

**Question No:** 012  
**Reference:** Page 57  
**Committee Member:** Mr Georganas MP

**Questions:**

**Mr GEORGANAS:** In terms of auditors, some of these groups that aren't doing the right thing don't seem to use top-tier audit firms, and they're required to provide audited accounts to ASIC. Is ASIC investigating any of the auditors of these schemes for breaches in their obligations?

**Ms Armour:** I would have to take that question on notice and have a look at that.

**Mr GEORGANAS:** Thank you. Let us know.

**Ms Armour:** We have had a number of surveillance activities over recent years looking at how firms in this sector manage client monies. I would be happy, also on notice, to provide you with the general results, which are public, but with references to those for you.

**Answers:**

In the 12 months to 30 June 2020, ASIC reviewed work on client monies in the audit of an Australian Financial Services (AFS) licensee at each of the largest four audit firms. Areas for improvement identified from these reviews will be included in our audit firm inspection report for the 12 months to 30 June 2020, which will be released in mid December 2020.

We may also review audit work on client monies of AFS licensees based on complaints and other intelligence. For example, an auditor applied for his registration as a company auditor to be cancelled in 2016 after ASIC had raised concerns with his audit work on client monies.

In June 2017, we updated the instructions to ASIC Form FS 71 *Auditor's Report for AFS Licensee* to include specific guidance on audit work relating to client monies. This guidance covers areas such as internal controls, the banking and withdrawal of client monies, and reconciliations of client balances with balances of segregated bank accounts.

We also highlighted audit work on client monies at AFS licensees as a focus area for auditors in the following documents:

1. ASIC Report 534 Audit inspection program report for 2015–16 (June 2017); and
2. ASIC Media Releases on financial reporting focus areas for directors, preparers and auditors:
  - a) 16-174MR ASIC calls on directors to apply realism and clarity to financial reports (2 June 2016);
  - b) 16-428MR ASIC calls on preparers to focus on useful and meaningful financial reports (8 December 2016);
  - c) 17-162MR ASIC calls on preparers to focus on the quality of financial report information (31 May 2017);
  - d) 17-423MR ASIC calls on preparers to focus on financial report quality and new requirements (8 December 2017); and
  - e) 18-159MR Major changes affecting reported net assets and profit, and other focuses for 30 June 2018 reporting (31 May 2018).

ASIC is not currently investigating any auditors in connection with their audit work on client monies held by an AFS licensee.

ASIC has also taken action against AFS licensees for breaches of the requirements for handling client monies. Examples are covered in the following ASIC media releases:

1. 19-344MR Pershing Securities Australia charged with breaching client money obligations and accepts additional licence conditions (10 December 2019); and
2. 20-252MR Societe Generale Securities Australia Pty Ltd receives \$30,000 penalty for breaching client money rules (21 October 2020).

### **Market Supervision Client Money work**

ASIC has undertaken extensive work on retail OTC derivative issuers' management of client monies over the years, including:

- 1) Regulation Impact Statement Retail OTC derivative issuers: Financial requirements (July 2012);
- 2) ASIC Report 316 Review of client money handling practices in the retail OTC derivatives sector, (December 2012);
- 3) ASIC Report 482 Compliance review of the retail OTC derivatives sector;
- 4) Info Sheet 226 Complying with the ASIC Client Money Reporting Rules 2017 (October 2017, reissued July 2019);
- 5) Introduction of the Derivative Client Money Rules 2017 and changes to Part 7.9 of the Corporations Act (2001) (which commenced in April 2018);
- 6) Regulatory Guide 212 Client money relating to dealing in OTC derivatives (April 2018); and
- 7) ASIC Media Releases:
  - a. 10-154MR ASIC releases guide to improve transparency for retail derivative investors (12 July 2010);
  - b. 16-134MR Ikon rectifies client trust accounts and improves disclosure (11 May 2016);
  - c. 16-197MR ASIC releases report highlighting significant failures in the retail OTC derivatives industry (20 June 2016);
  - d. 16-213MR XTrade to change client money practices following ASIC surveillance (1 July 2016);
  - e. 16-378MR ASIC welcomes 'client money' reforms (28 March 2017);
  - f. 17-338MR ASIC's client money reporting rules finalised (10 October 2017);
  - g. 18-036MR ASIC obtains interim injunctions and warns investors against AGM Markets, OT Markets and Ozifin (Trade Financial) (13 February 2018);
  - h. 18-089MR ASIC releases updated guidance on client money (4 April 2018);
  - i. 18-390MR ASIC obtains freezing orders against Berndale Capital Securities and Stavro D'Amore (20 December 2018);
  - j. 19-062MR ASIC obtains interim injunctions against Forex Capital Trading (21 March 2019); and
  - k. 19-373MR Interim asset restraint orders made against Corporate Authorised Representatives of OTC derivatives provider (23 December 2019).

Between December 2011 and August 2012, ASIC conducted a risk-based surveillance of client money handling practices of 40 retail OTC derivative issuers which resulted in the release of ASIC

report 316 in December 2012. The report identified, amongst other things, that about half of the reviewed CFD issuers used client money as collateral to hedge their exposure to client trades. Those that did not were typically either some of the largest, most established CFD issuers or CFD issuers that were in the startup phase and had few clients, making it relatively cheap to use their own money to support hedging initially.

In April 2015, ASIC conducted a review of a range of risks affecting the retail OTC derivative sector, including the handling of client money (risk 3) which resulted in a number of licensees changing their processes and in the publishing of Report 482 Compliance review of the retail OTC derivatives sector in June 2016. The key concerns identified in the report regarding the handling of client money were:

- Inadequate designation of client trust accounts;
- Use of general operational accounts to clear client funds;
- Use of overseas money managers or payment systems;
- Deposit of non-client money into client trust accounts;
- Withdrawals not permitted from s981B accounts; and
- Misuse of s1017E accounts.

After amendment to Part 7.9 of the Corporations Act (2001) in April 2018, OTC derivative issuers were no longer able to use retail client funds for business purposes, which resulted in a significant change in the way that retail OTC derivative issuers operated their business.

All licensees which held derivative client money on behalf of retail clients were also required under the newly established Derivative Client Money Rules as of April 2018 to report to ASIC on a monthly basis the total of these retail derivative client monies.

Since February 2018 ASIC has obtained injunctive orders against a number of retail OTC issuers due to concerns regarding the protection of client monies.

In addition to the public notifications listed above, the supervision team conducts regular reviews of retail OTC derivative client monies, including the review of all monthly reconciliations by licensees holding retail derivative client monies.

The supervision team are currently in the final stages of conducting a review of a sample of retail OTC derivative issuer client money procedures, where we are hoping to provide some public messaging on better and poorer practices early in 2021.

Furthermore, ASIC's 2020-2024 business plan explicitly stipulates a focus on the protection of retail client monies.