

Answers to questions on notice taken at hearing

ASIC oversight hearing, 12 September 2012

Question 1 (Hansard, p. 7)

Topic: Impact of FOFA Bill

Mr FLETCHER: On that point, I recollect that there was some discussion about the particular drafting of the bill and whether it actually achieved the result you have described, namely, that its practical impact does not take effect for two years from the implementation of the bill. Could I ask you to take on notice to explain how that mechanism works, particularly with respect to clients who are existing clients of advisers, as at 1 July 2013?

Mr Kell: I can do that.

Response

The opt-in provisions do not apply to an ongoing arrangement with an existing retail client. An opt-in notice will have to be provided to new clients. That is, clients who receive personal advice and who also enter in to an arrangement to pay ongoing fees after the commencement of FOFA. An opt-in notice for those new clients must be provided within 30 days of the two-year anniversary. The two-year timeframe from implementation of the bill is therefore relevant in that it is the earliest date on which the opt-in obligation will crystallise in relation to new clients. This also means that it will not be necessary for an industry code that obviates the need for opt-in to be in effect and approved by ASIC by 1 July 2013.

Question 2 (Hansard, p. 10)

Topic: Registration of SMSF auditors

(a) Senator BOYCE: How many of the 6,000 to 8,000 would you expect to go onto the register without competency requirements as a result of the transitional arrangements?

Mr Medcraft: Without a competency exam?

Senator BOYCE: Without a competency exam, sorry.

Mr Tanzer: I'm not sure that I can give you the answer.

Mr Medcraft: We will take it on notice. We do have those numbers, but we will take it on notice and give them to you. It's not because of the number years of experience, the numbers sitting exams—we will come back to with the numbers.

Response

It has been estimated that of the 6,000 to 8,000 expected to register under the transitional arrangements approximately 1,350 applicants would be required to sit a competency exam.

(b) Senator BOYCE: Is it likely that Mr Timothy Frazer, for example, would have gotten onto the register if this had come into place in, say, 2010 before you became aware of Trio?

Mr Medcraft: Essentially what you are saying is, effectively, a back test?

Senator BOYCE: No.

Mr Medcraft: I understand what you are saying.

Senator BOYCE: If you were unaware of the Trio Capital situation, would Mr Timothy Frazer—

Mr Medcraft: Have been eligible to be on the register?

Senator BOYCE: Yes.

Mr Medcraft: We will come back on that.

Response

If the proposed registration requirements, under the transitional arrangements, had been in place in 2010 Mr Frazer would have had to meet prescribed qualification requirements and fit and proper criteria. He may have been exempted from the competency examination requirement and the prescribed experience requirement under the transitional requirements. (ASIC is not aware of whether this is the case). Mr Frazer is currently subject to an enforceable undertaking (EU) with ASIC that includes a three year period of suspension as an RCA. Should he apply for registration with ASIC as an SMSF auditor after 31 January 2013 his EU and the related Trio matters would be considered significant factors in regards to assessing whether he meets the fit and proper requirements.

Question 3 (Hansard, pp 10–11;

Topic: Further information on registration of SMSF auditors

Mr Tanzer: I am not sure of the number of funds that he was an auditor for or any other circumstances.

Senator BOYCE: He was an auditor.

Mr Tanzer: I understand that.

Senator BOYCE: One assumes that—

Mr Tanzer: I don't know how many funds he was an auditor of or for how long he had been an auditor of those funds. In any case, I am happy to take it on notice.

Mr Medcraft: We will take it on notice and see. It is actually quite an interesting question.

Senator BOYCE: It does go to the heart, particularly if people try to use the register as a type of marketing tool in the way that some people try to use an AFSL licence.

Response

ASIC does not have access to this information. As the regulator for SMSFs, the Australian Taxation Office may have information as to the number of independent audit reports that an auditor provides for SMSF trustees each year.

We note that the ATO will continue to monitor the compliance of SMSF auditors and will refer matters to ASIC for consideration where action to disqualify the auditor may be appropriate.

Question 4 (Hansard, p. 11)

Topic: ASIC consideration of Securrency

Mr TONY SMITH: Okay. Could I take you, then, to the issue that I have asked about before—I asked back in March of this year—with respect to your consideration of matters pertaining to Securrency International and Note Printing Australia. You issued a press statement on Monday, 12 March, essentially saying that ASIC had decided not to take any action and not to make any further comment. It was a three- or four-line press release which I asked you about back in February. I am interested in how long that matter was under consideration by ASIC—or those matters, because there were two.

Ms Gibson: We were contacted by the AFP towards the end of 2011, and we looked at documents.

Mr TONY SMITH: I do not expect you to give me the precise date or anything.

Ms Gibson: Good.

Mr TONY SMITH: We can get that on notice later.

Response

ASIC held discussions with the AFP at various times in 2011. Following a discussion between ASIC and the AFP on 30 November 2011, in relation to a possible referral to ASIC, a meeting took place on 21 January 2012 at AFP offices. At that meeting ASIC staff were given a briefing as to the conduct of the AFP investigation and prosecutions. On 24 January 2012 ASIC was provided with a CD which contained the documents identified by the AFP as potentially relevant to the referral. These documents related to both NPA and Securrency.

ASIC held discussions with the AFP and analysed these documents for the purposes of deciding whether or not to commence an investigation. Based on that review ASIC noted that there were significant obstacles to commencing any action. ASIC then issued a statement on 12 March 2012 to advise it had decided not to proceed to a formal investigation.

Question 5 (Hansard, p. 12)

Topic: ASIC's monetary contribution to MoneySmart

Senator BOYCE: ... Can you tell us how much ASIC's contribution to be MoneySmart Week was? ...

Mr Kell: As to the exact amount, I am happy to take that question on notice.

Response

ASIC has not provided a financial contribution to MoneySmart Week.

Along with many other key supporters of MoneySmart Week, ASIC provided in-kind resources to assist in planning, implementing and promoting MoneySmart Week. In ASIC's case this comprised:

- Staff providing secretarial and operational support.
- ASIC gave Financial Literacy Australia Limited (the not-for-profit company running MoneySmart Week) permission to use the MoneySmart name.
- Hosting the MoneySmart Week website (moneysmartweek.org.au).

Background

- MoneySmart Week was held for the first time from Sunday 2 – Saturday 8 September 2012. The Week will become an annual event, in the first week of each September.
- MoneySmart Week is an initiative of members of the Australian Government Financial Literacy Board. They formed a new not-for profit company (Financial Literacy Australia Limited) to organise the Week. Attachment 1 has a list of directors.
- MoneySmart Week supports a key pillar of the National Financial Literacy Strategy: 'working in partnership and promoting good practice'. It was planned and delivered by volunteers from over 50 organisations across the business, community and government sectors. Supporting organizations are listed at Attachment 2.

Attachment 1 :Members and Directors of Financial Literacy Australia Limited*

Chairman - Mr Paul Clitheroe AM, Executive Director, ipac securities

Group Captain Robert Brown, Chairman, Australian Defence Force Financial Services Consumer Council

Mr Hamish Douglass, Chief Executive Officer, Magellan Financial Group

Mr Craig Dunn, Chief Executive Officer, AMP

Ms Linda Elkins, General Manager, Marketing, Colonial First State

Ms Fiona Guthrie, Executive Director, Financial Counselling Australia

Ms Elaine Henry OAM, Company Director

Mr Anthony Mackay, Executive Director of the Centre for Strategic Education

Mr Ian Silk, Chief Executive Officer of AustralianSuper

Mr Michael Smith OBE, Chief Executive Officer, ANZ Banking Group

Mr Robert Thomas, Chairman, Gardner Smith (Holdings) Pty Ltd

*This list represents all members of the Australian Government Financial Literacy Board except ASIC Commissioners. ASIC Commissioners have avoided formally joining Financial Literacy Australia Ltd to avoid any conflict of interest between ASIC's regulatory activity and Financial Literacy Australia's fund raising activity.

Attachment 2 - Organisations represented on MoneySmart Week Workstreams

ADF Financial Services and Consumer Council	First State Super
AMP	FutureMap
ANZ Banking Group	Good Shepherd (Microfinance division)
AON Hewitt	HESTA Super Fund
Association of Super Funds of Australia	Internal Consulting Group
Australasian Retail Credit Association	Liberty Financial
Australian Bankers' Association	M&CSAATCHI
Australian Government Department of Human Services	ME Bank
Australian Government Department of Families, Housing, Community Services and Australian Library and Information Association (through the NSW State Library)	Mercer
Indigenous Affairs	Mission Australia
Australia Post	NAB
Australian Securities and Investments Commission	Oliver Wyman
AustralianSuper	PricewaterhouseCoopers
Buchan Consulting	Sandstone Technology
Citi Australia	Suncorp
Clearview	10,000girl campaign
Commonwealth Bank Foundation	The Benevolent Society
EFTPOS Australia	The Smith Family
Financial Basics Foundation	University of Melbourne
Financial Counselling Australia	Wesley Mission
First State Super	Westpac Davidson Institute
	Women's Information and Referral Exchange Inc (WIRE)
	Woolworths

Many other organizations (e.g. The Australian Tax Office, Salvation Army, The Institute of Chartered Accountants) were represented in a broader group of supporters willing to promote MoneySmart Week through their networks.

Question 6 (Hansard, p. 15)

Topic: Frequency of hedge fund scrutiny

Senator BOYCE: I had been going to ask a question about the 6.6 years for hedge fund investment managers and REs. Are you able to provide on notice some more information about which funds come under scrutiny every 6.6 years? Do the top 10 get done more often? As you have with some of the others, are you able to break that down any further?

Mr Medcraft: We can.

Mr Tanzer: There is quite a lot of information about how we target our activities with respect to hedge funds and things that we publish, so we would be happy to provide some of that.....

Response

ASIC conducts both reactive and proactive surveillances of hedge funds. A reactive surveillance might be initiated on the basis of market intelligence or a complaint received. Pro-active surveillances are reviews initiated by ASIC and are focused on a particular theme (eg asset misappropriation) and involve us examining a sub-set of the wider hedge fund or hedge fund manager population. That sub-set might be selected on the basis of the amount of investors' money under management, whether the funds are retail or wholesale funds, or other relevant criteria, depending on the object of the surveillance. The overwhelming majority of our surveillance work on hedge funds is pro-active and the figure of 6.6 years to survey each manager in an identified population of 220 hedge fund managers is based on our proactive surveillance work.

In 2010 we undertook our first hedge fund systemic risk survey. This involved our largest nine managers (basically all local managers managing more than US\$500m in hedge fund assets) having to answer a comprehensive set of questions about potential sources of systemic risk, such as the asset classes their funds are invested in, where those assets were located, the level of leverage used, and the identity of their largest counter parties. These nine managers held 52% of known hedge fund assets under management (excluding assets held by funds of hedge funds to exclude any double counting). The surveillance was coordinated with similar exercises undertaken by our counterparts internationally, though the results were assessed locally and only aggregated summary results shared with other regulators here and abroad. We are about to undertake our second systemic risk surveillance using the same US\$500m threshold, and we estimate that approximately double the number of managers will be completing the survey. The increased number is a result of our having identified some more hedge fund managers, the appreciation of the AU\$ against the US\$, and an increase in the size of several managers' assets under management.

We are just now wrapping up our 2nd Red Flags hedge fund manager fraud surveillance. The first was done over the 2009/10 financial year. The Red Flag surveillances involve assessing managers of both retail and wholesale hedge funds against a set of indicators for the existence of, or vulnerability of their hedge fund to, manager fraud. The theme of the 2nd Red Flag surveillance was asset misappropriation, manipulation of fund returns and overpayment of management and

performance fees. We used various risk based filters to reduce the number of managers we looked at to 58. ASIC prefers not to disclose the detail of the risk filters we use, as fraudulent managers may use this information to escape detection.

ASIC expects to continue to conduct both types of surveillance every two years or so. As a result, the largest fund managers and the fund managers which exhibit more risk indicators will likely be reviewed more often than the average of 6.6 years, and potentially every two years or so. By contrast, managers of smaller funds and that exhibit fewer risk indicators will likely be reviewed less often than the overall average.

Question 7 (Hansard, p. 18)

Topic: Action by ASIC against auditors

Mr FLETCHER: Given the conduct in the case of Trio, and that the audits that were conducted extended earlier than 2008, has ASIC considered the possibility of action against any of the auditors?

Mr Price: We certainly have considered action in respect of various of the auditors, but I would like to take on notice any further detail around that area, if I may.

Mr FLETCHER: Yes, I would like to get an answer to that question on notice. Could I also get on notice the answer to whether you believe there are any other parties against whom recovery could potentially be made of the monies that have been lost?

Mr Price: Sure.

Response

ASIC is responsible for regulating the conduct of registered company auditors. ASIC has reviewed the conduct of the auditor of both the Astarra Strategic Fund and the ARP Growth Fund for the financial year ending 30 June 2008. ASIC has also reviewed the audit of the Astarra Strategic Fund for the financial year ending 30 June 2009.

As a result of the disciplinary issues identified by these reviews, ASIC entered into an Enforceable Undertaking with Mr Timothy Frazer in lieu of commencing proceedings in the Companies Auditors and Liquidators Board. This Enforceable Undertaking provided that Mr Frazer would not act as a registered company auditor for three years.

Trio Capital Ltd (in liquidation) as the responsible entity of both the Astarra Strategic Fund and the ARP Growth Fun would be the party who would bring proceedings for compensation in respect of shortcomings by the auditor of these funds. ASIC anticipates that the liquidators of Trio Capital Ltd (in liquidation) would examine the feasibility of such a claim.

ASIC has a discretion to commence civil recovery action on behalf of an aggrieved person or company (eg: s50 of the ASIC Act) if it is in the public interest to do so. ASIC is not however obliged to do so.

In considering whether it is in the public interest to take civil recovery action on behalf of an aggrieved investor ASIC will take into account a range of factors including:

- A viable cause of action being identified (that is, establishing misconduct by the defendant that gives rise to the basis for a compensation action);
- The regulatory effect of the action;
- The existence of other parties able to commence proceedings seeking compensation for aggrieved investors (such as an external administrator or the investors themselves);
- The availability of funds to satisfy a judgement against a defendant to the proceedings;
- The prospects of the action being successfully litigated by ASIC;
- ASIC's regulatory priorities at the time;
- Availability of alternative forms of dispute resolution.

In the case of the Trio auditor we consider that legislative provisions including those imposing proportionate liability would complicate the ability of a party to obtain significant compensation.

ASIC does not propose at this stage to pursue civil action against the Trio auditor.

In respect of possible recoveries from other parties, ASIC has looked at a range of persons and entities. Of these persons and entities considered we have not identified any significant funds, assets or insurance that would satisfy a judgement debt even if ASIC identified and successfully pursued a claim against these persons.

We are aware that a claim brought in the Supreme Court of New South Wales by an investor in the Astarra Strategic Fund has been settled in favour of the investor. Notwithstanding this successful proceeding we are of the view that the funds/ assets available are not sufficient to adequately compensation all the affected investors in the Astarra Strategic Fund given the size of the total losses.

Question 8 (Hansard pp 20–21)

Topic: Investors in frozen funds

Mr Tanzer: ... But you can see at least a positive movement from November 2009 where we had a total of 87 schemes involved with \$25.3 billion down to now in the order of 50 schemes with \$6.36 billion that remains frozen.

Senator BOYCE: Do you know how many investors there are in those?

Mr Medcraft: We can take that on notice.

Mr Tanzer: I do not have that figure here, I am sorry.

Senator BOYCE: No, that is okay. If you can do this without vast amounts of work, can you indicate whether they are individuals or organisations.

Mr Medcraft: We will see if we can get the numbers.

Mr Tanzer: Yes, we will see what we have.

Response

ASIC does not presently collect or collate information regarding number and/or types of investors remaining in these frozen funds.

Question 9 (Hansard p. 21)

Topic: Defining liquidity of assets

Mr Price: One of the key issues in terms of the definition of whether assets are liquid or not at the moment is that, to some extent, it depends on the judgement of the relevant responsible entity, the relevant people who operate the fund. The nature of our suggested amendments is more around putting a more objective framework around judging whether assets are liquid or not.

CHAIR: How is that done?

Mr Price: We have made some suggestions to Treasury, but in terms of the priority of those suggestions or looking for an appropriate legislative vehicle, I would need to take that on notice. It is probably a question for Treasury in terms of where they see that.

Response

ASIC has been assisting Treasury develop possible amendments to the definition of Liquid Assets in the Corporations Act 2001. Whether amendments are made to the definition of Liquid Assets is a matter for the Government.

Further follow up information

The following were not taken as official questions on notice, but were matters on which ASIC undertook to provide further information.

A) Hansard p. 14

Topic: Auditor registration requirements for SMSFs

Ms SMYTH: Is there a registration fee? I believe there is.

Mr Tanzer: I think there is. I cannot tell you exactly what it is, but I will find out.

Response

The fee to register is \$100. We are waiting confirmation from Treasury as to whether this fee will be subject to CPI increases.

B) Hansard, p 23

Topic: Communications with World Bank about business registration

CHAIR: So, in the interests of raising from silver to gold, have you provided the World Bank with this information about changes to our business registration?

Mr Tanzer: I think they have their sources. I will go back and find out.

Mr Medcraft: When was that report done?

CHAIR: This year. June.

Mr Tanzer: But I think it is always based on work that they have done, so it runs up until the end of the previous year, I think. It would not yet—

Mr Medcraft: Take into account the business names and some of the other names. I am sure we will come back to you on it, but we will probably want a target to go on.

Response

The World Bank's Doing Business project provides measures of business regulations across 183 economies including Australia. The annual rankings are based on input from lawyers, accountants, judges, business people and public officials. The Treasury provides input on behalf of the Australian Government by way of an annual survey. The most recent survey was submitted by Treasury to the World Bank in July 2012. The survey response made reference to Australia's new online Business Names Register. The World Bank has indicated that Doing Business 2013 will be released around October this year.

Answers to questions on notice from Mr Fletcher MP

Expert Reports

Question 1

It seems that an expert report involves the provision by an expert of financial product advice. This is a financial service, so that the expert must hold a financial services license, and it is a condition of the license that the expert must attach a financial services guide to each report. This guide must set out, among other things, what a retail investor should do if they have complaint about the report. In essence, the investor must first refer the complaint to the expert and then if the investor is not satisfied with the expert's response, they may refer the complaint to an approved complaints resolution service, usually the financial Ombudsman Service.

Is that a fair summary of the present position?

Response

Independent experts providing financial product advice are typically required to hold an Australian Financial Services Licence (AFSL). However, some experts, such as geologists providing technical reports, are not required to hold an AFSL. AFSL holders need to have both internal and external dispute resolution procedures. If using dispute resolution processes, an investor should first complain to the expert directly. If they are not satisfied with the response they can contact the Financial Ombudsman Service (FOS) or other approved External Dispute Resolution Services. In addition, ASIC also closely monitors many expert reports and has issued substantial policy guidance on the standards expected of experts. ASIC assesses all complaints it receives regarding experts reports.

Question 2

Suppose a retail investor follows the directions in the financial services guide, and makes a complaint about the report in the first instance to the expert. How long might it take the expert to deal with the complaint?

Response

Under internal dispute resolution requirements, an expert / AFSL holder has up to 45 days to respond to a complaint (*Regulatory Guide 165: Licensing: Internal and external dispute resolution - para 100*).

Question 3

Isn't it the case that many of these corporate actions have run their ordinary course within about a month, meaning that in most cases, by the time the expert has dealt with the complaint, the corporate action is over?

Response

If commercial considerations mean that a transaction will likely be complete before any complaint is finalized through internal or external dispute resolution, ASIC strongly encourages investors to lodge their concerns with it.

ASIC reviews many transactions involving listed entities and we therefore recommend shareholders contact ASIC at first instance if concerns arise before the transaction is concluded. ASIC can use its position as a regulator to try to have any substantiated concerns addressed (for instance, by supplementary disclosure).

Question 4

If the investor is not satisfied with the outcome of the complaint and has time to refer the matter to the Financial Ombudsman Service, what expertise does the Financial Ombudsman Service have in relation to expert reports?

Response

Assuming a matter is referred to FOS rather than ASIC and they do not have internal expertise in a particular area, they are able to use the services of external experts to help resolve disputes. It should also be noted that FOS has discretion to refuse to consider the dispute where there is a more appropriate forum for a dispute to be heard (*FOS Terms of Reference 1 January 2010 (as amended 1 January 2012) - para 5.2(a)*).

Question 5

Can an officer of the Financial Ombudsman Service make an order correcting error in the report?

Response

FOS does not have the power to make amendments to an independent expert's report but it can order that compensation is paid.

Question 6

If the Ombudsman does not have time to correct the report, can he at least make an order compensating the complainant for financial loss?

Response

The maximum FOS can compensate applicants for direct financial loss and damage is \$280,000 (*FOS Terms of Reference 1 January 2010 (as amended 1 January 2012) - schedule 1*). However, an investor would need to show direct financial loss as a result of the actions of the expert in the course of them providing financial services.