SENATE ECONOMICS REFERENCES COMMITTEE
Inquiry into the performance of ASIC

**Questions on notice for ASIC**

**New Credit laws**

1. In ASIC's view, do the new credit laws address adequately all the failings and gaps in consumer protection that appeared in lending practices during the 2002–2010 period?

**Answer:**
**The new laws have made a significant impact in relation to:**

- **Excluding rogue players and establishing minimum honesty, competence and training standards – through the introduction of a national licensing regime for credit.**
- **Mandating membership and therefore access to an ASIC approved External Dispute Resolution Scheme for consumer borrowers.**
- **Requiring lenders and brokers to assess the capacity of borrowers to meet repayments – which addressed the experience under the former UCCC regime that many consumers took out unaffordable loans, including, on the fringes, "no doc" loans and loans provided as part of equity stripping practices (where consumers in default were refinanced into short-term high-cost loans that did not address their underlying financial difficulties).**
- **Addressing the specific risks associated with payday lending – primarily the risks that repeated use of these products means that an increasing proportion of the borrower's income will be used to meet the repayments, and the capacity of the borrower to use the credit for purposes that can improve their standard of living is diminished.**
- **Strengthening the protections for consumers who use reverse mortgages – by addressing the difficulties consumers have in balancing their current need for credit with the uncertainty of their future position (both in relation to the cost of the reverse mortgage, changes in the value of their home, and their health needs).**

**The *National Consumer Credit Protection Act 2009* (National Credit Act) has largely addressed the regulatory issues and market problems prevalent before 2010, although it may be too early to make a final assessment of how effectively it has done so. It has also given ASIC greater powers, which we have been able to utilise effectively, to protect consumers against those who engage in unlawful conduct.**

**However, this statement is qualified in that it only applies in relation to the categories of credit regulated by the Act. Under the 2008 COAG agreement in relation to credit the reforms were split into two Phases. COAG recognised that some areas of credit required further examination, given that there had been no significant changes to the scope of credit regulation since the previous Uniform Consumer Credit Code regime was introduced in 1996.**

**As a result, in December 2012, Treasury consulted on Phase 2 proposals for changes in relation to investment lending, peer-to-peer lending, small business lending, short-term and indefinite-term leasing, and a number of anti-avoidance mechanisms.**

2. To the extent the Government identifies gaps or problems in relation to these topics they have not been addressed. Under the new credit regime are borrowings by SMEs and by consumers for investment purposes adequately protected from irresponsible or poor lending practices?

**Answer:**

**As discussed above the National Credit Act:**

- **Does not apply at all to borrowings by SMEs**
- **Does not apply to borrowings for investment purposes, other than investment in real property.**

**Those borrowers are therefore not subject to new or additional protections under the National Credit Act, and are only able to take action under other laws, principally the *ASIC Act 2001* (ASIC Act).**

**The protections provided by the ASIC Act are critically important, although subject to the limitations set out below. Our experience suggests, however, that they have limited application to the types of issues typically raised by SMEs (such as access to credit).**

**By comparison with lending that is regulated by the National Credit Act, the protections provided under these laws are subject to limitations[1], such as:**

- **There is no universal EDR membership, restricting the capacity of borrowers to obtain redress where they have suffered a compensable loss.**
- **The philosophy behind the consumer protection provisions of the ASIC Act (and the Australian Consumer Law more generally) is to prohibit misconduct, which means the law can only be enforced after the misconduct has occurred. This produces different, and more limited, outcomes than the approach in the National Credit Act, which is to mandate appropriate conduct (for example, by requiring lenders to assess the borrower's capacity to meet repayments before entering into a contract).**
- **There is no capacity to exclude repeat offenders by removing a licence or taking banning action, so that there is less effective deterrence than if the conduct was regulated by the National Credit Act.**

**The difference in outcome can be illustrated by the fact that equity stripping practices still continue in relation to SMEs, even though this is no longer an issue for consumers borrowing for personal issue.[2]**

**The conduct prohibitions in the ASIC Act are directed at misconduct and so will generally not address practices that can be characterised as "poor" or undesirable. Whether the existing level of protection is adequate is a matter for Government, having regard to a range of other factors (including the impact on borrower's ability to access credit).**

3. Are there any areas of concern emerging as the new credit laws bed down?

**Answer:**
**ASIC considers that the following two substantive issues are areas of concern.**

**There can be a lack of competitive neutrality where players offer products that are functionally similar to regulated products but without having to meet, for example, the licensing and responsible obligations through the National Credit Act. This has two**

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[1] See the *Regulation Impact Statement: Small Business Credit* at pages 15-17, at: http://ris.dpmc.gov.au/2013/01/15/small-business-credit-regulation-impact-statement-the-treasury/

[2] The operation of these practices is discussed in detail in the *Regulation Impact Statement: Small Business Credit*, although the extent to which they occur is unknown.

**different contexts:**

- **Mainstream products, where the lack of regulation may be the result of innovations in product design (such as peer to peer lending).**
- **Avoidance activity on the fringes, where lenders and brokers deliberately change their business models and structures to be exempt from the law or aspects of the law.**

**We note the Government has recently taken steps to address some avoidance practices, by circulating draft regulations to close some gaps in the law being exploited by payday lenders and signalling a review of the exemption for indefinite and short-term leases in the National Credit Act.**

**However, given that the possible structures for avoiding the cap on costs are limited only by the ingenuity of those advising possible avoiders, the Government could consider a general anti-avoidance provision that sought to deter entities making repeated changes in business models to continue avoiding their obligations under the National Credit Act (rather than addressing each model as it emerges after the event).**

**Secondly, there has been an increase in the number of businesses that charge consumers fees to repair their credit records, or to pursue claims through the EDR schemes. These companies often charge high fees for services that would otherwise be provided free of charge by the dispute resolution services, and may exacerbate the consumer's financial difficulties where they pursue unmeritorious claims that delay or impede the resolution of their position.**

**While not an area of concern, ASIC considers that the implementation of responsible lending obligations will continue to be an area of review as the obligations are expressed in general terms, with therefor significant divergence in practices across the industry.**

**In addition, ASIC regularly identifies a range of technical or minor issues with the operation of the National Credit Act in the course of its surveillance work, which it brings to the attention of Treasury as appropriate.**

4. Should FOS/COSL have an expanded mandate and a special division to be able to deal with complaints from SMEs?

**Answer:**

**Currently there is no obligation on entities that exclusively provide SME credit to be a member of an EDR Scheme like FOS or COSL. In addition:**

- **In respect of the level of compensation, ASIC notes that the Senate Inquiry into the Post-GFC Banking Sector recommended that the cap on the maximum compensation that FOS can award be increased to $2 million when the dispute relates to a small business (recommendation 9.3); and**

- **The recent review of FOS included a recommendation that, in relation to large, complex commercial credit disputes, FOS should more actively exercise its discretions to refuse to consider the dispute (for example, because there is a more appropriate place to deal with the dispute such as a Court)3. ASIC**

[3] See the *2013 Independent Review of the Financial Ombudsman Service* at paragraph 10.5.3, at: http://www.fos.org.au/custom/files/docs/independent-review-final-report-2014.pdf

**understands that FOS will implement this recommendation.**

**To the extent the question of an expanded mandate refers to an increase in the obligations of lenders and brokers dealing with SMEs as borrowers, this is a question for Government.**

**In relation to the question of whether the EDR schemes should have a special division to be able to deal with complaints from SMEs, this is an operational question best addressed by FOS and COSL.**

5. Are there other alternatives to assist SMEs including farmers deal with disputes over credit related matters?

**Answer:**

**The following short summary of the alternatives (other than legislation and complaint to an EDR scheme) is provided:**

- **Voluntary Codes sponsored by an industry body. These can have the advantage of providing standards of conduct higher than those in legislation. However, they apply to particular industry sectors, rather than being universal in application.**
- **Advocates, such as Small Business Commissioners. ASIC is not able to comment on the operational effectiveness of these positions.**
- **State-specific legislation in relation to some farming contracts. For example, the *Farm Debt Mediation Act 1994* (NSW) provides a mechanism for farmers to request compulsory mediation after they have been given notice of intended enforcement action. ASIC has been advised that a more specialised model like this has advantages over the generalist EDR schemes, although it has no direct experience on this issue.**

6. Given the instances recounted in the submissions where highly vulnerable people were targeted and encouraged to take out loans or invest in risky products, should the whole area of what constitutes unconscionable conduct be reviewed?

**Answer:**

**This is a policy question for Government. It is worth noting that the need for consumer borrowers to rely on unconscionable conduct claims has been reduced by the introduction of the National Credit Act and in particular the more positive responsible lending obligations it contains. However, that is not the case for SME borrowers and those borrowing of investment other than in residential property. In those areas**

1. **The prohibition on unconscionable conduct in the ASIC Act covers a broad range of situations in addition to lending for investment purposes, so that the courts have generally applied it to address the most extreme classes of conduct in all cases. The prohibition therefore does not provide a nuanced remedy that addresses the complexities of a transaction where problems may arise because of the different interests of a consumer, a provider of an investment product, a lender and any finance broker. If a specific remedy is proposed it can be targeted to meet the specific concerns identified in relation to investment lending, and may therefore be more effective.**

2. **Fringe players often target consumers able to access large lump sums, and in practice therefore approach pensioners and persons approaching retirement**

**who have significant equity in their homes[4]. These borrowers are vulnerable if the investment fails or turns out to be a scams they will usually only able to meet the repayments under the loan by selling their home. This can have significant financial and social costs for the individual, and broader economic costs for Government.**

3. **Where the loan is secured against the equity in the borrower's home, the lender is protected against loss in the event of default and therefore has less incentive to consider whether the borrower can afford to make repayments, or to conduct other checks that are common in relation to lending for personal use.**

4. **A lender can, in practice, mitigate the risk of claims by interposing a finance broker between itself and the consumer. As the broker is typically treated as an agent of the consumer this limits the lender's responsibility for their conduct (even if the broker receives commissions paid by the lender).**

**Internal compliance**

7. Mr Medcraft informed the committee that 'it is far better for business to invest in compliance to achieve the outcome than to essentially have a regulator come in'. Committee Hansard, 19 February 2014, p. 32.

- In light of the poor performance of the internal compliance regime in some of Australia's supposedly most reputable institutions, for example the CFPL and Macquarie Private Wealth, could ASIC give the committee an overall assessment of the effectiveness of the internal compliance arrangements in Australian corporations?

**Answer:**

**In the time available, it is not possible to provide an assessment of the effectiveness of the internal compliance arrangements of Australian corporations in general, or of Australian financial services licensees (AFS licensees) in general.**

**However, to provide some background, AFS licensees have obligations under s912A(1) of the *Corporations Act 2001* (Corporations Act) to, among other things:**

- **do all things necessary to ensure that the financial services covered by their licence are provided efficiently, honestly and fairly;**
- **have adequate arrangements in place for managing conflicts of interest;**
- **comply with the conditions on their licence;**
- **comply with the financial services laws;**
- **take reasonable steps to ensure that their representatives comply with the financial services laws;**
- **unless they are regulated by APRA, have adequate financial, technological and human resources to provide the financial services covered by their licence and to carry out supervisory arrangements;**
- **maintain the competence to provide the financial services covered by your licence;**

[4] See the *Regulation Impact Statement: Credit for Investment Purposes* at page 16, at: http://ris.dpmc.gov.au/2013/01/15/credit-for-investment-regulation-impact-statement-the-treasury/

- **ensure that their representatives are adequately trained and competent to provide those financial services;**
- **if they provide financial services to retail clients, have a dispute resolution system; and**
- **unless they are regulated by APRA, establish and maintain adequate risk management systems.**

**Effective internal compliance arrangements are crucial to meeting these statutory obligations. In keeping with the principles-based nature of the financial services legislation, ASIC does not prescribe how licensees should meet these obligations. However, ASIC provides guidance that what licensees need to do to comply with their obligations will vary according to the nature, scale and complexity of their business (Regulatory Guide 104: *Licensing: Meeting the general obligations* (RG 104)).**

**While ASIC has not undertaken a specific assessment of the effectiveness of the internal compliance arrangements of AFS licensees, we undertook a review of the business and risk practices:**

- **of the 20 largest AFS licensees that provide financial product advice to retail clients in 2011 (Report 251 *Review of financial advice industry practice* (REP 251));**
- **of the top 21 to 50 AFS licensees that provide financial product advice to retail clients in 2013 (Report 362 *Review of financial advice industry practice: Phase 2* (REP 362)).**

**REP 251 review found that the top 20 licensees are focused on risk management and compliance. A number of issues were highlighted, including:**

- **Proactive licensee monitoring – this should be instrumental in detecting incidents and breaches; and**
- **Risk profiling tools - advisers should not rely on risk profiling tools without also considering if the outcomes are appropriate for their clients' circumstances.**

**REP 362 found that most of the top 21 to 50 licensees were taking steps to mitigate key risks, although a number of issues were highlighted, including:**

- **Monitoring and supervision of advisers – licensees must ensure their advisers comply with their stated procedures. Licensees must check references of new advisers to exclude 'bad apples'. Licensees must report breaches and demonstrate remediation plans are in place. Licensees should retain access to client records at all times.**
- **Product and strategic advice – conflicts of interest need to be managed. It is important to educate clients about risk and return so that their expectations are more realistic.**

8. Ms Bird told the committee the Macquarie Private Wealth had 'systemic failings of compliance and it had a poor compliance culture'. (Committee Hansard, 10 April 2014, p. 95)

- In this area of compliance, should or could more be done to impose greater self-regulation on corporations and if so how could this be achieved?

**Answer:**

**Self-regulation involves industry developing and enforcing its own regulatory rules, with no or minimum government intervention. Ideally, self-regulation should be initiated by industry, rather than imposed upon it. However, Government can create environments that encourage self-regulatory initiatives, for example, by recognising a self-regulatory regime in legislation and providing incentives to comply with the regime.**

**However, it should be noted that even with Government support there are impediments to effective self-regulation in the financial services industry. There are even greater impediments if the desire is to create a self-regulatory regime which applies to the whole of corporate Australia.**

**There are several factors that determine whether self-regulatory models are likely to be appropriate or effective. These factors relate to the nature of the relevant industry, the type of regulatory problem to be addressed by self-regulation and the level of risk to consumers if the regulation fails. Some of the factors that are necessary for effective self-regulation are:**

- **clearly defined problems but no high risk of serious or widespread harm to consumers;**
- **a mature industry environment with an active industry association with sufficient resources to implement and enforce the self-regulation and/or industry cohesiveness. Self-regulation is typically less effective where there are multiple industry associations and/or a fragmented industry;**
- **a competitive market that makes industry participants committed to participating in a self-regulatory regime, either to differentiate their products, or in fear of losing market share; and**
- **incentives for industry participants to initiate and comply with self-regulation (e.g. consumer recognition and preference for members of the scheme). The most significant incentive is a serious threat of timely law reform if self-regulation is not providing the desired market outcomes for consumers and investors.**

**ASIC supports self-regulatory measures, particularly where industry standards or requirements exceed legal requirements. However, ASIC's experience is that co-regulation, where there is a greater integration between industry-based regulation and more formal regulatory requirements, is likely to deliver better market outcomes than self-regulation. A successful example in the Australian market is the e-Payments code.**

**In fact, self-regulatory models are rarely an effective or acceptable alternative to explicit regulation in the context of retail financial markets because currently pre-conditions for effective self-regulation are rarely present in a fully developed state.**

What would be the advantages and disadvantages of the requirement to have a compliance director, who is a board member not a senior staff member, under a statutory duty to report to ASIC any management failing to remedy violations of the company's compliance program?

**Answer:**

**In the time available, ASIC is not able to provide a considered response to this question.**

**However, it may be useful to outline ASIC's guidance regarding:**

- **responsibility for compliance, as set out in RG 104 and RG 105;**
- **reporting of significant breaches, as required under s912D of the Corporations Act and as discussed further in Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78).**

***Responsibility for compliance***

**ASIC expects that a director or senior manager will be responsible for overseeing compliance measures and reporting to the governing body: RG 104.49.**

**In addition, Regulatory Guide 105 *Licensing: Organisational Competence* (RG 105) sets out how ASIC assesses compliance with the organisational competence obligation in s912A(1)(e); that is, by looking at the knowledge and skills of people who manage the financial services business (i.e. responsible managers). As set out in RG 105.26, the job description and title of responsible managers will vary from business to business. For example, in a small advisory business the directors are likely to be the main people who have direct responsibility for significant day-to-day business decisions, but in a larger financial services group anyone ranging from the chief executive officer down to middle management might have the required direct responsibility.**

***Reporting of significant breaches***

**AFS licensees are required (under s912D of the Corporations Act) to report to ASIC any significant breach (or likely significant breach) of their obligations under s 912A and 912B of the Corporations Act. Failure to comply with this obligation is an offence, punishable by 50 penalty units or imprisonment for one year, or both.**

Does ASIC have any suggestions how Australian corporations can develop and foster a compliance culture?

**Answer:**

**In the time available, ASIC is not able to provide a considered response to this question. However, there are a number of guides, standards and codes which may assist licensees to develop and foster a compliance culture:**

- **ASIC has released a number of regulatory guides including RG 104, RG 105 and Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165). RG104 refers to the Australian Standard AS 3806 – 2006 *Compliance Programs*, which sets out principles that support a compliance culture. RG 104 also refers to AS/NZS 4360:2004 (now updated to AS/NZS ISO 31000:2009) *Risk Management – Principles and Guidelines* which sets out how to create an effective risk management culture.**
- **Industry associations have released a number of standards and codes, including:**
  - **Financial Planning Association of Australia's *Code of Ethics and Professional Standards*;**
  - **Association of Financial Advisers' *Code of Ethics*; and**
  - **Accounting Professional and Ethical Standards Board's standard for the provision of financial planning services, APES 230 *Financial planning services* (applying from 1 July 2014).**

**Finally, internal compliance systems obviously vary greatly across the diverse range of corporations in Australia so it is difficult to generalise about any problems or solutions that are relevant to all.**

9. Vicky Comino suggested inserting a provision into the Corporations Act in similar terms to the former Trade Practices Act s85(1), as a means of 'encouraging' a corporate culture conducive to compliance with Corporation Act requirements. She noted:

> Section 85 (1) of the TPA did not mandate that companies have a compliance system in place, but encouraged them by providing a defence where they had a proper system and adequate supervision to ensure that the system was properly carried out. Indeed, under the TPA, companies gained two possible benefits. The first was a complete defence if they could satisfy the court that, notwithstanding a proper system, properly maintained, the contravention occurred and secondly mitigation of penalty if the court was satisfied that the system, although not adequate, indicated a corporate culture conducive to compliance …[5]

- What are your views on this suggestion or should or could legislation go even further?

**Answer:**

**The existence of a properly functioning compliance system that provides adequate monitoring and supervision is something that ASIC already takes into account when it is assessing instances of misconduct or possible contravention, and making a decision on what regulatory response is appropriate. For example, in an instance of serious misconduct by an individual adviser, ASIC may consider the licensee's systems and their effectiveness in deciding whether action in relation to the licensee is appropriate. In the case of compliance concerns around a licensee, the culture of the licensee will be relevant to the question of whether a licensing action such as suspension or cancellation is appropriate.**

## Focus of regulation—licensees vs financial product

10. The Consumer Action Law Centre and Professor Kingsford Smith noted that ASIC's powers were on regulating the conduct of licensees while the UK Financial Conduct Authority was empowered to regulate financial and credit product themselves.[6] The Law Council of Australia suggested that:

> …'merits' regulation of financial products for unsophisticated investors may need to be considered in Australia. That is, unsophisticated investors might need to have a limited range of investment choices that are limited to investments that are appropriate to their needs and circumstances or that have been approved by a regulator such as ASIC.[7]

- Is this suggestion a practical solution to preventing retail investors being exposed to unsafe products? In your view are their other solutions? Could you provide details?

**Answer:**

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5 Vicky Comino, 'Towards better corporate regulation in Australia', *Australian Law Journal of Corporate Law*, 2011, pp. 37–38.

6 *Submission 120.*

7 *Submission 150.*

**In both our main submission to the Senate inquiry into the performance of ASIC, and our recent submission to the Financial System Inquiry (FSI), we have noted that there are inherent limitations to a regulatory approach that relies solely on disclosure to address some of the problems investors and financial consumers face in financial markets, such as mis-selling of products (i.e. when a financial product does not meet an investor or financial consumer's financial situation, risk profile, objectives and needs). Reasons for the limitations of disclosure include that:**

- **people may not read or understand mandated disclosure documents, due to factors such as inherent behavioural biases or a lack of financial literacy skills, motivation and time; and**
- **the complexity of many financial products may mean that disclosure for such products can also be lengthy and complex, or excessively simplified and generalised.**

**We have also noted in our submissions that, internationally, regulators are looking for a broader toolkit to address such market problems, which could involve 'merits' regulation of financial products in some cases. Some of these different approaches are described in our answers to questions below.**

**Ultimately, such a change in approach would be a matter for the Government to decide. However our FSI submission lists some of the ways that our regulatory system has already moved beyond disclosure to more merits based regulation (see Table 2).**

- Could you explain the powers conferred on the Financial Conduct Authority to intervene in the design or categorisation of a product and what ASIC regards as the positives and negatives of a regulator being able to do so?

**Answer:**

**ASIC understands that FCA will continue a move initiated by its predecessor, the Financial Services Authority, towards 'product intervention'. It will periodically review particular financial services market sectors and examine how products are being developed, and the governance standards that firms have in place to ensure fairness to investors in the development and distribution of products.**

**To assist with this, the FCA has a spectrum of temporary 'product intervention' powers, to address problems seen in a specific product. These may include rules:**

- **requiring providers to issue consumer or industry warnings;**
- **requiring that certain products are only sold by advisers with additional competence requirements;**
- **preventing non-advised sales or marketing of a product to some types of consumer;**
- **requiring providers to amend promotional materials;**
- **requiring providers to design appropriate charging structures;**
- **banning or mandating particular product features; and**
- **in rare cases, banning sales of the product altogether.**

**Rules could apply to specific products, or a class of products, and may remain in place for 12 months.**

**While these tools range in degrees of intervention and, in serious cases, could include a ban on products or product features, we understand that use of the most interventionist tools is likely to be rare. Rather, the FCA has said that the extent and intrusiveness of the rules it will make will be based on finding the type of intervention best fitted to the problem it identifies. It will look to find a proportionate response to the problem, based on the perceived risk to:**

- **consumers;**
- **competition failings; and/or**
- **market integrity issues.**

**However, having access to this range of different types of regulatory approaches allows the FCA to design and implement targeted responses that are suited to achieving a particular market outcome.**

**The FCA has also published a guide, *Applying behavioural economics at the Financial Conduct Authority*. This will support the FCA in taking into account lessons from behavioural economics in designing effective interventions. This guide indicates that not all such interventions need to be strongly interventionist, and that simple 'nudges' (i.e. small prompts in decision making that do not restrict choice) are likely to achieve cost-effective results in many cases.**

**As the FCA's regulatory approach is relatively new, at this stage, it is difficult to draw any settled conclusions about the positive or negative aspects of such an approach. However, the Government may wish to consider whether such a broader regulatory toolkit would be appropriate in the Australian financial regulatory system.**

- Could ASIC respond to the thrust of suggestions that in Australia consideration should be given to regulating the financial product and its suitability for retail investors?

**Answer:**

**ASIC considers that having a broader and more flexible regulatory toolkit would enhance our ability to foster effective competition and promote investor and consumer protection. As we noted in our submission to the FSI, regulating product suitability is one type of approach that has been adopted internationally. In many cases, these have been implemented as investor assessment requirements (e.g. requiring intermediaries to assess investors' knowledge and experience about certain products before they can be sold).**

**In relation to Australian financial regulation, the national consumer credit regime requires credit providers and intermediaries to assess the suitability of credit for consumers before lending takes place. This recognises that the trade-off between accessing credit today and having fewer available funds in future when repayment is due may be difficult for consumers to readily appreciate, and that decision-making biases lead people to overvalue immediate gratification relative to future needs. A similar requirement applies under the financial services regime to margin lending facilities.**

**The Government may wish to consider extending such an approach more broadly, to encompass other financial products.**

- Does ASIC believe there is a need to review the definitions of 'wholesale investor', 'sophisticated investor' and 'retail investor'?

**Answer:**

**Please refer to Q12**

- Should it be mandated that a consumer must be informed of their classification as either retail or wholesale and the consumers protections that go with their classification?

**Answer:**

**A client's awareness of their status as either retail or wholesale is an issue that was specifically raised in Treasury's 2011 options paper, *Wholesale and Retail Clients Future of Financial Advice*. This issue should be considered in any changes the Government may make to the law in this area following the conclusion of this review.**

11. In her submission, Professor Dimity Kingsford Smith noted that:

In Britain the 'Treating Clients Fairly' program of the Financial Conduct Authority allows the regulator to intervene in the design of the product, not just place a stop order on disclosure. We think there is also room for ASIC to exercise powers to prohibit the issue of certain products in retail markets, if it is thought they are too complex, risky or leveraged to be appropriate.[8]

What are your views on giving a financial services regulator such powers? What are the advantages and potential downsides of conferring such authority on a regulator?

**Answer:**

**Please refer to ASIC's previous answer regarding the UK FCA's new**

**intervention powers.**

**<u>Wholesale/retail</u>**

12. At the last public hearing, Ms Bird told the committee that there was 'significant legal uncertainty' about what constitutes 'wholesale'. (Committee Hansard, 10 April 2014, p. 97)

In your view does this uncertainty need to be cleared up? If so how should it be done?

**Answer:**

**ASIC is of the view that the uncertainty should be removed by legislative amendment.**

**Where the line is drawn between wholesale and retail is a policy matter for government.**

**Financial Planners**

13. The Financial Planning Association recommended:

(a) restricting the ability of individuals to call themselves a financial planner if they are only selling a product;

(b) requiring financial planners to adhere to professional obligations by requiring financial planners to be members of a Regulator 'prescribed professional association'; and

(c) enshrining the terms financial planner/adviser in law.

- What are ASIC's views on these suggestions?

**Answer:**

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8 *Submission 153*, p. 8.

**The merits of the Financial Planning Association's recommendation are primarily a policy matter for government. However, ASIC has previously noted that restricting the terms 'financial planner' or 'financial adviser' to individuals that are licensed (or are representatives of a licensee) may help reduce inappropriate use of these terms.**

**Banning**

14. Is it correct that a person banned from providing financial services can continue to act as a director of a financial services corporation? If so, to your knowledge has the government given any consideration to preventing this situation from occurring? Are you aware of any impediments to extending the ban to being a director of, or a person occupying a position of influence in, a financial services corporation?

**Answer:**

**While ASIC has powers to cancel an AFS license or credit licence, or ban a person from providing financial services or credit services, a missing element is a power to prevent a person from having a role in managing a financial services business or credit business.**

**This means ASIC can have difficulty in removing these managing agents who do not themselves provide a financial service but are integral to the operation of a financial services business.**

**This issue was recently highlighted in ASIC's submission to the *Senate inquiry into the performance of ASIC* (October 2013). We recommended amending the law to provide ASIC with the power to ban a person from managing a financial service business or credit business.**

**Data and intelligence gathering**

15. Dr Suzanne Le Mire et al expressed concern about 'the relative lack of statistics and data for researchers, stakeholders and the wider public'. Her group noted that ASIC receives and stores prescribed information under legislation, and while acknowledging that some of it cannot be made public, argued that 'anonymous and aggregate statistics can be made public if ASIC chose to do so.[9] Other submitters also criticised ASIC for not producing informative statistics.

- In your view could ASIC do more to promote 'informed participation' in the market by making information more accessible and presented in an informative way?
- Are they particular obstacles preventing ASIC from doing so?
- Should there be a legislative requirement for ASIC to make available statistics based on the information gathered especially to keep the market informed and for research purposes?
- Some have questioned the high fees ASIC charges to access data from its data bank—would you like to comment?

**Answer:**

**Searching of ASIC Registers**

**Most of the information collected by ASIC is available free of charge and can be accessed via our 'ASIC Connect' service through the ASIC website.**

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9 *Submission 152.*

**However, ASIC is also bound by legislation (including the Corporations Fees (Regulations) 2001 (Cth), Business Names Registrations (Fees) Regulations 2011, National Consumer Credit Protection Act 2009 and Superannuation Industry (Supervision) Act 1993) to charge fees to obtain certain registry information and/or documents.**

**The fees and charges are set by Government and are indexed annually in line with the CPI index. ASIC has little discretion in administering the charging of fees for information obtained via its registers.**

**ASIC publishes statistical data on our website free of charge, including the total number of companies on the register and the number of new registrations. This data is presented on a monthly basis (from 1999) and includes the split of companies by the state/territory in which their registered office is located. More extensive registry statistics are provided in ASIC Annual Report.**

**The Annual Report contains a wide range of statistical data. An example is the six-year summary of key stakeholder data that includes, among other examples of business data: company information, credit licenses, criminals jailed, litigation outcomes, total searches of ASIC databases, fees and charges collected by ASIC, and ASIC staffing levels.[10]**

**The ASIC website includes statistical data on insolvency and equity market data. ASIC also releases statistical data in published reports such as Market Supervision reports, Consumer reports, Relief applications, and Enforcement outcomes[11].**

**Particular requests for a customised search on data held by ASIC can be made by members of the public. Any such request will be directed to the relevant business area. The request will be assessed as to whether the legislation will permit the release of the data, and whether ASIC's data storage systems can support such a request. If the information requested by the customer can be provided, the fee is determined according to the accessibility of the data and the work involved in producing it. For example, if copies of documents are requested then the number of documents provided will impact the prescribed fee.**

**In the 2013 calendar year, ASIC responded to 53 one-off requests from the public by providing customised data from its registers. Customers included academics, information brokers, and government bodies. The average cost to the customer for these requests was $276.00, with a range of $9.00 to $1,100.00. A further 41 one-off requests for customised data were not provided due to the unavailability of the data requested, the legislation restricting the release of the data, or the customer declining to proceed with payment.**

**The statistical data that ASIC provides on its website and in publications is in response to public demand. Customised requests for data are particular to the specific needs of the customer and are usually one-off in nature. If there were sufficient demand for certain types of statistical data, and its release satisfied legislative and technological parameters, ASIC would certainly consider making it readily available.**

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[10] *ASIC Annual Report, 2012-2013*, Six-year summary of key stakeholder data, p152.

[11] http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Statistics

**Use if media**

16. The committee has received a submission and heard evidence from Dr Stuart Fysh. Dr Fysh has recently had his conviction for insider trading quashed by the New South Wales Court of Criminal Appeal.

- In 2008, ASIC issued a media release announcing that it had obtained an asset preservation order against Dr Fysh and that ASIC was investigating share trading by Dr Fysh. Dr Fysh argues that the freeze order was obtained with his full cooperation, and although this was implicit in ASIC's media release, that this was a distinction not drawn by any journalist or prospective employer.
- Why did ASIC issue this media release?
- Was doing so in the public interest? Did it contribute to the fulfilment of ASIC's statutory objectives?
- Dr Fysh described ASIC's 'announce early and announce big' media strategy as a 'crushing blow to one who is innocent'. Was ASIC's strategy simply an attempt of trial by media? What policies are in place to govern how ASIC engages with the media about an ongoing investigation?
- Dr Fysh compares the media release issued by ASIC with the 'tone and tenor' of statements by the police to the media. He suggests that police would not name individuals they are contemplating laying charges against. Does ASIC agree with this observation? Why is ASIC's approach to media engagement on criminal matters different to that used by the police?

**Answer:**

**ASIC's issuing of media release in relation to investigation and enforcement action is outlined in IS 152, namely that:**

- **ASIC will normally only comment on action we are taking against an individual when the enforcement action has begun, such as when a civil proceeding has been commenced; and**
- **Where ASIC is a party to civil litigation, we will issue a media release on the outcome of that litigation.**

**ASIC addresses the specific questions with respect to the submission and evidence from Dr Stuart Fysh in its further submission relating to those matters.**

**Procedures around granting relief**

17. With regard to IFSA's request for relief, Mr Wheeldon stated in evidence that:

…parliament's intent was clear and that, as a matter of law, ASIC did not have the authority to grant IFSA's request for relief; and, even if the application had merit, ASIC first had to undertake public consultation.

- Was parliament's intention clear and hence was ASIC required to undertake public consultations on this matter?

**Answer:**

**The answer to both these questions is "no".**

**The broad, principles-based approach taken in the FSR legislation means that it is not always possible to discern a specific Parliamentary intention about how the**

**legislation was meant to apply to every particular activity. In this case, it was not explicitly clear whether Parliament intended that the providers of all types of financial calculators would require a personal advice AFS licence, and need to comply with the requirements of the personal advice regime under the Corporations Act.**

**This uncertainty about calculators was recognised in the Government's May 2005 consultation paper, *Refinements to financial services regulation*, which stated that ASIC would 'provide further guidance and/or relief of the provision of basic online calculators to promote their use', with the intended outcome of 'p]romot[ing] the provision of basic online calculators to enable consumers to understand and compare financial products and services without that being classed as personal advice'.**

**As a strict matter of law, whether the Parliament intends to regulate a particular activity does not limit the powers that Parliament has conferred on ASIC to exempt from or modify certain provisions of the legislation. The existence of those powers presupposes that there are things in the legislation in respect of which exemptions should be granted or modifications should be made from time to time. While ASIC of course exercises caution in providing relief in relation to activities that are clearly intended to be regulated, there will be instances where relief is appropriate, such as where the benefit of the legislation does not outweigh the burden that it imposes, or where an appropriate degree of investor protection is otherwise achieved.**

**The *Legislative Instruments Act 2003* requires ASIC, before making a legislative instrument, to be satisfied that it has undertaken any consultation that it considers to be appropriate and is reasonably practicable to undertake. There is no requirement under this Act that this process should necessarily involve a full public consultation in all cases. Further, as specified under the Government's best practice regulation requirements (currently set out in *The Australian Government Guide to Regulation*, March 2014), there is a range of ways that consultation can be carried out, from full public consultation to more targeted processes, and ASIC must select the most appropriate approach in each case.**

**In the case of the relief ASIC provided for superannuation calculators in June 2005, we undertook targeted consultation with the industry concerned. ASIC was relevantly satisfied that this consultation process was appropriate, particularly as this relief formalised our previously announced administrative position on superannuation calculators, released in May 2004 via Information Release (IR 04-17) *ASIC provides guidance on superannuation calculators*, that the provision of calculators having particular characteristics did not constitute the provision of financial product advice, rather than implementing a novel policy position**

**Prior to extending our relief to all financial calculators later that year, we undertook a public consultation process through the publication of Consultation Paper 70 *Online calculators* (CP 70). This dealt with a broad range of issues relating to different types of calculators so broader public consultation was appropriate in this case.**

**ASIC is confident that it had the power to make the class orders providing relief for the provision of generic superannuation and financial product calculators as:**

- **they are covered by the literal terms of the relevant exemption powers (i.e. they exempt a class of persons from particular provisions of Ch 7 of the Corporations Act, as ASIC is empowered to do under s926A and 951B(1)(a) of that Act);**
- **these exemption powers confer an unconstrained discretion and accordingly ASIC can take into account what we see fit in exercising the power, subject**

**only to limitations implied from the subject matter, scope and purpose of the legislation; and**

- **it is entirely consistent with the subject matter, scope and purpose of the legislation to:**

- **facilitate the provision of educational tools about superannuation and other financial products to the public: the *Australian Securities and Investments Commission Act 2001* (ASIC Act) specifically requires ASIC to promote the confident and informed participation of investors and consumers in the financial system: s 1(2)(b); and**

- **remove unintended consequences from the operation of the legislation: the ASIC Act also requires ASIC to maintain, facilitate and improve the performance of the financial system and entities in the system in the interests of, among other things, commercial certainty and reducing business costs: s 1(2)(a).**

On this point and on all subsequent questions relating to legal relief for online calculators please also see our separate submission on the Online Calculator issue.

- Does the Corporations Act require online super calculations to have a reasonable basis for the outputs they produce?

**Answer:**

**There is a requirement under the law that calculators should not be misleading. This was untouched by ASIC's class order relief and remains a legal requirement. In order to not be misleading, a calculator must be accurate within its assumptions. Under ASIC's class order relief, there is a requirement that calculators must have reasonable assumptions.. These are important consumer protections.**

**Prior to the introduction of the financial services legislation, no particular conditions applied to the provision of financial calculators. Following the introduction of the financial services legislation in 2001, there was real uncertainty over whether some online calculators were caught by the legislation at all, and for those that were not, no particular conditions or legal parameters applied before we regulated this area through our class order.**

**In 2005, the Corporations Act required financial services licensees and their authorised representatives to have a 'reasonable basis' for *personal* advice provided to retail clients. A reasonable basis would at the time have been required for the output of some superannuation calculators to the extent that the output did, in fact, amount to personal advice.**

**It is important to understand what a 'reasonable basis' meant in this context. This was part of the personal advice requirements, and included obligations to undertake a fact finding exercise to determine the client's relevant personal circumstances and make reasonable inquiries in relation to those personal circumstances. An additional requirement where personal advice was given was to provide the client with a statement of advice.**

**In 2004, ASIC indicated in public guidance we released in Information Release (IR 04-17) *ASIC provides guidance on superannuation calculators* that the provision of calculators having particular characteristics did not constitute the provision of financial product advice. It was calculators having these**

**characteristics that were the subject of the class order relief we gave for superannuation calculators in June 2005 (Class Order [CO 05/611] *Relief for providers of superannuation calculators*), and the broader relief we gave for all calculators in December 2005 (Class Order [CO 05/1122] *Relief for providers of generic calculators*).**

**In this way, the calculatorsthat are covered by the class orders do not have to satisfy the personal advice requirements. That said, under the conditions of those class orders, ASIC required that the default assumptions for the calculations had to be reasonable. As noted above, in this way, the conditions of the relief we issued in 2005 strengthened the consumer protections attaching to calculators.**

- Did IFSA follow accepted procedure and submit a formal relief application for calculator relief? If not, could you explain how it did apply and why formal channels were not followed?

**Answer:**

**No formal relief application was required, because the relief we provided was class order relief applying to calculators in general provided by any fund. Formal applications are only required where an individual applies to us for individual relief from the law as it applies to them. The way in which IFSA made representations in relation to the relief is consistent with the ordinary practices of industry bodies on behalf of their members in relation to class order relief.**

- Did an employee of MLC, a division of the National Australia Bank and member of ISFA, who was seconded to ASIC, assist in drafting IFSA's letters to ASIC 'lobbying for calculator relief?

**Answer:**

**An employee of MLC, Mr Grant Jones, was seconded to ASIC from September 2004 to March 2005. When he was asked to participate in ASIC's work on the calculator relief, he disclosed that he had been previously involved in the IFSA's deliberations on the matter. The ASIC officer to whom the disclosure was made recalled that Mr Jones indicated that he had been a member of a taskforce that had assisted in drafting IFSA's initial request for the relief of 4 August 2004.**

**There is no reason to think that Mr Jones was involved in IFSA's deliberations about the matter (which included the preparation of another letter) after his secondment started.**

**The relief did not only apply to IFSA members, but applied to the whole superannuation industry. The further relief we gave in December that year applies to all providers of generic financial calculators.**

- Did this same person amend ASIC's internal issues papers on calculator relief and draft emails to IFSA on behalf of ASIC?

**Answer:**

**Mr Jones was a member of the team that worked on the calculator relief, and as such, it could be expected that he participated in the preparation of documentation related to that work. Our examination of the relevant documents to date does not enable us to confirm whether he had any particular input to internal issues papers or to the**

**drafting of emails to any industry body. Any internal papers or emails to IFSA on the calculator relief would have been settled by a more senior ASIC officer. As we have explained, the decision to grant relief to the entire industry was made by the Commission's Regulatory Policy Group, on which Mr Jones did not have a role.**

**As a financial services industry secondee, Mr Jones was specifically placed in a team that dealt with whole of industry issues, rather than a team that dealt with issues affecting specific entities (e.g. applications for individual relief).**

**As above, it should be noted that the relief granted did not only apply to IFSA members, but applied to the whole superannuation industry.**

- Was this person in a position where he could actively promote his employee's interest?

**Answer:**

**Mr Jones was a team member on the calculator matter but was never a decision-maker, and any work he contributed to was closely supervised by a senior manager. Further, Mr Jones was only involved in assisting policy work concerning the industry as a whole.**

- Were concerns raised within ASIC about this person and conflicts of interest? What were they and what was ASIC's response?

**Answer:**

**Mr Wheeldon himself raised concerns within ASIC about the potential for a conflict of interest in Mr Jones' involvement in the project on superannuation calculators. The substance of these concerns were that:**

- **Mr Jones had been involved in the preparation of IFSA's request for relief;**
- **his employer, MLC, would benefit from any grant of relief; and**
- **he should not have participated in ASIC's work on the project.**

**Mr Wheeldon also alleged that there had been a breaches of s125 of the *Australian Securities and Investments Commission Act 2001* (which deals with conflicts of interests of ASIC staff) and ASIC's policies on conflicts of interests.**

**These concerns were referred to the then General Counsel of ASIC. The General Counsel reviewed the issues and informed the members of ASIC's Commission of his view that Mr Wheeldon's concerns had no legal or policy substance.**

- Did that person himself disclose a potential or real conflict of interest? What was ASIC's response?

**Answer:**

**ASIC was, of course, aware at all times that Mr Grant Jones was an employee of MLC. This was acknowledged in ASIC's consultancy/secondment agreement with Mr Jones. That agreement provided that '[i]n order to avoid any potential conflicts of interest that may arise during the consultancy work, the Consultant will not work on any matter for ASIC which directly involves NWMS or the broader NAB and MLC groups of companies'. After starting his secondment, Mr Jones completed a disclosure of interests form which all ASIC staff are required to complete. He stated on this form that he was an employee of NWMS.**

**As noted above, when Mr Jones was asked to participate in ASIC's work on the calculator relief, he disclosed that he had been previously involved in the IFSA's deliberations on the matter.**

**ASIC was of the view that any potential conflict that Mr Jones had in connection with the work on the relief could be appropriately managed. In particular, Mr Jones would work on the matter as a member of a team which included participants from other ASIC business units; any decisions to give the relief would be taken by ASIC's Regulatory Policy Group (of which Mr Jones was not a member); and any recommendations to that group would be signed off by senior ASIC officers. Additionally, as above, the work Mr Jones was involved with and the resulting relief granted did not only apply to IFSA members, but applied to the whole superannuation industry. As a financial services industry secondee, Mr Jones was specifically placed within the Regulatory Policy Branch because it dealt with whole of industry issues, rather than a team that dealt with issues affecting specific entities (e.g. applications for individual relief).**

18. On 15 June 2005, ASIC issued a class order granting IFSA relief.

- Following the class order, did MLC's online calculator have within it a capacity for modelling fees or did it in effect act as though fees did not exist?
- Did the MLC calculator hide the effect of fees and/or make it more difficult to compare low-fee funds with higher fee funds?
- Could it be described as misleading?
- Was it being used primarily as a marketing tool to get people into MLC's financial adviser network?
- How long was this calculator online?
- Are similar calculators still granted relief under the class order?

**Answer:**

**The premise of this question is not correct. The class order we issued in June 2005 did not apply to IFSA, or only to IFSA members, but to the whole of the superannuation industry.**

**ASIC is not aware of the version of the MLC calculator published back in 2005, and we did not review it.**

**There are many superannuation calculators that are currently provided under ASIC's relief. Under the terms of our relief, providers are required to give a clear and prominent explanation of why the calculator's assumptions, are reasonable for the purposes of working out the estimate, including how the effect of fees has been incorporated. If we receive a complaint that an online calculator is misleading we will investigate and take action if appropriate (as ASIC has done in the past).**

19. Mr Wheeldon suggested that the explanatory statement to the class order was misleading.

- In your view, did the explanatory statement alert parliament to the possibility that the online calculators could be used as a marketing tool as well as an educational one? If not, why not?
- Is it possible that the statement that the relief was of 'a minor and machinery nature' could have misled members of parliament?

**Answer:**

**Mr Wheeldon has alleged that ASIC's explanatory statement to the Class Order we issued in June 2005 Class Order [CO 05/611] *Relief for providers of superannuation calculators* was misleading, including in stating that our relief was of a 'minor and machinery' nature, and that ASIC therefore misled the Parliament when the class order was tabled as required under the *Legislative Instruments Act 2003*.**

**As noted in the explanatory statement, the relief formalised our previously announced administrative position on superannuation calculators, released in May 2004 via IR 04-17 (see answer to question 17). That position was to the effect that the provision of calculators in certain circumstances did not trigger regulatory obligations. Giving relief in those circumstances amounted to simply removing any legal uncertainty and as such was minor or machinery.**

**The explanatory statement also explains that the relief was made to give effect to the then Government's intentions as part of the Refinements to Financial Services Regulation project, which was ongoing at that time.**

**The explanatory statement also adequately explained the minimum conditions applying to the relief, which were intended to ensure that calculators would serve the purpose of educational tools. Among other things, the explanatory statement noted that one of the conditions of the relief was that calculators should not provide financial product advice in relation to a specific financial product. ASIC was of the view that the conditions of the relief provided adequate protection to ensure that calculators provided under the relief would serve the purpose of an educational tool rather than for marketing purposes.**

**Whistleblowers**

20. Should whistleblower protections be extended to cover anonymous disclosures?

**Answer:**

**We understand that potential whistleblowers may wish to remain anonymous for fear of reprisal, reputational damage or other negative consequences of their whistleblowing. Nevertheless, it can be important for ASIC to know the identity of a whistleblower for practical purposes, including to substantiate their claims and progress the investigation.**

**Ensuring that whistleblowers' identities can be protected from disclosure to third parties is a different, and significant issue. In our submission to the Senate inquiry, we suggested providing ASIC with greater scope to resist the production of documents revealing a whistleblower's identity, in order to better ensure the protection of this information.**

21. Are there circumstances where whistleblower protections should apply to external disclosures to third parties, such as the media?

**Answer:**

**There may be circumstances where a person suffers reprisal following their making external disclosures to third parties, such as the media, and it may be useful to consider extending the whistleblower protections in such a situation. However, ultimately, this is a policy question for government.**

22. Several witnesses have told the Committee that the requirement that a whistleblower make a disclosure in 'good faith' is out-of-date and serves only to discourage would-be whistleblowers from making a disclosure. Should the 'good faith' test be removed from Australia's corporate whistleblower protections?

**Answer:**

**Whistleblowers are in a unique position to provide particularly useful 'inside' information, and can also be particularly vulnerable to potential reprisal or victimisation, or ongoing reputational damage. ASIC agrees that, if there are any deficiencies identified in the current whistleblower protections that may be proving to be an impediment to potential whistleblower disclosures, these should be carefully reviewed and change considered. However, this is also ultimately a policy question for government.**

23. Several witnesses have highlighted the importance of good internal systems within corporations to encourage and protect whistleblowers.

    a. What is ASIC's view on the suggestion from Dr Vivienne Brand and Sulette Lombard that there should be a mandated requirement for Australian corporations to institute internal structures to facilitate whistleblowing?

    b. What is ASIC's view on Professor AJ Brown's suggestion that Part 9.4AAA should 'incentivise businesses to adopt whistleblower protection strategies by offering defences or partial relief from liability [for reprisals against a whistleblower], for itself or its managers, if the business can show (a) it had whistleblower protection procedures of this kind, (b) that the procedures were reasonable for its circumstances, and (c) that they were followed (i.e. that the organisation made its best efforts to prevent or limit detriment befalling the whistleblower)'?

    c. The *Public Interest Disclosure Act 2013* includes a requirement that government departments have a designated 'disclosure officer' to receive disclosures. Should a similar requirement exist for the private sector?

**Answer:**

**While this is a matter for government, ASIC would support consideration of any reforms that improve companies' governance arrangements to ensure that they support and meet their obligations towards whistleblowers.**

24. Professor AJ Brown suggests that the compensation provisions in Part 9.4AAA are limited and vague, providing no clear guidance on how an application for compensation can be made, the potential relief from costs risks, the situation regarding vicarious liability, the burden of proof, and so on. Does ASIC have a view on the adequacy of the compensation provisions in Part 9.4AAA?

**Answer:**

**As the compensation provisions relate to private matters between whistleblowers and corporations, ASIC is not directly involved in situations where compensation is sought and cannot provide comment on this.**

25. In their submission, Dr Vivienne Brand and Dr Sulette Lombard note that the where a decision is made not to investigate a disclosure, the *Public Interest*

*Disclosure Act 2013* 'creates a statutory requirement to inform the whistleblower of the reasons why, and requirements are imposed in relation to the length of any investigation, as well as an obligation to give the whistleblower a copy of the report of the investigation.' Would there be value in including such requirements in Part 9.4AAA?

**Answer:**

**The new *Public Interest Disclosure Act 2013* addresses the inherent public interest in the transparency of public institutions, and in relation to investigations about potential misconduct by public officials. This transparency is ensured in a number of ways including freedom of information legislation, as well as the new public interest disclosure legislation. However, there may be different considerations that need to be balanced in relation to investigations into private institutions, including privacy and confidentiality considerations.**

**In our enforcement role, we are conscious of the need to be as transparent as possible in the decisions we make and the actions we take. We also understand that whistleblowers have a particular interest in the outcomes of our investigations arising out of their disclosures, including because they may have taken significant personal risks in order to make the disclosures. As described in our submission to the Senate inquiry, we have updated our approach to dealing with whistleblowers to ensure that our communication with them is consistent and regular.**

**Nevertheless, while we endeavour to communicate clearly with whistleblowers, there will always be limitations in the information that ASIC can provide to them. Whistleblowers are not themselves subject to confidentiality obligations, and they may have different or additional motives to those of ASIC. In general, it can be difficult for ASIC to be as open about our investigations as we would like to in all cases, including because this could jeopardise the success of the investigations or future legal proceedings. These factors would need to be considered in deciding whether to include such requirements in Pt 9.4AAA.**

26. Several witnesses have made the case for rewards for whistleblowers or *qui tam* arrangements similar to those in United States. Does ASIC believe there would be any value in implementing such approaches in Australia?

**Answer:**

**ASIC supports consideration of ways to encourage whistleblowing. We understand that whistleblowers take significant personal risks in making their disclosures. Providing a more concrete incentive for whistleblowing, such as the possibility of a monetary payment, could potentially help in counteracting such concerns. Nevertheless, we have some reservations about whether a system for the payment of monetary awards to whistleblowers would work in Australia. For example, payments calculated with reference to the sanctions handed down may be less effective in Australia given the generally lower level of penalties available. This is an issue we have highlighted in our recent Report 387 *Penalties for corporate wrongdoing* (REP 387). Also, as noted by ASIC's Chairman during the hearing of the Inquiry on 17 February 2014, there may also be a question of whether such a system would be effective within Australian culture.**

27. The Blueprint for Free Speech recommends the creation of a dedicated Ombudsman with powers to investigate and hear the complaints of whistleblowers. Does ASIC have a view on the merits of this recommendation?

**Answer:**

**We have some reservations about the value of such an approach, in that the Ombudsman would likely not have powers to directly respond to the substance of the whistleblower's disclosures (e.g. to investigate the corporate misconduct that underlies the whistleblower's complaint), and would need to refer this on to ASIC or another agency as appropriate. This could add an additional layer of process and communication and potential delay in investigating disclosures.**

28. To what extent do the recent reforms to the Commonwealth public sector whistleblowing legislation, and specifically the *Public Interest Disclosure Act 2013*, provide a template for potential reform to Australia's whistleblower protections in the corporate and private sector?

**Answer:**

**There may be some elements of the reforms that could be considered in any review of the corporate whistleblower provisions. However, there may also be some different considerations applying to disclosures about private institutions than public institutions, including the greater need to balance privacy and confidentiality considerations.**

29. ASIC's submission notes that where a whistleblower:

> …seeks to rely on the statutory protections against third parties, they will generally have to enforce their own rights or bring their own proceedings under the relevant legislation to access any remedy. The legislation does not provide ASIC with a direct power to commence court proceedings on a whistleblower's behalf.[12]

- Is it fair to say that ASIC does not have a substantive role as an advocate for corporate whistleblowers? How does ASIC's role in this respect compare to the role of regulators in other countries? If ASIC was given greater power to act as an advocate for whistleblowers, might this encourage more would-be whistleblowers to make disclosures to ASIC?

**Answer:**

**The whistleblower provisions do not either require or empower ASIC to treat whistleblowers or the information they provide in any particular way. We are not aware of how this approach compares to the role of regulators in other countries. In our submission to the Senate inquiry, we suggested providing ASIC with greater scope to resist the production of documents revealing a whistleblower's identity, in order to better ensure the protection of whistleblowers' identities. Ultimately, amending the legislation to change ASIC's role in relation to whistleblowers is a matter for the Government to consider.**

30. What precautions does ASIC take to protect whistleblowers coming to its offices?

12 ASIC, *Submission 45.2*, p. 136.

**Answer:**

**As part of our new approach to whistleblowers, we have more generally enhanced our approach to dealing with whistleblower reports, including:**

i. **providing appropriate training and expertise in all stakeholder and enforcement teams for the handling of whistleblower complaints;**

ii. **establishing a coordinated, centralised procedure for the tracking and monitoring of all whistleblower reports;**

iii. **giving appropriate weight to the inside nature of the information provided by whistleblowers in our assessment and ongoing handling of the matter;**

iv. **providing prompt, clear and regular communication to whistleblowers to the extent possible and appropriate during our investigations; and**

v. **maintaining the confidentiality of whistleblowers within the applicable legal framework.**

**Our procedures to protect the identity of whistleblowers include:**

i. **applying appropriate security to files and records; and**
ii. **exercising caution when contacting whistleblowers to ensure third parties are not made aware of the whistleblower's disclosure.**

**We have also provided an information sheet to assist whistleblowers to understand their rights and the protections available to them, Information Sheet 52 *Whistleblowers and whistleblower protection* (INFO 52).**

**All of these protections apply equally to whistleblowers coming directly to ASIC's offices as well as those who contact us via other means.**

## Section 2

## Case Studies

The following section contains case studies taken from the submissions. Although, the committee received many complaints involving a higher degree of complexity, the ones selected for detailed examination typify recurrent criticism of ASIC's performance.

**Anthony Brownlee (submission 423)**

In his submission Mr Brownlee outlines the following sequence of events:

- In September 2007 he pleaded guilty in the Local Court of NSW to six charges under 206A(1)(b) Corporations Act 2001—the charges related to a group of six private family companies.
- He was sentenced to the maximum available 12 month custodial sentence less a discount of 25% in reply to my plea of guilty, to be released after serving three months.
- He was released on bail pending appeal.

Mr Brownlee has a prior conviction (1 Global Metal Exploration Action Group 6) in a commonwealth matter relating to tax, which remains contested.

According to Mr Brownlee, ASIC listed the result of the Magistrate's sentence on its site the following day. As at the date of listing the information was correct. He explained, however that:

- in May 2008 his appeal was heard in the District Court;
- the sentence was set aside and a monetary fine together with a good behaviour bond was imposed;
- in respect of the custodial sentence, the appeal Judge stated: 'I do not think that this matter gets to the first stage of considering whether a period of imprisonment is warranted';
- the judge stated further, 'Inferentially, it must be clear and…I will state explicitly, that I do think that a sentence of imprisonment was severe and, indeed manifestly severe in light of the circumstances of the criminality involved'.

Mr Brownlee noted, however, that:

> More than 5 (five) years later the original sentence remains upon the ASIC site with no mention of the outcome of the appeal.

He noted that the sentence imposed has 'destroyed his business interests in the market by inference of the custodial sentence and caused significant hardship and permanent damage to family members'.

He argued:

> The market would have ignored the imposition of a fine or good behaviour bond as was and is the marked sentence for these offences when isolated to the offence only. ASIC staff in the rear of the Court on 11 September 2007 cheered and clapped loudly when the sentence of imprisonment was imposed? [sic]
>
> ASIC, either negligently or intentionally have failed to display the result of the appeal in parallel to the text of the original sentence, for a period exceeding 5 years, inflicting damage upon me which continues to this day. I recently applied to lease a residential premise. I was declined: as stated by Agents: 'you went to jail in 2007'.

***Questions***

- Given the reputational damage suffered by Mr Brownlee, why did ASIC not immediately correct the record on its website?

**Answer:**

**ASIC issued a media release on 12 September 2007 (the 2007 release) which detailed Mr Brownlee's sentence (nine months imprisonment with a minimum term of three months' imprisonment) following his plea of guilty to six charges brought by ASIC.**

**On 10 July 2008, ASIC issued a further media release (the 2008 release) which stated that Mr Brownlee's appeal against the severity of his sentence was upheld and that he was fined $15,000 and placed on a three-year good behaviour bond.**

**However, it was not until 13 March 2014 – when ASIC reviewed Mr Brownlee's submission to the Senate Inquiry – that ASIC was alerted to the fact that the 2008 release may not have been sufficiently prominent.**

**After making inquiries, we discovered that the 2008 release:**

- **Was only able to be located on ASIC's website by searching for the release number (08-158);**
- **Did not show up in searches of the name "Anthony Brownlee" on both ASIC's website and google. We are informed by ASIC's electronic publishing manager that this may have occurred for the following reasons:**

➢ **(Primarily) The traffic to the 2007 release for two years to November 2013 was 700 page views. The traffic to the 2008 release over this period was 28 page views. This would have increased the ranking of the 2007 release, further accentuating the difference in traffic between the two releases (a 'positive feedback' effect); and**

➢ **(Possibly) The 2008 release was missing a <h1> tag in the title of the 2008 media release contents page, which may have had some impact on the ranking of the 2008 release.**

**To resolve these issues, we updated both the 2007 and 2008 release by:**

- **including Mr Brownlee's full name (Anthony John Brown) in the title of the release. According to ASIC's electronic publishing manager, this may assist in ensuring that the 2007 and 2008 releases show up in ASIC website and google searches.**
- **Adding an editor's note to the effect that Mr Brownlee's full name was included in the headline of the release on 28 March 2014.**

**We also updated the 2007 release by:**

- **Adding the following editor's note: "*An appeal by Mr Brownlee against the severity of his sentence was upheld in the Downing Centre District Court on 16 May 2008. Mr Brownlee was fined $15,000 and placed on a three-year good behaviour bond"*; and**
- **Adding a link from the 2007 release to the 2008 release.**

**These changes were made on 28 March 2014.**

- Does ASIC's website still list the Magistrate's sentence on its website. If not when was this removed or an update provided on the sentence being set aside?

**Answer:**

**Yes. Please refer to the answer to question 1.**

- Has ASIC given any indication on its website that Mr Brownlee's custodial sentence was set aside on appeal? If so, when was this information posted on the website?

**Answer:**

**Yes. Please refer to the answer to question 1.**

- In your view, is the information on the sentence being set aside sufficiently prominent to rectify any impression that Mr Brownlee served a custodial sentence?

**Answer:**

**Following the changes that were made to the ASIC website on 28 March 2014, ASIC is of the view that the information on the sentence being set aside is sufficiently prominent to rectify any impression that Mr Brownlee served a custodial sentence.**

***Submissions 81 (Name withheld), 249 (Mr Dennis Chapman) and 367 (Mr Simon Grundel) – Managed investment schemes: Premium Income Fund (MIS) / Wellington Capital (RE)***

The committee has received submissions from investors in the Premium Income Fund, a managed investment scheme. They advise that on 10 May 2011, Wellington Capital Limited announced it had amended the constitution of the Fund, enabling heavily discounted new units to enter the Fund. ASIC registered the amendment to the constitution on 10 May. The amendment was subsequently overturned in the Federal Court. However, the Court could not reverse the 75 million units entered on the Fund's register which were entered after ASIC registered the amendment to the Fund's constitution. Despite being discounted, the units were promised equality in all respects. Given a class action is underway, the earlier investors are concerned that if the court rules that all units must be treated equally, they will share all potential litigation returns that the Fund achieves. Alternatively, if the court rules that only the units that suffered the loss are to share litigation returns, the investors are concerned that the new units will take legal action against the Fund because of the promise of equality.

***Questions***

- What role does ASIC have when constitutions of funds are changed to allow heavily discounted new units to enter a fund, thus diluting the returns and weakening the voting strength of the other unit holders?
- Please outline the court proceedings ASIC has taken against Wellington Capital.

Submission 81 advises that in response to a complaint to ASIC, ASIC's letter stated:

> 'Wellington Capital confirmed to ASIC that it considers the amendments to be within its power and in the best interests of the members of the [Premium Income Fund]. In these circumstances ASIC is not prepared to take further action in relation to the specific issues raised in relation to the Placement and Non-Renounceable Rights Issues'.

- Was this statement sent to investors who complained to ASIC?
- Did ASIC's investigation allow it to conclude Wellington Capital's response was justified, or was it just taken at face value?
- What led ASIC to decide to subsequently take action against Wellington Capital?
- Why has ASIC taken action against Wellington Capital on behalf of Premium Income Fund investors, but not on behalf of MFS, Octavier or Maximum Yield Fund investors?

**Answer:**

**<u>ASIC's role with respect to amendments of scheme constitutions</u>**

**ASIC has limited powers to act on constitutional amendments made by responsible entities. *The Corporations Act 2001* (Act) provides that the constitution of a registered scheme may be modified, or repealed and replaced with a new constitution by the responsible entity, if the responsible entity reasonably considers the change will not adversely affect members' rights[13]. The responsible entity is required to lodge with ASIC a copy of the modification or new constitution and any modification or repeal and replacement cannot take effect until the copy has been lodged[14]. It is important to**

[13] 601GC(1)(b)

[14] 601GC(2)

**note that ASIC does not register these amendments or have any power to compel or require a responsible entity to amend the constitution of a registered managed investment scheme. While ASIC is not obligated to review modification or replacement constitutions, where concerns arise about proposed or actual amendments to constitutions ASIC may engage with the responsible entity about those concerns where it appears that the amendments may adversely affect members rights. If ASIC was of the view that a responsible entity made an amendment to a constitution that adversely affected members' rights, then ASIC would need to consider whether it would be appropriate to apply to the Courts for relevant orders. ASIC may also review the disclosure provided to unit holders about any proposed offers of units and take action if the disclosure is defective as that term is defined under the Act.**

**Wellington Capital Limited**

**In October 2012 ASIC commenced proceedings in the Federal Court in Sydney challenging whether Wellington Capital Limited (Wellington) was legally able to make an *in specie* distribution of shares in an unlisted company, as opposed to cash, to the unit holders in the Premium Income Fund (PIF). The unlisted company, Asset Resolution Ltd (ARL), issued shares to the custodian of PIF as consideration for its purchase of over $90 million of PIF assets in September 2012. ASIC alleged that the constitution of PIF did not permit Wellington to distribute the ARL shares to Unit Holders. On 17 October 2012, the Federal Court found that the constitution of PIF provided Wellington with the power to make the transfer of ARL shares to unit holders. ASIC appealed this decision. ASIC's appeal was heard by the Full Court of the Federal Court of Australia on 17 May 2013. On 28 May 2013, the Full Court delivered judgment in favour of ASIC. The Full Court made declarations that the *in specie* transfer of ARL shares from Wellington as responsible entity of PIF to the unit holders of PIF was beyond the power of Wellington under the constitution of PIF and by making the *in specie* transfer of ARL shares to unit holders of PIF, Wellington did not operate PIF and perform the functions conferred on it by PIF's constitution, and contravened section 601FB(1) of the Act. This decision is currently the subject of an appeal to the High Court of Australia and will be heard on 13 May 2014.**

**The statement referred to in submission 81 was sent to a number of investors in PIF who raised concerns with to ASIC about an earlier amendment to the constitution.**

**ASIC made enquiries with Wellington about the amendment to the constitution but did not conduct an investigation into the conduct. It appeared from our enquiries that there was not a sufficient basis for ASIC to take action against Wellington about the amendment. ASIC considered the impact of the Placement and Rights issue in the context of paragraph 601GC(1)(b) of the Act. ASIC's position at that time was that the test under the Act as to whether an amendment would adversely affect members rights was not a general question whether members would be "worse off" if the change is made (for example, it was not a general question of prejudice or financial disadvantage). Rather it was a specific question that went to the narrow matter of the effect of the amendments on member's rights as set out in the constitution, for example, a member's right to vote or a member's right to withdraw from the PIF. However, in June 2011, as result of proceedings initiated by investors in PIF, the Federal Court in Victoria made orders that the constitutional amendments made by Wellington were in breach of the Act and the Rights Issue could not proceed unless members agreed to the amendment to the constitution. The Court did not order that the Placement, which had already taken place, be unwound. ASIC appeared as amicus in these proceedings and made submissions to the Court about the higher duties a responsible entity owes to members of PIF. The Court determined that members' rights were broader, and that the dilution of the value of existing units as a result of a**

**Placement is an example of an adverse effect to members' rights. The scope of members' rights has been the subject of subsequent judicial decisions which have resulted in both more restrictive and broader interpretations of the scope of members' rights. The most recent decision supported a broader interpretation of members' rights.**

**MFS Investment Management**

**ASIC also has on foot current Supreme Court of Queensland civil penalty proceedings in respect of transactions entered into by MFS Investment Management Limited (MFSIM) as responsible entity of the PIF. In October 2009 ASIC filed civil proceedings against MFSIM and five former directors/officers in relation to the alleged misuse of approximately $130 million drawn down from a loan facility with the Royal Bank of Scotland in late 2007, as well as subsequent falsification of documents. The proceedings seek declarations that the defendants failed to act honestly and consequential penalty and compensation orders. As currently pleaded any compensation awarded by the court will be paid to the current responsible entity of PIF for the benefit of unit holders at the time the compensation is received. The trial was part heard in November and December 2013 with further trial dates scheduled in April, May and August 2014.**

**The proceedings seek: a) declarations that the defendants failed to act honestly, and b) orders for monetary penalties and compensation.**

**<u>Maximum Yield Fund</u>**

**ASIC received and considered a number of allegations about the management of the Maximum Yield Fund and determined that it would take no further action in relation to the specific issues raised in submissions 81, 249 and 367. ASIC's decision not to take further action was communicated in writing and in a number of face-to-face and telephone conversations with an investor in the Maximum Yield Fund.**

**As outlined in ASIC Information Sheet 151, ASIC carefully considers how to respond to all potential breaches of the law, but we do not undertake a formal investigation of every matter that comes to our attention. We consider a range of factors when deciding whether to investigate and possibly take enforcement action, to ensure that we direct our finite resources appropriately. The specific factors we consider will vary according to the circumstances of the case. Broadly, we consider the following four issues in deciding to take enforcement action:**

- **Strategic significance (e.g. what is the extent of harm or loss?)**
- **Benefits of pursuing misconduct (e.g. is enforcement cost-effective?)**
- **Issues specific to the case (e.g. what evidence is available?)**
- **Alternatives to formal investigation**

***Submission 99 (Global Metal Exploration Action Group)***

The submission advises Global Metal Exploration's (GXN) share price fell 75 per cent in 12 months while administration costs, including directors' fees, continue to exceed expenditure on exploration. The submission claims they had the votes to remove the directors, however, the submission alleges that following notice under s. 249 of the Corporations Act to consider board changes, the directors arranged for new shares to be issued. The shareholders allege that the prospectus granted the directors the discretionary power to place any shortfall shares and that, despite complaints, ASIC ignored deficiencies in the prospectus. The directors allocated the shortfall shares to supportive investors and the vote to remove two directors was defeated.

***Questions***

- How many complaints have ASIC received about Global Metals Exploration?

**Answer:**

**ASIC has received 30 reports of misconduct (ROM) from 13 reporters about GXN since April 2013. The majority of the reporters are shareholders. One ROM is a s. 311 report from GXN's auditor.**

- Why did ASIC not take action in this matter?

**Answer:**

**ASIC has taken action in this matter.**

**ASIC has responded to a number of reporters encouraging the provision of any evidence to assist in our enquiries, to which nothing has been forthcoming. ASIC has also responded to the reporters, informing them of action available to them under Chapter 2F CA dealing with shareholder rights and remedies.**

**ASIC has also conducted surveillance and a subsequent investigation in relation to some of the allegations made, engaging with both shareholders and the company on a number of occasions. Following its investigation, ASIC is now considering the most appropriate regulatory outcome for this matter in light of the available evidence.**

- Do you have an example of a case where ASIC has pursued directors for misconduct for engaging in self-preservation strategies in the face of their likely removal?

**Answer:**

**Self-preservation strategies used by directors may sometimes give rise to a breach of directors' duties, such as the duty:**

- **to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person in a like position would exercise in the circumstances (s180 CA, which is a civil obligation only),**
- **not to make improper use of position as a director (s181 CA, also a civil obligation only),**
- **not to improperly use their position or use information obtained as a director to gain an advantage for themselves or someone else or cause detriment to the corporation (ss182 and 183 CA respectively, again civil obligations only), and**
- **not to recklessly or intentionally dishonestly fail to exercise their powers and discharging their duties in good faith in the best interests of the corporation or for a proper purpose (s184(1) CA, which is a criminal offence),**

- **not to improperly use their position dishonestly or use information obtained as a director dishonestly to intentionally or recklessly gain an advantage for themselves or someone else or cause detriment to the corporation (ss184(2) and (3) CA, which are criminal offences).**

**In the time available, ASIC has not found an example of a prosecution against directors for misconduct for engaging in self-preservation strategies in the face of their likely removal. However, ASIC is happy to consider pursuing such an action if it meets the normal criteria we have set out for taking enforcement action in Information Sheet 151.**

***Submission 223 (Laharum Bulk Handling)***

Laharum Bulk Handling Co Pty Ltd alleges that between 2008 and 2009, it was trading with a group of companies that, in 2009, were required to repay NAB $40 million. However, the companies continued to take prepayments from Laharum and other companies but did not supply the required products as the prepayments were used to repay the bank. Laharum advised that court examinations have revealed that ASIC conducted an onsite visit to these companies head office as a result of the companies failing to file returns for the 2008, 2009 and 2010 financial years. However, ASIC did not take any action to wind up these operations.

**Answer:**

ASIC understands that Laharum Bulk Handling Company Pty. Ltd. (ACN 006 068 962) raises concerns in its submission about its dealings with a fertiliser company group based in South Australia.

ASIC is aware of Laharum Bulk Handling's concerns. ASIC commenced a National Insolvent Trading Program surveillance activity in May 2009 into the fertiliser company after we received a breach report from the company's auditor under section 311 of the *Corporations Act* (Corporations Act) in April 2009. The National Insolvent Trading Program sought to:

- make company directors aware of their company's financial position;
- make directors of potentially insolvent companies aware of their responsibilities and the implications of continued trading if they know they are insolvent;
- encourage directors to seek external advice from accountants and lawyers on restructuring; and
- encourage directors to seek advice from insolvency professionals where appropriate, and to take action to appoint a voluntary administrator or liquidator where necessary.

The surveillance took place nearly two years prior to the collapse of the corporate group and involved meeting with the company's directors, and their advisers, to review the operations of the company for the purposes of ensuring compliance by directors of their duties as set out in section 180 of the Corporations Act and directors' duties to prevent insolvent trading under section 588G of the Corporations Act.

ASIC's correspondence required the company's directors to address each of ASIC's concerns and identify how the directors would discharge their obligations to prevent the company from trading while insolvent.

Given that the directors sought professional insolvency advice and had the apparent ongoing support of the company's secured lender and had confirmed that unsecured debts were continuing to be met as and when they fell due, ASIC again wrote to the company in September 2009 reminding them of their obligations to remain vigilant to avoid insolvent trading and to seek immediate, further professional advice if any event occurred which might lead to the directors being unable to discharge their duties pursuant to s588G of the Corporations Act.

The prime responsibility for avoiding insolvency rests with the directors of the company and ASIC took steps to ensure they complied with the requirements of the Corporations Act.

ASIC corresponded with the company about its failure to lodge its financial statements and directors' reports. However, given our previous regulatory action against the company and that the company subsequently entered external administration; we exercised our discretion not to pursue the company for its failure to lodge financial statements.

ASIC engaged with the external administrators following the appointment of Voluntary Administrators, and the subsequent appointment of liquidators by the Federal Court of Australia.

**Question: Does ASIC have responsibility for companies taking payment for goods and not supplying them? If not, which agency does?**

***Answer:***

As set out in ASIC Information Sheet 161 *Disputes about goods and non-financial services* and ASIC Information Sheet 173 *Disputes about unpaid debts*, ASIC does not intervene in disputes between commercial parties relating to the non-performance of a contract or non-payment of a debt. These matters relate to the contractual rights between the parties and ASIC considers that these matters are best resolved through communication between the parties or the parties seeking legal advice to enforce their rights. Consumers are also able to raise their concerns about these kinds of disputes with the Australian Competition and Consumer Commission and the state and territory consumer affairs agencies.

We note that creditors have the ability, and responsibility to their own companies, to take steps to recover their debt or mitigate their loss when experiencing difficulty recovering debts due from their private enterprise activities.

When a company may enter external administration, creditors can participate and make their claims to the external administrators by lodging proof of debts or exercising their legal rights, including any claims they have under contract, retention of title, other legal title claims. If a creditor is not satisfied with an external administrator's decision in relation to their claim, creditors have rights to make an application for a Court order.

ASIC has no role in assessing or adjudicating a creditor's claim in an external administration.

**Question: Has ASIC taken action against the directors, or is it considering taking action? If not, why not?**

**Answer:**

As discussed above, ASIC conducted a surveillance into the fertiliser company under our National Insolvent Trading Program that was in place at the time. We finalised our surveillance as its purpose was completed.

ASIC has determined not to take any further action in relation to concerns about the directors of the fertiliser company. The information available to ASIC about these matters does not provide sufficient grounds for us to take further action. ASIC's position on how we select matters for formal investigation or enforcement action is set out in ASIC Information Sheet 151 *ASIC's approach to enforcement*.

This guide states that we consider a range of factors when determining which matters we will select for regulatory action, including whether the concerns suggests any breaches of the legislation we administer, whether we have sufficient grounds to suspect that a breach has

occurred, and whether regulatory intervention would be for the benefit of the broader community beyond the affected individuals.

Creditors of the fertiliser company may wish to seek their own advice about pursuing their rights against the company.

***Submissions 277 (Mr Phillip Sweeney), 109 (Name withheld), 133 (name withheld) and 146 (name withheld) – The Provident Fund***

The committee has received several submissions regarding the Provident Fund, an employee benefit fund (superannuation fund) that was established in 1913. The submissions claim that qualifying male officers are entitled to a pension for life and their widows are then entitled to a survivorship pension. The submissions allege that the original trust deed was fraudulently altered and the conditions of the original trust deed are not being complied with (i.e. the pensions are not being paid).

***Questions***

- How many complaints have ASIC received regarding the trust deed of the Provident Fund? When was the first complaint received?
- Could you outline ASIC's responsibilities in this area? Is ASIC the correct body for individuals with these types of concerns to contact?
- What investigation did ASIC undertake into these allegations? Did ASIC decide that the complaints did not have merit, or did ASIC not investigate because the complaints did not meet the tests ASIC uses when assessing a matter?

**Answer:**

**ASIC first received correspondence concerning the Provident Fund (the Fund) in March 2009. Since that time, ASIC has received approximately 400 individual pieces of correspondence, as well as having processed over 100 freedom of information (FOI) requests or reviews of FOI decisions. These complaints and FOI requests have all originated from five separate individuals (the Reporters).**

**Broadly speaking, ASIC's primary responsibility in relation to superannuation is ensuring that trustees make adequate disclosure and provide sufficient information to enable members to make informed decisions concerning their superannuation. ASIC also grants Australian financial services (AFS) licences and has responsibility for monitoring these licensees and ensuring that they comply with their licence obligations. These obligations, as outlined under section 912A of the *Corporations Act 2001* (the Act), require that AFS licensees act efficiently, honestly and fairly, and that they maintain adequate arrangements to provide for compliance procedures, as well as the ongoing competence and financial viability of the licensee. These obligations are broad and provide ASIC with significant scope for undertaking further enquiries where concerns have been brought to ASIC's attention. A number of superannuation trustees hold AFSLs with ASIC.**

**ASIC notes that a large number of the complaints and FOI requests received in relation to the Fund have not principally concerned allegations of fraudulent behaviour, but rather allegations that the trustee of the Fund has failed to comply with its disclosure obligations under section 1017C of the Act. Section 1017C of the Act requires trustees to provide a concerned person – typically a member of the fund within the preceding 12 months – with certain information, including information they reasonably require for the purposes of understanding any benefit entitlements that they may have under the relevant superannuation product.**

**In this regard, the Reporters have alleged that the trust deed has been illegitimately altered since the Fund's inception in 1913 to the detriment of members' benefits. As a result of this conduct, the Reporters consider that changes to the trust deed were not legally effective, meaning that the trust deed which was used to calculate their payouts is not effective.**

**As a result, a large number of the complaints received by ASIC concerning the Fund have been in relation to the Reporters' attempts to access trust deeds for the Fund**

**dating back to its inception. The Reporters are of the view that the trustee is obliged to provide access to these documents under section 1017C of the Act.**

**In considering all the complaints received, ASIC has determined that no further action is required in relation to these matters because, variously:**

- **there was insufficient evidence of breaches of the laws we administer;**
- **ASIC did not have jurisdiction to pursue these matters (such as to enforce any obligations under private trust or contractual arrangements or under state-based trust law);**
- **ASIC did not exist at the time the alleged misconduct occurred and ASIC is statute barred from taking criminal action in relation to conduct occurring more than five years previously; or**
- **in some instances, ASIC considered that the Reporters' allegations or their understanding of the law were misconceived.**

**Where ASIC identifies issues that are beyond the ambit of our regulatory responsibilities these issues will be referred to the appropriate regulator. Allegations of fraudulent behaviour by superannuation trustees are often beyond ASIC's regulatory ambit, and may be more appropriately considered by the Australian Prudential Regulation Authority (APRA). The Superannuation Complaints Tribunal (SCT) also provides an independent dispute resolution process for members, which deals with complaints relating to the decisions and conduct of trustees, among other things. Finally, we note that any decision made by ASIC does not preclude the Reporters from pursuing any private rights that may be available to them.**

**The various concerns raised in these complaints have received detailed consideration by ASIC, including by our Misconduct and Breach Reporting team, our Investment Managers and Superannuation stakeholder team, our Chief Legal Office, and the Senior Executive Leader responsible for Stakeholder Services.**

**ASIC has undertaken substantive and comprehensive inquiries, including engaging with the Reporters' employers, the Fund's trustees, and APRA on multiple occasions. ASIC has had, and continues to have, ongoing discussions with the Fund's trustee in respect of its obligations under the Act. Nonetheless, following these extensive inquiries, ASIC has consistently determined that there has been insufficient evidence of any contraventions of the laws administered by ASIC, and therefore, no further action has been appropriate.**

**ASIC considers that its processes and findings in relation to the complaints received are both fair and reflective of the laws administered by ASIC. This position is supported by the significant and ongoing scrutiny to which these decisions are subjected, both internally within ASIC, and the reviews undertaken by independent external bodies, such as the Commonwealth Ombudsman.**

***Submission 246 (Dorman Investments Pty Ltd)***

The submission claims that ASIC ordered the winding up of Co-Develop Australia in 2004, however, four weeks later the owner was allowed to raise up to $56 million in capital under the name CoDevelop (i.e. without the hyphen). The submitters claim a string of failures followed. One of the failures was Citywide Cabinets, formerly EuroDirect. The submission claims that ASIC did not investigate their complaint about the actions of the liquidator. ASIC only asked for correspondence between the complainant and the liquidator, and the submission argues that this limited correspondence 'could in no way highlight the failure to follow procedure which resulted in the liquidator auctioning property which belonged to us and giving the proceeds to creditors'.

***Questions***

- **Please outline the investigation ASIC undertook into the liquidator appointed to Citywide Cabinets.**

  **Answer:**

  ASIC conducted its assessment of the Citywide Cabinets matter in 2013 which concerned conduct allegedly occurring in 2007 and which conduct involved agreements entered into 2005.

  The dispute is based on the allegations made by the reporter, who is a shareholder of a failed company, pertaining to his purported rights over certain assets of the company which the external administrator sold at auction.

  ASIC correctly:

  · identified the regulatory issues for ASIC relevant to this report of misconduct;

  · identified the relevant provisions of the Corporations Act;

  · considered the information that ASIC received from the reporter and made appropriate enquiries, including antecedent searches concerning the subject;

  · assessed the weight and quality of the available evidence;

  · assessed the matter overall; and

  · concluded that there was insufficient evidence of a breach of the liquidator's duties under the Act to warrant further action.

  ASIC advised the reporter of the alleged misconduct that ASIC has no role in adjudicating upon the legitimacy or efficacy of a shareholder's claim over the property in dispute.

  The reporter contended that the Registered Liquidator failed in his duties to creditors and other stakeholders. ASIC reviewed the evidence available and found no basis for this contention as the liquidator met his duty in taking possession of the assets of the company and realising them for the benefit of creditors as a whole. Anyone else, who had a competing claim to those assets, has the responsibility of proving that claim. ASIC has no role in this process.

  They were advised that, in the event that such a dispute cannot be resolved with an external administrator, a remedy for an aggrieved party is to appeal to the Court under section 1321 of the Act.

The reporter was advised of ASIC's review decision by way of letter dated 1 August 2013.

- **Why did ASIC only request correspondence between the complainant and the liquidator? Was an assessment of these documents the extent of the investigation?**

**Answer:**

ASIC's review of the facts and circumstances pertaining to a private shareholder dispute is necessarily limited to the documents that exist and provided by the reporter of misconduct.

Importantly, as noted above, ASIC does not adjudicate in private disputes.

- **What steps does ASIC undertake when investigating allegations of misconduct by liquidators?**

**Answer:**

We carefully consider how to respond to all potential breaches of the law, but we do not undertake a formal investigation of every matter that comes to our attention.

We consider a range of factors when deciding whether to investigate and possibly take enforcement action, to ensure that we direct our resources appropriately.

The specific factors we consider will vary according to the circumstances of the case. Our priorities necessarily evolve and change over time and that influences our enforcement focus. Information sheet 151 enunciates these factors more fully.

We assess the seriousness of the alleged misconduct and particularly its market impact, which includes its impact on market integrity or the confidence of investors and financial consumers. The action we take will depend on the facts of each matter and will be heavily influenced by the evidence that is available to establish those facts.

We also look for the regulatory benefits of pursuing misconduct.

The action we take, if any, will vary according to circumstances of the matter at hand but ASIC will encourage private dispute resolution between those involved, if that is the most appropriate response especially in case of shareholder disputes, such as is the case in this instance.

We are less likely to investigate matters that would be better addressed by another agency or by private dispute resolution between those involved.

- **How many complaints do ASIC receive each year about the conduct of liquidators? (for the past three financial years). How many are escalated to an investigation? How many liquidators face enforcement action?**

**How many complaints do ASIC receive each year about the conduct of liquidators for the past three financial years**

**Answer:**

During calendar year of 2013, ASIC's Insolvency Practitioners stakeholder team considered 385 inquiries and reports of alleged misconduct by registered.

We individually assess conduct matters referred to us and, in instances where the matter does not warrant a referral for formal investigation, we record the information obtained as part of our profiling of registered liquidators.

Reports of alleged misconduct against registered liquidators remained stable at approximately 3% of total reports of misconduct that ASIC received during the period 2011 to 2013.

| | **2011** | **2012** | **2013** |
|---|---|---|---|
| Total complaints and enquiries concerning registered liquidators | 426 | 437 | 385 |

| **Outcomes of complaints/enquiries concerning registered liquidators (by %)** | **2011 %** | **2012 %** | **2013 %** |
|---|---|---|---|
| Provided assistance to resolve the complaint or enquiry | 23 | 24 | 20 |
| Insufficient evidence was identified to support the alleged breach | 38 | 33 | 37 |
| No breach of the Corporations Act identified | 8 | 11 | 9 |
| Referred to a specialist team within ASIC for further review | 14 | 14 | 13 |
| Referred to investigation | 0 | 1 | 1 |
| Referred to assist existing investigation or other surveillance | 8 | 7 | 3 |

| | | | |
|---|---|---|---|
| Action otherwise precluded | 10 | 12 | 17 |
| **Total (rounded)** | **100** | **100** | **100** |

***Submission 132 (Mr Peter Leech)***

The submission relates to alleged phoenix activity (a private security firm in Western Australia that Mr Leech was previously employed by). The submission claims that there is a cycle of behaviour intended to avoid financial obligations, and that despite the liquidation, 'the director is operating with the same clients, some of the same staff, the same uniform, the same business premises, the same website, but under a different ACN/ABN!'. The submitter objects to responses from ASIC advising that ASIC has chosen not to proceed and that ask the complainant to provide further evidence.

***Questions***

**Under the laws ASIC administers, what action can ASIC take in response to phoenix activity?**

**Answer:**

**It is important to note that there is no specific legal definition of phoenix activity nor offence of "phoenix activity". Regulators, such as ASIC, need to assess the particular conduct that is alleged to be phoenix activity, in order for them to determine if there have been any contraventions of laws that they administer.**

**In ASIC's case, a director potentially engages in illegal activity if they intentionally act in a manner that denies creditors of the company equal access to the assets of the company. The most common scenario is where a director transfers assets of a company to another company for little or no consideration. The directors leave the debts with the old company, often placing that company into administration or liquidation, leaving no assets to pay creditors.**

**Meanwhile, a new company, often operated by the same directors and in the same industry as the old company, continues the business under a new structure. By engaging in this illegal practice, the directors avoid paying debts that they are owed to creditors, employees and statutory bodies (e.g ATO).**

**In this scenario, the director may be in contravention of section 180 to 183 of the Corporations Act 2001 (civil provisions) and sections 184 and 590 of the Corporations Act 2001 (criminal provisions).**

**What steps does ASIC undertake when investigating allegations of phoenix activity? What documents and information does ASIC gather?**

**Answer:**

**Allegations of illegal phoenix activity are registered as reports of misconduct by Misconduct and Breach Reporting (M&BR). Analysts in M&BR undertake a preliminary assessment to determine if there have been contraventions of laws that are administered by ASIC. If the conduct concerns a significant company with wider public impact (for example a public company), the matter will be referred to an appropriate Enforcement Team (most likely the Corporations / Corporate Governance Enforcement Team) in regards to criminal and civil contraventions. If the matter is not considered as, amongst other criteria, having such a public impact that requires a referral to an Enforcement Team) for example it involves a small proprietary limited company) but there appear to be contraventions of laws administered by ASIC, it may be referred to Small Business Compliance and Deterrence**

**(SBC&D) for investigation, but only in regards to potential bannings of directors under the Corporations Act 2001.**

**When the matter is being assessed by Analysts in M&BR, they will undertake a preliminary assessment in regards to the report of alleged misconduct. Once a matter is referred to an Enforcement Team or SBC&D, they will undertake a comprehensive investigation to determine if the alleged contraventions have occurred. That may include conducting interviews with relevant witnesses, using ASIC's coercive powers to obtain documents / examine people and conducting records of interview in criminal investigations. If there is evidence to support the allegations, ASIC may seek to ban the directors from being involved in company management following an administrative proceeding, file an application in civil proceedings, or refer a brief of evidence to the Commonwealth Director of Public in criminal proceedings (CDPP).**

**Could you provide recent examples of ASIC pursuing phoenix activity in the courts?**

**Answer:**

**There are no recent examples that have been prosecuted recently. ASIC has recently referred a matter to the CDPP, but charges have yet to be issued.**

**MR 14-090 www.asic.gov.au/asic/asic.nsf/byHeadline/14-090MR%20ASIC%20bans%20Sydney%20directors%20following%20company%20failures?opendocument**

**Does ASIC pursue solicitors, accountants or other professionals that may facilitate phoenix activity? Do you have an example of this?**

**Answer:**

**Yes. The matter of Sommerville is an example.**

**In this case the the New South Wales Supreme Court has found eight directors of unrelated companies to have acted in breach of the Corporations Act by engaging in what ASIC regards as illegal 'phoenix' activity and that their Sydney solicitor, Mr Timothy Donald Somerville, also contravened the Corporations Act by being involved in the directors' breaches.**

**By his advice and conduct, Mr Somerville had facilitated his clients breaching their directors' duties and as a consequence he was found to have aided and abetted their breaches. In this case, Acting Justice Windeyer was satisfied that Mr Somerville had devised a series of transactions, with the appearance of legitimacy, to bring about asset stripping and disadvantage to creditors.**

**Declarations of breaches of their duties, under sections 181(1), 181(2) and 181(3) of the Corporations Act, were made against each of the eight directors. Declarations for breaches of these provisions were also made against Mr Somerville as it was found, pursuant to section 79 of the Act, that he aided and abetted the directors in their breaches.**

http://www.asic.gov.au/asic/asic.nsf/byheadline/09-174AD+Legal+adviser+and+company+directors+found+liable+in+relation+to+'phoenix'+activity

**How does ASIC work with other bodies such as the ATO to combat phoenix activity?**

**Answer:**

**ASIC works with a number of regulatory agencies to combat illegal phoenix activity. The ATO and ASIC are primarily responsible for regulating and investigating illegal phoenix activity.**

**ASIC is a member of the ATO Chaired, Inter-Agency Phoenix Working Group that comprise of thirteen Commonwealth and State regulatory agencies. The Inter-Agency Phoenix Working Gruop was established to bring together key government agencies to share intelligence and identify, design and implement cross-agency strategies to reduce and deter fraudulent phoenix activity.**

**ASIC also has a number of Memorandum of Understanding (MOU) with other Commonwealth regulatory and government agencies on collaborative working arrangements. The MOU's allow ASIC and other agencies to cooperate and assist one another in sharing information to combat illegal phoenix activity. ASIC has used the MOU to refer a number of matters to the ATO for investigation and vice versa.**

**Another example of how regulators work together is when ASIC, ATO and Fair Work Building and Contraction hosted a building and construction round table in December 2013 that was attended by ten of Australian biggest construction companies.**

**Constuction is an industry that is at risk of illegal phoenix activity and this roundtable sought to discuss this risk with Principal and Head Contractors.**

**To address phoenix activity, and only phoenix activity, should disqualification be available as an enforcement remedy when a director is associated with a single failed company? What other remedies should be available to address phoenix activity?**

**Answer:**

**Director Disqualification as an enforcement remedy is available if a Director is associated with a single failed company (refer ss 206C – civil penalty provisions)**

**A person is automatically disqualifiied from being a director if they are convicted of any indictable offences in respect of the making, or participation in making of decisions that affect the whole of a substantial pat of a company, or that has the ability to affect significantly, the corporation's financial position (206B(1)(a)) or if they are convicted of an offence that is punishable by imprisonment for a period greater than 12 months, or that involves dishonesty and is punisable by imprisonment for at least 3 months (s206B(1)(b)) or is convicted of an offence against the law of a foreign country that is punisable by imprisonment for a perid greater than 12 months (s206B(1)(c)).**

**In the case of a criminal conviction, the person is automatically disqualified from managing Corporations for 5 years from the date of conviction or release from custody. In the case of a civil penalty action, the Court may in its discretion make a disqualification order for any period.**

**In terms of administrative action, ASIC currently has the ability to administratively disqualify a person from managing corporations for a period of up to 5 years, where they have been involved in two or more companies that have been placed in liquidation where a liquidator has lodged a report under section 533 of the Corporations Act 2001. Liquidators often report to ASIC that directors have engaged in conduct that has constituted illegal phoenix activity, and ASIC has taken administrative action to ban 57 directors in the 2013/14 financial year. However, there are no legal provisions for ASIC to disqualify a person from managing a corporation where they have been the director of one failed company and this would require law reform. If so, ASIC could disqualify more persons (subject to having the resources to do so).**

**In regards to other remedies, as noted above the law currently provides for criminal, civil and administrative remedies to combat illegal phoenix activity.**

**Financial advice**

**Submission 190 (Mr Ben Burgess)**

The submitter is a financial planner who advises that one of their clients had $8.8 million in a term deposit. At majority, the client contacted another bank about an advertised rate. The submission alleges that subsequently the client was misled and coerced into investing into various high risk investments, despite requesting a much lower risk term deposit. The client lost an estimated $3 million. The submitter alleges the bank's documents are deficient with, among other things, some of the paperwork was compiled after having the client sign the last page of investment documents.

The submission advises that ASIC took no action. The submitter objects to this and the 'vast amount of time, effort and expense incurred…in fighting for this complaint and doing a large part of the work that ASIC itself should have done'.

***Questions***

- Why did ASIC not take action on this particular case? Do advisers have anything to fear if isolated cases are not pursued?

**Answer:**

**This matter was brought to ASIC's attention by a letter to Deputy Chair Jeremy Cooper from Peter Downes (Senior Adviser on Superannuation to the Hon Senator Nick Sherry MP) dated 6 March 2009.**

**Deputy Chair Jeremy Cooper responded to Peter Downes on 26 March noting that we do not generally initiate legal action on behalf of individuals where we do not have evidence of systemic issues that suggest action by ASIC would be in the public interest. The letter went on to say that we understand the individual had sought preliminary legal advice and that we will recommend that they pursue this avenue in terms of seeking redress.**

**ASIC has finite resources and cannot take action in relation to all misconduct in the financial services industry – no regulator can. Matters where there are no systemic issues and where the consumers are better placed to take action on their own behalf are not generally matters that ASIC will take on.** How many complaints from financial advisers alleging misconduct does ASIC receive each year (for the past three financial years)?

**Answer:**

**The table below shows the complaints from financial advisers alleging misconduct for the last three financial years:**

| **Year** | **Number of complaints** |
|---|---|
| 2010/11 | 27 |
| 2011/12 | 18 |
| 2012/13 | 32 |
| | **Total 77** |

**Note: this table does not include complaints about financial advisers by members of the public other than financial advisers. Additionally, it does not include breach reports by AFS licensees.**

- Can ASIC point to any enforcement action taken against a financial institution as a result of a complaint from a financial adviser? Why should financial advisers bother reporting misconduct to ASIC?

**Answer:**

**Many of our whistleblower matters are ones where an adviser raises issues, and some of these have resulted in regulatory outcomes. In order to protect the whistleblowers, we prefer not to name these matters publicly.**

**We consider that reports from advsiers are one of the most important sources of information (as are matters brought to our attention by other people in the industry). . In all these cases, as with all matters, we consider them in detail against four key questions:**

- **What is the extent of harm or loss from the misconduct?**
- **What are the benefits of pursuing the misconduct?**
- **How do other issues like the type and seriousness of the misconduct and the available evidence affect our consideration of the matter?**
- **Also, and importantly, is there an alternative course of action?**

**Reports from financial advisers, and other industry members, provide us with valuable information and intelligence. However, not every matter will be one we take immediate or individual action. Many pieces of information and intelligence are recorded and considered in light of future information that may be gathered, or they may influence the choice of pro active surveillance projects that we undertake. There are other ways we work proactively to identify compliance problems through our liaison with financial advisers:**

- **gathering and using industry intelligence from advisers;**
- **using advisers to help assess the findings of our regulatory work (eg through participating in the assessment panel for shadow shopping exercieses); and**
- **consulting advisers on the targeting of surveillances and proactive sectoral 'health checks' in the advice sector.**

**In recent years ASIC'S priorities have included an extensive ongoing surveillance program of financial advisers. We have focused on the following financial advice themes:**

- **aggregator licensees;**
- **quality of advice;**
- **advice relating to complex products such as capital guaranteed products; and**
- **the use of managed discretionary accounts (MDAs).**

**This focus has resulted in a number of enforcement outcomes including a 2010 enforceable undertaking (EU) with Professional Investment Services Pty Ltd and a 2011 EU with UBS Wealth Management Australia.**

- Mr Medcraft, at the 19 February hearing argued that one in five Australians sees an adviser today, and that it probably should be one out of two. He suggested that the sector should be thinking about this. If complaints from experienced professionals such as Mr Burgess are not taken seriously, and if matters they consider represent a serious contravention are not investigated, how does this affect their approach they take to their compliance obligations?

**Answer:**

**The complaint from Mr Burgess was taken seriously. ASIC does not have the resources to investigate and take action on every complaint, but this should not be taken to mean that we do not carefully consider all matters brought to our attention. We carefully assess all matters, and apply consistent criteria to choose which of these we can and should pursue further. We find that experienced professionals generally understand the limitations on ASIC's ability to investigate every complaint, and that this does not affect the seriousness with which they approach their compliance obligations.**

**Supplementary questions on notice**

In the committee's public hearing on 10 April 2014, Senator Bishop raised the possibility with Mr Jeff Morris of the committee recommending 'a full, properly independent review' of the files of CFP clients, in the context of ensuring the compensation offered to CFP clients was adequate (page 49 of the Proof Committee Hansard).

In light of this comment, and putting aside any cost considerations, would there be any legal obstacle to ASIC requiring the CBA to initiate a full, independent review of CFP client files to ensure the adequacy of compensation offered and/or provided to CFP clients for losses incurred as a result of inappropriate advice received? Would, for instance, clause 2.17 in the Enforceable Undertaking entered into by the CFP have any bearing on ASIC's ability to require the CBA to initiate such a review?

**Answer:**

**ASIC could not require CFPL to do a review of all client files. Such a remedy (i.e. undertaking an independent review of all CFPL client files) would not be available if ASIC were successful in criminal, administrative or civil action against CFPL.The only possible way for ASIC achieve an outcome whereby CFPL undertook an independent review of all client files would be if CFPL offered[15] to do so in the context of an enforceable undertaking or settlement agreement[16].**

**By way of background, a party enters into an enforceable undertaking or settlement agreement with ASIC as an alternative to ASIC taking enforcement action[17] against the party. While negotiated outcomes (such as enforceable undertakings and settlement agreements) can and often do secure outcomes beyond what can be achieved through enforcement proceedings - particularly in the case of compensation schemes - they are subject to what can be negotiated between the parties. It is therefore unlikely that a party will offer to take action or incur costs under a negotiated agreement if those actions or costs go far beyond what a court[18] would order[19].**

**CFPL did not offer to undertake an independent review of all client files during the course of the enforceable undertaking negotiations with ASIC in 2010. It is unlikely that they would have done so, given the prohibitive cost and time involved in such a process. Further, the cost involved in undertaking such a process would have been far in excess of the financial penalty that a court would have required CFPL to pay (had ASIC taken court proceedings against CFPL and been successful).**

**For the same reasons, it is unlikely that CFPL would offer to undertake an independent review of all client files if ASIC and CFPL had reason to enter into enforceable undertaking or settlement agreement negotiations in the future. This is quite apart from other obstacles identified in the answer below.**

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[15] ASIC cannot compel a party to agree to an enforceable undertaking. A party may offer an enforceable undertaking and ASIC may agree to its terms.

[16] If CFPL breached the terms of the enforceable undertaking or settlement agreement relating to the obligation to undertake an independent review, ASIC could approach the court for orders compelling CFPL to undertake the independent review.

[17] Civil or administrative action.

[18] Or ASIC delegate or tribunal (such as the Companies Auditors and Liquidators Disciplinary Board) or panel (such as the Takeovers Panel).

[19] if ASIC brought successful proceedings against that party.

*Can ASIC now require CFPL to undertake an independent review of CFPL client files under the terms of the enforceable undertaking?*

**Answer:**

**No. See the answer to the preceding question. In addition, the enforceable undertaking between ASIC and CFPL was formally brought to a close on 26 November 2013; that is, the date on which ASIC accepted PwC's[20] final report[21]. Accordingly, ASIC cannot, under the terms of the enforceable undertaking (including clause 2.17), *require* CFPL to initiate an independent review of CFPL client files.**

*Are there any circumstances under which ASIC could require CFPL to initiate an independent review of CFPL client files?*

**Answer:**

- **See answers to the two preceding questions.**

*Are there any other alternatives?*

**ASIC may ask CFPL to initiate an independent review of CFPL client files; however, any agreement by CFPL to do so would only result in a voluntary undertaking between CFPL and ASIC. ASIC would not have the power to apply to the court for orders (i.e. compelling CFPL to undertake the independent review) if CFPL did not comply with the voluntary undertaking.**

Can ASIC suggest any way that committee can be reassured that everyone who suffered a loss because of the improper actions of financial advisers in CFPL has been appropriately compensated. The committee was especially concerned about the most vulnerable who did not have legal representation during the compensation process and would be unlikely to voice their concerns?

**Answer:**

**ASIC maintains that the CFPL compensation process, as originally designed, adequately compensated those who suffered financial loss as a consequence of inappropriate advice, including those who did not have legal representation.**

**The compensation process, as originally designed:**

1. **had a robust methodology[22];**
2. **had safeguards including the ability for clients to obtain independent advice (from an accountant, lawyer or licensed financial adviser) up to the value of $5,000 and paid for by CFPL;**
3. **was overseen by an independent expert;**
4. **provided clients with the option of taking their claim to FOS, in the event that they were dissatisfied with the amount offered by CFPL. We note that FOS has not raised any concerns about the compensation process in the matters that it has considered.**

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[20] PwC was engaged by CFPL as an independent expert under the terms of the enforceable undertaking.

[21] Clause 4.5 of the enforceable undertaking between ASIC and CFPL states that "*ASIC and CFP acknowledge that this undertaking ends on acceptance by ASIC of the Final Report*".

[22] Refer to ASIC's supplementary submission on CFPL.

**Recently, CBA informed ASIC that two measures, from the original compensation process, were not applied consistently across all affected customers[23]. These measures were:**

- **upfront communication with affected customers of advisers where there were concerns about the quality of advice, advising them of those concerns, informing them that there would be a review of the advice previously provided to them and providing an opportunity to raise issues; and**
- **the offer of $5,000 to customers to obtain independent advice in order to help them assess whether the review of their advice and any compensation offer was adequate.**

**Both measures were implemented in relation to customers of two former advisers within CFPL – Don Nguyen and Anthony Awkar. However, they were not applied to customers of other former CFPL24 and Financial Wisdom advisers, about whom there had been concerns.**

**ASIC has taken immediate action to remedy the inconsistent treatment. Customers who did not get the benefit of those measures will now get them which will allow them to access independent advice and seek compensation or test their compensation amount. This will be regardless of whether they have entered into a settlement. They will also have access to the Financial Ombudsman Service if they are not satisfied with the outcome.**

**These corrective measures will be subject to oversight by an ASIC-appointed independent expert. The expert will also check to confirm that there were no other changes to the original methodology. The independent expert will report to ASIC and the results made public.**

**To be clear, ASIC has not identified problems with the actual file reviews done in the compensation process, nor with the amounts of compensation offered to customers. The problem was not with the original compensation arrangements, but in the implementation.**

To what extent would settlements reached containing confidentiality clauses prevent further investigation?

**Answer:**

**We understand that settlement agreements reached between CFPL and individual clients contain clauses which prevent the client from:**

- **disclosing the terms of the agreement or making public comment about the agreement;**
- **taking action against CFPL in relation to the inappropriate financial advice provided by the relevant CFPL adviser.**

**Notwithstanding these clauses, clients who signed settlement agreements and later sought to re-open settlement negotiations with CFPL, have been advised by CFPL that it will not object to the FOS determining the issue of compensation afresh.**

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[23] Refer to ASIC's second supplementary submission on CFPL.

[24] Including those CFPL advisers included in the Past Business Review (the compensation scheme under the enforceable undertaking).

**These settlement agreements do not prevent ASIC from further investigating matters in connection with the inappropriate financial advice provided by CFPL advisers (including the administration of the CFPL compensation scheme).**

**However, clause 4.2(a) of the enforceable undertaking does prevent ASIC from investigating these matters to the extent that they were the subject of ASIC's concerns in the enforceable undertaking.**

The committee is in the final stages of drafting its report and is in the processes of finalising its thinking on a number of matters.

In this context, Senator Bishop has a point of clarification dealing with ASIC's ability to suspend an adviser immediately where ASIC suspects that his/her conduct is so egregious that an immediate suspension is warranted. This is in the context of a discussion that took place at the public hearing on 19 April and Senator William's concerns. (extract attached).

- Has the new law that amended ASIC's licensing and banning powers so that ASIC can cancel/suspend a licence where a person is likely to contravene (rather than will breach) its obligations, made an immediate suspension possible, or at the very least made it easier and quicker for ASIC to suspend an adviser?

  **Answer:**

  **In short that law reforms expanded the potential grounds upon which ASIC can seek a banning, and in that sense made it easier to do so, however that law reform did not change the steps, processes and procedures ASIC needs to follow in order to seek a banning, so it has not had a broader impact on the speed with which a banning can be put in place.**

  **ASIC's Australian financial services (AFS) licensing powers have been enhanced by legislative amendments made through the Future of Financial Advice (FOFA) legislation, including an amendment to the licensing test. Before the amendments (which came into effect on 1 July 2012), ASIC could refuse a licence application, suspend/cancel a licence or ban a person if there was a reason to believe that the licensee or representative 'will not comply' with its obligations, which was very difficult for us to satisfy. The new licensing test allows ASIC to refuse a licence if we determine an applicant 'is not likely to comply' with its general obligations in future. In addition, new grounds on which ASIC may make a banning order are where ASIC has reason to believe:**

  - **the person is not of good fame and character;**
  - **the person is not adequately trained or competent to provide financial services; or**
  - **the person is likely to become involved in the contravention of a financial services law by another person, or has been so involved.**

    **The changes to the tests in ASIC's licence suspension/cancellation and representative banning powers have introduced criteria that are more reasonable for ASIC to satisfy, for example, the previous, very onerous, standard of being satisfied that a licensee or representative 'will not' meet their licensing obligations.**

    **The recent changes to ASIC's licensing and banning powers have not changed the fact that ASIC can only make an immediate suspension of an AFS licence in very limited circumstances. These are where a licensee:**

- **ceases to carry on the financial services business;**
- **becomes an insolvent under administration;**
- **is convicted of serious fraud;**
- **suffers a mental or physical incapacity to manage the business; or**
- **requests ASIC to suspend or cancel the licence themselves.**

**The changes to ASIC's powers to ban a representative have also not altered the fact that we cannot ban an adviser representative without meeting certain procedural requirements described below (unless the person has been convicted of serious fraud).**

**To suspend or cancel a licence, or make a banning order, there are certain steps that ASIC needs to carry out, which affect the speed with which we can use these licensing powers:**

- **We must prepare a brief with sufficient material to enable an ASIC delegate (i.e. a person authorised by ASIC to exercise its powers on its behalf) to make a decision about whether to exercise ASIC's powers. The material used to support he recommendation for a licence suspension/cancellation or banning order must be is relevant, credible and probative.**
- **The speed with which we can do this may be impacted by the degree to which we receive timely material from licensees, particularly breach reports and additional information about their representatives, and the quality of that material (for example, poorly kept or incomplete files need much more time for an effective analysis).**
- **Before an ASIC delegate can make an administrative decision, including a decision whether to suspend/cancel a licence or impose a banning order, a person typically has a statutory right to be heard, either in person or via written submissions, or both (see ASIC Act Part 3 Div 6). ASIC provides persons invited to a hearing with a 'Notice of Hearing', which outlines their rights to be heard.**
- **In making a decision, ASIC's delegate must apply the tests set out in the law and ensure that the material presented before them is sufficient to be satisfied that the licence should be suspended or cancelled or the banning order made.**

- Does the new law apply to individuals or only the licensee?

  **Answer:**

  **The new law applies to both individuals and to licensees.**

  **The new law was applied consistently across the various licensing and banning tests that ASIC administers and affects both individuals and corporate entities in respect of ASIC's banning powers and individual licensees and corporate licensees in respect of ASIC's licensing powers.**

  **For example, the new standard applies to ASIC's power to suspend or cancel a licence (which typically affects corporate licensees, although it may be used in relation to an individual who holds an AFS licence in their own name), and the power to make a banning order prohibiting a person from providing financial services—in this case, a 'person' includes both individuals and entities.**

- If the new law does not allow ASIC to act immediately to stop a person from serious wrong doing has consideration been given to conferring such power on ASIC and what are the arguments against such conferral?

  **Answer:**

  **We have limited the scope of our answer to whether ASIC should be provided with a power to immediately impose a banning order on an individual person (e.g. an adviser), rather than whether the power should also extend to allow us to immediately suspend/cancel an AFS licence.**

  **This issue is ultimately a matter for Government, and as far as we know, there has been no consideration of the proposed change or options for implementing it, and we have not had discussions with Treasury about it.**

  **There would clearly be benefits for consumers if ASIC had the ability to quickly remove advisors that were engaging in serious misconduct, most particularly in preventing further loss or damage. However, as detailed below, consideration of reforms to speed the process would need to take into account a number of issues. If Government were minded to confer this type of power on ASIC, general issues that would need to be taken into account in determining what process to adopt include:**

  - **A person's right to be heard before a significant decision is made (e.g. before ASIC makes a decision to make a banning order) is a fundamental component of natural justice and a key aspect of administrative law before any final decision is made by ASIC to make the banning order.**
  - **The proposed power would still need to set a threshold test or standard of belief ASIC would need to reach in order to exercise the power. In practice, ASIC would still need to carry out the necessary information gathering and investigative work to determine whether the test had been met, and follow the process of adequately briefing a person authorised to exercise ASIC's powers. This would ultimately impact on the immediacy with which the power could be exercised.**
  - **A faster, expedited process would be most useful, and arguably most appropriate, in cases of clear and serious misconduct, e.g. misuse of client funds. It would be less useful where the conduct involved complex factual and legal questions about whether advice provided was above or below the necessary legal standard.**

- What if any options have been discussed that would in effect allow ASIC to act immediately suspend an adviser who poses a high and very real risk to consumers?

  **Answer:**

  **As noted above, the issue of whether to confer an explicit power on ASIC to immediately suspend an adviser is ultimately a matter for Government, and as far as we know, there has been no consideration of the proposed change or options for implementing it.**

  **Beyond just the immediate process and procedural steps around the banning, other factors that could significantly speed the process of removing bad advisors, and the level of protection provided to consumers through bannings, include:**

  - **Having a regime that clearly mandates prompt breach reporting and provides incentives to comply with the breach reporting requirements.**

**As proposed in its earlier submission, ASIC considers that a more appropriate and flexible penalty for failure to breach report, i.e. ability serve an infringement notice, is necessary in this regard. Faster breach reporting means ASIC can initiate action earlier, and access evidence of misconduct that is current rather than in the past.**

- **Having the ability not just to ban the individual advisors who directly provide the advice, but the managers within the business where they have significantly contributed to the provision of inappropriate advice by those that they manage.**
- **Having a public register of all advisors, including employed advisors, and mandated reference checking, such that ASIC is better able to track problem advisors, consumers are able to check the history of the advisor they are dealing with, and problem advisors are less able to more from firm to firm.**

**Currently, in our compliance and enforcement role, we do work to take action against advisers who pose a high risk to clients, in a timely way. This includes seeking the cooperation of licensees to provide us with relevant information so that we can carry out the banning process more quickly and efficiently, and potentially to place the adviser under additional supervisory or disciplinary arrangements.**

**In instances where licences have been cancelled, we have spoken to licensees who have taken on the authorised representatives for the former licensee to remind them of the poor compliance environment in which the representative had previously operated.**

Extract Hansard, 19 February 2014 pp. 19–20

Senator WILLIAMS: Of course there are appeal rights to AAT. We are well aware of that. What needs to be changed in regulation or legislation to give you the power when you get substantial evidence—and, when the Commonwealth Bank hands the file over, I would consider that very substantial evidence—to make a phone call and ban or suspend that financial planner from operating as a financial planner on the spot? What do we need to do?

Mr Medcraft: 'Suspend' is probably more appropriate—'suspend subject to natural justice'.

Senator WILLIAMS: Suspend is a better word. You put words together far better than me, Mr Medcraft.

Mr Medcraft: I think it was your idea, actually.

Senator WILLIAMS: What do we have to do?

Mr Kirk: In practical terms, generally speaking—and this was the case with Gillespie—the fact that they had reported this conduct to us meant that he was no longer providing advice for them. They had taken action. As to what we can do, under the current legal settings we have to establish proof, have a hearing and give him a right to be heard. That involves cross-examination of any witnesses and evidence and all those formal legal processes. That is designed to test whether the allegations being made, coming from outside the firm or from within the firm itself, are true and made out. Again, the current legal settings are that the planner is entitled to have that material tested, even when it is coming from the firm itself. The firm can take its own action—and it did in this case. To allow immediate suspension on a legal basis, where ASIC was doing it, would involve our being given powers that overrode people's right to hear the case against them and have it tested before there was a legal outcome that took away their right to earn a living in the area they have been working.

Mr Medcraft: I think that what the senator is suggesting is that you would have a suspension—you would reverse the onus. You would get suspended and then—I think what you are suggesting, senator, is a protection mechanism, which I think is reasonable thing, if an individual is causing a lot of damage. The law already reflects at times when you have to take protected action to stop damage to individuals.

Senator BUSHBY: An AVO, or something like that.

Mr Medcraft: Exactly. Basically, the onus then comes back to suspend them and essentially then have a process where they have to defend why that suspension should not become a permanent banning or whatever. I think that is what is being suggested. We probably have examples of that elsewhere in the law where—

Mr Price: Stop orders.

Mr Medcraft: Yes. We issue stop orders on prospectuses, where we go: 'Look, this isn't good enough. I'm sorry; you want to raise money but it is not good enough until you fix it.' The principle is already there in the law in relation to other aspects, even within Corporations Law, so I don't think unreasonable what you are suggesting, that there be that ability to suspend where it was seen that there was evidence that it was so egregious, especially if the company itself had suspended it. What you do there is at least stop the planner from going and getting a job with another planner. Frankly, I think it is a good idea. I think it is worth exploring.

Mr Kell: If you were to look at a power like that, it would probably need to operate through the licence holder. There would probably need to be some requirement imposed on the licence holder to suspend the planner. I will make one point of clarification here: you are giving credit to the Commonwealth Bank for reporting an adviser, but that was there basic obligation under the law.

Mr Medcraft: I think it does stop this issue we have just discussed, where you suspend them and they go somewhere else and start doing damage there.

Senator WILLIAMS: That is the point. I know that some did leave Commonwealth financial planning and go somewhere else such as Ord Minnett. Where I am getting at are those words of Adele Ferguson: having a regulator that is feared. If you have a system where you can suspend a financial planner and also a liquidator—

Mr Medcraft: Especially if the employer has already suspended them.

Senator WILLIAMS: I instigated the inquiry into liquidators back in 2008. It was a good inquiry, very interesting. There were a lot of submissions and there were unanimous recommendations by the politicians on the committee at the time—it was chaired by former South Australian Labor senator. Sadly, the previous government did not take up any of the recommendations. If we had liquidators licensed and you had the power to suspend their licence—I will give an example: the infamous Stuart Ariff. You had complaints about Stuart Ariff for four years. I have spoken many times to people whose lives he destroyed. He is now serving a six-year jail term. It cost Carlovers $1.8 million to have him removed from their company, which he was feeding off. When your company is in administration or liquidation you do not have a lazy $1.8 million to get someone like him out. However, if liquidators were licensed and you had the power to suspend a liquidator just with a phone call, I think you would become feared in many of these professional industries. Licensing structure is something this committee needs to look at—license financial planners and liquidators and give ASIC the power to suspend them, with one phone call, from their profession; however, allow them to go to the AAT, perhaps, to put a claim in.