Parliamentary Joint Committee on Corporations and Financial Services

Statutory Oversight of the Australian Securities and Investments Commission

August 2006

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DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

  (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

  (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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2.62 ASIC and the DPP should regularly update the committee as to the effectiveness of the revised Memorandum of Understanding.

Recommendation 3

2.96 The committee recommends that ASIC provide advice to the Australian Government on its concerns regarding the enforcement effects of:

- **the proposal to broaden the 'business judgment rule' as set out in the Corporate and Financial Services Regulation Review of April 2006; and**
- **any other proposals in the Corporate and Financial Services Regulation Review of April 2006 that would have significant enforcement implications.**

Chapter 1

Statutory oversight

1.1 The Parliamentary Joint Committee on Corporations and Financial Services was established by the *Australian Securities and Investments Commission Act 2001*. Section 243 specifies the Committee's duties, which include:

(a) to inquire into, and report to both Houses on:

(i) the activities of the Australian Securities and Investments Commission (ASIC) … or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed.

1.2 This report is presented in execution of the committee's duty under s.243(a)(i).

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

Public hearing

1.4 The committee held a public hearing on 13 June 2006 to examine matters falling within ASIC's regulatory jurisdiction. Evidence was provided by Mr Jeffrey Lucy, Chairman of ASIC and Mr Jeremy Cooper, Deputy Chairman.

1.5 A copy of the Hansard transcript from the hearing has been tabled for the information of the Parliament. It is also available online at http://www.aph.gov.au/hansard/joint/commttee/J9461.pdf.

Additional information

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

Chapter 2

Issues raised during the hearing

2.1 The committee's hearing with Australian Securities and Investments Commission (ASIC) officials on 13 June 2006 included discussion on a number of issues relating to ASIC's regulatory responsibilities. These were primarily:

- ASIC's ongoing regulatory involvement with respect to the Westpoint collapse;
- superannuation advice and ASIC's shadow shopper exercise;
- ASIC's educative role;
- conflicts of interest in the financial services industry;
- ASIC's new memorandum of understanding with the Commonwealth Department of Public Prosecutions;
- ASIC's assistance to the Victorian Police in the Vizard matter;
- increases to ASIC's budget funding;
- prosecution rates for corporations law breaches;
- the burden of financial services regulation compliance; and
- a proposal to incorporate a business judgment rule into the Corporations Act.

2.2 The committee notes that a number of these issues were also discussed with ASIC officers shortly prior to the 13 June hearing, at the Senate Economics Committee's budget estimates hearing on 31 May 2006. As the two hearings occurred within a two week timeframe, many committee members had taken the opportunity to follow up on some of these matters at the committee's ASIC oversight hearing shortly after. Consequently, this report has drawn on evidence taken during budget estimates where it has provided the basis for discussions at the hearing relevant to this report.

Westpoint

Backgound

2.3 The Westpoint Corporation is at the centre of a complex mezzanine finance investment scheme that collapsed in late 2005, owing 3000 - 4000 investors up to $400 million in total. Most of the money raised for the various property development schemes in the Westpoint group came from the issue of promissory notes; unsecured and similar to an IOU. Westpoint offered investors a 12 per cent p.a. return on their investment. Many were channelled into the schemes on the advice of financial planners receiving commissions as high as ten per cent.

2.4 Issuing promissory notes of over $50,000 to retail investors allowed Westpoint to exploit a legal loophole, enabling them to raise funds without meeting the usual disclosure requirements, ie registering a prospectus or disclosure statement. Concerned they were deliberately attempting to place their activities outside ASIC's jurisdiction, ASIC instigated proceedings against two Westpoint mezzanine companies in the WA Supreme Court. The court determined in favour of ASIC when it found that the notes constituted managed investment schemes and therefore fell within the scope of the Corporations Law. It also determined against ASIC when it ruled that the notes were not debentures, as ASIC had argued, subject to more rigorous disclosure requirements. They were deemed not to be a financial product and therefore ASIC did not have jurisdiction over them, particularly with respect to acting on Westpoint issuing misleading information to investors. Both sides appealed the decision and the outcome is discussed at paragraph 2.15.

2.5 Although the decision technically gave ASIC the power to wind up the scheme, ASIC Chairman Mr Jeffrey Lucy has indicated that to seek to wind up Westpoint in court would have required concerns over their insolvency. In the absence of complaints that investors were not getting paid, combined with Westpoint's auditors giving their 2004 accounts an unqualified pass, ASIC has claimed it had little evidence to provide to the court that the appeal process should be bypassed and the scheme wound up.[1]

Timeliness of ASIC's engagement with Westpoint

2.6 ASIC has been subjected to criticism over the timeliness of its response to warnings about the various Westpoint schemes well before their ultimate collapse. Specifically, the Real Estate Consumers Association in 2001, and the WA Department of Consumer and Employment Protection in 2002, formally raised their concerns with ASIC.

2.7 At the Senate Economics Committee's estimates hearing on 31 May 2006, ASIC outlined the genesis of its later court action against Westpoint:

> ...in 2002 when there were discussions between the Department of Consumer and Employment Protection in WA and staff of ASIC and consumer warnings were issued, ASIC also started looking more closely at what could be done to deal with the risk that seemed to exist. A matter was commenced in the enforcement directorate of ASIC in January or February 2003 to look more closely at this issue.[2]

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1 This information was provided during the Senate Economics Committee's budget estimates hearing, *Committee Hansard*, 31 May 2006, pp. 60-80. See also Gary, J. 'Did ASIC fail over Westpoint', *Australian Financial Review*, 26 April 2006, p. 60; Burrell, A. 'Meet Norm Carey, property spiv', *Australian Financial Review*, 7 April 2006, p. 1; Four Corners, *Transcript of interview with Jeff Lucy*, 8 May 2006.

2 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 62

2.8 ASIC explained its attempt to persuade Westpoint to comply with their disclosure requirements; that they were not justified in exploiting the existing legislative 'exclusion':

> There was an express exclusion for promissory notes over $50,000 from the definition of 'debentures'; that was the problem. We looked at what could be done given that that is what the situation appeared to be, that these were not covered by the legislation that we are tasked to regulate. We developed an argument that we thought had some merit and we thought we needed to raise directly with Westpoint to persuade them that what they were doing, which purported to rely upon the exclusion, did not in fact do so.[3]

2.9 This continued until ASIC realised it was not making progress, when court action was taken:

> That occupied several months in 2003. It would be fair to say there was a lot of toing-and-froing between ASIC and Westpoint and in particular their lawyers, Freehills—they might say 'toing-and-froing'; we might say 'cat and mousing'—over this issue. We eventually realised by the end of 2003 that we were being stalled, we were being given the run around, and we delivered an ultimatum to Westpoint to either comply with the argument that we had put forward about the Corporations Act or we would take court action. We ended up taking court action to force Westpoint to comply with the Corporations Act, based on a very difficult technical argument that in part relied upon an interpretation of the Bills of Exchange Act rather than the Corporations Act. Nonetheless, we had to fight for our jurisdiction and that is what we did.[4]

2.10 The time consuming nature of achieving an outcome through this process is obviously of concern now that Westpoint has cost investors so much of their money. However, ASIC justified its approach on the basis that it was the most appropriate one that could have been taken at that time:

> ...the issue we were facing, as a practical pragmatic matter, was that we were dealing with the here and now; we had to do something. It was not a matter of waiting for law reform through the normal processes. I am not sure how long that would have taken. We had to deal with something in the here and now and that is what we did.[5]

2.11 In 2002, the then Parliamentary Secretary to the Treasurer, Senator the Hon. Ian Campbell, wrote to the WA Minister for Consumer Affairs regarding concerns over mezzanine financing. Senator Campbell indicated in correspondence that: 'If required, the government will consider any recommendation ASIC makes to improve

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3 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 62

4 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 62

5 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 62

consumer protection in this area'.[6] In evidence to the committee, ASIC defended the route it had taken through the courts, rather than seeking legislative change:

> ...the decision to deliberately carve out promissory notes greater than $50,000 was a deliberate decision taken by parliament. That position existed. At that stage, as we have said in earlier forums, the complaints which we received were to do with the jurisdictional issues; they were not to do with business plan issue or business model issues. People were not suffering financial hardship at that time through their investments.

Mr Lucy added:

> We took the matter to court. At that stage you do not know whether or not the law needs changing until you test it in the court.
>
> ...
>
> The legal advice was that we would be successful, and we were not fully successful.[7]

2.12 The court's decision did, however, give ASIC the opportunity to take action against Westpoint on the basis that its scheme had been deemed to be a managed investment scheme. When questioned over why it did not seek to do so, ASIC stressed that the requisite concerns about Westpoint's solvency were not present:

> ...in order to take action at that point and, given that this trial was still on foot—the proceedings were still on foot—and the relief that we were seeking as a consequence of that finding was still before the court, we needed to have some additional here and now urgency or some here and now risk that meant the issue could not wait. We were very concerned about things like financial vulnerability. We had sought further audited accounts to be lodged by the Westpoint Group. They came back audited and unqualified, so we did not seem to have any financial grounds on which to attack Westpoint at that point.
>
> ...
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> We had circulated to all the investors about the action that we had taken in 2004. We did not hear any responses from them. In the meantime, Westpoint was continuing to meet redemption requests. It was continuing to pay monthly interest to investors. There did not seem, at that point, to be an urgent issue that would require the court to take immediate action as opposed to continuing to hear the matter in the normal course, which meant awaiting the appeal.[8]

2.13 The committee believes that a more effective response from ASIC may have been to seek the removal of the legislative exemption Westpoint exploited, in order to ensure ASIC's jurisdiction over the mezzanine schemes. However, the committee

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6 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 37

7 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 37

8 Senate Economics Committee, *Committee Hansard*, 31 May 2005, pp. 64-65

acknowledges that it is in a position to make such an assessment with the benefit of hindsight. Once the understandable decision to test the matter in court had been instigated, ASIC was left to await the judgment of the court before agitating for legislative change. ASIC contacted the relevant investors to invite them to join its action claiming Westpoint's communications were false and misleading; none responded. Audited accounts sought by ASIC were returned unqualified and there were no complaints from investors regarding unpaid capital or interest.

2.14 The committee is of the view that ASIC cannot be blamed for the deception and/or inept behaviour of the parties that contributed to this corporate collapse. ASIC should now focus on improving investors' financial literacy to avoid being trapped by such schemes (see later discussion beginning at paragraph 2.47), investigating and prosecuting those that have committed offences, and ensuring that losses through similar schemes are prevented.

2.15 The committee notes that following ASIC's appearance before the committee, the WA Court of Appeal upheld the original Supreme Court judgment. Consequently, the legal loophole exploited by Westpoint may, according to ASIC, continue to operate with respect to similar mezzanine schemes. Following the judgment, an ASIC spokesperson was quoted as saying: 'The loophole should be plugged – that would have to be the conclusion...'.[9] Chairman Mr Jeffrey Lucy was also quoted as suggesting the loophole be closed by raising the exemption threshold from \$50 000 to \$500 000, or more.[10]

Current investigation

2.16 ASIC informed the committee that it was in the process of seeking intelligence from investors who lost money in the collapse:

> We have sought communications from essentially all of the investors. I cannot give you the number, but I can give you a statistic. Investors who total \$300 million in aggregate of investment out of about \$350 million to \$400 million have responded. We have a very high participation rate and we are in the process of collating that intelligence.[11]

2.17 Mr Lucy told the committee:

> We are in a position where we have a very active investigation on foot in relation to Westpoint ... we are investigating all circumstances dealing with Westpoint, including the role of directors, officers and third parties, including auditors. That is a matter that we are working on. We have it in front of us, but it is not appropriate to go into any particular detail.[12]

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9 Jacobs, M. 'ASIC says loophole ties hands', *Australian Financial Review*, 16 June 2006, p. 7

10 Buffini, F. 'ASIC wants Westpoint loophole closed', *Australian Financial Review*, 28 June 2006, p. 1

11 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 27

12 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 26

2.18 Although ASIC has not been prepared to comment on the specifics of the case, it has confirmed that the investigation will encompass the role of Westpoint directors, financial services licensees, advisers recommending the mezzanine schemes with high commissions, KPMG's role in auditing Westpoint's accounts and advising (or otherwise) ASIC regarding concerns over Westpoint's solvency, and other third parties. The committee also notes ASIC's efforts to return persons of interest in their investigation to Australia.[13]

2.19 The committee also notes the possibility of investors recovering a portion of their money through litigation if common law negligence by the auditors can be proved.[14]

2.20 The committee urges ASIC to pursue this matter as vigorously as possible and encourages people who invested money with Westpoint to assist ASIC with its investigation.

Other potential investor losses

2.21 Aside from minimising the damage associated with the Westpoint collapse and prosecuting those who have committed offences, the committee is concerned that other, similar, high-risk mezzanine schemes could be placing investors at risk of losing their savings.

2.22 ASIC has indicated that there are indeed other mezzanine schemes operating that need to be monitored. At a budget estimates hearing, Mr Lucy stated:

> ...we are surveilling the Australian financial market landscape very closely. We have dialogue with a small number of entities where we have varying levels of concern and we think that those issues are being managed satisfactorily.[15]

2.23 However, he told the committee that the pending court decision prevented immediate action to unambiguously legislate these schemes within ASIC's jurisdiction:

> One of the difficulties which we all face is that we have an open-ended appeal decision with the Western Australian Court of Appeal. Once that decision is finalised, then we can recommend to the government that they need to look at amendments; or, if the decision goes in our favour, then we do not need to worry about that. We are all up in the air over that particular issue.[16]

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13 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 27; Senate Economics Committee, *Hansard*, 31 May 2006, pp. 67 -73

14 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 79

15 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 65

16 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 30

2.24 In a strictly regulatory sense, ASIC's principal preventative measure has been to issue stop orders. These are utilised where ASIC believes there has been inadequate disclosure about specific financial products, either through the prospectus or product disclosure statement, depending on the type of product. This prevents those subject to the order from raising any further capital.[17]

2.25 From a consumer perspective, ASIC has also attempted to persuade the media to take responsibility when choosing whether or not to carry advertisements for similar high-risk mezzanine schemes.[18] However, ASIC stressed that the best way to avoid such disasters is through literate investors seeking advice with licensed planners:

> There is a distinct advantage, in our view, in people dealing with licensed advisers; they have very clear responsibilities. Also, we are stressing to people that they need to take responsibility for their decisions. They need to have regard to risk and what they can afford to lose. They need to have regard to their own financial circumstances. They need to understand that it is a bit like the bull’s eye in the centre. One can deposit money with an APRA regulated bank and the risk is absolutely minimal. The further you move out, the greater the level of risk. There is nothing wrong with undertaking risk as long as it is properly balanced with what you can afford and what your circumstances are as to whether or not you are employed or retired. It is a matter of balancing. In the case of financial advisers, those are exactly the responsibilities that they have—to know their client and to know their products.[19]

2.26 The committee notes other similar schemes referred to at the Senate Economics Committee's budget estimates hearing in May 2006.[20] This area is of considerable concern to the committee and it will continue to monitor ASIC's efforts to prevent such schemes from providing misleading information to investors.

Superannuation advice and ASIC's shadow shopper exercise

Survey results

2.27 In April 2006 ASIC released the results of its 'Shadow Shopping Survey on Superannuation Advice', which surveyed 259 individual advisers - representatives of 102 Australian Financial Services Licence (AFSL) holders - to assess 306 examples of financial advice provided to real consumers.

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17 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 66

18 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 66

19 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 27

20 *Committee Hansard*, 31 May 2006, pp. 80-83. The schemes referred to are Paridian Property Development Fund and Sovereign Capital Ltd.

2.28 In the committee's view, the survey results are of major concern. ASIC found that superannuation advice did not, overall, meet its expectations. The survey revealed that:

- given the client's individual needs, 16 per cent of advice was unreasonable;
- one third of advice suggesting a switch in funds lacked credible reasons;
- unreasonable advice was between three and six times more likely where a conflict of interest (eg high commissions) was present; and
- advisers failed to give a requisite Statement of Advice (SOA) on 46 per cent of cases (though one fifth of these were verbal advice to stay in an existing fund).

2.29 ASIC identified the major problems as being advisers not examining existing funds before recommending new ones, and SOAs not adequately disclosing the reasons for recommended action and not disclosing the consequences of switching super funds.[21] Significantly, most clients that had received poor advice were not aware that it was so.

2.30 ASIC stated that the breakdown of advice given on the basis of commission or fee-for-service was 50 per cent each.[22]

Approved product lists

2.31 A major issue identified by the committee is the relationship between super switching advice and financial services licensees' approved product lists. When recommending a switch from one superannuation fund to another, planners must be in a position to properly assess the relative merits of the existing 'from' fund to the potential 'to' fund. That is, the fund being switched to must be of greater benefit to the customer than the one they are already in. ASIC Deputy Chairman Mr Jeremy Cooper told the committee:

> Where you are recommending a switch, you need to look at the existing arrangements that the customer has and assess the plusses and minuses of moving out of that product and into a new product. You need to explain those to the client and then include them in the statement of advice. The report that you were referring to, the super switching report, had some rather unhappy outcomes. For example, people had existing funds, where they had quite reasonable insurance, and through lack of care on the part of the adviser it was recommended that they move into another product. They either lost that insurance or ended up having to pay much more for it. We set all that out in that report. That is really a summary of the legal obligation. It makes perfect sense. If you are giving professional advice to someone about whether they should move out of a fund, it is not rocket

21 ASIC, 'Survey finds quality of advice on super still needs improvement' *Press release,* 6 April 2006

22 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 23

> science to expect that you would have a look at what fund they are already in and see how it stacks up with what you are recommending. It is that simple.[23]

2.32 This requirement dictates that if a person's existing 'from' fund is not on their financial adviser's approved product list, then a recommendation to switch cannot be made because advisers are not permitted to provide advice about funds that are not on their licensee's list. ASIC described this as a sensible risk management tool for licensees:

> If I were a financial services licensee, I would want to know which products my authorised representatives were advising on and which ones they were not. If they want to advise people about moving out of a superannuation fund into another one, they need to make sure that the list is sufficiently broad. Otherwise, they are going to have a very small amount of work to do in that area.[24]

2.33 The major difficulty with this situation arises when the requirement for planners to provide advice about products only on approved funds lists intersects with the highly commission-based structure of the financial planning industry. In particular, industry funds do not pay commissions to financial planners to market their product. Where a client's existing fund is an industry-based one, ASIC admitted this can be problematic when seeking superannuation advice:

> ...the remuneration model at the moment often means that many financial advisers do not advise about industry funds. We are not making any secret of that.[25]

2.34 Hence advisers are placed in a 'catch 22' situation which may be factor in some of the superannuation switching advice shortcomings detected in the ASIC survey.

2.35 However, ASIC advised the committee that this sort of scenario was, in the context of the recently enacted Super Choice regime, causing the industry to move towards a market-driven solution. Mr Cooper told the committee:

> I am saying to you that [the commission-based fee model] is a difficulty, but already the industry is racing towards a solution in creating a different fee model where people will be able to get that advice.[26]

2.36 When asked if ASIC was advocating that licensees move to fee-for-service remuneration models, he stated:

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23 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 10

24 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 11

25 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 13

26 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 14

> That is for the industry. In our shadow shopping work, we show that there is a fairly worrying correlation between commission models, conflicts and so on and advice that does not have a reasonable basis. We will leave it at that.[27]

2.37 The committee believes that superannuation advice should ultimately be given on the basis of the product that is best for the client. It welcomes any move by the industry towards providing services on a fee-for-service basis. However, the committee recognises that this will become a reality only when there is a change of attitude by consumers, who thus far have shown a reticence to pay such fees. Further, for some consumers fee-based advice would be unaffordable.

Commission-based remuneration

2.38 The role of commissions paid by the suppliers of financial products to advisers appears to be an issue in relation to poor advice. Some advisers are not recommending the most appropriate products for their clients, instead preferring to encourage investment in those that offer the greater commission-based reward. This presents a clear conflict of interest that ASIC says needs to be managed through disclosure. ASIC has stated that paying commissions for financial product sales is not going to be outlawed, but the situation has to be managed when providing advice:

> The people who pay commissions are the people who make the products. The government has spoken in relation to whether or not those product issuers can pay commissions. The landscape is that they can pay commissions. Where we are coming from is how licensed advisers and their authorised representatives handle that scenario where they are advising on products where there are commissions being paid. That is an entirely different perspective. We are not seeking to regulate whether or not product issuers can pay commissions. We are looking at the conduct of people who give advice about those products—that is, at how they disclose their commissions, at whether they get bias from those commissions and at whether it makes them cut corners. That is what we see in the shadow shopping work.[28]

2.39 Mr Lucy has previously suggested that commissions in excess of two per cent should be disclosed separately.[29]

2.40 When assessing the problem of poor super advice, the committee recognises the complex interplay between the level of commission on offer to advisers, the possible effect that has on the advice given, the monitoring role of financial services licensees to ensure their advisers are giving appropriate advice, and significantly, the financial literacy of the general public when choosing how to invest their savings.

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27 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 14

28 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 15

29 'ASIC survey damning on super advice', *Inside Business transcript of interview*, 9 April 2006

Although the many facets of this issue make it a difficult one for ASIC to address, the committee expects this exercise to lead to a substantial overall improvement on the disappointing standard reflected by the survey. This is discussed further from paragraphs 2.44 – 2.46.

ASIC's strategy

2.41 ASIC indicated that 14 (undisclosed) licensees are the subject of specific follow-up action resulting from the survey results.[30] While admitting that 'major players' were surveyed, ASIC stated that the exercise was intended to provide 'data capture', rather than publicly shaming individual planners or licensees:

> We did not want this one to be yet another confrontation where ASIC seemed to be beating up on either individual planners or licensees. Even on the way the project was designed, we had to give undertakings of confidentiality to each one of the participants. We had in this survey over 300 people who actually were our real life guinea pigs. In order for us to do that, and also to get Roy Morgan's assistance, we had to assure each one of them that their affairs and the advice they had been giving had been kept confidential. That in itself very much pitched the way that this work was going to go forward. It was not going to be a name and shame exercise and it was not going to be a big enforcement exercise, where ASIC was getting out the big stick. Instead, it was going to be much more of a data capture on what exactly was happening. I think the way that the industry has actually responded to this work bears that out. It has had perhaps a much more constructive outcome than some of the other ones we have done.[31]

2.42 To allay committee concerns that such an approach would not assist current, ordinary investors to identify the consistently worst culprits for poor advice, Mr Lucy indicated that:

> ...it is reasonable to assume that we are carrying out surveillance on them. To the extent that there are outcomes as a result of that surveillance regarding poor activities or inappropriate activities, we will be making that very much a public outcome.[32]

2.43 In evidence, ASIC sought to impress that although only a small fraction of investors were surveyed, the targeting of poor performers through these sorts of activities and ongoing surveillance would protect investors more broadly.

2.44 The committee acknowledges the dilemma faced by ASIC. Its preferred strategy is to bring about cultural change through industry cooperation by accurately highlighting current substandard industry practice in a non-confrontational way. As

30 ASIC, 'Survey finds quality of advice on super still needs improvement' *Press release,* 6 April 2006

31 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 17

32 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 18

noted above, if licensees feel targeted with a 'big stick' then the practice of notifying breaches and efforts to better monitor advisers by licensees may diminish. Nonetheless, the survey shows a level of performance that indicates thousands of customers are receiving advice that will unknowingly cost them enormous amounts of money, often tens or even hundreds of thousands of dollars in additional fees and charges. This is unacceptable at a time when investors have the opportunity to easily switch their superannuation fund.

2.45 The committee is of the view that the survey results should serve as a warning to those offering unreasonable superannuation advice. ASIC should undertake a similar exercise in 2007 and, if results have not significantly improved, repeat offenders who have been found to have repeatedly and seriously breached the requirement to provide reasonable advice should be publicly named.

Recommendation 1

2.46 The committee recommends that ASIC conduct a shadow shopping survey on superannuation switching advice in 2007 and publicly name advisers and licensees identified as responsible for repeatedly and seriously breaching the requirement to provide reasonable advice.

ASIC's educative role

2.47 Besides enforcing and regulating companies and financial services laws, ASIC is responsible for consumer protection in superannuation, insurance, deposit taking and credit.[33] A large component of this protective role is in improving the financial literacy of the general community, often referred to as 'mums and dads investors'. In view of investors' losses associated with the Westpoint collapse and exposed by ASIC's shadow shopper exercise, this is an area in which ASIC could become more effective.

2.48 ASIC told the committee that, in order to broaden the education campaign audience, its communications through the press had been extended beyond publications such as the *Australian Financial Review* to include the *Daily Telegraph* and talkback radio. According to ASIC though, the problem of over-exposure looms:

> The balance is that we cannot oversell ASIC. We do not want ASIC to get to the point where people say, ‘Goodness me, it’s ASIC again in the press,’ which reaches a point where it is a turn-off. We need to continue our currency and for people to continue to want to listen to our messages.[34]

2.49 The committee suggested that ASIC assist investors by maintaining an 'offenders' register' of individuals who have been sanctioned by ASIC. Although it may be difficult to administer, an easily accessible list would help alert investors

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33 ASIC website, http://www.asic.gov.au/asic/asic.nsf/byheadline/About+ASIC?opendocument, accessed 26 June 2006.

34 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 4

considering investing money with, or taking advice from, those that were subject to an adverse finding by ASIC. The committee believes that such a list would also have a deterrent effect on individuals who may otherwise choose to engage in unethical behaviour within ASIC's jurisdiction.

2.50 With respect to superannuation switching advice (dealt with in detail at paragraph 2.27 onwards), ASIC told the committee that its website contained fee information on nearly 1000 funds.[35]

Conflicts of interest in the financial services industry

2.51 In April 2006 ASIC released a discussion paper on managing conflicts of interest in the financial services industry. Using illustrative scenarios, the paper outlined a number of conflicts within the industry that ought to be managed. In the report ASIC also identified two conflicts of interest for financial advisers that should be avoided completely. They are: shelf fees and payments for switching funds. Shelf fees are paid, in addition to commission, by an issuer of financial products to get their fund on the approved product lists of financial planning companies. The latter conflict involves product issuers paying an adviser to switch all his/her clients from a competitor's fund to theirs. Part of the fee may be rebated to clients.

2.52 Following feedback and consultation with the industry, the discussion paper and the responses to it will inform ASIC's policy statement (no. 181) on this issue. ASIC stressed it is not attempting to 'cover the field' of conflicts of interest that may arise, instead seeking to provide illustrative guidance to industry:

> ...we do not think handling conflicts is a situation where the regulator issues endless prescriptive guidance so we end up with a book of 5,000 pages, you look up the conflict that you think you are involved with and, lo and behold, ASIC has set out a rule on that conflict. We are definitely not going to be doing that. We did think that there was a need to bring the high-level policy work down to a more recognisable level and deal with various little scenarios in each industry.[36]

2.53 ASIC was not able to inform the committee as to the timeframe for its next publication, be that another discussion paper or a policy statement, on this issue. However, officers indicated that ASIC would seek to provide further clarity on the appropriate response to particular conflicts:

> The next time ... I think people are going to be looking for perhaps more commentary. The main thing we wanted to do was to get the scenarios out, get people engaged with them and get some feedback. I think the ball is now back in our court to consider each conflict situation a bit more fully and have a little bit more of a think about what the answer is. I will not say that the document that went out was relatively superficial, but it did not

35 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 21

36 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 7

> spend a lot of time actually addressing the real answer on each particular conflict.[37]

2.54 The committee will seek an update on this process at its next oversight hearing.

DPP memorandum of understanding

2.55 On 1 March 2006 ASIC signed a new memorandum of understanding (MOU) with the Commonwealth Department of Public Prosecutions (DPP). This replaced the earlier memorandum agreed in 1992. The main features of the new MOU are:

- ASIC will, in a timely manner, refer a brief to the DPP where it believes an offence has been committed and sufficient evidence to support that view has been gathered;
- ASIC is permitted to prosecute summary regulatory offences with agreement from the DPP;
- ASIC will consult with the DPP before applying for a civil penalty order; and
- liaison arrangements between the agencies.[38]

2.56 In an article in the *Australian Financial Review* on 1 June 2006, Mr Peter Wood, a former executive director with ASIC's enforcement division, criticised the MOU for not addressing the critical issues of consent and delay in the approval of criminal charges for breaches of the corporations law. He stated that 'ASIC has failed to take responsibility for making its own criminal enforcement decisions and has no guarantee of a more responsive service from the DPP'.[39]

2.57 Mr Lucy told the committee that the requirement for DPP approval of criminal prosecutions is appropriate, providing an important balance against ASIC's own investigations powers:

> The first issue is whether or not ASIC should have the right to take on a criminal proceeding as a result of our own determination; that has never been my view. My view is that the independence or the independent role of the Commonwealth Director of Public Prosecutions is extremely important. It is important for a number of reasons. One is that we have significant powers available to us in our investigation area. I think that if we had both those powers and also the power to undertake our own prosecution, then it

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37 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, pp. 7-8

38 ASIC, *Memorandum of Understanding*, 1 March 2006; ASIC, 'New MOU for ASIC and DPP', *Press Release*, 3 March 2006.

39 Peter Wood, *Australian Financial Review*, 1 June 2006, p. 62

> may well be that parliament would look to minimise those powers, and I do not think that would be the right outcome.[40]

2.58 He further described tension between ASIC and the DPP as inevitable:

> As far as the working relationship with the Commonwealth Director of Public Prosecutions, inevitably there is a level of tension. I think if there was no tension on either side there would be a risk that either we would not be providing enough referrals or they would not be providing their own level of scrutiny. They have a role to play and we think that role is played well.[41]

2.59 Mr Lucy added that during his tenure there had not been an instance where the two bodies disagreed over whether a particular matter should be prosecuted.[42]

2.60 The other significant issue raised by Mr Wood was that of the timeliness of the DPP's responses to ASIC briefs, and the absence of any targets for the DPP contained in the MOU. ASIC indicated that this aspect of the relationship was improving:

> ...the MOU is a principle document. Like any MOU, it is a non-binding document; it is there to set a level of principles. Underneath that are some working targets.

It further stated:

> ...the time taken by the DPP to bring charges—and these are dealing with years ended 2002, 2003, 2004 and 2005—has gone from 10 to nine to seven to six months. The time taken by the DPP to formally bring a matter to a conclusion over the same period was 14, 13, 11 and six months. The time taken by the DPP to return the brief for no further action was 13, 18, 10 and six months. That is consistent with our own experience that the DPP is receptive to the need to treat us as a core client and to provide proper turnaround and proper service.[43]

2.61 The committee accepts that the DPP's involvement in prosecuting ASIC investigations may be sensible, ensuring that ASIC is not both policeman and prosecutor. However, the effectiveness of ASIC's relationship with the DPP, as directed by the new MOU, needs to be continually monitored. The committee believes that should the new arrangements fail to ensure effective collaboration between the two agencies, a new MOU should be agreed to further clarify each organisation's obligations.

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40 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 32

41 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 32

42 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 33

43 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 35

Recommendation 2

2.62 ASIC and the DPP should regularly update the committee as to the effectiveness of the revised Memorandum of Understanding.

ASIC's assistance to the Victorian Police in the Vizard matter

2.63 The Vizard matter was discussed at some length in the committee's previous oversight hearing and in the previous report of December 2005.[44] Since then, the media has reported the prospect of perjury charges against Mr Vizard relating to possible discrepancies in evidence provided by him in separate cases. The first case was a March 2003 Magistrate's Court committal hearing of Mr Vizard's former book keeper, Mr Roy Hilliard. On this occasion, Mr Vizard denied on oath that he had engaged in insider trading. Later, in July 2005, an agreed statement of facts between Mr Vizard and ASIC was put before the Federal Court. In this Mr Vizard agreed that he had used information acquired as a Telstra Director to trade shares for a personal benefit.[45]

2.64 The committee was interested to know whether ASIC had given consideration to the consistency of the statement of facts put before the Federal Court and Mr Vizard's previous sworn testimony. Mr Lucy took the question on notice, indicating that he did not want to prejudice Victorian Police investigations.[46]

2.65 ASIC's later response indicates that their focus was not on the possible implications of Mr Vizard's apparently inconsistent evidence:

> In preparing the statement of agreed facts, ASIC considered all the evidence it had obtained during the course of the investigation. This evidence included sworn testimony given by Mr Vizard and other parties. The statement of agreed facts that ASIC filed with the Federal Court represents a version of events that ASIC believes to be accurate and that, in ASIC's opinion, is supported by the evidence. Mr Vizard had agreed to that version of events.
>
> As for the possibility that Mr Vizard may have committed perjury in the preceding committal hearing of Mr Hilliard, that is a matter for the relevant state authorities, namely the Victoria Police and the Victorian Director of

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44 Joint Corporations and Financial Services Committee, *Statutory Oversight of the Australian Securities and Investments Commission*, December 2005. This can be accessed at http://www.aph.gov.au/senate/committee/corporations_ctte/asic/asic_05_2/index.htm.

45 Drummond, M. 'Vizard urges resolution of Hilliard perjury matter', *Australian Financial Review*, 9 June 2006, p. 4; Gluyas, R. 'Vizard in spin over claims of perjury', *The Australian*, 9 June 2006, p. 3; Wood, L. 'Another episode in the tangled tale of Steve Vizard', *The Age*, 9 June 2006, p. 2.

46 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 51

> Public Prosecutions. ASIC has and will continue to provide whatever assistance it can to any enquiries by the Victoria Police.[47]

2.66 As to ASIC's assistance to the Victorian Police, Mr Lucy stated:

> The answer is, yes, we have provided assistance to the Victorian police in their investigation and we provided, at their request, the agreed statement of facts that was provided by us to the court in our proceedings. Whether or not that assists in proving perjury is a matter for time to tell. We have assisted the Victorian police in the manner that I have outlined.[48]

2.67 It is unclear from ASIC's response to the question whether Mr Vizard's evidence to the preceding committal hearing was considered in the preparation of the statement of facts filed in the Federal Court.

2.68 It is also unclear what consideration ASIC gave to the consequences of the Federal Court receiving differing facts to those considered in the committal hearing, and any influence possible perjury may have had on the sentence handed down by Justice Finkelstein.

2.69 The committee invites ASIC to clarify these issues.

2.70 In its December 2005 ASIC oversight report, the committee noted that the 'missing link' in the evidentiary chain was the potential evidence of Mr Vizard's former accountant, Mr Greg Lay. ASIC told the committee that Mr Lay had refused to provide a signed statement, leaving ASIC and the DPP with insufficient evidence to mount a successful prosecution.[49]

2.71 In a statement published on crikey.com.au on 22 June 2006, Mr Lay's lawyer, Mr Graham Lederman, stated that Mr Lay had declined to sign a witness statement on legal advice, but had not refused to testify against Mr Vizard and had not been asked to provide sworn evidence.[50]

2.72 In response to correspondence from the committee requesting ASIC's interpretation of the crikey.com.au report, ASIC Chairman Mr Jeffrey Lucy indicated that Mr Lay continued to refuse to sign the witness statement required for further action, or to discuss the matter further with the regulator. He wrote:

> In respect of the statement attributed to Mr Lay's lawyer, we can only assume that:

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47 ASIC response to question on notice, Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 51, see appendix 2.

48 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 52

49 Joint Corporations and Financial Services Committee, *Statutory Oversight of ASIC*, December 2005, pp. 6-7

50 crikey.com.au, *Crikey Daily*, 22 June 2006.

- By stating that "at no stage did Mr Lay refuse to testify against Mr Vizard", Mr Lay's lawyer is distinguishing between a "refusal to testify" and Mr Lay not agreeing to sign a witness statement and Mr Lay not willing to engage in any further discussions with ASIC or the CDPP in relation to the prospect of giving evidence.
- By stating that "at no point in time was Mr Lay asked to give sworn evidence against Mr Vizard", Mr Lay's lawyer is distinguishing being asked to give "sworn evidence" and being asked to sign a witness statement in a form required for a committal hearing which carries an appropriate acknowledgement that a person giving a false statement is liable to an action for perjury.[51]

2.73 The letter concluded:

> In light of [Mr Lay's] response, at this point in time there is no additional evidence to submit to the CDPP that could warrant a reconsideration of its decision that there is insufficient evidence to commence a criminal prosecution of Mr Vizard.[52]

2.74 The committee notes Mr Lay's apparent, continuing refusal to provide further assistance to ASIC in this matter.

2.75 However, the committee reiterates its concern, raised in its previous oversight report,[53] that ASIC and the DPP have not appropriately communicated on the possibility of utilising s.19 of the ASIC Act to compel Mr Lay to provide evidence under oath before an ASIC officer.

Budget funding

2.76 The 2006-07 budget provided ASIC with additional funding of $120 million over four years for 'litigation contingency' for 'exceptional matters of public interest'. Previously, funding to meet ASIC's enforcement costs, ie significant legal matters, were met through special one-off appropriations. Investigations were funded from ASIC's 'business as usual' funding. A different funding model to meet such costs has been implemented whereby both investigation and enforcement costs may be drawn from this $30 million per year reserve where agency costs for a particular matter exceed the stipulated $1.5 million threshold.

2.77 ASIC officers indicated that the 'exceptional matters of public interest' test would be determined by ASIC. The Westpoint collapse and potential future related prosecutions is an example of such a matter. Mr Lucy stated that ASIC had yet to

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51 Letter from My Jeffrey Lucy to Senator Grant Chapman, 1 August 2006.

52 Letter from My Jeffrey Lucy to Senator Grant Chapman, 1 August 2006.

53 Joint Corporations and Financial Services Committee, *Statutory Oversight of ASIC*, December 2005, p. 8

determine whether the guidelines it will prepare for drawing on these funds will be made public:

> Clearly we are going to have some guidelines. To the extent that we do not want the people who we are litigating against to be able to use those guidelines against us, I am not sure that is particularly constructive.[54]

2.78 At the Senate Economics Committee's budget estimates hearing ASIC stated that a staffing increase from 1476 to 1578 was primarily to undertake increased surveillance. Mr Lucy also indicated that the increase would assist in dealing with ASIC's increased enforcement capacity as a consequence of the aforementioned litigation contingency funding.[55]

Prosecution rates for corporations law breaches

2.79 ASIC has been the subject of criticism over the rate at which it prosecutes breaches of the corporations law. An article in the *Sydney Morning Herald* on 22 April 2006 suggested that in 2004-05 'compliance action' was taken against less than one per cent of breaches of the corporations law reported by receivers and trustees in bankruptcy.[56] In response to this assertion, Mr Lucy stated that:

> The difficulty with some of those statistics is that they are fairly unreliable. What the government has sought with this assetless administration is, where liquidators are currently not in a position to be able to complete their role as far as providing a report to ASIC regarding the background of what breaches might be, the opportunity for ASIC to fund those people. Previously we had a situation where liquidators may have made essentially uninformed observations; now they will be in a position to actually do the work to find out whether or not their observations are real live situations and real live problems. Firstly, we would expect the quality of referrals from liquidators to increase significantly. I would like to think that the liquidator will therefore, across Australia, make sure that they meet their obligation so that if there is mischief out there we hear about it. Part of the funding is that we are more robustly funded to take on those additional referrals.[57]

2.80 He continued to say that ASIC's decisions on which cases to litigate were appropriate:

> ...do I think that we could be more aggressive with our litigation? No, I do not. There is litigation in two categories, civil and criminal. Our dialogue with the DPP is effective. There is the right level of attention as to whether or not matters should be taken on criminally, so I think that is appropriately dealt with. Similarly, with the civil side of things, we have a success rate in

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54 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 47

55 Senate Economics Committee, *Committee Hansard*, 31 May 2006, p. 59.

56 'Shameless laugh all the way to the mansion', *Sydney Morning Herald*, 22 April 2006.

57 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 2

> the courts of some 97 per cent. We are very energetic with our investigations to make sure that if there are opportunities for prosecutions we will follow them through.[58]

Compliance burden of financial services regulation

2.81 The committee raised several criticisms of the high compliance cost of Financial Services Regulation (FSR). In particular, reference was made to a submission from an unnamed financial adviser to the *Corporate and Financial Services Regulation Review* of April 2006, who claimed that compliance under FSR has turned into 'a monster for small dealers'.[59] The adviser's submission contends that:

> Form has become the requirement rather than substance. This is bad for consumers whose objective is good advice. Consumers want substance and not form...The huge fundamental flaw in FSR compliance is that it is focused on process and not output. FSR seeks to regulate for good advice or at least regulate against bad advice. As FSR is constructed, the regulator could use FSR to focus on that objective but instead ASIC seeks to focus its regulatory activity on process and fails to focus on policing advice output.[60]

2.82 ASIC acknowledged that the adviser is correct in that the legislation does not impose a high benchmark, stating:

> When you look at the various elements of what an advisor has to do: the advisor has to know the product, know the client...and has to have a reasonable basis for giving advice that is appropriate for the client. That is a pretty low hurdle, not exactly a pole vault bar, that you have to jump over.

However:

> In a sense the industry is lucky that the legislation does not say that you actually have to give good advice because I am not sure that we, as a regulator, are actually qualified to judge whether advice is good or not. I think that is a policy platform that obviously was not taken up by the government.[61]

2.83 In the adviser's view the system is 'very anti advice-focused advisers who tailor advice to individual clients and very pro the product distribution model of the big financial planning subsidiaries or the big product providers'.[62] In response, ASIC admitted that the statement contained 'an element of truth', but indicated that it had to

58 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 3

59 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 38

60 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 39

61 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 39

62 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 39

work within the context of an industry that was 'borne out of a product-producing and product-selling environment'.[63]

2.84 The committee also questioned ASIC officials about the potential of substantially increased audit fees resulting from the recent inclusion of audit standards under the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9). In response Mr Lucy indicated that ASIC is undertaking ongoing surveillance of the auditing profession. In particular he stated that ASIC:

> ...will respond to any suggestion of [inflated audit fees] being played out in the marketplace, including through industry groups such as company directors and so on, to make sure that people understand that it would be quite mischievous for auditors to increase their fees on [the basis of auditing standards becoming enforceable under CLERP 9].[64]

2.85 In its previous examination of FSR legislation the committee has expressed concern over the effect of excessive regulation in this area, particularly with regards to small business.

Proposed business judgment rule

2.86 In April 2006 the Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce MP, released a consultation paper on a variety of corporate and financial services regulatory issues, including a proposed extension to the business judgment rule.

2.87 The business judgment rule is based on the well established legal principle that the courts are reluctant to pass judgment on the merits of business decisions taken in good faith.[65] The rule is codified in subsection 180(2) of the Corporations Act which provides that a director is presumed to have met their statutory duty of care and diligence where:

- the judgment is made in good faith and for a proper purpose;
- the director has no material personal interest in the judgment;
- the director informed themselves about the subject matter; and
- the director believes the judgment is in the best interests of the corporation.[66]

2.88 The note to subsection 180(2) emphasises that the business judgment rule only operates in relation to the duty of care and diligence in section 180 and not to any

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63 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 39

64 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 41

65 See for example *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483 at 493.

66 Paraphrasing subsection 180(2) of the *Corporations Act 2001*.

other provisions of the Corporations Act or under any other law. That is, the business judgment rule does not currently apply, for example, to the duty of good faith (s181), the duty not to misuse position or company information (ss182-183) and the duty to prevent insolvent trading (s588G).

2.89 The *Corporations and Financial Services Regulation Review* consultation paper sought comments on whether the business judgment rule should be extended to provide 'a general protection for directors, excusing them from liability under the Corporations Act, subject to certain conditions'.[67] If adopted, the proposal would excuse a director from liability for breaching *any* obligation under the Corporations Act provided they act:

- in a bona fide manner;
- within the scope of the corporation's business;
- reasonably and incidentally to the corporation's business; and
- for the corporation's benefit.[68]

2.90 According to the consultation paper the proposal is broad in nature. It states:

> This protection would extend to any obligation the director or officer has under the Corporations Act such as the duties of good faith, use of position and use of information, the duty not to trade while insolvent, the duty to keep books and records and declarations relating to financial statements.[69]

2.91 In August 2006, the Parliamentary Secretary to the Treasurer announced progress on the topics outlined in the consultation paper. According to his press release the proposed extension to the business judgment rule is one of several topics that 'merit a more focused approach, because of the scope and complexity of the policy issues they raise'.[70] The attachment to the press release indicates that the proposed extension of the business judgment rule 'will be progressed in conjunction with other reviews by Treasury'.[71]

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67 Department of the Treasury, *Corporate and Financial Services Regulatory Review Consultation Paper*, April 2006, p. 10.

68 Department of the Treasury, *Corporate and Financial Services Regulatory Review Consultation Paper*, April 2006, p. 32.

69 Department of the Treasury, *Corporate and Financial Services Regulatory Review Consultation Paper*, April 2006, p. 32.

70 The Hon Chris Pearce MP, Parliamentary Secretary to the Treasurer, 'Pearce Announces Progress Towards Simpler Regulatory System Bill', Press release 028, 14 August 2006, http://parlsec.treasurer.gov.au/cjp/content/pressreleases/2006/028.asp (accessed 15 August 2006).

71 Department of the Treasury, Corporate and Financial Services Regulatory Review Consultation Paper – Progressing Consultation Topics, August 2006, p. 9, www.treasury.gov.au/documents/1138/PDF/Attachment_A__Table_on_Progressing_CFS_Regulation_Review.pdf (accessed 15 August 2006).

2.92 ASIC officials were asked their opinion of the proposed extension to the business judgment rule. Mr Cooper raised concerns about the practical operation of the proposed changes stating:

> We simply do not see how it would actually function. That is not surprising in the sense that a proposal like that is a complex thing that needs to be worked through. The consultation paper is nothing more than a series of proposals, and we are looking forward to understanding how a proposal like that might work.[72]

2.93 A recent editorial piece from the *Australian Financial Review* also questioned whether it is sufficient for a major policy change such as this to be explained in such little detail. It noted that the proposal is 'all dealt with in two paragraphs' and '[c]hanges of this scale require more detailed study...'.[73]

2.94 Mr Cooper went on to say that the proposed change could make it harder for ASIC to enforce the law and that 'if there is a suggestion that the rule itself is somehow different [from the existing business judgment rule], our position is that we do not support that.'[74] He also acknowledged that ASIC has not been asked for advice on this proposal.

2.95 Given the broad nature of the proposed extension to the business judgment rule and the enforcement concerns raised by ASIC, the committee is of the view that these concerns should be provided to the government so that it fully understands the enforcement issues when it considers the merits of the proposal. From Mr Cooper's evidence relating to some of the 54 other proposed changes outlined in the consultation paper, it is clear that ASIC has enforcement concerns that go beyond the proposed extension to the business judgment rule. On this basis the committee recommends the following.

Recommendation 3

2.96 The committee recommends that ASIC provide advice to the Australian Government on its concerns regarding the enforcement effects of:

- **the proposal to broaden the 'business judgment rule' as set out in the Corporate and Financial Services Regulation Review of April 2006; and**
- **any other proposals in the Corporate and Financial Services Regulation Review of April 2006 that would have significant enforcement implications.**

72 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 48

73 Editorial, 'Red tape pledge can't be trusted', *Australian Financial Review*, 23 May 2006, p.62.

74 Joint Corporations and Financial Services Committee, *Committee Hansard*, 13 June 2006, p. 48

Senator Grant Chapman

Chairman

Appendix 1

Public hearings

Tuesday 13 June 2006 - Canberra

Australian Securities and Investments Commission

Mr Jeffrey Lucy, Chairman

Mr Jeremy Cooper, Deputy Chairman

Appendix 2

Answers to questions on notice

Question 1

(Possible KordaMentha conflict, p. 29)

Senator SHERRY—What about the potential conflict though where KordaMentha are acting for a bank who would be first mortgagees in most cases, I assume?

Mr Lucy—Probably a receiver, which would mean a floating charge. It may also mean that they have a specific charge but they would be in there as a receiver because of a floating charge.

Senator SHERRY—Whatever moneys flow or are left over, it is first mortgagee first, usually a bank, and then whatever is left—if there is anything left—goes to the consumer. Do you see any conflict with KordaMentha working in respect to the bank and also being the general receiver?

Mr Lucy—I will take that on notice because, for example, let us say company A and company B are both under the Westpoint family. I could imagine company A having a firm of receivers appointed and company B having that firm as liquidator, but I could not envisage company A having both the same firm acting as receiver and liquidator.

Answer:

ASIC does not believe that there is any conflict of interest with KordaMentha. KordaMentha have 2 separate and distinct roles.

First, they are receivers or receivers and managers of assets of certain companies in the Westpoint Group, by various secured creditors pursuant to various securities (such as debenture charges). Their powers under these private appointments will be governed by the terms of the lenders' relevant security and appointment documents. Such powers are likely to include a power to realise assets with a view to satisfying amounts owing to the relevant secured creditor.

Second, they have been appointed by the Federal Court as 'receivers' of certain property of:

(b) various directors of companies associated with the Westpoint Group (that is, Messrs Carey, Beck, Dixon and Rundle); and

(c) certain different companies connected to the Westpoint Group (such as Richstar Enterprises).

KordaMentha's limited and specific powers as Court appointed 'receivers' are principally to identify, preserve and secure all of the property of the defendants for the benefit of potential creditors (but to still permit the defendants to pay their living expenses and continue carrying on business).

A principal purpose of appointing KordaMentha as 'receivers' of the defendants' property was to ensure the preservation of such property pending ASIC's continuing investigations.

As Court appointed receivers, their role is not (in the absence of a specific order by the Court) to realise assets.

As far as ASIC is aware, KordaMentha have not been privately appointed as receivers and/or receivers and managers (that is, by any lender) to any of the same companies as those to which the Federal Court has appointed them as 'receivers' (with the principal purpose of preserving assets).

Therefore, no conflict of interest for KordaMentha is apparent.

However, if – as Court appointed 'receivers' – KordaMentha feel that they may be placed in or face a conflict of interest in performing that role (given their appointment as receiver and/or managers appointed by any secured lender or for any other reason), they would be required to bring that matter to the Court's attention and make an application to the Federal Court for directions.

Similarly, if ASIC became aware of KordaMentha facing an actual or potential conflict, it would consider whether that matter ought be brought to the attention of the Court.

In ASIC's view, this is an appropriate way for any potential conflict to be managed and is not uncommon in insolvency practice.

Question 2

(Banking complaints, p. 30)

Senator SHERRY—I have just a couple of matters relating to banks—away from Westpoint and super for a moment. Has ASIC examined recently, and if so when, the internal disputes procedures of banks?

Mr Lucy—My recollection is that a similar question came up at estimates and we took that on notice.

Senator SHERRY—If it did it probably came from me, but I cannot recall getting into this area.

Mr Lucy—To the best of my recollection it did, including the issue of fees. We have that on notice. To the extent that you would like to expand on that with your own question on notice, we are happy to take it on board.

Answer:

ASIC's oversight as to the way in which banks and other AFS Licensees handle complaints through their internal procedures is an ongoing process.

Background

The Corporations Act requires that all AFS Licensees providing financial services to retail clients, including banks, have an internal dispute resolution (IDR) system that complies with standards made or approved by ASIC and covers complaints made by retail clients in connection with the provision of all financial services covered by the licensee (ss 912A(1)(g) and 912A(2)(a)).

ASIC Policy Statement 165 explains ASIC's requirements for IDR procedures. In part, PS 165 applies the Essential Elements of IDR set out in Section 2 of the Australian Standard on Complaints Handling (AS 4269-1995). PS 165 also provides guidance on the application of AS 4269-1995 to the financial services industry and outlines additional matters necessary for compliant IDR procedures. ASIC is satisfied that all banks have procedures in place to ensure their IDR procedures comply with these requirements.

Oversight of compliance

As this is a licence obligation, failure to maintain a compliant IDR process would be a matter for a breach notification, if such a failure is characterised as a significant breach, or likely breach of the licensee’s obligations (s912D).

ASIC also reviews the efficacy of IDR procedures when considering individual complaints made by or on behalf of consumers or analysing complaints data provided by banks under Statutory Notices in relation to particular issues.

It is an additional licence requirement that AFS Licensees be a member of an ASIC approved External Dispute Resolution (EDR) Scheme. ASIC Policy Statement 139 explains how ASIC will approve an EDR scheme. PS139.62 requires that EDR schemes identify issues that are systemic or that involve serious misconduct and report such issues to ASIC. Failures to adequately deal with complaints at the IDR level are likely to result in systemic issues capable of being identified by the relevant EDR scheme (in the case of banks – the Banking and Financial Services Ombudsman), which will in turn be reported to ASIC.

ASIC therefore monitors the effectiveness of the IDR procedures by banks through feedback from the BFSO and through reviewing complaints.

Question 3

(Banking complaints, p. 31)

Senator SHERRY—What about their internal dispute procedures? Every bank has their own internal consumer disputes mechanism and then there are, beyond that, other processes. Have you examined those recently?

Mr Cooper—Not as far as I am aware, but we can take that on notice. Again, I think you will find that they are off our patch.

Answer

Please see answer to PJC [question] 2

Question 4

(Banking complaints, p. 31)

Senator SHERRY—Do you have any statistics on complaints in respect of banking activities?

Mr Lucy—We can take that on notice. It has been pointed out to me that it is in our answer that we have provided.

Senator SHERRY—I will have a look at those answers that you have on notice.

Answer

ASIC collects banking statistics when monitoring compliance with the Electronic Funds Transfer Code of Conduct ('EFT Code'). The last publicly reported EFT complaint statistics covered the period April 2003 to March 2004.

The complaints statistics collected as part of the EFT Code monitoring are basic volume statistics. Statistics are only collected for complaints that are covered under the EFT Code, i.e. not all banking complaints. The April 2003 to March 2004 EFT complaints breakdowns included:

- Institution type (Major Bank, Other Bank, Building Society, Credit Union, Other Institution)
- Transaction type (ATM, EFTPOS, Internet, Phone, Other)
- Handling status (handled internally, discontinued, referred to EDR)
- Resolution status (customer liable, institution liable, outstanding)

- Whether the complaint was about a system malfunction or an unauthorised transaction.

These complaints statistics are available in the annual monitoring reports, which are posted to both the ASIC and FIDO websites: www.fido.asic.gov.au/fido/fido.nsf/byheadline/compliance+with+financial+industry+codes+of+practice+FIDOv?openDocument

Question 5

(Westpoint, p. 36)

Senator SHERRY—I return to a question on notice relating to Westpoint applying for a licence. I refer to E43, question AT36. I asked whether they had applied for one and you said:

> No, Westpoint Finance Pty Ltd held an Investment Adviser's licence ... from 27 June 1996 to 21 January 1999. ASIC has no record of Westpoint Finance Pty Ltd ever making an application for an AFSL, however it was an Authorised Representative ... for CGU Insurance Ltd ... during the period 4 February 2004 to 14 July 2004.

As Westpoint was an authorised representative of CGU, could or did ASIC take any action against Westpoint at that time as an authorised representative of CGU?

Mr Lucy—Was that a question on notice 10 days ago or at some earlier time?

Senator SHERRY—This relates to the additional estimates of 16 February 2006. We got the answer in that batch last week and I have those in front of me.

Mr Lucy—I will have to take that question on notice. I am not aware of whether or not we looked at the CGU issue.

Senator SHERRY—According to ASIC's answer on notice, Westpoint Finance Pty Ltd were an authorised representative of CGU for a period of time. In those cases, can ASIC take action against the authorised representative because it was licensed through CGU?

Mr Cooper—In relation to what? We will have to take this on notice. It could well be that that licence was in order to advise about and sell CGU insurance to people who invested in real estate.

Senator SHERRY—Take that on notice. It does not make that clear.

Mr Cooper—It does not.

Answer

If, in the course of acting as CGU's authorised representative, Westpoint Finance Pty Ltd breached the law and there was evidence of this, ASIC may be able to take action against CGU.

ASIC is not aware of any complaints against Westpoint Finance Pty Ltd that relate to it acting as an authorised representative of CGU and has not taken any action against Westpoint Finance Pty Ltd as an authorised representative of CGU to date.

If there is any evidence available to support an allegation that in the course of acting as CGU's authorised representative, Westpoint Finance Pty Ltd breached the law, ASIC will look into those allegations.

Question 6

(S8, p. 40)

CHAIRMAN—The other issue I wanted to raise was in relation to a company called S8 which is a major tourism company in Queensland that has been under investigation by the Queensland department of fair trade in relation to various allegations. The allegation that has been made to me is that S8 has not disclosed to investors in the company the fact that it is being investigated. Are you aware of that situation?

Mr Lucy—We would have to take it on notice. To the extent that the background is reliable, that may well be an event that they would have disclosed to us and we will tie the ends together.

Answer

ASIC examined the matter about whether the non-disclosure of the potential Queensland Office of Fair Trading action was in breach of the Corporations Act.

At the time, the action was threatened, not initiated, and was already in the public domain. The view was taken that there was not contravention of the continuous disclosure provisions.

Question 7

(Budget for HIH case, p. 45)

Senator WONG—How much more did you ask for for HIH than you got?

Mr Lucy—I would have to take that on notice but, to the best of my knowledge, for all of those matters, whatever we have sought, we have received.

Answer

The HIH funding bid was jointly prepared by ASIC and DOFA, and no gap existed between what was requested and the final amount received by ASIC.

Question 8

(Business judgment rule, p. 49)

Senator WONG—Have you been asked for advice as to the enforcement impact of anything in the discussion paper?

Mr Cooper—Not that I am aware of, but we could take that one on notice.

Answer

ASIC was not asked to advise on anything in the Parliamentary Secretary to the Treasurer's 'Corporate and Financial Services Regulation Review Consultation Paper' (April 2006).

Question 9

(Earlier question on notice AT20, p. 50)

Senator WONG—Mr Lucy, in the context of this hearing I want to draw your attention to a question on notice, AT20, that you responded to through the additional estimates in relation to the history of the section 19 issue.

Mr Lucy—Yes.

Senator WONG—When you went back to Treasury and asked about the ability to improve your powers.

Mr Lucy—I do recall that discussion.

Senator WONG—The answer to the question on notice is, ‘A history of a request to Treasury to amend the ASIC Act to enable ASIC to compel a person to provide a witness statement in certain circumstances was not raised at the PJC hearings in September 2005.’ I did ask you specifically whether we could have a copy of the proposed amendments and I also want to know the history of the request to Treasury and the process of that. Could you take that on notice in this hearing?

Mr Lucy—We will.

Answer

There appears to be some confusion about the questions and the responses that ASIC has provided.

Senator Wong refers to the response to Question AT20, and indicates that it was not an answer to her request for a copy of the proposed amendment. The response that provided a copy of the amendment proposed by ASIC was the response to Question AT18. This response set out the suggested amendment to s49 of the ASIC Act to enable ASIC, in certain circumstances, to compel people who had attended a s19 examination to provide a signed statement admissible in a criminal prosecution.

The response to which Senator Wong refers above, the response to Question AT20, refers to her subsequent question as to why disclosure of the proposal to amend s49 was not made to the previous hearings. The answer to this was that the line of questions at that hearing was such that there was not an opportunity to do so.

(Attachment below)

Question: AT 20

Topic: Section 19 in the context of Vizard issue

Hansard Page: E8

Senator WONG asked:

Mr Lucy, why was this not disclosed to the committee previously when questions were asked about the section 19 issue?

Mr Lucy—I am not sure that we were asked that question.

Senator WONG—We did ask quite a lengthy range of questions, in the context of the Vizard matter, about why section 19 had not been utilised.

Mr Lucy—I would have to take that on notice and refer back to the questions that were specifically asked. Obviously we do not make the laws, but, as to that particular reference, I would need to go back to Hansard.

Senator WONG—I am not suggesting you make the laws, Mr Lucy. I am asking why, when the committee was inquiring into this issue, it was not raised. If you want to take that on notice, obviously you can do that.

Answer:

The history of a request to Treasury to amend the ASIC Act to enable ASIC to compel a person to provide a witness statement in certain circumstances was not raised at the PJC hearings in September 2005 because during that hearing the line of questioning referred to whether ASIC did or should have conducted an examination of a person in relation to an investigation into conduct by Mr Vizard. Ms Redfern attempted to raise the issue of reluctant witnesses (CFS11), but was asked to address questions on use of the power to conduct s19 examinations.

The discussion then moved on to the utility of conducting a s19 examination of the person in question, and what consideration ASIC had given to this and what advice it had received. In the context of the discussion – that the person proved not to be appropriate as a witness – it was not directly relevant to attempt again to refer to a proposal for law reform that would very likely not have assisted in the case in question.

Question 10

(Vizard, p. 51)

Senator WONG—Did ASIC have any concern in putting that statement of agreed facts before the court in the insider trading case that there might have been an inconsistency between that evidence and the evidence that Mr Vizard had given previously?

Mr Lucy—The evidence that we put was to do with director's duties as distinct from insider trading. The evidence was put forward to the court in a manner that the court required.

Senator WONG—That is not really an answer to my question.

Mr Lucy—To the extent that there were any inconsistencies, that is not a matter for ASIC to follow through. That is properly a matter for the Victorian police.

Senator WONG—No, but you put forward a statement of agreed facts on the basis of which a guilty plea was entered and submissions were made as to what penalty should be in place. Surely it is incumbent upon ASIC to ensure that the facts put forward were facts that could be relied on by the court. Surely it was incumbent on you to look at whether that statement of agreed facts was consistent or not with previous evidence given by the defendant.

Mr Lucy—We might in part take this on notice. Our anxiety is that we do not say anything that might prejudice the Victorian police. To the extent that there was material in the background that we might have considered, which I think is the real thrust of your point, we should take that aspect of it on notice.

Senator WONG—I want to know, when you were preparing the statement—whatever facts went before the court in the Vizard matter to which ASIC was a party—whether regard was had to evidence previously given by Mr Vizard—

Mr Lucy—Understood.

Senator WONG—and whether you turned your mind to the issue of any possible inconsistency.

Mr Lucy—Understood, and we will take that on notice.

Answer

In preparing the statement of agreed facts, ASIC considered all the evidence it had obtained during the course of the investigation. This evidence included sworn testimony given by Mr Vizard and other parties. The statement of agreed facts that ASIC filed with the Federal Court represents a version of events that ASIC believes to be accurate and that, in ASIC's opinion, is supported by the evidence. Mr Vizard had agreed to that version of events.

As for the possibility that Mr Vizard may have committed perjury in the preceding committal hearing of Mr Hilliard, that is a matter for the relevant state authorities, namely the Victoria Police and the Victorian Director of Public Prosecutions. ASIC has and will continue to provide whatever assistance it can to any enquiries by the Victoria Police.

Question 11

(HIH, p. 52)

Senator WONG—Has any investigation been conducted or material provided by ASIC?

Mr Lucy—I would have to take that on notice, because that would be almost certainly historical as distinct from current.

Answer

ASIC has regularly liaised with the Liquidator of HIH since the collapse of the HIH Group in March 2001, within the limits of its statutory obligations.

On 3 May 2004, General Re Australia Ltd (formerly General & Cologne Re Australia Limited (GCRA)) paid $27.2 million to the Liquidator of FAI General Insurance Company Limited as part of an enforceable undertaking provided to ASIC. The enforceable undertaking followed ASIC's investigation into reinsurance arrangements entered into by FAI with GCRA in 1998.

The Liquidator has provided ASIC with a broad account of proposed civil actions including actions relating to the takeover of FAI. The takeover of FAI by HIH was not the subject of a specific referral to ASIC from the HIH Royal Commission, however, ASIC did conduct a preliminary assessment as to whether there were civil remedies available for ASIC to pursue regarding the takeover prior to the receipt of the HIH Royal Commission referrals.

At the request of the HIH Liquidator, HIH material obtained by ASIC from the HIH Group of Companies, pursuant to ASIC's compulsory powers, and from the HIH Royal Commission, was returned in electronic form to the Liquidator on 19 July 2006 to assist the Liquidator with current and proposed civil actions. ASIC will continue to liaise with the Liquidator with a view to facilitating any requests arising from the conduct of proceedings.

Question 12

(MLA reporting/Philps letter, p. 53)

CHAIRMAN—We have received correspondence from Mr Russell Philp regarding the adequacy of Meat and Livestock Australia's communication with its members and relevant stakeholders. You are probably aware that MLA is a producer owned body that funds research—

Mr Lucy—Like you, we received that today also and so we are looking at that. Therefore, if we take it on notice we will be able to respond to you.

Answer

Meat and Livestock Australia is an unlisted public entity and is also not a disclosing entity.

Mr Philip's main complaint is that the company discloses that "they feel the ASX [Corporate Governance] Principles are an appropriate benchmark for guiding MLA practices" and "MLA's corporate governance practices are now consistent with the ASX Recommendations to the extent they are relevant to MLA as a non-listed company".

The complainant disputes this.

ASIC is currently reviewing the extent to which MLA does not comply with these guidelines.

It should be noted that the complainant does not disclose any contraventions of the Act.

Question 13

(Timeshare, p. 53)

CHAIRMAN—Sure. Also, you published in May 2006 the consultation paper Review of policy statement 160: time-sharing schemes, with certain proposals. Have you had any response so far to those proposals and, if so, what?

Mr Lucy—I will have to take it on notice.

Senator MURRAY—Can you add to that the time line in which you intend to come to a view on it?

CHAIRMAN—Do you consider that an extended cooling-off period will overcome the problems associated with pressure selling?

Mr Lucy—I think that is all part of the same issue so we will roll that into it.

CHAIRMAN—Do you propose to deal with the problems of disclosure highlighted in our report on time share that we tabled in September last year?

Mr Lucy—Again, we need to roll that into the answer to the question on notice.

Answer

Question 14

(Possible offenders register, p. 5)

Senator MURRAY—As you know, I am a great fan of your press release service because I think it is very informative. Regarding those responsible for approving or encouraging unethical behaviour such as directors, accountants, lawyers, valuers and those sorts of people, do you have offenders lists?

Mr Lucy—No. Perhaps I was a bit quick: Jeremy has pointed out that we do have a list on our website.

Mr Cooper—There are two mechanisms for doing that. You can comprehensively search the website for whether somebody has been mentioned in one of our media releases.

Senator MURRAY—Does that not require you to type in the name?

Mr Cooper—It does.

Senator MURRAY—Then it requires the search engine to work.

Mr Cooper—We also have a specific list of people who we have banned. If you wanted to find out, for example, whether or not a financial advisor firstly had been licensed by us or, secondly and more importantly, had been banned by us, that is all there on the website.

Senator MURRAY—It seems to me that you should consider going further. For the period in which a person is prohibited from acting as a director, for the period under which somebody is banned or for the period under which a particular action has been taken, it would seem to me a list of names which is easily accessible would be of great assistance. That extends further to those lawyers, accountants or valuers who have been tied up in schemes which have been disallowed or have had the force of law attached to them. I am not suggesting you should become judge, jury and executioner; I am talking post facto or after a judgment has been made.

The professional damning of somebody who has had a conviction or a finding against them has a very salutary effect. The difficulty for anyone, including someone like me who watches all your stuff very carefully, is to remember names. I think investors, bankers and the general public themselves should be able to go straight to a list which would be alphabetically listed and say, 'Is this name there, and should that ring alarm bells with me?' There is no way that any person, apart from somebody with a prodigious memory, will remember that somebody three years ago had an eight-year penalty put on them.

Mr Lucy—Would you contemplate the listing of the name only during the currency of the ban?

Senator MURRAY—Yes, because you have to accept a rehabilitation process and that people learn their lesson. I think it would be against natural justice to carry it on afterwards.

Mr Lucy—I agree. We could have a look at that.

Senator MURRAY—It is not like the sex offenders' register where they are on there forever.

Mr BAKER—But if they are serial offenders, more than once, they should stay on.

Mr Lucy—In colour code.

Mr BAKER—That is right: red for danger.

Mr Lucy—We will have a look at that to the extent that there are legislative barriers. We will identify any and come back to you. We will certainly take that matter further.

Answer

Under the law, ASIC maintains public statutory registers of persons who are:

- banned or disqualified from providing financial services (Corporations Regulation 7.6.06); and
- disqualified from managing corporations (s.1274AA of the Corporations Act).

These registers are easily searchable by the public, both by means of ASIC's general website (www.asic.gov.au) and its consumer website (www.fido.gov.au) and via popular search engines such as Google. Any person who wishes to determine whether a particular individual is listed on one of these registers may do so at no cost to them.

The terms for which particular disqualifications and bannings apply, or previously applied, are also clearly apparent from the registers.

A consolidated alphabetical list of banned and disqualified persons appearing on these registers would be duplicative of the current arrangements, but ASIC will give further consideration to whether there might be any demand for, and utility in, such a list.