustees:

• There are 18 responsible entities, 40 superannuation fund trustees and six custodians for which ASIC has identified risks or concerns.

• There are 33 responsible entities and 8 super fund trustees identified as most at risk of non-compliance.

Could you provide the committee with information on:

a. why the number of responsible entities identified as most at risk of non-compliance has risen to 33 from 9 or 10 in the previous 3 years?

b. why the number of responsible entities for which ASIC has identified risks or concerns has dropped from over 90 in the previous 3 years to 18 in 2015–16?

c. the nature of the risks or concerns or non-compliance identified as a result of ASIC's surveillance.

d. the potential impact on customers.

e. any enforcement action that ASIC has taken in response.

Answer:

The surveillance coverage numbers quoted in the annual report are categorised as either proactive or reactive surveillance. Each year stakeholder teams within ASIC such as the Investment Managers and Superannuation stakeholder team (IMS) identify how they will address the risks identified in their particular sector. Proactive surveillance is one of the tools used to address culture and conduct risk. As part of this process IMS reviews the resources available to undertake proactive surveillance. Priorities and level of resource available for proactive surveillance changes from year to year. These are the primary factors that drive how many responsible entities or superannuation trustees will be the subject of proactive surveillance.

a) Why the number of responsible entities identified as most at risk of non-compliance has risen to 33 from 9 or 10 in the previous 3 years?

The responsible entities in this category are part of annual proactive surveillance programs focused on trying to identify responsible entities most at risk of non-compliance with obligations on the basis of information held by ASIC. The program is referred to as our risk profiled entities program. There are three main reasons for the significant increase in the number of responsible entities in this segment:

- IMS changed its approach to this program resulting in a greater coverage of responsible entities. In previous years IMS would identify a smaller number of responsible entities and undertake a detailed surveillance of each entity. In 2014-2015 this involved 10 responsible entities over two programs. In 2015-2016 these programs were merged and we obtained detailed information from 28 responsible entities identified through our profiling before determining a final list of four for more high intensity broad based surveillance. The information provided by each of the 28 responsible entities covered areas of compliance with AFS licence conditions, governance and risk, complaints management, breaches, conflicts of interest cyber-security, rewards and incentives, policies and procedures and information about schemes identified by ASIC and disclosure. Each of the surveillances within this program is considered to be high intensity. This change in process including the provision of information in a digital format has enabled IMS to increase the level of coverage with limited impact on resourcing.
- In previous years, ASIC reported the number of unique responsible entities that were subject to proactive surveillances under our risk profiled entities program that were commenced during the year. In the 2015 – 2016 annual report ASIC has reported the number of unique responsible entities that were the subject of proactive surveillance through our risk profiled entities program where the surveillance was commenced, closed or current throughout the financial year.
- Finally, each year as outlined above the number of responsible entities in this program will change to take into account resources and other priorities.

b) Why the number of responsible entities for which ASIC has identified risks or concerns has dropped from over 90 in the previous 3 years to 18 in 2015–16?

The responsible entities in this category are part of a range of proactive projects aimed at addressing particular issues in the sector. The key reason for the reduction in the numbers reported is essentially a change in priorities. For example the 2014 – 2015 financial year included in addition to the risk profiled entities program projects related to risk management by responsible entities[1] and conflicts management in vertically integrated businesses in the funds management industry[2]. In 2015 - 2016 additional resources were allocated to surveillance in the superannuation sector to address risks identified in that sector and resources were moved from surveillance to focus on other non-surveillance work including sun-setting of legislative instruments and revision of associated regulatory guides.

[1] 15-020MR ASIC enquires into risk management by responsible entities
[2] REP 474 Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry

c) The nature of the risks or concerns or non-compliance identified as a result of ASIC's surveillance.

The nature of risks, concerns or non-compliance identified through surveillance, depends on the issues being considered through the surveillance. For example notable compliance concerns include:

- non-compliance with licence conditions including professional indemnity insurance requirements, external dispute resolution scheme membership and financial resource requirements;
- defective or misleading disclosure and advertising material and an absence of effective controls over the authorisation and review of promotional materials and disclosure documents;
- deficiencies in compliance and governance frameworks, including: inadequate internal processes, failures to comply with established internal procedures, inconsistencies between funds' governing documents and internal policies, as well as inadequate record keeping to demonstrate compliance with licensee obligations; and
- in a small number of cases, absence of an appropriate monitoring processes to ensure that returns information of a licensees' funds, published by third party data aggregators, are consistent with the returns published by the responsible entity. This led to discrepancies between returns information available from these third party service providers and those published by the responsible entities.

We publish the outcomes of our proactive surveillance work over time[3] and are finalising a public report outlining the findings and results of the risk profiled entity work undertaken in the 2015 – 2016 financial year. We plan to issue this report in early 2017.

To give a sense of general findings across the responsible entities involved we have identified significant variations in the:

- depth and scope of professional indemnity insurance regardless of nature, size and complexity of business including failures to meet the minimum requirement of $5 million cover;
- standards adopted by REs in the management of cyber risks;
- adoption of effective policy and commitment to managing whistleblowing;
- embedding of rewards and incentive structures that promote compliant behaviours;
- independence and integrity of product approval and review processes; and
- involvement of the boards in areas such as product design and calculation of payments and returns as well as disclosure.

[3] For example see: 15-251MR ASIC seeks improved compliance by responsible entities and superannuation trustees

We have where necessary required responsible entities to take steps to address identified instances of non-compliance or areas for improvement.

d) The potential impact on customers.

Our proactive surveillance work is focused on aligning conduct in a market based system with investor and consumer interests to increase investor trust and confidence. Our activities focus on areas that pose the highest risk to investor trust and confidence. We believe our proactive surveillance assists in raising standards within individual responsible entities and across the sector increasing transparency and a greater focus on consumer outcomes, including:

- fair treatment of fund members and investors
- financial products and services that are transparent, fit-for-purpose and aligned with consumer needs and preferences;
- the right balance between innovation and risk to meet fund objectives and
- ensure investors are fully compensated when losses result from poor conduct.

e) Any enforcement action that ASIC has taken in response.

ASIC has taken a range of actions in response to non-compliance by responsible entities identified through proactive surveillance, including:

- rectify breaches of licence conditions;
- to amend and update compliance measures including for complaints, conflicts and breaches;
- to develop procedures around due diligence and authorisation of disclosure documents and promotional material;
- changes to their risk management arrangements and implement additional measures to monitor the reporting of returns;
- to withdraw disclosure documents and marketing materials;
- to issue revised or supplementary disclosure;
- the imposition of additional AFS licence conditions in one case (see 14-251MR ASIC imposes additional AFS licence conditions on mortgage scheme operator); and
- the cancellation or variation of 8 Australian financial services licenses in circumstances where they failed to meet revised net tangible asset requirements.

Question No: **QON No. 6**
Topic: **Annual Reports**

Question:

The annual report indicates on page 22 that ASIC's work on insurance surveillance includes reactive surveillances and targeted reviews across 133 insurers. Annual reports for the previous three years indicate that each insurer was covered once every seven years on average.

a. How often will ASIC conduct surveillance of insurers in future?

b. Insurance issues that have come to light recently include life insurance, add-on card yard insurance, funeral insurance, Youi. How many of these issues were first detected by ASIC's surveillance program?

Answer:

a. Insurance surveillances form an important part of ASIC's ongoing work. A substantial part of ASIC's additional funding (announced by the Minister of Revenue and Financial Services in April 2016) will be directed to insurance related work. Of the insurers regulated by ASIC, we determine which insurers we will focus on depending on the risks of the conduct involved, and the areas of focus we have selected. We have planned targeted surveillances and industry reviews for general and life insurers, including:
    - Following the findings in ASIC Report 498: *Life insurance claims handling – an industry review* (REP 498), targeted surveillances of claims handling practices of life insurers;
    - Direct sales of life insurance – an industry-wide review;
    - targeted surveillances of life insurers in relation to total and permanent disability claims;
    - Sale of add-on insurance – with general insurers and life insurers targeted for ongoing surveillance;
    - Surveillance of targeted general and life insurers in relation to their surveillance and investigations practices affecting claimants;
    - Ad hoc surveillances responding to issues as they arise.

    ASIC continues to dedicate significant resources to investigating reports of misconduct received about general and life insurers, and to proactively initiating work in this area. Reports of misconduct help inform our work in this area.

b. ASIC's work is generated from both proactive programs of work and reactive sources, such as reports of misconduct. Both are valuable sources to ensure ASIC performs its regulatory functions and meets its strategic priorities. Often it is a combination of proactive and reactive work that informs our strategic priorities.

ASIC's add-on insurance work is an example where ASIC proactively reviewed add-on insurers and identified areas of concern and made recommendations for improved consumer outcomes, which we set out in two public reports this year. ASIC's proactive work in this area has already led to significant improvements for consumers, including small business consumers paying up to 80% less for their add-on insurance premiums through car dealerships. ASIC's proactive work in this area continues with further surveillance and investigation work planned.

ASIC also proactively reviewed funeral insurance during 2015 and released a public report setting out our findings covering nine insurers offering funeral insurance across 40 brands.

ASIC proactively joined with other consumer protection agencies in the 'Avoid a funeral rip-off' campaign which aims to improve awareness among Indigenous consumers of their options when it comes to paying for funerals.

ASIC has taken action in recent years on misleading advertising of funeral insurance and has produced research and information about alternative ways consumers can pay for their funeral, including superannuation, term deposits, funeral bonds and pre-paid funeral plans.

ASIC undertook a life insurance review following the allegations that aired on a Four Corners report. Following this program, ASIC immediately launched an investigation into CommInsure and also a broader review of life insurers' claim handling practices to report on whether any systemic issues existed. ASIC released its public report during October this year after a six month review (REP498). ASIC has a broad range of ongoing work arising from our findings in REP 498.

ASIC has been in regular and close liaison with Youi prior to and following the publication of allegations and subsequent action by the New Zealand regulator.

Question No: QON **7**
Topic: **ASIC Surveillance**

Question:

The annual report summarises ASIC's market surveillance on page 23.

a. Why has the frequency of surveillance of market participants been increased from every three years to every six months and has the change been successful? i. What findings has ASIC made based on that surveillance?

b. What findings has ASIC made from its increased frequency of surveillance for insolvency practitioners?

c. The number of financial markets has grown from approximately 18 in 2012–13 to 52 in 2015–16, with the majority of the growth being in the authorised, but unlicensed financial markets. The annual report indicates on page 23 that the licensed financial markets are subject to surveillance every year, while the rapidly growing number of authorised unlicensed markets only receives reactive surveillance. i. Why are there two groups of markets, licensed and unlicensed?

ii. Are consumers exposed to different risks directly or indirectly in the different market groups?

iii. Why are the two groups monitored differently?

iv. How is ASIC able to provide assurance to Parliament that the rapidly growing group of authorised but unlicensed financial markets (currently 34) are operating with the same level of integrity as the more regulated and more closely monitored licensed financial markets?

v. Can Parliament be satisfied that the growing group of authorised but unlicensed markets won't be the subject of financial scandals in future due weaker regulatory settings?

vi. Can Parliament be satisfied that the growing group of authorised by unlicensed markets are not facilitating growth in front running of market trades through high frequency trading?

vii. How confident is ASIC that it has the sufficiently advanced technology to be able to monitor trading activity fast enough monitor high frequency traders?

Answer (a):

The increase in the frequency of surveillances in the annual report is due to changes in the way that we record our surveillance activities with intermediaries. The surveillance numbers for 2015-16 include all of our compliance liaison visits, risk assessment detection and response visits, and reactive and proactive compliance reviews. Previously, these numbers were separated for reporting purposes. The previous frequency of every three years only reflected our risk assessment detection and response (RADAR) surveillances.

ASIC uses a number of techniques, including direct engagement such as surveillances, to achieve positive behavioural change and improving practices. Other techniques include broader industry education and training.

Compliance Liaison visits

Our compliance liaison meetings focus on gathering intelligence for information and assessment purposes, raising market participants' awareness of their obligations, and highlighting ASIC's current areas of focus. We expect to complete around 100 of these meetings per year.

During each meeting, a series of questions are asked about key risks to the business and industry—providing crucial insight into what the current issues of the day are, as well as monitoring trends.

Risk Assessment Detection and Response visits

We also conduct risk assessment detection and response (RADAR) visits. These visits provide the same benefits as our compliance liaison meetings, with an additional assessment of the particular risks associated with each market participant's business.

Proactive and reactive compliance reviews

Proactive reviews include key themes that we have identified as risks in the industry, including conduct and culture, handling of confidential information and conflicts, and cyber resilience. Reactive reviews are based on intelligence we receive that is specific to an intermediary.

Further information

Future annual reports will also include our surveillance activities with investment banks due to the merger of the market and participant supervision, and investment banks teams.

Over the 2015-2016 financial year we completed the following surveillances:

- 38 RADARs of market participants
- 100 Compliance Liaison Visits of market participants
- 85 compliance reviews of market participants
- 38 compliance reviews of securities dealers

Answer (b):

ASIC is responsible for the registration and supervision of registered and official liquidators who accept formal appointments as external administrators of companies in Australia. We

supervise their compliance with the Corporations Act 2001 (Corporations Act) and the Corporations Regulations 2001 (Corporations Regulations).

ASIC has now published five annual reports into the supervision of registered liquidators. Our reports focus on our work in supervising registered liquidators through our assessment of reports of misconduct, and through our surveillance and enforcement activities.

Report number	**Report date**
REP 479	June 2016
REP 430	April 2015
REP 389	April 2014
REP 342	May 2013
REP 287	May 2012

It is also important to note the work we do with registered liquidators and our most recent report REP 479 also outlines the collaborative work undertaken with registered liquidators.

Registered liquidators perform an important function in winding up or restructuring insolvent companies. We assist liquidators in this work, through our liquidator assistance program and the Assetless Administration Fund (AA Fund), by helping them to obtain records or funding their preliminary investigations to enable them to report to ASIC. These reports from registered liquidators support ASIC's own investigations and, where appropriate, ASIC action, including litigation against directors and others.

Answer (c):

i. Unlike almost every other developed financial centre, Australia <u>does not</u> have a tiered market license framework. Instead, Australia has only one type of market licence, which is modelled on the traditional exchange type market (e.g ASX). Particularly in recent years, most jurisdictions have seen further developments (additional categories/tiers) in their market licensing framework (such as Swap Execution Facilities (SEF) in the USA) to accommodate new types of market models.

Because it is modelled on the traditional exchange type market, the current Australian market licensing regime does not readily accommodate these other types of trading facilities for professional investors (including trading platforms like SEFs). s791C of the Corporations Act does however, give the Minister the power to exempt a particular financial market or type of financial market from the operation of Part 7.2 of the Corporations Act, as well as the power to impose conditions on the exemption. These are the additional unlicensed markets referred to. In order to maintain Australian participants' access to global markets, ASIC has advised the Minister to exempt these professional trading facilities from the requirement to hold an Australian market licence - but only subject to conditions that seek to address the risks that may be created by these platforms operating in Australia.

In the absence of a tiered market licensing framework like exists in other jurisdictions, ASIC has indicated it will support a market licensing exemption, where certain specific conditions are met - notably that users are only professional investors and products traded on exempt markets are not usually traded on public (licensed) markets (e.g. like shares).

ii. Retail consumers are not directly exposed to risks in exempt markets due to the fact that participation in such markets is restricted to professional investors only (as defined under s9 of the Corporations Act) who participate in the market on their own behalf or on behalf of other professional investors.

iii. Refer above. ASIC's regulatory powers in relation to licensed markets and exempt markets differ; as such exempt markets are subject to different levels of supervision relative to licensed markets, and commensurate with the different risks for consumers.

iv. Refer above. ASIC has advised the government on the desirability of law reform that would allow these platforms to become licenced financial markets subject to more detailed regulatory oversight by ASIC.

v. Refer above. ASIC has advised the government on the desirability of law reform that would allow these platforms to become licenced financial markets subject to more detailed regulatory oversight by ASIC.

vi. ASIC monitors trading venues for potential risks to market integrity. For a discussion of the current measures used to monitor HFT activity please refer to item vii below.

vii. ASIC is confident that its Market Surveillance system (Market Analysis and Intelligence - MAI) is able to monitor high frequency trading and identify market misconduct when it occurs. ASIC's surveillance system has the ability to run reports for very large datasets and trading periods in a fraction of the time compared with its previous surveillance system. MAI allows ASIC analysts to identify suspicious transactions and traders more quickly and request information from brokers earlier than under the previous system. MAI has the capacity to handle a continued increase in high frequency trading and other algorithmic trading, and improves on technology previously designed for a single market. MAI has the capacity to handle a significant increase in trading messages, which could be up to 1 billion messages per day. ASIC recognises the concerns expressed by investors and the financial press in relation to high frequency traders and we routinely examine our markets for patterns of manipulation and take action where we identify breaches of the Corporations Act or

ASIC market integrity rules. Importantly, ASIC is confident that it has supervisory staff with extensive expertise in automated trading system design to identify misconduct and address concerning trading patterns when they are identified.

Question No: QON **8**
Topic: **Market Integrity Reports**

Question:

ASIC Report 486 on research and advice services for securities trading issued in August 2016 indicates that ASIC identified a number of concerns relating to the management of confidential information and conflicts of interest, including:

- inappropriate arrangements for handling confidential information including that such information may be passed to sales desks
- inconsistent practices on conflicts of interest and remuneration
  a lack of independence and separation of research and advisory activities
  the firm or staff trading in securities for which the firm is managing a capital raising; and
- the use of "director clubs" in which research and advice houses provide office space and service to company directors, potentially creating a conflict of interests.

These problems sound similar to those we have seen with financial advice and insurance.

Could ASIC provide the committee with information on:

a) the number of customers affected;
b) the potential financial losses incurred;
c) what actions have been taken against the companies involved; and
d) what protections currently exist for customers who may be affected.

Answer:

a. Report 486 *Sell-side research and corporate advisory: Confidential information and conflicts* sets out key observations from our review of the way financial intermediates handle material non-public information and manage conflicts of interest. We examined the policies, procedures and practices of a range of Australian based firms and a sample of transactions. Report 486 was not an enforcement action based on quantifiable consumer losses; therefore we do not have any definitive information about the number of consumers affected or the potential financial losses incurred. We are continuing our

inquiries into potential breaches of the financial services laws identified during our review.

b. To operate effectively, markets need to be fair and efficient, and investors must have trust and confidence in their operation. The proper handling of material, non-public information and the management of conflicts of interest promotes market integrity, improves market efficiency and increases investor confidence. In matters such as this ASIC does not usually quantify the number of people affected, nor the financial impact on individual parties. Given the nature of the matters currently under review, the quantum of potential financial losses has not been determined.

c. We seek enforcement actions where we consider there has been conduct that is unlawful under the financial services laws and which meets our criteria for enforcement action. In July 2014, the Federal Court of Australia found Newcrest Mining contravened its continuous disclosure obligations and required Newcrest to pay a civil penalty of $1.2 million: see *Australian Securities and Investments Commission v Newcrest Mining Limited* [2014] FCA 698. Newcrest was found to have disclosed material non-public information. Following the court's decision, ASIC continued its investigation into related parties that received material, non-public information from Newcrest and provided recommendations to relevant firms on measures they can implement to strengthen their control frameworks.

We are conducing further inquiries into the matters we have identified during our work on Report 486, and we will be able to provide information when further facts about the alleged misconduct can be gathered, analysed and tested.

d. ASIC has previously released guidance that sets out our expectations of how Australian financial services licensees should handle material non-public information and manage conflicts.

Regulatory Guide 181 *Licensing: Managing conflicts of interest* sets out ASIC's approach to compliance with the statutory obligation to manage conflicts of

The conflicts management obligations form part of the licensing regime, which promotes the following primary outcomes:
(a) confident and informed decision making by consumers;
(b) fairness, honesty and professionalism by those who provide financial services; and
(c) fair, orderly and transparent markets for financial products: s760A.

RG 181 helps licensees and Australian financial services (AFS) licence applicants:
(a) assess the adequacy of the arrangements they currently have in place to manage conflicts of interest;
(b) if necessary, develop adequate arrangements to manage conflicts of interest; and.
(c) understand what we look for when assessing whether a licensee or licence applicant has in place adequate conflicts management arrangements.

Regulatory Guide 79 *Research report providers: Improving the quality of investment researc*h provides guidance to help licensees improve the quality and reliability of investment research. RG 79 focuses on key phases of the research process to improve:
• the quality, methodology and transparency of research report production and distribution;
• the management of conflicts by research report providers, including avoiding, controlling and disclosing these conflicts; and
• the ability of users of research to understand and compare the research services of different research report providers.

ASIC intends to consult on more detailed guidance for licensees in relation to how conflicts of interest are managed to ensure the resultant research has credibility and integrity and can be relied upon by Australian investors.

Question No: QON **9**
Topic: **Market Cleanliness**

Question:

9. In August 2016, ASIC released Report 487 on Australian equity market cleanliness. That report found that five per cent of material price-sensitive announcements had anomalous trading patterns which could indicate potential inappropriate trading or misconduct.

a. How many of those announcements has ASIC investigated and how many examples of misconduct were identified?

b. Where misconduct was identified, how many people were affected and what is the financial impact estimated to be?

c. What actions have been taken where misconduct was identified?

d. What consumer protections currently exist for people who may have been affected?

Answer:

a. Out of the five percent, ASIC examined a sample of the more recent material price-sensitive announcements that were preceded by high concentrations of anomalous trading. Of these, 86% had been identified, reviewed and prioritised by ASIC's market surveillance team following real-time alerts generated by ASIC's Market Analysis and Intelligence (MAI) surveillance system. A small percentage of these matters progressed to formal enquiries, whilst the majority were finalised without further escalation. That is, Surveillance analysts did not identify connections or associations linking the suspicious trading to potential sources of inside information or sufficient prima facie evidence to trigger formal investigations. The remaining 14% of incidents identified did not meet materiality thresholds to warrant further assessment. Further information about our surveillance and enforcement outcomes may be found at: http://www.asic.gov.au/regulatory-resources/find-a-document/reports/rep-501-market-integrity-report-january-to-august-2016/

b. Ordinarily, in insider trading matters ASIC does not quantify the number of people effected, nor the financial impact on individual parties. In these matters the greater harm is the impact on the confidence of all investors and (in the long run) the cost of capital for public companies. In markets where investors perceive they are at an informational disadvantage they tend to protect themselves by reducing their exposure to the market. Alternatively they might demand a higher return to compensate for the adverse selection risk they experience as a result of information asymmetry. Reduced investor participation and confidence in markets can lead to lower turnover, higher cost of trading and inefficient allocation of capital from investors to entities seeking

funding. A 2002 study found that, in a sample of 103 countries, effective insider trading enforcement was associated with a lower cost of capital, ranging from 0.3%–7%. For the financial year ended 30 June 2015, companies listed on ASX had a total market capitalisation of around $1.6 trillion and raised around $89 billion. A small change in the cost of capital can significantly affect listed companies' valuations and cost of funds.

c. Where circumstances surrounding the announcement and the availability of evidence linking suspicious traders to potential sources of inside information support a breach, cases are investigated by ASIC's Enforcement division and prosecuted where sufficient evidence is available. See link for ASIC's enforcement report highlighting key enforcement outcomes for January-June 2016 (http://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-247mr-asics-enforcement-report-highlights-key-enforcement-outcomes-for-january-june-2016/).

d. Investors affected by equity market misconduct such as insider trading and market manipulation are typically not compensated directly through actions commenced by ASIC. These actions tend to be conducted in the criminal courts against the perpetrator of the conduct. In fact, a person trading against someone with inside information may not know that they have been affected or who they have traded against because of the nature of anonymous markets. In the civil courts, it would be open to, but difficult for, an individual to prove an accurate calculation of any loss suffered. The most common exception to this is class actions against entities which have failed to keep the market informed under the continuous disclosure obligations. The difficulty in obtaining compensation highlights the importance of market cleanliness, as distinct from redress after an event, for investors to confidently participate in the market.

Question No: QON **10**
Topic: **Questions regarding ASIC report 482 Compliance review of the retail OTC derivatives sector**

Question:

10. In June 2016, ASIC Released Report 482 on Over-The-Counter Derivatives. That report found that over 70% of Australian Financial Service licensees participating on over-the-counter derivatives had high rates of non-compliance with requirements including:
• net tangible asset requirements;
• product disclosure statements;
• financial reporting obligations;
• not providing a financial service despite being licenced for several years; and
• lack of awareness of Australian regulatory requirements and outsourcing aspects of financial services to jurisdictions with little or no regulatory oversight.

The report indicates that 150 regulatory outcomes were obtained against 55 licensees. Could ASIC provide the committee with information on:
3 ASIC, Report 482 Compliance review of the retail OTC derivatives sector, June 2016, pp. 9–11. http://download.asic.gov.au/media/3899926/rep482-published-20-june-2016.pdf
a. the number of customers affected;
b. the potential financial losses incurred;
c. what actions have been taken against the companies involved; and
d. what protections currently exist for customers who may be affected.

Answer:

a. and b.

Please note, Report 482 was in regards to a targeted surveillance checking for compliance with Australian standards, it was not an enforcement action based on quantifiable consumer losses. We therefore do not have any definitive information about the number of consumers affected or the potential financial losses incurred. In addition, as this is an over-the-counter market (i.e. there is no exchange) the information about the number of investors involved in this market is not readily available.

In assessing the likely impact upon investors we note a study undertaken by the French regulator, the AMF, which found the number of clients that lost money in this market segment over a four year period was over 89%. In addition, the ACCC recently announced in September that Australians had lost $3 million in binary option related scams since the beginning of the year. On 6 December the UK FCA announced stricter rules for Contracts For Difference (CFDs) and margin Foreign Exchange products and referred to its analysis of a representative sample of client accounts for CFD firms which found that 82% of clients lost money on these products.

c. The actions taken against the companies and the outcomes achieved as a consequence of the surveillance include:
   - Licence suspensions and cancellations;
   - Net Tangible Asset issues rectified;
   - Client money breaches rectified;
   - Product Disclosure Statement (PDS) issues rectified;
   - Website disclosure improved;
   - Overdue financials submitted;
   - Authorised Representative issues rectified – including some authorised representative arrangements being cancelled;
   - Competency to provide financial services improved (e.g. updating responsible manger information;
   - Unlicensed conduct ceased;
   - Professional Indemnity Insurance rectified;
   - Financial Ombudsman Service membership obtained;
   - Share registry information corrected;
   - Referrals to other International regulators;
   - Media releases and public warnings published informing investors poor conduct; and
   - Infringement notices for misleading and deceptive behaviour.

d. Protections that exist for customers who may be affected:
   - Where investors have concerns about breaches by the licensee that have caused them loss they can use the licensee's internal dispute resolution system to make a complaint and if they are not satisfied with the outcome of the process they can make a submission to the Financial Ombudsman Service.
   - Australian clients who receive financial services from an entity that is not appropriately licensed may have the right to rescind their agreement with the entity and may be entitled to recover brokerage, commissions and other fees paid to that entity.
   - Regulatory Guide 227 Over-the-counter contracts for difference*: Improving disclosure for retail investors (RG 227)* outlines seven benchmarks which aim to help investors understand the risks and benefits of OTC CFDs. Issuers must address these benchmarks in product disclosure statements. The seven benchmarks mean issuers will need to address each issue in their PDSs on an 'if not, why not' basis. The benchmarks are:
     - client qualification
     - opening collateral
     - counterparty risk - hedging
     - counterparty risk - financial resources
     - client money
     - suspended or halted underlying assets

- margin calls.

RG 227 also outlines the standards ASIC expects issuers to meet when advertising OTC CFDs to retail investors.

- ASIC's guide RG 212 Client money relating to dealing in OTC derivatives aims to promote better disclosure and help retail investors properly understand the handling of client money and associated counterparty risks, in particular regarding:
  - the treatment of money which is paid to, or left with, a licensee;
  - the timing and basis of any payments out of the client money account;
  - any use of client money to meet a licensee's trading obligations for other clients;
  - the treatment of interest earned on client money; and
  - the risks associated with client money.
- Class Order CO 12/752 sets out additional financial requirements for retail OTC derivative issuers. Issuers of retail OTC derivatives that have an actual or contingent liability to retail investors must, at all times, have NTA that is the greater of $1 million or 10% of average revenue. They must also have 50% of the required NTA in cash or cash equivalents (excluding any other cash or cash equivalents that are held in respect of any liability or obligation to clients) and 50% in liquid assets. The policy objectives of the financial requirements for AFS licensees are designed to ensure that:

  (a) AFS licensees have sufficient financial resources to conduct their financial services business in compliance with the Corporations Act;

  (b) there is a financial buffer that decreases the risk of a disorderly or non-compliant wind up if the business fails; and

  (c) there are incentives for owners of the business to comply with the Corporations Act through risk of financial loss.

- ASIC has also made many statements about retail OTC derivatives being complex products and has issued a number of significant consumer/educational warnings about these types of products, including margin FX, CFDs, and binary options. ASIC encourages all investors to thoroughly research these products, to understand the risks and consider the appropriateness of the products before deciding to invest, including on the following MoneySmart pages:
  - Contracts for difference https://www.moneysmart.gov.au/investing/complex-investments/contracts-for-difference
  - Foreign exchange trading https://www.moneysmart.gov.au/investing/complex-investments/foreign-exchange-trading
  - Binary options https://www.moneysmart.gov.au/investing/complex-investments/futures-and-options/binary-options.

Question No: **QON 11**
Topic: **Additional funding**

Question:

Could you update the committee on the status and use of the additional funding announced by the government following the Financial System Inquiry and the ASIC Capability Review?

Answer:

On 20 April 2016, the Government announced an additional $127.3m funding support for ASIC over four years to better protect consumers. This comprised support for three specific measures:

- $61.1 million to enhance ASIC's data analytics and surveillance capabilities as well as improving ASIC's information management systems
- $57 million for surveillance and enforcement on an ongoing basis, particularly in the areas of financial advice, responsible lending, life insurance and breach reporting
- $9.2 million in funding for ASIC and Treasury (ASIC: ~$3m and Treasury: ~$6m) to accelerate implementation of certain measures recommended by the FSI, including
    - a product intervention power to enable ASIC to respond to market problems in a flexible, timely, effective, and targeted way;
    - product distribution obligations for industry to foster a more customer-focussed culture;
    - a review of ASIC's enforcement regime, including penalties, to ensure that it can effectively deter misconduct; and
    - the strengthening of consumer protections in the ePayments Code.

On 7 November 2016, the relevant appropriation Bill passed both houses of Parliament and ASIC has now received the funds.

ASIC has had to wait until it received the funding before commencing work, but there has been detailed planning around proposed recruitment and areas of work in the meantime. Recruitment activity has now commenced and we are ramping up our work on each element of the measures.

Question No: QON **12**
Topic: **Industry funding model**

Question:

The annual report indicates on page five that the government will introduce an industry funding model for ASIC. Could you update the committee on the implementation of that and any views that ASIC has on the funding model proposed by Treasury in November 2016?

Answer:

ASIC welcomes the Government's continued support for the introduction of an ASIC industry funding model and the release of the Government's proposals and supplementary papers on 7 November 2016.

ASIC has worked closely with Treasury in developing the revised industry funding model in response to feedback provided to the Government's previous consultation between August and October 2015.

The Government is currently consulting on a revised industry funding model proposal, with the closing date for submissions on 16 December 2016.

Question No: **QON 13 (P8)**
Topic: **Financial Advice**

Question:

Senator O'NEILL: Can I just find out the flow in terms of banks sending people to get an RG 146: how many of them are doing their training in-house, how critiqued it is, how many people are picking up the very cheap eight-hour online version and are essentially able to set up their own financial services, get their licence and go out and give dangerous advice. What is happening with RG 146? The end of it has been long delayed.

Answer:

We do not have the information requested about how the banks train their staff. This information should be requested directly from the banks.

The Parliament is currently considering the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016. This Bill deals with the education and training standards for advisers who provide personal advice to retail clients on Tier 1 products. In light of this ASIC does not think it is appropriate for it to amend the standards in RG 146 for this group of advisers. If the Bill is passed, the broad education and training framework will be set by legislation and the proposed new Standard Setting Body will determine the detailed requirements.

If the Bill is passed, RG 146 will still set the education and training standards for those advisers who provide general advice on Tier 1 products to retail clients and those who provide personal or general advice on Tier 2 products. ASIC proposed to review the standards in RG 146 for these advisers after the Standard Setting Body has determined the standards for those who provide personal advice to retail clients on Tier 1 products. We do not think it is appropriate to do so before then because we believe we should have regard to the requirements set by the Standard Setting Body when considering the relevant standard for those who provide general advice on Tier 1 products to retail clients and those who provide personal advice on Tier 2 products.

In terms of the number of new advisers in the industry, according to the information provided by licensees for the Financial Advisers Register, there were 1,542 advisers who first started providing advice in 2015, and 2,785 advisers who first started providing advice in 2016.

Question No: **QON 14 (P19)**
Topic: **Creditors - voting allocation**

Question:

Senator WILLIAMS: The creditors can pass a motion to sack the liquidators. When those creditors vote on it, is that based on value and number? If you have five creditors, and one is owed $2 million out of a total of $3 million, would that one creditor have two-thirds of the vote?

Mr Price: I think I know the answer to that question. I would like to take it on notice, to be honest.

Answer:

Current law

Under the Corporations Act 2001, creditors can vote to replace the liquidator at the first meeting of creditors under s497(11) of the Act. Similarly, creditors can replace a voluntary administrator at a first meeting of creditors under s436E(4) of the Act.

To pass a resolution to replace an external administrator, a vote is decided on the creditors' voices (a simple majority of over 50% of creditor voices present at the meeting). However, if a poll is demanded, a resolution to replace an external administrator is carried when:

- the majority in number of creditors (in person, by proxy or by attorney) vote in favour of the resolution; and
- the majority in value of debt, admitted for voting purposes, of creditors (in person, by proxy or by attorney) vote in favour of the resolution.

If there is a voting deadlock (for instance, where a majority in number of creditors vote in favour and a majority in value of debt of creditors vote against), the Chairperson is entitled to make a casting vote to resolve the deadlock.

In your scenario, and assuming a poll is demanded, the creditor (who has a $2 million debt that is admitted for voting purposes) would have a majority in value of the debt of all creditors entitled to vote at the meeting. However, to carry the resolution (and without need of a Chairperson's casting vote) three creditors (a majority) would need to vote in favour of the resolution.

Insolvency Law Reform Act 2016

Upon introduction of the ILRA, creditors will have the power to remove an external administrator by resolution passed at a meeting of creditors for which at least five business days' notice has been given. The ousted external administrator may apply to court to be re-appointed; which can occur of the court is satisfied that the removal was an improper use of the powers of one or more creditors.

The Insolvency Practice Rules, yet to be finalised, will specify how a resolution is passed. Based on draft Practice Rules [Rule 75-105]:

- a resolution is passed if a majority of creditors in number and value vote in favour of it
- a resolution is not passed if a majority of creditors in number and value vote against it
- where there is not a majority in number and value the person presiding at the meeting may exercise a casting vote. However, where the resolution relates to the removal of an external administrator, the external administrator may only exercise a casting vote in favour of the resolution (i.e. for their removal). If they do not exercise their casting vote for their removal the resolution is not passed.

Question No: **QON 15 (P25)**
Topic: **Unfair preference payments**

Question:

What about companies that have a major creditor who is an interrelated company and then, all of a sudden, they fall over. What are the actions ASIC takes?

Mr Price: At the first instance, when there is an insolvency, the insolvency practitioner plays a very important role in terms of analysing what has gone wrong. They also have a role in terms of looking at whether there are any what is called 'unfair preference payments.' And if there are any concerns about inter-company payments, they actually have a statutory obligation to report that to us. At that stage, we will become involved.

CHAIR: Are you able to see how much success there is in getting those preferred payments back through the court? Or is it usually too difficult to process?

Mr Price: I do not have that data to hand, so I might take that on notice if I can to see what we—

Mr Medcraft: Often we help with the liquidator assistance program trying to get that [inaudible] payment.

Mr Price: Yes, that is exactly right in the sense that if it is not reflected in books and records, then you—

Mr Medcraft: Basically, that is when sometimes we will say to the liquidator we will actually give you money to go after something.

Mr Day: The problem is that it is hard to get data [inaudible] about this because those actions are run by the liquidators in terms of the preference payments. Because they are run through the different state court systems or, sometimes federal systems, the alignment of that data and the reporting back to us is not high. But, again, that is an example going back to a very early discussion this morning; that it might be the type of question we start asking liquidators in the future so we can get better ideas about that. This is where we want to make sure we have got that flexibility—answering your question, Mr Keogh—into the future, so that we can get the type of data points we need to get the right insights into those things.

Answer:

<u>Unfair Preference</u>

Under the Corporations Act, a liquidator can seek recovery of certain payments made by the company to individual creditors before the start of the liquidation, (known as 'unfair preferences').

Broadly, a related party receives an unfair preference if, during four years prior to liquidation (for ordinary unsecured creditors, the period is six months), the company is insolvent, the related party reasonably suspects the company is insolvent, and the related party receives

payment of their debt (or part of it) such that the related party receives more than they would in the winding up of the company.

A liquidator has a duty to collect, protect and realise a company's assets and, investigate the company's financial affairs to identify possible voidable transactions (e.g. unfair preferences, uncommercial transactions etc).

If a company is without sufficient assets, one or more creditors may agree to indemnify a liquidator for their costs and expenses of taking action to recover unfair preferences for the benefit of creditors. A liquidator may also seek litigation funding. Prior to embarking on litigation funding, a liquidator should be satisfied that it would be in the interest of creditors as a whole to take action.

A liquidator should only pursue recovery of unfair preferences where there is a reasonable prospect of success, having regard to the available evidence, the likely cost and return. The liquidator should seek legal advice as to the strength of the claim, and if appropriate, apply to the court for directions. The liquidator should also consider making or accepting sensible settlement offers in order to avoid unnecessary costs, where possible.

The Corporations Act provides various defences to an unfair preference claim, including that the related party, at the time it received the payment(s) from the company, had no reasonable grounds for suspecting that the company was insolvent.

External administrators submit statutory reports to ASIC when they suspect company officers may have committed offences and/or where they believe unsecured creditors are unlikely to receive more than 50 cents in the dollar on their debts. External administrators predominantly lodge reports with ASIC in electronic form (Form EX01), which involves the external administrators responding to set questions or required data fields. Regarding unfair preferences, the Form EX01 presently asks the set questions:

> Have you initiated, or are you considering initiating, recovery procedures under Part 5.7B of the Act?
>
> Yes/No
>
> If yes, please indicate: (type of proceeding) e.g. Unfair preference

However, external administrators generally submit these statutory reports within the first six months of an external administration and the information contained in those reports are estimates only, based on the information known to the external administrators at the time the reports submission. They may subsequently take action to recover unfair preferences but not have indicated in their report to ASIC that they would do so.

External administrators are also required to lodge six monthly accounts of receipts and payments entered into during the external administration (Form 524). This form may disclose receipts reflecting recovery of unfair preferences. , In July 2014 , ASIC created 'structured data' Forms 524 to allow registered liquidators to lodge their accounts

electronically. However, not all external administrators adopted the electronic format. Therefore, data collected to date is incomplete.

Law reform

Upon introduction of Insolvency Law Reform Act 2016, external administrators will be required to lodge an 'End of Administration Return' following finalisation of an external administration. It is proposed the EAR will summarise all of the receipts and payments entered into during the period of the external administration (including recovery of voidable transactions).

ASIC is currently consulting with stakeholder groups about the format and content of various returns introduced under the ILRA, including the EAR.

ASIC will be able to electronically capture historical data about external administrations once the EAR is implemented and industry fully adopts electronic lodgement. Depending upon the outcome of the consultation process, this may include information about recovery of unfair preferences.

Question No: **QON 16 (P27)**

Question:

Ms BUTLER: Might I say on that—and I should be really clear—that no-one reasonable would suggest that because a senior employee of an organisation was engaged in unlawful activity then the entire organisation should have its reputation besmirched or be questioned.

Mr Medcraft: Absolutely. And equally, I will say that we have no evidence that has compromised any of our investigations at all. It is also important to underline that.

Mr KEOGH: Perhaps I could ask some further questions just on that one point before we turn to the broader issue. Who identified the alleged offending? Was it identified by ASIC internally? Or was it identified by an external law enforcement agency?

Mr Tanzer: There is a gentleman before the court. I suspect that the way in which all of that came forward will be a matter before the court. I am worried about commenting publicly about that. It is a criminal matter that is before the court, so I would prefer not to answer in a public hearing.

Mr KEOGH: It is an allegation—

CHAIR: There is a principle of sub judice, is that right, that we need to—

Mr KEOGH: I do not think that question crosses over the matter of—

Mr Tanzer: I am not sure that that will not be an issue of fact before the court.

Mr Medcraft: We can take it on notice, if you like, and come back and look at it.

Mr Tanzer: I am not trying to be evasive. I do not know, and I do not want to be in a position where we could compromise our—

Mr KEOGH: If you could take that on notice, that would be great.

Mr Medcraft: We will take it on notice.

Mr KEOGH: And I have one further question on that, and maybe I will phrase it in such a way as to avoid that problem. Is it yet a public part of the case that is being alleged against this alleged offender whom they were assisting by providing information?

Mr Tanzer: I do not believe so.

Mr Medcraft: That is not public. I have underlined that is not information in relation to any of our own ASIC activity. And that probably gives you a pretty strong hint that it nothing to do with ASIC activity. But otherwise, no.

Mr KEOGH: Maybe when that information is able to be released you can provide that on notice as well.

Answer:

As this matter is before the courts it would be inappropriate for ASIC to comment. The matter will before the courts again on 20 December 2016.

Question No: **QON 17 (P28)**
Topic: **Registry Separation**

Question:

Ms BUTLER: I should have asked before when we were talking about the registry privatisation: under the privatisation, would whistleblowers within the registry be subject to the public interest disclosure regime, or the Corporations Act regime? Do you know, Mr Tanzer?
Mr Tanzer: I do not know.
Ms BUTLER: Perhaps you could take it on notice. Let's not get derailed by it.
Mr Tanzer: Sure.

Answer:

The tender process for the ASIC registry business, including the proposed frameworks and legislative change, is being led by the Department of Finance. It would be appropriate that the question be directed to them.

Question No: **QON 18 P32**
Topic: **Whistleblowing/Deferred Prosecution Agreements**

Question:

Finally on this [whistleblowing]: how would you see this relating to penalties and penalty types if you were to be given the option of having a deferred prosecution agreement type option as a penalty?

Answer:

The impact of a Deferred Prosecution Agreement (DPA) scheme on whistleblowing more broadly will vary in accordance with the form of DPA to be adopted. The Attorney-General's Department (AGD) conducted an initial public consultation process earlier in 2016 that sought comment on various potential features of a DPA scheme, i.e. no particular model was posited. ASIC understands that AGD is currently in the process – with input, in particular, from the Commonwealth Director of Public Prosecutions – of developing a more definitive DPA proposal for the purpose of further consultation.

As a DPA scheme is, by its nature, directed toward persons and/or entities that are believed to have committed criminal offences, the intersection with whistleblowing is limited to a particular subset of whistleblowers: those who have engaged in wrongdoing.

The tasks of detecting, investigating and prosecuting serious corporate crime can be significantly facilitated by obtaining the cooperation of persons and entities involved in the offending. This cooperation can take a variety of forms including self-reporting and providing admissible evidence that incriminates others.

At present, the two principal mechanisms or tools available to secure cooperation of this type in cases of serious corporate crime are the sentencing "discounts" that will be applied by the courts to recognise the value of such cooperation and, less frequently, the power of the CDPP[1] to provide an undertaking (or "immunity") that will operate to preclude the prosecution of an accomplice in order to secure their testimony for the prosecution.

As set out in the *Prosecution Policy of the Commonwealth*[2], ideally it would not be necessary to grant concessions such as immunity from prosecution to those who have participated in alleged offences in order to facilitate the prosecution of other participants. It is preferable, and accordingly remains the "general rule", that an accomplice should be prosecuted, with their cooperation recognised by a reduction in the sentence imposed. However, it has been recognised that practicality and the interests of justice may justify departing from this ideal and the general rule when certain conditions are met.

In ASIC's view, the possible introduction of a Commonwealth DPA scheme should be

[1] Pursuant to s.9(6), (6B) or (6D) of the *Director of Public Prosecutions Act 1983* (Cth)
[2] At paragraphs 6.4 and 6.5.

viewed in this context. Just as the granting of "immunity" is regarded as a useful tool to be applied to appropriate cases to advance the interests of justice, so DPAs could properly be employed for this purpose.

Due, however, to the fact that DPAs – like the granting of immunity – would involve making an exception to the ordinary and fundamental principle of prosecuting criminality, it is important that this concession is only made available in circumstances that are perceived to, and do in fact, advance the interests of justice. To do otherwise would run the risk of undermining public confidence in the capacity of Commonwealth agencies and the criminal justice system to deal with serious corporate crime. For these reasons, ASIC's views on the form of any DPA scheme are guided by the desire to maximise the potential benefits – particularly in the area of self-reporting – within prudent boundaries.

For instance, ASIC's submission to AGD expressed the view that DPAs should not be available to individuals. This is the approach adopted under the UK's DPA scheme. To a significant extent, this limitation on the availability of a DPA is dictated by the outcomes that are envisaged as appropriate to being achieved by way of a DPA. These outcomes are principally pecuniary in nature – financial penalties, reparation and compensation – and are therefore more consistent with the limited outcomes that are currently available when dealing with companies (imprisonment, for example, being unavailable). Similarly, with these principally pecuniary outcomes in mind, there would be a risk that applying such a scheme to individuals might unfairly favour those persons who could afford to pay appropriate penalties, reparation and compensation.

Ultimately, the prosecution of the individuals who have effected the criminality is fundamental to deterring future misconduct. In the exceptional scenario in which the prosecution of an individual offender is considered worth foregoing in order to assist in the prosecution of others, this is appropriately dealt with pursuant to the CDPP's existing powers to grant "immunity".

Question No: **QON 19**
Topic: **ASIC Annual Report**

Question:

For its 2015–16 Annual Report, could ASIC identify when the Minister complied with subsection 136(4) of the *Australian Securities and Investment Commission Act 2001*, which requires the Minister to provide a copy of ASIC's annual report to the Attorney-General of each State and Territory as soon as practical after the Minister receives the report.

Answer:

This is a question for the relevant minister.

ASIC's 2015-16 annual report was tabled in the Federal Parliament on 31 October 2016.

Question No: **QON 20**
Topic: **Fair Work (Registered Organisations) Amendment Bill 2014**

Question:

Would ASIC please inform the committee of any implications for ASIC's funding or workload that may arise from the Fair Work (Registered Organisations) Amendment Bill 2014

Answer:

There are no obvious implications for ASIC's funding or workload arising from the Fair Work (Registered Organisations) Amendment Bill 2014