

The Senate

Economics
References Committee

Performance of the Australian Securities and
Investments Commission

June 2014

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Abbreviations

| | |
|------------------|--|
| AAT | Administrative Appeals Tribunal |
| ABC | Australian Broadcasting Corporation |
| ABN | Australian Business Number |
| ACCC | Australian Competition and Consumer Commission |
| ACI | Advisers' Committee for Investors |
| ACLEI | Australian Commission for Law Enforcement Integrity |
| ADI | Authorised Deposit-taking Institution |
| AFP | Australian Federal Police |
| AFS licence | Australian financial services licence |
| AFSA | Australian Financial Security Authority |
| AFSL | see AFS licence |
| ANAO | Australian National Audit Office |
| ANZ | Australia and New Zealand Banking Group Limited |
| APRA | Australian Prudential Regulation Authority |
| ARITA | Australian Restructuring Insolvency and Turnaround Association |
| ASIC | Australian Securities and Investments Commission |
| ASIC Act | <i>Australian Securities and Investments Commission Act 2001</i> (Cth) |
| ASX | Australian Securities Exchange |
| ATO | Australian Taxation Office |
| AWB | Australian Wheat Board |
| BFCSA | Banking and Finance Consumers Support Association (Inc) |
| BoQ | Bank of Queensland |
| Campbell Inquiry | 1981 report of the Committee of Inquiry into the Australian Financial System, chaired by Sir J. Keith Campbell |
| CAP | Consumer Advisory Panel |

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| CBA | Commonwealth Bank of Australia |
| CCLC | Consumer Credit Legal Centre (NSW) Inc |
| CDPP | Commonwealth Director of Public Prosecutions |
| CEO | Chief executive officer |
| CFO | Chief financial officer |
| CFP | see CFPL |
| CFPB | Consumer Financial Protection Bureau (US) |
| CFPL | Commonwealth Financial Planning Limited |
| CICP | Continuous Improvement Compliance Program |
| CLERP | Corporate Law Economic Reform Program |
| CLERP 6 | <i>Financial Services Reform Act 2001 (Cth)</i> |
| CLERP 9 | <i>Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth)</i> |
| COAG | Council of Australian Governments |
| Corporations Act | <i>Corporations Act 2001 (Cth)</i> |
| Corporations legislation | The Corporations Act, ASIC Act and rules of court made or applied by specified court (See Corporations Act, s. 9) |
| COSL | Credit Ombudsman Service Limited |
| CPSU | Community and Public Sector Union |
| DPP | see CDPP |
| EDR | External dispute resolution |
| EU | Enforceable undertaking |
| FCA | Financial Conduct Authority (UK) |
| FMA Act | <i>Financial Management and Accountability Act 1997 (Cth)</i> |
| FNA | Financial needs analysis |
| FOFA | Future of Financial Advice |
| FOS | Financial Ombudsman Service Limited |
| FSCC | Financial Services Consultative Committee |

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| FSP | Financial services provider |
| FTE | Full-time equivalent |
| FWL | Financial Wisdom Limited |
| G20 | Group of Twenty |
| GFC | Global financial crisis |
| ICAA | Institute of Chartered Accountants in Australia |
| IMF | International Monetary Fund |
| IOSCO | International Organization of Securities Commissions |
| IPA | Insolvency Practitioners Association (now ARITA) |
| ITSA | Insolvency & Trustee Service Australia (now AFSA) |
| KPI | Key performance indicator |
| LMIM | LM Investment Management Limited |
| MEL | Macquarie Equities Limited |
| MOU | Memorandum of understanding |
| MPF | LM Managed Performance Fund |
| MYEFO | Mid-year Economic and Fiscal Outlook |
| NAB | National Australia Bank Limited |
| National Credit Act | <i>National Consumer Credit Protection Act 2009</i> (Cth) |
| NZ | New Zealand |
| OECD | Organisation for Economic Co-operation and Development |
| OTC | Over-the-counter |
| PGPA Act | <i>Public Governance, Performance and Accountability Act 2013</i> (Cth) |
| PIDA | <i>Public Interest Disclosure Act 2013</i> (Cth) |
| PJCCFS | Parliamentary Joint Committee on Corporations and Financial Services |

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| PJCCFS CLERP 9 report | Report of the Parliamentary Joint Committee on Corporations and Financial Services: <i>CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters</i> (June 2004) |
| PwC | PricewaterhouseCoopers |
| RBA | Reserve Bank of Australia |
| RE | Responsible entity |
| RG 146 | ASIC's Regulatory Guide 146, <i>Licensing: Training of financial product advisers</i> (July 2012) |
| RIS | Regulation Impact Statement |
| RMF | Risk management framework |
| SCT | Superannuation Complaints Tribunal |
| SEC | US Securities and Exchange Commission |
| SME | Small and medium enterprises |
| SMSF | Self-managed superannuation fund |
| SoA | Statement of Advice |
| UAE | United Arab Emirates |
| UCCC | Uniform Consumer Credit Code |
| UK | United Kingdom of Great Britain and Northern Ireland |
| US | United States of America |
| UTS | University of Technology, Sydney |
| Wallis Inquiry | The 1997 review of the financial system chaired by Mr Stan Wallis AC |

Executive summary

As the national corporate, markets and financial services regulator, the Australian Securities and Investments Commission (ASIC) is involved in most areas of Australia's commercial world. With the limited resources available to it, ASIC should be commended for how it performs certain functions and many of the outcomes it has achieved. ASIC will never be able to do everything the community may expect of it. In some respects, nor should it. It would be unrealistic to expect that ASIC could be funded at a level where all breaches or allegations of misconduct were pursued. Despite this, the size and growth of Australia's financial sector and the fact that millions of Australians are involved in it, not least because of compulsory superannuation, makes it essential that modern and adaptable regulations are in place and regulators such as ASIC are at the top of their game. ASIC needs to ensure it sets appropriate priorities and that its actions encourage widespread compliance.

This report underlines the critical importance of ensuring that Australia has a robust corporate regulatory system under the stewardship of a strong and effective regulator.

The committee examined many aspects of ASIC's work, but two case studies in particular assisted it to assess ASIC's performance. The first looked at consumer credit since 2002, which set the groundwork for the report. It introduced a number of key findings that surface and resurface in different contexts throughout this work. They include that:

- ASIC has limited powers and resources but even so appears to miss or ignore clear and persistent early warning signs of corporate wrongdoing or troubling trends that pose a risk to consumers;
- the financial services industry is dynamic with new products and business models emerging, which requires ASIC to be alert to the changes and any risk they pose to consumers or investors;
- there are always people looking to find ways to circumvent the law—ASIC needs to have the skills and industry experience to be able to match their ingenuity;
- consumers trust their advisers/brokers/financial institutions to do the right thing by them to the extent that they may sign incomplete or blank documents, do not ask questions and do not seek second opinions—importantly such trust is open to abuse;
- consumers have unrealistic expectations of what ASIC can do and the extent to which the regulator is able to protect their interests or investigate their complaints;
- ASIC's communication with retail investors and consumers needs to improve significantly;

- participants in the financial services industry can have an important role in assisting ASIC to fulfil its responsibilities, which then allows the regulator to concentrate its limited resources on serious and systemic matters; and
- between 2002 and 2010, some financial advisers, brokers and lenders systematically targeted more vulnerable members of the community, especially older Australians with assets but without high levels of financial literacy.

The second case study reinforced these findings but in greater detail and with sharper focus. In particular, it showed ASIC as a timid, hesitant regulator, too ready and willing to accept uncritically the assurances of a large institution that there were no grounds for ASIC's concerns or intervention. ASIC concedes that its trust in this institution was misplaced.

In this case study, the committee examined misconduct that occurred between 2006 and 2010 by financial advisers and other staff at Commonwealth Financial Planning Limited (CFPL), part of the Commonwealth Bank of Australia Group (CBA). Advisers deliberately neglected their duties and placed their personal interests far above the interests of their clients. The assets of clients with conservative risk positions, such as retirees, were allocated into high-risk products without their knowledge to the financial benefit of the adviser, who received significant bonuses and recognition within CFPL as a 'high performer'. There was forgery and dishonest concealment of material facts. Clients lost substantial amounts of their savings when the global financial crisis hit; the crisis was also used to explain away the poor performance of portfolios. Meanwhile, it is alleged that within CFPL there was a management conspiracy that, perversely, resulted in one of the most serious offenders, Mr Don Nguyen, being promoted.

Initially the committee found:

- the conduct of a number of rogue advisers working in CFPL was unethical, dishonest, well below professional standards and a grievous breach of their duties—in particular the advisers targeted vulnerable, trusting people;
- both ASIC and the CBA seemed to place reports of fraud in the 'too hard basket', ensuring the malfeasance escaped scrutiny and hence no one was held to account;
- the CBA's compliance regime failed, which not only allowed unscrupulous advisers to continue operating but also saw the promotion of one adviser, thus exposing unsuspecting clients to further losses;
- there was an inordinate delay in CFPL recognising that advisers were providing bad advice or acting improperly and in CFPL acting on that knowledge and informing clients and ASIC;
- ASIC was too slow in realising the seriousness of the problems in CFPL, instead allowing itself to be lulled into complacency and placing too much trust in an institution that sought to gloss over its problems;

- ASIC did not pay sufficient attention to the whistleblowers who raised serious concerns about the conduct of Mr Nguyen and the actions of CFPL.

As the committee gathered more and more evidence, however, lingering doubts began to grow about the robustness and fairness of the ASIC-sanctioned compensation process for CFPL clients who had suffered losses because of adviser misconduct. The committee could see major flaws in the process being implemented by CFPL, in particular:

- the manner in which information about adviser misconduct was conveyed to clients, which rather than reassure clients tended in some cases to intimidate and confuse them;
- CFPL's obfuscation when clients sought information on their investments or adviser;
- a strong reluctance on the part of CFPL to provide files to clients who requested them;
- no allowance made for the power asymmetry between unsophisticated, and in many cases older and vulnerable clients, and CFPL;
- no client representative or advocate present during the early stages of the investigation to safeguard the clients' interests when files were being checked and in many cases reconstructed;
- numerous allegations of missing files and key records, of fabricated documents and forged signatures that do not seem to have been investigated;
- the CFPL's initial offer of compensation was manifestly inadequate in many instances; and
- the offer of \$5,000 to clients to pay the costs of an expert to assess the compensation offer was made available only after the CFPL had determined that compensation was payable and an offer had been made.

Recent developments, whereby both ASIC and the CBA have corrected their testimony about the compensation process, have only deepened the committee's misgivings about the integrity and fairness of the process. The committee is now of the view that the CBA deliberately played down the seriousness and extent of problems in CFPL in an attempt to avoid ASIC's scrutiny, contain adverse publicity and minimise compensation payments. In effect, the CBA managed, for some considerable time, to keep the committee, ASIC and its clients in the dark. The time is well overdue for full, frank and open disclosure on the CFPL matter.

The committee is concerned that there are potentially many more affected clients that have not been fairly compensated. The clients that gave evidence at a public hearing were exceptional in that they were willing to voice their concerns publicly and were able to fight for compensation because of their circumstances. They were fortunate because they had a family member determined to assist them, were able to obtain

independent expert advice, or were able to obtain a copy of their original file from one of the whistleblowers.

At this stage, the committee's confidence in ASIC's ability to monitor the CBA's implementation of its new undertaking regarding the compensation process is severely undermined. Furthermore, the CBA's credibility in the CFPL matter is so compromised that responsibility for the compensation process should be taken away from the bank. The committee considered five options to finally resolve the CFPL matter. But, given the seriousness of the misconduct and the need for all client files to be reviewed, the committee believes that an inquiry with sufficient investigative and discovery powers should be established by the government to undertake this work. To resolve this matter conclusively and satisfactorily, the inquiry would need the powers to compel relevant people to give evidence and to produce information or documents.

The committee is of the view that a royal commission into these matters is warranted.

The CFPL scandal needs to stand as a lesson for the entire financial services sector. Firms should understand that they cannot turn a blind eye to unprincipled employees who do whatever it takes to make profits at the expense of vulnerable investors. If this matter is not pursued thoroughly, there will be little incentive for Australia's major financial institutions to take compliance seriously.

The examination of CFPL, however, was just one aspect of this inquiry. Many issues and cases that encompass ASIC's broad responsibilities and regulatory roles were also considered. The committee's additional findings build on those resulting from the case studies, emphasising the importance of ASIC becoming a self-evaluating and self-correcting organisation.

The committee's recommendations recognise the good work that ASIC has done in a challenging environment. Even so, the committee identified the need for ASIC to become a far more proactive regulator ready to act promptly but fairly. ASIC also needs to be a harsh critic of its own performance with the drive to identify and implement improvements. With this aim in mind, the committee's recommendations are intended to strengthen ASIC in several key ways.

A main objective is to improve ASIC's understanding and appreciation of Australia's corporate environment and those it regulates, and to ensure that ASIC has access to independent, external expertise. ASIC needs to be alert to emerging business models or new financial products and to match the inventiveness and resourcefulness of those in the industry who seek to circumvent the law. In this regard, the committee considers that ASIC should more effectively tap into the experience, knowledge and insight of retired and highly respected business people, legal professionals, academics and former senior public servants to help it identify and minimise risks that have the potential to cause significant investor or consumer harm.

Recommendations are also aimed at encouraging better quality reporting to ASIC, and for the regulator to use this information more effectively. Building the analytical and investigative skills within ASIC necessary to discern early warning signs of unhealthy trends or troubling behaviour is a key goal. Australia needs a corporate and financial services regulator that has these skills in order to identify and act on problems early and decisively. ASIC should develop an internal management system that fosters a receptive culture that would ensure that misconduct reports or complaints indicative of a serious problem lodged with ASIC are elevated to the appropriate level and receive due attention. The committee also believes that the corporate whistleblowing regime needs to be strengthened to encourage whistleblowers to come forward. Informed individuals need to be confident that they can report alleged misconduct, potentially unsafe products or dubious practices in Australia's corporate world and for their reports to be taken seriously and dealt with accordingly.

Given the resource constraints and knowledge gaps that a body like ASIC will always encounter, the committee has also designed recommendations intended to make the regulatory system more self-enforcing, allowing ASIC to concentrate on key priorities and trouble areas. To achieve this, ASIC needs to work effectively with other industry and professional bodies that share ASIC's goals. In particular, ASIC needs to ensure it has strong, constructive and cooperative relationships with all of the financial system gatekeepers, such as professional associations. ASIC could also work with companies to strengthen their internal compliance regimes and their systems for reporting non-compliance to ASIC. Finally, ASIC should be primarily funded through a user-pays system of industry levies designed to reflect the cost associated with regulation and to incentivise sectors to minimise the attention the regulator needs to devote to them. Again, more effective self-regulation will allow ASIC to focus on and more effectively deal with egregious misconduct.

ASIC's communication with members of the community needs to improve. In particular, ASIC must be more responsive and sensitive to the concerns of retail investors and consumers. Expectations about what ASIC can do also need to be appropriately managed. In this regard, steps to improve the level of financial literacy in Australia will, in the long-term, help to limit the number of people that encounter difficulties and turn to ASIC. The committee acknowledges ASIC's existing work in this area and urges ASIC to intensify its efforts.

ASIC's enforcement role is one of its most important functions. ASIC needs to be respected and feared. It needs to send a clear and unmistakeable message, backed-up and continually reinforced by actions, that ASIC has the necessary enforcement tools and resources and is ready to use them to uphold accepted standards of conduct and the integrity of the markets. To assist ASIC with this, the penalties currently available for contraventions of the legislation ASIC administers should be reviewed to ensure they are set at appropriate levels. Monetary penalties may also need to become more responsive to misconduct, with multiple of gain penalties or penalties combined with disgorgement considered. The resolution of a particular matter through enforcement action, however, is not the end of the process—ASIC needs to ensure that a culture of compliance results from the enforcement action. For example, when ASIC accepts an

enforceable undertaking, it needs to have a mechanism in place that will provide assurances to the public that the desired changes have indeed taken place and that the entity has introduced safeguards that would prevent similar misconduct from recurring. The transparency associated with enforceable undertakings should also be enhanced; in particular, the report of an independent expert appointed as a result of an undertaking should be made public. On the other hand, when ASIC is unsuccessful in enforcement action it needs to reflect and learn what it can from the experience.

The cases of misconduct in the financial advice industry and ASIC's evidence regarding the regulatory gaps in that industry have convinced the committee that various changes need to occur. The committee's recommendations in this area seek to improve the overall standards in the sector and provide ASIC with greater information and powers regarding problem advisers. For example, ASIC should be able to ban someone from managing a financial services business if ASIC has already banned them from directly providing financial services.

The committee also considered ways for ASIC to become more accountable and transparent. Increased transparency of its operations and how its functions are performed would be appropriate and may counter perceptions of the regulator being captured by big business. Some of the changes are straightforward, such as ASIC publishing more of its internal policies. ASIC also should keep the business and academic worlds better informed about developments and trends in corporate Australia by providing and disseminating information it receives from a range of sources, as well as ASIC's analysis of this information.

Finally, the range of tasks ASIC performs was considered. ASIC is overburdened and charged with tasks that do not assist its other regulatory roles. The committee is of the view that ASIC's registry function should be transferred elsewhere to allow ASIC to concentrate on its core functions.

The committee's recommendations are intended to address gaps in the corporations and financial services legislative and regulatory frameworks and to encourage ASIC to consider how its performance can be improved. These recommendations will enable ASIC to fulfil its responsibilities and obligations more effectively. However, many of the issues with ASIC's performance cannot be addressed by anyone other than ASIC. In the committee's opinion, ASIC has been in the spotlight far too frequently for the wrong reasons. It is acknowledged that not all of the criticisms levelled at ASIC are justified; ASIC is required to perform much of its work confidentially and in a way that ensures natural justice. It is also constrained by the legislation it administers and the resources given to it for this purpose. Nevertheless, the credibility of the regulator is important for encouraging a culture of compliance. That ASIC is consistently described as being slow to act or as a watchdog with no teeth is troubling. The committee knows, however, that ASIC has dedicated and talented employees that want to rectify the agency's reputation.

This inquiry has been a wake-up call for ASIC. The committee looks forward to seeing how ASIC changes as a result.

List of recommendations

Recommendation 1

5.80 The committee recommends that ASIC develop a multi-pronged campaign to educate retail customers about the care they need to take when entering into a financial transaction and where they can find affordable and independent advice or assistance when they find themselves in difficulties because of that transaction.

Recommendation 2

6.39 As part of the multi-pronged campaign (see Recommendation 1), the committee recommends that ASIC actively encourage consumers to report any suspected unscrupulous conduct related to consumer credit.

Recommendation 3

6.40 The committee recommends that as the national credit reforms introduced in 2010 bed down, ASIC should:

- carefully monitor the implementation of the new laws giving particular attention to activities that may fall outside the legislation but which pose risks to consumer interests;
- ensure that it acts quickly to alert consumers to likely dangers and the government to any problems that need to be addressed; and
- build capacity to monitor and research lending practices and to be prepared to launch marketing and education strategies should poor practices begin to creep back into the industry.

Recommendation 4

7.39 The committee recommends that ASIC devote a section of its annual report to the work of the financial services and consumer credit external dispute resolution (EDR) schemes, accompanied by ASIC's assessment of the systemic and significant issues the EDR schemes have raised in their reports to ASIC. Further, the committee recommends that ASIC include in this commentary information on any action taken in response to the matters raised in these reports.

Recommendation 5

7.82 The committee recommends that the Financial Ombudsman Service and the Credit Ombudsman Service set key performance indicators (KPIs) for meeting milestones in their management of a complaint, publish these milestones and KPIs on their website and report their performance against these KPIs in their annual reports.

Recommendation 6

7.83 The committee recommends that ASIC, in consultation with the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service (COSL):

- consider amending the terms of reference for FOS and COSL so that the caps on the maximum value of a claim that the EDR schemes may consider and the maximum amount that can be awarded are increased and indexed to the consumer price index;
- examine the processes for reporting to ASIC matters of significance and emerging systemic issues with a view to improving the reporting regime;
- establish protocols for managing allegations of less serious fraud to ensure that such complaints do not get lost in the system and are recorded properly on ASIC's databases;
- improve the guidance provided to complainants so they fully understand that FOS and COSL are dispute resolution bodies and that complainants must prepare their own cases; and
- consider establishing special divisions in FOS and COSL to deal with small business complaints.

Recommendation 7

12.28 The committee recommends that the government establish an independent inquiry, possibly in the form of a judicial inquiry or Royal Commission, to:

- thoroughly examine the actions of the Commonwealth Bank of Australia (CBA) in relation to the misconduct of advisers and planners within the CBA's financial planning businesses and the allegations of a cover up;
- identify any conduct that may amount to a breach of any law or professional standard;
- review all files of clients affected or likely to be affected by the misconduct and assess the appropriateness of the compensation processes and amounts of compensation offered and provided by the CBA to these clients; and
- make recommendations about ASIC and any regulatory or legislative reforms that may be required.

Recommendation 8

13.33 The committee recommends that ASIC establish a pool of approved independent experts (retired experienced and hardened business people with extensive knowledge of compliance) from which to draw when concerns emerge about a poor compliance culture in a particular company. The special expert would review and report to the company and ASIC on suspected compliance failings with the process funded by the company in question.

Recommendation 9

13.34 The committee recommends that the government consider increased penalties and alternatives to court action, such as infringement notices, for Australian financial services licensees that fail to lodge reports of significant breaches to ASIC within the required time.

Recommendation 10

13.35 The committee recommends that ASIC review its surveillance activity with a view to making it more effective in detecting deficiencies in internal compliance arrangements.

Recommendation 11

13.36 In light of the Commonwealth Financial Planning matter, the committee recommends that ASIC undertakes intensive surveillance of other financial advice businesses that have recently been a source of concern, such as Macquarie Private Wealth, to ensure that ASIC's previous concerns are being addressed and that there are no other compliance deficiencies. ASIC should make the findings of its surveillance public and, in due course, provide a report to this committee.

Recommendation 12

14.112 The committee recommends that, consistent with the recommendations made by ASIC, the government develop legislative amendments to:

- expand the definition of a whistleblower in Part 9.4AAA of the *Corporations Act 2001* to include a company's former employees, financial services providers, accountants and auditors, unpaid workers and business partners;
- expand the scope of information protected by the whistleblower protections to cover any misconduct that ASIC may investigate; and
- provide that ASIC cannot be required to produce a document revealing a whistleblower's identity unless ordered by a court or tribunal, following certain criteria.

Recommendation 13

14.113 The committee recommends that an 'Office of the Whistleblower' be established within ASIC.

Recommendation 14

14.114 The committee recommends that the government initiate a review of the adequacy of Australia's current framework for protecting corporate whistleblowers, drawing as appropriate on Treasury's 2009 *Options Paper* on the issue and the subsequent consultation process.

Recommendation 15

14.115 The committee recommends that, subject to the findings of the broader review called for in Recommendation 14, protections for corporate whistleblowers be updated so that they are generally consistent with and complement the protections afforded to public sector whistleblowers under the *Public Interest Disclosure Act 2013*. Specifically, the corporate whistleblower framework should be updated so that:

- anonymous disclosures are protected;
- the requirement that a whistleblower must be acting in 'good faith' in disclosing information is removed, and replaced with a requirement that a disclosure:
 - is based on an honest belief, on reasonable grounds, that the information disclosed shows or tends to show wrongdoing; or
 - shows or tends to show wrongdoing, on an objective test, regardless of what the whistleblower believes;
- remedies available to whistleblowers if they are disadvantaged as a result of making a disclosure are clearly set out in legislation, as are the processes through which a whistleblower might seek such remedy;
- it is a criminal offence to take or threaten to take a reprisal against a person (such as discriminatory treatment, termination of employment or injury) because they have made or propose to make a disclosure; and
- in limited circumstances, protections are extended to cover external disclosures to a third parties, such as the media.

Recommendation 16

14.116 The committee recommends that, as part of the broader review called for in Recommendation 14, the government explore options for reward-based incentives for corporate whistleblowers, including *qui tam* arrangements.

Recommendation 17

15.66 The committee recommends that ASIC, in collaboration with the Australian Restructuring Insolvency and Turnaround Association and accounting bodies, develop a self-rating system, or similar mechanism, for statutory reports lodged by insolvency practitioners and auditors under the *Corporations Act 2001* to assist ASIC identify reports that require the most urgent attention and investigation.

Recommendation 18

16.42 The committee recommends that ASIC establish a dedicated channel for complaints from certain key professional bodies, industry bodies and consumer groups, as well as for accountants and financial advisers/planners.

Recommendation 19

16.43 The committee recommends that ASIC examine carefully:

- its triage system to ensure that the officers managing this process have the skills and experience required to identify complaints and reports of a serious nature requiring attention;
- its misconduct reports management system to ensure that once identified, a serious misconduct report is elevated and more senior people are available to deal with the issue; and
- its culture to ensure that those managing complaints and reports who wish to draw to the attention of senior officers what they perceive as a potentially serious matter are encouraged to do so; that is, for ASIC to foster an open and receptive culture within the organisation so that critical information is not siloed.

Recommendation 20

16.44 The committee recommends that ASIC look at the skills it needs to forensically and effectively interrogate its databases and other sources of information it collates and stores, with a view to ensuring that it is well-placed to identify and respond to early warning signs of corporate wrongdoing or troubling trends in Australia's corporate world.

Recommendation 21

16.45 The committee recommends that ASIC put in place a system whereby, after gross malfeasance is exposed, a review of ASIC's performance is undertaken to determine whether or how it could have minimised or prevented investor losses or consumer damage. Spearheaded by a small panel of independent, experienced and highly regarded people (with business/legal/ academic/public sector and/or consumer advocacy backgrounds), together with all ASIC commissioners, this investigation would identify lessons for ASIC to learn and how to incorporate them into ASIC's mode of operation. The committee recommends further that their findings be published including details of any measures ASIC should implement.

Recommendation 22

17.49 The committee recommends that the balance of ASIC's enforcement special account be increased significantly.

Recommendation 23

17.51 The committee recommends that the Attorney-General refer to the Australian Law Reform Commission an inquiry into the operation and efficacy of the civil penalty provisions of the *Corporations Act 2001* that relate to breaches of directors' duties.

Recommendation 24

17.54 As enforceable undertakings can be used as an alternative to court proceedings, the committee recommends that when considering whether to accept an enforceable undertaking, ASIC:

- require stronger terms, particularly regarding the remedial action that should be taken to ensure that compliance with these terms can be enforced in court;
- require a clearer acknowledgement in the undertaking of what the misconduct was;
- as its default position, require that an independent expert be appointed to supervise the implementation of the terms of the undertaking; and
- consider ways to make the monitoring of ongoing compliance with the undertaking more transparent, such as requiring that reports on the progress of achieving the undertaking's objectives are, to the extent possible, made public.

Recommendation 25

17.55 The committee recommends that ASIC should more vigilantly monitor compliance with enforceable undertakings with a view to enforcing compliance with the undertaking in court if necessary.

Recommendation 26

17.56 The committee requests that the Auditor-General consider conducting a performance audit of ASIC's use of enforceable undertakings, including:

- the consistency of ASIC's approach to enforceable undertakings across its various stakeholder and enforcement teams; and
- the arrangements in place for monitoring compliance with enforceable undertakings that ASIC has accepted.

Recommendation 27

17.57 The committee recommends that ASIC include in its annual report additional commentary on:

- ASIC's activities related to monitoring compliance with enforceable undertakings; and
- how the undertakings have led to improved compliance with the law and encouraged a culture of compliance.

Recommendation 28

17.58 The committee recommends that ASIC develop a code of conduct for independent experts appointed as a requirement of an enforceable undertaking. In particular, the code of conduct should address the management of conflicts of interest.

Recommendation 29

18.22 The committee recommends that ASIC improve its procedures for updating past online media releases and statements to reflect recent court developments, such as the outcome of an appeal or when proceedings are discontinued. ASIC should ensure that these updates are made in a timely manner and published in a more prominent position than what currently occurs.

Recommendation 30

18.46 The committee recommends that when ASIC has been unsuccessful in court proceedings both an internal review and an independent review of the initial investigation and case must be undertaken.

Recommendation 31

19.50 The committee recommends that the accounting bodies and ASIC work to repair their relationship and commit to a more constructive approach to discussing regulatory issues. The committee requests that ASIC provide a written report to the committee in six months' time informing the committee of progress achieved in strengthening this relationship.

Recommendation 32

19.53 The committee recommends that ASIC publish on its website information about its secondment programs and the policies and safeguards in place that relate to these programs.

Recommendation 33

19.56 The committee requests that the Commonwealth Ombudsman consider undertaking an own-motion investigation into the allegations related to the process that resulted in ASIC granting regulatory relief for generic online calculators in 2005. An investigation undertaken by the Ombudsman should, in particular, consider whether the process was undermined because ASIC did not adequately manage a conflict of interest identified by a person on secondment from a financial services firm.

Recommendation 34

19.59 The committee recommends that after exercising its discretionary powers to grant relief from provisions of the legislation it administers, ASIC should ensure that it puts in place a program for monitoring and assessing compliance with the conditions of the relief.

Recommendation 35

20.33 The committee recommends that ASIC include on all registry search results and extracts a prominent statement explaining ASIC's role and advising that ASIC does not approve particular business models.

Recommendation 36

20.34 The committee recommends that in bringing together the multi-pronged campaign to educate retail customers outlined in Recommendation 1, ASIC have regard to the fact that:

- many retail investors and consumers have unrealistic expectations of ASIC's role in protecting their interests; and
- financial literacy is more than financial knowledge but also incorporates the skills, attitudes and behaviours necessary to make sound financial decisions.

Recommendation 37

20.41 Recognising the importance of giving priority to the needs of consumers when ASIC develops regulatory guidance and provides advice to government, the committee recommends that ASIC should consider whether its Consumer Advisory Panel could be enhanced by the introduction of some of the features of the United Kingdom's Financial Services Consumer Panel.

Recommendation 38

21.33 The committee recommends that ASIC undertake an internal review of the way in which it manages complaints from retail investors and consumers with the aim of developing training and professional development courses designed to:

- have ASIC officers more attuned to the needs of vulnerable and disadvantaged consumers and to enhance ASIC's consumer advisory role;
- devise strategies and protocols for responding to retail investors and consumers registering a complaint, many of whom are at their wits end and in desperate need of help;
- ensure that ASIC officers, when advising a consumer to transfer their complaint to the relevant external dispute resolution scheme, make that transfer as seamless and worry-free as possible while conveying the sense that ASIC is not discarding their complaint; and
- acknowledge the advantages of making a return call to the complainant and provide guidance for ASIC officers on the times when making a return call would be appropriate.

Recommendation 39

22.28 The committee recommends that ASIC promote 'informed participation' in the market by making information more accessible and presented in an informative way.

Recommendation 40

22.38 The committee recommends that ASIC consider the aims and purposes of its website and redesign its website so that these aims and purposes are achieved. Particular consideration should be given to:

- explaining ASIC's role clearly on the website's homepage;
- providing a 'for consumers' category of information; and
- redesigning the homepage to give greater prominence to key information and services and less prominence to recent media releases.

Recommendation 41

23.13 The committee recommends that the government commission an inquiry into the current criminal and civil penalties available across the legislation ASIC administers. The inquiry should consider:

- the consistency of criminal penalties, and whether some comparable offences currently attract inconsistent penalties;
- the range of civil penalty provisions available in the legislation ASIC administers and whether they are consistent with other civil penalties for corporations; and
- the level of civil penalty amounts, and whether the legislation should provide for the removal of any financial benefit.

Recommendation 42

24.57 The committee recommends that financial advisers and planners be required to:

- successfully pass a national examination developed and conducted by relevant industry associations before being able to give personal advice on Tier 1 products;
- hold minimum education standards of a relevant university degree, and three years' experience over a five year period; and
- meet minimum continuing professional development requirements.

Recommendation 43

24.58 The committee recommends that a requirement for mandatory reference checking procedures in the financial advice/planning industry be introduced.

Recommendation 44

24.59 The committee recommends that a register of employee representatives providing personal advice on Tier 1 products be established.

Recommendation 45

24.60 The committee recommends that the *Corporations Act 2001* be amended to require:

- that a person must not use the terms 'financial adviser', 'financial planner' or terms of like import, in relation to a financial services business or a financial service, unless the person is able under the licence regime to provide personal financial advice on designated financial products; and
- financial advisers and financial planners to adhere to professional obligations by requiring financial advisers and financial planners to be members of a regulator-prescribed professional association.

Recommendation 46

24.61 The committee recommends that the government consider whether section 913 of the *Corporations Act 2001* and section 37 of the *National Consumer Credit Protection Act 2009* should be amended to ensure that ASIC can take all relevant factors into account in making a licensing decision.

Recommendation 47

24.62 The committee recommends that the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.

Recommendation 48

24.63 The committee recommends that the government consider legislative amendments that would give ASIC the power to immediately suspend a financial adviser or planner when ASIC suspects that the adviser or planner has engaged in egregious misconduct causing widespread harm to clients, subject to the principles of natural justice.

Recommendation 49

25.57 The committee recommends that the scoping study examining future ownership options for ASIC's registry function take account of the evidence that has been presented to the committee.

Recommendation 50

25.61 The committee recommends that the current arrangements for funding ASIC be replaced by a 'user-pays' model. Under the new framework, different levies should be imposed on the various regulated populations ASIC oversees, with the size of each levy related to the amount of ASIC's resources allocated to regulating each population. The levies should be reviewed on a periodic basis through a public consultation process.

25.62 The government should commence a consultation process on the design of the new funding model as soon as possible.

Recommendation 51

25.63 Following the removal of ASIC's registry responsibilities and the introduction of a user-pays model for funding ASIC outlined in Recommendations 49 and 50, the committee recommends that the government reduce the fees prescribed for chargeable matters under the *Corporations (Fees) Act 2001* with a view to bringing the fees charged in Australia in line with the fees charged in other jurisdictions.

Recommendation 52

26.24 The committee notes that the Parliamentary Joint Committee on Corporations and Financial Services could be well-placed to monitor ASIC's performance against the government's statement of expectations and ASIC's statement of intent. The committee recommends that the Parliamentary Joint Committee consider this as part of its statutory ASIC oversight function.

Recommendation 53

26.25 The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services consider how it could undertake its statutory duties in a way that places a greater emphasis on emerging issues and how action could be taken to pre-empt widespread investor losses or major frauds. As a first step the Parliamentary Joint Committee could, on an annual basis, reserve a public hearing to emerging issues, taking evidence from both ASIC and relevant experts.

Recommendation 54

26.26 The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services inquire into the various proposals which call for a lifting of professional, ethical and educational standards in the financial services industry.

Recommendation 55

26.46 The committee recommends that at the end of two years, the government undertake a review of the *Australian Securities and Investments Commission Act 2001* that would consider ASIC's governance arrangements, including whether ASIC should be governed by a board comprised of executive and non-executive members.

Recommendation 56

26.49 The committee recommends that ASIC publish a code of conduct for its statutory office-holders.

Recommendation 57

27.30 The committee recommends that the government give urgent consideration to expanding ASIC's regulatory toolkit so that it is equipped to prevent the marketing of unsafe products to retail investors.

Recommendation 58

27.32 The committee recommends that the Financial System Inquiry (FSI) carefully consider the adequacy of Australia's conduct and disclosure approach to the regulation of financial product issuers as a means of protecting consumers. In particular, the FSI should:

- consider the implementation of measures designed to protect unsophisticated investors from unsafe products, including matters such as:
 - subjecting the product issuer to more positive obligations in regard to the suitability of their product;
 - requiring the product issuer to state the particular classes of consumers for whom the product is suitable and the potential risks of investing in the product;
 - standardised product labelling;
 - restricting the range of investment choices to unsophisticated investors;
 - allowing ASIC to intervene and prohibit the issue of certain products in retail markets; and
- assess the merits of the United Kingdom's Financial Conduct Authority model which allows the Authority to suspend or ban potentially harmful products.

Recommendation 59

27.36 The committee recommends that the government clarify the definitions of retail and wholesale investors.

Recommendation 60

27.37 The committee recommends that the government consider measures that would ensure investors are informed of their assessment as a retail or wholesale investor and the consumer protections that accompany the classification. This would require financial advisers to ensure that such information is displayed prominently, initialled by the client and retained on file.

Recommendation 61

27.52 The committee recommends that the government commission a review of Australia's corporate insolvency laws to consider amendments intended to encourage and facilitate corporate turnarounds. The review should consider features of the chapter 11 regime in place in the United States of America that could be adopted in Australia.

PART I

Introduction and background

Chapter 1

Introduction

1.1 On 20 June 2013, the Senate referred the performance of the Australian Securities and Investments Commission (ASIC) to the Economics References Committee for inquiry and report by 31 March 2014. The committee was to give particular reference to:

- (a) ASIC's enabling legislation, and whether there are any barriers preventing ASIC from fulfilling its legislative responsibilities and obligations;
- (b) the accountability framework to which ASIC is subject, and whether this needs to be strengthened;
- (c) the workings of ASIC's collaboration, and working relationships, with other regulators and law enforcement bodies;
- (d) ASIC's complaints management policies and practices;
- (e) the protections afforded by ASIC to corporate and private whistleblowers; and
- (f) any related matters.¹

1.2 On 5 August 2013, the then Governor-General prorogued the 43rd Parliament and a general election was held on 7 September 2013. The 44th Parliament commenced on 12 November 2013. Two days later, the Senate agreed to the committee's recommendation that this inquiry into ASIC's performance be re-adopted with a reporting date of 30 May 2014. The Senate also agreed to the recommendation that the committee have the power to consider and use the records of the Economics References Committee appointed in the previous parliament that related to this inquiry. At the commencement of the 44th Parliament, the committee had already published over 250 submissions with another 70 or so waiting for the committee's consideration.

1.3 Initially, the committee called for submissions to be lodged by 21 October 2013, but, in light of the election and the start of a new parliament, the committee resolved to continue to receive submissions with a closing date of 10 January 2014.

1.4 On 28 May 2014, the committee tabled an interim report requesting an extension to present the final report by 26 June 2014.

1 *Journals of the Senate*, 2010–13, no. 150 (20 June 2013), p. 4110.

Conduct of the inquiry

1.5 The committee advertised the inquiry on its website calling for written submissions. The committee also wrote directly to a range of government departments and agencies, organisations, academics and other people known to be interested in the performance of ASIC, drawing their attention to the inquiry and inviting them to make written submissions.

1.6 The committee received 474 submissions and a further 104 supplementary submissions, as well as additional information including answers to a series of questions taken on notice by witnesses. These documents are listed at Appendices 1 and 2. The committee held five public hearings: two in Sydney (19 and 20 February 2014) and three in Canberra (21 February 2014 and 2 and 10 April 2014). A list of the hearings and the names of witnesses who appeared before the committee is at Appendix 3. In addition to its appearances before this committee on 19 February 2014 and 10 April 2014, while this inquiry was underway ASIC gave evidence at three estimates hearings held by the Economics Legislation Committee (20 November 2013, 26 February 2014 and 4 June 2014). Members of this committee questioned ASIC's chairman, commissioners and other officers at those hearings and this evidence has been taken into account for this report.

Background to the inquiry

1.7 Throughout 2012 and 2013, media reports raised serious concerns about the practices of financial advisers in Commonwealth Financial Planning Limited (CFPL), part of the Commonwealth Bank of Australia Group. ASIC was also issuing notifications regarding actions it had taken on this matter. On 4 June 2013, the Economics Legislation Committee questioned ASIC about the CFPL matter and was clearly dissatisfied with ASIC's response. Within weeks, the Senate referred the inquiry on ASIC's performance to this committee.

1.8 The emerging revelations about the misconduct of financial advisers in CFPL and ASIC's failure to provide satisfactory answers in relation to this matter to the Economics Legislation Committee was the main catalyst for the inquiry. But it was not the only driver. A number of previous inquiries and other information in the public domain had exposed serious shortcomings in corporate conduct in Australia and ASIC's response to them. Thus, the committee's terms of reference reflect this broader context and, indeed, the submissions traverse a wide range of concerns about ASIC's performance.

Submissions

1.9 The majority of the submissions came from individuals or groups of concerned investors or consumers who wanted to draw the committee's attention to their specific grievance. Often their case involved allegations of corporate misconduct that had resulted in significant personal financial loss and sometimes financial ruin.

Individual grievances

1.10 Unfortunately, the committee was not able to investigate every individual matter that was raised in submissions. Clearly from the contents of some submissions, people had expectations that the committee could in some way assist them to resolve their difficulties. This was not the committee's role. The committee, however, gave great weight to their accounts and experiences; this evidence helped inform the committee's deliberations and assisted the committee in formulating recommendations.

Confidential material

1.11 The committee prefers to take evidence in public. With this inquiry, however, a number of submitters requested the committee to receive their submission in confidence or to withhold the publication of their names. Even with the protection of parliamentary privilege, some submitters were not willing to place their criticisms of ASIC on the public record because ASIC makes decisions that may affect their business. Also, in some cases, and without the submitters' request, the committee itself resolved to receive submissions in camera or to withhold sections from publication. Such decisions were based on a variety of reasons including:

- the matter was still under investigation or consideration by a court or tribunal;
- concern over publicising a person's private circumstances; and
- reluctance to allow a person to be publicly traduced or embarrassed where their involvement in an alleged offence appeared to be incidental or not relevant to the committee's inquiry.

1.12 The committee also declined to receive several submissions or sections of submissions. The overriding reason in most instances stemmed from the submissions' failure to address the committee's terms of reference. Some submitters were clearly disappointed with the committee's decision either to not receive their submission or to remove names or sections of their submission before publication. Where such information was deemed to be irrelevant to the committee's inquiry, however, it could not be accepted as evidence.

1.13 Where the committee did include evidence received on an in camera basis in this report, it was careful to ensure that such information was used to support information that was already publicly available or where it had sought verification from other sources.

ASIC's submissions

1.14 ASIC provided the committee with nine submissions in total. Three submissions addressed the CFPL matter (*Submissions 45, 45.3 and 45.6*). ASIC's first supplementary submission (*Submission 45.1*) related to reforms to the credit industry and low doc loans, and was provided in response to the significant number of submissions the committee received on these topics. In October 2013, ASIC provided

its second supplementary submission: a 196 page document that addressed all of the inquiry's terms of reference (*Submission 45.2*). ASIC and the committee have referred to this submission as ASIC's 'main submission'. The remaining submissions from ASIC dealt with particular issues or cases and were provided in response to evidence the committee received, lines of questioning or developments that occurred as the inquiry was underway. For example, in May 2014 ASIC provided *Submission 45.7* on a proposed alternative model for funding ASIC.

Scope and structure of the report

1.15 During this inquiry the committee has studied some enforcement actions or allegations of misconduct in detail. These cases have assisted the committee to consider the broad questions that the Senate has asked it to focus on (that is, the specific clauses of the inquiry's terms of reference). One example is the CFPL matter, which provided the committee with key insights into ASIC's approach to misconduct and enforcement action but also informed the committee's analysis of Australia's corporate whistleblower protections.

1.16 Many different and varied issues were raised during the course of the inquiry. Nevertheless, some common themes emerged that linked these disparate matters. This report is divided into the following five parts:

- **Part I (Introduction):** This part outlines recent developments and growth in Australia's financial services industry to provide some context about the environment in which ASIC operates (Chapter 2). It then describes ASIC's current role and functions (Chapter 3) and its approach to regulation (Chapter 4).
- **Part II (Case studies):** In this part, the committee examines two case studies where retail investors or financial consumers found themselves in dire financial difficulties because of bad financial advice and unethical and irresponsible practices. The first relates to consumer credit and poor lending practices between 2002 and 2010. The second case study relates to the CFPL matter. The chapters included in this part examine:
 - the lending practices between 2002 and 2010 based on the experiences of over 160 people who made submissions to the inquiry, and ASIC's response to these practices (Chapter 5);
 - the effectiveness of Australia's new credit laws in redressing some of the problems identified during this period (Chapter 6);
 - the two external dispute resolutions schemes approved by ASIC for financial services and credit—the Financial Ombudsman Service and the Credit Ombudsman Service (Chapter 7);
 - what went wrong at CFPL and why, including how an aggressive sales-based culture fostered an environment where advisers were able to circumvent compliance requirements and take advantage of investors (Chapter 8);

- ASIC's investigation of misconduct at CFPL, and its handling of information from CFPL whistleblowers and other sources regarding that misconduct (Chapter 9);
- the adequacy and efficacy of ASIC's enforcement actions relating to the CFPL matter, and the integrity of the arrangements put in place to compensate CFPL clients (Chapters 10, 11 and 12);
- the internal compliance regimes of Australian companies, using the Commonwealth Bank and Macquarie Bank as recent examples where ASIC raised serious concerns about a culture of non-compliance (Chapter 13).
- **Part III (Investigations and enforcement):** This part examines ASIC's investigative and enforcement function. The chapters in this part of the report cover:
 - Australia's corporate whistleblowing framework, and how that framework might be improved (Chapter 14);
 - ASIC's procedures for receiving complaints and reports of corporate wrongdoing including the processes for the preliminary assessment and investigation of such reports (Chapter 15);
 - factors influencing ASIC's responsiveness to complaints and reports of corporate wrongdoing (Chapter 16);
 - ASIC's approach to enforcement and factors that may influence the remedy it decides to pursue (Chapter 17);
 - ASIC's handling of enforcement matters (Chapter 18).
- **Part IV (Communication and engagement):** In this part of the report, the committee analyses ASIC's engagement and communication with professional bodies in the financial services industry and with retail investors and consumers. It also examines community expectations about ASIC's role, financial literacy and the way the regulator communicates with concerned industry bodies and members of the public. The chapters in this part address:
 - ASIC's relationship with key industry stakeholders (Chapter 19);
 - community expectations of the extent to which ASIC can protect investors and consumers from corporate collapses, substandard financial advice and unsafe financial products and, in this context, the current licensing tests and the importance of financial literacy and education (Chapter 20);
 - ASIC's relationship and communication with people seeking assistance from the regulator (Chapter 21); and
 - how ASIC provides services and publishes information (Chapter 22).
- **Part V (Directions for the future):** The final part of the report evaluates options for enhancing ASIC's ability to fulfil its obligations. It examines possible ways to encourage better enforcement outcomes (Chapter 23) and

options to address concerns about the quality of financial advice given to consumers and improve the professional standing of the financial advice industry (Chapter 24). It also scrutinises ASIC's resources, governance structure and capacity to meet the challenges presented by a dynamic industry where new business models and financial products are constantly emerging (Chapters 25 and 26). This final part of the report will also consider areas that may need to be reformed or where significant legislative changes may be required (Chapter 27) and contains the committee's final conclusions and observations about ASIC (Chapter 28).

Acknowledgements

1.17 During the course of the inquiry, the committee has benefitted greatly from the participation of many individuals and organisations located throughout Australia. The committee thanks all those who assisted with the inquiry, especially the witnesses who put in extra time and effort to answer written questions on notice and provide valuable feedback to the committee as it gathered evidence. ASIC in particular was of great assistance in providing the committee with information that it requested.

1.18 But most particularly, the committee acknowledges the many people who wrote to the committee recalling their experiences. They range from whistleblowers, who placed their careers in jeopardy in order to expose corporate wrongdoing, to individuals who, through no fault of their own, found themselves in dire financial circumstances. Without their personal accounts, the committee would not have been able to appreciate fully the need for stronger action to ensure that Australia's financial services regulatory framework is robust and focused on protecting the retail investor and consumer from unscrupulous operators.

Chapter 2

ASIC's role in context

2.1 Australia's population of 23.2 million¹ represents only around 0.03 per cent of the world's estimated population of 7.1 billion people. Despite this, Australia is the world's 12th largest economy.² The Australian Securities Exchange (ASX) has a total market capitalisation of around \$1.5 trillion.³ In 2012–13, the total annual turnover on Australia's financial markets was \$135 trillion.⁴ The superannuation system now represents the fourth largest pool of superannuation savings in the world; as at December 2013, Australia's superannuation assets were estimated to total \$1.8 trillion.⁵

2.2 ASIC's role and its performance needs to be considered in the context of the growing importance of Australia's financial sector. This chapter outlines some key developments and likely future directions for the sector. The remainder of this chapter is principally based on research undertaken for the committee by the Parliamentary Library. The committee is grateful to the Library for this assistance.

Relative size and growth of the financial services industry

2.3 The financial services industry as a share of the Australian economy has grown significantly since the introduction of the superannuation guarantee in 1992, rising from around six per cent to eight per cent by 2012 (Figure 2.1). However, this growth was preceded by growth in the industry from around the mid-1980s in response to a range of deregulation measures including the floating of the Australian dollar, the entry of foreign banks, removal of controls on bank deposits and the introduction of dividend imputation.⁶

1 Estimated resident population as at 30 September 2013. ABS, cat. 3101.0.

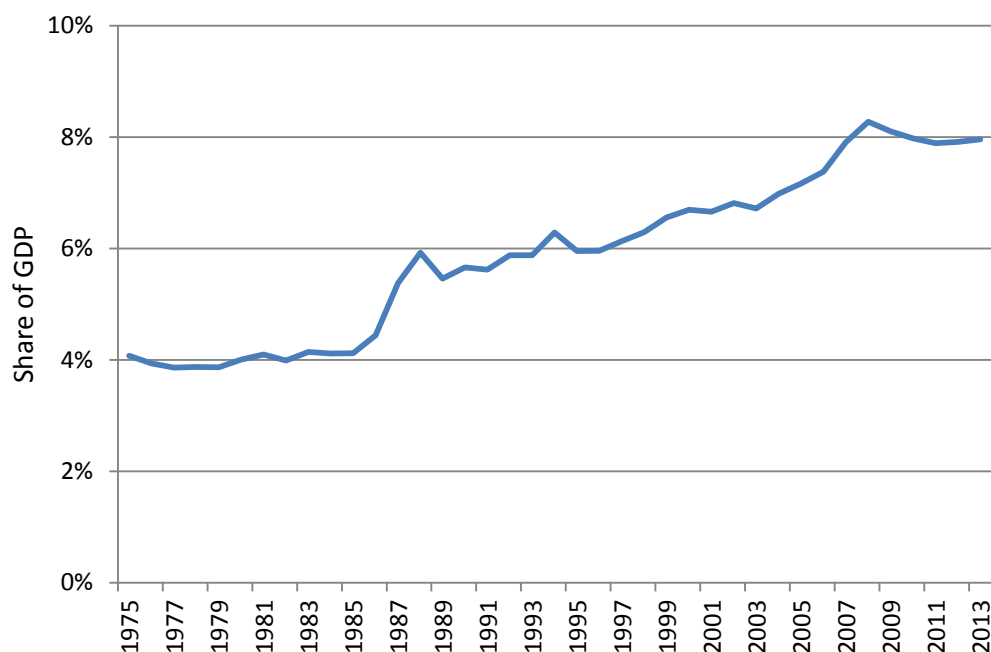
2 Based on 2012 gross domestic product. See <http://data.worldbank.org/data-catalog/GDP-ranking-table>.

3 ASX, 'Corporate Overview', www.asx.com.au/about/corporate-overview.htm (accessed 13 May 2014).

4 Australian Financial Markets Association, *2013 Australian Financial Markets Report*, p. 2.

5 APRA, Statistics: Quarterly Superannuation Performance, December 2013 (issued 20 February 2014).

6 Diana Beal, 'Overview of financial services post-deregulation', www.reconciliation.org.au/getfile?id=81&file=diana_beal.doc (accessed 2 May 2014).

Figure 2.1: Financial services industry as a share of the economy (1975 to 2012)

Source: Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product, cat. 5206.0, Table 33, December 2013 and March 2014.

2.4 Contributing to this growth has been the expansion of the global presence of Australia's financial services industry and a rise in services exports from the industry. Although Australian financial services businesses are concentrated in the Asia Pacific region, they also have a presence in Europe and the Americas (Figure 2.2).

Figure 2.2: Australian financial services global footprint, 2009

| | <i>Asia Pacific</i> | <i>Europe</i> | <i>Americas</i> | <i>Africa and Middle East</i> |
|---------------------------|--|--|-----------------------------|-------------------------------|
| Banking | China, Fiji, Hong Kong, India, Indonesia, Japan, NZ, Singapore, Vietnam | Malta, UK | Canada, Cayman Islands, USA | |
| Funds management | Fiji, Hong Kong, Japan, Korea, Malaysia, NZ, Singapore, Taiwan, Thailand | Germany, Ireland, Luxembourg, Netherlands, Switzerland, UK | Canada, USA, Brazil | Oman, UAE, South Africa |
| Financial planning | Hong Kong, Singapore, Thailand | | | |
| Insurance | China, Fiji, Indonesia, NZ, Samoa | | | |
| Investment administration | China, Hong Kong, Malaysia, NZ, Singapore, Taiwan | France | Canada, USA, Brazil | |

| | | | | |
|------------------|--|----------------------|-------------|--------------|
| Mortgage broking | China, NZ | | USA | |
| Stock brokering | Hong Kong, Indonesia, Japan, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand | Germany, Switzerland | Canada, USA | South Africa |

Source: Innovation & Business Skills Australia, *Environment Scan 2013: Financial Services Industry*, p. 13 (accessed 8 May 2014).

Expansion in retail investors

2.5 Government privatisations during the 1990s (including the Commonwealth Bank of Australia (CBA), Telstra, various state banks and Qantas) and demutualisation of a number of financial services providers and other entities (AMP, National Mutual and the NRMA) provided opportunities for household investors to participate in the ownership of equities.⁷

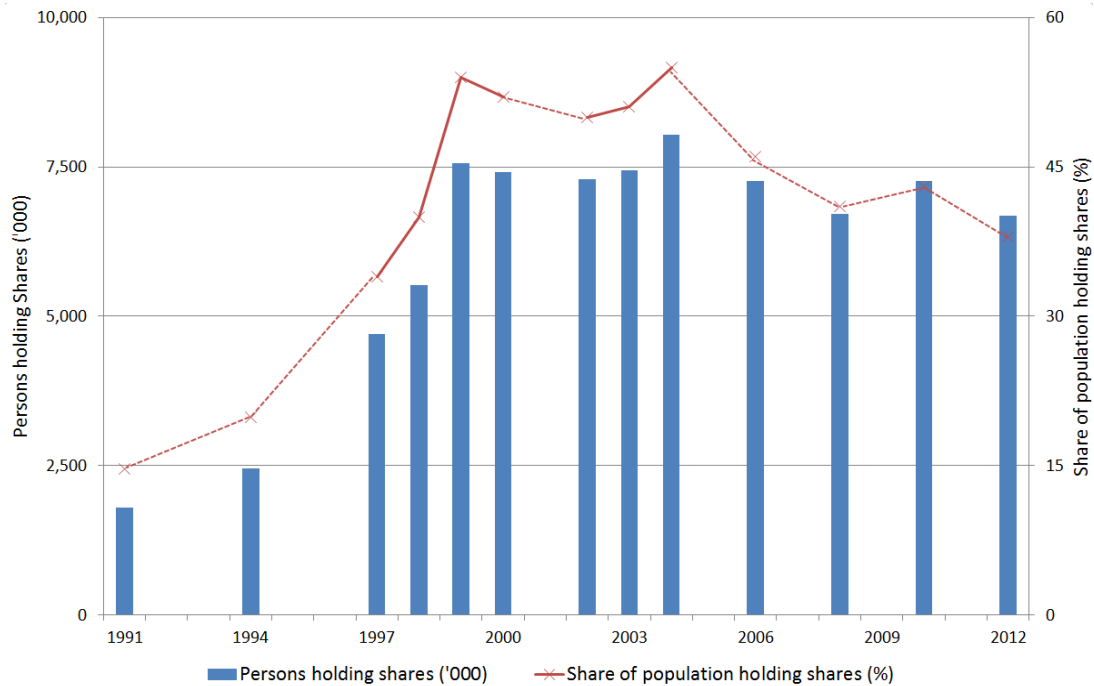
2.6 Regular surveys of share ownership in Australia by the ASX since 1991 show the considerable growth in the number and proportion of people investing directly and indirectly (via superannuation for example) in shares. In 1991, only 1.8 million (15 per cent) of Australian adults directly or indirectly held shares (Figure 2.3). By 2012, 6.7 million (38 per cent) of Australian adults directly or indirectly held shares. While there has been some decline in share ownership since the peak of 2004—this has been attributed to the repayment of debt, the exit of 'passive' investors and a shift to property investment⁸—the level of share ownership in Australia remains high compared to other developed countries.⁹

7 Demutualisations and privatisations in the 1990s were summarised in: Reserve Bank of Australia, 'Demutualisation in Australia', *RBA Bulletin*, January 1999, www.rba.gov.au/publications/bulletin/1999/jan/pdf/bu-0199-1.pdf (accessed 30 April 2014).

8 ASX, *2006 Australian Share Ownership Study*, 2007, www.asx.com.au (accessed 1 May 2014), p. 7.

9 ASX, *2012 Australian Share Ownership Study*, May 2013, www.asx.com.au (accessed 1 May 2014), p. 29.

Figure 2.3: Share ownership in Australia, 1991 to 2012

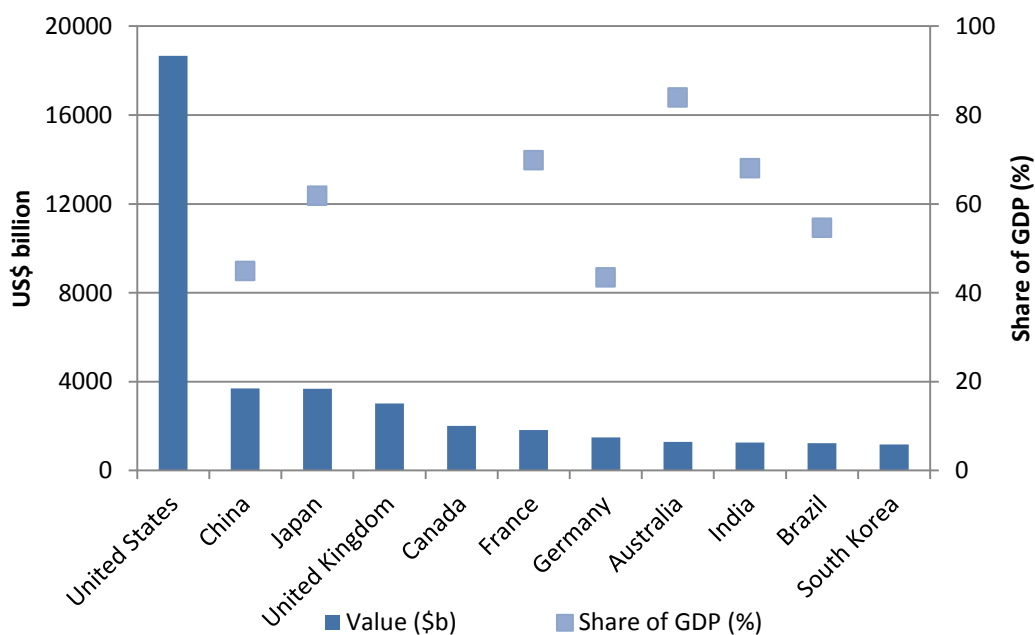


Source: ASX, 2012 Australian Share Ownership Study, May 2013, www.asx.com.au (accessed 1 May 2014) and previous issues.

Overall significance of Australia's capital markets

2.7 Capital markets comprise a range of financial products including loans, equities, bonds and other financial instruments. In 2012, Australia had the eighth highest equity market capitalisation of global equity markets by value (Figure 2.4).

Figure 2.4: Market capitalisation of equity markets, 2012 (\$US billion)

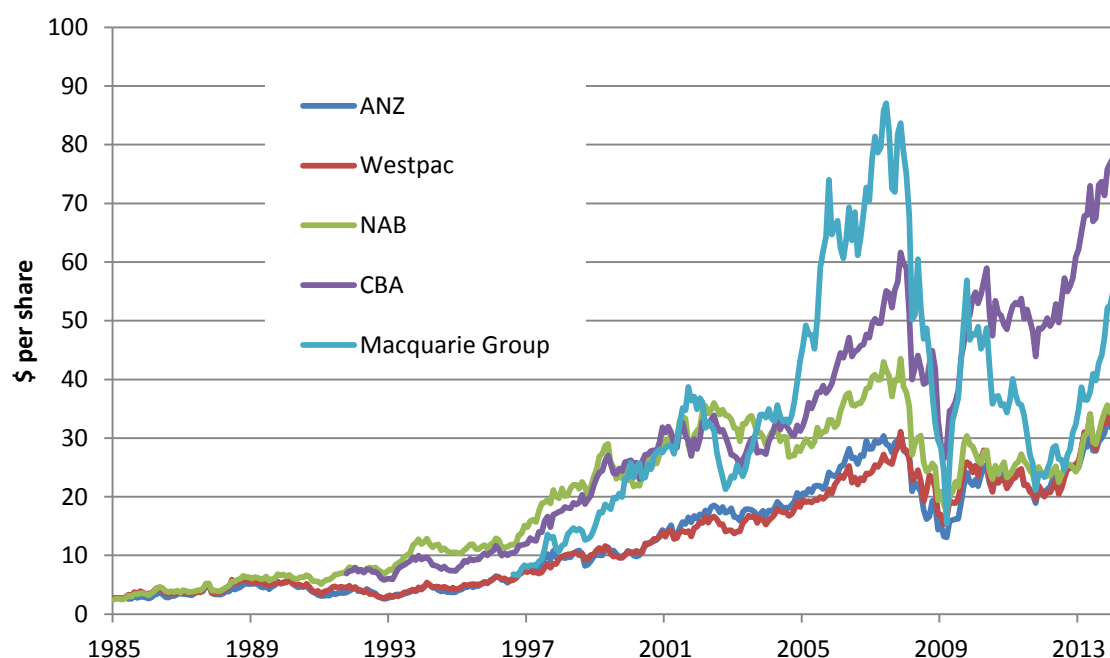


Source: The World Bank, World Development Indicators 2014, 9 April 2014.

Overall significance of large financial sector firms to the Australian economy

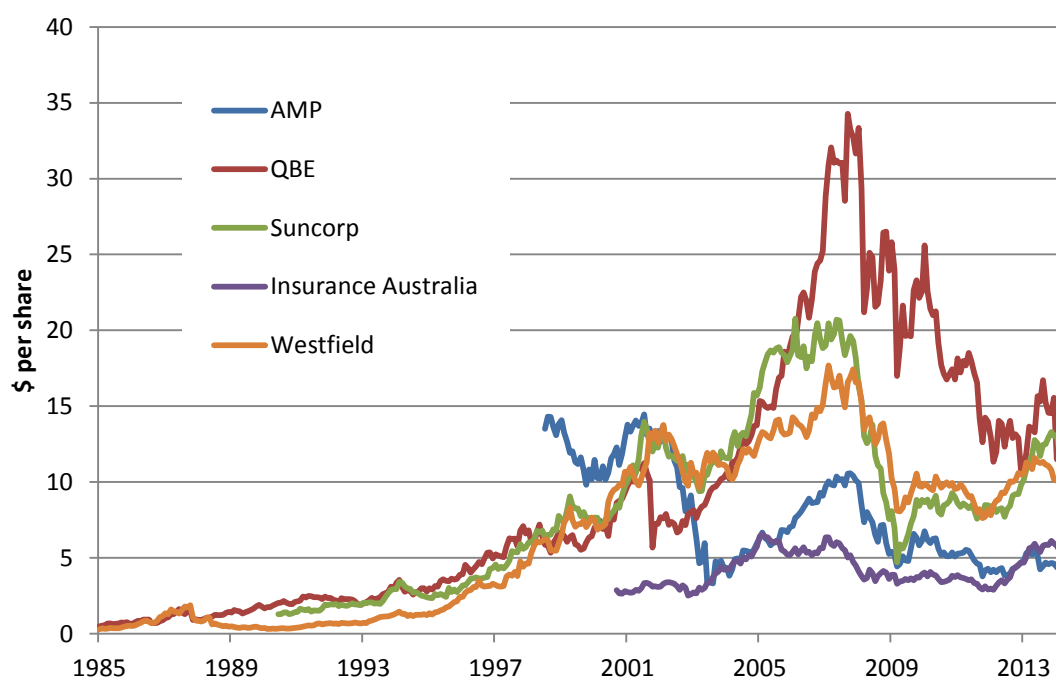
2.8 Of the top 20 companies by market capitalisation listed on the ASX, half are classified as being in the 'financials' sector. These include companies such as the big four banks (CBA, NAB, Westpac and ANZ) and insurance providers AMP, QBE, Suncorp and Insurance Australia. Fund managers Macquarie Group and Westfield were also part of the sector.¹⁰ At the end of April 2014, these ten companies accounted for around one-third of total ASX market capitalisation.¹¹ For these ten companies, share prices are generally still below peaks experienced prior to the global financial crisis. However, most shareholders of these companies have enjoyed significant increases in share prices in recent years and over the long term (Figure 2.5).

Figure 2.5: Share price trends, financials sector companies in the top 20 ASX listed companies by market capitalisation, 1985 to 2014 (as at April 2014)



10 As at May 2014. The composition of the S&P 20 index is revised regularly and as a result companies can move in and out of the index over time.

11 ASX 200, www.asx200list.com (accessed 8 May 2014).



Source: Datastream.

Indications of where Australia's financial sector is headed

2.9 The superannuation industry will continue to benefit from growing superannuation contributions. The gradual increase in the superannuation guarantee from nine per cent to 12 per cent by 2019–20 and strong positive cashflows into superannuation funds will see net superannuation contributions (contributions less payments) result in significant additional funds flowing into the financial system. One projection has total assets in superannuation funds rising to more than \$7.6 trillion by 2033.¹²

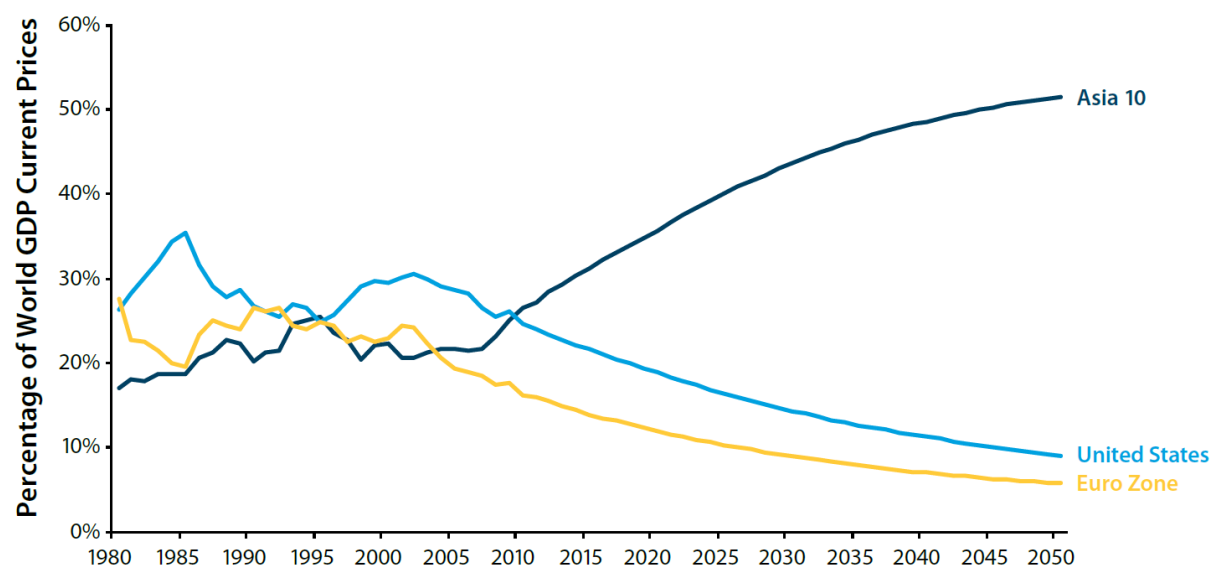
2.10 This growth in superannuation funds should provide a solid cornerstone for the growth in the financial services industry generally, with a substantial portion of these funds to be invested in Australian equities and providing liquidity in cash deposits with banks. A growing skilled labour force of advisers, accountants and information technology providers will also be required to invest these additional funds efficiently.

2.11 The health of the financial sector in Australia is heavily dependent on general economic and financial market conditions. With strong domestic economic growth compared to much of the developed world and the growing pool of superannuation funds, there appears to be no shortage of available domestic capital and business opportunities to grow the sector.

12 Deloitte, *Dynamics of the Australian Superannuation System—The next 20 years: 2013 – 2033*, September 2013, www.deloitte.com (accessed 4 June 2014), p. 7.

2.12 There will also be a significant rebalancing of the world economy in the next 40 years, with around half of global economic production expected to take place in Asia by 2050 (Figure 2.6). While Australia's traditional merchandise export destinations still account for most of Australia's exports of financial services, the presence of Australia's financial services companies in the fast growing Asian region will support future export opportunities for the industry.

Figure 2.6: Projected share of world GDP, by specific regions, 1980 to 2050



Source: ANZ Research, 'Caged Tiger: The transformation of the Asian Financial System', *ANZ Insight*, Issue 5, March 2014, www.media.anz.com/phoenix.zhtml?c=248677&p=irol-insight (accessed 8 May 2014). Based on CEIC and ANZ projections.

2.13 To position Australia to benefit from this change, successive governments have pursued an interest in developing Australia into a regional financial services hub. The current government's Financial System Inquiry is another opportunity to look again at how Australia's financial services industry can better interact with international capital markets and benefit from economic growth in our region. That superannuation will be a key consideration of the inquiry is clear: one estimate presented to the inquiry was that in 40 years, funds controlled by superannuation will exceed that of the banking industry.¹³ Some issues raised in submissions to that inquiry have included how to better link superannuation to the economy, the need to support technological innovation and consumer protection requirements.¹⁴

13 Rodney Maddock, 'Superannuation asset allocations and growth projections', Paper prepared for the Financial Services Council, 17 February 2014, www.fsc.org.au/downloads/uploaded/2014_0226_140226-FSC_Maddock-Capital Flows Report FINAL_2d88.pdf (accessed 11 May 2014), p. 25.

14 See, for example, submissions made to the Financial System Inquiry by the Australian Bankers' Association, Association of Superannuation Funds of Australia and the Financial Services Council: www.fsi.gov.au.

Committee comment

2.14 This inquiry has necessarily required the committee to review ASIC's past performance, however, the committee has also been mindful of the likely future directions of Australia's financial system and their implications for ASIC's role.

2.15 The size and growth of Australia's financial sector and the fact that millions of Australians are involved in it, not least because of compulsory superannuation, makes it essential that modern and adaptable regulations are in place and regulators such as ASIC are at the top of their game. Although Australia's experience during the global financial crisis demonstrated that the regulation of Australia's financial system is fundamentally sound, there cannot be complacency about the effectiveness of the regulations in place and the performance of the regulators charged with administering them. As a key financial regulator, ASIC's role and performance should be of interest to all Australians.

Chapter 3

Overview of ASIC

3.1 This chapter aims to acquaint readers with the Australian Securities and Investments Commission (ASIC). ASIC is the corporate, markets, financial services and consumer credit regulator. It has existed as an independent Australian government statutory authority¹ since 1991, when the Australian Securities Commission, as it was then known, commenced operation.²

3.2 ASIC has general administration of the *Corporations Act 2001*, the principal legislation governing the affairs of companies in Australia. ASIC oversees company registration and notifications, and is tasked with seeking to ensure that companies, schemes, directors, company officers, auditors, insolvency practitioners and other market participants fulfil their legal obligations. ASIC licenses providers of financial services. It also licenses and regulates individuals and businesses that engage in consumer credit activities. In addition, ASIC's market regulation role makes it responsible for supervising financial market operators and participants, including real-time trading on Australia's domestic licensed markets.

3.3 These responsibilities mean that ASIC's work involves over two million companies, 5,000 Australian financial services (AFS) licensees, 5,800 credit providers, 4,800 registered company auditors, 680 registered liquidators, 4,150 registered managed investment schemes and 18 authorised financial markets.³ Illustrating its broad remit, ASIC provided an overview of its activities and outcomes achieved. In the last three years to October 2013, ASIC:

- completed over 4,000 surveillances and 554 investigations with a broad range of regulatory outcomes;
- banned 131 individuals from providing financial services or credit services and 228 directors from managing a corporation;
- completed 73 civil and 79 criminal proceedings;
- entered into 56 enforceable undertakings with entities, as well as numerous other negotiated outcomes;
- cancelled, suspended or varied 72 AFS licences and credit licences;

1 That is, an Australian government body established by legislation and empowered to perform its key functions independently of the government.

2 The Australian Securities Commission was renamed ASIC on 1 July 1998 when it became responsible for consumer protection in the areas of superannuation, insurance and deposit taking. The Australian Securities Commission's predecessor was the National Companies and Securities Commission (with functions also performed by state and territory agencies).

3 ASIC, *Annual Report 2012–13*, pp. 152.

- obtained over \$349 million in compensation for consumers;
- handled over two million telephone and 200,000 email queries;
- participated in over 1,500 stakeholder meetings;
- launched the MoneySmart consumer education website;
- implemented the new national business names register;
- granted relief (waivers) from the law to over 3,000 applicants to facilitate their business transactions; and
- handled nearly 40,000 complaints about misconduct.⁴

ASIC's statutory objectives and functions

3.4 ASIC has functions under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the Corporations Act and other legislation.⁵ The ASIC Act requires that, in performing its functions and exercising its powers, ASIC must strive to:

- maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy;
- promote the confident and informed participation of investors and consumers in the financial system;
- administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements;
- receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it;
- ensure that information is available as soon as practicable for access by the public; and
- take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.⁶

3.5 In its main submission to the committee, ASIC provided the following overview of how it sees its role:

4 ASIC, *Submission 45.2*, p. 9; and ASIC, correspondence dated 23 December 2013, p. 1.

5 Namely, the *Business Names Registration Act 2011*, *Business Names Registration (Transitional and Consequential Provisions) Act 2011*, *Insurance Contracts Act 1984*, *Superannuation (Resolution of Complaints) Act 1993*, *Superannuation Industry (Supervision) Act 1993*, *Retirement Savings Accounts Act 1997*, *Life Insurance Act 1995*, *National Consumer Credit Protection Act 2009* and the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003*.

6 *Australian Securities and Investments Commission Act 2001*, s. 1(2).

[ASIC] has a growing regulatory remit and operates in a global environment that is both complex and dynamic.

The forces of market-based financing, financial innovation-driven complexity and globalisation that are converging on our financial system create opportunities to fund economic growth; however, they also create risks.

Our challenge as a regulator is to respond quickly to the matters that require our attention, inform and educate investors and financial consumers so they can make confident and informed decisions, and ensure we have the capacity to effectively regulate financial markets, financial products and financial services providers, within the resources we have.⁷

3.6 When it was established in 1991, the main stated purpose of the Australian Securities Commission, as ASIC was then known, was 'to regulate companies and the securities and futures industries in Australia'.⁸ ASIC's responsibilities have increased since then following various reforms pursued by successive governments, including as a result of intergovernmental agreements that resulted in the Commonwealth taking over certain responsibilities from the states and territories. In particular, ASIC gained significant new responsibilities between 2009 and 2012. However, as indicated by the following observation made in 2004 by ASIC's then acting chairman, ASIC has been required to operate in an environment of reform and change for a sustained period:

The background to all of these activities of ours is one of constant and continuous change. You have seen that the evolution of financial and corporate regulation in Australia over the last decade has been rapid and dramatic. Reform—legislative, common law, self-regulatory, industry-driven—seems to have been constant and will certainly not stop or really even pause in 2004. But that reform has been necessary, simply to try and keep pace (if indeed it has done that), with the growth and evolution of the markets in Australia that rely on effective regulation.⁹

3.7 A timeline of key legislative reforms and other developments that are relevant to ASIC's responsibilities is at Appendix 4.

Powers available to ASIC

3.8 ASIC has the ability to register companies, businesses and managed investment schemes; grant AFS licences and Australian credit licences; register auditors, self-managed superannuation fund (SMSF) auditors and liquidators; grant relief from various legislative requirements; make rules aimed at ensuring the integrity

7 ASIC, *Submission 45.2*, p. 6.

8 Explanatory Memorandum, Australian Securities Commission Bill 1988, p. 2.

9 Jeffrey Lucy AM, Acting Chairman, ASIC, Address to the Institute of Chartered Accountants in Australia Queensland 2004 CA Business Forum, Sanctuary Cove, Queensland, 13 March 2004, [www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ICAA_speech_130304.pdf/\\$file/ICAA_speech_130304.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ICAA_speech_130304.pdf/$file/ICAA_speech_130304.pdf) (accessed 5 September 2013), p. 2.

of financial markets; order the winding up of a company in certain circumstances; and impose a stop order if a product disclosure statement is defective. To assist it to carry out its functions, ASIC has been granted a variety of investigative and enforcement tools under the ASIC Act and the Corporations Act. These include the power to:

- conduct investigations into suspected contraventions of the ASIC Act and the Corporations Act (s. 13 of the ASIC Act);
- obtain a search warrant to investigate criminal offences (s. 3E of the *Crimes Act 1914*, pursuant to the general investigative power in s. 13 of the ASIC Act);¹⁰
- require persons to appear and answer questions under oath, and to give all reasonable assistance with an investigation (s. 19 of the ASIC Act);
- conduct hearings related to the performance or exercise of ASIC's functions or powers, including the power to summon witnesses to give evidence and produce documents (ss. 51 and 58 of the ASIC Act);¹¹
- access telecommunications records (part 4-1 of the *Telecommunications (Interception and Access) Act 1979*) and make an application for a stored communications warrant (s. 110 of the *Telecommunications (Interception and Access) Act 1979*);
- inspect the books of a corporation (s. 29 of the ASIC Act), require the production of books relating to financial products, futures contracts and financial services (ss. 31, 32 and 32A of the ASIC Act); require the production by any person of books relating to the affairs of corporations and other regulated entities (s. 33 of the ASIC Act); and apply for a warrant to seize books not produced (ss. 35 and 36 of the ASIC Act);
- require a person to identify property of a corporation and explain how the corporation has kept account of that property (s. 39 of the ASIC Act);
- require a financial services business operator to disclose particulars relating to the acquisition or disposal of financial products (s. 41 of the ASIC Act) and require an officer of a corporation to disclose information relating to dealings with financial products (s. 43 of the ASIC Act);
- make orders in relation to securities, for example restraining persons from disposing or acquiring interests or exercising voting rights (ss. 72 and 73 of the ASIC Act);
- prosecute alleged offences against the corporations legislation¹² (s. 49 of the ASIC Act);

10 ASIC, *ASIC's compulsory information-gathering powers*, Information Sheet 145, September 2011, p. 6.

11 During the hearing ASIC must observe the rules of natural justice. *Australian Securities and Investments Commission Act 2001*, s. 59(2)(c).

-
- institute civil proceedings for the recovery of damages or property (s. 50 of the ASIC Act);
 - order that a person pay the expenses of an investigation that led to conviction or declaration of contravention (s. 91 of the ASIC Act);
 - apply to the court for enforcement of an undertaking given to ASIC (ss. 93A and 93AA of the ASIC Act);
 - disqualify a person from managing corporations for up to five years in defined circumstances (s. 206F of the Corporations Act);
 - apply for the enforcement of a licensed market's operating rules (s. 793C of the Corporations Act);
 - apply for orders freezing assets, appointing receivers, requiring the surrender of passports to the court and prohibiting a person from leaving Australia (s. 1323 of the Corporations Act);
 - apply for an injunction regarding contraventions or proposed contraventions of the Corporations Act (s. 1324 of the Corporations Act);
 - issue an infringement notice for alleged breaches of the provisions of the Australian Consumer Law that relate to financial products and services (s. 12GXA of the ASIC Act) or the continuous disclosure provisions (s. 1317DAC of the Corporations Act);
 - issue a notice requiring claims made regarding financial services to be substantiated (s. 12GY of the ASIC Act).

Governance and organisational structure

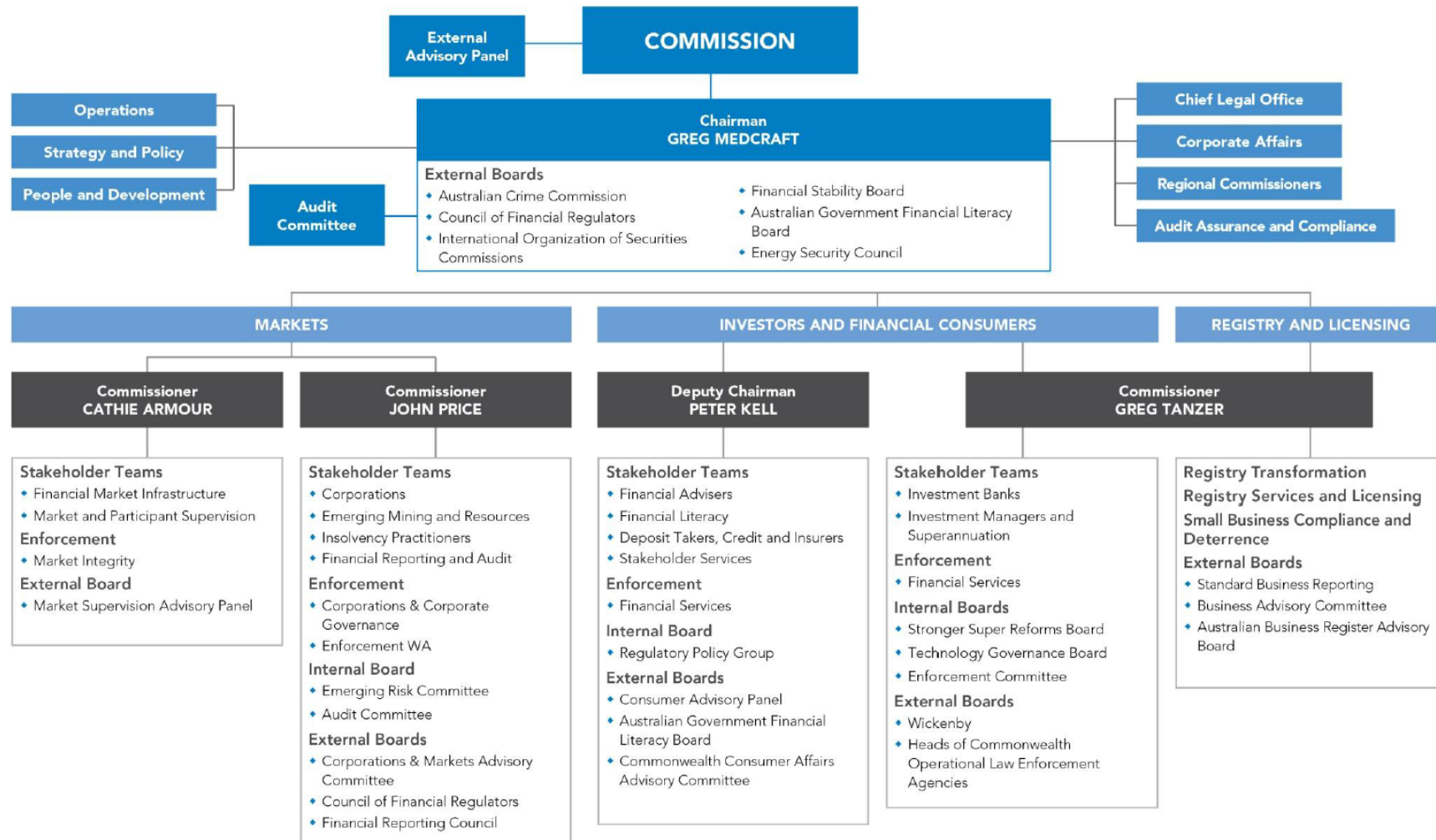
3.9 ASIC is established under the ASIC Act. It comprises a chairperson, a deputy chairperson and between one and six other members (the commission).¹³ ASIC's governance structure is considered in more detail in Chapter 26.

3.10 ASIC's overall organisational structure separates its operations into three broad 'clusters': markets; investors and financial consumers; and registry and licensing. Within these broad operations areas are multiple stakeholder and enforcement teams. ASIC's organisational structure is depicted at Figure 3.1.

12 The corporations legislation consists of the Corporations Act, the ASIC Act and rules of court made or applied by specified courts, such as the Federal Court and state supreme courts. See *Corporations Act 2001*, s. 9.

13 Members of the commission are appointed by the Governor-General acting on the advice of the minister. The Commonwealth is also required to consult the Legislative and Governance Forum for Corporations (a council of COAG previously known as the Ministerial Council on Corporations) on the making of appointments to the commission. See Corporations Agreement 2002, as amended, 16 November 2005, subclause 601(1).

Figure 3.1: ASIC's corporate structure (as at October 2013)



Source: ASIC, *Submission 45.2*, p. 15.

ASIC's resources

3.11 In 2012–13, ASIC received \$350 million in appropriation revenue and \$17 million from other sources. Its operating expenses were approximately \$411 million. ASIC employed 1,844 staff on a full-time equivalent (FTE) basis.¹⁴

3.12 At times, ASIC has been granted additional funding through the Budget process either as a result of new responsibilities it has been given or to supplement its operations. Some recent examples are listed below:

- The 2013–14 Budget included around \$10 million over the forward estimates in additional funding for ASIC's client contact centre (as a result of the national business names registration system); over-the-counter derivatives market supervision; the Superannuation Complaints Tribunal (SCT); and the tax agent licensing regime for financial advisers.¹⁵
- In the 2012–13 *Mid-Year Economic and Fiscal Outlook* (MYEFO), it was announced that ASIC would receive additional operating funding of \$20 million over two years to support its regulation and supervision of financial markets. An additional \$2.1 million relating to the administration of transferring unclaimed monies to ASIC was also announced.¹⁶
- In the 2012–13 Budget, an additional \$101.9 million over four years for ASIC's operational funding was announced. Also allocated was \$23.9 million to facilitate the implementation of the Future of Financial Advice (FOFA) reforms and \$43.7 million over four years to enhance ASIC's market surveillance system.¹⁷
- ASIC received an additional \$4.6 million over four years 'for licensing, compliance and deterrence activities in relation to [AFS] license holders dealing in carbon permits' in the 2011–12 MYEFO.¹⁸
- In the 2011–12 Budget, ASIC received \$28.8 million to supplement its operating activities.¹⁹
- In the 2010–11 Budget, an extra \$29.1 million was provided for the national business names register. An additional \$5.9 million over four years was also provided for the SCT.²⁰

14 ASIC, *Annual Report 2012–13*, p. 19.

15 Australian Government, *Portfolio Budget Statement: Treasury Portfolio*, 2013–14 Budget, p. 156.

16 Australian Government, *2012–13 Mid-Year Economic and Fiscal Outlook*, pp. 276–77.

17 Australian Government, *2012–13 Budget: Budget Paper No. 2*, pp. 277–78.

18 Australian Government, *2011–12 Mid-Year Economic and Fiscal Outlook*, pp. 287–88.

19 Australian Government, *2011–12 Budget: Budget Paper No. 2*, p. 318.

20 Australian Government, *2010–11 Budget: Budget Paper No. 2*, pp. 276 and 299.

3.13 However, ASIC has also been subject to the efficiency dividend applied to government departments and agencies.²¹ ASIC's funding over the forward estimates was also reduced as part of the most recent Budget. The amount of funding provided to ASIC and the funding model utilised to determine its funding clearly will have a significant impact on the agency's performance. These issues are examined in more detail in Chapter 25.

21 The efficiency dividend is an annual reduction in funding for Commonwealth departments and agencies that receive government appropriations. The efficiency dividend generally targets departmental appropriations rather than administered appropriations. Since the 2011–12 Budget, however, the efficiency dividend has been applied at the portfolio level rather than to each agency. N Horne, *The Commonwealth efficiency dividend: an overview*, Background Note, Australian Parliamentary Library, 13 December 2012, pp. 8–9, 38.

Chapter 4

Regulatory theories and their application to ASIC

4.1 The previous chapter outlined ASIC's extensive functions. However, all regulators face a multitude of challenges. They can be tasked with a long list of responsibilities that involve an enormous regulated population and a staggering amount of activity. The expectations about what the regulator is supposed to achieve may not be clear or they may not match the community's expectations. They may have a role as an arbitrator that works with entities to seek efficient outcomes, while also being required to investigate and prosecute entities for contraventions of the law. They can be criticised for being inflexible and burdening business when times are good, and criticised for not having acted when a crisis occurs.

4.2 Regulators need to make decisions about how to use their limited resources to address conflicting priorities. Many regulated entities will have significantly greater resources at their disposal than those available to the regulator. For many reasons a regulator may consider that it does not have all the powers necessary for it to perform its role, or that its powers have not kept pace with emerging developments. Many of the good outcomes they achieve are not made public or are not newsworthy. They can be criticised for losing cases while also being criticised for not pursuing certain matters.

4.3 Various theories of regulation consider the challenges that regulators in general face and propose techniques that regulators can adopt to carry out their functions. This chapter introduces and examines some of the sets of principles on which regulation can be based, such as response regulation and risk-based regulation.¹ The theories discussed are not mutually exclusive options; elements of each may be relied on by policymakers or by ASIC. Specific regulatory ideas that are relevant to the financial services sector are outlined at the end of the chapter.

Fundamentals of regulation

4.4 Regulation is generally considered in response to a market failure. The 1997 review of the financial system chaired by Mr Stan Wallis (the Wallis Inquiry) observed that regulation can be categorised into the following three broad purposes. These purposes, in order of decreasing frequency, are to:

- ensure that markets work efficiently and competitively—such regulation would promote adequate disclosure and target fraud, unfair practices and anti-competitive behaviour;
- prescribe particular standards or service quality, such as food standards; and

1 Other strategies such as self-regulation are not examined in this chapter, but are noted elsewhere in the report.

- achieve social objectives, such as community service obligations.²

4.5 The development and implementation of regulation that achieves its stated aims is a difficult challenge and one that is not limited to corporate or financial regulation. Professor Julia Black, a researcher at the London School of Economics who has written extensively on regulatory regimes, concluded that 'paradoxes abound' in regulation, with policymakers and regulators often achieving the opposite outcome to that intended:

This is so regardless of the regulatory techniques adopted. For example regulation to reduce risks can inadvertently lead to greater risks, for example safety regulation can create moral hazard, increasing risk-taking activity. Clean-ups can lead to greater environmental harm. Regulation to enhance disclosure can inhibit it. Warnings or bans on activities can produce the very conditions that they are designed to prevent: warnings about dangerous sports can make them more attractive to risk-seekers; conversely warnings that a particular bank is likely to fail can create a run on the bank, so precipitating its failure.³

4.6 Policymakers and regulators also have to consider the likely response of the regulated entities to any regulation imposed and the regulator that administers it. In this regard, a 2007 consultation paper on sanctions for breaches of corporate law identified two alternative views on the starting point of a regulatory regime: the 'deterrence' model and the 'accommodative' model. These models reflect the opposite ways in which the behaviour of individuals and corporations can be considered. Proponents of the deterrence model argue that individuals and corporations are motivated entirely by profit-seeking and will comply with rules only when confronted with suitably severe penalties. The accommodative model takes the view that the entities are 'ordinarily inclined to comply with the law, partly because of belief in the rule of law, and partly as a matter of long-term self-interest', and that as a result regulatory compliance is more likely to be achieved through persuasion and cooperation.⁴ However, the consultation paper observed that a regulatory system based solely on the deterrence or accommodative model 'is not desirable', as major disadvantages arise if one model is adopted exclusively:

It has been shown that a predominantly punitive policy fosters resistance to regulation and may produce a culture that facilitates the sharing of knowledge about methods of legal resistance and counter attack. It has been suggested that laws that promote a 'tick the box' approach to compliance may have the effect of weakening the ethical sinews of society by absolving participants of any responsibility for choosing to act in a manner that is right. An unintended consequence of a regulatory system designed to

2 Financial System Inquiry, *Final Report*, March 1997, pp. 177–78.

3 Julia Black, 'Paradoxes and Failures: "New Governance" Techniques and the Financial Crisis', *Modern Law Review* 75:6 (2012), p. 1039 (footnotes omitted).

4 Australian Government, *Review of Sanctions for Breaches of Corporate Law: Consultation Paper*, March 2007, pp. 4–5.

ensure that people cannot choose to do what is wrong is that they can no longer choose to do what is right. They no longer choose at all, they merely comply. Another concern is that if regulators adopt a purely punitive method of regulating, whereby they assume that individuals are solely self-interested and motivated by financial gain, this may be perceived as unreasonable and will dissipate the will of well-intentioned individuals to comply. In addition to the negative psychological effect of an undue focus on deterrence, punishment is often time consuming and expensive.

Adopting a purely accommodative model of regulation, which assumes all individuals are honest, would be naïve. This regulatory style fails to recognise that there are individuals who may not be honest and who will take advantage of being presumed to be so. There are a number of recent examples of conduct by corporate actors in Australia that confirm that some people will intentionally breach rules to secure an economic benefit.⁵

4.7 When considering regulation, it is clear that there is also a choice about the type of rules to enact. For example, regulation can be drafted starting from either a rules-based or a principles-based approach. Rules-based regulation is generally characterised by specific provisions and detailed rules, whereas principles-based regulation 'involves formulating rules which are broad, general and purposive and which may or may not be elaborated in further rules or guidance, for example, "you shall act with integrity" or "firms shall act in the best interests of their clients".⁶

4.8 In his evidence to the committee, Professor Justin O'Brien explained that the United States of America (US) has predominately taken a rules-based approach to financial regulation, while the United Kingdom (UK) has adopted a principles-based style. However, the choice between rules-based and principles-based regulation is generally not one at the expense of the other; for example, Professor Black noted that despite the UK's financial services regulations being designed using a principles-based approach, the rulebook of its regulator still comprises several thousand pages.⁷

4.9 Both rules-based and principles-based approaches also present challenges to the regulator. A rules-based approach can result in the rules being 'transacted around'.⁸ In addition, the managing director of the UK's Financial Conduct Authority has observed that historically, systems based on whether particular sets of rules were followed to the letter can create 'a cottage industry out of compliance' but 'did not

5 Australian Government, *Review of Sanctions for Breaches of Corporate Law: Consultation Paper*, March 2007, p. 5 (footnotes omitted).

6 Julia Black, 'Paradoxes and Failures', p. 1043.

7 Julia Black, 'Paradoxes and Failures', p. 1043.

8 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 54.

necessary lead to good outcomes'.⁹ A principles-based approach also presents challenges:

The problems with the principles based approach is sometimes they lack the granularity to be enforceable and as [Hector Sants at the Financial Services Authority] put it very succinctly, he firmly believed in the value of principles based regulation but it does not work with people with no principles...¹⁰

Responsive regulation

4.10 One regulatory theory that has contributed to corporate law in Australia is 'responsive regulation' (also known as 'strategic regulation theory').¹¹ This approach to regulation influenced the introduction in 1993 of the civil penalty regime for contraventions of the statutory duties of company directors and other officers.¹² The theory was articulated and expanded on by Ian Ayres and John Braithwaite.¹³ Responsive regulation 'recognises that it is not possible for any regulatory agency to detect and enforce every contravention of the law it administers and provides insights into how regulatory compliance can be achieved effectively'.¹⁴ It is essentially a convergence of the 'deterrence' and 'accommodative' models of regulation; responsive regulation focuses not on 'whether to punish or persuade, but *when*

9 Martin Wheatley, Financial Conduct Authority, 'The institutionalisation of customer service', Address to the Chartered Institute for Securities & Investment, 12 March 2013, www.fca.org.uk (accessed 4 March 2014). Mr Wheatley also referred to a 2012 report by consulting firm Oliver Wyman which discussed 'firms' "obsession" with compliance; their tendency to follow the letter of the law rather than its spirit'.

10 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 54.

11 As Dr Vicky Comino notes, responsive regulation and strategic regulation theory are terms often used interchangeably. These theories are intended to apply to various regulatory environments, not just corporate law. See Vicky Comino, 'Towards better corporate regulation in Australia', *Australian Journal of Corporate Law* 26:1 (2011), p. 7.

12 Vicky Comino, 'Towards better corporate regulation in Australia', p. 7.

13 The concept of an enforcement pyramid was first outlined in John Braithwaite, *To Punish or Persuade: Enforcement of Coal Mine Safety* (Albany, NY: State University of New York Press, 1985). Responsive regulation was expanded on in Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York: Oxford University Press, 1992). For an outline of the history of responsive regulation theory, see Vicky Comino, 'Towards better corporate regulation in Australia', p. 7.

14 Vicky Comino, 'Towards better corporate regulation in Australia', p. 7. Ayres and Braithwaite argued that 'for the responsive regulator, there are no optimal or best regulatory solutions, just solutions that respond better than others to the plural configurations of support and opposition that exist at a particular moment in history'. Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York: Oxford University Press, 1992), p. 5; cited in Dimity Kingsford Smith, 'A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector', *University of British Columbia Law Review* 44:3 (September 2011), p. 700.

to punish and *when* to persuade'.¹⁵ As Aakash Desai and Ian Ramsay note, to achieve maximum regulatory compliance the theory promotes 'responsive' or 'strategic' supervision by regulators. Methods for promoting voluntary compliance, such as persuasion and education, are made more effective as a result of the credible sanctions of escalating severity available to the regulator that it can threaten to utilise or pursue. This structure of sanctions is generally referred to as the 'enforcement pyramid' or 'compliance pyramid'; the shape is intended to reflect the theoretical less frequent use of the most severe sanctions, which form the apex of the pyramid, compared to the persuasion-focused methods of resolution that form the pyramid's base.¹⁶

4.11 Responsiveness can also be defined as 'the ability of a regulator to respond purposively and effectively to the particular context of regulation, and persuade the regulated firm to do so too'.¹⁷ To achieve this, the theory of responsive regulation requires that a combination of punishment and persuasion exists that is premised on 'minimal sufficiency' and the projection of 'regulatory invincibility'. Professor Dimity Kingsford Smith explains these two principles and how they operate according to responsive regulation theory:

[Minimal sufficiency] involves signalling to the organization that the regulator will use the least intrusive strategy first (such as asking for a defect to be fixed), and only escalate to more formal enforcement if minimally sufficient strategies do not work. At the same time, in order to make the threat of escalation credible, the regulator has to keep in the background the threat of serious enforcement action: prosecution, civil penalty sanctions, and license cancellation. Clearly it is easiest to convey an intention to intervene minimally if the regulator has powers and resources to do so—inspection is an ideal setting for this. Clearly too, it is easiest to project invincibility and to keep the threat in the background if the regulator has powers and resources for enforcement, and enjoys formal enforcement successes. It is in signalling its intention to move between these poles that the regulator shapes a responsive regulatory relationship.¹⁸

4.12 The sanctions made available to ASIC in legislation, and the enforcement policy developed and published by ASIC, reflect many aspects of responsive regulation.¹⁹ ASIC's enforcement pyramid includes: punitive action (prison sentences,

15 Australian Government, *Review of Sanctions for Breaches of Corporate Law: Consultation Paper*, March 2007, p. 6.

16 Aakash Desai and Ian Ramsay, 'The Use of Infringement Notices by ASIC for Alleged Continuous Disclosure Contraventions: Trends and Analysis', *University of Melbourne Legal Studies Research Paper*, no. 547 (2011), pp. 22–23 (footnotes omitted); Dr Marina Nehme, *Submission 140*, p. 5.

17 Dimity Kingsford Smith, 'A Harder Nut to Crack? Responsive Regulation in the Financial Services Sector', *University of British Columbia Law Review* 44:3 (September 2011), p. 711.

18 Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 717.

19 This approach is not unique to corporations and financial services law; other Australian regulators such as the ACCC also have powers based on an enforcement pyramid model.

criminal or civil monetary penalties), protective action (such as disqualifying orders), preservative action (such as court injunctions), corrective action (such as corrective advertising), compensation action and negotiated resolution (such as an enforceable undertaking). ASIC can also issue infringement notices for certain alleged contraventions, however, in the event that the recipient elects not to pay, this would likely need to be followed by court proceedings seeking a civil penalty.²⁰ The application of the enforcement pyramid to ASIC is discussed in Chapter 17.

4.13 While the responsive regulation model highlights the need to resort to severe punishments in some circumstances, in the context of Australia's corporate law it has been argued that this 'must be balanced against the potential for severe penalties to have a "freezing effect" on responsible risk taking and commercial decision making'.²¹

Risk-based regulation

4.14 A regulatory structure based on strategic regulation theory may be complemented by a 'risk-based' regulatory approach. Recognising that not all contraventions can be detected and addressed, risk-based regulation seeks to inform the decisions that a regulator takes when determining its priorities and allocating its resources. According to risk-based regulation, a regulator would deploy its inspection and enforcement resources in accordance with an assessment of the potential risk that particular regulated entities or individuals pose to the regulator's aims.²² Julia Black and Robert Baldwin explain that risk-based regulatory frameworks 'focus on risks not rules', as regulators 'are usually overburdened by rules' and cannot enforce every rule at all times. A risk-based framework acknowledges the selections about enforcement that regulators have always implicitly made and provides a framework of analysis for making those selections.²³

4.15 After examining various government regulators across jurisdictions, including financial services regulators, Baldwin and Black consider that the frameworks adopted have the following five core elements in common:

First, they require a determination by the organization of its objectives—of the risks 'to what' that it is concerned to control. Secondly, they require a determination of the regulator's own risk appetite—what type of risks is it prepared to tolerate and at what level...Thirdly, risk-based frameworks involve an assessment of the hazard or adverse event and the likelihood of it occurring...Fourthly, regulators assign scores and/or ranks to firms or activities on the basis of these assessments...Fifthly, risk-based frameworks provide a means of linking the organization and supervisory, inspection,

20 ASIC, 'ASIC's approach to enforcement', *Information Sheet 151*, September 2013.

21 Australian Government, *Review of Sanctions for Breaches of Corporate Law: Consultation Paper*, March 2007, p. 9.

22 Vicky Comino, 'Towards better corporate regulation in Australia', p. 9.

23 Julia Black and Robert Baldwin, 'Really Responsive Risk-Based Regulation', *University of Denver Law & Policy* 32:2 (April 2010), p. 184.

and often enforcement resources to the risk scores assigned to individual firms or system-wide issues.²⁴

4.16 However, Baldwin and Black have also identified that risk-based approaches can present certain challenges, as they may result in an inclination for regulators to:

- focus on known risks, resulting in new or developing risks going undetected (a related issue is that risk-based approaches 'tend to be backward looking and "locked in" to an established analytic framework');
- neglect areas determined to be of lower risk, which may ultimately result in considerable damage; and
- focus on individual firms rather than on how compliance across regulated entities can be improved.²⁵

Formalising the role of non-state bodies: strategies of co-regulation and enrolment

4.17 The possible regulatory strategies available to policymakers and regulators can be considered as a spectrum. At one end, representing the form of regulation with the most involvement by the government, is command-and-control regulation. At the other end of the spectrum is no regulation (or self-regulation if no regulation was considered to be an unviable option). Where the state and regulated entities start to interact more closely is when strategies such as co-regulation are considered. Under a co-regulation strategy, the regulated entities develop and administer the regulatory arrangements, which are underpinned by legislation set by the government.²⁶

4.18 Another theory of regulation that has some application to ASIC's work is a strategy based on enrolment. This approach relies on others who are 'enrolled' to support the regulator. These entities are 'gatekeepers', described by Julia Black as those who are 'not directly the subject of regulation, but who have a strategic position over those who are'.²⁷ In Australia's financial system, directors, company officers, auditors and insolvency practitioners are some examples of gatekeepers. These groups have professional bodies that can promote better practices through standards, education, training and advocacy. The standards or rules adopted by these other bodies

24 Julia Black and Robert Baldwin, 'Really Responsive Risk-Based Regulation', p. 185.

25 Robert Baldwin and Julia Black, 'Really Responsive Regulation', *Modern Law Review* 71:1 (2008), pp. 59, 66–67; cited in Vicky Comino, 'Towards better corporate regulation in Australia', p. 10.

26 Australian Government, *The Australian Government Guide to Regulation*, March 2014, p. 28.

27 Julia Black, 'Paradoxes and Failures', p. 1048.

can also be enrolled by regulators or policymakers.²⁸ ASIC frequently highlights the important role that gatekeepers perform.²⁹

4.19 A strategy based on enrolment can encounter problems. Julia Black argued that gatekeepers were not necessarily reliable and may not perform the role that regulators assume.³⁰ In its examination of the collapse of Trio Capital, the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) also highlighted expectations gaps between the role of gatekeepers and investors' expectations of that role. The PJCCFS formed the view that the current system of gatekeepers did not work in relation to Trio Capital and that '[t]here is no reason to believe that this system will be any more successful in detecting fraud in the future'.³¹ Julia Black concluded that enrolment is a 'potentially useful' strategy of regulation, however:

...whether the strategy is successful depends on the motivation, regulatory capacity, and most importantly, the broader market context, culture and incentives of those being relied upon to act as gatekeepers. Unless these are aligned with the goals of the regulatory regime, regulators will find that their reliance is dangerously misplaced.³²

Effectiveness of the regulatory regime and ASIC's regulatory approach

4.20 Responsive regulation and risk-based approaches to regulation have influenced the development of Australia's corporations law and the approach taken by ASIC. The following paragraphs outline general observations about the extent it is considered that these theories apply to ASIC. Issues considered by regulatory theory have been contemplated when particular aspects of ASIC's work were examined in detail, however, to avoid repetition the discussion of regulatory theory is generally confined to this chapter.

ASIC's responsiveness and ability to conduct surveillance

4.21 Professor Dimity Kingsford Smith has described ASIC's after-the-loss approach to enforcement as: 'waiting for complaints, investigating a minute proportion

28 For example, international accounting standards developed by the International Accounting Standards Board. Julia Black, 'Paradoxes and Failures', pp. 1050–51.

29 ASIC's chairman, Mr Greg Medcraft, has described gatekeepers as a 'cornerstone' of the system, along with ASIC and the Corporations Act. See *Senate Economics Legislation Committee Hansard*, Estimates, 31 May 2011, pp. 83, 96.

30 Examples cited in support of this argument include auditors in corporate collapses such as Enron and what the global financial crisis revealed about credit rating agencies. Julia Black, 'Paradoxes and Failures', p. 1049.

31 Parliamentary Joint Committee on Corporations and Financial Service, *Inquiry into the collapse of Trio Capital*, May 2012, Parliamentary Paper No. 138/2012, pp. 111–12.

32 Julia Black, 'Paradoxes and Failures', p. 1049.

of them, and prosecuting even fewer'.³³ Dr Vicky Comino has suggested that 'ASIC has generally behaved in a reactive rather than a proactive fashion' and that the 'discovery of corporate breaches is often almost accidental'.³⁴

4.22 A former enforcement adviser at ASIC agreed that regulation cannot eliminate all misconduct, but argued ASIC could still be more vigilant at after-the-loss enforcement. Transnational crime was an issue he particularly highlighted:

Things happen, but that does not mean that you put hands in the air and not chase people overseas. If people steal from mums and dads in Australia, we should pursue those individuals to the end of the earth and tell them, and the world, that if you come here you cannot steal from our mums and dads, who have worked hard all their lives.³⁵

4.23 In September 2012, ASIC published figures on the number of staff allocated to each of its stakeholder teams, the number of regulated entities they oversee and, for the first time, the number of years it would theoretically take to conduct surveillance on every entity. An updated set of these figures is reproduced in Table 4.1.

Table 4.1: ASIC's surveillance coverage of regulated populations in 2012–13

| ASIC team | Staff | Key industry statistics and ASIC's surveillance coverage |
|--|-------|---|
| Financial advisers | 29 | 3,394 AFS licensees authorised to provide personal advice: <ul style="list-style-type: none"> - Top 20—0.8 years on average - Next 30—1.8 years on average - Remaining 3,344—primarily reactive surveillances 1,395 AFS licensees authorised to provide general advice—reactive surveillances only Two ASIC-approved external dispute resolution schemes—every year |
| Investment banks | 23 | 26 investment banks—once a year 250 hedge fund investment managers/REs—11.3 years on average 43 retail OTC derivative providers—every year Seven credit rating agencies—every year |
| Investment managers and superannuation | 40 | 483 active responsible entities <ul style="list-style-type: none"> - Top 25—70% of funds under management—every two years - Nine identified as most at risk of noncompliance—every year - 91 responsible entities in sectors where risks have been identified or where ASIC has concerns—varies from year to year - Remaining 358—primarily reactive surveillances 200 super fund trustees <ul style="list-style-type: none"> - Five identified as most at risk of noncompliance—every year - Remaining 195—primarily reactive surveillances 20 major custodians—2.9 years on average |

33 Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 698.

34 Vicky Comino, 'Towards better corporate regulation in Australia', p. 36.

35 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 7.

| | | |
|--|------|--|
| Deposit-takers, credit and insurers | 65.5 | 173 authorised deposit-taking institutions (ADIs) <ul style="list-style-type: none"> - Big four ADIs—every year - Remaining 169—13 years on average 141 insurers—seven years on average 641 licensed non-cash payment facility providers—primarily reactive surveillances 13 trustee companies—seven years on average 5,688 non-ADI credit licensees (lenders and intermediaries) with 28,201 credit representatives—37 years on average |
| Corporations (including emerging mining and resources companies) | 49 | 21,690 public companies, including 1,983 listed entities (excludes foreign companies) <ul style="list-style-type: none"> - All control transactions for listed entities - A significant proportion of prospectuses - A small sample of entities in areas of emerging risk—every year - Remaining entities—reactive surveillances only |
| Financial reporting and audit | 38 | 86 audit firms: <ul style="list-style-type: none"> - the big four audit 95% of listed entities by market capitalisation—1.5 years on average - the next eight audit 4% of listed entities by market capitalisation—2.5 years on average - the remaining 74 audit 1% of listed entities by market capitalisation—10.3 years on average Financial reports of 1,983 listed entities (excludes foreign companies) and 26,000 unlisted entities: <ul style="list-style-type: none"> - top 500 listed entities – three years on average - remaining 1,500 listed entities (excludes foreign companies)—12 years on average - 300 unlisted entities with larger numbers of users—90 years on average supplemented by reactive surveillances |
| Insolvency practitioners | 23.5 | 685 registered liquidators—3.6 years on average |
| Financial market infrastructure | 28 | 18 authorised financial markets—every year Six licensed clearing and settlement facilities—every year |
| Market and participant supervision | 67 | Monitoring of the ASX, Chi-X, NSX and ASX24 markets—every day 136 market participants—3.3 years on average 800 securities dealers: <ul style="list-style-type: none"> - 100 larger entities (clients and volumes)—four years on average - 700 smaller entities—reactive surveillances and targeted reviews of high risk entities |

Source: ASIC, *Annual Report 2012–13*, pp. 16–17.

Notes: The figures on ASIC's surveillance coverage indicate the number of years it would theoretically take to cover the entire regulated population through high intensity surveillances, based on the number of surveillances ASIC conducted in the 2012–13 financial year. ASIC noted that, in practice, its risk-based approach to surveillance means that 'some portion of the population would be touched multiple times while others would not be touched at all'. Figures on staff numbers are on a full-time equivalent basis.

4.24 The figures on the number of years it would theoretically take ASIC to conduct high intensity surveillance on the entire regulated population indicate that relationships between the regulator and many regulated entities could be underdeveloped. When its surveillance coverage figures were first released,

the chairman of ASIC, Mr Greg Medcraft, outlined how the level of surveillance depends on ASIC's resources. In particular, with the resources it has, ASIC undertakes a risk-based approach to surveillance that relies on financial system gatekeepers:

I guess the warning we have to Australians is frankly what we have is a system that is based on self-execution and relies on people to do the right thing. It is so important—I will not emphasise this more—that it is up to the gatekeepers to do the right thing. The amount of surveillance we do is based on the resources we have. We try and do risk based surveillance, so we target the largest licensees, and for those where we have complaints we go reactive. But in terms of proactive surveillance with the resources we have, ...It is really important that this surveillance coverage that we have released publicly for the first time is explaining to Australians that ASIC is not a prudential regulator, not a conduct and surveillance regulator... We are not resourced to be looking at everybody, and that is a very important message. That is why education is really important. Australians are proactive in getting educated and understanding what they should be doing.³⁶

4.25 In a 2011 journal article that responded to the 2009–10 surveillance statistics, Professor Kingsford Smith observed that the figures reveal 'in very brutal terms of resources and enforcement policy, there is at present no realistic prospect of developing anything approaching a regular surveillance or inspection program'. Although alternative responsive strategies could be considered, 'as things stand it is difficult to see how there could be sufficient contact between the financial services firms and the regulators for responsive regulation to be a success at the low end of the regulatory register'.³⁷ With the aim of suggesting ways that financial regulation could be encouraged to be more relational which, in her view, would result in more effective regulation, Professor Kingsford Smith questioned the current application of responsive regulation theory to financial markets. She argued that responsive regulation has been successful 'in regulatory contexts where physical inspection of workplaces, mines, nursing homes, and so on is undertaken', but it has been less successful in environments, such as the financial services sector, that have:

...large populations of regulatees and insufficient resources for visits, inspections, or other regular checks, and where detection of non-compliance is difficult. Here the regulatory circumstances do not provide the bridge for contact between the regulator and the firm, which allows a relationship to develop which can support responsive action.³⁸

4.26 Despite this, Professor Kingsford Smith maintained that inspections in the financial sector could still be an effective regulatory technique as they 'remind the regulated entity that the regulator is paying attention to what they do, or fail to do':

36 Mr Greg Medcraft, Chairman, ASIC, *PJCCFS Hansard*, Oversight of the Australian Securities and Investments Commission, 12 September 2012, pp. 14–15.

37 Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 724.

38 Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 695.

It provides a location for practical, responsive remedial action. In a situation where inspection is not a possibility but where the regulator has noticed a trend in a particular type of infringement, a letter to all the regulated actors doing the same type of business, pointing out the trend and asking for details of their compliance, alerts the regulated to the fact the regulator is watching. It projects, even at the lower end, an appearance of capacity in detection that may be greater than the reality. Depending upon the responses received and reviewed, further action in the regulatory relationship could be pursued: slating some firms for surveillance, reviewing relevant firm disclosure documents, or checking the firm's complaints register.³⁹

ASIC's ability to change behaviour

4.27 An element of effective regulation is how the regulatory environment and the regulator's actions and reputation influence the behaviour of regulated entities. The chief executive officer of CPA Australia, Mr Alex Malley, questioned whether ASIC has exhibited the culture it needs to act in the public interest and argued that ASIC had failed to show appropriate leadership.⁴⁰ According to Mr Malley:

Leadership can be benchmarked against principles of proactivity, capacity to positively influence and ability to take stakeholders and the community along a journey. Over a long period of observation, with many considered public statements made by us, it is our informed view that ASIC has failed to exhibit these characteristics. In fact it displays the opposite. It is reactive, it is defensive, it is contradictory and it is insecure in its own ability to provide solutions.⁴¹

4.28 Some witnesses were asked whether ASIC should 'become an agency of fear', where significant punishments would be promptly imposed when particular contraventions occurred. In his response, Mr Malley expressed support for the overall enforcement pyramid approach of escalating penalties and sanctions, although he reiterated that there was greater scope for ASIC to show leadership and influence behaviour within this framework:

...I think what people should understand is that there is a process that allows them to perform within a marketplace and have the comfort that the regulator is willing to work with them to improve the way things work. I think it has to have a very, very severe punishment mechanism, but it also should be not the starting point of the dialogue of the regulator of the

39 Dimity Kingsford Smith, 'A Harder Nut to Crack?', 735. Professor Kingsford Smith also suggested other 'minimally sufficient, but cheap to implement' strategies that ASIC could apply, including allocating a key officer to each regulated entity and requiring regulated firms to report to ASIC events that are not breaches of the Corporations Act, but which indicate changes in the firm's circumstances. See Dimity Kingsford Smith, 'A Harder Nut to Crack?', pp. 736–37.

40 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 42.

41 Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 42.

market. There should be a very clear message that, should one go past a point, there is no doubt that there will be a significant punishment. So I believe in that but, from all of my business experience, the only way to lead any organisation, whether it be a regulator, a government or a business, is to lead by positive influence and by seeking to have the very best outcomes and behaviours.⁴²

4.29 Mr Lee White, the chief executive officer of the Institute of Chartered Accountants Australia (ICAA), expressed a similar view. Mr White stated that:

...the best regulatory outcomes are achieved through effective communication and the ability to persuade...The second elements is that we need to be very careful around culture. If the culture gets too dominated by, 'We have all these powers and can exercise them when rightfully so,' it is very hard to turn off the mindset that I can now collaborate or work with the people. It becomes such a dominant force in how people are approached.⁴³

4.30 Many academics recognise that the ethical culture and perception of risk within corporations are key factors in regulatory compliance, with the effective enforcement of corporate law beginning within the corporation itself.⁴⁴ Dr Comino points to HIH Insurance and the action taken by the Australian Competition and Consumer Commission (ACCC) against Visy as examples where the culture inside organisations can be unreceptive to compliance.⁴⁵ Professor Kingsford Smith has suggested that ASIC cannot act effectively as 'a benign big gun' and, therefore, it cannot simultaneously project power and use 'minimal sufficiency' techniques as suggested by responsive regulation. To support her argument, Professor Kingsford Smith noted that while ASIC's powers are great on paper 'it has a track record of prosecuting small, rather than large, firms'.⁴⁶ Professor Kingsford Smith also argued that while the reputation of financial services regulators generally, including ASIC, have suffered as a result of the global financial crisis, ASIC has 'contributed to its own lowered regard':

...by using its enforcement powers in a series of high profile cases which it has lost resoundingly, and at very great public expense. So in implementation of its high-level enforcement powers, ASIC has had mixed success, and this diminishes its ability to project itself as invincible.⁴⁷

42 Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 49.

43 Mr Lee White, Chief Executive Officer, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 49.

44 For a list of references see Roman Tomasic, 'The Challenge of Corporate Law Enforcement: Future Directions for Corporations Law in Australia', *University of Western Sydney Law Review* 10 (2006), pp. 9, 11.

45 Vicky Comino, 'Towards better corporate regulation in Australia', p. 18.

46 Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 697 (footnotes omitted).

47 Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 725 (footnotes omitted).

4.31 CPA Australia also argued that perceptions about ASIC's effectiveness impact its ability to regulate:

Being regular front-page news on questions of your performance rather than your outcome leaves ASIC in a difficult position to influence better behaviours of others. No-one wins in this circumstance.⁴⁸

4.32 Others consider there are wide-spread and established 'dysfunctional elements in Australian business culture' that ASIC is unable to counter because of its structure and culture:

ASIC, as with its institutional predecessors, was born with a regulatory emphasis on enhancing disclosure and transparency in the financial marketplace, and has acquired a dominant culture that underpins that emphasis. ASIC has yet to acquire a culture commensurate with the cowboy frontier environment that it is expected to regulate.⁴⁹

4.33 How regulated entities respond to enquiries from or action taken by the regulator is also significant. The potential for ASIC to have an adversarial relationship with regulated entities is readily apparent. For example, Baldwin and Black, in describing the theory of 'really responsive risk-based regulation',⁵⁰ provided the following observation about risk-based regulators relationship with the entities they regulate:

[Risk-based] regulators need considerable information from firms to sustain their oversight. They may, however, have to use formal enforcement actions, such as fines, to change the behaviour of many firms. In such circumstances, responding to noncompliance with a deterrence approach may cut across the ability to detect that noncompliance in the first place. Firms know that any information they give to the regulator may potentially be used against them in an enforcement action, and this can have a chilling effect on their cooperation with that regulator. A good, albeit anecdotal, example is the contrast in enforcement approaches of the two Australian financial regulators, APRA and [ASIC]...APRA has a model of intensive supervision for its high-risk financial institutions, but this does not involve using formal enforcement actions. ASIC, on the other hand, has moved to a much more deterrence-based approach. The consequence for their respective monitoring functions was noted recently by an Australian

48 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 42.

49 Evan Jones, 'The Crisis and the Australian Financial Sector', *Journal of Australian Political Economy* no. 64 (Summer 2009), pp. 91, 110.

50 Really responsive risk-based regulation is 'a strategy of applying a variety of regulatory instruments in a manner that is flexible and sensitive to a series of key factors'. The theory arises from the need for risk-based regulators to 'attune the logics of risk analyses to the complex problems and the dynamics of real-life regulatory scenarios'. See Julia Black and Robert Baldwin, 'Really Responsive Risk-Based Regulation', p. 182.

lawyer, who quipped, "When APRA asks for information, firms give it to them; when ASIC asks, they call their lawyers" (Note on file with author).⁵¹

Reflection and self-assessment by ASIC

4.34 A further element of really responsive risk-based regulation is whether the regulator assesses their successes and failures and then modifies their approach accordingly.⁵² It is considered that:

Really responsive risk-based regulators will be performance sensitive: they will be capable of measuring whether the enforcement tools and strategies in current use are proving successful in achieving desired objectives. Such regulators will also operate systems that allow them to justify their performance to the public and other interested parties. They will also be able to adjust their strategies in order to improve on the levels of performance that they have assessed.⁵³

4.35 ASIC's actions in response to the misconduct within CFPL, a key reason for the referral of this inquiry, are examined in detail in Chapters 8 to 11. Nevertheless, at this point it is useful to note that during Senate Estimates in June 2013 ASIC focused on the outcome achieved in the CFPL matter, which the deputy chairman eagerly outlined. ASIC was less forthright when asked about the investigation and the whistleblower.⁵⁴ ASIC's first submission to this inquiry was more reflective and acknowledged inadequate aspects of how it handled the investigation.⁵⁵ ASIC also advised that it has considered all of the submissions received by the committee 'in an effort to learn as much as we can from them and also to enable ASIC to do a better job'.⁵⁶ ASIC's main submission also outlined the actions it has taken to improve how it deals with whistleblowers.⁵⁷

51 Julia Black and Robert Baldwin, 'Really Responsive Risk-Based Regulation', p. 199. A similar point was made by Professor Kingsford Smith who suggested that '[f]irms turn to their lawyers, not to the regulator for a negotiation about how the complaint might be resolved' and that 'the ensuing conversation will likely concentrate entirely on the particular complaint and not on deeper difficulties—which might be better diagnosed if firms understood that through regular visits the regulator intended at least initially to be reasonable, and to persuade and support rather than prosecute'. Dimity Kingsford Smith, 'A Harder Nut to Crack?', p. 734.

52 This is one of the regulatory tasks that Robert Baldwin and Julia Black suggest a really responsive regulator would consider. See Robert Baldwin and Julia Black, 'Really Responsive Regulation', *Modern Law Review* 71:1 (2008); cited in Julia Black and Robert Baldwin, 'Really Responsive Risk-Based Regulation', p. 183.

53 Julia Black and Robert Baldwin, 'Really Responsive Risk-Based Regulation', p. 200.

54 *Senate Economics Legislation Committee Hansard*, Estimates, 4 June 2013, pp. 115–117.

55 ASIC, *Submission 45*, p. 16.

56 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 1.

57 ASIC, *Submission 45.2*, p. 137.

The philosophy underpinning Australia's financial services regulation regime

4.36 The final section of this chapter focuses on one specific and high-profile aspect of ASIC's work: its role as a financial services regulator. The bulk of submissions received by the committee relate to this function. This section provides some background information on the principles that have guided policymakers to date, such as those outlined by the 1997 Wallis Inquiry. However, it should be noted that the latest review of the financial system that is currently underway, the Financial System Inquiry chaired by Mr David Murray AO, has been tasked with refreshing the philosophy that underpins Australia's financial system.⁵⁸

Efficient markets theory

4.37 The current approach to regulating Australia's financial services industry largely stems from the 1981 report of the Committee of Inquiry into the Australian Financial System (the Campbell Inquiry) and the Wallis Inquiry of 1997. Both of these inquiries were guided by 'efficient markets theory', that is, a belief that 'markets operate most efficiently when there is a minimum of regulatory intervention'.⁵⁹ The Wallis Inquiry maintained the fundamental view that investors have the responsibility to make good decisions.⁶⁰ It also observed that 'all markets, financial and non-financial, face potential problems associated with the conduct of market participants, anti-competitive behaviour and incomplete information'.⁶¹ Nevertheless, the Wallis Inquiry concluded that although the objectives of conduct and disclosure regulation in the financial system are similar to those that apply to non-financial markets, specialised regulation for the financial services sector is necessary:

...to ensure that market participants act with integrity and that consumers are protected. The financial system warrants specialised regulation due to the complexity of financial products, the adverse consequences of breaching financial promises and the need for low-cost means to resolve disputes.⁶²

4.38 On consumer protection, the Wallis Inquiry observed that information asymmetry can arise between consumers and providers of financial products as

58 The Hon Joe Hockey MP (Treasurer), 'Financial System Inquiry', *Media Release*, 20 December 2013.

59 ASIC, *Submission 45.2*, p. 49.

60 Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', *Company and Securities Law Journal* 29:5 (2011), p. 334.

61 Financial System Inquiry, *Final Report*, March 1997, p. 186.

62 The Wallis Inquiry also recognised that financial safety regulation, that is, prudential regulation, has a role in some areas of the financial system. The Wallis Inquiry concluded that this type of regulation 'should be the greatest where the intensity of financial promises and hence risks of market failure are greatest'. Financial System Inquiry, *Final Report*, March 1997, p. 175.

'consumers lack (and cannot efficiently obtain) the knowledge, experience or judgment required to make informed decisions...a situation where further disclosure, no matter how high quality or comprehensive, cannot overcome market failure'.⁶³ Others have noted that there is 'also a view that consumers need protection from themselves, due to their vulnerability to making poor financial decisions, their susceptibility to certain sales messages when framed in a particular way, and their underestimation of their own lack of financial understanding'.⁶⁴

4.39 The Wallis Inquiry also distinguished between investments and the consumption of other goods and services. It argued that as investments are not based on consumption but rather the sharing of risk (and the reward for bearing that risk), there should be an appropriate balance between investor protection and market efficiency.⁶⁵ Although the Wallis Inquiry envisaged a role for regulation in the financial system beyond that applied to markets generally, as the financial system fundamentally engages in risk it did not support the elimination of risk by regulation:

If regulation is pursued to the point of ensuring that promises are kept under all circumstances, the burden of honour is effectively shifted from the promisor to the regulator. All promisors would become equally risky (or risk free) in the eyes of the investing public. Regulation at this intensity removes the natural spectrum of risk that is fundamental to financial markets. If it were extended widely, the community would be collectively underwriting all financial risks through the tax system, and markets would cease to work efficiently...Primary responsibility should remain with those who make financial promises. It would be inequitable for the government to underwrite some financial promises but not other promises made by participants in the broader economy.⁶⁶

4.40 ASIC noted that this philosophy is not only reflected in Australia's financial system, but applies to financial regulators in foreign jurisdictions as well:

...the settings established by the parliament for our financial system are such that no financial regulator can prevent all risk of losses from occurring. Our system is designed this way because removing the risk of loss would substantially reduce economic growth, individual choice and return to investors. Preventing all risk of loss from poor products, misconduct or criminal activity would involve highly expensive and intrusive regulatory intervention. For financial regulators like us—[securities] regulators around the world—the systems are similarly designed to ours. While the risk of loss can never be entirely removed from the financial markets, we work hard to enforce the law and to deal with misconduct that puts investors at risk. We also work hard to help consumers

63 Financial System Inquiry, *Final Report*, March 1997, p. 191.

64 Richard Sandlant, 'Consumer financial protection: future directions', *Finsia Journal of Applied Finance*, no. 4 of 2011, p. 42.

65 Financial System Inquiry, *Final Report*, March 1997, p. 251.

66 Financial System Inquiry, *Final Report*, March 1997, p. 192.

and investors make appropriate choices in their dealing with financial services providers.⁶⁷

Developments since the Wallis Inquiry

4.41 Seventeen years have passed since the Wallis Inquiry finalised its report. As this chapter has noted, a new Financial System Inquiry is currently underway which has been tasked with refreshing the philosophy that underpins Australia's financial system. However, in considering ASIC's performance, it is useful to note some of the developments since 1997 that have led to some of the assumptions that informed the Wallis Inquiry being questioned or departed from.

The growth in superannuation

4.42 Australians are increasingly becoming involved in the financial markets as a result of the superannuation system which, because of its compulsory nature, is considered to be 'the most significant exception' to efficient markets theory in Australia's financial system.⁶⁸ This exposure has been reinforced by the increase in the superannuation guarantee over the past two decades and the significant increase in the number of SMSFs. More recent government inquiries and reforms to superannuation have diverged from certain principles expressed in the Wallis Inquiry report.⁶⁹

The global financial crisis

4.43 The global financial crisis that began in 2007 and intensified as a result of numerous events in 2008 has, in particular, caused some of the assumptions about how financial markets function to be questioned. For example, in 2009 the then ASIC chairman Mr Tony D'Aloisio noted that efficient markets theory emphasises the importance of disclosure. It also assumes that investors (both retail and institutional) have 'the tools to understand what disclosure means'. To illustrate how the global financial crisis revealed that this was not always the case, Mr D'Aloisio noted that at the institutional level there was widespread disclosure on credit default swaps and collateralised debt obligations, however, 'that disclosure did not translate into an

67 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 2.

68 ASIC, *Submission 45.2*, p. 51.

69 The report of the 2010 *Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System* (the Super System Review, or Cooper Review) disagreed with the Wallis Inquiry's conclusion that superannuation fund members should be treated as rational and informed investors protected by disclosure and conduct requirements: *Final Report*, part 1, June 2010, p. 8. One of the review panel members outlined how developments in behavioural economics thought have 'pointed to some of the flaws of standard economics in modelling behaviour' and reveal that some of the assumed behaviours outlined by the Wallis report 'do not apply unequivocally': David Gruen and Tim Wong, 'MySuper—Thinking Seriously about the Default Option', Address to the Australian Conference of Economists, 28 September 2010, www.treasury.gov.au (accessed 26 August 2013).

understanding of the risks associated with those products'.⁷⁰ In her submission, Professor Kingsford Smith argued that there should be some thought given to how the variety of different investors are treated. As an example, she noted the complex products offered to local councils as sophisticated investors, when in reality they were 'very unfamiliar with the products being offered'.⁷¹ Various other informed observers have also commented on regulatory issues that the crisis revealed.⁷²

4.44 In its main submission to this inquiry, ASIC noted that since the global financial crisis, regulators internationally 'are looking for a broader toolkit to address market problems, moving beyond traditional conduct and disclosure regulation to design regulatory interventions that address the types of problems investors and financial consumers often experience in financial markets'. ASIC noted the recent restructure of financial services regulators in the UK, and in particular the new temporary product intervention powers given to the Financial Conduct Authority.⁷³

Implications of the current financial services regulatory system for ASIC

4.45 The promotion of market integrity and consumer protection is generally undertaken through conduct and disclosure regulation, although certain reforms enacted in the past five years, such as the national credit regime (which will be examined in the following chapters) have diverged from this approach.⁷⁴ This has clear implications for the role of ASIC. In its main submission, ASIC presented the following argument:

70 Tony D'Aloisio, 'Regulatory Response to the Financial Crisis', address to the Asia Securities Forum, Sydney, 12 October 2009, www.asic.gov.au (accessed 28 August 2013), p. 11.

71 Professor Dimity Kingsford Smith also argued that the Westpoint cases 'showed how relatively easy it was in a country with compulsory superannuation, for comparatively modestly wealthy clients to be financially eligible for "sophisticated client" products, which they did not understand'. *Submission 153*, p. 18.

72 During a previous inquiry by this committee Professor Stephen King noted that regulations in the financial sector have been built on the assumption that there is no deposit insurance in Australia. A deposit guarantee was introduced by the government in response to the global financial crisis. See *Committee Hansard*, Inquiry into competition in the Australian banking sector, 21 January 2011, p. 105. In 2010 Professor Ian Harper, one of the members of the Wallis Inquiry committee, also suggested that certain assumptions need to be reviewed and outcomes revealed by the crisis considered, such as the pervasiveness of systemic risk and how it afflicts financial markets. ASIC, *Securities and investments regulation beyond the crisis*, ASIC Summer School 2010 Report, www.asic.gov.au (accessed 27 August 2013) pp. 33–34.

73 ASIC, *Submission 45.2*, p. 55.

74 ASIC, *Submission 45.2*, p. 47. Despite recent developments, however, the Wallis Inquiry remains influential. For example, in a 2012 newspaper opinion article Mr Medcraft wrote that the Wallis Inquiry discussed 'vital ideas', such as adopting a flexible approach to regulation, which remain relevant to ASIC's surveillance and its risk-based regulatory approach'. Greg Medcraft, 'Surveillance doesn't remove the risk factor', *Australian Financial Review*, 17 September 2012, www.afr.com (accessed 10 July 2013).

Consistent with the underlying philosophy of the financial services regulatory regime, ASIC's role is not to control the types of products that are available in financial markets, to prevent investments from failing, or to place checks on investors' investment decisions.

We understand that, where investors suffer losses, a natural tendency is to question why this has happened, and ask why ASIC has not prevented the losses from occurring. Nevertheless, ASIC's performance should be assessed in terms of how we fulfil our role in the financial services regulatory system, and not against the benchmark of whether we have been able to prevent all losses suffered by investors

...ASIC can, and does, try to minimise the risk of losses occurring. We try to help investors and financial consumers to use financial markets successfully through our work on financial literacy. We set standards for the conduct of industry participants by enforcing compliance with the law. We focus on preventing losses arising out of bad advice, addressing conflicts of interest that could lead to poor outcomes for investors, and detecting and addressing instances of outright fraud and other misconduct.⁷⁵

4.46 The case studies on lending practices and financial advice contained in the following chapters of this report highlight the real implications that the regulatory framework can have for consumers. The committee uses these case studies to start its examination of how ASIC has fulfilled its role in the financial services regulatory system. The committee assesses ASIC's performance against its own stated objectives: of trying to minimise the risk of loss occurring; of helping consumers to use financial markets successfully through improved financial literacy; and by setting and enforcing industry standards.

75 ASIC, *Submission 45.2*, pp. 52–53.

PART II

Case studies

Overview of Part II

At the public hearings and in written questions placed on notice, the committee questioned ASIC about many aspects of its regulatory responsibilities and tested ASIC on particular investigations or enforcement cases. As ASIC's responsibilities are extensive and its enforcement actions involve complexities and nuances that can require detailed explanations, the committee has selected two case studies to examine in detail and assess ASIC's performance.

The first case study relates to claims of unethical and irresponsible lending practices between 2002 and 2010 that affected vulnerable people. Many people raised this issue in their submissions, drawing on their personal experiences to make serious allegations of wrongdoing and to highlight concerns about ASIC's inadequate response.

The second case study relates to the catalyst for this inquiry: ASIC's response to serious and widespread misconduct within Commonwealth Financial Planning Limited.

Chapter 5

ASIC's role and credit providers

5.1 Before July 2010, the states and territories had primary responsibility for regulating consumer credit. ASIC, however, did have some involvement. Since March 2002, under the ASIC Act, the regulator has had a consumer protection role for credit facilities, which included household and investment and small business credit. ASIC took over this responsibility from the ACCC as part of the reform of business and investment regulation under the Corporate Law Economic Reform Program. This Commonwealth level regulatory function for credit in the marketplace was limited in scope with ASIC's jurisdiction under part 2 of the ASIC Act confined to broad standards of conduct covering unconscionable conduct and misleading or deceptive conduct.¹ ASIC's licensing powers did not extend to brokers who only advised on credit products. At that time, as credit was not considered a 'financial product' for the purposes of the Corporations Act, brokers were not required to have an Australian financial services (AFS) licence.

5.2 In July 2010, ASIC's responsibilities expanded considerably under the *National Consumer Credit Protection Act 2009* (National Credit Act) which imposed licensing requirements, general conduct obligations and responsible lending obligations on credit providers and persons providing credit assistance.

5.3 In this chapter, the committee's main focus is on ASIC's performance and its regulatory role before the National Credit Act came into force. It is concerned with allegations of imprudent lending involving unconscionable conduct, misleading and deceptive conduct, including possible cases of fraud, that occurred after March 2002 but before the new legislation came into effect.

Early indications of irresponsible lending practices

5.4 The period from the late 1990s through to the first half of the 2000s was marked by considerable product innovation in the Australian mortgage market. Reflecting on that period, the Assistant Governor (Financial Markets) of the Reserve Bank of Australia (RBA) explained that lenders sought to cater for a wider range of potential borrowers and found new ways to assess their borrowing capacity. He noted:

Lenders introduced home-equity loans, redraw facilities and reverse mortgages, all of which allowed households to borrow against the equity they have built up in their homes. Lenders also introduced interest-only

1 See for example, Consumer Credit Legal Centre (NSW) Inc, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 39; ASIC, *Protecting wealth in the family home: An examination of refinancing in response to mortgage stress*, March 2008, p. 4; and ASIC, *Submission 45.1*, p. 6.

loans and shared equity loans, which made it easier for households, particularly first home buyers, to purchase their home.

Loan products that better meet the needs of certain types of borrowers, such as those with irregular income streams or those who do not meet the standard lending criteria, were also introduced. Low doc loans, for which borrowers self-certify their income in the application process, accounted for about 10 per cent of newly approved housing loans in 2006 compared with less than ½ per cent in 2000.²

5.5 According to the Assistant Governor, while the overwhelming effect of these changes had been to widen the range of households who could access finance, some of the innovation had resulted in 'an easing in lending standards and an increase in risk for both borrowers and lenders'.³

5.6 The Consumer Credit Legal Centre (NSW) Inc (CCLC) also noted the emergence of 'non-conforming lending' in the home loan market during the early 2000s. It stated that 'while some lenders specifically targeted and priced their products for marginal borrowers, the trend soon spread into the mainstream, with most mainstream lenders including the major banks offering low doc loans'.⁴

Growing use of mortgage brokers

5.7 This period also witnessed growth in the use of financial brokers as intermediaries between borrowers and lenders, which meant that an increasing number of Australians approached mortgage brokers rather than a lender to arrange loans. For example, a 2003 survey by the Australian Prudential Regulation Authority (APRA) on broker initiated loans recorded that 56 institutions indicated that they had used brokers to originate loans (14 banks, 34 credit unions, and eight building societies), which represented approximately 25 per cent of all authorised deposit-taking institutions (ADIs). The survey also predicted a continuation of this trend in the market with 25 institutions indicating at the time that they planned to use brokers for the first time in the next 12 months.⁵

5.8 Based on its results, the survey noted that only a minority of institutions were placing too much reliance on brokers to assess loans and inadequately tracking and

2 Dr Guy Debelle, 'The State of the Mortgage Market', Address to the Mortgage Innovation Conference, Sydney, 30 March 2010, p. 6.

3 Dr Guy Debelle, 'The State of the Mortgage Market', p. 5.

4 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 13.

5 Anoulack Chanthivong, Anthony D. F. Coleman and Neil Esho, *Report on Broker-originated Lending*, Results of a survey of authorised deposit-taking intuitions, undertaken by the Australian Prudential Regulation Authority, January 2003, pp. 4, 5. The survey recorded that the total dollar value of broker-originated housing loans was \$76.3 billion, which represented roughly 23% of all housing loans made by ADIs. Broker-introduced housing loans accounted for 23% of banking industry housing loans, 2% of credit union housing loans, and 35% of building society housing loans.

assessing broker-introduced loans. Even so, it cautioned that independent loan review was necessary to ensure an ADI's credit standards were 'being applied to assess and approve loans'. It advised that an independent review should be 'a fundamental element of risk management'.⁶

5.9 The survey also covered broker remuneration. It found that over half of the institutions (53 per cent) based the broker's remuneration solely on the volume of business generated. According to the survey reviewers, this provided brokers with an incentive to generate loan volume without appropriate regard for risk. Again, the reviewers observed that with such an incentive structure it was critical for ADIs to have procedures in place to ensure their own credit assessment standards were applied rigorously to broker-introduced loans.⁷ Looking back over this period, the CCLC stated that:

Brokers carried none of the default risk worn by lenders and had a strong financial incentive (in the form of commissions) to get as many and as big a loans as possible accepted by the financial institutions and other lenders. The presence of the 3rd party in the transaction also allowed the lender (keen to grab or retain market share) to distance themselves from the transaction and to either genuinely miss, or effectively turn a blind eye, to irregularities in loan applications.⁸

5.10 As noted previously, ASIC assumed Commonwealth-level responsibility for consumer protection in the credit market in 2002 at a time when the use of mortgage brokers was on the rise and lending practices were easing.

Early warning signs

5.11 During the early 2000s, community advocates and caseworkers began to express concerns about the growing incidence of complaints involving brokers. Their experiences led them to conclude that the industry was lightly and unevenly unregulated and contained some high-risk players and unfair practices.⁹ In response to the increasing number of complaints involving brokers, ASIC, on the recommendation of its Consumer Advisory Panel, commissioned the CCLC to examine and report on the mortgage and finance broker industry.

Increasing concerns about broker conduct

5.12 Consistent with the findings of the 2003 APRA survey, the CCLC also registered some troubling trends about this poorly regulated sector of the industry.

6 Chanthivong et al, *Report on Broker-originated Lending*, p. 7.

7 Chanthivong et al, *Report on Broker-originated Lending*, p. 9.

8 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 13.

9 Consumer Credit Legal Centre (NSW) Inc, *A report to ASIC on the finance and mortgage broker industry*, March 2003, www.asic.gov.au, p. 5.

Its report identified a number of features that hindered the development and maintenance of professional standards for broker conduct, including:

- minimal or no entry requirements for participants in the industry;
- the use of commissions as the dominant method of remuneration for brokers;
- a shift in distribution channels used by lenders from branch networks to brokers, with lenders competing against each other to gain access to broker client bases, through increasing the commission they were prepared to pay to brokers;
- a consequent shift in the preparation of loan applications from lenders to brokers, with some brokers prepared to provide inaccurate information about the financial circumstances of their clients, in order to ensure that loan applications met the acceptance criteria of the lender;
- difficulties for lenders seeking to discipline brokers, due to the capacity of brokers to switch the lender to whom they directed client applications for finance;
- a lack of accountability of brokers for poor advice due to the inability of consumers to access alternative dispute resolution forums; and
- some brokers not properly promoting the interests of their consumer clients.¹⁰

5.13 The report recognised that consumers were relatively inexperienced when using brokers and, given the confusing range of loans and providers, could become dependent on brokers for advice. Importantly, the report noted that some brokers were 'prepared to exploit that dependency' and that a number of fringe players in the broker industry systematically adopted unfair practices, and pursued 'their own financial interests over those of their clients'.¹¹ It cited cases involving disputes about the quality of advice provided by brokers which included:

- brokers recommending interest only loans in inappropriate circumstances— case studies indicated that some brokers were making widespread use of 'interest only' loans;¹²
- brokers misrepresenting the savings available from changing a home loan;
- brokers arranging for borrowers to declare, incorrectly, that a loan was for investment rather than personal use (with the result that the consumer lost statutory protections provided under the Uniform Consumer Credit Code (UCCC));

10 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, pp. 6–7.

11 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, pp. 8, 11.

12 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 30.

- brokers charging excessive fees, or fees in circumstances where the broker was aware that there was little prospect of the borrower being approved for a loan;
- borrowers being placed into a loan where they could only afford the repayments with substantial hardship (81 per cent of the caseworkers surveyed by the CCLC who dealt with broker complaints indicated that they often saw problems of this type); and
- brokers arranging finance for an amount less than that requested by the customer (particularly where the funds were required to complete a property purchase).¹³

5.14 The report noted that these practices resulted in 'higher costs to consumers, an increased risk of default by the borrower, and exposure of their home where this was used as security for the debt'.¹⁴ It also suggested that most consumers would be unaware that by signing a declaration that the loan was for investment purposes, and therefore outside the UCCC regime, they made it significantly easier for the lender to take possession of any security, such as their home, in the event of default'.¹⁵ The report drew particular attention to a most troubling practice:

A significant and, from a regulatory viewpoint, disturbing trend in the broker industry is the incidence of fraudulent mortgage applications. The shift in responsibility for the preparation of the loan application from persons such as bank employees to brokers has seen a shift in the interests of that person, from applying proper risk assessment techniques to earning commissions through having the loan approved. Increased reliance on brokers therefore creates an increased risk of this type of mortgage fraud.

At the soft end, mortgage fraud can involve the broker misrepresenting the consumer's personal or financial information in order for the lender to finance a marginal application for credit. Because brokers have ongoing contact with a credit provider, they become familiar with its lending criteria and can manipulate the content of applications to ensure the loan will be approved. There are a number of ways in which the broker can camouflage the borrower's circumstances, such as not disclosing all liabilities, reducing the number of dependants, or inflating the value of assets.¹⁶

5.15 The report recognised the urgent need for the implementation of interim measures to protect consumers and improve standards of conduct in the broker industry, which included:

- increased and visible enforcement action by regulatory agencies;

13 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 29.

14 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 29.

15 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 34.

16 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, pp. 34–35.

- the introduction of improved codes of conduct by industry bodies together with greater monitoring and enforcement of their obligations;
- improved access to industry-based dispute resolution procedures such as the Mortgage Industry Ombudsman Scheme, and ASIC approval (pursuant to Policy Statement 139) of the operation of such schemes, in order to provide greater transparency in the operation and decision-making practices of these schemes; and
- state and territory governments encouraging a greater degree of supervision of brokers by lenders...¹⁷

5.16 A 2003 APRA discussion paper also highlighted the increased use of brokers and recognised that some ADIs were relying on broker valuations and income checking when providing a loan. Instead of verifying the information, certain ADIs were placing greater weight on the security underlying the loan than the ability of the borrower to repay the loan.¹⁸ The paper referred to a particular problem with low doc loans¹⁹ where the potential borrower did 'not provide income details', and the lender did not 'verify the borrower's self-declared income levels and/or self-declared servicing ability'.²⁰

5.17 Clearly, by the close of 2003 some persistent and undeniable alarms were warning of dubious lending practices and the potential for them to spread, especially with brokers receiving commissioned-based remuneration and with the increasing availability of low doc loans.

5.18 Commentary on, and concerns about, the role and conduct of brokers continued for the next few years. According to the RBA's September 2004 *Financial Stability Review*, brokers typically received upfront commissions from lenders for each loan they originated. It observed that most lenders also paid brokers ongoing or trailing commission over the life of the loan, which were generally 'small relative to upfront commissions'. The *Review* noted that this created some incentive for borrowers to periodically refinance with a different lender.²¹

17 CCLC, *A report to ASIC on the finance and mortgage broker industry*, March 2003, p. 66.

18 APRA, *Proposed Changes to the Risk-Weighting of Residential Mortgage lending*, Discussion paper, November 2003, p. 2.

19 A loan that requires less financial documentation than that required for other loans. Primarily for borrowers who do not meet the standard loan application criteria, such as the self-employed and other borrowers whose income could not be readily verified.

20 APRA, *Proposed Changes to the Risk-Weighting of Residential Mortgage lending*, p. 4.

21 Reserve Bank of Australia, *Financial Stability Review*, September 2004, pp. 39–40.

5.19 In 2007, the RBA reported that mortgage brokers in Australia had been under discussion for some time. It explained:

In part, this reflects concerns that a small number of brokers may have been associated with predatory lending practices and that their remuneration structures—predominantly high upfront and low trailing commissions—might have adverse consequences for both borrowers and lenders.²²

5.20 In September 2007, the House of Representatives Standing Committee on Economics, Finance and Public Administration tabled a report on home loan lending. Although the report noted the positive results stemming from changes in the housing lending market, it also referred to negative aspects, including instances where lending had been inappropriate. The report cited the concerns of the Credit Ombudsman Service, which had identified:

...a disturbing trend among some lenders, normally fringe lenders, to refinance home loans in circumstances where the borrower has no capacity to repay the loan. These lenders rely solely on the value of the security, not the borrower's ability to meet the repayments. The borrower is invariably in default of their existing loan and is at risk of losing their home.²³

5.21 The House of Representatives' committee recommended that the Commonwealth take responsibility for regulating credit including mortgages.

5.22 By 2008, widespread support for reform was mounting.²⁴ In March 2008, the Council of Australian Governments (COAG) agreed in principle to the Commonwealth taking over the role of regulating mortgage credit and advice to protect consumers. The states' agreement to refer constitutional powers to the Commonwealth paved the way for the introduction of the Consumer Credit Protection Reform Package.

Committee comment

5.23 Prior to 2008, ASIC had been aware of emerging problems in the mortgage brokering industry, including predatory lending and the potential for it to grow. As the years passed, the trend continued but the push for reform was not sufficiently strong until 2008 when agitation for legislative change gathered the necessary force to compel reform. Before the committee considers the effectiveness of the reforms, it examines ASIC response to the problem of predatory lending as it crept into mainstream lending after 2002.

22 Reserve Bank of Australia, *Financial Stability Review*, September 2004, p. 40.

23 See House of Representatives Standing Committee on Economics, Finance and Public Administration. *Home loan lending, Inquiry into home loan lending practices and the processes used to deal with people in financial difficulty*, September 2007, Parliamentary Paper No. 191/2007, p. 24.

24 Productivity Commission, *Review of Australia's Consumer Policy Framework*, Vol. 1, No. 45, 30 April 2008, p. 28.

ASIC's response to lending practices

5.24 In the following section, the committee looks closely at the nature of this predatory lending, the effects it had on individual consumers, and why, despite the warnings, such practices were allowed to continue. While the committee acknowledges ASIC's limited regulatory function over the provision of credit during this period, its focus nonetheless is on the measures that ASIC could or should have taken to arrest the trend in predatory lending and to protect the interests of retail borrowers.

Previous inquiry

5.25 The committee has previously inquired into poor lending practices as part of its broader 2012 inquiry into the post-GFC banking sector. It took evidence from people claiming that they had been the victims of predatory lending. Ms Denise Brailey, who headed up the Banking and Finance Consumers Support Association (BFCSA), asserted that fraud and maladministration, especially related to low doc loans was prevalent. The allegations were serious and went to matters such as the falsification of application loans.²⁵

5.26 During that inquiry, ASIC informed the committee that it had taken enforcement action regarding low doc loans over a number of years and that it had 'not identified widespread evidence of systemic misconduct in the banking sector along the lines described by Ms Brailey'. At the time, the committee expressed its concern about the obvious discrepancies between ASIC's account and Ms Brailey's claims of predatory lending and fraud. It believed that the matter warranted further investigation and that, upon receipt of allegations that presented an arguable case of wrongdoing, ASIC should undertake its own investigations to establish whether a prima facie case of fraud existed.²⁶

5.27 Following this suggestion, ASIC wrote to Ms Brailey requesting the documentation she had referred to that would support her allegations of misconduct. ASIC obtained and reviewed the documents provided by Ms Brailey but considered that the material did not provide evidence of any breach of the law by lenders.²⁷ According to ASIC, additional information posted on the BFCSA's website did not provide evidence of breaches of the laws administered by ASIC 'or indicate that any of the credit providers were aware of, encouraged, or inserted misleading information in application forms'.²⁸ This current inquiry into the performance of ASIC provided

25 Senate Economics References Committee, *The post-GFC banking sector*, November 2012, Parliamentary Paper No. 448/2012, p. 102.

26 Senate Economics References Committee, *The post-GFC banking sector*, pp. 105 and 107–108.

27 ASIC, *Submission 45.1*, pp. 28–29.

28 ASIC, *Submission 45.1*, p. 29.

another opportunity for people who have suffered loss because of poor lending practices to recount their personal experiences.

Submissions

5.28 The committee received well over 160 submissions from people expressing concerns about the conduct of brokers and lending institutions. Most provided their own account of being caught up in poor lending practices and as a consequence losing their family home, life savings, credit rating and in many cases their health. A significant number of those who wrote to the committee were approaching retirement or had retired. Their experiences align with those cited in the CCLC 2003 report and are consistent with the findings of APRA and the RBA around that time.

5.29 According to the BFCSA, older retirees and pensioners have been the favoured target of white collar crime in Australia over the past two decades.²⁹ In respect of irresponsible lending, evidence before the committee supports this contention. For example, one couple, aged 71 and 64 years, had a loan of \$900,000 approved. They asked how was it possible for the bank to approve such an amount for 'a 30-year term to people of our advanced age when we were Centrelink recipients earning \$23,000 per annum combined'.³⁰ Another couple in their late 60s received a loan of \$360,000.³¹ These examples were not isolated cases of a person or retired couple receiving an annual income of below \$35,000 obtaining a considerable loan over a 30-year term.³² One son noted that his father, on the pension of less than \$30,000 a year and, in his opinion, losing his faculties, was 'granted a loan of \$300,000 to invest in the stock market'.³³ Another retired couple on the aged pension obtained a loan in 2007 of some \$415,000 on a property and \$209,000 on their home. They also received a \$165,000 buffer loan 'to provide some portion of the deposits, and then provide a bit of capital to assist the loans'. In 2009, they got another loan from a different bank to refinance another property. They explained:

We are now aged 75 and 68 and face the very real prospect of losing our home as we have no income apart from the pension. We have sold our shares, a car, spent our invested money and, where we were in a fairly sound financial position with assets over \$1.5m we now have about \$250,000 in equity and this is declining and we have no prospect of any improvement in our situation and find ourselves in an overwhelmingly frightening position.³⁴

29 Banking and Finance Consumers Support Association Inc, *Submission 156*, p. 5.

30 Ms Ann Marie Delamere, *Submission 3*, p. 1.

31 Name withheld, *Submission 27*.

32 See also *Submissions 19, 25, 27, 103, 178 and 265*.

33 Mr and Mrs Graeme and Nat Powell, *Submission 8*, p. 1.

34 Name withheld, *Submission 55*, p. 1.

5.30 Another couple informed the committee that:

...we are about to lose our family home and everything we have worked towards for over 40 years to secure a self-funded, comfortable retirement. Instead, we are broken mentally and physically and are now looking at a life of dependence on the old aged pension and an unnecessary drain on the public purse (the very thing we have worked our whole lives to avoid!).³⁵

5.31 In their words:

We thought and trusted our 'Professional' Financial Planner, the Broker and the Lender on the understanding that they operated under strict legislation and Codes of Practice in 'a very stable Australian Banking System' as it was explained to us at the time. This misplaced trust has destroyed our lives.³⁶

5.32 The loan offers were directed at people who could borrow on the equity in their home or other assets. According to one couple who were 'spruiked into buying investment properties for their retirement':

...we were 58 years old, we were asset rich and income poor after 40 years of hard work, we owned our factory premises our business and business equipment, savings and we had a small loan on our house. The banks said we could afford these low doc loans...These loans were never affordable, our income was exaggerated, our assets were overstated, our rental income was overstated. At 58 we got 30 year loans, we would have to work until we were 90 years of age, there has to be something wrong. We used our savings, everything we earned, buffer loans, selling our vehicles and equipment and after 7 years of stress we cannot pay anymore, it was a transferral of our wealth to the banks. This has happened all because we placed our trust in the banks, and ASIC protects the banks.³⁷

5.33 While consumers have a responsibility to attend to their own interests, a number of submissions spoke of unconscionable or misleading and deceptive conduct on the part of brokers and lenders. Welcome Australia Limited told the committee of the deliberate targeting of asset rich-income poor 'Australians with the intention of reaping financial gain that would invariably and knowingly lead to the loss of the victim's home'. It referred to campaigns directed at retirees, many of whom were living solely on the pension, enticing them to mortgage their homes 'while offering them the world'. According to Welcome Australia:

The majority of these retirees have no idea as to the true picture of what is actually taking place, for once they sign that contract the money begins to flow, to the bankers, the financial institutions and the property speculators,

35 *Submission 67* (Confidential).

36 *Submission 67* (Confidential).

37 Name withheld, *Submission 93*, p. 1.

while the investor/retiree begins to witness the dissolution of their asset, their family home.³⁸

5.34 Retired couples were not the only targets. One submitter stated that he was 55 years old and had recently lost his job; even though the submitter indicated in writing that he was unemployed, he was successful in obtaining a \$480,000 loan.³⁹ Another was a newly widowed 56-year-old woman who was not working, receiving a widow allowance and in poor health due to the stress and grief of losing a partner, when she refinanced her mortgage with a major bank. She later discovered that her income was recorded incorrectly in the loan application form and stated that, had she been earning that amount, she 'would never have had a need for a mortgage'. Arguing that the bank had taken advantage of, and defrauded, her, she wrote:

Now aged 64, no longer a home owner for the first time in 34 years, robbed of a chunk of my rightful equity, not enough now to buy anything outright unless miles away from family friends...⁴⁰

5.35 A third case, but again only one of many, was a single mother who was studying and working part-time. She had been fortunate to have received an inheritance which had allowed her to buy her own home and to feel 'fairly secure'. She then explained:

I was naive about investments and finances and believed what people with experience told me. I was told by a broker that I should invest in property, which I did with a low doc loan. I now clearly realise that I was never in a position to be able to pay back a loan as I did not have the income. I now have massive loans, no savings and have mortgaged my house. Life is now a struggle month to month to pay the loans.⁴¹

5.36 A person on a disability pension, now forced to rent out her home and live at her daughter's house, was among the many who wrote to the committee.⁴² In some other instances, the banks approved unaffordable loans to people 'who could hardly read and write' or who had a poor command of the English language.⁴³

Disclosure

5.37 Many of the people who wrote to the committee were clearly hard working Australians who over their lives had built up a nest egg so that they could support themselves comfortably in their retirement. As one couple remarked:

38 Welcome Australia, *Submission 230*, p. 3.

39 Name withheld, *Submission 46*, p. 1.

40 Name withheld, *Submission 158*, p. 3.

41 Ms Kirsty Torrens, *Submission 180*, p. 4.

42 Name withheld, *Submission 16*.

43 *Submissions 52 (Confidential) and 183*.

We have both worked all our lives in good jobs, paid our bills and our taxes and raised our family, and had finally taken time out to relax when we were approached with this bank scam. However, we were completely sucked in by the scam and particularly when we were told the bank was the Commonwealth which we had always associated with being a good Australian citizen.⁴⁴

5.38 Many asked the same question—how could they find themselves in such a predicament? As one submitter put it:

How did I [end] up with \$530K debt when I had no income when Low Document Loan was approved to me...I will be facing a Bankruptcy as my house is only worth \$430K.⁴⁵

5.39 For some, there was a definite sense that the banks had betrayed them. One submitter, who referred to herself as 'a loyal customer of 35 years', did not suspect that the bank would take advantage of long standing customers.⁴⁶

5.40 Another common complaint involved the failure to inform the borrower about the loan documents; important details of the loan structure; and how the loan arrangements would or could affect the borrower's circumstances.⁴⁷ A most disturbing element, however, involved information contained in the loan application forms being deliberately fabricated after the applicant had signed the documents or in some cases signatures themselves being forged. Indeed, most of the people who wrote to the committee about being the victims of predatory lending also referred to forged loan application forms and the failure of the respective lending institution to verify the information.⁴⁸ Falsified information included: inflated income details; over-valued and over-stated assets; fake Australian Business Numbers (ABNs); embellished employment details; and false income tax details. For example, one couple listed the anomalies in their application:

Our actual total income has been changed and in fact overstated by almost \$200,000, contrary to documented proof that was provided at the time, in the form of tax returns and other official documentation.

No dependants included. In fact we have 2 children both at home, one at school.

44 Name withheld, *Submission 29*, p. 1.

45 Ms Hifumi Robbie, *Submission 15*, p. 1.

46 Name withheld, *Submission 158*, p. 3.

47 *Submissions 15* and *52*.

48 Many submissions used their own experiences which taken together provided some sense of the nature and extent of the practice. For example, see *Submissions 3, 5, 7, 9, 12, 13, 14, 15, 16, 17, 19, 20, 21, 23, 24, 26, 27, 28, 32, 39, 48, 51, 52, 58, 64, 66, 68, 69, 71, 72, 93, 101, 104, 105, 131, 158, 171, 177, 183, 185, 195, 207, 218, 220, 221, 317, 320, 322, 351, 353, 378, 380, 381, 382* and *401*.

The actual value of our assets has been changed and in fact overstated, contrary to documented proof that was provided at the time.

The actual cost of our expenses has been changed and in fact understated, contrary to documented proof that was provided at the time.

The actual cost of our expenses has been changed and in fact understated, contrary to documented proof that was provided at the time, in the form of official documentation.⁴⁹

5.41 According to this couple, after they had signed and submitted the original documents to the bank, changes were made to the loan application form by person or persons unknown to them and without their authority, permission or knowledge.⁵⁰ A 73-year-old self-funded retiree and a permanent carer to his son provided another example that typified the range and extent of falsification of a loan application form:

My income was altered from about \$34,000 p.a. to \$75,000 p.a.

My 1999 Toyota worth about \$6000 was valued at \$25,000.

My employment record was false. I had retired in 1995 and since then was never self-employed as a tutor as claimed falsely in the [loan application form].

My superannuation and \$325,000 in non-existent shares were fabricated.

I have never had an accountant or ABN as claimed.

A Family Trust was fabricated and I have never been a sole trader.

My home was overvalued by \$100,000.

I had signed a different declaration. I never signed the affordability statement/self-employment forms claimed to be held on file.⁵¹

5.42 Again the submitter told the committee that the bank had 'never checked details with me to prove that I could service the loan'.⁵² Another couple told the committee that they were 'absolutely shocked' to find that their details had been 'grossly falsified' and incomes 'hugely inflated'. They believed that the alterations were made by the bank after they had signed the forms. They explained further:

We never had contact with the bank as this was done through a broker, if the lender had made just one phone call to us to check that these details were correct the loan would not have been approved and we wouldn't be in this position.⁵³

49 Name withheld, *Submission 14*, pp. 1–2.

50 Name withheld, *Submission 14*, p. 2.

51 Name withheld, *Submission 60*, p. 1.

52 Name withheld, *Submission 60*, p. 2.

53 Name withheld, *Submission 27*, p. 1. See also, *Submissions 28, 36, 52, 66, 67 and 72*.

5.43 For some, this practice was 'incomprehensible' and that no 'sane person would have continued with these loans had they been aware of the level of tampering required to get them approved'.⁵⁴ One such submitter, who was receiving WorkCover payments, told the committee that her employment details had been altered but that the bank did not 'bother to collect any taxation returns to verify the income'.⁵⁵ Another submitter informed the committee that the bank had never contacted his father's accountant to ascertain his financial position. He asked a question posed by so many others:

Would it not be a financial provider's responsibility to perform at least the most basic due diligence before providing a large loan to anyone, let alone an 80 year old man?⁵⁶

5.44 One couple remarked that while the bank never phoned them or made inquiries into their ability to repay the loan, it did go 'to great lengths to get a valuation' on their property.⁵⁷ Another could not understand why banks could undertake credit checks but not check income.⁵⁸

5.45 The committee suspects that there are many other people who, too embarrassed or disheartened by their experiences, have not come forward to reveal their own stories of improper lending practices. Indeed, the CCLC told the committee that it used to see such cases with 'alarming regularity'.⁵⁹

5.46 Many of the people who contacted the committee spoke of their sense of deep shame in succumbing to predatory lending. They felt humiliated and defeated by the whole business, which commonly had dragged on for years, draining their energy, damaging their personal relations as well as their physical and mental health. One submitter spoke of the indignity in finding herself in such desperate straits:

I am ashamed of the position I am in because of bank approved low doc loans, there is fraud and forgery on our low doc loans, these loans ought to have been rejected, they were never affordable from the beginning, the depression, the stress, the fighting with my family, all our life savings gone, because of low doc loans.⁶⁰

54 *Submissions 68 and 69.*

55 Name withheld, *Submission 66*, p. 1.

56 *Submission 52 (Confidential)*. See also *Submissions 67, 75 and 101*.

57 Name withheld, *Submission 29*, p. 1.

58 Name withheld, *Submission 72*, p. 1. See also Mr Edmund Schmidt and Ms Cynthia Lawrence, *Submission 265*.

59 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 42.

60 Name withheld, *Submission 226*, p. 3.

5.47 A 64-year-old pensioner who at first declined to accept an offer of a loan but subsequently was persuaded to borrow a much larger amount than initially requested summed up his situation:

I am the victim of a Low Doc Loan which has sucked my life away and placed me on the brink of suicide. The poverty, sadness, despair and hopelessness which have been caused by my attempting to keep up repayments on a Low Doc loan which should never have been granted are real, cruel and horrible.⁶¹

5.48 Another stated that, on reflection, he was encouraged to think beyond his circumstances. He realised that a more prudent decision, which he started with, 'was to purchase an affordable property but was convinced otherwise by an offer presented as a 'sensible and tax effective way to increase my superannuation'.⁶²

5.49 People spoke of having to live on the breadline just to try to repay the money after having worked all their lives; paid their bills and taxes; and raised their family.⁶³ The fear of losing their home was particularly alarming. One couple in their late 50s stated they 'should be planning retirement not worrying constantly if we will have a roof on our heads next week or next month'.⁶⁴ One submitter, the sole carer of his son, feared that there would be no financial support or home for him.⁶⁵

5.50 Many borrowers who wrote to the committee also felt let down by ASIC. They believed that the system was unjust and consumer protection non-existent.⁶⁶ One submitter noted:

I am left thinking that a consumer purchasing a domestic refrigerator has more consumer protection than a bank customer negotiating a loan over an asset that's taken a lifetime to acquire.⁶⁷

5.51 Another, who also argued that the Australian government appointed ASIC to protect consumer interests against misconduct by the financial institutions, stated that ASIC seems to be 'in bed with the banks'.⁶⁸ In numerous cases, borrowers argued they had mounted a strong case of maladministration in lending but that when they contacted ASIC for assistance, it failed to act on their complaint in any effective way.⁶⁹ Mr Timothy Chapleo voiced a common view:

61 Name withheld, *Submission 344*, p. 1.

62 Name withheld, *Submission 46*, p. 1.

63 See for example, *Submission 29*.

64 Name withheld, *Submission 21*, p. 2. See also *Submission 27*.

65 Name withheld, *Submission 60*, p. 2.

66 Name withheld, *Submission 43*, p. 1.

67 Name withheld, *Submission 39*, p. 1.

68 Mr Spencer Murray, *Submission 23*, p. 1.

69 See for example, *Submission 71*.

If they cannot be of any real value in policing rogue business and large organisations such as financial lenders and enforcing corrective measures then what value are they in a role that should see them being able to have some real ability to protect members of our society from unfair and bad elements in business.⁷⁰

5.52 The few cases cited so far only hint at the extent of the problem and the number of people who believe that they have been the victims of predatory lending. In many cases these people were desperate to stem the losses and salvage whatever they could from the financial mess they found themselves in and in particular to save or regain their family home. Their trust in the banking system has been shattered and their confidence in ASIC as an effective regulator destroyed.

Loan application forms—anomalies and discrepancies

5.53 The committee has recounted the stories of many borrowers who found themselves in dire circumstances because of irresponsible lending practices. In account after account, submitters expressed their shock at discovering that their forms had 'been manipulated to suit the purpose of the loan'.⁷¹

5.54 The stories of altered loan application forms are hard to believe. The reported extent of these manufactured application forms raises many questions about why the practice was allowed to continue seemingly unchecked for so many years. As noted earlier, a 2003 ASIC-commissioned report referred to this matter as did both APRA in 2003 and the RBA in 2004. Yet the practice continued for several more years until finally the states agreed to refer powers to the Commonwealth and new credit laws were passed.

5.55 Many who obtained their loan through a broker indicated that the lender did not contact the borrower to check the details in the loan application form or take measures to verify the accuracy of the information. They claim that had the lender done so, it would not have approved the loan.⁷² Some were convinced that the banks were required by law to ensure the affordability of the loan: that it was the bank's responsibility to confirm that the information contained in the loan application form was accurate.⁷³ One submitter stated that the bank 'did not protect us by communicating with us or checking any of the paperwork as a prudent lender would be expected to do...'⁷⁴

70 Mr Timothy Chapleo, *Submission 7*, p. 1.

71 Name withheld, *Submission 12*, p. 2. See also Financial Ombudsman Service, *Determination: Case number 323234*, 17 December 2013, p. 3.

72 *Submissions 27, 28 and 29*.

73 *Submissions 36 and 68*.

74 Name withheld, *Submission 72*.

5.56 In this regard, it should be noted that the 2003 Code of Banking Practice states clearly that before a bank offers or gives a credit facility, or increases an existing credit facility, it would 'exercise the care and skill of a diligent and prudent banker' in selecting and applying credit assessment methods and in forming an opinion about the borrower's ability to repay it.⁷⁵

Loan calculator

5.57 It would appear that in most, but not all, cases before the committee, it was the broker who altered or inserted incorrect information in the loan application form. Many of the borrowers argued that the broker did not act on their behalf but was in effect the agent of the bank. In their view, the lender paid the broker, who often had access to the lender's computer systems, and 'was instructed by the lender on how to get various loans across the line and operated under the lender's systems and instructions'.⁷⁶ Ms Brailey cited the use of a service calculator as evidence that brokers were indeed agents of the banks. She stated:

I want to highlight that everything is predicated on a service calculator... All 11,000 brokers have a screen in front of them. They must put the base income in the top corner. At the bottom, it spits out a figure. The broker is then taught by the business development managers at bank level. They come out to your office and teach you how to use it. They ask the broker to write that figure on the loan application form in their own handwriting. So he or she writes \$180,000, when the figure was \$50,000. That, in a nutshell, is how that fudged figure emerges.

The service calculator is a tool—it is a weapon.⁷⁷

5.58 ASIC argued, however, that ultimately the person who entered the incorrect information or tampered with the loan application form was the one responsible for the act:

If an individual, whether a finance broker or a borrower, falsifies information in order to make a loan fit a calculator, it is the individual who has engaged in misconduct, not the person who has made the calculator available.⁷⁸

5.59 That is, the lender was not held responsible for the misuse of the calculator by the broker, even though the lender may have supplied the calculator and provided advice and instruction on its use.

5.60 While the courts have tended to accept that brokers were not agents of the banks, the lending institutions do not come out of this period blameless. The banks

75 Australian Bankers' Association, *Code of Banking Practice 2003*, subsection 25.1.

76 *Submission 67* (Confidential).

77 *Proof Committee Hansard*, 20 February 2014, p. 46.

78 ASIC, *Submission 45.1*, p. 29.

and other lending institutions must have been aware of the dubious practices employed by some of the brokers arranging loans but chose to ignore them. Moreover, in some cases, the lending institutions clearly failed not only to exercise the skill and care of a diligent and prudent banker but were negligent even complicit in deceiving their customers. It should be noted that in its 2009 report on financial services and products, the Parliamentary Joint Committee on Corporations and Financial Services expressed some doubt about the degree to which banks acted 'ethically, appropriately, morally and prudently in their decisions to grant loans to some Storm customers'.⁷⁹

Committee view

5.61 It would seem that on the face of the evidence, some lenders, irrespective of the loan application form, should not have approved certain loans: they were unaffordable and likely to fail. In other cases, again irrespective of the loan application form, the borrower should have taken care before signing the actual loan contract to make sure that the repayments were sustainable and would not jeopardise the assets securing the loan.

5.62 Even so, the fact that this practice of manipulating information and faking signatures was allowed to continue for so long reflects badly on the brokers, the lenders and the regulator. It highlights the vulnerability of unwary and trusting borrowers, who were taken advantage of by unprincipled and self-interested brokers and lenders.

ASIC's role and limitations

5.63 Many submitters were of the view that the regulator did little to prevent predatory lending. ASIC informed the committee, however, that it made 'strategic use of the jurisdiction it did have'. It took court action; provided guidance to industry in areas where practice was poor; developed resources, tools and information for consumers of credit; and undertook surveillance activities where it saw problems in the industry. Moreover, ASIC endeavoured to understand the causes and effects.⁸⁰ For example, ASIC took the following action with regard to deceptive and misleading conduct:

- 2004—accepted an enforceable undertaking from mortgage broker Structured Solutions;
- 2006—took civil and criminal action against mortgage broker Tonadale Pty Ltd and Kelvin Sheers;
- 2006—obtained orders against mortgage brokers Sample & Partners Pty Ltd; and

79 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, Parliamentary Paper No. 321/2009, p. 35.

80 ASIC, *Submission 45.1*, p. 7.

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- 2009—took action against Whyte Corporation Pty Ltd.⁸¹

5.64 As well as citing these few cases, ASIC drew attention to the difficulty of bringing the lender to account for the misconduct of the broker. It noted that ASIC intervened in the Tonto Home Loans Australia Pty Ltd matter to argue that, 'in the circumstances, the brokers should be considered agents of the lender and that the actions of the lender were unconscionable'. The courts did not accept ASIC's submissions. ASIC explained:

The Supreme Court of New South Wales Court of Appeal ultimately held that the broker was not the agent of the lender and, as a result, that the lender's conduct was not unconscionable, but that the relevant contracts were unjust under state legislation.⁸²

5.65 ASIC informed the committee that:

The courts have found that, barring special circumstances, a mortgage broker is the agent of the borrower, and not the lender. This poses significant challenges for establishing unconscionable conduct where a broker is involved in the transaction, because:

- the broker's actions are attributed to the borrower. For instance, if the broker has manipulated the loan application, unbeknownst to the borrower and the lender, the action is taken to be that of the borrower, and not the lender; and
- the knowledge of a broker cannot necessarily be imputed to a lender. In these circumstances, as the lender typically deals with the broker and may not have any direct contact with the borrower, it is difficult to establish that the lender has sufficient knowledge of the borrower's circumstances for the lender's conduct to be unconscionable.⁸³

5.66 It appeared to ASIC that dishonest or fraudulent conduct had been 'more commonly found in relation to mortgage and finance brokers rather than lenders'.⁸⁴ The committee was told, however, that even where bank offers were alleged to have fabricated the loan forms, ASIC was reluctant to take action.⁸⁵ In specific reference to the provision on unconscionable conduct in the ASIC Act, ASIC explained that as the provision covers a broad range of situations, the courts have 'generally applied it to address the most extreme classes of conduct in all cases'. It explained further:

...the prohibition therefore does not provide a nuanced remedy that addresses the complexities of a transaction where problems may arise

81 ASIC, *Submission 45.1*, p. 6.

82 See ASIC, 'ASIC intervenes in low doc loan proceedings', *Media Release*, no. 09-39AD, 6 March 2009.

83 ASIC, *Submission 45.1*, p. 6.

84 ASIC, *Submission 45.1*, p. 26.

85 Ms Rosie Cornell, *Submission 285*.

because of the different interests of a consumer, a provider of an investment product, a lender and any finance broker.⁸⁶

5.67 ASIC noted further that borrowers who elected to pursue matters in court faced the same barriers as ASIC in establishing that a lender's conduct was unconscionable.⁸⁷ Additional difficulties borrowers could face when taking action against the broker were also recognised by ASIC:

Although a borrower may have a remedy against a finance broker for unconscionable conduct, the ability to obtain such a remedy, and value thereof, may be reduced in circumstances where the borrower is in financial hardship, due to an inability to repay the loan, and may be facing separate enforcement or legal action in relation to their home.⁸⁸

5.68 Thus, under the laws that existed before 2010, the people who were deceived by their brokers and abandoned by their lenders, had little prospect of success in the courts even though a lay person would clearly have understood the conduct of the broker or lender as unconscionable.

Fraud

5.69 As mentioned earlier, most complaints centred on the loan application form and the inaction by ASIC to deal with what the complainant considered was blatant fraud. In responding to alleged fraud occurring before the commencement of the National Credit Act, ASIC advised that the relevant state and territory police forces were the 'more appropriate authorities to investigate'. It noted that state and territory police had investigated some matters.⁸⁹ ASIC stated further that it appeared that dishonest or fraudulent conduct had been 'more commonly found in relation to mortgage and finance brokers rather than lenders'.⁹⁰

Guidance, education and warning notices

5.70 ASIC also informed the committee that it offered guidance for consumers through financial literacy material available on its website on managing credit and loans and debt. It also worked with industry, consumer groups and the external dispute resolutions schemes to improve practices. ASIC cited its work in fostering:

- the development of a code of practice applicable to brokers and non-bank lenders; and

86 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 4.

87 ASIC, *Submission 45.1*, p. 26.

88 ASIC, *Submission 45.1*, p. 6.

89 ASIC, *Submission 45.1*, p. 26.

90 ASIC, *Submission 45.1*, p. 26.

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- enhancements to the codes of practice of both the banking industry and mutual sector.⁹¹

5.71 As noted earlier, however, the banks already had a Code of Banking Practice requiring them to 'exercise the care and skill of a diligent and prudent banker'.⁹²

Committee view

5.72 ASIC had available to it persuasive and less formal measures to stop unscrupulous practices. In this regard, the committee believes that ASIC did not take the opportunity to intervene in a far more direct and public way. It did not send a strong message regarding its concerns about irresponsible lending practices to lenders. Nor did ASIC do enough to alert Australian consumers to the risks associated with low doc loans, their vulnerability to irresponsible or even fraudulent activity, and of the need to protect their own interests. Such early and decisive publicity may have educated the community about ASIC's limited ability to protect their interests and minimised the damage.

Individual complaints and ASIC's responsibility

5.73 The CCLC argued that the role of a large national regulator is 'to respond to systemic and serious breaches of law within the industry that it regulates'. According to the CCLC, the expectation that ASIC would investigate and take action in complaints prior to the new credit laws was 'unreasonable':

ASIC cannot be expected to resolve each individual consumer dispute, nor would it be in the public interest. ASIC should carefully consider how to respond to all potential breaches of the law, but should not necessarily undertake a formal investigation of every individual complaint that comes to its attention.⁹³

5.74 Furthermore, the CCLC highlighted that even in the face of 'extensive poor conduct' in lending in Australia, the laws then were limited and cases 'very difficult to win'.⁹⁴ It stated:

...prosecuting a case in relation to the conduct of an individual entity under the ASIC Act (without the credit laws) is a resource intensive exercise and will not necessarily result in the players being banned from the industry now. It will certainly not turn back time, nor enable consumers to keep assets they could not afford in the first place, or to retain assets used for security when the funds have been expended for the consumer's benefit.⁹⁵

91 ASIC, *Submission 45.1*, p. 8.

92 See paragraph 5.56.

93 CCLC, *Submission 194*, p. 16.

94 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 43.

95 CCLC, *Submission 194*, p. 15.

5.75 According to the CCLC, 'expending resources investigating conduct that has already been identified as a problem and has been the subject of major law reform is also clearly of limited value'.⁹⁶

5.76 The committee understands that ASIC's role between 2002 and 2010 when the new credit laws came into force was limited. The fact remains, however, and is a potent lesson for the regulator, that despite all the warning signs, ASIC remained in the background while borrowers found themselves exposed to unscrupulous lending practices and at risk of losing their homes and life savings.

Conclusion

5.77 The committee understands that ASIC receives a large number of complaints and reports of alleged wrongdoing and that it cannot possibly deal with such a large volume of individual complaints. But it also believes that individual complaints can provide early markers of a broader problem that ASIC should monitor and address. In this particular case of irresponsible lending, each single complaint was symptomatic of a more widespread and growing problem.

5.78 The one compelling lesson to be learnt from the many cases of predatory lending that occurred between 2002 and 2010 is that ASIC must be more proactive and more assertive in stepping forward and exposing poor practices as soon as they surface. The committee concludes that ASIC should have done more to:

- alert the public to the dangers of irresponsible lending and of the practices of some brokers that put their clients' interests at risk;
- inform consumers about the need to protect their interests when entering into a loan: to make sure that it was affordable and warn them of the pitfalls of particular loans such as low doc loans;
- educate the public about the importance of requesting and reading key documents and the dangers of signing incomplete documents;
- identify that a systemic problem was emerging or already entrenched in the industry that needed decisive action to prevent further consumer harm;
- take a stand against and investigate fraudulent activity such as the allegations of doctored loan documents including forged signatures and fabricated information, and of possible unconscionable conduct (enticing vulnerable people to take out unaffordable loans);
- engage the banks in serious conversation about their duty to 'exercise the care and skill of a diligent and prudent banker', as stated in subsection 25.1 of the Code of Banking Practice, and urge them to adhere to this undertaking;

96 CCLC, *Submission 194*, p. 16.

- join forces with ASIC-approved external dispute resolution schemes to combat the misuse of loan service calculators and loan application forms, and any behaviour in the credit industry that went to unconscionable conduct; and
- improve the way it conversed with borrowers who were seeking the regulator's assistance.

5.79 Some recommendations that would have flowed naturally from the evidence presented in this chapter have been made redundant by recent reforms. There are others, however, that remain relevant but are developed and appear in later chapters. Noting ASIC's existing work on financial literacy, the committee, for the moment, makes the following recommendation.

Recommendation 1

5.80 The committee recommends that ASIC develop a multi-pronged campaign to educate retail customers about the care they need to take when entering into a financial transaction and where they can find affordable and independent advice or assistance when they find themselves in difficulties because of that transaction.

New credit laws

5.81 Due to the national credit reforms implemented in 2010, many of the unscrupulous practices identified in this chapter should now be unlawful and people involved in the provision of credit, including intermediaries such as brokers, subject to tighter regulation. In the following chapter, the committee considers the new credit laws and their effectiveness in protecting consumers from irresponsible lending practices.

Chapter 6

New credit laws

6.1 There can be no doubt that between 2002 and 2010 improper, lax and even predatory lending practices were not uncommon. Indeed, these practices led to major reforms in the provision of credit. Effective from 1 July 2010, the *National Consumer Credit Protection Act 2009* (National Credit Act) introduced for the first time in Australia stringent responsible lending obligations on credit providers and intermediaries such as finance brokers.

6.2 In this chapter, the committee considers ASIC's new role and the effectiveness of the new laws in stamping out irresponsible lending practices.

Background

6.3 The committee's consideration of inappropriate lending practices between 2002 and 2010 is not the first time that a parliamentary committee has recently identified irresponsible lending practices as a problem. It should be noted that the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) received evidence about poor lending practices from many investors caught up in the failure of Storm Financial. Borrowers reported that they had signed blank loan applications and, following Storm's collapse, discovered they had taken out additional loans of which they were unaware. They also claimed copies of forms provided by the banks post-collapse show overstated income figures or asset values that led to grossly inaccurate representations of their capacity to repay the loans.¹ Some of Storm's clients did not understand, or fully comprehend, that by borrowing against the equity in their family home they were, in effect, putting the ownership of their home at risk.² The PJCCFS found that practices by institutions lending for investment purposes were below community expectations and not subject to appropriate regulatory control.³

Need for reform

6.4 As noted in the previous chapter, from 2002 there had been a general and growing awareness in the industry of problems with inappropriate lending practices. This awareness led COAG to announce in March 2008 the need for a broad regulatory reform agenda that would include taking early action and progress on mortgage credit and advice, margin lending and non-deposit taking institutions.

1 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, Parliamentary Paper No. 321/2009, p. 23.

2 PJCCFS, *Inquiry into financial products and services in Australia*, November 2009, p. 28.

3 PJCCFS, *Inquiry into financial products and services in Australia*, November 2009, p. 90 and ASIC, *Submission 378*, pp. 87–88.

6.5 The following month, the Productivity Commission found that a single national regulatory regime covering both mortgages and mortgage brokers would be 'an efficient response to the need to address a number of malpractices on the part of certain brokers'.⁴ It recommended that responsibility for the regulation of credit providers and intermediaries providing advice on credit products ('finance brokers') should be transferred to the Australian government, with enforcement to be undertaken by ASIC. Amongst other things, the new national credit regime should:

- cover all consumer credit products and all intermediaries providing advice on such products (including through electronic or other arms-length means); and
- include a national licensing system for finance brokers, and a licensing or registration system for credit providers that would give consumers guaranteed access to an approved dispute resolution service.⁵

6.6 In July 2008, COAG agreed to measures designed to provide better protections for financial consumers across Australia. It announced that the Commonwealth would assume responsibility for 'the regulation of trustee companies, mortgage broking, margin lending and non-deposit lending institutions as well as remaining areas of consumer credit'. It envisaged that:

National regulation through the Commonwealth of consumer credit will provide for a consistent regime that extinguishes the gaps and conflicts that may exist in the current regime. The new regime is anticipated to introduce licensing, conduct, advice and disclosure requirements that meet the needs of both consumers and businesses alike.

6.7 Over two years later, the Consumer Credit Protection Reform Package was introduced, which aimed to further this goal of a national, uniform approach to consumer credit laws. It included a national licensing scheme to overcome some of the current anomalies—a 'single standard and uniform regime for consumer credit regulation and oversight'.⁶

New credit laws

6.8 Under the new credit laws, credit licensees must comply with the responsible lending conduct obligations in chapter 3 of the National Credit Act. If the credit contract or consumer lease is unsuitable for the consumer, then credit licensees must not:

- enter into a credit contract or consumer lease with a consumer;

4 Productivity Commission, *Review of Australia's Consumer Policy Framework*, Inquiry report no. 45, vol. 1, 30 April 2008, p. 9.

5 Productivity Commission, *Review of Australia's Consumer Policy Framework*, vol. 1, 30 April 2008, p. 66.

6 The Hon Chris Bowen MP, Second Reading Speech, National Consumer Credit Protection Bill 2009, *House of Representatives Hansard*, no. 10, 2009 (25 June), p. 7148.

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- suggest a credit contract or consumer lease to a consumer; or
 - assist a consumer to apply for a credit contract or consumer lease.⁷

6.9 These conduct obligations apply to credit providers—such as banks, credit unions and small amount lenders—and to finance companies, lessors under consumer leases and credit assistance providers such as mortgage and finance brokers. The legislation requires credit providers to make inquiries into whether the loan would meet the borrower's requirements and objectives. In other words, since the National Credit Act came into force in 2010, both lenders and brokers have 'a positive obligation to make inquiries into a borrower's financial situation (i.e. that the loan will not cause substantial hardship), and to verify that assessment'.⁸ For non-ADIs, the responsible lending obligations came into effect on 1 July 2010 and for ADIs on 1 January 2011. Being banks and mutuals, ADIs had a pre-existing code of practice, which had a similar obligation.

6.10 Much consultation and negotiation took place before the legislation was introduced. According to Mr Philip Field, Financial Ombudsman Service (FOS), the process 'probably took the best part of two or three years of negotiations and roundtable meetings to get it into place and get people on board' including consumers, lenders, and brokers.⁹ Two parliamentary committees also scrutinised the proposed legislation that would introduce the credit reforms. Mr Raj Venga, Ombudsman, Credit Ombudsman Service (COSL), stated that the legislation was 'frankly, long overdue'.¹⁰

6.11 The committee appreciates that this legislation had a fairly long incubation period and a definite purpose based on a clear understanding of the problems it was addressing. In addition, all stakeholders had the opportunity to engage in consultation and provide feedback. Even so, reforms of this nature, no matter how well-intended and considered, need time for their effectiveness to be tested.

Views on its operation

6.12 In early 2014, Mr Field informed the committee that the Financial Ombudsman had not seen a lot of cases arise yet and was 'just starting to get disputes around responsible lending under the National Credit Code'. He explained that FOS was a 'rear-view organisation' and people approached it sometimes many years after the original event. While his best guess was that the new legislation was 'working quite well', he would like the chance to see how the legislation settles down in terms

7 ASIC, *Credit licensing: Responsible lending conduct*, Regulatory Guide 209, September 2013, p. 4.

8 Consumer Action Law Centre, *Additional Information 8*, p. 1.

9 Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service, *Proof Committee Hansard*, 20 February 2014, p. 24.

10 *Proof Committee Hansard*, 20 February 2014, p. 18.

of changing lender behaviour. He suggested that it be given a fair opportunity to work and to see whether it actually solves the problem.¹¹

6.13 Mr Gerard Brody, Consumer Action Law Centre, informed the committee that, since the introduction of the licensing regime and particularly the responsible lending obligations, experience in the mainstream lending area indicated that practices had improved. He explained:

Our experience is that the new obligations under the national credit law have improved processes and that we are not seeing the type of loss that people have experienced in the past, particularly because of the responsible lending obligations and the obligations upon credit providers to assess someone's capacity to repay and assess that a loan is in line with their objectives.¹²

6.14 The CCLC agreed with the view that within mainstream lending there had been 'a noticeable tightening of lending procedures, particularly within the areas where the law applies'. It had certainly experienced a major reduction in the type of poor lending that was occurring beforehand. According to Mrs Karen Cox, CCLC, they 'get one-off cases where things have gone wrong' but:

For consumer credit lending and residential investment lending we have not seen the sorts of cases seen in the past. That does not mean they do not exist, but we are not seeing them at all.¹³

6.15 Mrs Cox stated further that the CCLC had started to win a couple of cases at the dispute resolution schemes on the interpretation of the law. In her view, however, it was 'very early days yet in terms of what the law actually means'. Noting that it was also very early days in terms of the compliance reaction, Mrs Cox anticipated that:

...perhaps in time, we might see some people trying it on again. That would require ASIC to make sure that does not happen.¹⁴

6.16 Thus, while those who commented on the new credit laws were generally satisfied that the legislation was working well, they still noted that the laws needed time to bed down before a more conclusive assessment of their effectiveness could be made. In this regard, Mr Field observed that, where someone has obtained a loan they could not afford, difficulties would generally become apparent within the first or second year, depending on the nature of the loan. He did note, however, that with self-funding, the borrowers would not realise problems until the self-funding ran out.¹⁵

11 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 24.

12 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 42.

13 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, pp. 41–42.

14 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 42.

15 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, *Proof Committee Hansard*, 20 February 2014, p. 24.

6.17 Challenging this point, Ms Brailey argued that some problems with lending practices remain. She explained that people who took out a loan in 2010 will 'not know that their loan is fraudulent, toxic, service calculators were used or the same model used by 85 per cent of the major lenders'. In her view, the contracts 'do not implode for five years'.¹⁶ She explained:

The loans are being approved on the idea that you can afford it because you have some money in the bank. So where does that money come from? When the banks set up the loan, they give people \$300,000 to go and buy a small property. It is usually \$300,000 to \$400,000—that is the average. But they give them an extra \$50,000 and in some cases \$100,000 to afford it. So they are paying the payments with the bank's own money, and the bank approves it. Then you go on for another two or three years like that and that is where the refinancing comes in, which ASIC has been going on about a bit. The commissioner said to me, 'Denise, I can assure you refinances are finished.' They are not. It is still going on. I was seeing it written only six months ago. It is still there.¹⁷

6.18 Her concern was that when loans are taken out on the basis of the equity in an existing asset, the continuing refinancing and the continuing compounding interest on the debt increases the value of the loan which eats 'into the equity that is there'.¹⁸

Possible gaps or weaknesses

6.19 While in general the consumer advocacy centres recognised the benefits of the new legislation, they also identified a number of areas where there was a possible gap or weakness in the legislation. Mrs Cox from the CCLC noted that some areas of lending were not covered by the new law, including small business lending and other forms of non-residential investment lending.¹⁹ So, in her view, there were potential problems, but because the CCLC was not funded to assist people in this area, it would not necessarily receive evidence of what was going on there.²⁰ Even so, the CCLC stated quite clearly its belief that:

...investment lending has been instrumental in facilitating some spectacular investment failures with catastrophic results for many consumers, including self-funded retirees who have lost their homes and their life savings.²¹

16 Ms Denise Brailey, President, BFCSA, *Proof Committee Hansard*, 20 February 2014, p. 47.

17 Ms Denise Brailey, BFCSA, *Proof Committee Hansard*, 20 February 2014, p. 49.

18 Ms Denise Brailey, BFCSA, *Proof Committee Hansard*, 20 February 2014, p. 50.

19 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 42. ASIC also made it clear that the National Credit Act does not apply to all borrowings by SMEs or to borrowings for investment purposes, other than investment in residential property. ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 2.

20 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, pp. 41–42.

21 CCLC, *Submission 194*, p. 19.

6.20 The CCLC cited the Regulation Impact Statement (RIS) on credit for investment issued by the then Minister for Financial Services and Superannuation on 21 December 2012. The draft legislation recognised that consumer losses due to misconduct were 'amplified where the consumer has borrowed to invest'. The RIS indicated that the current legislative framework did not adequately address misconduct in the credit to invest area. According to the RIS, ASIC's enforcement activity was 'ineffective due to a combination of regulatory and enforcement gaps, the prohibitive cost and inefficiency of enforcement action and the unlikelihood of targeted enforcement action by ASIC resulting in behavioural change in the industry as a whole'.²²

6.21 The previous chapter referred to cases where people borrowed to invest and found themselves in difficulty. Also, as noted in the previous chapter, as early as 2003 there were warnings about brokers arranging for borrowers to declare, incorrectly, that a loan was for investment rather than personal use (with the result that the consumer lost statutory protections provided under the Uniform Consumer Credit Code). Clearly, this is an area that requires careful monitoring.

Fringe areas of lending

6.22 Currently, the Consumer Action Law Centre's concern and focus is on the fringe areas of the marketplace, such as payday lending and consumer leases, also known as rent to own products. It highlighted concerns about systemic problems with compliance in some of these areas.²³ For example, the Centre noted that property spruikers were not regulated and not licensed by ASIC. It suggested that 'there may well be commission arrangements between spruikers and certain brokers or lenders who encourage individuals to purchase property (with or without a loan) that are inappropriate'. The Centre cited the Victorian Parliament Law Reform Committee's 2008 report that made a raft of recommendations including that the Australian government regulate property investment advisers under its financial services laws in the same way as financial advisers.²⁴

6.23 Mr Brody also drew attention to concerns and consumer complaints about businesses established purportedly to help consumers in financial difficulty that charge significant fees. He explained that such businesses are termed the 'for-profit financial difficulty' businesses and target people who are in financial difficulty,

22 Treasury, *Regulation Impact Statement: Credit for investment purposes*, December 2012, p. 1.

23 Mr Gerard Brody, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 42.

24 Consumer Action Law Centre, *Additional Information 8*, pp. 1–2. The report cited is Parliament of Victoria, Law Reform Committee, *Inquiry into property investment advisers and marketeers*, Final report, April 2008 www.parliament.vic.gov.au/images/stories/committees/lawreform/property_investment/final_report.pdf. One recommendation called for the Victorian Government to propose to the Ministerial Council on Consumer Affairs that the Australian government amend the ASIC Act and chapter 7 of the Corporations Act so advice about direct property investment is included in the financial services regime.

ostensibly to help them.²⁵ According to Mr Brody, this type of business model does 'not fit neatly within current regulations or ASIC's purview, but they are related to issues within ASIC's responsibility'. He stated:

An effective regulator needs to be one that has the power to identify and act on new forms of consumer detriment in financial services...and we think that if the regulator's tools were improved this could improve the overall performance of ASIC.²⁶

...

One of the problems in raising those sorts of issues with ASIC is that within the current regulatory framework they do not neatly fit within ASIC's responsibility. They are not providing a regulated service, and that can mean there are challenges in getting action on those sorts of problems. To the extent that it can I think ASIC assists us in understanding and raising these issues as far as possible. We have recently had a roundtable with them on that exact business model. But there is a limitation in the scope of what ASIC can do in relation to those businesses because of the regulations.²⁷

6.24 Mr Brody informed the committee that the Consumer Action Law Centre was seeing a number of businesses adopting the 'for-profit financial difficulty' type of model and was of the view that it was a 'growing sector'.²⁸

6.25 As an example of this type of practice, a committee member cited a recent case that had come to his attention, where:

...a farm was in financial trouble and consultants came along and said, 'We'll refinance you. Pay us \$40,000 and we will get the money.' The \$40,000 was squeezed out of every last bit of juice and there was never any loan...²⁹

6.26 Mrs Cox informed the committee that the CCLC had dealt with a very similar situation involving a smaller amount. She explained:

There was a woman who had a range of debts after her marriage broke down, and they charged her a percentage—which amounted to somewhere between \$11,000 and \$17,000 in her particular case—to negotiate with her creditors. She could not raise that money, so they said, 'That's fine; we'll set up a direct debit arrangement and you can start paying us off.' By the time we came along, I think she had paid a fair amount on the direct debit arrangement. Absolutely nothing had been done, and her financial position was deteriorating. I assume that either they never intended to do anything or they were waiting till she had paid the entire fee before they began. We

25 *Proof Committee Hansard*, 20 February 2014, p. 43.

26 *Proof Committee Hansard*, 20 February 2014, p. 40.

27 *Proof Committee Hansard*, 20 February 2014, p. 44.

28 *Proof Committee Hansard*, 20 February 2014, p. 43.

29 *Proof Committee Hansard*, 20 February 2014, p. 44.

quickly became involved and were able to resolve a lot of her issues with the help of another financial counselling agency, and in that particular case we managed to argue to get her out of the money that she had also paid.³⁰

6.27 Mrs Cox observed that the person who was supposed to assist the individual in debt in the above example previously had a financial services licence but was now banned from providing financial services. She noted that there was absolutely nothing that could be done about this new activity.³¹ According to Mrs Cox, in order to be captured by the credit regulation, a person has 'to suggest that someone either take out or stay in a particular credit product'. She explained further:

The people providing such advice 'would argue—and, some legal advice suggests, successfully—that they are not actually suggesting any particular credit product; they are actually offering to negotiate with your creditors, and that is not caught as a credit activity or a financial service'.³²

6.28 In her experience, such practices were on the rise.³³ Mrs Cox also noted that the CCLC was still dealing with complaints in particular areas such as payday lending where it was 'seeing a lot of problems' including where people were 'blatantly avoiding the law'. She indicated that although ASIC had taken action and was working on some cases in that area, the Centre was 'usually frustrated because we want it go faster'. According to Mrs Cox:

Certain other members of the industry who believe they are complying and are upset that others are not being hung out to dry also express that frustration. Even those who believe they are complying in that sector we do not always agree with their interpretation of the law.³⁴

6.29 Mrs Cox noted that it was very important for ASIC to 'use the new tools that they have got under the new law to do whatever they can to actually prevent the type of behaviour that occurred between 2002 and 2010 from happening in the future'.³⁵ Clearly, this area of regulating the provision of credit services still requires close monitoring to ensure that the laws are providing the required level of consumer protection and to identify gaps that exist and should be covered by the credit laws.

ASIC's assessment

6.30 ASIC informed the committee that the National Credit Act had 'largely addressed the regulatory issues and market problems prevalent before 2010', although, in its view, 'it may be too early to make a final assessment of how effectively it has

30 Mrs Karen Cox, CCLC, *Proof Committee Hansard*, 20 February 2014, pp. 44–45.

31 *Proof Committee Hansard*, 20 February 2014, pp. 44–45.

32 *Proof Committee Hansard*, 20 February 2014, p. 44.

33 *Proof Committee Hansard*, 20 February 2014, p. 45.

34 *Proof Committee Hansard*, 20 February 2014, p. 42.

35 *Proof Committee Hansard*, 20 February 2014, pp. 40–41.

been done.³⁶ Nonetheless, when asked whether there were any areas of concern emerging as the new credit laws bed down, ASIC cited two substantive issues. The first was concern that there could be 'a lack of competitive neutrality' where players offered products that were 'functionally similar to regulated products but without having to meet, for example, the licensing and responsible obligations through the National Credit Act'. ASIC explained that there were two different contexts in which this might occur:

- mainstream products, where the lack of regulation may be the result of innovations in product design (such as peer-to-peer lending); and
- avoidance activity on the fringes, where lenders and brokers deliberately change their business models and structures to fall outside the law or aspects of the law.³⁷

6.31 ASIC informed the committee that the government had recently taken steps to address some avoidance practices. It had done so 'by circulating draft regulations to close some gaps in the law being exploited by payday lenders and signalling a review of the exemption for indefinite and short-term leases in the National Credit Act'. ASIC observed, however, that:

...given that the possible structures for avoiding the cap on costs are limited only by the ingenuity of those advising possible avoiders, the Government could consider a general anti-avoidance provision that sought to deter entities making repeated changes in business models to continue avoiding their obligations under the National Credit Act (rather than addressing each model as it emerges after the event).³⁸

6.32 In December 2012, Treasury consulted on proposals for changes relating to investment lending, peer-to-peer lending, small business lending, short-term and indefinite-term leasing, and a number of anti-avoidance mechanisms. ASIC stated that to the extent 'the Government identifies gaps or problems in relation to these topics they have not been addressed'.³⁹

6.33 The increase in the number of businesses that charge consumers fees to repair their credit records, or to pursue claims through the EDR schemes, was the second source of concern for ASIC. It explained:

These companies often charge high fees for services that would otherwise be provided free of charge by the dispute resolution services, and may exacerbate the consumer's financial difficulties where they pursue unmeritorious claims that delay or impede the resolution of their position.

36 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 1.

37 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 3.

38 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 3.

39 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 1.

6.34 ASIC considered that the implementation of the responsible lending obligations would continue to be an area of review as the obligations are expressed in general terms, which allows for significant divergence in practices across the industry.⁴⁰

Committee view

6.35 Since 2002, and undoubtedly well before, some unscrupulous people in the financial services industry exploited the inadequate regulation of consumer credit. Early indications suggest that the new credit laws have been effective in stamping out the predatory lending practices that existed between 2002 and 2010, though most submitters agreed that the laws need time to settle down before a definitive assessment of their effectiveness can be made.

Conclusion

6.36 The inescapable message coming out of the 2002–2010 period when irresponsible, even predatory, lending went largely unregulated and unchecked is that early indications of a problem must be attended to promptly and, where possible, stamped out before it takes root. This may mean simply enforcing existing laws or campaigning for new ones.

6.37 New credit laws are now in place and appear to be working effectively, although there are suggestions that some people are operating on the margins of the legislation in an endeavour to circumvent the law. Indeed, a number of witnesses, well-positioned to comment, identified areas on the fringes of mainstream lending that still expose consumers to risks, such as the 'for-profit financial difficulty' businesses. It is important for ASIC to match the ingenuity of these operators. Additionally, ASIC needs to be ready to take on the challenge created by a constantly changing industry with the creation of new products and business models—some deliberately designed to exploit legal loopholes. It is also important for ASIC to remain alert and receptive to any signs of poor or irresponsible lending practices, and when they emerge, it must educate consumers of the dangers; act quickly where it has the power to do so; and actively lobby for changes if the laws are deficient.

6.38 In the previous chapter, the committee recommended that ASIC consider adopting a multi-pronged campaign to educate retail customers. The campaign should focus on the care consumers need to take when entering into a financial transaction and where they can find assistance and affordable and independent advice when they find themselves in difficulties because of that transaction. In light of this chapter's discussion on the new credit laws, the committee builds on this recommendation.

40 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 3.

Recommendation 2

6.39 As part of the multi-pronged campaign (see Recommendation 1), the committee recommends that ASIC actively encourage consumers to report any suspected unscrupulous conduct related to consumer credit.

Recommendation 3

6.40 The committee recommends that as the national credit reforms introduced in 2010 bed down, ASIC should:

- carefully monitor the implementation of the new laws giving particular attention to activities that may fall outside the legislation but which pose risks to consumer interests;
- ensure that it acts quickly to alert consumers to likely dangers and the government to any problems that need to be addressed; and
- build capacity to monitor and research lending practices and to be prepared to launch marketing and education strategies should poor practices begin to creep back into the industry.

Chapter 7

Financial Ombudsman Service and the Credit Ombudsman Service

7.1 In many instances, consumers took their complaints about the conduct of brokers or lenders to one of ASIC's approved external dispute resolution (EDR) schemes. According to many submitters, however, they were dissatisfied or disappointed with the management of their case by the relevant EDR scheme.¹ Based on personal experience, they found that the EDR process did not do 'nearly enough to help distressed people who had turned to them for help'.²

7.2 In this chapter, the committee examines the role and functions of the two ASIC-approved EDR schemes that have a pivotal role in dealing with complaints about financial services and credit institutions.

Background

7.3 Under statute, holders of credit licenses and AFS licenses are required to be members of an ASIC-approved EDR scheme as a condition of their licence.³ EDR schemes provide an alternative dispute resolution mechanism that operates outside the court system. Their specific functions within the broader financial services and new national credit regulatory regimes are to provide:

- a forum for consumers and investors to resolve complaints (or disputes) that is quicker and cheaper than the formal legal system; and
- an opportunity to improve industry standards or industry conduct and to improve relations between industry participants and consumers/investors.⁴

7.4 Currently, two ASIC-approved EDR schemes operate—the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service (COSL).⁵ The benefits for borrowers seeking redress through the EDR process include:

- free access;

1 See for example, *Submissions 26 and 84*.

2 See for example, Name withheld, *Submission 35*, p. 1.

3 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 17.

4 See ASIC, *Regulation Impact Statement, Dispute resolution requirements for consumer credit and margin lending*, May 2010, paragraph 42.

5 The current regulatory architecture of the financial services complaints resolution system has its origins in the 1997 Wallis Inquiry, which identified the need for low-cost means to resolve disputes. See Financial Ombudsman Service, *Submission 193*, p. 3.

- the EDR schemes' broad remit to make decisions based on the additional factors of what is fair and reasonable and good industry practice;
- resolutions may include financial compensation; and
- decisions bind the lender but not the borrower.⁶

7.5 An EDR scheme means that consumers do not have to pursue a formal, expensive and often daunting process through the courts.⁷ In summary, the EDR framework is intended to provide a way for complaints between financial services or credit providers and their clients to be resolved in a quick, effective and efficient way that is informal and does not follow the strict legal rules of evidence that apply in the courts.⁸ They also free up ASIC and allow it to concentrate on the most serious transgressions and system-wide problems that have much broader implications for the financial services industry and consumers. As the Consumer Action Law Centre observed:

Fewer demands will be made of ASIC's resources where consumers have effective, fair and accessible options to resolve dispute with business themselves.⁹

7.6 Thus FOS and COSL should be a vital part of any successful consumer protection framework. Indeed, Mr Brody, Consumer Action Law Centre, noted that the 'existence of free and independent external dispute resolution schemes is probably one of the greatest advances in consumer protection we have had in the last 20 years'.¹⁰ Mrs Cox, Consumer Credit Legal Centre (NSW) Inc (CCLC), endorsed the view that the EDR schemes have a critical, valuable and important role. She noted that 'being able to send people to those schemes has been an amazing advance in consumer protection'. According to Mrs Cox:

...the fact that we can now send people to a scheme and have the issue looked at after they have received a statement of claim is so valuable to the ordinary person out there who may have hit a bad patch and be struggling to pay a home loan, or who may have been completely done over in some sort of circumstance where they would have no hope of ever realistically approaching a court about it.¹¹

6 See ASIC, *Regulation Impact Statement: Dispute resolution requirements for consumer credit and margin lending*, May 2010, paragraph 57 and ASIC, *Submission 45.1*, p. 27.

7 COSL, *Submission 418*, p. 1.

8 Mr Raj Venga, Chief Executive Officer and Ombudsman, COSL, *Proof Committee Hansard*, 20 February 2014, p. 17

9 Consumer Action Law Centre, *Submission 120*, p. 9.

10 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, pp. 42–43.

11 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 43.

Financial Ombudsman Service

7.7 In 2008 three schemes—the Banking and Financial Services Ombudsman, the Financial Industry Complaints Service and the Insurance Ombudsman Service merged to form FOS. FOS now has more than 16,000 members including banks, credit unions, building societies, credit providers, general and life insurance companies and brokers, superannuation providers, fund managers, mortgage and finance brokers, financial planners, stockbrokers, investment managers, friendly societies, time share operators and authorised representatives.¹² They come under two broad categories:

- Licensees—financial services providers (FSPs) that hold an AFS licence or a credit licence; and
- Authorised Credit Representatives—businesses that represent a licensee.¹³

Credit Ombudsman Service

7.8 COSL has about 17,000 members comprising mainly finance brokers, non-bank lenders, mutual banks, credit unions, building societies, time share operators, small amount short term lenders, debt purchases and some financial advice firms. Members are drawn mainly from the 'small end of town' with more than 90 per cent being sole traders or small businesses of less than five individuals. COSL informed the committee that most 'pay day lenders', time share operators and debt purchasers in Australia are members.¹⁴

Criticisms of FOS and COSL

7.9 In respect of ASIC's role in relation to the EDR schemes, a number of submitters held that ASIC, as the regulator, had abrogated its duty.¹⁵ One submitter suggested that ASIC failed to set proper guidelines for FOS and COSL and to use its powers to protect consumers where fraud and misrepresentation was 'so blatantly obvious to any outsider'.¹⁶ Another suggested that ASIC had failed to assess whether the EDR framework was working well.¹⁷

7.10 Concerns about the EDR schemes' performance related to matters such as delays; perceived lack of independence (merely mouthpieces for the lenders); confusion between the responsibilities and jurisdiction of FOS and COSL; their failure to investigate fraud; the ceiling on compensation; and time restrictions because of statute of limitations.

12 FOS, www.fos.org.au/members/search-for-members (accessed 31 January 2014).

13 FOS, www.fos.org.au/members/search-for-members (accessed 31 January 2014).

14 See for example, COSL, *Submission 418*.

15 See for example, *Submission 43*.

16 Name withheld, *Submission 26*, p. 1.

17 Name withheld, *Submission 184*, p. 5.

Timeliness

7.11 A number of submitters referred to the time taken by the EDR schemes to manage the process, for example to appoint a case manager.¹⁸ They highlighted the critical importance of dealing with complaints expeditiously: that delay posed a risk for customers, especially those falling behind in repayments and under threat of losing their property. One submitter suggested that the current 'ordinary wait time' was two years.¹⁹ The Consumer Action Law Centre also raised concern, shared by members of the industry, about delays.²⁰

7.12 FOS acknowledged that a theme through some of the submissions was the need to improve the speed with which it deals with complaints. In its submission, FOS informed the committee that in 2013 it accepted and resolved some 24,000 disputes across its jurisdictions in banking, general insurance and life insurance and investments. It also dealt with 230,000 telephone inquiries from members of the general public.²¹ According to FOS, it had seen 'a dramatic increase in the volume and complexity of disputes', which had affected its responsiveness.²² FOS accepted that the number of disputes and the time taken to deal with them was a key challenge for the organisation. It informed the committee that it had been working hard to improve the timeliness of its dispute process, which remained at the forefront of its efforts to improve its performance.²³

7.13 COSL explained that the time it takes to deal with a complaint depends on a number of different factors, including:

- the complexity of the complaint, including the evidence required to support each party's assertions,
- the need to allow each party the opportunity to respond to the other's statements and evidence, and
- the fact that it may need to extend the time within which a response is required.²⁴

7.14 According to COSL, within 24 to 48 hours of receiving a complaint, it writes to the consumer and the financial services provider to inform them that it has received the complaint. It provides them with the contact details of the case manager

18 See *Submissions 12, 23, 32, 179, 184 and 295*.

19 Name withheld, *Submission 217*, p. 1.

20 Mr Gerard Brody, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, pp. 42–43.

21 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 17.

22 FOS, *Submission 193*, p. 1.

23 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

24 COSL, *Submission 418*, p. 8.

responsible for dealing with the complaint. The case manager generally has full carriage of a complaint unless it is referred to the Ombudsman for determination at the end of the COSL process.

7.15 The overall workload also affects the time it takes COSL to deal with a complaint. COSL noted that with the number of complaints increasing year on year, it had implemented a number of initiatives to improve its timelines. To demonstrate that these initiatives had already yielded some positive results, COSL compared statistics for the 2012–13 financial year to the previous financial year, which showed there had been:

- an increase in complaints closed within a three month period from 56.8 per cent to 60.4 per cent; and
- an increase in complaints closed within a six month period from 76.2 per cent to 79.2 per cent.

7.16 COSL informed the committee that these results were achieved despite receiving a 28 per cent increase in complaints in the 2012–13 financial year, on top of the 38 per cent increase in the previous financial year. According to COSL, it would continue to look for ways to improve its timelines, which remained a top priority, 'without compromising the quality' of its decision-making.²⁵ While Mrs Cox of the CCLC cited some major problems with delay, she was hopeful that the schemes were working to resolve these issues.²⁶

Independence of the EDR schemes

7.17 A number of submitters were under the impression that the EDR schemes lacked independence and served merely as mouthpieces for the lenders—'a lapdog to the banks'.²⁷ Some submitters argued that a conflict of interest was clear as the financial services providers pay for the schemes; have a large influence on policy; 'make the rules'; and have ready access to the schemes. For example, one submitter suggested that he became aware that FOS was:

...funded by the banks! So what possibility is there of a person like me being properly represented through such an Ombudsman service?²⁸

7.18 Borrowers also cited what appeared to them to be:

- collusion between FOS and the banks to stall the supply of loan application forms;
- banks not held to time frames that FOS imposed; and

25 COSL, *Submission 418*, p. 8.

26 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 43.

27 Name withheld, *Submission 35*. See also *Submissions 48, 156* and Dr Evan Jones, *Submission 295*.

28 Name withheld, *Submission 77*.

- overly generous treatment toward the banks in allocating time for them to supply materials but threatening the claimant with loss of their claim should they fall short of imposed inequitable time frames.²⁹

Funding of the external dispute resolution schemes

7.19 FOS understood the strong likelihood that aggrieved consumers may perceive an industry-based dispute resolution scheme funded by the industry as inherently biased.³⁰ Mr Shane Tregillis, Chief Ombudsman, FOS, explained that FOS was partly financed through membership fees for its industry members, which account for around 20 per cent of FOS's funding. Case fees provide the bulk of FOS's funding; that is, FOS charges the financial institution a fee based on the stage at which a dispute is resolved.³¹

7.20 Mr Tregillis stated that the payment system was largely a user-pays system structured so that clearly there were incentives for financial institutions:

- not to bring complaints to FOS, because they pay a fee based on the number of complaints; and
- to seek to resolve that complaint early in the process through agreement rather than going through our later stages.³²

7.21 COSL's funding is also made up of a combination of membership and complaint fees levied on financial services providers. It noted that with about 17,000 members, most of its funding was derived from membership fees rather than complaint fees. It noted that the complaints it received and dealt with only accounted for about three per cent of its members: the overwhelming majority of its members did not pay any complaint fees. It could not understand the reason for submissions suggesting that its independence was compromised by the fact that it received complaint fees from financial services providers.³³

Board membership and industry

7.22 The composition of the EDR schemes' boards also drew criticism from some people who had their case managed by FOS or COSL. One submitter told the committee that the boards were made up of 'the who's who of the banking and financial industry along with their lawyers/solicitors of which some are the very ones who take the borrowers to court to claim their family homes'.³⁴ Another remarked that

29 See *Submissions 76, 77, 184, 217 and 259*.

30 FOS, *Submission 193*, p. 10.

31 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 28.

32 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 28.

33 COSL, *Submission 418*, p. 6.

34 Name withheld, *Submission 43*.

it seemed 'strange that bank employees are board members of FOS'.³⁵ In their view the conflict of interest was obvious.

7.23 FOS cited a number of inbuilt mechanisms that 'ensure that the schemes operate independently and with fairness and accountability', including requirements for:

- an independent decision making processes—to preserve the Ombudsman's independence, the board does not interfere with decisions or get involved in the detail of cases which come before the Ombudsman; and
- an oversight body with equal representation of consumers and industry together with an independent chair.³⁶

7.24 COSL acknowledged that some submitters expressed reservations about industry representatives being on its board. In this regard, however, it noted that ASIC 'requires a board of an EDR scheme to comprise an equal number of consumer and industry representatives and an independent chair'.³⁷ It informed the committee that:

The COSL Board is responsible for overseeing the operations of the Credit Ombudsman Service, for ensuring independent decision making by the Credit Ombudsman and staff of COSL, and for preserving the independence of the scheme and the COSL dispute resolution processes.³⁸

7.25 Indeed, the relevant ASIC regulatory guide requires FOS and COSL to be independent of the industry or industries that provide their funding and constitute their respective membership. The guide explains that such a requirement means that the decision-maker(s) and/or the staff of the scheme are:

- entirely responsible for the handling and determination of complaints or disputes;
- accountable only to the scheme's overseeing body (which as noted above should comprise an equal number of consumer and industry representatives and an independent chair); and
- adequately resourced to carry out their respective functions.³⁹

Committee view

7.26 The funding arrangements for the EDR schemes are appropriate and should not in any way compromise their independence. The equal number of consumer

35 Mr Neville Ledger, *Submission 347*.

36 *Submission 193*, p. 10 and FOS, www.fos.org.au/about-us/our-board (accessed 15 May 2014).

37 *Submission 418*, p. 6.

38 *Submission 418*, p. 7.

39 ASIC, *Approval and oversight of external dispute resolution schemes*, Regulatory Guide 139, June 2013, paragraphs 139.89 and 139.94.

representatives on the boards should also provide assurances that the schemes are independent of industry. That said, the committee encourages FOS and COSL to do their utmost to ensure that consumers are aware of the safeguards in place designed to secure their independence and are conscious of the need to maintain their reputations as independent and fair schemes.

Transparency

7.27 One submitter noted that the financial service provider or bank involved in any serious systemic issue is not identified in any required quarterly reporting to ASIC or named publicly. He argued that 'consumer information fundamental to the protection of consumer rights is purposely withheld from every member of the public'.⁴⁰ Likewise, Mr Peter Mair observed that while FOS's determinations are published, it does not identify institutions at fault. He stated further that apparently FOS is able to order refunds only to the policyholders that complain personally and 'does not make any open public comment on the character of malpractices it discovers'. In his assessment—'a reticence that protects the secrecy'.⁴¹

7.28 It should be noted that ASIC requires the EDR schemes' complaints and disputes handling and other procedures to accord with the principles of natural justice.⁴² COSL noted:

To ensure parties to a complaint are accorded procedural fairness, we provide written reasons for any decision we make about the merits of a complaint and provide the parties with a reasonable opportunity to respond to our decision.

To ensure the soundness and integrity of our decision-making process, all written decisions are reviewed internally by senior case managers before being issued. If a consumer seeks a (further) review of the decision, COSL's Head of Dispute Resolution will undertake a further review.

Almost all our case management staff are legally qualified, given that regard for relevant law is a key benchmark in our decision-making processes.⁴³

7.29 FOS informed the committee that it deals with complaints on an individual basis working with the parties through cooperation. FOS publishes its findings to provide general information to assist the public understand its findings and general values but does not name the institution or the applicant.⁴⁴ Mr Tregillis explained:

40 Name withheld, *Submission 192*.

41 Mr Peter Mair, *Submission 2*, p. 2.

42 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.110.

43 COSL, *Submission 418*, p. 7.

44 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 25.

If you started to name individual entities in determinations, I think we would become a much more court-like, complicated, contested process.⁴⁵

7.30 He noted that 'the essence of EDR was to be quick, easy and accessible, and to resolve most disputes by agreement'. According to Mr Tregillis, although the EDR schemes work well, there are always areas for improvement. He considered that the 'history of FOS, COSL and the other schemes is that we have always had to relook and innovate'.⁴⁶

7.31 The Consumer Action Law Centre noted that the schemes could be encouraged to 'provide more effective guidance to complainants from both sides about how disputes are resolved'.⁴⁷ Another submitter noted people who go to FOS should understand clearly that, although it has ombudsman in its title, it is a dispute resolution body and cannot put the complainant's case together for them.⁴⁸

Accountability and performance

7.32 FOS and COSL must also adhere to core principles that underpin accountability. They are required to report any systemic, persistent or deliberate conduct to ASIC. According to ASIC, serious misconduct may include 'fraudulent conduct, grossly negligent or inefficient conduct, and wilful or flagrant breaches of relevant laws'.⁴⁹ ASIC's understanding of 'systemic' relates to matters that 'have implications beyond the immediate actions and rights of the parties to the complaint or dispute'.⁵⁰ ASIC recognised that some systemic issues could involve the conduct of multiple scheme members and may 'include general trends that might not implicate individual scheme members, but might reflect, for example, the need for a change in our regulatory guidance'.⁵¹ COSL explained:

As a condition of ASIC's ongoing approval of COSL as an approved EDR scheme, we are required to report to ASIC, on a quarterly basis, any systemic issues or serious misconduct in relation to FSPs that we may identify while dealing with a complaint.⁵²

7.33 Consistent with this view, COSL noted that a systemic issue may arise out of a single complaint that has implications which extend beyond the parties to the particular complaint, or from multiple complaints which are similar in nature.

45 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

46 Mr Shane Tregillis, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

47 Mr Gerard Brody, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, pp. 42–43.

48 *Submission 473* (Confidential).

49 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.124.

50 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.119.

51 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.137.

52 COSL, *Submission 418*, p. 8.

COSL publishes information about systemic issues and serious misconduct it has identified in its *Annual Report on Operations*, which is available to stakeholders and the general public.⁵³

Reporting performance

7.34 In addition to reporting on systemic matters and serious misconduct, FOS and COSL are required to collect data and report to ASIC about complaints and disputes. Their annual reports should also provide such information. COSL explained:

We meet regularly with ASIC (on a quarterly basis at a minimum) to discuss, among other things, emerging issues or trends arising from the complaints we are dealing with. In this way, ASIC is able to effectively monitor and oversee our operations and ensure that we continue to meet the conditions of its ongoing approval of COSL as an approved EDR scheme.⁵⁴

7.35 Both schemes are also required to undergo regular independent reviews.⁵⁵ FOS recently underwent such a review.

Identifying and reporting systemic issues

7.36 Mr Field noted FOS's evolving approach to dealing with what appears to be emerging systemic issues. He stated that although there were some protocols in place when he first started at the Ombudsman's office in 2002, FOS's approach to systemic issues was very different today compared to then. He stated:

In fact, I think at that stage looking at systemic issues was very much in its embryonic stages. Staff at the office were probably unsure about how to raise and deal with a systemic issue. Over 2002 to 2010, that process developed, and the confidence in using the systemic issues process developed to where it is today. We now have quite a large team dealing with systemic issues. It was certainly a learning phase for everybody in dealing with that, including for our financial services members.⁵⁶

7.37 COSL has similarly improved its reporting on systemic issues. Although formed in 2003, it was not until 2006 that COSL had a single ombudsman model. Mr Venga was of the view that COSL's reports on systemic issues are much better now than before.⁵⁷

53 COSL, *Submission 418*, p. 8.

54 COSL, *Submission 418*, p. 8

55 ASIC, Regulatory Guide 139, June 2013, paragraph RG139.116 and FOS, *Submission 193*, p. 10.

56 Mr Philip Field, Lead Ombudsman, Banking and Finance, FOS, *Proof Committee Hansard*, 20 February 2014, p. 21.

57 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 21.

Committee view

7.38 The damage caused by poor lending practices during the 2000s underscores the importance of identifying and arresting such practices before they take hold. The EDR schemes are important early detectors and, while the committee is encouraged by the EDRs' promising assessment of their own reporting of serious and/or systemic issues to ASIC, they should be constantly looking for ways to strengthen this reporting regime.

Recommendation 4

7.39 The committee recommends that ASIC devote a section of its annual report to the work of the financial services and consumer credit external dispute resolution (EDR) schemes, accompanied by ASIC's assessment of the systemic and significant issues the EDR schemes have raised in their reports to ASIC. Further, the committee recommends that ASIC include in this commentary information on any action taken in response to the matters raised in these reports.

Jurisdiction, compensation and limitations

7.40 This section examines the evidence the committee received that focused on the EDR schemes' jurisdictions, the amounts of compensation they can award and other factors that limit the actions EDRs can take.

Confusion between FOS and COSL

7.41 One submitter referred to FOS 'passing the buck' to COSL, which in turn determined that FOS was 'the appropriate entity to investigate such issues'.⁵⁸ Another submitter also indicated that his case had gone from COSL to FOS back to COSL back to FOS back to COSL.⁵⁹ Ms Denise Brailey told the committee that cases are often 'used as a football, being tossed from one EDR to the other'.⁶⁰

7.42 COSL explained that under its rules, it can exercise its discretion to decline to deal with a complaint if it is satisfied that a more appropriate forum should manage the matter such as a court, tribunal or another ASIC-approved EDR scheme.⁶¹

Committee view

7.43 Both EDR schemes should be aware of the need to facilitate referrals between them and have procedures and officers within their organisations responsible for expediting the transfer of cases and for keeping consumers briefed on progress.

58 *Submissions 11* (Confidential) and 266.

59 Name withheld, *Submission 266*, p. 2.

60 Banking and Finance Consumers Support Association, *Submission 156*, p. 23.

61 COSL, *Submission 418*, p. 4.

Jurisdiction—fraud and retail clients

7.44 Most complaints made to the committee centred on the loan application form and the inaction by ASIC and the respective EDR schemes to deal with what submitters believed was blatant fraud. One submitter informed the committee that:

The EDR bodies of FOS and COSL which are licenced by ASIC are very much on song with each other, all refusing to acknowledge fraud. With COSL once fraud is mentioned the cases are closed instantly.⁶²

7.45 Ms Brailey supported this view. She suggested that COSL states 'if it's fraud we cannot assist you'.⁶³

7.46 According to COSL, the difficulty with fraud is determining whether it happened:

In most of the cases we have seen where complainants allege that they have been the victim of a home loan fraud, the financial services provider usually denies having engaged in the alleged conduct (and/or asserts that it was the consumer who had in fact committed a fraud).⁶⁴

7.47 COSL argued that an allegation of fraud is 'a very serious matter, capable of being the subject of both civil and criminal legal proceedings'. It explained that a claim of fraud in a civil action must still be determined according to the balance of probabilities. In this regard, COSL cited the approach taken by the courts, which have emphasised that the gravity of such allegations should be kept in mind and findings of fraud not made lightly. COSL stated:

To prove a case of fraud in legal proceedings (or defend against such an allegation), parties are able to, among other things, issue subpoenas for the production of documents, give evidence under oath and cross-examine witnesses. This rigorous process of collating and testing the available evidence and its credibility enables the court to make a thorough assessment of each party's version of events and ultimately decide which is to be preferred (on the balance of probabilities).⁶⁵

7.48 COSL noted that parties to a COSL complaint alleging fraud do not have access to these evidentiary mechanisms. Further, COSL is limited by its rules in terms of 'its ability to obtain information from the parties (and non-member third parties, who are invariably involved in the claims we have seen)'. According to COSL, an EDR scheme is not like a court:

We cannot subpoena witnesses, we cannot cross-examine people and we cannot take evidence under oath. That makes it very difficult for us to

62 Name withheld, *Submission 78*, p. 1.

63 Banking and Finance Consumers Support Association, *Submission 156*, p. 23.

64 COSL, *Submission 418*, p. 4.

65 COSL, *Submission 418*, p. 4.

establish that level of fraud. That is why we tend not to look at it. That is the qualification.⁶⁶

7.49 In its submission, COSL stated further that it would generally exercise its discretion not to deal with a complaint involving an allegation of fraud on the basis that it would be more appropriate for the complaint to be dealt with by a court. In doing so, it would have regard to:

- the gravity of an allegation of fraud;
- the limitations of the COSL process in terms of collating and testing each party's evidence to the degree of exactness required; and
- the availability of the courts as an alternate forum to deal with such claims.

7.50 According to COSL, however, it 'routinely considers whether, on their face, these complaints give rise to alternate claims—such as unconscionable conduct, unjust contract or misleading or deceptive conduct'. If COSL is satisfied there is an alternate claim that requires investigation, it advised that it would inform the parties of this and continue to deal with the complaint on this basis.⁶⁷

7.51 As noted in Chapter 5, prior to the enactment of the National Credit Act, ASIC was also reluctant to deal with reported cases of fraud. It preferred to refer such matters to the relevant state and territory police forces.⁶⁸

Committee view

7.52 The committee has concerns that a complaint of possible fraud, involving for example a forged loan application, may be lost in the process of determining whether the alleged conduct involved fraud or another form of wrongdoing. The committee understands the seriousness of an allegation of fraud but in cases where the alleged wrongdoing is of a less serious nature, the committee believes that the EDR organisations are equipped to resolve the dispute and should do so.

7.53 Where the allegation of fraud is of a most serious nature, the committee believes that the EDR schemes should refer the matter to ASIC immediately and also include the matter in their quarterly report. ASIC must then determine whether to refer the matter to the relevant police force. The committee is of the view that should the police decide not to act on the allegation, ASIC should take back responsibility for the matter. Essentially, the committee is concerned that complaints involving allegations of fraud are bouncing between agencies and no agency is taking responsibility for investigating these matters. The importance of acting on allegations of fraud is particularly evident when considering that allegations of forged and 'doctored

66 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 24.

67 COSL, *Submission 418*, p. 4.

68 ASIC, *Submission 45.1*, p. 26.

documents' were not confined to lending practices between 2002 and 2010 but were also evident in the Storm Financial case and, as will be seen later, the CFPL matter.

Statute of limitations

7.54 The CCLC noted that some of the consumers writing to the committee may be out of time with regard to their claims. In this regard, Mr Field of FOS informed the committee that there are time limits imposed by FOS's terms of reference. He stated that FOS 'can only consider a dispute about events that happened within six years. Some of those go back and are probably outside our terms of reference'.⁶⁹

7.55 When taking account of Ms Brailey's argument that some loans are designed to fail four or five years after the loan is granted, the six year limit seems too restrictive. The committee believes that ASIC and the EDR schemes should consider whether the limit of six years is appropriate.

Compensation cap

7.56 Currently, FOS and COSL are able to award compensation for loss up to \$280,000. They are, however, able to consider a complaint if the amount of compensation claimed is greater than the monetary compensation ceiling but does not exceed \$500,000.⁷⁰ Some submitters, however, were of the view that the ceiling placed on eligibility was too low.⁷¹ For example one submitter suggested that the maximum amounts for a dispute value of \$500,000 and an award sum of \$280,000 were 'grossly inadequate' and urgently needed to be increased.⁷²

7.57 In their response to the compensation cap, the EDR bodies focused on the amount of compensation that was likely to be awarded, as COSL explained:

...the fact that compensation is likely to exceed our monetary compensation limit does not in itself prevent us from dealing with a complaint; it only prevents us from making a compensation award for an amount in excess of that limit.⁷³

69 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 21.

70 FOS, *Submission 193*, p. 9 and Mr Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 21.

71 See *Submissions 79, 153, 156 and 285*.

72 Name withheld, *Submission 184*. See also Mr Errol Opie, *Submission 259*, who stated that cases which are closed and thrown out by FOS and COSL just because they exceeded the scheme's jurisdictional limit, must be re-opened and thoroughly investigated as they contain fraud.

73 COSL, *Submission 418*, p. 5.

7.58 Mr Field emphasised that it was not so much the amount of the loan but the amount of compensation that determines the jurisdiction to consider disputes. He stated:

In most cases the amount of compensation actually payable will generally fall within our compensation cap of \$280,000. Some borrowers want to have the whole of the loan written off. Where that amount exceeds \$500,000 we are unable to consider the dispute under our terms of reference.⁷⁴

7.59 But, according to Mr Venga, setting aside the loan is very rare and so the amount of compensation tends to be much less than the loan itself.⁷⁵ Thus, the EDR schemes do not consider the ceiling on compensation as being too low.

7.60 Mr Field referred back to the principle that underpins external dispute resolution schemes—to offer a service to consumers mainly and small businesses. Therefore, in his view, it was appropriate to have a limit somewhere. He noted that FOS deals with some very large loan claims but 'where you have got people with \$5 million or \$10 million loans, maybe they are better off dealt with in court'.⁷⁶ COSL agreed with this contention. It also noted that EDR schemes provide an alternative to court proceedings and are not bound by strict rules of evidence:

Quite often, the parties to a complaint have differing and competing versions of events, with little or no documentary evidence in support. In these cases, we draw inferences and conclusions based on the information obtained from the parties and make findings of fact on the balance of probabilities.

Given these limitations, we consider that some complaints are more appropriately dealt with by the more formal process of the courts, particularly if large sums of money are involved.⁷⁷

7.61 COSL also noted that the ceiling did not tend to exclude consumers. As an example, it explained that in the 2012–13 financial year it was unable to deal with only two complaints because the likely compensation would have exceeded its monetary compensation limit. According to COSL, in the preceding financial year, there was only one such complaint; these figures represented 0.06 per cent and 0.04 per cent, respectively, of all the complaints COSL finalised in each of those years.⁷⁸

74 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 18.

75 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 25.

76 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 25

77 COSL, *Submission 418*, p. 5.

78 COSL, *Submission 418*, p. 5.

Awarding compensation and consumer expectations

7.62 With regard to compensation, a number of submitters were also highly critical of the method for assessing damages. According to Mr Field, FOS's approach to the assessment of loss is intended to ensure that borrowers are compensated fairly where they have been provided with a loan that, had their lender acted in a diligent and prudent way, they should not have received.⁷⁹ He explained that, where the lender was at fault in approving the loan, the borrower would be compensated for the purchase, sale and holding costs. He noted, however, that in most cases the borrower is unable to repay the loan which means that the loan is not written off and the borrower does not get to retain the property that they acquired with the loan proceeds. Mr Field elaborated that, in such cases, 'the property should be sold and used to repay the loan'.⁸⁰

7.63 COSL reinforced the message that complaints upheld about irresponsible, unjust or unconscionable lending, 'rarely result in the entire loan being set aside'. In this regard, the law is conscious that a borrower must not be 'unjustly enriched'. COSL explained that applying this principle means that:

...while the borrower may be relieved from their obligations under their loan contract (in whole or in part), they will be required to account to the lender for any benefit they have received as a result of obtaining the loan, so as to ensure the borrower does not obtain a 'windfall'.⁸¹

7.64 According to COSL, it takes account of whether the borrower 'has actually obtained some material benefit as a result of entering into the loan—for example, by purchasing a property (either as a home or for an investment), obtaining funds for personal spending or renovations, or refinancing to a lower interest rate'.⁸² Mr Venga noted that at the end of the day borrowers have to be accountable for the benefit they obtained from the loan, 'whether it is by not paying rent or by having a house to live in and things like that'. He emphasised that this is what the law says, which in his opinion was 'quite fair'.⁸³

7.65 In some cases, the EDR organisations may also apportion a share of the liability to the borrower, where it deems that the borrower in some way contributed to the loss.

79 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 18.

80 Mr Philip Field, FOS, *Proof Committee Hansard*, 20 February 2014, p. 18.

81 COSL, *Submission 418*, p. 6.

82 COSL, *Submission 418*, pp. 5–6

83 Mr Raj Venga, COSL, *Proof Committee Hansard*, 20 February 2014, p. 25.

Financial Ombudsman Service—recommendations and determinations

7.66 Taken together the complaints against the two EDR schemes in essence centre on their apparent lack of independence and their bias toward the credit providers at the expense of the consumer. In this regard, the committee notes that EDR complaints/disputes handling and other procedures are bound by the principles of natural justice.⁸⁴

7.67 FOS decides each complaint before it on its merits having regard to the relevant law, good industry practice, codes of practice and previous FOS decisions.⁸⁵ In its determinations involving loans taken out before the National Credit Act's responsible lending obligations came into force, FOS has stated that:

...the statutory responsible lending provisions reflect pre-existing obligations for lenders to exercise the care and skill of a diligent and prudent lender when making their credit assessment.⁸⁶

7.68 For example, FOS would have regard to the provisions of the National Credit Code or its predecessor the UCCC. FOS would also have regard to a financial services provider's common law contractual duty and whether the particular circumstances of the case gave rise to a claim of unconscionable or misleading conduct under the ASIC Act and the applicable provisions of the Code of Banking Practice.

7.69 FOS has made a number of determinations on cases involving low doc loans and falsified loan application forms. FOS made it clear that it and its predecessor have held the long-standing view that 'low doc does not mean low care'. In its determinations, FOS has explained that if there is information provided to the financial services provider that 'a diligent and prudent lender would have (or should have) investigated further, then that investigation should have been undertaken':

A failure to exercise the care and skill of a diligent and prudent lender may result in a finding of maladministration.⁸⁷

7.70 In some instances, FOS has determined in favour of the borrower where it found that the lender engaged in maladministration because it did not act diligently or prudently in establishing that the borrower could service the loan.⁸⁸ For example, in one such determination, FOS stated:

...it was incumbent upon the FSP [financial service provider], exercising due care and skill, to make inquiries about the Applicant's income to be able

84 ASIC, *Approval and oversight of external dispute resolution schemes*, Regulatory Guide 139, paragraph 139.110.

85 FOS, *Determination: Case number 286455*, 19 November 2013, p. 16.

86 FOS, *Determination: Case number 254056*, 25 September 2013, p. 8.

87 FOS, *Determination: Case number 254056*, 25 September 2013, p. 9. See also FOS, *Determination: Case number 286455*, 16 November 2013, p. 6.

88 FOS, *Determination: Case number 233936*, 29 April 2013, pp. 6–7.

to repay the loan over the loan period. If it had done so, any adequate inquiry would have revealed that she...did not have the financial capacity to repay principal and interest repayments...⁸⁹

7.71 FOS explained further:

...the FSP's lending policy of not requiring independent verification of the Applicant's self-employment was contrary to good industry lending practice. Even though the FSP complied with its policy, by doing nothing more, it failed to exercise due care and skill in assessing the loan application. Its decision to lend \$700,000 to the Applicant was maladministration in lending.⁹⁰

7.72 FOS has also noted that:

...a borrower's self-certification of financial information in a low doc loan application would not 'necessarily protect a financial services provider from a claim of maladministration in lending if the circumstances were such that a diligent and prudent banker ought to have made inquiries to verify that information, but chose not to do so.'⁹¹

7.73 When resolving a dispute, FOS takes into account what is fair and reasonable. Thus, FOS explained that where borrowers have contributed to their loss by failing reasonably to protect their own interests, it may be appropriate to apportion loss between the borrower and the financial services provider.⁹² For example, FOS has found that 'a loan applicant who signs a loan application form in blank (or worse with false information) and then signs a loan contract and mortgage ought reasonably take some responsibility for their decision to apply for and enter into the loan contract'.⁹³ Thus in some cases FOS has determined that the borrower should share liability for his or her loss and assess the proportion of that liability. For example, in a determination FOS advised that:

A person who applies for a loan (in the absence of some vitiating conduct on the part of the FSP) should give consideration to their own financial situation and how they believe they will be able to repay the loan. It is not sufficient for a loan applicant to, in effect, turn a blind eye as to how they will repay the loan;

A person who applies for a loan should take care to protect their own interests by not signing an incomplete or blank loan application. It is reasonable to assume that the reason why a lender is requesting details the loan applicant's financial position is because it will rely on the information

89 FOS, *Determination: Case number 227019*, 29 May 2013, p. 14.

90 FOS, *Determination: Case number 227019*, 29 May 2013, p. 15.

91 FOS, *Determination: Case number 233936*, 29 April 2013 (involving loans taken out in 2008); FOS, *Determination: Case number 227019*, 29 May 2013, (involving loans taken out in 2006).

92 FOS, *Determination: Case number 233936*, 29 April 2013, p. 7.

93 FOS, *Determination: Case number 254056*, 25 September 2013, p. 13.

provided to make an assessment about their capacity to repay and whether it needs to make any further inquiries;

The loan applicant will have a further opportunity to protect their own interests when presented with the actual loan agreements. Again, absent some vitiating factor by the FSP, the loan applicant can decide not to sign the loan agreement.⁹⁴

Loan agreement

7.74 It would seem that from FOS's viewpoint, the loan agreement, which forms the legal contract binding lender and borrower, is the critical document and not the loan application forms. The onus is thus on the lender to ensure that it acts diligently and responsibly when offering a loan. Irrespective of the information contained in the loan application form, it is the terms of the agreement on which the validity of the contract rests. Therefore, the information contained in the loan application may be correct but the terms of the contract unjust and vice versa.

7.75 The committee understands the sense of betrayal and outrage that borrowers have experienced when they learn that their loan application forms have been falsified. But they should look to the terms of their loan agreement as evidence that the lender acted unjustly or unfairly in offering a loan for which they clearly could not service and which placed their home or other assets in jeopardy.

7.76 As the committee found in Chapter 5, it would seem that on the face of the evidence some lenders, irrespective of the loan application form, should not have provided particular loans: they were unaffordable and likely to fail. In other cases, again irrespective of the loan application form, the borrower should have taken care before signing the actual loan contract to make sure that the repayments were sustainable and would not jeopardise the assets securing the loan.

7.77 While the loan contract itself is the key document, the act of tampering with an application form cannot be justified under any circumstances. The committee is of the firm view that, although the broker may have been the instigator, the lender is complicit if it turns a blind eye to such wrongdoing.

Committee view

7.78 Effective external dispute resolution schemes free up ASIC to concentrate on the most serious transgressions and system-wide problems that have much broader implications for the financial services industry and consumers. The EDR schemes are a key part of any successful consumer protection framework. During the inquiry, many submitters who believed they were victims of predatory lending were not only critical of ASIC but also of its approved EDR schemes: FOS and COSL.

94 FOS, *Determination: Case number 227019*, 29 May 2013, pp. 15–16. See also FOS, *Determination: Case number 254056*, 25 September 2013, p. 13.

7.79 In many cases their criticism appeared unwarranted, but the submissions did identify a number of areas where the schemes could improve their performance, such as the time taken to manage a complaint. Clearly, this has been a problem for some time, however, both EDR schemes have indicated that they are committed to improvement in this area. Also, while accepting that an EDR process is intended to provide a low cost, less formal process to resolve complaints for consumers, the committee nonetheless is of the view that the caps on eligibility and compensation appear to be too low. There is a particular problem for small businesses seeking a resolution to a dispute that may breach the eligibility cap or in some other way not qualify under the EDR schemes' terms of reference.

7.80 The committee is also concerned about allegations of fraud and the likelihood of those of a less serious nature falling through the gaps. While certain claims, such as falsified information in loan application forms or forged signatures on such documents may be classified as less serious offences, they still warrant attention. In the committee's view, ASIC, together with FOS and COSL, should establish protocols to ensure that such allegations are not handed from one agency to another and then somehow abandoned in the process. Again, there should be some body, preferably the EDR schemes, responsible for dealing with complaints of less serious fraud involving tampered loan application forms including forged signatures.

7.81 Finally, although the committee notes the assurances by both EDR schemes that their reporting of systemic issues to ASIC is now much better, the committee believes ASIC could improve the overall transparency of this reporting regime and how it responds to significant matters contained in them.

Recommendation 5

7.82 The committee recommends that the Financial Ombudsman Service and the Credit Ombudsman Service set key performance indicators (KPIs) for meeting milestones in their management of a complaint, publish these milestones and KPIs on their website and report their performance against these KPIs in their annual reports.

Recommendation 6

7.83 The committee recommends that ASIC, in consultation with the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service (COSL):

- **consider amending the terms of reference for FOS and COSL so that the caps on the maximum value of a claim that the EDR schemes may consider and the maximum amount that can be awarded are increased and indexed to the consumer price index;**
- **examine the processes for reporting to ASIC matters of significance and emerging systemic issues with a view to improving the reporting regime;**
- **establish protocols for managing allegations of less serious fraud to ensure that such complaints do not get lost in the system and are recorded properly on ASIC's databases;**

-
- **improve the guidance provided to complainants so they fully understand that FOS and COSL are dispute resolution bodies and that complainants must prepare their own cases; and**
 - **consider establishing special divisions in FOS and COSL to deal with small business complaints.**

7.84 Before the committee concludes its consideration of predatory lending, it draws attention to the current concerns of the Consumer Credit Legal Centre (NSW). The Centre noted that a consumer support group was giving advice to many consumers, who borrowed between 2001 and 2010, that 'would appear to be not well founded in law'. It stated:

While some of these borrowers have definitely been adversely affected by poor lending practices, the remedies available at law at the time, and even now, are not as extensive as some borrowers have been led to believe. Many borrowers are being advised to stop making payments on their loans altogether and are risking the repossession of their properties as a result (in addition to possibly being liable for further interest, charges and enforcement expenses).⁹⁵

7.85 The committee has detailed numerous cases where highly vulnerable people were taken advantage of by unscrupulous brokers and in some cases negligent lenders. The submitters rightly call for justice. Despite the harm caused through the misconduct of others, some complainants, however, do not appreciate the legal obstacles to achieving what they would term a 'fair deal'. Indeed, there are two areas in particular where their expectations do not match the likelihood of success: holding lenders to account for the misdeeds of brokers; and the level of compensation due to them.

7.86 In this regard, the committee underlines the following messages from the consumer advocacy associations, EDR schemes and ASIC that relate to lending practices before 2010:

- Brokers as agents for the lender—the courts have found that, barring special circumstances, a mortgage broker was the agent of the borrower and not the lender; the broker's actions were attributable to the borrower; and the knowledge of a broker could not necessarily be imputed to the lender.
- Contract—the loan agreement is the legal contract binding lender and borrower and therefore is the critical document, not the loan application forms. The loan application forms 'do not in any way create or bind the applicants to a loan contract' with the financial service provider. Nor do they 'create an obligation' on the provider that it must offer finance to the applicant.⁹⁶ FOS explained further:

95 CCLC, *Submission 194*, p. 15.

96 FOS, *Determination: Case number 323234*, 17 December 2013, p. 5.

The existence of the errant signatures on the [loan application forms], do not void the subsequent...loan contracts offered by the FSP and accepted by the Applicants. The crucial question to be considered is whether a diligent and prudent lender would have approved the loans?⁹⁷

- Compensation—while the borrower may be relieved from their obligations under their loan contract (in whole or in part), they will be required to account to the lender for any benefit they have received as a result of obtaining the loan, so as to ensure the borrower does not obtain a 'windfall'.⁹⁸ This means that a court or EDR process would take into account whether the borrower 'has actually obtained some material benefit as a result of entering into the loan; for example, by purchasing a property (either as a home or for an investment), obtaining funds for personal spending or renovations, or refinancing to a lower interest rate'.⁹⁹ As COSL noted—setting aside the loan is very rare and so the amount of compensation tends to be much less than the loan itself.¹⁰⁰
- Standard of proof—what appears to be malfeasance to a borrower may be difficult to prove in a courtroom, thus borrowers who elect to pursue matters in court face the same barriers as ASIC in establishing that a lender's conduct was, for example, unconscionable or that fraud took place.¹⁰¹

Conclusion

7.87 This one case study of problems in consumer credit between 2002 and 2010 (when the new credit laws came into force) sets the groundwork for the report. It introduces a number of key issues that surface and resurface in different contexts throughout this work. They include:

- ASIC has limited powers and resources but even so appears to miss or ignore early warning signs of corporate wrongdoing or troubling trends that pose a risk to consumers;
- the financial services industry is dynamic with new products and business models regularly emerging, which requires ASIC to be alert to the changes and any risk they pose to consumers or investors;
- in this changing environment, there are always people looking to find ways to circumvent the law—ASIC needs to have the skills and industry experience to be able to match their ingenuity;

97 FOS, *Determination: Case number 323234*, 17 December 2013, p. 5.

98 COSL, *Submission 418*, p. 6.

99 COSL, *Submission 418*, pp. 5–6.

100 See paragraph 7.59.

101 ASIC, *Submission 45.1*, p. 26.

- consumers trust their advisers, brokers and financial institutions to do the right thing by them to the extent that they may sign incomplete or blank documents, do not ask questions and do not seek second opinions—importantly such trust is open to abuse;
- consumers have unrealistic expectations of what ASIC can do and the extent to which the regulator is able to protect their interests or investigate their complaints;
- ASIC's communication with retail investors and consumers needs to improve significantly;
- the important role other participants in the financial services industry can have in assisting ASIC in its regulatory role, which then allows the regulator to concentrate its limited resources on serious and systemic matters; and
- some advisers or brokers targeting, deliberately and systematically, the more vulnerable members of the community, especially older Australians with assets but without high levels of financial literacy.

7.88 In the following chapters, the committee considers in depth another case study—the Commonwealth Financial Planning Limited matter—which elaborates on some of the issues already raised but in a different context.

Chapter 8

Commonwealth Financial Planning Limited: What went wrong at CFPL and why?

8.1 One of the committee's major concerns during this inquiry was the misconduct by financial advisers and other staff at Commonwealth Financial Planning Limited (CFPL), part of the Commonwealth Bank of Australia Group (CBA), and what some regard as ASIC's failure to respond to reports of this misconduct in a timely and effective manner.

8.2 This chapter provides an overview of the CFPL case, an analysis of what went wrong at CFPL and why, and a critical appraisal of the CBA's characterisation of the misconduct at CFPL as 'inappropriate advice' to clients.

8.3 Other issues raised by the CFPL matter are explored in the next three chapters. Chapter 9 provides:

- an overview of the surveillance project that ASIC undertook in relation to CFPL in 2007–08, and an assessment of the Continuous Improvement Compliance Program (CICP) that was implemented as a result in April 2008; and
- a review of ASIC's response to reports of misconduct at CFPL, including the disclosures made by CFPL whistleblowers.

8.4 Chapter 10 assesses the adequacy and effectiveness of the enforcement actions taken by ASIC in relation to the CFPL matter including, among other things, the enforceable undertaking from CFPL that ASIC accepted in October 2011. Chapter 11 examines the integrity of the client file reconstruction and compensation process put in place by CFPL/the CBA. The committee's conclusions on the CFPL matter are contained in Chapter 12.

8.5 The committee has received evidence from various parties involved in the CFPL matter including CFPL clients, a CFPL whistleblower, the CBA and ASIC. In addition to submissions and oral evidence from ASIC and the CBA, the committee has published submissions from former CFPL clients, family members of former CFPL clients, or representatives of CFPL clients, who, in addition to being highly critical of the CBA, in varying degrees argued that ASIC failed to prevent the misconduct at CFPL or respond appropriately when the misconduct became known. Three of these submitters—Mrs Jan Braund, Ms Merilyn Swan and the law firm Maurice Blackburn—also provided oral evidence to the committee on 10 April 2014. In addition, the committee received a number of submissions and oral evidence from

one of the CFPL whistleblowers, Mr Jeffrey Morris, that was highly critical of the CBA and ASIC's handling of the matter.¹

Chronological overview

8.6 In mid-2010, public reports emerged of problems affecting the quality of financial advice being provided to CFPL clients. While the exact nature and extent of these problems is contested (and explored further below), it is accepted by all parties that multiple CFPL advisers failed to meet required compliance standards and provided advice that was irresponsible, self-serving and incidental to client interests. The precise timeframe of this adviser misconduct remains unclear, but in terms of the individual CFPL advisers subject to ASIC enforcement action, most of the misconduct appears to have taken place between 2006 and 2010. For one adviser, Mr Christopher Baker, ASIC found compliance failures from 1 March 2005; for another, Mr Jade Zaicew, ASIC suggested that misleading and deceptive conduct took place between August 2011 to May 2012.²

8.7 A chronological summary of the CFPL matter is provided below in Table 8.1.

Table 8.1: Chronological summary of the CFPL matter

| <i>Date</i> | <i>Event</i> |
|------------------|--|
| February 2007 | ASIC commenced a surveillance project in relation to CFPL. |
| February 2008 | ASIC notified CFPL of its concerns resulting from the findings of its surveillance project. |
| April 2008 | CFPL implemented the Continuous Improvement Compliance Program in response to ASIC's concerns. |
| September 2008 | Mr Don Nguyen, a CFPL financial adviser, was suspended from CFPL for compliance failures. |
| 15 October 2008 | Mr Nguyen returned to CFPL as a senior planner, in effect a promotion from his position prior to suspension. |
| 30 October 2008 | The CFPL whistleblowers faxed an anonymous report to ASIC (signed 'the three ferrets'), reporting Mr Nguyen's conduct and a 'high level' cover-up of that conduct at CFPL. |
| 10 November 2008 | The CFPL whistleblowers sent their first follow-up email to ASIC. In subsequent exchanges in November 2008 and February 2009, ASIC indicated that the issue was still 'under consideration'. |

1 Mr Jeffrey Morris, *Submission 421* (and supplementary submissions). Mr Morris appeared before the committee in Canberra on 10 April 2014.

2 On Mr Baker see ASIC, 'ASIC accepts enforceable undertaking from former Commonwealth Financial Planning adviser', *Media Release*, no. 12-63AD, 4 April 2012; on Mr Zaicew see ASIC, 'ASIC bans former Commonwealth Financial Planning adviser from financial services and credit activities', *Media Release*, no. 14-068MR, 4 April 2014.

| | |
|------------------|---|
| May 2009 | Frustrated by ASIC's apparent inaction, the CFPL whistleblowers provided their information to a journalist from <i>Investor Daily</i> . Articles about the CFPL matter were published in <i>Investor Daily</i> on 18 May 2009, 25 May 2009 and 22 June 2009. The article on 25 May named Mr Nguyen. |
| 2 June 2009 | Mr Jeffrey Morris, one of the CFPL whistleblowers, met with CBA Group Security and reported his knowledge about Mr Nguyen and the management 'cover up'. |
| 4 June 2009 | The CFPL whistleblowers sent an anonymous email to CBA senior management (the 'Mallord' email), providing information on Mr Nguyen and the management 'cover up'. |
| 29 June 2009 | Mr Nguyen met with CFPL managers and was told to resign. |
| 6 July 2009 | Mr Nguyen formally resigned, citing ill health and denying any wrongdoing. |
| 27 July 2009 | The CBA filed a breach report with ASIC regarding Mr Nguyen. |
| 24 February 2010 | The CFPL whistleblowers made their first visit to ASIC. Mr Morris later wrote they 'marched in ASIC's door...to demand action'. ³ |
| 24 March 2010 | ASIC issued notices to CFPL to hand over documents relating to Mr Nguyen. Mr Nguyen's client list and audit trail data was required immediately, and his client files were required by 9 April 2010. |
| 24 March 2010 | Project Hartnett, the CFPL's process for determining compensation payable to clients of Mr Nguyen and, later, clients of adviser Mr Anthony Awker, began. |
| 19 July 2010 | ASIC referred a brief on Mr Nguyen to a delegate for consideration of a banning action. |
| 21 July 2010 | CFPL gave ASIC a commitment to remediate former clients of Mr Nguyen. |
| 3 November 2010 | CFPL commenced a remediation project for former clients of Mr Nguyen. |
| 3 March 2011 | ASIC banned Mr Nguyen from providing financial services for seven years. |
| 25 October 2011 | CFPL entered into an enforceable undertaking with ASIC. |
| 19 March 2012 | Mr Nguyen's banning order was upheld by the Administrative Appeals Tribunal (AAT) on appeal. |
| 25 October 2013 | The independent expert engaged in relation to the enforceable undertaking, PricewaterhouseCoopers, provided ASIC with its final report. |
| 26 November 2013 | ASIC accepted the final report of the independent expert, formally bringing the enforceable undertaking between CFPL and ASIC to a close. |

3 Mr Jeffrey Morris, *Submission 421*, p. 3.

The misconduct of individual CFPL financial advisers

8.8 In its first written submission on the CFPL matter, ASIC outlined the various aspects of the conduct of individual CFPL advisers that most concerned the regulator and were the subject of regulatory action. These were:

- failing to have a reasonable basis for advice;
- failing to provide Statements of Advice;
- making statements that were false or misleading in a material particular;
- making forecasts that were misleading, false or deceptive;
- failing to make reasonable inquiries before implementing advice;
- providing asset allocation advice far above that recommended for the client's risk profile; and
- failing to complete 'financial needs analysis' documentation.⁴

8.9 ASIC has taken enforcement action against eight individual CFPL advisers.⁵ Five of these advisers were banned by ASIC from providing financial services, and three removed themselves from the industry under an enforceable undertaking. The advisers banned from providing financial services were:

- Mr Don Nguyen—banned for seven years on 3 March 2011, with the decision upheld by the AAT on 19 March 2012;
- Mr Anthony Awkar—permanently banned on 19 April 2012;
- Ms Jane Duncan—banned for three years on 19 April 2012;
- Mr Rick Gillespie—permanently banned on 30 October 2012; and
- Mr Jade Zaicew—banned for seven years on 4 April 2014.

8.10 The advisers who removed themselves from the industry for a defined period under an enforceable undertaking were:

- Mr Simon Langton—two years, from 9 January 2012;
- Mr Christopher Baker—five years, from 3 April 2012; and
- Mr Joe Chan—two years, from 1 June 2012.

8.11 A large proportion of the evidence received by the committee in relation to the CFPL matter concerned one CFPL adviser in particular, Mr Don Nguyen. Mr Nguyen was an authorised representative of CFPL between 1 October 2003 until his resignation on 6 July 2009. His conduct was the subject of a series of CFPL

4 ASIC, *Submission 45*, p. 12.

5 ASIC's submission, which was provided to the committee in August 2013, indicated that ASIC had taken enforcement action against seven CFPL advisers. An eighth former CFPL adviser, Mr Jade Zaicew, was banned by ASIC for seven years on 4 April 2014.

whistleblower reports to ASIC, the first of which was made anonymously on 30 October 2008 after Mr Nguyen returned to CFPL on 15 October 2008 following a period of suspension for suspected compliance failures. As noted above, Mr Nguyen was banned by ASIC from providing financial services for seven years on 3 March 2011.⁶

CFPL's sales-based culture

8.12 While Mr Nguyen's conduct was particularly egregious, it should be noted that it is broadly agreed—by ASIC, the CBA and Mr Morris—that the problems at CFPL did not start or end with Mr Nguyen. Rather, the problems that ASIC identified at CFPL went beyond any single adviser or group of advisers; at the heart of these problems were systemic and organisation-wide failures within CFPL. In one of its submissions, ASIC reports that it had concerns about the:

...adequacy of CFPL's processes and controls, its dealing with misconduct by its representatives in a consistent manner, its capacity for early identification of irregularities in its advice process, the adequacy of controls over its clients' records and the consistent application of its complaints handling and internal dispute resolution processes.⁷

8.13 Mr Morris told the committee that Mr Nguyen and other non-compliant advisers would not have been able to operate as they had were it not for the 'incredibly loose, non-compliant culture' at CFPL. He described an aggressive sales-based culture wherein advisers pushed clients into inappropriately high-risk products both to earn bonuses and 'avoid getting the sack'.⁸

8.14 Maurice Blackburn provided a similar assessment based on the experiences of former CFPL clients that it represented in various civil actions. Its work on behalf of these clients revealed a toxic, 'boiler room'-like environment at CFPL, where advisers chasing commissions would systematically target clients in conservative positions, selling them into high-risk products that were inconsistent with their conservative risk profiles. Maurice Blackburn explained that in order to do this, the advisers needed to circumvent processes that would usually 'work by putting some downward pressure on those sorts of extreme sale practices'. These processes included the preparation and maintenance of Financial Needs Analysis and Statements of Advice documents.⁹

8.15 Maurice Blackburn explained to the committee that almost all of its 30 clients were retirees, who had originally been in conservative investments. These clients had been:

6 ASIC, 'Clients of Commonwealth Financial Planning compensated and ASIC bans former financial adviser for seven years', *Media Release*, no. 11-42AD, 10 March 2011.

7 ASIC, *Submission 45*, pp. 12–13.

8 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 45.

9 Mr John Berrill, Lawyer and Principal, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 17.

...convinced by Mr Nguyen to transfer their moneys into much riskier and high-risk investments and they lost substantial moneys. The most stunning example we had was a couple in their mid-80s who had a \$5 million portfolio and lost \$2½ million of that. They were conservative investors and they were convinced by Mr Nguyen through a process that was completely flawed. It involved lots of cutting and pasting of documents, almost all of which were not completed by them or sighted by them.¹⁰

8.16 Interestingly, in a 2007–08 surveillance project carried out by ASIC in relation to CFPL (which is discussed in the next chapter), ASIC appeared to have identified the relationship between the amount of revenue a particular adviser was bringing in and the CFPL's tolerance of non-compliance on the part of that adviser. On 29 February 2008, ASIC wrote to the CFPL that it had found:

...that of the 38 representatives who were rated Critical [by the CBA's Risk Matrix system], CBA revoked the authorisation of only 12 representatives. We do not know why the remaining representatives continue to retain their authorisations. There appears to be some correlation between the amount of revenue generated by the representative and CBA not revoking an authorisation.¹¹

8.17 On 5 May 2014, the ABC's *Four Corners* program revealed documentation showing that in 2006 Mr Nguyen was, in fact, assessed by the CBA as being a 'Critical Risk' by its compliance team.¹² This information would appear consistent with the suggestion in ASIC's 2008 letter that CFPL/the CBA appeared willing to turn a blind eye to non-compliant advisers, so long as they were earning significant revenue for the company (as Mr Nguyen was).

8.18 In his submission, Mr Morris wrote that Mr Nguyen 'was widely known as "Dodgy Don" for years *before* the events of 2008–09'. That Mr Nguyen's 'dodgy' conduct was at once widely known and generally tolerated was, Mr Morris argued, indicative of a culture at CFPL/the CBA that was driven by 'sales and a metricated short term remuneration/bonus structure *at all levels* and where ethics and propriety at best take a back seat'.¹³ The abovementioned findings of ASIC's 2007–08 surveillance project, together with *Four Corners*' revelations about Mr Nguyen's 2006 risk assessment, appear to firmly support Mr Morris's assessment in this regard.

10 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 13.

11 ASIC, letter to Commonwealth Financial Planning Limited and Financial Wisdom Limited, 29 February 2008, *Additional Information 7*, p. 4.

12 ABC, *Four Corners*, 'Banking Bad', 5 May 2014, and supporting document at www.abc.net.au/4corners/documents/2014/BANKING/Nguyen_CBA_Internal_Review_2006.pdf.

13 Mr Jeffrey Morris, *Submission 421*, p. 4 (italics in source).

Allegations of forgery

8.19 One of the most serious allegations made against the CBA during the inquiry was Mrs Jan Braund's claim that the bank had either ignored or sought to cover up Mr Nguyen's misuse of her signature to facilitate product-switches and other transactions that she had not authorised.

8.20 Mrs Braund provided the committee with evidence demonstrating that a number of these transactions took place when she and her husband were overseas, when it would have been physically impossible for her to sign the transaction authorisations. A number of these transactions were apparently made using a copy of Mrs Braund's signature. Mrs Braund emphasised that she had never given Mr Nguyen permission to use her signature, and tabled a statutory declaration to that effect during her appearance before the committee.¹⁴

8.21 According to Mrs Braund, the CBA had refused to take any action in relation to her allegations that Mr Nguyen used a photocopy of her signature to invest against her profile.¹⁵ The CBA responded that it had in fact investigated Mrs Braund's claims of forgery, and accepted that she could not have put several of the signatures on authorising documents. The bank nonetheless maintained that the findings of its investigation of Mrs Braund's claims were inconclusive, and did not warrant a report to the police:

We had our security team investigate those issues. Our security team is a team comprised, in many cases, of ex-police officers, so they do have experience in these types of issues. We were not able to conclusively find evidence that we felt would be sufficient to lead to a brief to go to the police. I would draw a distinction there, because in other cases of advisers we did actually find clear evidence of forgery and we did report the matter to police and the police looked into the issues. In this particular case with Mr Nguyen, we were not able to form a conclusive view that there had been forgery.¹⁶

8.22 The CBA told the committee that Mrs Braund's allegations regarding the misuse of her signature to facilitate an unauthorised 'switch back' of funds to managed investments in October 2008 was 'based on her misunderstanding of circumstances'. According to the CBA, Colonial First State 'failed to execute' Mrs Braund's October 2008 request that her investment be switched from managed investments into cash. Therefore, rather than a 'switch back' taking place using her forged signature, the CBA claims that the original switch to cash never actually took place:

[A]s Mrs Braund's original October 2008 instruction had not been executed, there was no 'switch back' transaction at all. Therefore no 'switch back'

14 Mrs Janice Braund, *Proof Committee Hansard*, 10 April 2014, p. 8.

15 Mrs Janice Braund, *Proof Committee Hansard*, 10 April 2014, p. 2.

16 Mr David Cohen, General Counsel and Group Executive, Group Corporate Affairs, Commonwealth Bank of Australia, *Proof Committee Hansard*, 10 April 2014, p. 23.

document came into existence and as a result Mrs Braund's signature was not used.¹⁷

8.23 The CBA also addressed Mrs Braund's allegations regarding the use of her photocopied signature on a number of switch and withdrawal requests from 2006 to 2008 at times when she was overseas. As to why the misuse of Mrs Braund's signature on these occasions did not result in a report to the police, the CBA again argued that it 'found insufficient evidence to support a report to the police'. Specifically, the CBA told the committee that Mrs Braund had indicated that Mr Nguyen had informed her that he had photocopied her signature (although the bank did not directly state that Mrs Braund had authorised Mr Nguyen to use that signature). CFPL's investigation subsequently found that four signatures on withdrawal and withdrawal/switch requests appeared to be identical, but that all withdrawals had been deposited directly into the Braunds' non-CBA bank account:

CFP believes it is likely that the Braunds requested these four withdrawals and the instructions were submitted by Mr Nguyen or someone else at CFP to execute these instructions on behalf of the Braunds while they were overseas and not able to sign the forms themselves. CFP believes this was done in order to facilitate access to their funds while the Braunds were overseas. CFP has been unable to verify its belief with Mrs Braund because she has refused to meet with CFP.

CFP also investigated whether there was any advantage obtained by any staff member in the execution of these instructions. No benefit (payment, credit, bonus) was earned or received by any CFP staff member in relation to a withdrawal or switch on the Braunds' accounts involved in these four transactions.¹⁸

8.24 In addition, the CBA noted that there were certain difficulties in Mrs Braund's case which weighed against making a report to police. They included: the uncertainty around whether Mr Nguyen had himself affixed Mrs Braund's signature to the transaction requests; no benefit was to be gained by Mr Nguyen or any other CFPL employee from affixing Mrs Braund's signature to these requests; and as Mr Nguyen was no longer employed at CFPL it was not possible to question him about the matter.¹⁹

8.25 While the CBA did not make a report to the police regarding Mrs Braund's case, the CBA told the committee that it had, in the past, referred advisers to the police where it had found evidence of forgery. However, in the Nguyen case and in the case of Mr Gillespie, CBA investigations had not revealed the hard evidence needed to make a report to the police. Still, the CBA assured the committee that it would not hesitate to report these advisers to the authorities if it acquired the necessary evidence:

17 CBA, answer to question on notice, 24 April 2014, pp. 2–3.

18 CBA, answer to question on notice, 24 April 2014, p. 3.

19 CBA, answer to question on notice, 24 April 2014, pp. 4–5.

We have nothing to hide about this. If there was forgery perpetrated then we have nothing to hide. There is no gain. It is a criminal offence. It should be reported to the police, as we have done in the past and we would be prepared to do so in the future.²⁰

8.26 ASIC's evidence to the committee would tend to support the CBA's claim that it was willing to report forgery to the police when it had evidence available to make such a report. Mr Greg Kirk told the committee that his understanding was that the CBA had:

...referred at least one matter to the police—not Mr Nguyen but a Mr [Anthony Awkar]—that involved forgery. Mr [Awkar] was banned by us, in part using the evidence about the forgery. I think the police determined not to take the case further because they did not think they could prove that to a criminal standard in a court.²¹

8.27 In addition to being critical of the CBA's apparent inaction in relation to her allegations of forgery, Mrs Braund also told the committee that ASIC had failed to take any action in relation to her claims.²² Discussing the forgery allegations, ASIC also told the committee that it would be unlikely to prepare a brief for the DPP in relation to signature fraud simply on the word of a complainant. Even if it were clear that a signature was not the signature of the complainant:

...proving who actually did put the signature on [a form] is another question and we need to prove that beyond reasonable doubt. So it is not as simple as taking it straight to the DPP or indeed taking it to the court.²³

Don Nguyen's promotion and allegations of a management 'cover up'

8.28 As noted above, Mr Nguyen was suspended from CFPL in September 2008 for suspected compliance failures. According to Mr Morris, Mr Nguyen's suspension had been prompted by a number of developments, namely that: Mr Nguyen had failed a file audit; client complaints were 'pouring in' as Mr Nguyen's poor advice was exposed by the onset of the global financial crisis; Mr Nguyen had been caught paying \$50 'backhanders' to Chatswood Branch staff to give him client details directly; and he had been caught 'red handed' by a compliance manager defrauding CommInsure 'by tendering \$5,000 invoices for financial advice that was never provided'.²⁴ An internal CFPL memo provided by Mr Morris suggests Mr Nguyen was suspended in August 2008 'as a result of an issue raised with respect to an advice fee for a client in receipt

20 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 38.

21 Mr Greg Kirk, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 75.

22 Mrs Janice Braund, *Proof Committee Hansard*, 10 April 2014, p. 2.

23 Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 83.

24 Mr Jeffrey Morris, *Submission 421*, p. 8.

of a trauma claim'.²⁵ This advice fee is evidently the CommInsure fraud referred to by Mr Morris.

8.29 Despite what would appear to have been overwhelming evidence of misconduct on Mr Nguyen's part, on 15 October 2008 Mr Nguyen not only returned to work at CFPL, but was promoted to the position of senior planner. Mr Morris and the other CFPL whistleblowers alleged in their anonymous fax to ASIC on 30 October 2008 that Mr Nguyen's promotion was part of a management conspiracy to avoid paying client compensation. The amounts involved, the whistleblowers suggested, ran into the tens of millions—'enough to cost all the managers involved their jobs'. The whistleblowers explained that by promoting Mr Nguyen, CFPL management was able to ensure he had access to his clients, which was necessary to allow him 'to dupe and discourage clients from pursuing their complaints'. The whistleblowers further alleged that CFPL management realised that if they sacked Mr Nguyen, this would place the CFPL in a 'very poor position' to defend compensation claims by his clients. Conversely, promoting Mr Nguyen would 'tend to strengthen their position'.²⁶

8.30 Mr Morris explained that, following Mr Nguyen's suspension from CFPL in September 2008, he personally witnessed the workings of a CFPL management conspiracy to cover up Mr Nguyen's wrongdoing. His version of events, if accurate, would indicate a coordinated and systematic effort by CFPL/the CBA to mislead Mr Nguyen's clients and discourage them from pursuing compensation claims, and is worth quoting at length:

Contrary to what was said earlier [by CBA representatives appearing before the committee on 10 April 2014], [CFPL management] knew Nguyen had done all the things he was accused of; he was caught red-handed. They announced he had been suspended for fraud and he would not be coming back. The trouble is that, with the GFC going on, they needed a planner to hose down Nguyen's clients who were complaining. They offered his client book to another planner. They gave him his phone. After a week of this, of all the client complaints ringing up, and being told by the complaints people that they were not going to do anything for them, he threw the phone back and he said he would not have anything to do with it.

So they brought Nguyen back and reinstated him and promoted him so that he could fob off the clients and discourage them from making complaints about what had happened. At the same time, they had done a file review and they had found photocopied risk profiles in his fact files. The risk profile is probably the most critical thing a planner does. Nguyen just gave everybody more or less the same risk profile. He got to the point where he just photocopied them. They found this in 2008, and he should have been dismissed at that point. But they brought him back for two reasons. One

25 A copy of this memo, dated 25 November 2009, is attached to *Submission 421.5*. Elsewhere, the CBA has stated that Mr Nguyen was suspended in September (rather than August) 2008.

26 Mr Jeffrey Morris, *Submission 421*, pp. 11–12.

was to hose down the client complaints. The other was to sanitise his files. They gave him a second assistant to help sanitise the files. I saw him there, day after day, with liquid paper going through changing things in the fact files.²⁷

8.31 The CFPL whistleblowers alleged that while the compliance team at CFPL had recommended that Mr Nguyen be sacked for his misconduct, the team had evidently been warned to 'back off' by CFPL/CBA management 'on a sufficiently senior level'. The whistleblowers further alleged that CFPL's internal complaints handling area:

...also appears to have been got at (again at a senior level, probably above Commonwealth FP) and agreed to deal with complaints about Don Nguyen on a purely individual basis, just looking at what is in front of them for each case and ignoring the wider systemic issues of which they are well aware.²⁸

8.32 On 5 May 2014, *Four Corners* broadcast a handwritten document by a CFPL compliance officer on 24 November 2008 that read in part: 'If pulled Don out, huge compensation issue for CFP—Better to work for client's best interests to resolve all issues'.²⁹ This document, which Mr Morris has since provided to the committee, would appear to support the whistleblowers' claims that Mr Nguyen was promoted with a view to minimising any compensation costs for the CBA.³⁰

8.33 While the CBA conceded that the decision to promote Mr Nguyen was wrong, it also suggested that the reasoning at the time was that he would be subject to closer supervision in his new role:

In hindsight, it is very clear to us that he should not have been promoted. The reasoning at the time seems to have been that in this more senior position he would actually see fewer clients. He would supervise but he would actually physically see fewer clients. He was also relocated to Chatswood, where he would be under the closer supervision of his manager. Clearly, that was the wrong decision in view of the investigative reports and as events unfolded, but it was the decision taken at the time. Furthermore, I think at the time the full extent of his misconduct was clearly not known; but, with the benefit of hindsight, it was the wrong decision.³¹

8.34 The CBA made no attempt to defend the decision to promote Mr Nguyen. It should nonetheless be noted that if CFPL management genuinely believed that Mr Nguyen would see fewer clients as a senior planner, this evidently did not work.

27 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 47.

28 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, pp. 9–11.

29 ABC, *Four Corners*, 'Banking Bad', 5 May 2014, www.abc.net.au/4corners/stories/2014/05/05/3995954.htm.

30 A copy of the compliance note, dated 24 November 2008, is attached to *Submission 421.6*.

31 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 24.

Ms Swan, for instance, reports that her parents met with Mr Nguyen twice in November 2008.³²

8.35 A report by Adele Ferguson and Chris Vedalgo in the Fairfax press suggested that upon Mr Nguyen's return from suspension in late 2008 he was placed under supervision and his Statements of Advice were vetted before being provided to clients. Ms Ferguson and Mr Vedalgo report that on 22 December 2009, Mr Nguyen was notified that his advice to clients would no longer need to be vetted before being sent to clients.³³ This report, if accurate, would suggest that not only did Mr Nguyen remain in direct contact with clients as a senior planner, but also that any heightened supervision to which he was subject following his return from suspension was temporary.

8.36 Asked why the CBA did not make a breach report to ASIC when Mr Nguyen was first suspended in September 2008, the CBA told the committee that the findings from the investigation at the time were 'inconclusive'. While acknowledging 'the decisions made around' the investigation of Mr Nguyen in September 2008 and his subsequent return to work were 'the wrong decisions', the CBA did not directly concede that it should have made a breach report to ASIC at the time.³⁴

CBA's actions between Mr Nguyen's promotion and his forced resignation

8.37 According to Mr Morris, between Mr Nguyen's return from suspension in October 2008 and his forced resignation in mid-2009, Mr Nguyen set about sanitising client files 'literally liquid paper bottle in hand, with a little help from his two servicing planners'.³⁵ At the same time, Mr Nguyen continued to mislead and deceive clients. This included an episode in late 2008 where Mr Nguyen missed the team's Christmas party because:

...he and his two servicing planners were busy trying to stitch up a 93 year old with \$1.6 million to invest for a \$32,000 [2% flat] advice fee. It goes without saying that no financial planner with a shred of decency to them would have contemplated acting this way.³⁶

8.38 Frustrated by what they regarded as a CFPL management cover-up of Mr Nguyen's activities (and, as discussed in the next chapter, by ASIC's failure to act on their information) in May 2009 the CFPL whistleblowers provided their information to an *Investor Daily* journalist. The whistleblowers reasoned that:

32 Ms Marilyn Swan, *Submission 395*, pp. 7–8,

33 Adele Ferguson and Chris Vedalgo, 'Bank tried to hide documents from victims of banned planner', *Sydney Morning Herald*, 14 June 2013, p. 1.

34 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, pp. 23–24.

35 Mr Jeffrey Morris, *Submission 421*, p. 15.

36 Mr Jeffrey Morris, *Submission 421*, p. 14.

...going public would force CBA to act and go through the farce of a 'voluntary disclosure' to ASIC of what they had long known. That hot potato dumped in their lap should in turn force ASIC [to] act.³⁷

8.39 Articles based on the whistleblowers' information were published by *Investor Daily* on 18 May 2009, 25 May 2009 and 22 June 2009. The article on 25 May named Mr Nguyen. Shortly after the publication of the 25 May article, Mr Nguyen was suspended from work. Mr Morris, meanwhile, reported his allegations regarding a CFPL management cover-up of Mr Nguyen's conduct to CBA Group Security on 2 June 2009. On 4 June 2009, the CFPL whistleblowers also sent an anonymous email to CBA senior management (subsequently referred to as the 'Mallord' email, for the name that appeared in the sender's address) in an attempt to ensure the bank had no reason not to act.³⁸ Mr Morris suggests that the whistleblowers' actions were 'the direct cause of Nguyen's forced "resignation" on 2 July 2009 and CBA's filing of a Breach Report with ASIC regarding Nguyen on 27 July 2009'.³⁹

8.40 Mr Nguyen resigned from CFPL on 6 July 2009, while still on suspension. In his letter of resignation, he denied any wrongdoing and cited ill health as the reason for resigning.⁴⁰ Mr Morris alleged that Mr Nguyen was allowed to resign and receive payments from a generous CommInsure income protection policy (worth 75 per cent of his former salary) as a pay-off for not revealing what CFPL management had encouraged him to do since his first suspension.⁴¹

8.41 Asked to what extent the CFPL breach report to ASIC regarding Mr Nguyen was prompted by the *Investor Daily* articles, the CBA told the committee:

In reviewing the situation at that time, that was one contributing factor but not the sole one. There was already an investigation taking place and the information that actually came out allowed us to have some more information to follow up. So it was not the sole issue but it led to a combination of pieces of information.⁴²

8.42 According to ASIC's submission, when CFPL lodged its breach report regarding Mr Nguyen it indicated that it had conducted a review of 16 of Mr Nguyen's client files after receiving 'a couple of major complaints from clients'. The breach report, it implied, was prompted by this file review.⁴³ The CBA did not refer to the

37 Mr Jeffrey Morris, *Submission 421*, p. 15.

38 Mr Jeffrey Morris, *Submission 421*, pp. 17–18.

39 Mr Jeffrey Morris, *Submission 421*, p. 21 (italics in source).

40 A copy of Mr Nguyen's letter of resignation is attached to *Submission 421.6*.

41 Mr Jeffrey Morris, *Submission 421*, p. 25.

42 Ms Marianne Perkovic, Executive General Manager, Wealth Management Advice, CBA, *Proof Committee Hansard*, 10 April 2014, p. 22.

43 ASIC, *Submission 45*, p. 9.

internal disclosures of the whistleblowers, or the publication of the *Investor Daily* articles, as factors contributing to the decision to prepare the breach report.⁴⁴

CBA's characterisation of misconduct at CFPL as 'inappropriate advice'

8.43 In its written submission, the CBA acknowledged that 'in the past a small number of its advisers, none of whom remain with CFPL, provided inappropriate advice to some customers'.⁴⁵

8.44 The CBA was challenged to defend its characterisation of the misconduct at CFPL as 'inappropriate advice' during its appearance before the committee. The CBA's group general counsel, Mr David Cohen, responded as follows:

'Inappropriate' is the word we used because it covers the fact that in some cases advice was just not suitable for the client in question. 'Inappropriate' covers the fact that some of the behaviours, which I think you are alluding to, from some of our people just were not the appropriate behaviours, were not the behaviours that we expect and enforce today. As I said, the people, the structures and the culture just were not the right people, structures and cultures at the time, and we should have done better.⁴⁶

8.45 The CBA was further pressed on this issue, and asked why it had used the term 'inappropriate advice' in its submission when the chairman of the CBA, Mr David Turner, told shareholders at the CBA's 2013 annual general meeting that what had happened was 'shocking'. Mr Turner was further quoted as saying:

There's no excuse for giving bad advice, absolutely no excuse. We had the wrong people giving the advice and the business was structured wrongly, and remunerated wrongly, and the culture was wrong.⁴⁷

8.46 At the committee's public hearing, the CBA conceded that 'some of the workings of [CFPL] were shocking'.⁴⁸ It added that its use of the term 'inappropriate advice' did not mean that the CBA believed:

...the circumstances that occurred should be treated lightly, and we certainly do not treat it lightly. We had taken the view—a very serious view—that we needed to substantially improve the business because it was not run the way it should have been run. There is no doubt about that. I do not wish to downplay for a second the fact that the impact on customers was severe... We do not treat lightly the fact that we did have poor systems,

44 A copy of the breach report is attached to *Submission 421.5*.

45 CBA, *Submission 261*, p. 3.

46 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 20.

47 *Proof Committee Hansard*, 10 April 2014, p. 21. Mr Turner is quoted speaking at the CBA annual general meeting in Clancy Yeates, 'Rogue planner behaviour "shocking": CBA', *Sydney Morning Herald*, 8 November 2013.

48 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 21.

we did not have the right people and we did not have the right culture, as the chairman has said.⁴⁹

Pain and suffering resulting from the CFPL case

8.47 As noted above, despite characterising the misconduct at CFPL as 'inappropriate advice', the CBA acknowledged that the 'impact on [CFPL clients] was severe'. The evidence provided by a number of former CFPL clients drove home the extent of the harm caused, which went far beyond financial detriment. These clients spoke of being bullied by CFPL/the CBA, and described the stress and uncertainty that they and their families were subject to as a result of misconduct at CFPL.

8.48 The personal toll that this misconduct had on clients was made clear in a submission from Mr and Mrs Mervyn and Robyn Blanch. Mrs Blanch was a client of Mr Nguyen, and between May 2007 and March 2009, Mrs Blanch's \$260,000 investment in an Allocation Pension portfolio prepared by Mr Nguyen was reduced to \$92,000.⁵⁰ In addition to outlining the financial losses they suffered, Mr and Mrs Blanch emphasised the distress they experienced in dealing with Mr Nguyen and other CFPL and CBA staff:

Throughout our association with CBA/CFPL's staff and Nguyen we have been subjected to deliberate acts of fraud and deceptive and misleading conduct. We have been ignored, lied to, stonewalled, fobbed off, bullied, and sent fraudulent documentation by CFPL staff and CBA's senior management within Customer Relations. They actively tried to cover up Nguyen's activities, denying any knowledge of or liability for his conduct.⁵¹

8.49 In her appearance before the committee, Mrs Braund relayed how the investment she and her husband made with CFPL coincided with the onset of Mr Braund's dementia. Mrs Braund told the committee that her husband had always taken care of their finances; as Mr Braund's dementia worsened, she relied on Mr Nguyen to act with honesty and integrity. However, Mr Nguyen failed to carry out her request that their investments be moved to cash in early 2007 and used a copy of Mrs Braund's signature to move the Braunds' money into high risk investments without her approval. Ultimately, this betrayal of trust meant that at the same time as Mrs Braund was caring for her dying husband, she was also forced to deal with a massive decline in the value of her investment and a bank that refused to acknowledge any wrongdoing or provide meaningful compensation:

People's lives have been shattered. I have been scorned...

49 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 21.

50 In addition to the submission from Mr and Mrs Blanch, their experience is outlined in a submission from their daughter, Ms Marilyn Swan, *Submission 395*. Ms Swan also gave evidence at a public hearing on 10 April 2014.

51 Mr and Mrs Merv and Robyn Blanch, *Submission 300*, p. 1.

CBA has bullied me and they gave me this incredible feeling that, while I was dealing with Alan's dying, I still had to try to deal with them.⁵²

8.50 Mr Frazer McLennan, writing on behalf of his wife Gloria, who was a client of CFPL adviser Mr Chris Baker, described the effect on his wife of watching as her investment (which was placed in an aggressive portfolio without her knowledge) rapidly declined in value:

[M]uch of Gloria's anguish is caused by her deep down to the bone sense of fairness. She endeavours to make everything fair for all in any situation, and sometimes to her detriment. In this case her sense of fairness is being challenged, and it's not fair what Commonwealth Financial Planning is doing, and it does her head in, which does 'us' harm as well. They are being corporate bullies trying to wear down individuals who they have done wrong.⁵³

Committee view

8.51 The committee notes that in a limited way the CBA has acknowledged that there were problems in its financial advice business, and expressed regret that some of its customers were affected by 'inappropriate advice' received from a 'small number' of CFPL advisers. The CBA has also acknowledged that it mishandled the Nguyen matter, at least with respect to the CFPL investigation of his compliance failures in 2008 and his subsequent return to CFPL in October 2008 after a short period of suspension.

8.52 These modest acknowledgements aside, the committee believes that the CBA's characterisation of the misconduct at CFPL as 'inappropriate advice' provided by 'a small number' of CFPL advisers, deliberately and grossly understates the extent of the wrongdoing within CFPL. The committee believes the phrase 'inappropriate advice' comprehensively fails to capture the deceptive and misleading conduct of CFPL financial advisers. Indeed, the committee heard compelling evidence that client signatures were forged and/or misused by CFPL financial advisers, and while the committee reserves judgement on whether this activity would provide a basis for criminal action, it suggests that to characterise such activity as 'inappropriate' is, in itself, entirely inappropriate. Further, the phrase 'inappropriate advice' does not capture the systemic failures in the CFPL's business operations, including the ineffective compliance regime and toxic sales-based culture fostered by flawed remuneration arrangements.

8.53 The committee also notes that the phrase 'inappropriate advice' stands in stark contrast to the admission by the chairman of the CBA, Mr David Turner, that what happened at CFPL was 'shocking', and that there was 'absolutely no excuse' for the way the business was operated (see Box 8.1).

52 Mrs Janice Braund, *Proof Committee Hansard*, 10 April 2014, pp. 2–3.

53 Mr Frazer McLennan, *Submission 127*, p. 2.

Box 8.1: 'Inappropriate advice' or 'shocking' conduct?

'CFP acknowledges that in the past a small number of its Advisers, none of whom remain with CFP, provided inappropriate advice to some customers'.

Source: Commonwealth Bank of Australia Group, *Submission 261*, p. 4.
The submission was provided to the committee on 11 November 2013.

'What we did was shocking. There's no excuse for giving bad advice, absolutely no excuse. We had the wrong people giving the wrong advice and the business was structured wrongly, and remunerated wrongly, and the culture was wrong'.

Source: Mr David Turner, chairman of the CBA, speaking at the CBA's 2013 AGM on 8 November 2013, as quoted in Clancy Yeates, 'Rogue planner behaviour "shocking": CBA', *Sydney Morning Herald*, 8 November 2013, www.smh.com.au.

8.54 Moreover, the committee remains unconvinced by the CBA's explanation of the circumstances surrounding Mr Nguyen's promotion in October 2008 to the position of senior planner. While the CBA acknowledged the decision to promote Mr Nguyen was wrong, it explained that the reasoning at the time was that in his new role Mr Nguyen would be subject to higher levels of supervision. The CBA's explanation for Mr Nguyen's promotion is nonsense. Beyond the fact that Mr Nguyen's poor practices were already well established by 2008 (indeed, he had been rated a 'critical risk' by the CBA in 2006), there is little evidence that upon his return to CFPL in October 2008 Mr Nguyen was placed under heightened supervision for a prolonged period. The committee believes Mr Morris's explanation for Mr Nguyen's promotion is far more convincing: that is, CFPL management decided it would be easier to 'hose down' client complaints, and generally minimise the CBA's exposure to compensation claims, if Mr Nguyen remained a CFPL adviser.

Chapter 9

Commonwealth Financial Planning Limited: ASIC's investigations of misconduct at CFPL

9.1 As noted in the previous chapter, the committee received evidence from a number of CFPL clients and their representatives who contend that ASIC's handling of the CFPL matter was inadequate. In varying degrees, these witnesses argued that ASIC:

- erred in not publicly revealing that it had undertaken a surveillance project in relation to CFPL between 2007 to 2008 or that the problems revealed by this surveillance led to the imposition of the Continuous Improvement Compliance Program (CICP) in April 2008—this non-disclosure, it is suggested, left existing and future CFPL clients exposed to losses that might otherwise have been prevented;
- was slow to respond to whistleblower information about misconduct at CFPL, resulting in further losses to unsuspecting clients and enabling CFPL/the CBA to cover-up the extent of the misconduct at CFPL and thereby deny fair and reasonable compensation to victims; and
- has generally acted in a way that has privileged the interests of CFPL/the CBA over the interests of affected CFPL clients, and failed to provide adequate information or support to those clients.

9.2 Also, the CICP implemented in April 2008 proved to be an inadequate response to the misconduct at CFPL, and one that placed too much store in the ability and willingness of CFPL/the CBA to address the problems that had been detected effectively. These complaints and the conduct of ASIC's investigations into misconduct at CFPL are explored further in this chapter.

9.3 The related complaint that ASIC put in place an inadequate and inappropriate enforceable undertaking with CFPL in 2011, and that this has enabled CFPL/the CBA to manipulate the process of compensating affected CFPL clients, is considered in the next two chapters.

The 2007–08 surveillance project

9.4 ASIC suggested in its first written submission that it had long been alert to potential problems with the quality of advice being provided by the financial planning industry in Australia. ASIC's concerns in this regard, it wrote, had prompted it to initiate surveillance projects on three of the largest industry participants in Australia: CFPL, AMP and Professional Investment Services. ASIC's surveillance project in relation to CFPL commenced in February 2007 and was completed in

February 2008. The project involved interviews with various CFPL staff and the review of 496 pieces of advice provided by 51 advisers.¹

9.5 According to ASIC, its surveillance of CFPL was not intended to identify problem advisers, but rather to 'examine the quality of advice and processes overall within CFPL'. Its surveillance found:

...significant concerns in relation to supervision, file review procedures, advice templates, breach reporting, record keeping and compliance, and significant and widespread problems with the quality of advice.²

9.6 It is worth noting that the import of this surveillance project is contested: ASIC, on the one hand, suggested that the project (and others undertaken in relation to AMP and Professional Investment Services) 'ultimately led to enforceable undertakings with all three firms'. Mr Morris, by contrast, suggested that CFPL believed ASIC had given it the 'all clear' at the end of the surveillance project (as discussed further below). The enforceable undertaking referred to in ASIC's submission was put in place on 26 October 2011.

9.7 Putting aside the degree to which the surveillance project 'ultimately led' to the enforceable undertaking in October 2011, the immediate outcome of the surveillance project was that in February 2008 ASIC wrote to the CBA advising it of the problems detected by the surveillance project and the concerns ASIC had about the CFPL business.³

9.8 Following a request from the committee at a public hearing on 10 April 2014, ASIC provided the committee with a copy of the letter it sent to CFPL on 29 February 2008. The content of the letter is consistent with the summary ASIC provided in its submission of the surveillance project findings but for one important fact: ASIC had not previously mentioned that, in addition to CFPL, the surveillance project also focused on the operations of another CBA subsidiary, Financial Wisdom Limited (FWL). The advice provided by FWL, and in particular by Mr Rollo Sherriff (an adviser at the Cairns-based financial advisory firm, Meridien Wealth, which was a subsidiary of FWL), was addressed as part of a recent joint *Four Corners* and Fairfax Media investigation.⁴ Following this public disclosure, ASIC provided the committee with a supplementary submission explaining that it had conducted an investigation of Mr Sherriff's conduct, but had decided against taking any enforcement action against him. This supplementary submission, however, makes no mention of ASIC's

1 ASIC, *Submission 45*, p. 6.

2 ASIC, *Submission 45*, p. 6.

3 ASIC, *Submission 45*, p. 6.

4 Adele Ferguson and Mario Christodoulou, 'Rollo Sherriff and Meridien Wealth: How a rock-solid institution backed the wrong planner', *Sydney Morning Herald*, 3 May 2014, Business News, p. 1.

surveillance of FWL in 2007–08.⁵ The May 2014 revelations about CFPL and FWL are discussed further in Chapter 12.

9.9 ASIC's February 2008 letter to the CFPL referred to a number of compliance failures and other shortcomings in the CBA's financial advice business (specifically, CFPL and FWL), including:

- numerous weaknesses in the CBA's compliance framework, which ASIC concluded was not adequate to allow the CBA to comply with the requirements of paragraph 912A(1)(ca) of the Corporations Act;
- apparent failures in the CBA's Risk Matrix system in assessing the quality of advice and compliance of financial advisers, such that ASIC was 'concerned with how your policy is implemented and accordingly, your ability to ensure your representatives are complying with the law';
- widespread failures to maintain required documentation within client files and other significant record keeping failures, including missing or deficient Financial Needs Analysis and Statement of Advice documents;
- inadequate procedures for managing advisers who had been given the highest risk rating by the CBA, and insufficient evidence that poor compliance ratings had any impact on the bonuses an adviser received; and
- evidence suggesting a correlation between the CBA's tolerance of non-compliance on the part of an adviser and the amount of revenue that an adviser was generating for the business (as noted in the previous chapter).⁶

9.10 In its letter to the CFPL, ASIC also noted that only seven of 38 CBA representatives who had been rated as 'critical' by the CBA's Risk Matrix were reported to ASIC under s912D of the [Corporations Act], one of which was after the surveillance had commenced. ASIC wrote:

Given the seriousness of the conduct, we have concerns about CBA's ability to discharge their obligation to report significant breaches under s912D of the Act.⁷

9.11 ASIC expressed particular concern that many of the problems it identified in its surveillance project had previously been 'put to CBA in 2006, after a smaller surveillance was undertaken of CFPL's Bankstown branch and FWL's Cairns branches'. These recurring concerns included the non-completion or poor quality of Financial Needs Analysis and Statement of Advice documents, and the failure to report significant compliance breaches to ASIC as required by section 912D of the Corporations Act. ASIC stated:

5 ASIC, *Submission 45.8*.

6 ASIC, letter to Commonwealth Financial Planning Limited and Financial Wisdom Limited, 29 February 2008, *Additional Information 7*, pp. 1–5.

7 ASIC, letter to CFPL and FWL, 29 February 2008, *Additional Information 7*, p. 4.

Despite assurances from CBA in May 2006 that CBA had overhauled its compliance arrangements and the suggestion that many of ASIC's concerns were historical, we have reason to believe, on the basis of our findings in this Surveillance, that our concerns are ongoing.⁸

9.12 Finally, ASIC concluded its letter to the CFPL by indicating that it was considering what action to take in relation to its findings. It further stated that the purpose of the letter was 'to give CBA an opportunity to put to ASIC a proposal that will satisfactorily address these issues.'⁹

The Continuous Improvement Compliance Program

9.13 In April 2008, CFPL implemented the CICIP in response to ASIC's concerns. According to ASIC, the CICIP was 'also intended to address problems identified by CFPL in a number of reviews it had undertaken itself, including reviews using an external firm'. The CICIP consisted of eight work streams overseen by a CICIP project steering committee within CFPL: strategy and risk framework; breach/incident reporting; advice documentation; systems and management reporting; operating structure; people and culture; retrospective analysis; and adviser competence and supervision. The CICIP project steering committee met with ASIC on a monthly basis to discuss the project.¹⁰

9.14 The findings of ASIC's 2007–08 surveillance project and the subsequent implementation of the CICIP were not made public at the time. This was, ASIC explained in its submission, consistent with ASIC's then practice of not making public comment on regulatory matters. Appearing before the committee, ASIC further explained that the view at ASIC in 2008 was that if a matter was not made public 'there was more chance of negotiating a good outcome from the entity involved' without a protracted legal battle. When the CICIP was implemented, ASIC also reasoned that given the quality of financial advice was poor across the industry (affecting as much as 20 per cent of the market, according to ASIC's intelligence and analysis) it might have been unfair to publicly single out CFPL.¹¹

9.15 In her submission, Ms Swan was highly critical of ASIC's decision not to release the findings of its surveillance project and 'warn investors of this grave situation' at CFPL.¹²

9.16 ASIC conceded that the decision not to publicly announce the surveillance project findings and the subsequent CICIP was a mistake. While the decision was

8 ASIC, letter to CFPL and FWL, 29 February 2008, *Additional Information 7*, p. 5.

9 ASIC, letter to CFPL and FWL, 29 February 2008, *Additional Information 7*, p. 5.

10 ASIC, *Submission 45*, p. 6.

11 Mr Greg Kirk, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 74.

12 Ms Marilyn Swan, *Submission 395*, p. 18.

consistent with ASIC's approach to such matters at the time, ASIC emphasised that, were the surveillance and subsequent enforcement action to take place today, ASIC would make this public:

That was one of the other learnings. At the time, there was not sufficient public transparency around the continuous improvement compliance program, and the concerns that ASIC had at that time around CFP's advice were not announced publicly. As a matter of course, that would now be a public announcement with all the implications of that in terms of putting on additional pressure and public expectations, allowing committees like this to ask how things are going. So that is one aspect of an action today that would help to ensure that it progressed more effectively.¹³

Failure of the CICP to prompt the necessary change at CFPL

9.17 Evidence received by the committee, particularly from Mr Morris, indicated the CICP was regarded by staff at CFPL (including compliance staff) with an attitude that could be described as anything between indifference and contempt.

9.18 Mr Morris was damning in his appraisal of both ASIC's surveillance project, which he suggested took too long to gather too little information, and the resulting CICP, which, in his view, had no substantive effect on how CFPL conducted its business:

[T]hey took a year to look at it, which is an awful long time to just be there gathering intelligence. They looked at 500 pieces of advice from 50 planners. Well, that should not take 12 months. Then they took another couple of months in April 2008. That is when they decided to have the much vaunted CICP program. I was in that business for years and I could not perceive any impact from that program. Leaving that [aside], if they commenced that program in April 2008, as they say, and yet 3½ years later, in October 2011, ASIC find it is necessary to go to an enforceable undertaking, what were they doing for those 3½ years of that CICP process?¹⁴

9.19 The experience of Mr Morris, as relayed in both his written submissions and oral evidence, is instructive in terms of the apparent indifference at CFPL to the CICP. Mr Morris's induction as an employee of CFPL in March/April 2008 roughly coincided with the conclusion of the surveillance project and the implementation of the CICP. According to Mr Morris, he was told by a manager during his induction that ASIC had just undertaken a full review of CFPL and given it a 'clean bill of health'. While the manager in question did not refer to the surveillance project and the CICP specifically, Mr Morris has since concluded that this is what the manager was referring to. The view that ASIC had effectively given CFPL the 'all clear' and that the CICP largely reflected this was, in Mr Morris' opinion, widespread at CFPL:

13 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 68.

14 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 44.

I suspect that perusal of the actual ASIC 'findings' of February 2008 and notes of the monthly meetings of the 'steering committee' of their 'CICP' process will show a fairly detached, theoretical and leisurely approach to any problems found.¹⁵

9.20 Mr Morris also argued that, from what he was able to observe personally, the CICP led to no meaningful change in how the CFPL conducted its business. According to Mr Morris, even compliance managers at CFPL were indifferent to meeting the objectives of the CICP. Mr Morris referred to the experience of one of his fellow whistleblowers to demonstrate the point:

One of the other whistleblowers was one of the planners who was reviewed. I think I put in my submission that he was asked to change a few things in a couple of financial plans and a couple of months later he went to give it to the compliance manager who said, 'Don't worry about it. ASIC's lost interest and gone away.' Nobody took it seriously, I suspect.¹⁶

9.21 Highlighting the apparent indifference at CFPL to the CICP, evidence received by the committee during the inquiry indicated that the CBA Board likely had minimal or no awareness of the CICP. In its written submission, ASIC suggested that the CICP 'had a very senior project steering committee that reported both to the Board of CFPL and the Board of the Commonwealth Bank of Australia'.¹⁷ However, in response to questions from the committee, the CBA confirmed that the CBA Board had little if any visibility of the CICP. The CICP was, the CBA told the committee, initiated by the CFPL management team and neither required CBA Board approval nor operated under CBA Board oversight. The CBA further informed the committee that a review of the minutes of the CBA Board and its sub-committees suggested the CICP was first mentioned to the Board on 9 July 2009 (15 months after it was implemented) as part of a broader presentation on the CBA's financial advice business. The only other reference to the CICP in Board papers that the CBA could find was in a paper considered by the Board on 9 August 2011, which updated the Board on an internal audit report and regulator concerns regarding parts of the Colonial First State advice business. The reference to the CICP in that paper seems to have been a passing one in a paragraph outlining the history of regulatory issues at CFPL.¹⁸

9.22 Regardless of the level of CBA oversight of the CICP, ASIC acknowledged that it should have moved toward an enforceable undertaking from CFPL sooner, rather than relying on CFPL's ability to 'identify and rectify all the problems that

15 Mr Jeffrey Morris, *Submission 337*, p. 2.

16 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 44.

17 ASIC, *Submission 45*, p. 6.

18 CBA, answer to question on notice, no. 9 (received 24 April 2014), p. 6.

started to emerge'.¹⁹ ASIC told the committee that ultimately the latter approach, as pursued through the CICP:

...did not prove effective. It was not proving effective over time, and whilst it possibly was reasonable to try that initially, we should have cut that short earlier. We should have monitored it more closely and put tougher time limits on it and tougher testing of the monitoring all along the way and made a decision earlier to give up on that process and move to the tougher enforceable undertaking process.²⁰

9.23 The CBA itself conceded that the CICP failed to address the problems at CFPL, and suggested that ASIC was likely justified in eventually determining that the CICP was failing to achieve its objectives. Mr Cohen told the committee:

My impression is that, as [the CICP] progressed, ASIC increasingly felt uncomfortable around the business's ability to actually achieve the desired outcomes. That was my impression, that it was a gradual sense that came upon ASIC. I think, in fairness to ASIC and with the benefit of hindsight, that they had grounds for that concern. I do think that the CICP did not achieve what it was designed to achieve as quickly as it was designed to be achieved. That, I think, dawned upon ASIC as the matter progressed.²¹

ASIC's handling of reports of misconduct at CFPL

9.24 ASIC's acknowledgement that it should have 'monitored [the CICP] more closely and put tougher time limits on it' is particularly telling in light of the 17 months that elapsed between the whistleblowers contacting ASIC and ASIC moving toward formal enforcement action against CFPL. Indeed, one of the most important issues raised in this inquiry was why it took ASIC until March 2010 to form the view, as it puts it, that 'the CFPL matter needed to move from a cooperation resolution of concerns to a formal enforcement action with set timeframes and documents produced under notice'.²²

9.25 On 30 October 2008, seven months after the CICP was agreed, the CFPL whistleblowers made their first report to ASIC. In an anonymous fax, signed 'the three ferrets', Mr Morris and two of his colleagues detailed information regarding Mr Nguyen's misconduct and what they considered was a CFPL management cover up of that misconduct.²³ The CFPL whistleblowers concluded their fax to ASIC with a

19 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 68.

20 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 67.

21 Mr David Cohen, General Counsel and Group Executive, Group Corporate Affairs, CBA, *Proof Committee Hansard*, 10 April 2014, p. 31.

22 ASIC, answer to question on notice, Senate Economics Legislation Committee, Estimates, 4–6 June 2013, no. 180 (received 17 October 2013).

23 Of the three whistleblowers, only Mr Morris's identity has been revealed publicly. Mr Morris reports that one of the whistleblowers passed away at the age of 35; the other has elected to remain anonymous. Mr Jeffrey Morris, *Submission 421*, p. 31.

warning that the client files that could shed light on Mr Nguyen's misconduct were in the process of being sanitised by Mr Nguyen and his assistants:

The client files will basically tell the story—as they did for the internal compliance people. There is some urgency in securing them as they are being 'cleaned up'.²⁴

9.26 According to Mr Morris, the whistleblowers had expected ASIC to 'turn up with a warrant to seize the files'. When that did not happen, the whistleblowers followed up their fax with a series of anonymous emails urging action:

However as the days passed with no sign of a fire breathing regulator on the doorstep, we decided to follow up ASIC by email. Weeks turned into months. Email followed email. ASIC said they were investigating. But if that were so, why hadn't they seized the files?²⁵

9.27 In early December 2008, ASIC raised concerns about Mr Nguyen with CFPL, and requested that CFPL provide information on Mr Nguyen at a CICP meeting scheduled for 18 December 2008. Mr Nguyen's conduct was discussed at that meeting, and, according to ASIC, the CFPL advised in a follow-up communication that:

...four complaints had been received about Mr Nguyen, three of these had been resolved and CFPL was dealing with the remaining client, who had legal representation. CFPL also advised that Mr Nguyen was being closely supervised and his advice vetted prior to being provided.²⁶

9.28 Mr Nguyen's conduct was discussed at subsequent CICP meetings. ASIC acknowledged in its submission that while it informed the whistleblowers that their complaints were under consideration, it did not inform them of how the matter was being handled or the broader work being undertaken in relation to CFPL.²⁷ In this respect, ASIC's account is consistent with evidence from Mr Morris, who noted that in March 2009, in response to a query as to the progress of their complaint, the whistleblowers were simply told the 'issues are still currently being considered'.²⁸

9.29 In his submission, Mr Morris noted that after Mr Nguyen's resignation in July 2009, the CFPL whistleblowers were basically left exposed at CFPL, with ASIC apparently unwilling to take meaningful action against the organisation:

The Ferrets survived for the time being. The hostility from CFP managers towards us was pretty clear. It was an incredibly stressful situation. Aside from trying to survive in a hostile environment to continue gathering information, ASIC's indolence had forced us to basically expose ourselves

24 Mr Jeffrey Morris, *Submission 421*, p. 13.

25 Mr Jeffrey Morris, *Submission 421*, p. 14.

26 ASIC, *Submission 45*, p. 8.

27 ASIC, *Submission 45*, p. 8.

28 Mr Jeffrey Morris, *Submission 421.3*, p. 1.

[both CFP & Nguyen would easily work out who was behind the Investor Daily articles] and we had been concerned from the start about Nguyen's mental state. I always took special care when walking to my car in the underground carpark.²⁹

9.30 Mr Morris further reported that at the end of 2009, one of the whistleblowers left CFPL, 'suffering acutely from the stress of the situation'. Mr Morris's fellow-whistleblower had, according to Mr Morris, found the 'interrogation by [CBA] Group Security' particularly stressful.³⁰

9.31 By March 2010, exasperated by ASIC's apparent inaction in relation to the information they had provided, and frustrated by what they regarded as the CBA's ongoing efforts to cheat CFPL clients out of proper compensation, the whistleblowers visited ASIC's office. Mr Morris wrote:

ASIC tries to imply that they instigated this meeting. Whilst it is literally true that they invited us to 'come in from the cold' and meet with them, this invitation was only in response to persistent follow ups from us. We knew we could have gone in at any time. We did not do so earlier because of our concerns about Nguyen and ASIC's ability to keep a secret. We would have preferred all along to remain anonymous. We went in when we did because we despaired of ever getting ASIC moving otherwise, because our cover was blown anyway and because not even our actions in mid 2009 had succeeded in getting through to them.³¹

9.32 According to Mr Morris, the whistleblowers were told by ASIC during their first meeting that from that day forward, they had whistleblower protection (under the Corporations Act), but that it 'wouldn't be worth much'. The meaning of this comment specifically, and the inadequacies of the current whistleblower protections generally, are explored further in Chapter 14.

9.33 In their meeting with ASIC on 24 February 2010, the whistleblowers again urged ASIC to seize CFPL client files, 'which were still being worked on'. Mr Morris noted that they also offered their inside knowledge to help ASIC understand how client files had been manipulated; this offer, he pointed out, was never taken up.³²

9.34 Independent of the actions by the CFPL whistleblowers, in March 2010 Maurice Blackburn launched the first of a number of court actions in the NSW Supreme Court against CFPL. The institution of proceedings was reported in the

29 Mr Jeffrey Morris, *Submission 421*, p. 27.

30 Mr Jeffrey Morris, *Submission 421*, p. 27.

31 Mr Jeffrey Morris, *Submission 421*, p. 28.

32 Mr Jeffrey Morris, *Submission 421*, p. 28.

press, and Maurice Blackburn was advised that within 24 hours ASIC 'raided' CFPL's premises and confiscated documents and computer records.³³

9.35 On 24 March 2010, ASIC notified CFPL that it required the 'immediate production of documents relating to Mr Nguyen'.³⁴ In an answer to a question on notice from Senate estimates in June 2013, provided on 17 October 2013, ASIC clarified that immediate production was required for client list and audit trail data (a section 19 notice), while CFPL was given until 9 April 2010 to hand over client files (a section 33 notice).³⁵

9.36 Mr Morris was critical of the decision to give CFPL two weeks to hand over client files, suggesting this provided CFPL with time to undertake a final 'clean up' of the files. He also noted that only 79 client files were handed over to ASIC on 9 April 2010, with 423 files identified as missing. The fact that 139 of those 423 files were subsequently located and provided to ASIC on 17 June 2010 was, according to Mr Morris, more cause for suspicion. It should have been obvious to ASIC, he argued, that CFPL had used the extra time to 'work on these files'—that is, to further sanitise them.³⁶

9.37 Upon review of Mr Nguyen's files, on 19 July 2010 ASIC referred a brief on Mr Nguyen to a delegate for consideration of banning action. Several days later, ASIC meet with CFPL, and CFPL gave a commitment to remediate former clients of Mr Nguyen. As discussed in the next chapter, from August to October 2010, negotiations took place between CFPL and ASIC regarding the compensation process that would be put in place to this end.³⁷

9.38 ASIC's submission does not relate the exact sequence of events that led it to serve notices on CFPL requiring the production of documents. Nor does it shed any light on what role, if any, the whistleblower information or the action by Maurice Blackburn played in ASIC's decision-making. Rather, ASIC's submission simply reported: 'Following the work carried out in 2008 and 2009, ASIC made a decision in March 2010 that the matter should be dealt with by its Enforcement team'.³⁸

9.39 In addition to criticism from Mr Morris and former CFPL clients, ASIC's apparent lack of responsiveness to the misconduct at CFPL was heavily criticised by the Rule of Law Institute. ASIC's mishandling of the whistleblower disclosures,

33 Mr John Berrill, Lawyer and Principal, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 17.

34 ASIC, *Submission 45*, p. 10.

35 ASIC, answer to question on notice, Senate Economics Legislation Committee, Estimates, 4–6 June 2013, no. 200(f) and 200(g) (received 17 October 2013).

36 Mr Jeffrey Morris, *Submission 421.6*, p. 3

37 ASIC, *Submission 45*, pp. 10, 13.

38 ASIC, *Submission 45*, p. 10.

argued the Institute, allowed the misconduct at CFPL to continue, and by extension meant that CFPL clients lost more money than they otherwise would have:

The history of the Commonwealth Bank's whistleblowers, who alerted ASIC to allegations of corruption within the CBA in October 2008, as described in a number of newspaper articles by investigative journalists Adele Ferguson and Chris Vedelago, is sobering. The extensive delays in responding to the concerns appropriately with enforcement action and providing the public information as self-described by ASIC in its submission enabled corrupt practices to continue and vulnerable consumers to lose more.³⁹

9.40 ASIC conceded that it should have been more active in following up with the CFPL whistleblowers:

When we got that contact from the whistleblowers, we should have been back in contact with them, seeking more information straight away.

[...]

We acknowledge in our submission that that should have been done and did not happen. We have taken steps subsequently to make sure that in future a different approach will be taken.⁴⁰

9.41 Asked whether ASIC would handle the problem of CFPL differently today, ASIC told the committee:

Under current ASIC operations we would not be in the very awkward position of having a non-public broad program [that is, the CICP] in place that we could not discuss with whistleblowers when they contacted us because we had not made it public. So we would not have been carrying that baggage to begin with. We would now go back to those whistleblowers very quickly, get more information from them and focus in on that issue.⁴¹

9.42 As discussed in Chapter 14, ASIC also informed the committee that one of the key lessons it had taken from the CFPL matter was that it needs to improve how it communicates with whistleblowers and handles the information they provide. As a result, ASIC has put in place new processes relating to whistleblowers (again, these changes are discussed further in Chapter 14).

9.43 ASIC told the committee that the information it received from the whistleblowers about Mr Nguyen in October 2008 was in part integrated into its broader program of monitoring the CFPL—a process that ASIC conceded 'did not end up working adequately'. However, ASIC also followed up with CFPL about Mr Nguyen specifically. Discussing this process, ASIC told the committee that it now recognised that it placed too much faith in the capacity of the CFPL to address these

39 Rule of Law Institute, *Submission 211*, p. 6.

40 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 68.

41 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 69.

concerns. With regard to the whistleblower information on Mr Nguyen provided on 30 October 2008, ASIC advised that:

...within a month [it] confronted Commonwealth Financial Planning about Nguyen and asked for documents and various materials on Nguyen. We were given information on Nguyen and told that Nguyen was being addressed and that there was a program to look at the complaints that had been made and compensate people if necessary. Again, within the broader program that is the sort of thing that we were expecting them to do. Again, we put too much faith in them to do that well, and they did not do that as well as they should have. I think on their own evidence [the CBA] would acknowledge that.⁴²

9.44 The 'faith' that ASIC placed in CFPL/the CBA was discussed by critics of ASIC's handling of the CFPL matter. In his written submission, Mr Morris posited that ASIC's 'incredible reluctance' to act on evidence of malfeasance at CFPL was likely a function of ASIC's genuine belief that 'everything was fine with the big players' in the financial advice industry.⁴³ Similarly, Ms Swan suggested that ASIC was too close to large financial institutions such as the CBA and was, therefore, poorly placed to police potential misconduct:

There seems to be an incredibly cosy relationship between the CBA, ASIC and the financial institutions. ASIC has just depended on the large financial institutions saying, 'Everything is okay; you do not have to worry.'⁴⁴

Committee view

9.45 The committee notes that ASIC has acknowledged the shortcomings of the Continuous Improvement Compliance Program, and that all parties now accept that the CICIP failed to rectify the serious problems with the quality of advice and standards of practice at CFPL. Nonetheless, the committee is concerned that at the time of providing its first written submission in August 2013, ASIC appeared to believe that the CICIP had been subject to oversight from the CBA Board. Evidence from the CBA would suggest that whatever formal reporting lines existed between the CICIP steering committee and the CBA Board, in practice the Board effectively had no oversight or ongoing awareness of the CICIP.

9.46 The committee also believes that ASIC's suggestion that the surveillance project undertaken between February 2007 and February 2008 'ultimately led' to the enforceable undertaking accepted by ASIC in October 2011 needs to be heavily qualified. In particular, the committee notes that in the first instance the surveillance project led to an inadequate outcome: the CICIP. Moreover, evidence received by the committee would suggest that information from a number of other sources, not least the CFPL whistleblowers, may have been more decisive than ASIC's surveillance in

42 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 68–69.

43 Mr Jeffrey Morris, *Submission 421*, p. 1.

44 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 4.

2007–08 in leading to the enforceable undertaking. While the committee acknowledges that the intelligence gathered from the 2007–08 surveillance project may well have informed the subsequent decision by ASIC to seek an enforceable undertaking, it believes that the suggestion the project 'ultimately led' to the enforceable undertaking overstates the degree to which ASIC recognised the seriousness of the problems at CFPL prior to the CFPL whistleblowers forcing the issue.

9.47 Evidence received during this inquiry has underlined ASIC's poor handling of the CFPL whistleblowers and the information they provided. The committee regards the fact that it took ASIC nearly 17 months to take meaningful action in response to the information provided by the CFPL whistleblowers as a significant failure on the part of the corporate regulator. Having said that, the committee notes that ASIC has itself acknowledged its failures in this regard, both in terms of taking too long to move toward an enforceable undertaking (the terms and outcome of which are considered in the next two chapters) and in terms of its handling of the CFPL whistleblowers and the information they provided. The committee also notes advice from ASIC (discussed, along with the broader issue of Australia's corporate whistleblowing framework, in Chapter 14) that it has since reviewed its whistleblower processes.

9.48 So far in its examination of the CFPL episode, the committee has found that the conduct of some financial advisers was unethical, dishonest, well below professional standards and a grievous breach of their duty of care to their clients. The way in which they targeted vulnerable trusting people and placed conservative investors in high-risk products showed a callous disregard for their clients' interests. ASIC's slow response and the CFPL's apparent preoccupation with its own difficulties added to the damage that resulted. That a major and reputable financial institution could have tolerated for so long conduct that involved bad advice, poor record keeping, missing or incomplete client files as well as allegations of forged documents is not easy to accept. ASIC's lack of attention and action is also hard to explain.

Chapter 10

Commonwealth Financial Planning Limited: ASIC's enforcement action

10.1 This chapter continues the consideration of the CFPL matter by assessing the adequacy and effectiveness of ASIC's enforcement actions against individual advisers and the organisation since 2010. In particular, this assessment considers whether the enforceable undertaking from CFPL that ASIC accepted in October 2011 was an appropriate and sufficient response to the misconduct at CFPL, and whether it has led to positive changes in the way CFPL now conducts its business.

Adequacy of ASIC's enforcement actions against individual advisers

10.2 There was some discussion in the course of the inquiry regarding the enforcement actions ASIC took against individual CFPL advisers, and whether the sanctions against these advisers were adequate given the severity of their misconduct. Consideration was also given to whether the fact that only eight advisers were subject to ASIC's enforcement action accurately reflected the number of CFPL staff implicated in the misconduct. As noted in the previous chapter, five advisers received bans of varying duration, and three provided an enforceable undertaking removing themselves from the industry for a certain period. While Mr Awkar and Mr Gillespie received permanent bans, Mr Nguyen was only banned for seven years. Asked whether the seven-year ban imposed on Mr Nguyen was adequate, ASIC responded:

I think the best way to respond to that is not to comment in relation to one individual planner but the overall outcomes: the compensation program, the eight—it is now up to eight—planners who have been banned in one sense or another, the tens of millions of dollars that the Commonwealth Bank has had to expend fixing its procedures, the entire new leadership and so on and so forth. If you put all that together, we think it is a very important outcome, allowing for the fact of those lessons that we have been talking about in some detail that we could have done better.¹

10.3 Asked if advisers other than those subject to ASIC enforcement action might have been involved in misconduct, the CBA responded:

[O]nce issues were known and we did have a list of advisers, the business actually did go back and review all of the advisers, and that came up with a number of advisers that we did have concerns about. We then used an independent accounting firm to help us determine any patterns and they used some forensic techniques. That led to the total number of advisers that

1 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 76–77.

we did have concerns about which was 19 and that included Nguyen and Awkar.²

10.4 The CBA told the committee that some of these cases remained under review.

10.5 In its written submission, the CBA advised that in addition to the CFPL advisers named in media articles and subject to ASIC enforcement action, CFPL had 'terminated a number of other Advisers whose advice standards did not meet the level required by the CFP'.³ Asked how many staff had left CFPL following the revelations of misconduct at CFPL and subsequent ASIC enforcement actions, the CBA told the committee that:

... a number of people left the business over the period as part of the change that we instituted in the business. Approximately 72 people in total left the business either through resignation because they were not happy with the way we were changing things or as a result of being terminated. A number of those were planners. I think a total of 12 planners were terminated, and another 11 planners resigned of their own accord. There were other staff who also left as a result of that. There were other sanctions, but those are the main ones, and that was part of the process of changing not only the people but also the attitude within the business.⁴

The enforceable undertaking and change at CFPL

10.6 On 25 October 2011, ASIC accepted an enforceable undertaking from CFPL. As the CBA explained in its submission, the undertaking 'required CFP to assess the adequacy of its Risk Management Framework (RMF) against generally accepted risk management standards. On completion of this assessment, CFPL was required to develop an Implementation Plan that would not only address deficiencies in the RMF but also specifically address certain concerns raised by ASIC in the [enforceable undertaking]'. These concerns were whether:

- a) There have been adequate processes and controls in place to deal with ongoing risks of noncompliance.
- b) Representative misconduct has been dealt with in a consistent manner.
- c) Recurring themes have been appropriately identified.
- d) Data analysis processes and reporting capabilities allow for early detection of advice process irregularities.
- e) There have been adequate controls over client records.

2 Mr David Cohen, General Counsel and Group Executive, Group Corporate Affairs, CBA, *Proof Committee Hansard*, 10 April 2014, p. 37.

3 CBA, *Submission 261*, p. 6.

4 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 35.

- f) There has been consistent application of CFP's complaints handling and internal dispute resolution processes.⁵

10.7 The enforceable undertaking was announced by ASIC on 26 October 2011. The media release provided the following explanation:

CFP has agreed to conduct a comprehensive review of its risk management framework and legal and regulatory obligations regarding the provision of financial services, financial advice and the monitoring and supervision of its representatives...Under the [enforceable undertaking], CFP will proceed to develop an implementation plan to address any unresolved deficiencies identified by the assessment of its risk management framework. The implementation of the plan will be the subject of review and ongoing reporting to ASIC over the next 2 years by an independent expert (whose engagement is to be approved by ASIC). Where a client is found to have been adversely impacted by the conduct of a representative, CFP will consider the circumstances and appropriately remediate the client.⁶

10.8 One of the issues addressed during the committee's consideration of the CFPL matter was whether the CFPL enforceable undertaking had been effective in driving improvements in the CFPL's business operations. Both the CBA and ASIC argued that the enforceable undertaking had been successful in this regard; other witnesses, however, contended that the enforceable undertaking was a weak and poorly targeted response to the misconduct at CFPL, and that it had failed to bring about the necessary changes in the way the business operated.

CBA on cultural and system changes at CFPL

10.9 The CBA reported that as a result of the revelations of misconduct at CFPL and the subsequent enforceable undertaking, it had 'significantly transformed' its financial advice business, in terms of 'the management, the culture, the processes and the business systems'.⁷

10.10 In its appearance before the committee, the CBA emphasised that the 'cultural change component was a very big piece of the change process' in its financial advice business. The current executive general manager of the CBA's Wealth Management division, Ms Marianne Perkovic, explained to the committee that a key factor in this cultural change was a revision of remuneration structures at CFPL:

The main driver of changing that culture was restructuring the remuneration and also the KPIs of not just the planners but all of the management within the advice business, up to my level as well. Two of the key changes in that were gate openers across remuneration payment, firstly, for risk culture and,

5 CBA, *Submission 261*, pp. 6–7.

6 ASIC, 'ASIC accepts enforceable undertaking from Commonwealth Financial Planning', *Media Release*, no. 11-229MR, 26 October 2011.

7 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 20.

secondly, for adherence to compliance. Each of those needs to be met before any remuneration is paid to the adviser. And then we have moved to a more balanced scorecard approach, where the focus is absolutely on quality advice and quality advice measures for the advisers but also for people across the business—so the managers of advisers as well.⁸

10.11 The CBA added that to drive cultural change in its financial advice business, it had sought to encourage people within the business to 'speak up' when they had concerns.⁹ The CBA also told the committee that there was no-one currently in the CBA's wealth management advice leadership team who was in the team in 2010. The bank added that none of the advisers 'who were found to have issues' remained employed at CFPL.¹⁰

10.12 Whereas the CBA's financial advice business was previously under Colonial First State, the CBA reported that the business now reported directly to the CBA's Wealth Management division. This change, it suggested, reflected:

...the scale and importance of the business, and also addresses any conflict or perception of conflict of interest with regard to Colonial First State, so advice now is a stand-alone business.¹¹

10.13 The CBA explained that it had implemented major changes in how its compliance and risk management operations were structured in relation to CFPL. It told the committee that whereas risk and compliance functions were previously located within CFPL, parts of these functions were now located:

...outside of the business, as well as there being enhanced risk and compliance inside the business, with an enhanced adviser insurance team operating risk and advice solutions teams inside the business as well as an enhanced focus on risk and compliance from outside the business, and an independent organisation reporting to the [chief risk officer].¹²

10.14 One of the most blatant failures of the CFPL revealed in evidence was its inadequate file management system. The CBA noted that a large proportion of the discussion regarding CFPL's failures had focused on its poor file management, and that it recognised:

8 Ms Marianne Perkovic, Executive General Manager, Wealth Management Advice, CBA, *Proof Committee Hansard*, 10 April 2014, p. 34.

9 Ms Annabel Spring, Group Executive, Wealth Management, CBA, *Proof Committee Hansard*, 10 April 2014, p. 39.

10 Ms Annabel Spring, CBA, *Proof Committee Hansard*, 10 April 2014, p. 39.

11 Ms Annabel Spring, CBA, *Proof Committee Hansard*, 10 April 2014, p. 38.

12 Ms Annabel Spring, CBA, *Proof Committee Hansard*, 10 April 2014, p. 38.

...it is very important to be able to have access to files and we have spent \$25 million putting in a document management system so that we will be able to have online access to our files and file retention.¹³

10.15 The CBA also reported that it had made a substantial investment in its IT infrastructure in order to develop an 'early warning system' to facilitate investigation and compliance:

This [system] has factors like concentration risk, risk profiles and generally the activity of the investment that is happening. These systems allow us to immediately be notified if there are issues or concerns across any of the investments of our customers and any behaviours across advisers. So that system is our first point of call and is working; it has worked in the business for coming up to 12 months now.¹⁴

10.16 The CBA has also implemented a IT system called Connect, which it claims provides:

...a single view of the adviser, consolidated information around that adviser—including their qualifications, their actions, their clients and, importantly, particularly their customer complaints—so that we are able, with the click of a button, to see all of that with regard to individual advisers.¹⁵

10.17 In response to a question taken on notice, the CBA informed the committee that whereas on 1 January 2008 CFPL had 15 staff employed in compliance officer roles, as of 1 January 2014 there were 43 compliance officers.¹⁶

Critics of the enforceable undertaking and its impact

10.18 One former client of CFPL suggested that ASIC's decision to seek an enforceable undertaking, rather than pursue court action against CFPL, was indicative of ASIC's tendency to privilege the interests of CFPL over the interests of CFPL clients. The submitter was of the view:

ASIC's willingness to accept enforceable undertakings instead of taking Court action against CFP for breaches of legislation and reported criminal activity, fraud and forgery, suggests preferential treatment and protection of CFP over the actual victims of those crimes.¹⁷

10.19 Mr Morris explained that while the enforceable undertaking might have brought CFPL 'up to current minimum industry standards', he was not convinced that it had addressed the underlying problems at CFPL. He suggested that while CFPL

13 Ms Annabel Spring, CBA, *Proof Committee Hansard*, 10 April 2014, p. 38.

14 Ms Annabel Spring, CBA, *Proof Committee Hansard*, 10 April 2014, pp. 35, 38.

15 Ms Annabel Spring, CBA, *Proof Committee Hansard*, 10 April 2014, p. 38.

16 CBA, answer to question on notice, no. 9 (received 24 April 2014), p. 11.

17 Name withheld, *Submission 374*, p. 1.

might well be complying with the enforceable undertaking, the problem remained that:

...the subtleties that allow a place like CFP to operate are not picked up in the [enforceable undertaking]. For example, at Commonwealth Financial Planning one of the big problems was that because it is basically a bucket shop and a sales channel, the overwhelming proportion of the advice that I saw and most of the advice that Nguyen gave is what is called defined scope advice. By narrowing the scope down to advice to invest in a certain product, you basically wipe out all your duties to the client to take into account other considerations. All you are going to do is invite them to invest in this product and the [enforceable undertaking] does not address that problem.¹⁸

10.20 Mr Morris seemed to suggest that the changes implemented at CBA were a case of 'too little, too late'; he argued it was unlikely these changes would have addressed the underlying problems at CFPL:

[W]hat they have done is what they had to do and it has probably taken the firm to where it should have been six years ago. To have taken this long to put in an electronic system to store documents seems incredible to me, particularly when a sister business of Commonwealth Financial Planning had that system in place years ago. What they have done, I think, is basically enough to address the Don Nguyen situation, but what remains is, I think, symptomatic of broader problems in the industry, in that, although they have changed their remuneration model, when you look at the detail of their submission, they do not say that the bonus scheme is now based purely on quality of advice. There is a reduced emphasis on sales volumes. I do not know exactly what that means. I have a difficulty with any professionals with a fiduciary duty where you are also making them salesmen. I think that is an impossible conflict of interest to reconcile. As well, I have broader concerns about vertical integration in the industry based on what I have seen at CFP and what happened there.¹⁹

10.21 Assessing the enforceable undertaking within the context of ASIC's overall handling of the entire CFPL matter, Mr Morris, argued that ASIC's enforcement actions were designed more to disguise ASIC's incompetence than punish CFPL/the CBA:

I submit that, as the ineffective regulator responsible for the industry, ASIC has a fundamental conflict of interest in exposing the full extent of the corruption and dishonesty of such a major institution such as CFP/CBA; as that would in turn be such a damning indictment of their own incompetence and abysmal failure in supervision that it must in turn have implications for ASIC itself.

18 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 49.

19 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 48.

ASIC has therefore chosen to ignore the full extent of CFP/CBA's malfeasance in favour of lauding itself for the easy wins of imposing an Enforceable Undertaking and banning seven crooked planners—all of whom were actually offered up by CFP/CBA rather than being caught by ASIC.²⁰

ASIC's assessment of the impact of the enforceable undertaking

10.22 ASIC told the committee that whereas the CICP lacked a 'clear delineation' of what CFPL needed to do to satisfy ASIC's requirements, the enforceable undertaking had been more rigorous in this respect. Pressed to explain the differences between the CICP and the enforceable undertaking, ASIC told the committee that the undertaking had stronger mechanisms for driving cultural and system changes at CFPL:

It is that the CICP process did not involve a commitment to change the remuneration structures. The underlying drivers of the bad culture and the bad advice were not removed. At that stage it would have been a difficult thing to require as part of a less formal, non-enforcement agreement for those things to change, because they were the structures that were throughout the industry. They were driving the culture of the entire industry. For an informal agreement to say this firm rather than any other has to change its remuneration when we did not have any backing from the law in terms of bans on commissions or anything would have been a very difficult thing. I think that, by the time we got to the [enforceable undertaking] with the serious threat of investigation and legal action, that pushed them that extra step to start changing those remuneration structures. I think that, in terms of really changing things going forward, changing the culture and what drives the planners within the firm was the big difference.²¹

10.23 ASIC told the committee that it appeared that positive changes had taken place at CFPL:

We have seen a lot of progress in that respect. There is an entirely new management and leadership team. There are different remuneration structures, different management structures and so on and so forth.²²

10.24 At the same time, ASIC acknowledged that change at CFPL remained, in some respects, 'a work in progress'. In particular, ASIC noted that the CFPL still needed to improve its breach reporting to ASIC, and indicated this remained an area that ASIC would continue to monitor closely.²³ The need for CFPL to improve its breach reporting to ASIC was, in fact, noted in the final report from

20 Mr Jeffrey Morris, *Submission 421*, p. 1.

21 Mr Greg Kirk, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 69-70.

22 Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 77.

23 Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 77.

PricewaterhouseCoopers (PwC), the independent expert appointed in respect to the enforceable undertaking. Specifically, the independent expert report, which was provided to ASIC on 25 October 2013, found that CFPL appears to take longer than the required timeframes to determine whether issues and incidents within the business are significant and therefore reportable to ASIC.²⁴ Mr Kell underlined this issue at the public hearing on 10 April 2014:

I just wanted to note that one of the core problems that we had with CFP was the adequacy of their breach reporting. Indeed, it remains an ongoing issue. While most elements of the enforceable undertaking have been carried out and implemented to our satisfaction, we are still requiring CFP to test the effectiveness of their breach reporting procedures. We still have concerns in that area, and that is an area where we are following up with them. We do take that very seriously. It has not been an area where we have been happy with the standard of the reporting.²⁵

10.25 Asked if ASIC maintained that an enforceable undertaking was the best mechanism to address CFPL's conduct, and whether it achieved what it was intended to achieve, ASIC concluded:

We do believe the enforceable undertaking allowed us to make much more wide-ranging changes at CFP than a more formal court based process would have allowed for, including major changes to their compliance systems and record keeping along the lines that we have just indicated. It is also worth remembering that the penalties available to apply through a more formal court process against CFP at the time this occurred were around \$170,000...

...The key issue here is: have we in fact required or forced CFP to make the sorts of changes that mean that it offers much higher quality advice to its clients? That is really what we needed to achieve at the end of the day to lift its game very dramatically. We think in many of those areas that it has happened, and in some areas where we still have concerns there is ongoing work. But that has been occurring within the framework of the [enforceable undertaking], and I mentioned earlier breach reporting is one of those ongoing areas.²⁶

How independent was the 'independent expert'?

10.26 There was also some discussion during the public hearing about whether the independent expert appointed under the terms of the enforceable undertaking, PwC, had a potential conflict of interest, given it also acts as the CBA's auditor. The CBA rejected the idea that PwC had a conflict of interest in its appointment as independent expert:

24 CBA, *Submission 261*, p. 15.

25 Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 76.

26 Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 84.

As auditors, PricewaterhouseCoopers have to be independent of us. You may be aware that Sarbanes-Oxley requirements in the US drove a big change in how auditors must be independent of the companies that they audit. So PricewaterhouseCoopers have to maintain an arm's length from us in order to be our auditors generally. When it comes to the actual [enforceable undertaking], they and we and ASIC were comfortable that their independence as auditors allowed them to be the independent expert in the case of the [enforceable undertaking].²⁷

10.27 Speaking more generally, the CBA told the committee that it was confident in the rigour of the enforceable undertaking process and the role of independent experts therein. In particular, the CBA emphasised that independent experts appointed under the enforceable undertaking had a strong reputational incentive to ensure they undertook their work in a diligent and properly independent manner:

As you probably know, we have had other enforceable undertakings. Our experience in each case has been that the scope of the independent expert's role is very detailed, it is very clear what that role is, and the independent expert is a party to those discussions, because the independent expert obviously has to be satisfied that it can perform that scope. In terms of the actual implementation, the independent experts that we have dealt with, being major accounting firms, have their own reputation to consider. It would be risky for them in the extreme to allow business at the line management level to remain as it was and yet to report to ASIC that things had changed. We have never experienced that. I am surprised to hear that it exists, but it is certainly not reflective of the experience we have had at all. We have found that our independent experts involved in the process have been very active, have been quite prepared to speak out whenever things have not been proceeding according to plan and have been quite open with ASIC about that. We have encouraged that. I would find it curious if an independent expert were prepared to run the risk of allowing things not to change and yet report to ASIC that things have changed.²⁸

10.28 ASIC told the committee that while it had the power of veto over the CBA's choice of independent expert, it had been satisfied with PwC's appointment. ASIC also noted that as part of the tender process, all tenderers (including PwC) 'had to address issues around whether there were conflicts and how they might be handled'.²⁹

10.29 At the same time, Mr Medcraft and Mr Kell both acknowledged that PwC's dual roles as auditor of CBA and independent expert under the CFPL enforceable undertaking did raise questions about a potential conflict of interest:

Mr Medcraft: ...I think you make a good point, Senator; if somebody is the auditor and they want them to be the independent expert, essentially you should have a sceptical presumption about how they are going to manage

27 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, pp. 35–36.

28 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, pp. 32–33.

29 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 88.

the independence issue, the potential conflicts of interest. There should always be a presumption and questioning on this particular issue. I think that is an important point.

Mr Kell: And I suspect that we would take a different approach today compared to the approach we took back then.³⁰

10.30 In addition to underlining issues regarding the integrity of the CFPL enforceable undertaking process, these comments also raise broader questions about the procedures around the use and appointment of independent experts in enforceable undertakings. These broader questions are considered further in Chapter 17.

10.31 In the course of the discussion about the independent expert appointed under the CFPL enforceable undertaking, the CBA was asked whether reports of these experts should be made public. The CBA indicated it would have no objection to such reports being made public, and that to do so would allow the seriousness with which the CBA regards such matters to be 'appropriately reflected in the full transparency of daylight'.³¹ As discussed further in Chapter 17, ASIC also indicated that it believes there would be merit in making independent expert reports publicly available.³²

Committee view

10.32 The committee notes the advice provided by the CBA and ASIC on the important changes implemented at CFPL as a result of the enforceable undertaking. Among the CBA's key assertions are that it has, in respect of CFPL:

- expended millions of dollars to fix its procedures;
- cleared out CFPL staff suspected or proven to have engaged in wrongdoing;
- installed an entire new leadership at CFPL;
- significantly transformed its financial advice business; and
- achieved a cultural transformation and now encourages people to 'speak up'.

10.33 If these changes have indeed taken place and produce the intended result, the committee should generally be satisfied that they will make future compliance failures at CFPL less likely and, where compliance failures do occur, more likely to be detected and addressed in a timely and effective manner. The Future of Financial Advice (FOFA) reforms are also addressing some of the previously identified problems in the financial advice industry that were again exposed through the committee's examination of CFPL. In particular, the requirement that advisers must act in the best interest of clients and the ban on conflicted remuneration are improving standards and moving the industry away from a sales-based culture. The committee

30 Mr Greg Medcraft and Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 88.

31 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 32.

32 Mr Greg Medcraft, Mr Peter Kell and Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 70–71.

does, however, note with some concern that CFPL's breach reporting to ASIC continues to be deficient. The CBA needs to address this issue as a matter of high priority. Furthermore, the eleventh hour revelation about inconsistencies in CBA's evidence before the committee, to be considered in Chapter 12, casts serious doubts about whether the desired changes have taken root.

Chapter 11

Commonwealth Financial Planning Limited: The file reconstruction and compensation process

11.1 A central concern of the committee's inquiry was the adequacy and integrity of the ASIC-approved compensation arrangements that the CBA put in place for affected CFPL clients. While ASIC and the CBA maintain that the process resulted in fair outcomes for affected clients, the committee has also received evidence from other witnesses that suggested the CBA's compensation assessments were based on files that were incomplete or otherwise compromised by the original non-compliance of CFPL staff. Mr Morris and Ms Swan go so far as to suggest that the CBA deliberately 'doctored' files or otherwise manipulated the compensation process in order to dupe clients out of the money they were entitled to receive.

11.2 This chapter examines the integrity of the file reconstruction and compensation process.

Summary of the file reconstruction and compensation process

11.3 In March 2010, CFPL initiated Project Hartnett, which, according to ASIC, was the process for determining whether compensation was payable to a CFPL client and, if so, how much. In summary, the Project Hartnett process involved:

- contacting clients to advise that CFPL had concerns about the advice they had received;
- assessing whether a client's circumstances were accurately reflected in his or her file and, where appropriate, directly contacting a client in order to make such an assessment (on the basis of this assessment, CFPL would then assess if compensation was payable); and
- meeting, where appropriate, with CFPL clients to obtain detailed information regarding their circumstances and assess whether the advice they received was appropriate to those circumstances.¹

11.4 On 21 July 2010, CFPL gave ASIC a commitment to remediate former clients of Mr Nguyen. Between August and October 2010, negotiations took place between ASIC and CFPL regarding the adequacy of the CFPL's proposed compensation arrangements. ASIC had particular concerns that CFPL's initial proposal did not include a mechanism for the independent review of compensation offers. As a result of the negotiations, the compensation arrangements announced in November 2010 included the following key elements:

- a review of all relevant client files by CFPL;

1 A more detailed explanation is available in ASIC, *Submission 45.3*, pp. 13–14.

- the ability for clients to obtain independent advice, up to the value of \$5,000 and paid for by CFPL, to assess the compensation offer (in some cases more than \$5,000 was paid);
- a process whereby clients were informed of dispute resolution options, notably the free external dispute resolution scheme, the Financial Ombudsman Service (FOS), if the compensation was still in dispute; and
- the appointment of an independent expert to review the adequacy and appropriateness of the compensation processes, including:
 - whether all relevant clients were covered;
 - calculation methodologies for compensation offers; and
 - client communication, including those few cases where clients were unable to be contacted.²

11.5 ASIC also negotiated with CFPL to ensure that all of Mr Nguyen's clients who had received a settlement offer prior to the commencement of Project Hartnett in March 2010, were reviewed and assessed using the Project Hartnett methodology.³ ASIC explained that the 'overarching aim' of the compensation process was to:

...restore clients to the financial position they would have been in had the inappropriate elements of the advice not occurred and they had been provided with appropriate advice.

This was done by assessing the advice strategy and comparing the client's actual portfolio financial position against a reference portfolio, based on their assessed risk profile. The difference was paid as compensation to the client. CFPL also repaid any fees that did not reflect value for the service provided. The compensation amount also considered the time value of money and taxation impacts as appropriate.⁴

11.6 Project Hartnett later also included clients of Mr Awkar. A second phase of compensation was developed as part of the enforceable undertaking to remediate clients of other CFPL advisers (that is, not Mr Nguyen or Mr Awkar) who had been the subject of a breach report by CFPL to ASIC. This compensation phase is referred to as the 'Past Business Review'.⁵

11.7 As many of the client files of Mr Nguyen and other CFPL advisers were incomplete or compromised by the non-compliant behaviour of CFPL advisers, the compensation assessment process involved the reconstruction of client files so as to provide an accurate picture of a client's actual financial circumstances. However, as

2 ASIC, *Submission 45*, pp. 10–13.

3 ASIC, *Submission 45.3*, p. 12.

4 ASIC, *Submission 45.3*, p. 13.

5 ASIC, *Submission 45.3*, p. 12.

discussed further below, the nature and intent of this reconstruction process is contested.

11.8 ASIC informed the committee that the CFPL compensation process ultimately involved the review of more than 7,000 client files, with compensation totalling approximately \$51 million paid to over 1,100 of these clients.⁶ This evidence will be revisited in Chapter 12.

Criticisms of the file reconstruction and compensation process

11.9 Maurice Blackburn told the committee that its own clients were ultimately satisfied with the compensation processes and outcome put in place by CFPL following ASIC's intervention in 2010 and the settlements of all the Maurice Blackburn civil court actions in 2011. The law firm, however, expressed 'some concerns about the compensation arrangements that were put in place and in particular, whether unrepresented persons' losses would have been adequately assessed'.⁷ In particular, Maurice Blackburn was concerned that CFPL's own calculation of compensation due to each client relied in part on information from CFPL's client files, 'some of which were tainted with the questionable practices of Mr Nguyen'. Moreover, CFPL's assessments were, in Maurice Blackburn's experience:

...sometimes more risk tolerant (thereby resulting in lower financial losses) than was ultimately negotiated at mediation. Therefore, unless clients disputed CFPL's retrospective reassessments, they may well have received compensation which did not reflect their losses.⁸

11.10 The CFPL's program for compensating Mr Nguyen's victims did have a review mechanism, whereby an independent expert oversaw the compensation arrangements. However, Maurice Blackburn suggested that:

...to be fully effective, this [review mechanism] required the independent expert to have the resources to conduct full retrospective reviews of all CFPL's and Nguyen's clients' investment positions and to conduct forensic analyses to compare the investment positions with the outcome achieved under Mr Nguyen's advice.

To have such a review in place would have been a big undertaking requiring very significant resources to support the independent expert to examine the portfolios of the hundreds of clients of CFPL and Nguyen. To the best of our knowledge this did not occur.⁹

11.11 Maurice Blackburn also suggested that the external oversight of the process 'really has very little impact on the rigor of the process unless the external oversight

6 ASIC, *Submission 45.3*, p. 12.

7 Maurice Blackburn, *Submission 200*, p. 2.

8 Maurice Blackburn, *Submission 200*, p. 2.

9 Maurice Blackburn, *Submission 200*, pp. 2–3.

includes a whole raft of people conducting the same reviews on an individual basis'.¹⁰ Asked to summarise its concerns, Maurice Blackburn told the committee that, at the heart of the problem, was that the compensation process involved self-assessment by CFPL with a lack of external oversight.¹¹ In order to compensate clients, CFPL needed to assess whether the products that Mr Nguyen had been selling them were appropriate to their risk profile, and doing so on the basis of their Financial Needs Analysis. However, CFPL did this reassessment 'based on documents they had, some of which were tainted and flawed'.¹² It was not clear, Maurice Blackburn further explained, to what extent CFPL tested the integrity of these documents through consultations with aggrieved clients.¹³

11.12 Asked whether those CFPL clients who were not represented by Maurice Blackburn would have had materially different compensation outcomes if they had been represented, Maurice Blackburn told the committee:

I think they probably would have been, yes. It seemed to us that the few clients who came to us after they had signed up to the direct compensation arrangements had been put in a higher risk tolerance category and therefore their losses were assessed as being less than they might otherwise have been. For example, one of the main people we acted for, before he came to us, was offered one-tenth of what we ultimately negotiated for...them.¹⁴

11.13 Mrs Braund's own experience would appear to support claims that the files used by the CBA to assess compensation payable to clients had been compromised. Mrs Braund explained in her submission that Mr Morris provided her with a copy of her CFPL client file as a safeguard against the risk of the file otherwise 'disappearing' from the CBA's records. She further reported that she later received a copy of her file from the CBA, but certain documents included in the client file provided by Mr Morris were missing from the CBA-supplied client file. According to Mrs Braund, this included the original document from 2002 where she established her investment with CFPL on the basis that it was to be invested conservatively 'and that I would only use proceeds from capital'.¹⁵ This document, which was a handwritten note that appears to have been prepared by Mr Nguyen, was tabled by Mrs Braund during her appearance before the committee on 10 April 2014.

11.14 Like Maurice Blackburn, Ms Swan suggested that the offer of compensation made to her parents was based on a file that had been compromised. Unlike Maurice

10 Mr John Berrill, Lawyer and Principal, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 15.

11 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 13.

12 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 14.

13 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 14.

14 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 16.

15 Mrs Janice Braund, *Proof Committee Hansard*, 10 April 2014, p. 6.

Blackburn, Ms Swan directly alleged that CFPL/CBA staff had in fact fraudulently altered client files in order to deny clients fair compensation:

My detailed submission to this inquiry exposed the role of CBA and ASIC in reducing my parents' investment of \$260,000 to only \$92,000 within 22 months. I am here today because CBA's financial planner, Don Nguyen, and CBA's senior management engaged in systematic fraud, forgery, and deceptive and misleading conduct, to retrospectively cover up Nguyen's activities, to specifically refute my parents' claims and to minimise CBA's financial liability.¹⁶

11.15 Specifically, Ms Swan alleged that after first advising that they had lost her parents' files, the CBA sent her parents:

...copies of fraudulently altered and falsified documents that CBA management had manufactured to convince my parents that they were responsible for choosing high-risk investments.¹⁷

11.16 These documents, according to Ms Swan, included a fraudulent Statement of Advice and Financial Needs Analysis, complete with forged signatures.¹⁸ Asked how she knew the documents were fraudulent, Ms Swan explained:

Because, unlike most of the clients of Mr Nguyen, my parents walked off with an original copy of their statement of advice...So, when they send me documentation and claim it is a copy of the statement of advice or extracted from the statement of advice or part of the contract in the statement of advice, I fortunately have an original, so I can prove categorically that the documentation they sent me was fraudulent.¹⁹

11.17 Ms Swan contended that the 'cover up' extended well beyond CFPL itself, and was in fact endorsed by senior management at CBA:

Instead of saying, 'Yes, we've been caught, we own up, we'll compensate you, we'll rewind this problem and we'll apologise,' there was a deliberate decision made by senior management at CBA, right at the top, to cover this up.²⁰

11.18 Ms Swan also claimed that despite the commitment given by CFPL to review and assess settlements made prior to the commencement of Project Hartnett in March 2010 (as referred to above), her parents were never contacted by the CBA:

When ASIC became involved, they directed CBA to contact all of the affected clients and advise them that they could have their compensation

16 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 1.

17 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 1.

18 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 1.

19 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 4. Copies of these documents were tabled by Mrs Swan during her appearance before the committee.

20 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 3.

reviewed. That has not happened. My parents have never received a letter reopening that. When I eventually engaged Financial Resolutions Australia on my behalf to contact them to renegotiate or reopen and review our compensation, we merely received this letter from [the director of CBA Customer Relations] in 2013 to say, 'It had been reviewed, it was appropriate, and we will not be discussing this anymore.'²¹

11.19 Ms Swan discounted the value of the oversight of the compensation assessment process by an independent expert. Ms Swan argued that the independent expert's review would itself have been based on 'fraudulent documentation which does not reflect the true situation'. Given her scepticism regarding the compensation assessment process and the independent expert's review of that process, Ms Swan expressed concern that the compensation process had not been:

...open to any scrutiny by the clients. We have not been invited in to have it explained. I do not know how the [compensation assessment] calculation is done.²²

11.20 Ms Swan concluded that, given the compensation process appeared to have been based on the 'CBA's own fraudulent documentation', the CBA's claim that the 'compensation process and discussions with their customers have been honest and transparent are farcical'.²³

11.21 Mr Morris who, as noted in Chapter 8, claims to have personally witnessed Mr Nguyen and his colleagues doctoring client files, told the committee that he was also able to observe the compensation process 'very closely'. It appeared to Mr Morris that 'a lot of bad faith' underlined that process:

The vast majority of people got a letter in the mail with an offer of money that said: 'You may have received inappropriate advice. Here is \$100,000'—or \$50,000 or whatever number [it] was—and here is a panel of six law firms or you can see somebody else if you want to. Here is five grand to get that ticked off.' For most people who get an offer like that in the mail it is just going to be manna from heaven. I observed close-up what they were doing to massage that process to minimise the compensation cost.²⁴

11.22 According to Mr Morris, rather than seeking to compensate the clients of 'rogue planners' (as CFPL/the CBA characterised them), CFPL instead:

...sought at every turn, by every means, to cover up what occurred, to destroy or suppress the evidence in the files and to defraud the victims of the compensation they were entitled to.²⁵

21 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 5.

22 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, pp. 5–6.

23 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 1.

24 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 49.

25 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 40.

11.23 Mr Morris voiced particular suspicions regarding Project Hartnett, suggesting that given there were about 50 people working on the project over a period of several years, it was difficult to accept that these people were simply working on reconstructing 182 files. He told the committee that if the intention were simply to reconstruct files, it:

...would be [a] simple matter to print out a statement of advice. If it was on the system, all you have to do is press the print button and add that to the file. It simply does not compute that those people were engaged on an innocent file reconstruction and compensation program.²⁶

11.24 Asked whether there was a need for a 'full, properly independent review' of CFPL client files, Mr Morris responded:

Absolutely and also of more clients than just the Don Nguyen ones. It is a business where even ASIC said there were fundamental widespread problems with the advice. Of the 7,000 pieces of advice that were reviewed, 16 per cent of them resulted in compensation being paid. That is a massive proportion. It is a business that was clearly non-compliant. To say there were only seven rogue planners and only 7,000 pieces of advice that needed to be considered in that environment I think is ludicrous. I suspect a broader review is going to uncover there are a lot more, like tens of thousands of clients, who are probably entitled to compensation. It has never been looked at.²⁷

CBA's response to criticism regarding file reconstruction and compensation

11.25 The CBA defended the integrity of the file reconstruction process, and told the committee that the process included extensive checks and balances to ensure fair compensation outcomes for CFPL clients.

11.26 Given the deficient state of many client files, the CBA was asked if it had considered contacting individual clients and asking them to review their respective files for completeness and accuracy. The CBA confirmed that its remediation process:

...did not include asking clients to review the Bank's file in toto. Depending on the issue(s) we found with each adviser, we determined what information was required in order to re-evaluate the advice given.

In many cases we had all of the information required to re-assess the advice received, whether through documents in the client file, or by referencing data in our electronic records management and product systems. Where hardcopy documentation was lacking, CFP printed file documents from electronic storage or contacted relevant customers, requested their records and used these to assist its review.

26 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 43.

27 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 49.

Almost half of the client cases reviewed (3289 of 7038) involved CFP contacting the client to seek additional information. In approximately one third of those cases (1166 of 3289), the clients provided additional information that was used by CFP in evaluating their case.²⁸

11.27 Not surprisingly, the CBA told the committee that it was confident the compensation process had:

...correctly compensated adversely affected customers with a fair and reasonable outcome, by correcting their position as if they had received appropriate advice.²⁹

11.28 The CBA also suggested that 'almost all of those customers who were affected by these events have been restituted to their satisfaction'.³⁰ Only a 'handful' of affected CFPL clients, the bank told the committee, remained dissatisfied with the restitution provided or offered to them.³¹

11.29 Asked about Ms Swan's suggestion that there was 'no facility in the compensation process for clients or their advisers to review the documents being used for the compensation calculation', the CBA told the committee:

We do acknowledge the lack of documentation that the business did have in reviewing customer information. We relied on a lot of information from current systems and processes that we did have. In some cases where we were not clear on the information that was recorded in the file, we contacted the customer and asked them if they had documentation, and we relied on that documentation. So through the Blanches, through Marilyn Swan, we did work with the group that was representing her for two years and did actually ask for a copy of the original documentation that would have assisted us in deciding or discussing the remediation process that we had.³²

11.30 The CBA further stated that it did not believe the remediation process was deficient.³³ It outlined the steps taken in Project Hartnett when files were incomplete:

Each of the cases that we reviewed had a case manager—so there was contact with customers. We spoke to them directly or they had a representative acting on their behalf. Through that engagement and through the process we established an amount that we thought was the compensation amount had they had appropriate advice. We did actually explain the process around the information that led to that, the allocation of

28 CBA, answer to question on notice, no. 9 (received 24 April 2014), p. 8.

29 CBA, answer to question on notice, no. 9 (received 24 April 2014), p. 8.

30 Mr David Cohen, General Counsel and Group Executive, Group Corporate Affairs, Commonwealth Bank of Australia, *Proof Committee Hansard*, 10 April 2014, p. 20.

31 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, pp. 36.

32 Ms Marianne Perkovic, Executive General Manager, Wealth Management Advice, CBA, *Proof Committee Hansard*, 10 April 2014, p. 27.

33 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 28.

the client's risk profile and the observations that we made about the investments that that client had with us and other investments that they had. It was in those initial conversations that it came to light that it was not correct or that there was other information that the customer may have had and those were the records that we then relied on going through that process.

With the 7,000 client cases that we looked at through this whole remediation process of [Project Hartnett] plus through the enforceable undertaking, a lot of those cases were remediated and we had very good communication between the customer or their legal representative. There was a selection of customers where it did take a longer time, because on multiple requests of information we did not receive it and we had to act on the information that we received—albeit continuing to ask for other information that would help us clarify and help us determine any differences in what the framework was giving us.³⁴

11.31 CBA explained to the committee that some client files, particularly for Mr Nguyen, were 'not in the right order'. It stated further that:

...in terms of the files themselves, and the customers that those files belonged to, we started to work through what other information the bank had that could be contributed, which we could put into those files. I am talking about things like application forms on their investment that we had access to. Those were the pieces of information that we put on the client. It was known as a client file through the Hartnett process, not the original file.³⁵

11.32 The CBA also told the committee that it had advised ASIC of the state of the CFPL client files, including the number of missing files. It had, in turn, agreed with ASIC on a process for securing enough information so that it could determine the appropriate level of compensation for each client.³⁶

ASIC's evidence on file reconstruction and compensation

11.33 While acknowledging that the poor record keeping practices at CFPL had proven a major problem, ASIC told the committee that CFPL/the CBA had been upfront about the need to reconstruct client files:

Record keeping was very poor. Again, because they were not adequate, there was a process of trying to reconstruct files, and CFP were telling us they were doing that. They were very open. That needed to be done to try to find out what had happened and regenerate from their system some of the documents.³⁷

34 Mr David Cohen, CBA, *Proof Committee Hansard*, 10 April 2014, p. 28.

35 Ms Marianne Perkovic, CBA, *Proof Committee Hansard*, 10 April 2014, p. 30.

36 Ms Marianne Perkovic, CBA, *Proof Committee Hansard*, 10 April 2014, p. 30.

37 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 77.

11.34 Alluding to Mr Morris's suggestion that the CFPL had engaged in a systemic effort to fraudulently reconstruct files in order to deny CFPL clients proper compensation, ASIC suggested that:

...there is some chance that, internally within CFP, people observing [the file reconstruction] may have interpreted that as an illegitimate process whereas it was a process that we understood [was undertaken] for proper purposes and was openly advised to us.³⁸

11.35 ASIC also told the committee that it had not generally pursued claims that CFPL client files had been 'sanitised' or 'doctored' in order to defraud CFPL clients. Such allegations, it told the committee, had generally taken the form of vague 'Chinese whispers within the CFP' that files were being cleaned up.³⁹ Similarly, responding to Ms Swan's suggestion that her parents' file had been 'doctored' by the CFPL, ASIC said:

We know the file was to some degree reconstructed. Essentially, it was not clear to us from looking at the material that there was evidence that it had been doctored in some way to try and benefit CFP subsequent to its original generation, beyond the general reconstruction.⁴⁰

11.36 ASIC also clarified that while it believed it had misplaced its trust in CFPL in terms of expecting it to make the cultural and system changes that needed to be made at the time of the CFCP, this did not mean ASIC believed the CFPL had 'sanitised' or 'doctored' client files in order to defraud CFPL clients of proper compensation. Mr Kirk told the committee:

My comment earlier that our trust was misplaced was not intending to suggest it was misplaced in the sense that we now think that CFP had a program for changing or doctoring files. We do not think that is the case. We have not seen evidence that that is the case. I just wanted to clear that up. We trusted them that they would be able to uncover all of their own problems and fix them and change their culture, and that trust was misplaced—not a trust about honesty about files.⁴¹

11.37 Asked if ASIC was comfortable with the CBA not writing to all of its clients and asking them to provide any material that might be relevant to assist in the reconstruction of the files, ASIC responded:

We were certainly conscious of that as a problem and we tried to put some measures in place in the compensation scheme to address it. Generally, with clients subject to the review, they were all notified that they were part of the review. They were not sent their file.

[...]

38 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 77.

39 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 77.

40 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 82.

41 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 79.

In a second phase, CFP had to go through the file and analyse whether it contained full records of the client's position...There was a process whereby they had to check whether the file was adequate or whether there were gaps in it. Where there were problems, they then made contact with the client and tried to reconcile what the client understood the history and instructions to have been with what was in the file. That contact was initially by phone, to check whether there was any disparity between the client's understanding and what was in the file. If that showed up any problems at all, the next step was a full interview with the client. It is a difficult issue to address when the files are inadequate. There was a process to try and do that. I guess the final step in that process was to have access, for the people getting compensation offers, to an adviser and that paid for, so there could be a test at that point and some push-back against what had been offered to them, some questioning of whether the records were accurate and consistent with what the client was telling that adviser.⁴²

11.38 In an answer to a question on notice, ASIC further suggested that it would likely have been 'largely futile' for the CBA to send every client a copy of his or her file. Most clients, ASIC contended, could not be expected to be aware of all the documents that should be contained in their file. Moreover, such a process would probably have significantly delayed the compensation process, as clients took time to respond, 'or, more likely, did not respond at all given the difficulty of the questions being posed'.⁴³

11.39 ASIC further explained that the professional services firm appointed under Project Hartnett was required to assess the compensation methodology, review a number of client files and randomly select client cases to test the adequacy of compensation offers, including cases where there was a dispute with the client about the compensation on offer.⁴⁴ Moreover, ASIC itself reviewed aspects of the compensation process, 'especially if there were matters that seemed to involve a high level of disputation towards the end of the process'.⁴⁵ Clients who disputed the compensation offer also had the option of taking their claims to FOS.⁴⁶

11.40 ASIC told the committee that while the process of reviewing and reconstructing CFPL client files might not have been perfect, ultimately it was satisfied with the integrity of the process and the compensation outcomes it delivered for affected CFPL clients:

I think in the circumstances, where there was this problem with record keeping and inadequate files, the process put in place, in terms of a large, mass-scale thing, where 7,000 clients were looked at, had appropriate steps

42 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 78.

43 ASIC, answer to question on notice, no. 11 (received 21 May 2014), p. 6.

44 ASIC, *Submission 45.3*, p. 14.

45 Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 79.

46 ASIC, answer to question on notice, no. 11 (received 21 May 2014), pp. 8, 9.

to try and address that problem. I am not saying that that is going to be perfect in every file. When documents do not exist, the situation is very difficult, no matter what process you adopt.⁴⁷

11.41 Asked about unresolved CFPL client claims, and its contact with the various parties regarding these claims, ASIC told the committee:

In terms of the contact with CFP, it is not only getting reports from them on progress but getting copies from them of correspondence sent to the clients and knowing the content of that material and stipulating what needs to be in some of that. One of the things we did towards the end of last year was to make sure that they made it unambiguously clear to the remaining people with contested claims that not only could they go to FOS to have it resolved but CFP would waive any jurisdictional limits in that process. Some of those problems are under limited jurisdiction or they are disputes about whether there had been a previous agreement and there was already a binding deed of release and such. We got them to clarify for all of those customers that they were willing to waive those things.⁴⁸

11.42 ASIC explained that across the compensation program (which included former clients of both Mr Nguyen and other CFPL advisers) it understood there were 57 former clients with issues potentially remaining, although for 45 of these the problem was they were uncontactable.⁴⁹ Excluding clients who could not be contacted, there remained 12 clients with unresolved claims against CFPL, out of a client base of 7,000, and after over 1,100 compensation offers had been made across this client base.⁵⁰

CBA's offer of \$5000 to offset the cost of an independent review

11.43 The CBA offered affected CFPL clients \$5,000 to help pay for an independent review of his or her compensation assessment by a 'qualified accountant, solicitor, or licensed financial adviser of the customer's choice'.⁵¹

11.44 Ms Swan claimed that she was unable to access CBA's \$5,000 offer to pay for an accountant or lawyer:

They refused to pay [Financial Resolutions Australia], whom I have chosen to represent me, that money to do this investigation. Furthermore, the Commonwealth Bank are picking and choosing which companies they will

47 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 78.

48 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 84.

49 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 84. Mr Kell also noted that one of the tasks of the independent expert was to track down clients who were difficult to contact. Mr Peter Kell, ASIC, *Proof Committee Hansard*, p. 84.

50 Mr Greg Kirk, Mr Peter Kell and Mr Greg Medcraft, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 84–85.

51 CBA, *Submission 261*, p. 9.

deal with. This is not an open process. They are picking and choosing which accountants and which lawyers you can employ.⁵²

11.45 Asked about the utility and adequacy of \$5,000 on offer from the CBA, Maurice Blackburn told the committee:

To the extent to which people did access independent information and advice, that is fine. To the extent to which \$5,000 would have been enough, it depends who you go to, I suppose, and what their expertise is. But, again, from a principled point of view, you would say: yes, there is the potential for that to provide independent rigour, independent oversight and independent review, but was it taken up and was that the way it was played out? Not from the experience we had or the information we had seen from other clients.⁵³

11.46 Upon further questioning, Maurice Blackburn revealed that the cost of the service it provided to the 30 CFPL clients it represented would have been around \$30,000 to \$35,000 per client (these costs were covered by the CFPL as part of the settlement).⁵⁴

11.47 ASIC at one point implied that it would be reluctant to require the CBA to undertake the type of comprehensive file review undertaken by Maurice Blackburn, because such an approach would be prohibitively expensive for the CBA. Specifically, when the committee pointed out that Maurice Blackburn's client file reviews had cost somewhere in the order of \$35,000 per client, and indicated that this might be the cost per client of a proper file review, ASIC responded that when multiplied across the 7,000 affected clients at CFPL the cost to the CBA would run into the hundreds of millions of dollars (see Box 11.1). Drawing on ASIC's approach to the enforceable undertaking negotiations with CFPL, it would also seem to indicate that, in its approach to negotiating enforceable undertakings more generally, ASIC may give excessive regard to the burden an undertaking might impose on a company. This broader point concerning ASIC's approach to enforceable undertakings is explored further in Chapter 17.

ASIC on the possibility of a new review of CFPL client files

11.48 Asked if there would be any legal obstacle to ASIC requiring the CFPL to undertake a full, independent review of CFPL client files, ASIC responded that it could only do so in the context of an enforceable undertaking or settlement agreement. Given the CFPL did not offer to undertake such a review in the context of their enforceable undertaking negotiations with ASIC in 2010, ASIC advised that it would be unlikely to do so now or in the future given the 'prohibitive cost and time involved in such a process'. ASIC also informed the committee that it was unable to require

52 Mrs Marilyn Swan, *Proof Committee Hansard*, 10 April 2014, p. 5.

53 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 15.

54 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 15.

CFPL to undertake such review under the terms of the 2011 enforceable undertaking, and that there were only limited (and highly unlikely) circumstances in which it could now require CFPL to do so.⁵⁵ In any case, ASIC reiterated its view that the CFPL compensation process adequately compensated CFPL clients who had suffered a financial loss as a result of inappropriate advice, including clients without legal representation.⁵⁶

Box 11.1: Is ASIC reluctant to make CBA pay for a client file review?

The following exchange during the public hearing on 10 April 2014 raises questions about ASIC's willingness to require the CBA to undertake a comprehensive review of CFPL client files because of the cost associated with that review:

CHAIR: We all understand the process, because we had it in exhaustive detail this morning, but our questioning queries the utility of that process, when CBA did not seek every person to provide any relevant supplementary material to help in the reconstruction of the file. That is the first point. The second complaint this morning was the inadequacy of the \$5,000 ceiling. We had evidence from the lawyers from Maurice Blackburn, who handled 30 or 40 clients, to the satisfaction of all of their clients, that their costs per file were something like an average of \$35,000. What I am putting to you, Mr Kirk, is that the process of review, remediation, reconstruction of files, was in and of itself inadequate and necessarily led to poor outcomes. That is what I am asking you to address. Why were you satisfied with that process?

Mr Kirk: I think in the circumstances, where there was this problem with record keeping and inadequate files, the process put in place, in terms of a large, mass-scale thing, where 7,000 clients were looked at, had appropriate steps to try and address that problem. I am not saying that that is going to be perfect in every file. When documents do not exist, the situation is very difficult, no matter what process you adopt.

CHAIR: Yes, but, if the problem derives from the fact that the officers of Commonwealth Financial Planning at first instance, with any or all of the 7,000 clients, did not do their job properly, did not maintain records, falsified records, falsified signatures, so that nothing could be reconstructed properly, in terms of outcomes, bad luck for the Commonwealth Bank. It should have been instructed to do the job properly, as was done by this law firm in Melbourne, Maurice Blackburn. If that cost \$35,000 or \$40,000 per client, well, that is the penalty for not operating properly in the marketplace at first instance.

Mr Kirk: But doing that for 7,000 clients, at \$35,000 or \$40,000, would be a few hundred million dollars.

55 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 51.

56 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 52.

CHAIR: It would. That is not your concern. It is the concern of the shareholders of Commonwealth Bank, the concern of the directors of Commonwealth Bank. Let the directors go to the meeting and explain that the dividend has been reduced by 10c this year because of the incompetence that was allowed by the senior managers. It is not your concern. That is the point I am trying to make. Who cares?

Source: *Proof Committee Hansard*, 10 April 2014, p.78.

Questions about the compensation scheme for non-Project Hartnett clients

11.49 To this stage of the case study, most of the evidence has been drawn from clients of Mr Don Nguyen. Their evidence clearly indicates that, since becoming aware of misconduct in CFPL, they have been bitterly disappointed with the process of rectification and the bank's attitude. A number of similar accounts can also be drawn from confidential submissions. They include:

- A elderly man, whose wife was housebound, had his only assets of around \$100,000 in term deposits—the CBA convinced him to switch all his money into the Colonial Mortgage Fund. The financial adviser did not produce a Statement of Advice but used a Transaction Without Advice document. This document is meant to be used where a client comes into the bank asking for a particular product themselves and receives no advice from the planner, which was clearly not so in this case. It was alleged that the planner claimed the commission on this false basis. Although the Fund was frozen, with the help of an advocate, the man was able to receive several thousand dollars in compensation for the losses he sustained but did not receive compensation for the extreme distress due to the defective advice.
- A woman in her 90s was put into the Colonial First State Enhanced Income Fund on the understanding that it was a conservative product and better than a term deposit. She received no explanation from her adviser that there was risk attached to this product. The money was in the fund for 20 months during the global financial crisis with a loss of \$1,500 on the entry price and exit price. Over that period of time, the client missed out on some \$30,000 in interest payments that would have been received had the funds been in a term deposit. With the assistance of an advocate, she was able to obtain over \$30,000 compensation in contrast to the original offer of \$1,500.
- A Centrelink recipient, with very poor literacy skills, signed documents that he could not understand including a Statement of Advice and was placed in an aggressive portfolio.⁵⁷

11.50 Although these particular clients of CFPL eventually received compensation, it was only through the intercession of an advocate who 'kicked and screamed' on their behalf and even then there was no allowance for the clients' pain and suffering.

11.51 It must be kept in mind that there were other people who also have suffered loss because of the actions of other CFPL advisers. Clients of Mr Nguyen, and later clients of Mr Anthony Awkar, were subject to the compensation scheme known as Project Hartnett. Subsequently, another compensation scheme, referred to as the Past Business Review, was initiated to recompense clients of other advisers that were named in breach reports or about whom CFPL received complaints.⁵⁸

11.52 The accounts given by Mr Nguyen clients and those of other now banned financial advisers stand in stark contrast to those of CBA and ASIC. Indeed, the committee has received submissions from a number of CFPL clients whose experiences of the process after 2009 reveal quite a different story from the bank's. One such client who, in 2007, rolled over the last of her AMP superannuation fund into CFPL became alarmed at the large amounts of money disappearing from her superannuation. Her financial planner was Mr Chris Baker who left CFPL in February 2009. She cannot recall hearing from CFPL until 2013 when a staff member:

...who apparently had been my new financial advisor since 2009, contacted me to tell me about the Christopher Baker Enforceable Undertaking to ASIC and informing me that I might be entitled to compensation.⁵⁹

11.53 She explained that:

- she had to ask for copies of her file on three separate occasions from three separate people;
- her signature appears on some pages of the documents but she does not remember having ever discussed the content with Mr Baker let alone seen or received a Statement of Advice; her middle name is spelt incorrectly, twice and crossed out; the information on the medical practitioner is spelt incorrectly; and the answers to the questionnaire on her medical history and family medical history are not true;
- for many years she had been paying for 'very expensive insurance' that she did not want and did not know she had; and
- since 2009, her adviser, who replaced Mr Baker, had never once called her or returned her calls or responded to messages left for him.⁶⁰

11.54 She noted further that there was another document from 2008, which she supposedly signed with her married name even though she had reverted to using her maiden name. In her view, the document was 'dodgy':

58 ASIC, *Submission 45*, pp. 13–14.

59 Name withheld, *Submission 374*, p. 6.

60 Name withheld, *Submission 374*, pp. 6–7.

I have no idea what this document is or what it is saying. I have asked... the complaints officer at CBA, three times for more information on the original of the document, where it is, who is the author and what does it mean.⁶¹

11.55 When she finally spoke to someone at CBA and asked if she could see her file she was told:

...Baker did not keep good records and what he did have was with a special team of case managers who were looking into Baker's client files to determine how much financial loss his clients had suffered. He also told me Baker had about 1500 clients and CFP were flat out trying to clean up the problem.

I said I wanted to speak to the case manager looking into my case and I wanted access to my records. He told me that was not possible. The records were located somewhere else and not on CFP's premises. He said he did not know exactly where they were. He told me that I could not see the case manager because he was about to go on holidays.⁶²

11.56 This CFPL client received a letter of offer with a 60-day time limit in which to accept or reject the offer, five days before the time limit expired. She explained:

I was so upset by this. It was so unfair. I tried calling again but the numbers they had provided were disconnected and I couldn't get through to anyone. I had to leave another voicemail message for [name withheld] and eventually called CBA general complaints before I got someone to respond to me.⁶³

11.57 Another case also demonstrates that the damage caused was not confined to financial loss. Indeed, some clients have been completely bewildered by the remediation process itself, which they have found confusing and stressful. One such person only learnt of the extent of Mr Rick Gillespie's misconduct from ASIC in a letter received as late as April 2014. The submitter had been a client of Mr Gillespie and her instructions to him were that she was risk averse and wanted to protect her principal 'at all costs'. In summary, the submitter identified the following facts:

- money was lost from her super fund while Mr Gillespie was her financial planner;
- CBA knew at the time of assigning her account to Mr Gillespie that he was under investigation;
- although the bank was aware of Mr Gillespie's fraudulent activities the bank did not contact her—thereby not providing her with the opportunity to scrutinize and reassess her finances;

61 Name withheld, *Submission 374*, p. 7.

62 Name withheld, *Submission 374*, p. 8.

63 Name withheld, *Submission 374*, p. 10.

- there was total confusion and mixed messages from the bank about who was managing her affairs after Mr Gillespie left CFPL;
- ASIC's focus appeared to be on gathering evidence against Mr Gillespie and not on supporting the victim—indeed the submitter was of the view that she would not be protected by ASIC and that it was not acting on her behalf; and
- CFPL did not advise her of the full extent of wrongdoing alleged against Mr Gillespie until April 2014—for example, she met with representatives from CBA in April but even then did not know the extent or involvement of any wrongdoing by the bank regarding her financial situation.⁶⁴

11.58 At this late stage, rather than being reassured by the remediation process, this victim has been left even more troubled:

This is a problem not of my making. All this cloak and dagger stuff with ASIC and 4 Corners is all well and good, but it is making me sick and at the end of the day I still have no way of knowing if I have been a victim of a CBA staff financial planner who failed to comply with financial services laws.⁶⁵

11.59 The husband of another CFPL client informed the committee that:

I have witnessed on a number of occasions Gloria becoming upset to the point of tears while on the phone to Commonwealth Financial Planning trying to obtain information, ask questions, and correct the record.⁶⁶

11.60 The committee has also received correspondence from a couple who entrusted the CBA/Colonial with '\$1 million hard earned dollars from two middle class Australians who worked hard at jobs and renovated homes and sold them to get ahead'. In late 2009, they complained to the CBA's state manager over their losses and no service. They eventually had \$12,000 in fees returned for no service. However, at no stage were they informed about Mr Gillespie and his conduct. The bank blamed the poor performance of their portfolio on the global financial crisis.⁶⁷

11.61 Following the May 2014 *Four Corners* program, a CBA case manager contacted the couple, sent them a package of documents with a request to verify their signatures. After viewing the documents, they identified 17 forged signatures—many of the forgeries related to moving superannuation into the fund, switching, statements of advice and withdrawals. The CBA case manager did not provide them with any information or explanation for pursuing this matter now, after all these years.

64 *Submission 469* (Confidential).

65 Name withheld, *Submission 127*, p. 1.

66 Mr Frazer McLennan, *Submission 127*, p. 1.

67 Correspondence to committee (name withheld).

11.62 The cases dealing with CFPL cited throughout this report clearly demonstrate that the wellbeing of a number of the bank's customers was not a priority—whether it was during the initial stage of receiving financial advice through to seeking and in some cases obtaining compensation.

11.63 As the committee gathered more and more evidence, lingering doubts about the robustness and fairness of the compensation process began to grow. It could see major flaws in the process, in particular:

- the delays in CFPL recognising that advisers were providing bad advice or acting improperly and in CFPL acting on that knowledge and informing clients;
- the use of letters or the telephone to contact clients and the manner in which information was conveyed, which rather than reassure clients tended in some cases to intimidate and confuse them;
- CFPL's obfuscation when clients sought information on their accounts/adviser;
- a strong reluctance on the part of CFPL to provide files to clients who requested them;
- no allowance made for the power asymmetry between unsophisticated, and in many cases older and vulnerable clients, and the CFPL;
- throughout the compensation process the client was being used to test decisions or conclusions already reached by CFPL;
- no client representative or advocate was present during the early stages of the investigation to safeguard the clients' interests when files were being checked and in many cases reconstructed;
- the numerous allegations of missing files and key records, of fabricated documents and forged signatures, which do not seem to have been investigated;
- instances where the CFPL's initial offer of compensation was manifestly inadequate; and
- the offer of \$5,000 to clients to pay the costs of an expert to assess the compensation offer was made available only after the CFPL had determined that compensation was payable and an offer had been made.

11.64 Recent developments have only deepened the committee's misgivings about the integrity and fairness of the process.

Chapter 12

Commonwealth Financial Planning Limited: Recent developments and committee conclusions

12.1 This chapter outlines the developments that occurred in the final two months of the committee's inquiry that led to ASIC and the CBA correcting key evidence about the compensation process that both organisations gave to the committee. This chapter also contains the committee's overall conclusions on the CFPL matter.

Developments in May 2014

12.2 As noted in Chapter 9, following a request from the committee at a public hearing on 10 April 2014, ASIC provided the committee with a copy of the letter it sent to CFPL on 29 February 2008.¹ The content of the letter revealed that ASIC's surveillance project focused on the operations of another CBA subsidiary, Financial Wisdom Limited (FWL), in addition to CFPL.

12.3 The content of this letter is troubling for several reasons. First, the letter indicates that ASIC's surveillance was directed towards advice provided by two CBA subsidiaries, not just CFPL. The fact that FWL was subject to surveillance was not revealed in ASIC's summary of the surveillance project in its written submission,² nor had ASIC referred to its concerns regarding FWL at any prior point in the inquiry. The issues relating to FWL, and in particular with regard to adviser Mr Rollo Sherriff, were not widely revealed until Fairfax Media published allegations regarding FWL and Mr Sherriff on 3 May 2014. Subsequently, ASIC provided the committee with a supplementary submission which explained that ASIC had conducted an investigation into Mr Sherriff's conduct, but decided against taking any enforcement action against him. ASIC also noted that its 'work on this matter led to CBA reviewing all advice given by Mr Sherriff to his clients and FWL paying compensation totalling \$7.3 million to 98 of Mr Sherriff's clients'.³

12.4 Since that letter was provided to the committee, further revelations and significant developments have occurred. On the evening of Friday, 16 May 2014, both ASIC and the CBA provided the committee with statements correcting evidence previously given during this inquiry. According to the CBA, some elements of the compensation process described in its submission were not applied consistently. The primary differences were:

1 ASIC, letter to Commonwealth Financial Planning Limited and Financial Wisdom Limited, 29 February 2008, *Additional Information* 7.

2 ASIC, *Submission 45*, pp. 12–13.

3 ASIC, *Submission 45.8*, p. 1.

- not all CFPL and FWL customers were offered \$5,000 to obtain independent advice to review their compensation offer;
- not all CFPL and FWL customers received all the written correspondence described in the CBA's submission including upfront communication with affected customers to advise them of concerns about the quality of advice provided; and
- an independent accountancy expert did not endorse and oversee the remediation process for FWL clients as FWL was not subject to the CFPL enforceable undertaking.⁴

12.5 The CBA advised that where it discussed total compensation payments and the remediation process in its submission or at a public hearing, this applied to both CFPL and FWL customers. ASIC provided a further supplementary submission that noted some of the information ASIC put to the committee about the compensation process was inaccurate because it was based on the CBA's submission.⁵ ASIC's previous submissions reported that the compensation paid to affected clients of CFPL totalled \$51 million. The total compensation is now \$52 million; of that amount, \$10.5 million was paid to affected clients of advisers of FWL and \$41.5 million was paid to affected clients of advisers of CFPL.⁶

12.6 Since becoming aware of anomalies in CBA's advice, ASIC informed the committee that it would impose, by agreement with the CBA, conditions on the AFS licences of CFPL and FWL. The revised conditions follow concern that customers of other high-risk advisers in CFPL and FWL were disadvantaged because their compensation process was different from the clients of Mr Nguyen and Mr Awkar—that compensation arrangements were applied inconsistently cross all affected customers of the businesses. The new conditions require CFPL and FWL to apply the conditions agreed to under Project Hartnett to all clients who did not originally receive the benefit of those measures.⁷ This includes offering up to \$5,000 to seek independent advice from an accountant, lawyer and/or licensed financial adviser; and allowing all affected clients to reopen the question of compensation.⁸

12.7 The committee was not satisfied with the information contained in ASIC's late supplementary submission or the CBA's correspondence. Although both documents were supposed to correct misinformation provided to the committee, they only added to the confusion already surrounding the compensation process. The committee then wrote to CBA seeking clarification. For example, the committee sought to establish the meaning of 'not all CFPL and FWL customers were offered \$5,000 to obtain

4 CBA, *Additional Information 10*.

5 CBA, *Additional Information 10*.

6 ASIC, *Submission 45.6*, p. 5.

7 See paragraph 11.4.

8 ASIC, *Submission 45.6*, p. 5.

independent advice to review their compensation offer'. The advice received is now clear that 'none' of the customers under the Past Business Review or three other CFPL advisers received this offer.⁹

12.8 Information provided to the committee shows that:

- under the Past Business Review 2,287 cases were considered and 403 offered compensation; and
- of the three other CFPL advisers, 573 cases were reviewed of which 55 cases were offered compensation.¹⁰

12.9 The clients of FWL were not part of the Past Business Review but, according to CBA, FWL 'adopted a remediation policy that was very closely based on the Past Business Review'. Thus, the committee concludes that these customers (of the 793 cases where advice was provided, 258 cases were offered compensation) similarly did not receive the \$5,000 offer to assist them obtain independent advice.

12.10 It also turns out that not one of the above clients received an initial letter stating that the CFPL/FWL had concerns about the advice provided. According to the CBA:

Communications to clients of advisers in the Past Business Review were made when further information was required from the customer in order to assess the case and/or there was an assessment of inappropriate advice and compensation was assessed as payable.

The communication with respect to the FWL clients was similar to those in the Past Business Review.¹¹

12.11 For months the committee had been led to believe that all clients, not only those of Mr Nguyen and Mr Awkar, had received equal treatment under the compensation schemes. In part, this discrepancy may explain why some people have written to the committee completely confused and distressed by recent correspondence from the CBA.

12.12 This obfuscation by the CBA has further undermined the committee's confidence in the integrity of the process.

12.13 The committee wants to make two final points about the compensation offered: the amounts were substantial and, in a number of cases, the difference between the CBA's first and final offers was significant. The committee has cited a few cases already. For example, Maurice Blackburn referred to one of its clients who, before he sought legal representation, 'was offered one-tenth of what Maurice

9 CBA, answer to question on notice, no. 18, p. 13.

10 CBA, answer to question on notice, no. 18, p. 7.

11 CBA, answer to question on notice, no. 18, p. 15.

Blackburn ultimately negotiated'.¹² In order to obtain some sense of the gap between the first and final offers, the committee obtained from the CBA in confidence a sample from the highest to the lowest. The figures have been rounded and approximate but they included an initial offer of \$230,000 to a final offer of around \$657,000 (a difference of about \$427,000), an initial offer of \$29,000 to a final offer of \$101,500 (a \$72,500 difference) and an initial offer of \$5,500 to a final offer of \$33,900 (a difference of around \$28,000). On the lower end of the scale they ranged from an initial offer of \$49,000 to a final offer of \$50,000 (a difference of just over \$1,000). From the indicative sample provided, the other differences recorded between the initial offer and the final offer involved sums of \$23,800, \$13,600, \$12,700, \$10,800, \$6,900, \$2,000, \$184 and zero.

Committee view

12.14 The preceding chapters have outlined the committee's concerns about ASIC's response to the seriousness of the problems at CFPL. The committee also has significant concerns about the process for providing restitution to affected clients. From the very beginning of the inquiry, the committee has been troubled by the CBA's attitude and the information it has provided.

12.15 Firstly, the committee believes that the CBA's bland suggestion that clients received 'inappropriate advice' ignores the very real distress experienced by CFPL clients as a result of the calculated deceit by their financial advisers. The committee has little doubt that the pain and suffering experienced by the CFPL clients who gave evidence was almost certainly experienced by countless other CFPL clients.

12.16 Secondly, the FWL matter was not disclosed to the committee, either by ASIC or the CBA, until April 2014 when the committee obtained from ASIC a letter it sent to the CBA on 29 February 2008. The letter indicated that ASIC's surveillance was not only directed toward the advice being provided by the CFPL, but also the advice from another CBA subsidiary, FWL.

12.17 Finally, there were the developments in May 2014 that led to licence conditions being imposed on CFPL and FWL and both ASIC and the CBA providing statements to the committee correcting their evidence. This shows that, for some time, both the committee and ASIC had not been kept fully or properly informed of the compensation process for clients affected by serious misconduct within two of the CBA's businesses. Until ASIC and the CBA provided corrections to their evidence, the committee had not been provided with accurate information on the total amount of compensation or the process for remediation. The imposition of licence conditions on CFPL and FWL show that ASIC has finally begun to hold the CBA to account. Nevertheless, ASIC continues to maintain that the compensation process, as originally devised, 'was fair and robust'.¹³

12 Mr John Berrill, Maurice Blackburn Lawyers, *Proof Committee Hansard*, 10 April 2014, p. 16.

13 ASIC, *Submission 45.6*, p. 5.

12.18 Notwithstanding the recent developments, the committee is deeply concerned by both the number of clients that were potentially affected by serious misconduct who have not received fair compensation and the processes put in place by the CBA to reconstruct incomplete client files and compensate CFPL clients. The committee is particularly concerned by the apparent asymmetries of knowledge and negotiating power inherent in the compensation process, wherein vulnerable clients without expert financial knowledge or legal representation (including clients without the means to access legal representation) were largely forced to rely on the CBA's assurances about the integrity of the process. The evidence received from the law firm Maurice Blackburn that suggested CFPL clients without legal representation may have received inadequate compensation was telling in this regard. There was a clear incentive for CFPL to minimise the amounts it repaid clients; clients that challenged the compensation offered and had copies of their documentation had their payments substantially increased.

12.19 The committee considers that there are potentially many more affected clients that have not been fairly compensated. The clients that the committee invited to give evidence at a public hearing were exceptional in that they were willing to voice their concerns publicly and were able to fight for compensation because of their circumstances, either because they had a family member determined to assist them with their case or because the next CFPL adviser they dealt with after a rogue adviser was Mr Jeffrey Morris, one of the whistleblowers, who gave them a copy of their original file.

12.20 The committee notes that the CBA made (or will make) \$5,000 available to each affected CFPL client to help pay for an independent review of the compensation offered. The CBA, however, controlled which accountants or lawyers could be selected. In any case, the committee believes this \$5,000 is inadequate for its intended purpose. In this connection, the committee points to the evidence received from Maurice Blackburn suggesting that the reviews it conducted of client files cost somewhere in the order of \$35,000 per client (this cost being covered in the eventual settlement between Maurice Blackburn's clients and the CBA). While the committee does not believe that Maurice Blackburn's charges are necessarily indicative of the amount other law firms (or other suitably qualified professionals) might charge for this service, it would nonetheless strongly suggest that the \$5,000 offered by the CBA was inadequate.

12.21 The committee has carefully weighed the evidence received about the file reconstruction process, including evidence from ASIC and the CBA suggesting the process was fair and proper, and evidence from Mr Jeffrey Morris and Ms Marilyn Swan suggesting the process involved the manipulation of client files to reduce compensation payable. The committee believes that serious questions remain unanswered on this score. A more comprehensive, independent review of both CFPL client files and the file reconstruction process is necessary to remove doubts about the integrity of the process. The committee believes that such a review should include a forensic re-examination of the files of each client potentially affected by misconduct

within CFPL, and assess whether the compensation made available to CFPL clients was adequate.

12.22 To the committee, it appears that the following five options are available:

- (a) the arrangements in place as a result of the licence conditions ASIC recently imposed on CFPL's and FWL's AFS licences are left to run their course;
- (b) the above arrangements or a separate review process agreed to by ASIC and the CBA, and funded by the CBA, with the addition of a client advocate appointed as part of the review process to ensure client interests are properly represented;
- (c) a complete review of the compensation arrangements for all clients of financial advisers suspected of providing bad advice, to be undertaken by an independent law firm or other expert appointed by the government, again with a client advocate appointed;
- (d) an independent inquiry established by the government and headed by an eminent and knowledgeable person, such as a retired judge; or
- (e) a Royal Commission.

12.23 As noted above, the committee is not satisfied with option (a), that is, the current arrangements. It is acknowledged that the process has the advantage of compensation potentially being determined in a timely fashion. It is also acknowledged that an ASIC-appointed independent expert will now oversee the compensation process. However, the committee notes that the independent expert was not appointed to act as an advocate for client interests. The absence of a client advocate in the compensation process is, in the committee's view, a key deficiency in that process. The compensation arrangements are also supposed to comfort affected clients; yet, the committee has been contacted by several clients now anxious and confused by the CFPL's communications with them. Another key concern is that the CBA is still determining the compensation amounts based on files that contain documents claimed to be fraudulent or that are 'missing' key documents. The scheme also applies only to a limited number of clients, whereas the committee has received evidence indicating that the problems with CFPL were far more widespread.

12.24 Options (b) and (c) aim to improve on the current arrangements by requiring a client advocate. These processes may still result in relatively timely determinations. They also have other advantages such as greater independence from the CBA and, unlike a public inquiry, the cost of the review could be borne entirely by the CBA. However, both options (b) and (c) only deal with instances of misconduct that have currently been identified. The committee has no reason to believe that the cases on the public record to date represent the entirety of the serious misconduct that took place within CFPL.

12.25 The committee's confidence in ASIC's ability to get the process right this third time is severely undermined and the committee is not convinced that the regulator

should be left to manage this matter any longer. ASIC has shown that it is reluctant to actively pursue misconduct within CFPL and FWL; rather, it appears to accept the information and assurances the CBA provides without question. The committee is also strongly of the view that the CBA's credibility in the CFPL matter is so compromised that it should not be directly involved in future arrangements for investigating the misconduct or reviewing the compensation process.

12.26 There were fundamental and widespread problems within CFPL. It is essential that:

- all rogue advisers are identified and that any conduct that may amount to a breach of any law or professional standard pursued; and
- all clients who have suffered as a consequence of the serious misconduct that occurred receive just compensation.

12.27 Given the seriousness of the misconduct involved and the need for all client files to be reviewed, the committee believes that a review with sufficient investigative and discovery powers should be established by the government to undertake this work. To resolve this matter conclusively and satisfactorily, the inquiry would need the powers to compel relevant people to give evidence and to produce information or documents. The committee is of the view that a judicial inquiry is warranted. The CFPL scandal needs to become a lesson for the entire financial services sector. Firms need to know that they cannot turn a blind eye to rogue employees who do whatever it takes to make profits at the expense of vulnerable investors. If this matter is not pursued thoroughly, there will be little incentive for Australia's major financial institutions to take compliance seriously.

Recommendation 7

12.28 The committee recommends that the government establish an independent inquiry, possibly in the form of a judicial inquiry or Royal Commission, to:

- **thoroughly examine the actions of the Commonwealth Bank of Australia (CBA) in relation to the misconduct of advisers and planners within the CBA's financial planning businesses and the allegations of a cover up;**
- **identify any conduct that may amount to a breach of any law or professional standard;**
- **review all files of clients affected or likely to be affected by the misconduct and assess the appropriateness of the compensation processes and amounts of compensation offered and provided by the CBA to these clients; and**
- **make recommendations about ASIC and any regulatory or legislative reforms that may be required.**

Chapter 13

Internal control systems

13.1 The committee has discussed significant non-compliance issues in one of Australia's most reputable organisations—the CBA. The previous chapter, however, concluded with the committee expressing concerns that the financial services sector needs to draw lessons from the CFPL experience of non-compliance. In this regard, during the inquiry the committee also considered non-compliance issues within another major financial institution—Macquarie Group (specifically Macquarie Equities Limited, a financial advice and investment service business within Macquarie Group that carries on its business under the name Macquarie Private Wealth). Moreover, in its consideration of lending practices between 2002 and 2010, the committee found that some of Australia's banking institutions turned a blind eye to irresponsible and unethical conduct, including predatory lending, in breach of their code of practice and community standards.

13.2 In light of what appear to be serious flaws with the internal risk management processes related to legislative and regulatory compliance in these companies, the committee believes that this aspect of non-compliance warrants a much closer look. In this chapter, the committee briefly underlines some of the critical compliance failings in CFPL and then in greater detail looks at the internal compliance workings in Macquarie Equities Limited to tease out whether it adds to or allays the committee's concerns about non-compliance, particularly as it relates to consumer protection. The committee also considers the effectiveness of ASIC's role in ensuring that companies have robust compliance management systems in place. The committee shines a light on, and considers whether, the system of internal control is adequate as it relates to compliance risk.¹

Compliance

13.3 ASIC's chairman, Mr Greg Medcraft, stated that firms' compliance arrangements played a crucial role in ensuring that the firms do not fail to meet expected standards, which was 'a very important message that goes to the heart of companies' compliance arrangements'. He said compliance 'should be seen as an investment, not as a necessary evil, and if compliance professionals can ensure they have strong arrangements in place then hopefully we will not have to pay them a visit'.² The Governance Institute of Australia insisted that the primary responsibility for corporate misconduct resides with the individuals and companies that carry out these actions. The regulator's role is 'to provide guidance as to duties and

1 By compliance risk, the committee means the potential for a company to fail to comply with all applicable laws, regulations and codes of practice.

2 Thomson Reuters, *Special Report: ASIC: The Outlook for Enforcement 2012–13*, p. 5.

responsibilities, and undertake enforcement where breaches of those duties and responsibilities occur'.³

Commonwealth Financial Planning

13.4 A condition of an AFS licence is to 'establish and maintain compliance measures that ensure, as far as reasonably practicable, that the licensee complies with the provisions of financial services laws'.⁴

13.5 The committee has in great detail chronicled the failings in CFPL. In this chapter, the committee is concerned predominately with the institution's compliance regime. The committee understands that as early as 2006, as a result of its surveillance, ASIC alerted the general manager of the CFPL to key concerns about CFPL's compliance framework. One such concern was that representatives rated as critical (the highest risk category) as a result of serious misconduct were not 'effectively addressed within the current framework'.⁵ In particular, ASIC doubted CBA's 'ability to ensure its representatives were complying with the law'.⁶ In February 2008, ASIC wrote to CFPL about the inadequacy of its processes and controls:

...we are concerned that your own data suggests that your compliance framework is not adequately detecting serious misconduct. We are therefore concerned that you are not adequately using your framework to continuously ensure you are meeting your licence obligations.⁷

13.6 ASIC noted further that only seven of the 38 representatives who were rated as critical were reported to ASIC under section 912 of the Corporations Act. It concluded that given the seriousness of the conduct, ASIC had concerns about CBA's ability to discharge this obligation to report significant breaches under that section. ASIC informed the CFPL that despite the bank's assurances back in May 2006 that it had overhauled its compliance arrangements, ASIC had reason to believe, on the basis of its surveillance findings, that its concerns were still 'ongoing'.⁸

13.7 Soon after this letter and a meeting between CFPL and ASIC, the CFPL implemented a Continuous Improvement Compliance Program (CICP). After some time, however, it became evident that this plan was ineffective, which then led to the execution of an enforceable undertaking in October 2011—five years after ASIC

3 Governance Institute of Australia, *Submission 137*, p. 4.

4 See for example, Enforceable Undertaking from Commonwealth Financial Planning Limited, accepted by ASIC on 25 October 2011.

5 ASIC, letter to Commonwealth Financial Planning Limited and Financial Wisdom Limited, 29 February 2008, *Additional Information 7*, p. 1.

6 ASIC, letter to CFPL and FWL, 29 February 2008, *Additional Information 7*, p. 2.

7 ASIC, letter to CFPL and FWL, 29 February 2008, *Additional Information 7*, p. 3.

8 ASIC, letter to CFPL and FWL, 29 February 2008, *Additional Information 7*, p. 5.

raised its initial concerns. ASIC conceded that the process between the CACP and the enforceable undertaking was 'too long'. According to ASIC:

We should have monitored it more closely and put together tougher time limits on it and tougher testing of the monitoring all along the way and made a decision earlier to give up on that process and move to the tougher enforceable undertaking process.⁹

...with the benefit of hindsight we feel we should not have placed as much reliance on Commonwealth Financial Planning's ability to identify and rectify all of the problems that started to emerge.¹⁰

13.8 While the committee accepts that ASIC could have insisted on a more robust process and more carefully monitored the implementation of that process, questions about the CFPL's own compliance mechanisms remain. As Mr Kirk explained, ASIC had trusted the CFPL. ASIC believed that the CFPL 'would be able to uncover all of their own problems and fix them and change their culture'.¹¹ This trust was misplaced.

13.9 As agreed to in the enforceable undertaking in October 2011, CFPL undertook to initiate a review that would address ASIC's concerns, including whether:

- there were adequate processes and controls in place to deal with ongoing risks of non-compliance;
- representative misconduct had been dealt with in a consistent manner;
- recurring themes had been appropriately identified;
- data analysis processes and reporting capabilities allow for early detection of advice process irregularities;
- there had been adequate controls over client records; and
- there had been consistent application of CFPL's complaints handling and internal dispute resolution processes.¹²

13.10 This list underscores the significant nature of ASIC's concerns. One of the most troubling aspects of the conduct of some CFPL financial planners was that it was deliberate and systematic, not negligent or sloppy. The conduct was targeted at vulnerable and trusting customers who sustained significant losses; it was a breach of the bank's fiduciary duty and obligation to use reasonable care. The supervisors who knew of such behaviour failed miserably in their duty to report such misconduct. Without doubt the compliance culture in and around CFPL was seriously compromised.

9 Mr Greg Kirk, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 67.

10 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 68.

11 Mr Greg Kirk, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 79.

12 ASIC, 'ASIC accepts enforceable undertaking from Commonwealth Financial Planning', *Media Release*, no. 11-229, 26 October 2011.

13.11 Of grave concern is that weaknesses in this area of compliance are still evident. As noted in Chapter 10, the independent expert's final report found that the CFPL needed to improve its breach reporting and ASIC regarded this area as an ongoing issue. Both assessments, however, were made before 16 May 2014, when the CBA informed the committee belatedly that the remediation process was 'not applied consistently'.¹³

13.12 In April 2014, the CBA led the committee to believe that, among other things, it had implemented 'major changes' in how its compliance and risk management operations were structured—it spoke of 'enhanced risk and compliance inside the business'. Yet within five weeks, the CBA wrote to the committee revealing what it termed inconsistencies in its accounts of the compensation process. In effect, the CBA's group general counsel, the bank's representative for this inquiry, had been unaware that he was misleading the committee. His eleventh hour revelations about the compensation process whereby not all clients were treated equally suggest that the concerns about risk management and compliance within CFPL are far from being addressed.

Macquarie Private Wealth

13.13 In January 2013, ASIC expressed its concern that Macquarie Equities Limited's (MEL) management 'may have failed to foster and maintain a proper commitment to, and culture of, compliance' within the Macquarie Private Wealth business.¹⁴ ASIC found MEL had failed to address recurring compliance deficiencies that involved a significant number of advisers. MEL entered an enforceable undertaking on 29 January 2013.

13.14 MEL's compliance deficiencies were initially identified by MEL's own client file reviews dating back to 2008. Indeed, the enforceable undertaking noted that between 2008 and March 2010, Macquarie Private Wealth conducted client file reviews of its representatives, which 'indicated deficiencies involving a significant number of the Representatives'. These shortcomings were recurring and not reported to ASIC nor were they rectified in all cases. Between December 2011 and August 2012, ASIC conducted surveillance checks of Macquarie Private Wealth. These checks identified similar issues to those identified by Macquarie Private Wealth's own reviews.¹⁵ Specifically, the deficiencies included instances of:

- client files not containing statements of advice;
- advisers failing to demonstrate a reasonable basis for advice provided to the client;

13 CBA, *Additional Information 10*. See also paragraphs 10.24–10.25.

14 Enforceable Undertaking from Macquarie Equities Limited, accepted by ASIC on 29 January 2013, paragraph 2.17.

15 Enforceable Undertaking from Macquarie Equities Limited, accepted by ASIC on 29 January 2013, paragraphs 2.6–2.10.

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- poor client records and lack of detail contained in advice documents;
 - lack of supporting documentation on files to determine if there was a reasonable basis for the advice provided to the client; and
 - failing to provide sufficient evidence that clients were sophisticated investors.

13.15 Again, as with the CFPL, these identified deficiencies were of considerable significance and go to serious breaches of duty of care to customers. ASIC stated that these five areas of deficiencies were not reported to ASIC. Unequivocally, it described these deficiencies as 'serious' and noted that 'any remediation initiatives attempted by MEL over a four year period had been ineffective'.¹⁶ ASIC was concerned that MEL may have failed to address satisfactorily weaknesses in the Licensee Risk Framework. Among the numerous areas of concern, were whether:

- there had been effective licensee risk policies, processes, controls and systems having regard to the nature, size and complexity of its business;
- there had been compliance with the obligations regarding the provision of personal advice, general advice and execution-only dealing transactions, including necessary detail in advice documents to enable retail investors to make informed decisions;
- representative conduct had been dealt with in a consistent and appropriate manner, including having robust consequences or non-compliant representatives;
- recurring issues had been effectively identified and addressed over a period of time; and
- effective compliance training and education had taken place.

13.16 On 15 March 2013, ASIC's deputy chairman, Mr Peter Kell, informed the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) that one aspect of ASIC's concerns with Macquarie Private Wealth's operations was that Macquarie had identified a range of compliance problems within its business, but not reported them to ASIC. He explained this issue of failing to report was something that ASIC wanted to highlight more broadly across the financial services industry:

We have seen inconsistencies in the approach of different firms in terms of how they report breaches. We have been highlighting recently that we expect firms to, if you like, err on the side of caution and come to us if they have identified a problem within their own operations, rather than make an assumption that this can fly under the radar and is not a concern. We are highlighting that as an area where we expect to see stronger action from the industry as a whole.

...Perhaps in some firms there are issues around the compliance staff, compliance units and compliance functions within the firms' operations. It

16 ASIC, 'ASIC accepts enforceable undertaking from Macquarie Equities Ltd', *Media Release*, 13-010MR, 29 January 2013.

has been a longstanding issue that they are not always dealt with as seriously as we would like, but we are seeing that change across the industry.¹⁷

13.17 According to Mr Kell, ASIC continues to emphasise that reporting non-compliance was 'an important part of a well-functioning system'. He said:

...where firms identify problems with their own operations—advisers who have behaved inappropriately or provided inappropriate advice; systems errors that have caused significant issues for consumers—we expect to hear about that sooner rather than later.¹⁸

13.18 Fellow commissioner, Mr John Price, stated that the enforceable undertaking required Macquarie 'to rethink significantly the way it monitors its representatives and to create a culture where compliance is central to getting that advice'.¹⁹ Importantly, Ms Joanna Bird of ASIC told the committee that Macquarie Private Wealth had 'systemic failings of compliance and it had a poor compliance culture'.²⁰ Mr Medcraft told that committee that he gets annoyed 'when basically there is not that self-reporting'. He noted further that the troubling thing was when ASIC finds something and it asks the question, 'Well, there's a problem there; what else is there?' He stated further:

But I think for Australians to be confident in participating in the financial system it is actually really important that those that are part of that system do self-report where there is a problem. Transparency is, I think, really important. It is not a systemic problem, but there is a broad spread of behaviour, and some of it is at the very top end of our system...that some of the issue about self-reporting relates to some very large financial services holders. It is not just maybe at the bottom end. It is at the top end.²¹

13.19 It should be noted that the CFPL and Macquarie Private Wealth are not the only highly regarded institutions that have come to public attention. ASIC found in 2009 that ANZ Custodians had failed to report significant breaches of its obligations to ASIC and demonstrated a poor compliance culture. In 2011, the regulator also questioned whether UBS Wealth Management Australia had appropriate compliance

17 Mr Peter Kell, Deputy Chairman, ASIC, *Parliamentary Joint Committee on Corporations and Financial Services Hansard*, Oversight of the Australian Securities and Investments Commission, 15 March 2013, pp. 15–16.

18 Mr Peter Kell, ASIC, *PJCCFS Hansard*, Oversight of ASIC, 15 March 2013, p. 16.

19 Mr John Price, ASIC, *PJCCFS Hansard*, Oversight of ASIC, 15 March 2013, p. 13.

20 Ms Joanna Bird, Senior Executive Leader, Financial Advisers, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 95.

21 Mr Greg Medcraft, Chairman, ASIC, *PJCCFS Committee Hansard*, Oversight of ASIC, 15 March 2013, p. 16.

risk management policies, although ASIC did acknowledge that UBS informed it of possible breaches.²²

13.20 Professor Justin O'Brien and Dr George Gillian underscored the need to have 'substantive rather than technical compliance'.²³ The question remains, considering the repeated instances of non-compliance, have the institutions now put in place risk management mechanisms that would prevent any repeat of the mistakes of the past?

ASIC's response

13.21 ASIC noted that AFS licensees have obligations under subsection 912A(1) of Corporations Act, among other things, to:

- do all things necessary to ensure that the financial services covered by their licence are provided efficiently, honestly and fairly;
- have adequate arrangements in place for managing conflicts of interest;
- comply with the conditions on their licence;
- comply with the financial services laws;
- take reasonable steps to ensure that their representatives comply with the financial services laws;
- unless regulated by APRA, have adequate financial, technological and human resources to provide the financial services covered by their licence and to carry out supervisory arrangements;
- maintain the competence to provide the financial services covered by the licence;
- ensure that their representatives are adequately trained and competent to provide those financial services;
- if they provide financial services to retail clients, have a dispute resolution system; and
- unless they are regulated by APRA, establish and maintain adequate risk management systems.²⁴

13.22 According to ASIC, it has not undertaken a specific assessment of the effectiveness of the internal compliance arrangements of AFS licensees. It had, however, undertaken a review of the business and risk practices of the top 50 AFS licensees that provide financial product advice to retail clients.²⁵ In 2011,

22 Enforceable Undertaking from Australia and New Zealand Banking Group Limited and ANZ Nominees Limited, accepted by ASIC on 6 March 2009; and Enforceable Undertaking from UBS Wealth Management Australia Ltd, accepted by ASIC on 17 March 2011.

23 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, p. 3.

24 ASIC, answer to question on notice, no. 12 (received 21 May 2014), pp. 5–6.

25 ASIC, *Review of financial advice industry practice*, Report 251, September 2011.

ASIC found in respect of the top 20 licensees that, while they were focused on risk management and compliance, there were a number of issues, including:

- proactive licensee monitoring, which should be instrumental in detecting incidents and breaches; and
- risk profiling tools, whereby advisers should not rely on risk profiling tools without also considering if the outcomes are appropriate for their clients' circumstances.²⁶

13.23 ASIC found in 2013 that most of the top 21 to 50 of these AFS licensees were taking steps to mitigate key risks, although a number of issues were highlighted, including:

- monitoring and supervision of advisers, whereby licensees:
 - must ensure their advisers comply with their stated procedures;
 - must check references of new advisers to exclude 'bad apples';
 - must report breaches and demonstrate remediation plans are in place;
 - should retain access to client records at all times; and
- product and strategic advice, whereby conflicts of interest need to be managed and clients educated about risk and return so that their expectations are more realistic.²⁷

13.24 According to ASIC, effective internal compliance arrangements were 'crucial to meeting these statutory obligations'. In keeping with the principles-based nature of the financial services legislation, however, ASIC does not prescribe how licensees should meet these obligations but has released a number of regulatory guides.²⁸ Industry associations have also published a number of standards and codes.

13.25 ASIC noted that self-regulation involved industry developing and enforcing its own regulatory rules, with no or minimum government intervention. ASIC went on to explain:

Ideally, self-regulation should be initiated by industry, rather than imposed upon it. However, Government can create environments that encourage self-regulatory initiatives, for example, by recognising a self-regulatory regime in legislation and providing incentives to comply with the regime.²⁹

26 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 6.

27 ASIC, *Review of financial advice industry practice: Phase 2*, Report 362, July 2013.

28 These include Regulatory Guide 104, *Licensing: Meeting the general obligations*; Regulatory Guide 105, *Licensing: Organisational competence*; and Regulatory Guide 165, *Licensing: Internal and external dispute resolution*.

29 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 7.

13.26 Although ASIC supported self-regulatory measures, especially where industry standards or requirements exceeded legal requirements, it stated that based on its experience:

...self-regulatory models are rarely an effective or acceptable alternative to explicit regulation in the context of retail financial markets because currently pre-conditions for effective self-regulation are rarely present in a fully developed state.³⁰

13.27 Mr Tregillis, a long-term regulator who understands that regulators have a very difficult job in meeting the demands placed upon them, cited the approach being taken in the UK toward compliance. He noted:

The UK regulator, for example, has a special-person sort of regime whereby they can, where they are concerned about compliance failings, not wait until there is a breach but actually require an expert person or a special person to do a review and report to the regulator. That is double edged, but it is a proactive mechanism. It is useful in the sense that it does not mean that the regulator has to have permanent resources; you can get people with expertise to do it. That is something that could be considered.³¹

ASX corporate governance principle 3

13.28 In this chapter, the committee has focused simply on the internal risk management systems that cover compliance with applicable laws and regulations. However, the ASX sets the bar higher. Commentary accompanying its corporate governance principle 3 states:

Acting ethically and responsibly goes well beyond mere compliance with legal obligations and involves acting with honesty, integrity and in a manner that is consistent with the reasonable expectations of investors and the broader community. It includes being, and being seen to be, a 'good corporate citizen'...

The board of a listed entity should lead by example when it comes to acting ethically and responsibly and should specifically charge management with the responsibility for creating a culture within the entity that promotes ethical and responsible behaviour.³²

13.29 The committee found that two major companies fell far short of the expected standard of compliance. Clearly, more effective internal systems of self-regulation, monitoring and reporting within companies to address cultural issues dealing with non-compliance need to be devised and implemented. Having a compliance model

30 ASIC, answer to question on notice, no. 8 (received 21 May 2014), p. 7.

31 Mr Shane Tregillis, Chief Ombudsman, FOS, *Proof Committee Hansard*, 20 February 2014, p. 26.

32 ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, 3rd Edition, Principle 3.

that is able to detect corporate breaches, recognise their significance, and promptly report on and rectify any deficiencies is vital to the health of the corporation.

13.30 It may be time for the ASX and ASIC to review their guidance on risk management, placing an emphasis on the adequacy of internal compliance arrangements and appropriate reporting obligations for non-compliance. The government should also look more closely as to whether the legislation needs to be strengthened to require companies to have more robust systems in place to help them comply with applicable laws and regulations to foster a culture of compliance.

13.31 It should be noted that the maximum penalty for not reporting a significant breach (or likely breach) within ten business days of becoming aware of the breach (or likely breach) is:

- for an individual, \$8,500 or imprisonment for one year, or both; and
- for a company, \$42,500.³³

13.32 ASIC should also bear in mind the lessons to be learnt from the CFPL and Macquarie Private Wealth cases and ensure that its surveillance of companies for compliance is far more intrusive and less trusting. Further, in light of the poor performance of the internal compliance regime in CFPL and Macquarie Private Wealth, the committee is also inclined to share Mr Medcraft's scepticism and ask 'what else is there?' The committee is concerned with Macquarie's failure to report and particularly the breakdown in its compliance regime. Indeed, as noted previously, Ms Bird told the committee that Macquarie Private Wealth had 'systemic failings of compliance and it had a poor compliance culture'.³⁴ The committee is concerned with the efficacy of the enforceable undertaking entered into as a result of serious compliance deficiencies within Macquarie Private Wealth. Given that ASIC did not, until recently, fully understand how the CBA was implementing its compensation schemes for clients affected by the CFPL scandal, the committee doubts ASIC is fully aware of the Macquarie business and remediation process. While the enforceable undertaking remains in place, ASIC should undertake intensive surveillance of Macquarie Private Wealth to ensure that ASIC's concerns are in fact being addressed and that a culture of compliance is being adopted.

Recommendation 8

13.33 The committee recommends that ASIC establish a pool of approved independent experts (retired experienced and hardened business people with extensive knowledge of compliance) from which to draw when concerns emerge about a poor compliance culture in a particular company. The special expert would review and report to the company and ASIC on suspected compliance failings with the process funded by the company in question.

33 See ASIC, *Breach reporting by AFS licensees*, Regulatory Guide 78, February 2014, paragraph RG 78.32.

34 Ms Joanna Bird, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 95.

Recommendation 9

13.34 The committee recommends that the government consider increased penalties and alternatives to court action, such as infringement notices, for Australian financial services licensees that fail to lodge reports of significant breaches to ASIC within the required time.

Recommendation 10

13.35 The committee recommends that ASIC review its surveillance activity with a view to making it more effective in detecting deficiencies in internal compliance arrangements.

Recommendation 11

13.36 In light of the Commonwealth Financial Planning matter, the committee recommends that ASIC undertakes intensive surveillance of other financial advice businesses that have recently been a source of concern, such as Macquarie Private Wealth, to ensure that ASIC's previous concerns are being addressed and that there are no other compliance deficiencies. ASIC should make the findings of its surveillance public and, in due course, provide a report to this committee.

PART III

Investigations and enforcement

Overview of Part III

Of ASIC's many and varied responsibilities, it is ASIC's discretionary role of investigating and taking enforcement action in response to alleged contraventions of the laws it administers that is the most high-profile and controversial aspect of ASIC's work.

This report has already begun examining ASIC's performance in relation to its enforcement responsibilities through the two case studies outlined in Part II. These case studies highlighted issues with specific cases. Some of the concerns identified, however, have wide application; for example, the experience of the CFPL whistleblowers is relevant to all corporate whistleblowers.

This part of the report draws on multiple cases and general observations to undertake a broader study of ASIC's enforcement record. In particular, it considers how ASIC receives and assesses misconduct reports, conducts an investigation, decides whether to pursue a particular case and how its enforcement action is conducted.

A selection of significant enforcement matters that ASIC has been involved in over the past five or more years can be found at Appendix 5. This selection may assist the reader understand ASIC's enforcement record and the varied nature of misconduct that the regulator may need to pursue. The matters outlined are the James Hardie litigation, Australian Wheat Board, Centro, the case against Andrew Forrest and Fortescue, ABC Learning, various collapsed property finance schemes, mortgage funds and debenture issuers, Opes Prime, Storm Financial, Stuart Ariff and Trio Capital. These cases may have been referred to in submissions and by witnesses at the public hearings, and may be noted in the report where relevant, but they are not examined in detail. Many of these cases have already been the subject of a parliamentary inquiry or extensive public discussion.

Chapter 14

Corporate whistleblowing: ASIC's performance and issues with the current protections

14.1 Paragraph (e) of the terms of reference for this inquiry provides that the committee should consider the performance of ASIC with regard to the 'protections afforded by ASIC to corporate and private whistleblowers'. The importance of this aspect of the inquiry has been underlined by suggestions that ASIC was slow and ineffective in responding to information provided by whistleblowers at Commonwealth Financial Planning Limited (CFPL) about alleged misconduct within the organisation.¹

14.2 This chapter provides:

- an overview of the protections afforded to corporate and private whistleblowers in Australia, and an explanation of ASIC's place within Australia's corporate whistleblower framework;
- an analysis of evidence received by the committee on the need to reform Australia's corporate whistleblower protections, and an overview of recommendations for reform made by witnesses; and
- the committee's recommendations for improving Australia's corporate whistleblowing regime.

Why is whistleblowing important?

14.3 In his submission, Professor AJ Brown provided the following definition of 'whistleblowing':

[W]histleblowing means the 'disclosure by organisation members (former or current) of illegal, immoral or illegitimate practices under the control of their employers, to persons or organisations that may be able to effect action'...In other words, whistleblowers are organisational employees, officers and other insiders—as distinct from customers, members of the public or others who may have evidence or complain of organisational wrongdoing.²

14.4 There was broad agreement from witnesses that effective and appropriately broad corporate whistleblower protections were of fundamental importance in ensuring good regulatory and corporate governance outcomes. For instance, ASIC wrote that whistleblower reports provided it with 'important information about the

1 ASIC's handling of the information received from the CFPL whistleblowers was examined in Chapter 8.

2 Professor AJ Brown, *Submission 343*, p. 2.

activities and the culture of the companies and other entities we regulate'. It further noted that whistleblowers 'are often particularly well placed to provide direct information about corporate wrongdoing by virtue of their relationships or position'.³

14.5 Systems that encourage would-be whistleblowers to make disclosures, and that in turn protect whistleblowers from retribution, are important because whistleblowers play a key role in preventing and detecting corporate wrongdoing. Dr Bowden pointed to a 2009 PricewaterhouseCoopers survey on economic crime (along with similar surveys and studies) to demonstrate this point, noting that the survey found 'whistleblowers were the highest source for identification of internal wrongdoing'.⁴

14.6 Dr Bowden, also suggested that effective corporate whistleblower protection regimes provide substantial financial and economic benefits, not least because trusted organisations are more profitable and their costs of compliance lower.⁵

14.7 The Blueprint for Free Speech reported findings from surveys suggesting the Australian public recognises the value of measures that protect and encourage whistleblowing:

81% of Australians believe that people should be supported for revealing serious wrongdoing, even if it means revealing inside information. 87% of those surveyed in Australia, agreed that if someone in an organisation has inside information about serious wrongdoing, they should be able to use a journalist, the media, or the internet to draw attention to it.⁶

14.8 CPA Australia, meanwhile, noted that whistleblowing was 'an effective mechanism for the identification and rectification of wrongdoing'. At the same time, CPA Australia stressed that the positive benefits of corporate whistleblowing in Australia were contingent on the trust would-be whistleblowers had in ASIC to act on the information they provided. That is, would-be whistleblowers would be far more likely to actually make a report to ASIC if they were confident that the information they provided was going to be taken seriously and addressed.⁷

14.9 Dr Bowden made a related if broader point in an article he supplied to the committee. In that article, Dr Bowden argued that the exposure of wrongdoing by whistleblowers was not, by itself, sufficient to ensure that the wrongdoing would cease. In his view, it was also necessary for a whistleblowing support system to

3 ASIC, *Submission 45.2*, p. 135.

4 Cited in Dr Peter Bowden, *Submission 412.1*, p. 2.

5 Dr Peter Bowden, *Submission 412*, p. 1.

6 Blueprint for Free Speech, *Submission 165*, p. 3.

7 CPA Australia, *Submission 209*, pp. 5–6.

'ensure that the allegation will be investigated, and that, if found to be true, it will be stopped, and if a crime has been committed, the perpetrator will be punished'.⁸

Whistleblower protections in the Corporations Act

14.10 Since 1 July 2004, the Corporations Act has provided certain protections to whistleblower activities. These protections are intended, as ASIC notes on its website, 'to encourage people within companies, or with special connections to companies, to alert ASIC and other authorities to illegal behaviours'.⁹ The protections were introduced by the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (CLERP 9).

14.11 The protections in Part 9.4AAA of the Corporations Act were summarised by ASIC in its main submission to this inquiry. They include:

...protection from any civil liability, criminal liability or the enforcement of any contractual right that arises from the disclosure that the whistleblower has made. Part 9.4AAA also includes a prohibition against the victimisation of the whistleblower, and provides a right to seek compensation if damage is suffered as a result of that victimisation. For example, under Pt 9.4AAA, a whistleblower whose employment is terminated, or who suffers victimisation as a result of their disclosure, may commence court proceedings to be:

- a) reinstated to their job or to a job at a comparable level; and
- b) compensated for any victimisation or threatened victimisation.¹⁰

14.12 The Corporations Act also includes a confidentiality protection for the whistleblower, making it an offence for a company, the company's auditors, or an officer or employee of that company to reveal the whistleblowers' disclosed information or identity.¹¹

14.13 Part 9.4AAA outlines the types of information disclosures that attract whistleblower protections under the Act; who can qualify as a whistleblower; who the disclosure of information should be made to; and the conditions in which such a disclosure must be made. In order to receive protection under the Corporations Act as a whistleblower, the person disclosing misconduct within a company must be:

- an officer or employee of that company; or
- have a contract to provide goods or services to that company; or

8 Dr Peter Bowden, *Submission 412.1*, p. 5.

9 ASIC, 'Protection for whistleblowers', www.asic.gov.au.

10 ASIC, *Submission 45.2*, p. 134. The protections are also summarised in Treasury, *Submission 154*, pp. 10–11.

11 Disclosure of this information to ASIC, APRA, a member of the Australian Federal Police or disclosure with the whistleblower's consent is allowed.

- be an employee of a person that has a contract to provide goods or services to that company.¹²

14.14 In order to be protected, the whistleblower must make the disclosure of misconduct to ASIC, the company's auditor, or certain persons within that company.¹³

14.15 The Corporations Act also provides that, in order to qualify for whistleblower protection, the person making a disclosure cannot do so anonymously. The discloser must make the disclosure in good faith and have reasonable grounds to suspect that:

- the company has, or may have, contravened a provision of the corporations legislation; or
- an officer or employee of the company has, or may have, contravened a provision of the corporations legislation.¹⁴

ASIC's role in relation to whistleblowers

14.16 ASIC has a central role in relation to whistleblowing in the Australian corporate sector. As noted above, the Corporations Act prescribes that other than internal disclosures and disclosures to a company's auditor, only disclosures made to ASIC are covered by the whistleblower protections within the Act.

14.17 It appears that ASIC receives a substantial amount of information from whistleblowers. Demonstrating this point, in its main submission ASIC noted that it received 845 reports of misconduct in 2012–13 from people who could potentially be considered whistleblowers under the Corporations Act. Table 20 in the submission provided a breakdown of the outcome for these reports—for example, 129 were referred internally for further action, 105 were resolved and 115 were not within ASIC's jurisdiction.¹⁵

14.18 While the Corporations Act establishes an explicit role for ASIC as a receiver of whistleblower disclosures, a number of witnesses pointed to the fact that the Act is silent on how the regulator should actually handle the information it receives from whistleblowers. ASIC itself noted that the protections:

...operate to protect and provide remedies for whistleblowers against third parties rather than mandating any particular conduct of ASIC. These

12 *Corporations Act 2001*, s. 1317AA(1)(a).

13 *Corporations Act 2001*, s. 1317AA(1)(b).

14 *Corporations Act 2001*, ss. 1317AA(1)(d)–(e). As ASIC notes in its main submission, similar protections 'are available to a whistleblower in possession of information relating to contraventions of banking, insurance and superannuation legislation, under the *Banking Act 1959*, the *Insurance Act 1973*, the *Life Insurance Act 1995* and the [*Superannuation Industry (Supervision) Act 1993*]. ASIC, *Submission 45.2*, p. 135.

15 ASIC, *Submission 45.2*, pp. 136–37.

protections do not deal with how ASIC is to treat whistleblowers and documents relating to whistleblowers.¹⁶

14.19 Similarly, while the Corporations Act establishes protections available to whistleblowers, it does not mandate or enable ASIC to act on behalf of whistleblowers to ensure their rights as whistleblowers are protected. Indeed, as ASIC noted in its submission, where a whistleblower:

...seeks to rely on the statutory protections against third parties, they will generally have to enforce their own rights or bring their own proceedings under the relevant legislation to access any remedy. The legislation does not provide ASIC with a direct power to commence court proceedings on a whistleblower's behalf.¹⁷

14.20 While the Part 9.4AAA whistleblower protections do not mandate any particular conduct by ASIC in relation to whistleblowers, ASIC noted that the ASIC Act nonetheless requires it to:

...protect any information provided to us in confidence, from all reports of misconduct, whether or not the confidential information is received from a whistleblower or any other person.¹⁸

14.21 However, ASIC also points out that while it seeks to prevent the unauthorised use or disclosure of information provided to it by whistleblowers, current legislation does not provide additional protections for documents that contain whistleblower information, including information that might reveal a whistleblower's identity. Moreover, ASIC has had past difficulties 'resisting applications for the production of such documents during litigation'.¹⁹ This is a cause for concern for ASIC, and as such one of its recommendations for regulatory change (as noted below) is to amend the legislation so that ASIC cannot be required to produce a document revealing a whistleblower's identity unless ordered to do so by a court or tribunal.

The need for whistleblower reform

14.22 Overwhelmingly, those witnesses who addressed the issue of Australia's corporate whistleblower framework were of the view that reform was needed in the area. ASIC itself, as discussed in the next section, argued for modest reforms to enhance whistleblower protections.

14.23 Admittedly, not all submissions received by the committee supported the case for whistleblower reform. Most notably, the Corporations Committee of the Law Council of Australia's Business Law Section maintained that there was 'no serious

16 ASIC, *Submission 45.2*, p. 135.

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

18 ASIC, *Submission 45.2*, p. 135.

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

defect in [the Part 9.4AAA] provisions or the way they have operated in practice'.²⁰ This view, however, proved an exception, with most witnesses regarding the current whistleblower regime as, in varying degrees, out-of-date and inadequate. Areas of particular concern included: the Corporations Act's overly narrow definitions of who might be considered a whistleblower and the type of disclosures that could attract whistleblower protections; the absence of any requirement in the Act for internal whistleblowing processes within companies; and the fact that the Act does not mandate a role for ASIC in protecting whistleblowers.

14.24 In making the case for reform, several witnesses suggested that the current legislation had proven ineffective in protecting the interests of whistleblowers. The Rule of Law Institute focused its criticism on ASIC specifically, contending that it had failed to protect whistleblowers from reprisals.²¹ CPA Australia, meanwhile, wrote that 'recent high profile cases appear to have undermined ASIC's reputation in regards to managing whistleblowing disclosures'.²² In the CFPL matter, the decision of Mr Morris and the other CFPL whistleblowers to blow the whistle on the misconduct at CFPL ultimately proved very costly for each of them on a personal level. Professor Brown told the committee that stories like Mr Morris's:

...are not unusual, and they have not been unusual for quite a long period of time. People have been going to regulators with information; it is just that they then become quiet collateral damage and walk away from it, much as often happens in the public sector.²³

14.25 Professor Brown suggested there was a lack of empirical evidence 'regarding the incidence, significance, value and current needs and challenges' with respect to the management of whistleblowing in Australia. While acknowledging this 'knowledge gap', Professor Brown also argued that 'Australia's legal regimes for facilitating, recognising, and responding appropriately to public interest whistleblowing in the corporate and private sectors are patchy, limited and far from international best-practice'. He added that given the deficiencies in the primary national private sector statutory provisions on whistleblowing, 'it is not surprising that ASIC's track record as a key agency responsible for whistleblowing is generally regarded as poor'.²⁴

14.26 In addition to the need to make specific improvements to the Corporations Act, Professor Brown also identified a need for a comprehensive approach to corporate whistleblower protections across jurisdictions in Australia:

As pressure builds for more effective whistleblower protection in the corporate and private sector, failure to take a comprehensive approach may

20 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 7.

21 Rule of Law Institute, *Submission 211*, p. 6.

22 CPA Australia, *Submission 209*, p. 6.

23 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 53.

24 Professor AJ Brown, *Submission 343*, p. 2.

well result in a proliferation of separate whistleblowing requirements on business in different areas of regulation, leading to heightened complexities, confusion and cost for Australian businesses and regulators alike.²⁵

14.27 Dr Bowden made a similar point, arguing that Australia should avoid adopting a whistleblower protection scheme for each industry, as the United States has done. The complexity of the US approach, he argued, served to discourage would-be whistleblowers from reporting misconduct, as it often was not even clear who they should make a disclosure to or which legislation covered their disclosure.²⁶

14.28 The Governance Institute of Australia argued that there appeared to be a 'disconnect between the regulatory framework in place for protecting corporate and private whistleblowers and the way in which it operates in practice'.²⁷ The Governance Institute, therefore, recommended a targeted review of:

...the regulatory framework for corporate and private whistleblowing which recognises the involvement of multiple regulators in the process of investigating and prosecuting corporate and private whistleblowing.²⁸

14.29 The Governance Institute pointed to what it regarded as the technical and narrow operation of the Corporation Act's whistleblower protections. The Institute suggested that while ASIC is 'doing its best' within the constraints of the legislation, a need remains for:

...a much broader whistleblowing protection that applies to all people who bring complaints in good faith to the attention of all regulators, whether they are the ACCC, ASIC, the ATO, the Federal Police or state based authorities.²⁹

The 2004 parliamentary committee report on CLERP 9

14.30 Even when the current corporate whistleblower protections were added to the Corporations Act in 2004, observers suggested that it was likely that further reform would be needed. Indeed, the Parliamentary Joint Committee on Corporations and Financial Services' (PJCCFS) report on the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003 (the CLERP 9 Bill), characterised the whistleblower protections in the Bill as 'sketchy in detail', even if

25 Professor AJ Brown, *Submission 343*, p. 2.

26 Dr Peter Bowden, *Submission 412*, pp. 1–2; Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 51.

27 Governance Institute of Australia, *Submission 137*, p. 3.

28 Governance Institute of Australia, *Submission 137*, p. 3.

29 Mr Douglas Gratton, Director, Governance Institute of Australia, *Proof Committee Hansard*, 10 April 2014, pp. 62–63.

their intention was clear. The committee concluded that the whistleblower protections would ultimately require 'further refinement'.³⁰

14.31 Specific concerns raised by the PJCCFS included the limited scope of the definition of protected disclosures, the lack of any requirement that companies establish internal processes to facilitate whistleblowing, and the fact the proposed protections were silent on what role, if any, ASIC had in preventing reprisals against whistleblowers or acting to protect whistleblowers when reprisals took place. The PJCCFS also criticised the fact that the whistleblower protections did not extend to cover anonymous disclosures, and recommended removing the requirement that a whistleblower be acting in 'good faith'. The PJCCFS concluded that the proposed whistleblowing provisions were a step in the right direction, but 'only a first step' and 'not ambitious' at that.³¹ Tellingly, the PJCCFS foreshadowed the future need for a comprehensive review of Australia's whistleblower framework:

Once the proposed whistleblower provisions come into operation, answers to the questions that it poses may become clearer. Indeed the longer term solution may be found in the development of a more comprehensive body of whistleblower protection law that would constitute a distinct and separate piece of legislation standing outside the Corporations Act and consistent with the public interest disclosure legislation enacted in the various states.³²

Is Australia lagging behind the world on whistleblower reform?

14.32 Highlighting the lack of progress on whistleblower reform since 2004, a number of experts on whistleblowing suggested that Australia's corporate whistleblower framework had fallen behind those in other parts of the world.

14.33 Several submitters noted that high profile corporate failures had driven moves in other countries to improve systems to encourage and protect corporate whistleblowers. For example, Professor AJ Brown noted that the United States had been progressively developing and strengthening its corporate whistleblowing regime since several high-profile corporate collapses in 2000 and 2001, which led to a strengthening of the corporate whistleblower regime by the Sarbanes-Oxley Act of 2002. The global financial crisis prompted a second wave of reform of the US whistleblower framework, with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 including provision for a whistleblower bounty program. Professor Brown noted that while the Australian reforms of 2004 were

30 Parliamentary Joint Committee on Corporations and Financial Services, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003, Part 1: Enforcement, executive remuneration, continuous disclosure, shareholder participation and related matters*, June 2004, Parliamentary Paper No. 122/2004, p. xxii.

31 PJCCFS, *CLERP 9 Bill*, June 2004, p. 29.

32 PJCCFS, *CLERP 9 Bill*, June 2004, p. xxii.

a 'partial response' to the first of the two waves of reform, Australia had made no further reforms since.³³

14.34 Other witnesses tended to agree that Australia's corporate whistleblower protections compared poorly to those in other countries. Dr Bowden was unequivocal on this point:

We are behind the rest of the world—simple—and it is a shame that we are. As I said, I am looking for this committee to change it and bring us into the 20th century—not the 21st century, just the 20th century.³⁴

Treasury's 2009 review of corporate whistleblower protections

14.35 The current corporate whistleblower protections were the subject of a 2009 Treasury options paper, *Improving protections for corporate whistleblowers*. In a foreword to the paper, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, acknowledged that the current corporate whistleblower regime did not appear to be working as intended:

The importance of protecting corporate whistleblowers has been recognised for many years. However, while legislative protections have been provided under the *Corporations Act 2001* since 2004, they appear to have been poorly regarded and rarely used. At the time this paper was written, only four whistleblowers had ever used these protections to provide information to ASIC.³⁵

14.36 Despite the Minister's criticisms of existing protections, the review process stalled in early 2010 after a brief series of consultations on the issues raised in the options paper. In its submission, Treasury reported that the comment received on the option's paper 'provided no strong consensus on reforming protections for whistleblowers, and the issue was not taken further by the previous government'.³⁶

Public Interest Disclosure Act 2013

14.37 In contrast to the lack of reform in relation to corporate whistleblowing, Australia's public sector whistleblower framework recently underwent a major reform process. These reforms were given effect by the *Public Interest Disclosure Act 2013* (PIDA). Several witnesses suggested that PIDA represented a best-practice approach to whistleblower legislation, and recommended that it be used as a template for corporate whistleblower reform. For example, the Blueprint for Free Speech wrote that PIDA was a 'world-leading protection regime for whistleblowers' in the public

33 Professor AJ Brown, *Submission 343*, p. 3.

34 Dr Peter Bowden, *Proof Committee Hansard*, 10 April 2014, p. 52.

35 Treasury, *Improving protections for corporate whistleblowers: options paper*, October 2009, http://archive.treasury.gov.au/documents/1620/PDF/whistleblower_options_papers.pdf, p. iv.

36 Treasury, *Submission 154*, p. 11.

sector.³⁷ The Blueprint for Free Speech argued that key elements of the protection regime for public sector whistleblowers that might be considered in some form for the private sector regime included:

- the requirement for government departments to have a designated 'disclosure officer' to receive disclosures;
- better and easier access to compensation for whistleblowers in cases where they suffer reprisals;
- extension of whistleblower protections to allow external disclosures (for example, to the media) in situations where the whistleblower believes that an internal or ASIC investigation was inadequate;
- cost protections, so that in instances where a whistleblower seeks to enforce their rights through legal action, the costs of that action are only payable by the whistleblower where the action was brought vexatiously;
- protections for anonymous whistleblowers; and
- the existence of a dedicated Ombudsman with powers to investigate and hear the complaints of whistleblowers.³⁸

14.38 Dr Sulette Lombard made the point that whereas PIDA provided some guidance to whistleblowers and others as to what happens with information provided by whistleblowers, the Corporations Act was silent on this.³⁹

14.39 While by no means rejecting the value of PIDA-like arrangements in the private sector, Professor AJ Brown cautioned that 'detailed consideration' would need to be given to how such arrangements may need to be adjusted so that they operated effectively in the private sector.⁴⁰

14.40 ASIC made a similar point. It suggested, on the one hand, that there might be 'some elements' of the public sector reforms that could be considered in a review of the corporate whistleblower protections. However, ASIC added that:

...there may also be some different considerations applying to disclosures about private institutions than public institutions, including the greater need to balance privacy and confidentiality considerations.⁴¹

37 Blueprint for Free Speech, *Submission 165*, p. 4.

38 Blueprint for Free Speech, *Submission 165*, pp. 4-5

39 Dr Sulette Lombard, *Proof Committee Hansard*, 10 April 2014, p. 52.

40 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 52.

41 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 24.

Committee view

14.41 The committee believes a strong case exists for a comprehensive review of Australia's corporate whistleblower framework, and ASIC's role therein.

14.42 The fact that momentum appears to have been lost following the release of the 2009 Treasury options paper is unfortunate. In that paper, the then Minister for Financial Services, Superannuation and Corporate Law described the corporate whistleblower protections in the Corporations Act as 'poorly regarded and rarely used'. The committee has heard from a number of whistleblowers in the course of this inquiry, including one of the CFPL whistleblowers, whose experiences suggest that this very much remains the case. The committee notes that progress on the issue stalled in early 2010 because, as Treasury puts it, there was 'no strong consensus on reforming protections for whistleblowers'. Even if this were the case, the committee believes reform remains necessary. A comprehensive review process would help build the consensus necessary to deliver this reform.

14.43 The committee notes that PIDA includes whistleblower protections that are widely regarded as world's best-practice. As such, the committee believes a comprehensive review of Australia's corporate whistleblower should have regard to the provisions in PIDA and give detailed consideration to whether these provisions might have valuable application in the private sector.

ASIC's revised approach to handling whistleblower disclosures

14.44 At various points during the inquiry, ASIC acknowledged that one of the key learnings from the CFPL matter was that it needed to improve its communication with whistleblowers and better utilise whistleblower information. Specifically, ASIC acknowledged that it:

...could have and should have spoken to the whistleblowers earlier, sought more information from them and, within the limitations [imposed by ASIC's confidentiality obligations or the need to ensure the appropriate administration of justice], provided them with some assurance that ASIC was interested and active in the matter, that their report was being dealt with seriously and that something was being done.⁴²

14.45 ASIC informed the committee that as a result of these learnings, it had enhanced the way it identifies and communicates with potential whistleblowers. ASIC explained in its main submission that this approach seeks to ensure that ASIC:

- a) has appropriate training and expertise in all stakeholder and enforcement teams for the handling of whistleblower reports;
- b) maintains a coordinated, centralised procedure for the tracking and monitoring of all whistleblower reports;

42 ASIC, *Submission 45.2*, p. 137.

- c) gives appropriate weight to the inside nature of the information provided by whistleblowers in our assessment and ongoing handling of the matter;
- d) provides prompt, clear and regular communication to whistleblowers to the extent possible and appropriate during our investigations; and
- e) maintains the confidentiality of whistleblowers within the applicable legal framework.⁴³

14.46 In his submission, Professor AJ Brown noted that ASIC has only put in place 'operational systems to support its limited role in whistleblowing in very recent times, despite [the whistleblower provisions in Part 9.4AAA of the Corporations Act] having been in place for almost 10 years'.⁴⁴ However, during his appearance before the committee, Professor Brown acknowledged that the recent changes ASIC had implemented to improve its interactions with whistleblowers and how it handles the information they provide represents a substantial step forward. In this sense, he implied that ASIC's handling of its interactions with the CFPL whistleblowers could be viewed as historical rather than current problems. Professor Brown suggested:

...we already know that ASIC's performance on the question of managing whistleblowers has changed enormously since some of the circumstances which contributed to the inquiry and the circumstances as they stand today. So, to the extent that there might be justifiable criticism of ASIC's performance in relation to whistleblowers in 2008 or 2009, we already know that we are dealing with a completely different landscape now, because of the fact that ASIC, as the major corporate regulator, has clearly woken up to and is responding to whistleblowing as an issue in its jurisdiction in very distinct and clear ways, from which other regulators and other agencies probably can already start to learn.⁴⁵

14.47 For its part, the Governance Institute welcomed 'the steps that ASIC is taking to improve its handling of whistleblowers', but reiterated that 'ASIC can only do so much in the narrow legislative regime that it has at the moment'. As such, the Governance Institute emphasised the need for:

...a more extensive regime giving much, much better protection not only to the regulator, which I think is what ASIC is focused on, but also to the whistleblower concerned.⁴⁶

43 ASIC, *Submission 45.2*, p. 137. Also see Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 2.

44 Professor AJ Brown, *Submission 343*, p. 2.

45 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 50.

46 Mr Douglas Gratton, Director, Governance Institute of Australia, *Proof Committee Hansard*, 10 April 2014, pp. 62–63.

Committee view

14.48 The committee welcomes the steps ASIC has recently taken to improve how it interacts with whistleblowers and handles the information they provide. At the same time, the committee believes that more substantive legislative and regulatory changes will likely be required to improve Australia's corporate whistleblower framework.

ASIC's recommended options for legislative and regulatory change

14.49 In addition to reporting on the steps ASIC has taken to improve its handling of whistleblowers and the information they provide, ASIC's main submission also provided three recommendations for regulatory and legislative change in relation to whistleblowers. These recommendations, reproduced below in Table 14.1, relate to the definition of 'whistleblower', the scope of disclosures covered by whistleblower protections and clarifying when ASIC may resist orders for the production of information that might reveal a whistleblower's identity.

Table 14.1: ASIC's options for change regarding whistleblowers

| <i>Issue</i> | <i>Regulatory change options for consideration by government</i> |
|--|---|
| The definition of 'whistleblower' does not cover all of the people who may require whistleblower protections | <i>Expanding the definition</i> —expanding the definition of whistleblower in Pt 9.4AAA of the Corporations Act to include a company's former employees, financial services providers, accountants and auditors, unpaid workers and business partners |
| The whistleblower protections do not cover information relating to all of the types of misconduct ASIC may investigate | <i>Expanding the scope</i> —expanding the scope of information protected by the whistleblower protections to cover any misconduct that ASIC may investigate |
| The whistleblower protections are not sufficiently clear as to when ASIC may resist the production of documents that could reveal a whistleblower's identity | <i>Protecting whistleblower information</i> —amending the legislation so that ASIC cannot be required to produce a document revealing a whistleblower's identity unless ordered by a court or tribunal, following certain criteria |

Source: ASIC, *Submission 45.2*, p. 13.

14.50 ASIC's recommendations did not prove contentious. To the extent that witnesses commented on the recommendations, it was simply to suggest that they were a good starting point for reform. For instance, Professor AJ Brown supported ASIC's recommendation that the protections in Part 9.4AAA be extended to information indicating a contravention of any legislation that ASIC can investigate, including breaches of relevant criminal law, rather than simply the corporations legislation. However, he also suggested that the extension and clarification of the

definitions should be done in a way that not only aligns with ASIC's investigate jurisdiction, but also achieves the purpose of encouraging and protecting disclosures.⁴⁷

Committee view

14.51 The committee believes ASIC's recommendations in relation to whistleblowers are a sensible and measured response to broadly recognised deficiencies in the current whistleblower protections. The committee recognises that the definition of 'whistleblower' in the Corporations Act is currently too restrictive, as is the scope of information that can attract whistleblower protections. The committee also agrees that there would be value in clarifying when ASIC can resist the production of documents which might reveal a whistleblower's identity.

14.52 While the committee believes the changes suggested by ASIC would be of benefit, it views the proposed changes as first steps in a broader reform process.

Other potential areas for reform

14.53 As noted earlier, most witnesses who addressed the issue of Australia's corporate whistleblower framework argued that there was a need to strengthen current arrangements. Ideas for reform suggested by one or more of these witnesses included:

- extending corporate whistleblower protections to cover reports from anonymous whistleblowers;
- removing the requirement that whistleblowers need to make their disclosure in 'good faith';
- legislative and regulatory changes to encourage or require better systems within Australian corporations for encouraging and protecting internal disclosures;
- extending whistleblower protections to cover external disclosures (for example, to the media) in certain circumstances;
- providing for a clearer and fairer system for compensation to whistleblowers in cases where the whistleblower protections have not worked and the whistleblower has suffered as a result of making a disclosure;
- the possible introduction of reward-based whistleblower incentives or *qui tam* arrangements, similar to those that exist in the United States;
- enhancing or clarifying ASIC's ability to act as an advocate for whistleblowers;
- strengthening the penalties that might be applied against persons or companies that disadvantage or seek to disadvantage a whistleblower; and

47 Professor AJ Brown, *Submission 343*, p. 5.

- measures that would enhance ASIC's ongoing contact with whistleblowers, and recognise the importance whistleblowers generally place on being informed of actions undertaken in relation to matters they make a disclosure about.

14.54 Each of these ideas is set out below. Several of these ideas were addressed in the PJCCFS's 2004 report on the CLERP 9 Bill; where this is the case, it is noted to provide policy context.

Protecting anonymous disclosures

14.55 The PJCCFS's 2004 report on the CLERP 9 Bill recommended that the government consider extending whistleblower protections to cover anonymous disclosures. It argued that a requirement that a person making a disclosure must have 'an honest and reasonable belief' that an offence has or will be committed (the PJCCFS's preferred alternative to the 'good faith' test that was ultimately legislated) would provide a safeguard against vexatious anonymous disclosures.⁴⁸

14.56 The government of the day rejected the PJCCFS's recommendation, arguing that extending the whistleblower protections to cover anonymous disclosures:

...may encourage the making of frivolous reports, and would generally constrain the effective investigation of complaints. Allowing anonymity would also make it more difficult to extend the statutory protections to the relevant whistleblower.⁴⁹

14.57 Professor AJ Brown argued for the extension of whistleblower protections to anonymous whistleblowers, suggesting this would not:

...raise practical difficulties, since the protections and other obligations are only triggered if or when the identity of the whistleblower is subsequently revealed, and confirmed to be within the statutory definition above.⁵⁰

14.58 Mr Jeffrey Morris explained to the committee that part of the reason the CFPL whistleblowers elected to make an anonymous report was that they lacked confidence in ASIC's 'ability to keep a secret'.⁵¹ Interestingly, when asked if the lack of protections in Part 9.4AAA for anonymous disclosures gave him and his fellow whistleblowers cause to reconsider making their disclosure to ASIC, Mr Morris said it did not, because:

48 PJCCFS, *CLERP 9 Bill*, June 2004, p. xxix.

49 Australian Government response to Parliamentary Joint Committee on Corporations and Financial Services, *CLERP (Audit Reform and Corporate Disclosure) Bill 2003* [hereafter Government response to PJCCFS CLERP 9 report], March 2005, p. 4.

50 Professor AJ Brown, *Submission 343*, p. 4.

51 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 41.

...if ASIC had acted on the information we had given them, the whole matter would have been resolved and we would never have needed to have broken cover.⁵²

14.59 Asked if whistleblower protections should be extended to cover anonymous disclosures, ASIC responded:

We understand that potential whistleblowers may wish to remain anonymous for fear of reprisal, reputational damage or other negative consequences of their whistleblowing. Nevertheless, it can be important for ASIC to know the identity of a whistleblower for practical purposes, including to substantiate their claims and progress the investigation. However, ensuring that whistleblowers' identities can be protected from disclosure to third parties is a different and significant issue. In our submission to the Senate inquiry, we suggested providing ASIC with greater scope to resist the production of documents revealing a whistleblower's identity, in order to better ensure the protection of this information.⁵³

The 'good faith' requirement

14.60 As noted earlier, in order to qualify for the whistleblower protections in the Corporations Act, a discloser must make the disclosure in good faith. In the course of the inquiry, a number of witnesses questioned the value of the 'good faith' requirement, and argued for its removal.

14.61 The PJCCFS's 2004 report on the CLERP 9 Bill recommended that the 'good faith' requirement be removed, arguing the protections should be based on the premise that:

...the veracity of the disclosure is the overriding consideration and the motives of the informant should not cloud the matter. The public interest lies in the disclosure of the truth.⁵⁴

14.62 The then-government did not accept the recommendation, responding that the 'good faith' requirement would help minimise vexatious disclosures and ensure persons making disclosures did not have 'ulterior motives'. The removal of the 'good faith' requirement could, it argued:

...give rise to the possibility that a disgruntled employee might attempt to use the [whistleblower] provisions as a mechanism to initiate an unnecessary investigation and thereby cost the company time and money.⁵⁵

52 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 41.

53 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 21.

54 PJCCFS, *CLERP 9 Bill*, June 2004, p. 21.

55 Government response to PJCCFS CLERP 9 report, March 2005, pp. 3–4.

14.63 Professor AJ Brown argued that the 'good faith' requirement is 'out of date and inconsistent with the approach taken by Australia's public sector whistleblowing legislation, as well as best practice legislative approaches elsewhere'.⁵⁶

For several reasons, 'good faith' is not a useful concept to appear at all in whistleblowing legislation. Motives are notoriously difficult to identify and may well change in the process of reporting, for example, when an internal disclosure is ignored or results in the worker suffering reprisals. Because it is such a subjective and open-ended requirement, the likely effect of a good faith test is negative—that workers simply choose not to report their suspicions about wrongdoing, because they are unsure whether or how this test would be applied to their circumstances.⁵⁷

14.64 Professor Brown suggested that the only proper test was that which applied in PIDA: that a disclosure must be based on an honest belief, on reasonable grounds, that the information shows or tends to show defined wrongdoing; or does show or tend to show such wrongdoing, on an objective test, irrespective of what the discloser believes it to show.⁵⁸ Similarly, the Blueprint for Free Speech suggested that the 'good faith' requirement had the unhelpful effect of shifting the focus from the importance of the information disclosed to the motives of the whistleblower.⁵⁹

14.65 Dr Bowden explained why he believed the 'good faith' requirement should be removed by way of example:

[I]f you were under a supervisor who consistently pushes the envelope on his ethical behaviour and eventually you end up by blowing the whistle on something that you think is going to get through, are you acting in good faith or not? It is hard to tell. But if you pointed out a wrongdoing, that is enough for me. My own belief is that the good faith requirement should be scrapped entirely. It is whether they have revealed a wrongdoing and a clear wrongdoing at that, a provable wrongdoing at that.⁶⁰

14.66 Dr Brand supported Dr Bowden's reasoning, telling the committee that the issue was the 'quality of the information' rather than the motive for providing that information. Dr Brand's colleague, Dr Lombard, added that while it was reasonable to want to prevent vexatious whistleblowing, there were better ways to achieve this than the current 'good faith' test.⁶¹

14.67 Professor Brown explained that all the research on why people became whistleblowers indicated that a decision to make a disclosure basically involved a

56 Professor AJ Brown, *Submission 343*, p. 4.

57 Professor AJ Brown, *Submission 343*, p. 4.

58 Professor AJ Brown, *Submission 343*, p. 4.

59 Blueprint for Free Speech, *Submission 165*, p. 3.

60 Dr Peter Bowden, *Proof Committee Hansard*, 10 April 2014, p. 54.

61 Dr Sulette Lombard, *Proof Committee Hansard*, 10 April 2014, p. 54.

judgement on whether anybody was going to be interested in receiving the information, and whether the discloser would receive support and recognition for making the disclosure. Professor Brown explained that 'those very basic messages':

...are influenced very strongly as soon as you introduce things like a good faith requirement. The classic example was that, previously, I think in around 2007 or 2008, on the ASIC website there was specific guidance to anybody who was seeking to use part 9.4AAA that they would have to reveal the information in good faith. At that time, the advice on the ASIC website was to the effect that that would not include information that was malicious. All good investigators—and I have my own investigation background—know that information that is provided for malicious reasons can be just as useful and important and revealing as other information. It does not mean that it is not information which should be revealed.⁶²

14.68 According to Professor Brown, the lack of precision as to what was meant by 'good faith' left whistleblowers vulnerable to accusations that they had an ulterior motive in making a disclosure. As such, would-be whistleblowers might conclude that it was not worth making a disclosure on the grounds that no one would take them seriously.⁶³

14.69 In response to a question on notice, ASIC declined to take a position on the merits of the 'good faith' requirement, suggesting this was 'ultimately a policy question for government'. Nonetheless, in declining to take a position on the subject, ASIC made the general point that:

...if there are any deficiencies identified in the current whistleblower protections that may be proving to be an impediment to potential whistleblower disclosures, these should be carefully reviewed and change considered.⁶⁴

Protecting disclosures to third parties, such as the media

14.70 Professor Brown argued that the fact that the Part 9.4AAA protections do not extend to corporate whistleblowers who take their disclosure to the media or other third parties is a 'major gap'. There were circumstances, Professor Brown argued, in which it was widely accepted that this approach was reasonable; for example, where an internal disclosure or disclosure to the regulator was not acted on, or where it was impossible or unreasonable to make an internal disclosure or disclosure to ASIC.⁶⁵

14.71 Asked whether the whistleblower protections should be extended to cover external disclosures to the media in certain circumstances, ASIC responded:

62 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 55.

63 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 55.

64 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 22.

65 Professor AJ Brown, *Submission 343*, p. 9.

There may be circumstances where a person suffers reprisal following their making external disclosures to third parties, such as the media, and it may be useful to consider extending the whistleblower protections in such a situation. However, ultimately, this is a policy question for government.⁶⁶

Improving internal disclosure systems

14.72 Several witnesses argued for the introduction of a regulatory requirement for companies to establish internal whistleblower systems. Such an approach, these witnesses suggested, could improve corporate governance outcomes while reducing the regulatory burden on ASIC.

14.73 The PJCCFS's 2004 report on the CLERP 9 Bill recognised the importance of internal corporate disclosure systems. The PJCCFS recommended that:

...a provision be inserted in the Bill that would require corporations to establish a whistleblower protection scheme that would both facilitate the reporting of serious wrongdoing and protect those making or contemplating making a disclosure from unlawful retaliation on account of their disclosure.⁶⁷

14.74 In making its case, the PJCCFS noted that in the United States the Sarbanes-Oxley Act requires that every public company in the United States establish mechanisms which allow employees to provide information anonymously to the company's board of directors. Sarbanes-Oxley also stipulates that disclosures made through this internal reporting mechanism constitute protected whistleblower activity.⁶⁸

14.75 The then government did not accept the recommendation, on the basis that:

Prescribing particular systems which all companies must implement in order to facilitate whistleblowing could prove to be overly rigid and unsuitable for particular companies in the Australian market.⁶⁹

14.76 Professor Brown explained to the committee that the overwhelming majority of whistleblower complaints in the private sector (over 90 per cent) were made internally in the first instance. In cases where an internal disclosure was dealt with quickly and properly, Professor Brown reasoned, the entire whistleblower system worked more efficiently and the burden on ASIC was reduced.⁷⁰ Professor Brown added having a requirement for companies to have internal whistleblower

66 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 21.

67 PJCCFS, *CLERP 9 Bill*, June 2004, p. xxii.

68 PJCCFS, *CLERP 9 Bill*, June 2004, p. 12.

69 Government response to PJCCFS CLERP 9 report, March 2005, p. 2.

70 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 59.

arrangements in place could work in the interest of a company. In fact, Professor Brown suggested that such a requirement should:

...incentivise businesses to adopt whistleblower protection strategies by offering defences or partial relief from liability, for itself or its managers, if the business can show (a) it had whistleblower protection procedures of this kind, (b) that the procedures were reasonable for its circumstances, and (c) that they were followed (i.e. that the organisation made its best efforts to prevent or limit detriment befalling the whistleblower).⁷¹

14.77 Professor Brown also noted that this positive approach appeared to be working in the United States.⁷²

14.78 The lack of a 'mandated requirement for Australian corporates to institute internal structures to facilitate whistleblowing' was a key point of concern in the submission made by Dr Brand and Dr Lombard. Such a requirement, they argued, would encourage rates of whistleblowing, with evidence suggesting that 'the level of whistleblowing activity in a corporation is positively associated with the level of internal support for whistleblowing'. Also, rather than increasing the regulatory burden on ASIC, good internal systems 'have the potential to ensure tips are "screened", thus reducing pressure on the public regulator (i.e. ASIC) and preserving resources'.⁷³

14.79 Dr Brand and Dr Lombard further noted that PIDA appears to recognise the advantages of internal reporting systems, inasmuch as external disclosures are generally only permitted after an internal disclosure has been made. In this way, they argued:

...PIDA offers a model for increased activity within corporations in relation to whistleblowing handling and response, with the possibility of concomitant increases in the level of whistleblowing activity, and the potential for reduced demand on ASIC's resources.⁷⁴

14.80 Discussing the potential regulatory burden of a requirement for companies to establish and maintain internal whistleblower systems, Dr Brand emphasised that the internal compliance requirements that might be imposed on companies should be 'part of a positive message', and undertaken in a 'light touch' manner. Such an approach might include:

...saying the directors' annual report needs to refer to whether there is an internal whistleblowing system and whether there was ever an occasion in a given 12-month period where the timelines for response were not met, or where the matter was referred externally because the whistleblower was not

71 Professor AJ Brown, *Submission 343*, pp. 5–6.

72 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 59.

73 Dr Vivienne Brand and Dr Sulette Lombard, *Submission 419*, pp. 1–2.

74 Dr Vivienne Brand and Dr Sulette Lombard, *Submission 419*, p. 2.

happy with the response they got, which is the public interest disclosure model. We think even a little thing like that could make a big difference...⁷⁵

14.81 Asked to comment on recommendations from witnesses aimed at improving the internal systems within corporations to encourage and protect whistleblowers, ASIC responded that this was a matter for government. At the same time, ASIC indicated that it would 'support consideration of any reforms that improve companies' governance arrangements to ensure that they support and meet their obligations towards whistleblowers'.⁷⁶

Compensation for whistleblowers

14.82 In his submission, Professor Brown argued that the compensation provisions in Part 9.4AAA of the Corporations Act are limited and vague, providing no clear guidance about how an application for compensation can be made, the potential relief from costs risks, the situation regarding vicarious liability, the burden of proof, and so on. Professor Brown recommended that the compensation entitlements be amended so that they were consistent with PIDA.⁷⁷

Reward-based whistleblower incentives and qui tam arrangements

14.83 A number of witnesses, including Mr Morris, told the committee that consideration should be given to introducing rewards or other monetary incentives for corporate whistleblowers. Mr Morris told the committee that a system that rewarded whistleblowers, like the system in the United States, would help to improve compliance in the Australian financial services industry:

I think what would clean up this industry overnight would be some form of financial compensation for whistleblowers that would allow them to move on with their lives and would encourage people to come forward, as we did. In [the CFPL] case, the compensation paid to victims so far is in the order of \$50 million. If the institution at fault, as part of whistleblowing provisions, then had to pay the whistleblower, say, a certain percentage based on the actual compensation paid to victims—so that is established malfeasance, I suspect you would have a lot more whistleblowers coming forward. I would suspect you would find the institutions would have to improve their behaviour overnight if literally any employee could bring them down when they were doing the wrong thing with some sort of incentive—not necessarily a huge incentive, like in the United States, but some reasonable basis to allow people to move on with their lives.⁷⁸

75 Dr Vivienne Brand, *Proof Committee Hansard*, 10 April 2014, p. 56.

76 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 22.

77 Professor AJ Brown, *Submission 343*, p. 7.

78 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 42.

14.84 Asked if he was advocating an incentive based scheme to reward whistleblowers who disclose malfeasance, Mr Morris answered that he would like to see either incentives or a compensation scheme introduced:

The last time I saw the person at ASIC he basically said to me in as many words, 'Thanks for sacrificing yourself.' It is not a very attractive prospect for anybody else to want to emulate what we did.⁷⁹

14.85 Professor Bob Baxt AO told the committee that while any reward-based system would need appropriate safeguards, careful consideration should nonetheless be given to whether would-be whistleblowers in Australia might be encouraged through monetary rewards. He suggested that with proper safeguards, it was likely:

...the regulators will get better results which means that people will get better recovery regimes and the government will get a bit of money, because it will recover fines.⁸⁰

14.86 Professor Baxt also discounted the notion that a reward-based system would somehow be inconsistent with Australian culture. At the very least, he argued, the merits of such an approach should be subject to careful assessment before being rejected.⁸¹

14.87 In his submission, Professor Brown highlighted the success of *qui tam* or reward-based disclosure incentives in other countries, including the United States, in helping detect corporate wrongdoing. Allowing a whistleblower a percentage of the amount of money recovered from fraud or of the penalty imposed had, he suggested, 'been at the heart of a significant expansion of attention on whistleblowing by the United States Securities and Exchange Commission'.⁸² Professor Brown concluded that *qui tam* should be considered if Australian corporate whistleblower protections are to be best practice.⁸³

14.88 Dr Bowden similarly argued that Australia should consider the adoption of a rewards scheme for whistleblowers similar to that in place in the United States. He noted the monies recovered through fines and levies paid by US companies to the US Government as a result of *qui tam* cases.⁸⁴ In his view, concerns that a rewards scheme would negate the moral position of the corporate whistleblower were not necessarily well-founded, as the 'ultimate result is that the wrongdoing is stopped'.⁸⁵

79 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 43.

80 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 15.

81 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 16. Professor Baxt also made this point in his written submission: *Submission 189*, p. 6.

82 Professor AJ Brown, *Submission 343*, p. 9.

83 Professor AJ Brown, *Submission 343*, p. 9.

84 Dr Peter Bowden, *Submission 412*, p. 2.

85 Dr Peter Bowden, *Submission 412*, p. 2.

14.89 The Blueprint for Free Speech also suggested that consideration should be given to *qui tam* remedies, such as those which exist in the United States.⁸⁶

14.90 The committee explored this point with ASIC during the public hearings. Mr Medcraft acknowledged that a reward system for whistleblowers might provide would-be whistleblowers with some comfort by knowing that, if they lost their jobs or damaged their careers as a result of their disclosure, they would nonetheless receive some compensation. At the same time, Mr Medcraft explained that before an effective bounty reward system for corporate whistleblowers could be implemented in Australia, it would likely be necessary to revise upwards the civil penalties Australian corporations were subject to:

Senator, on your question about the payment of a bounty, one of the issues, when we looked at it, is that the penalties are really low in Australia and the way that the system works in the States is that you get a percentage, and so would it actually be meaningful to have that? I guess it is a bit of a chicken-and-egg situation. If the penalties were more realistic then paying a percentage of them actually might then become an incentive. So I think you need to look at the issue with the penalties in mind as well.⁸⁷

14.91 Mr Medcraft added that ASIC had also considered whether a reward-based system would be consistent with Australian culture:

Are we a bounty hunter culture? Is it the Australian ethos to go after money in the same way? That is really a matter for community debate. But certainly, as you say, in America it seems to work quite effectively—getting a bounty. But I think you need to look at the issue from a cultural perspective and then, secondly, the incentive—and making sure that it does give them that comfort, that they will have that financial security.⁸⁸

ASIC's role as an advocate for whistleblowers and the penalties for victimising a whistleblower

14.92 A key finding to emerge from the committee's consideration of the protections afforded by ASIC to corporate and private whistleblowers is that ASIC does not appear to have a clear substantive role in protecting the interests of whistleblowers. Indeed, as noted earlier, ASIC stated that whistleblowers 'will generally have to enforce their own rights' if seeking to rely on the statutory protections.⁸⁹ Asked if it was fair to conclude that ASIC does not have a substantive role as an advocate for corporate whistleblowers, ASIC agreed that the current whistleblower provisions

86 Blueprint for Free Speech, *Submission 165*, p. 5.

87 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 25. Whether the current penalty amounts and approach to corporate penalties should be reviewed is examined in Chapter 23.

88 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 25. See also ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 23.

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

'do not either require or empower ASIC to treat whistleblowers or the information they provide in any particular way'.⁹⁰

14.93 One of the more troubling pieces of evidence received from Mr Morris was that the CFPL whistleblowers were effectively reconciled to losing their jobs as a result of their decision to make a disclosure to ASIC. In his first submission, Mr Morris recalled that when the whistleblowers met with ASIC for the first time on 24 February 2010 (16 months after providing ASIC with an anonymous report) they were told by an ASIC official that from that day forward they had whistleblower protection, but that 'wouldn't be worth much'.⁹¹ Asked about this comment, Mr Morris told the committee that he believed the ASIC officer in question was 'just being frank' about the limitations of the whistleblower protections:

[T]he whistleblower protection basically, as he said, [are] not worth much. But I think we had made a decision. We recognised at the outset that we would be giving up our jobs by what we were doing.⁹²

14.94 On the CFPL whistleblowers' expectations regarding ASIC's role in protecting them, Mr Morris also told the committee:

...I do not think at the outset we seriously expected ASIC to protect us. If you look at their whistleblower protections, there are a lot of weasel words in there and it is very, very limited. I suspect, if a company wants to get rid of a whistleblower, they never do it because you are whistleblower.⁹³

14.95 In an article by journalist Adele Ferguson, Mr Morris indicated that he was essentially left to negotiate his own exit from the CBA when he raised concerns with ASIC about death threats he believed had been made. He reported that:

...I was told by my ASIC contact in a rather offhand manner, 'It's probably bullshit, but if you're worried, go to police.'⁹⁴

14.96 This issue is by no means new. In fact, in its 2004 report on the CLERP 9 Bill, the PJCCFS noted that while the Bill made causing, or threatening to cause, detriment to a whistleblower a contravention of the Corporations Act:

...it does not specify whether ASIC or the company have a role in preventing reprisals from taking place and if they do what action they should take. In other words, it is unclear whether the onus rests solely on the whistleblower who has been subject to unlawful reprisal to defend

90 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 24.

91 Mr Jeffrey Morris, *Submission 421*, p. 28.

92 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 41.

93 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, p. 41.

94 Adele Ferguson, 'ASIC "asleep on the job" over CBA', *Sydney Morning Herald*, 6 August 2013.

his/her interests or whether the agency receiving the report should assume some responsibility for protecting the whistleblower.⁹⁵

14.97 In light of this, the PJCCFS recommended that 'a provision be inserted in the Bill that would allow ASIC to represent the interests of a person alleging to have suffered from an unlawful reprisal'.⁹⁶ However, the PJCCFS's recommendation was not accepted by the government of the day. The government argued that in instances where a company violates the whistleblowing provisions, whistleblowers could pursue compensation under the statute:

Existing section 50 of the ASIC Act already provides ASIC with the ability in certain circumstances to commence civil proceedings in a person's name to recover damages. Where it is in the public interest, this would generally permit ASIC to represent a whistleblower in a claim for damages. However, this provision would not permit ASIC to conduct a criminal prosecution or to represent a whistleblower in an action for reinstatement. The Government considers that an ability for ASIC to represent a person in this sort of action is not necessary.⁹⁷

14.98 Several witnesses suggested this current state of affairs was unacceptable. Professor Brown, for example, argued that ASIC needed the ability to investigate and remedy alleged reprisals regardless of whether the primary alleged wrongdoing is being investigated.⁹⁸ In his appearance before the committee, Professor Brown underlined the importance of this issue:

[T]he crucial question is: whether or when or which Commonwealth regulator, whether it is ASIC or whether it shared, should have a responsibility for being able to, more or less, intervene and seek remedies or take injunctions or step in in the management of and in the fates of individual whistleblowers before it gets any worse. Or if it has already got to the stage of being something which is compensable damage, stepping in to make sure that the action is taken that would lead to that compensation being paid. So the questions are about who should provide the real glue in the system to make protection and/or compensation real. Those are very important questions. Somebody has to do it, otherwise it will not happen.⁹⁹

14.99 Professor Brown subsequently explained that in the absence of an overarching system for protecting all corporate whistleblowers, ASIC should have a responsibility to protect its own whistleblowers. However, he suggested there was ultimately a need to:

95 PJCCFS, *CLERP 9 Bill*, June 2004, p. 27.

96 PJCCFS, *CLERP 9 Bill*, June 2004, p. 28.

97 Government response to PJCCFS CLERP 9 report, March 2005, p. 5.

98 Professor AJ Brown, *Submission 343*, pp. 11–13.

99 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 57.

...think about creating an infrastructure whereby that responsibility can be satisfied more effectively, whether it is by the Fair Work Ombudsman or through the Fair Work system, or more generally, or a separate office that covers whistleblower protection right across all employers, so that ASIC does not have to do it and can retain its core focus on corporate regulation and enforcement of corporate law.¹⁰⁰

14.100 Professor Brown recommended that, consistent with the approach taken in PIDA, the victimisation of whistleblowers in circumstances of deliberately intended detriment should be a criminal offence.¹⁰¹

The need to keep whistleblowers 'in the loop'

14.101 Mr Jeffrey Morris told the committee that one of the frustrations of the CFPL whistleblowers was what he referred to as the 'one-way flow of information'. This was a reference to the lack of information from ASIC about how it was acting on the information provided by the whistleblowers.¹⁰²

14.102 The Blueprint for Free Speech wrote that for whistleblowers, who often risk their jobs and even their long-term careers to reveal wrongdoing, it is very important to know that something is being done about the wrongdoing they have disclosed.¹⁰³

14.103 As noted earlier, ASIC claimed that one of the lessons it has taken from the CFPL matter is that it needs to improve the way it communicates with whistleblowers. According to ASIC, it has already implemented a new approach to how it manages whistleblowers and the information it receives from them (as outlined earlier).

14.104 Dr Brand and Dr Lombard noted that the Corporations Act provides little or no guidance in terms of keeping a whistleblower informed of actions taken in relation to the information they provide. This serves, they argued, to dissuade would-be whistleblowers from making disclosures. By contrast, PIDA outlines how disclosures should be dealt with and imposes a general obligation to investigate disclosures. Further, where a decision is made not to investigate a disclosure, PIDA:

...creates a statutory requirement to inform the whistleblower of the reasons why, and requirements are imposed in relation to the length of any investigation, as well as an obligation to give the whistleblower a copy of the report of the investigation.¹⁰⁴

14.105 When asked about Dr Brand and Dr Lombard's suggestion, ASIC responded that whereas PIDA was directed towards the inherent public interest in the

100 Professor AJ Brown, *Proof Committee Hansard*, 10 April 2014, p. 58.

101 Professor AJ Brown, *Submission 343*, p. 8.

102 Mr Jeffrey Morris, *Proof Committee Hansard* 10 April 2014, p. 43.

103 Blueprint for Free Speech, *Submission 165*, p. 3.

104 Dr Vivienne Brand and Dr Sulette Lombard, *Submission 419*, pp. 2–3.

transparency of public institutions, different considerations may need to be weighed in regard to the private sector. ASIC acknowledged the interest whistleblowers have in how ASIC has acted on the information they have provided, and reiterated that it had updated its approach to communicating with whistleblowers. At the same time, ASIC told the committee that there were limitations on the amount of information it could provide to whistleblowers:

Whistleblowers are not themselves subject to confidentiality obligations, and they may have different or additional motives to those of ASIC. In general, it can be difficult for ASIC to be as open about our investigations as we would like to in all cases, including because this could jeopardise the success of the investigations or future legal proceedings. These factors would all need to be considered in deciding whether to include such requirements in Pt 9.4AAA.¹⁰⁵

Committee view

14.106 The committee believes there is merit in a number of the recommendations for whistleblower reform made by witnesses during the inquiry.

14.107 The weight of evidence received by the committee would suggest that Australia's corporate whistleblower protections should be extended to cover anonymous disclosures. The committee also believes the 'good faith' requirement serves as an unnecessary impediment to whistleblowing, and should be removed from the Corporations Act. The committee received some evidence suggesting that the whistleblower protections should be extended to cover external disclosures to third parties, such as the media, in certain circumstances. On the face of it, this would seem a sensible reform. However, the committee believes that further consideration of the issue is required.

14.108 The committee acknowledges the importance of internal whistleblower systems, and believes that consideration should be given to mechanisms that encourage or require companies to implement such systems. The benefits of any regulatory requirement that companies implement such systems should, however, be weighed against the regulatory burden this might impose on Australian businesses.

14.109 The committee notes that most witnesses who addressed the issue of compensation or rewards for whistleblowers felt that consideration should be given to introducing a reward-based or *qui tam* scheme for corporate whistleblowers. This would represent a fundamental shift in approach to corporate law enforcement in Australia, and the committee is mindful of concerns that such an approach might be considered by some to be inconsistent with Australian culture. Nevertheless, the committee agrees with witnesses that reward-based or *qui tam* systems do seem to improve rates of whistleblowing, and by extension the detection of corporate

105 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 23.

misconduct. As such, these approaches should be given careful consideration as part of a broader review of Australia's corporate whistleblower arrangements.

14.110 Another aspect of the current whistleblower protections in the Corporations Act that concerns the committee is that ASIC does not appear to have a clear role in actually ensuring that the protections are applied. At the same time, the committee is not convinced that ASIC currently has the expertise or resources necessary to act as an effective advocate for whistleblowers. Therefore, the committee believes that, subject to a broader review of Australia's corporate whistleblower arrangements, an 'Office of the Whistleblower' should be established within ASIC. The office could provide a dedicated point for all whistleblowers to contact ASIC, ensuring that specialist staff are managing and protecting whistleblowers. The office could also undertake work to encourage whistleblowers to come forward, and would be advertised in a prominent place on ASIC's website. An Office of the Whistleblower could also help improve ASIC's communication with whistleblowers and ensure that they are kept 'in the loop' regarding any action taken in relation to the matters raised by their disclosures (subject, of course, to ASIC's confidentiality obligations and the need to ensure the appropriate administration of justice). In this sense, the office would help embed and advance the work ASIC has recently undertaken to improve its ongoing communication with whistleblowers.

14.111 Finally, the committee notes Professor Brown's concern regarding the adequacy of penalties that can be imposed if a whistleblower is victimised. While little evidence was received on this point, the committee believes this issue should be considered as part of a broader review of Australia's corporate whistleblower arrangements.

Recommendation 12

14.112 The committee recommends that, consistent with the recommendations made by ASIC, the government develop legislative amendments to:

- **expand the definition of a whistleblower in Part 9.4AAA of the *Corporations Act 2001* to include a company's former employees, financial services providers, accountants and auditors, unpaid workers and business partners;**
- **expand the scope of information protected by the whistleblower protections to cover any misconduct that ASIC may investigate; and**
- **provide that ASIC cannot be required to produce a document revealing a whistleblower's identity unless ordered by a court or tribunal, following certain criteria.**

Recommendation 13

14.113 The committee recommends that an 'Office of the Whistleblower' be established within ASIC.

Recommendation 14

14.114 The committee recommends that the government initiate a review of the adequacy of Australia's current framework for protecting corporate whistleblowers, drawing as appropriate on Treasury's 2009 *Options Paper* on the issue and the subsequent consultation process.

Recommendation 15

14.115 The committee recommends that, subject to the findings of the broader review called for in Recommendation 14, protections for corporate whistleblowers be updated so that they are generally consistent with and complement the protections afforded to public sector whistleblowers under the *Public Interest Disclosure Act 2013*. Specifically, the corporate whistleblower framework should be updated so that:

- anonymous disclosures are protected;
- the requirement that a whistleblower must be acting in 'good faith' in disclosing information is removed, and replaced with a requirement that a disclosure:
 - is based on an honest belief, on reasonable grounds, that the information disclosed shows or tends to show wrongdoing; or
 - shows or tends to show wrongdoing, on an objective test, regardless of what the whistleblower believes;
- remedies available to whistleblowers if they are disadvantaged as a result of making a disclosure are clearly set out in legislation, as are the processes through which a whistleblower might seek such remedy;
- it is a criminal offence to take or threaten to take a reprisal against a person (such as discriminatory treatment, termination of employment or injury) because they have made or propose to make a disclosure; and
- in limited circumstances, protections are extended to cover external disclosures to a third parties, such as the media.

Recommendation 16

14.116 The committee recommends that, as part of the broader review called for in Recommendation 14, the government explore options for reward-based incentives for corporate whistleblowers, including *qui tam* arrangements.

Chapter 15

Early intervention

15.1 In June 2012, ASIC's chairman stated that ASIC 'was very focused on proactive surveillance, by working with the media to call things early, to try and warn consumers and to actually engage with product manufacturers early and say, 'Is this really the right product you want to be selling to the market?'. According to Mr Medcraft, ASIC is 'trying to be proactive not just being, if you want, the ambulance that arrives at the scene of the accident when it occurs'.¹

15.2 Many witnesses to the inquiry were of the view, however, that ASIC does not deal with all the complaints it receives adequately; rather they argued ASIC ignores grassroots warnings of impending collapses and crisis.² The committee has already cited two cases as particular examples of where, without any effective form of early intervention, an emerging problem was allowed to develop causing harm to many retail consumers and investors. In this chapter, the committee's primary focus is on the way in which ASIC receives and investigates complaints and reports of corporate wrongdoing.

Managing complaints and receiving reports of corporate wrongdoing

15.3 As evident in this report so far, a regulator's failure to respond effectively to an emerging problem can result in significant losses incurred by consumers and investors. For example, the committee looked at the poor lending practices that were allowed to continue long after they became evident. Indeed, over a period of eight or so years the accumulation of many individual acts of irresponsible or predatory lending caused great harm to many people. According to the Banking and Finance Consumers Support Association (BFCSA), 'almost all of the consumers affected who are BFCSA members, could have avoided serious loss, had ASIC delivered detailed warnings and simultaneously took criminal action against the promoters'. It stated further that 'in particular ASIC ought to have immediately banned unsafe products'.³

15.4 With regard to the CFPL matter, Mr Frazer McLennan could not understand why ASIC's processes took so long. He stated:

The length of time it took for ASIC to get Commonwealth Financial Planning to a point where it had to admit to wrongdoings was far too long.⁴

1 Mr Greg Medcraft, Chairman, ASIC, *Parliamentary Joint Committee on Corporations and Financial Services Hansard*, Statutory Oversight of the Australian Securities and Investments Commission, 22 June 2012, p. 13.

2 *Submissions 130, 132, 136, 140, 141, 156 and 160.*

3 Banking and Finance Consumers Support Association, *Submission 156*, p. 8.

4 Mr Frazer McLennan, *Submission 127*, p. 1.

15.5 ASIC's slow response meant that many investors suffered significant financial loss as well as emotional distress.

15.6 Unfortunately these two case studies are not isolated. It is important to place the committee's current inquiry in a broader context that takes account of recent corporate failures and subsequent inquiries, which importantly exposed familiar problems. This inquiry is only the latest to demonstrate, and further highlight, areas where ASIC needs to improve. To convey some sense of the problems associated with ASIC's slow response to warning signs, the committee briefly touches on the findings from two recent inquiries.

Liquidators inquiry

15.7 A dominant theme in the committee's 2009 report on liquidators was ASIC's unresponsiveness to the complaints it received about the conduct of some liquidators or administrators. Many submissions noted that their complaint to ASIC about the behaviour of an insolvency practitioner was either put aside, answered months later, or simply recorded on a database with no subsequent action taking place. The committee cited account after account of individuals writing to ASIC just to have, in their view, their concerns brushed away. The lack of regulatory response to the many and persistent complaints about Mr Stuart Ariff was most damning.

Storm Financial

15.8 The 2009 inquiry that examined the collapse of Storm Financial also highlighted ASIC's failure to act early to prevent further losses. Evidence before the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) highlighted the general understanding that ASIC's response was inadequate. During that inquiry, CPA Australia suggested that ASIC's approach to acting on complaints had been too reactive, possibly due to resource constraints:

They really need to toughen up on the proactive, doing things earlier, and if that means more resources...then that is where the energies should be, because at the moment...they seem to come in either after the fact or when they go in early we do not see anything actually happen that changes the course of events that subsequently follows.⁵

15.9 A number of submitters to that inquiry suggested that a ready, willing and able regulator was needed to take the necessary steps to ensure that all the participants in the industry comply with the laws. Some of the observations included:

5 Mr Paul Drum, CPA Australia, *Parliamentary Joint Committee on Corporations and Financial Services Hansard*, Inquiry into Financial Products and Services in Australia, 26 August 2009, p. 68.

- ASIC should strive for a primarily preventive function, through greater monitoring, supervision and enforcement of obligations imposed on AFS licensees and other entities falling within its jurisdiction;⁶ and
- ASIC needs to be able to 'respond pre-emptively'.⁷

Evidence before this committee

15.10 The criticism about ASIC's slow response and its failure to join up the dots is also a recurring theme in submissions to this new inquiry. The submitters who commented on ASIC's tardiness in responding to reports of possible breaches of the law included retail investors, registered ASIC agents, licensed financial planners and liquidators.

15.11 One submitter was of the view that over many decades, ASIC's inaction has seen significant, consistent and ongoing consumer and investor losses through failed entities such as Fin Corp, Westpoint, Rothwells, Tricontinental, Opus Prime, Lift Capital, Bond Corp, HIH, Ansett, One.Tel, Quintex, Basis Capital, Great Southern, Timbercorp, Babcock & Brown and Trio Capital. He was of the view that, had ASIC analysed and understood the real causes of the historical failures of such entities, it could have either attempted to prevent the losses or have at least reduced the quantum of losses to consumers. In his opinion, ASIC could have done so by 'implementing or regulating a system that more readily identifies companies that have a much higher level of risk, having potential "red flag" issue/s and or, failure altogether'.⁸

15.12 As a specific concern, the Institute of Chartered Accountants similarly identified the amount of time that it takes ASIC to act and respond to a complaint or information. It stated that while there was no doubt that ASIC must be thorough in its investigations, questions have been raised about 'why it can sometimes take a number of years to respond to allegations made in the public arena'. The Institute contended that:

In certain cases, a quick and timely response can have the effect of limiting the adverse consequences of any actual market misconduct that relates to the allegations. A timely and effective process of working through such allegations can also send the right signal to others who may have access to information that would be helpful to ASIC achieving the right regulatory outcomes.⁹

6 Q Invest, *Submission 374* to the PJCCFS's Inquiry into Financial Products and Services in Australia, p. ii.

7 Mr John Brogden, Investment and Financial Services Association, *PJCCFS Hansard*, Inquiry into Financial Products and Services in Australia, 28 August 2009, p. 50.

8 Mr Bruce Keenan, *Submission 197*, p. 5.

9 Institute of Chartered Accountants Australia, *Submission 203*, p. 4.

15.13 The Australian Shareholders' Association was concerned about ASIC's complaints management policies and practices, which to the interested or affected party, appear to be reactive and not alert to potential problems. It gained the impression that overseas regulators were able to act more quickly to assess a situation, take action and reach a conclusion compared to Australia where it seemed litigation, or the threat of such, delayed these steps. In its view, actions such as 'withdrawing a product or suspending/banning an individual take too long'.¹⁰ The Consumer Credit Legal Centre (NSW) likewise expressed concerns about the 'very long time' for ASIC to act on a complaint.¹¹ It noted:

Even where consumer advocates are pleased with the ultimate outcome, the void that exists between complaint(s) and outcome is disconcerting at best and downright infuriating where consumer harm is accumulating and industry practice becoming entrenched.¹²

15.14 Mr Brody, Consumer Action Law Centre, also maintained that the time taken between raising an issue and a result was an area of consistent frustration. As an example of delay, the Consumer Action Law Centre cited the very large number of serious complaints about the debt collection firm ACM that it had referred to ASIC from 2008 requesting it to intervene.¹³ The Law Centre explained that it continued to refer complaints to ASIC and, 'growing increasingly frustrated with the lack of response we took the unusual step of criticising ASIC in a 2010 media release'.¹⁴ It noted further that ultimately ASIC commenced proceedings against ACM in May 2011 and secured 'an excellent outcome' in the Federal Court in October 2012. The Law Centre observed, however,

...a great deal of consumer detriment may have been avoided had ASIC responded more quickly—it is notable that the 2011 proceedings concerned conduct by November 2008 and June 2010, and that the court outcome was not achieved until 2012, some four years after the issue was initially identified.¹⁵

15.15 Indeed, the Commonwealth Ombudsman noted that one of the most frequent complaints about ASIC lodged with his office was that the regulator had not investigated and/or taken enforcement action in relation to a report of misconduct or breach of legislation. He explained:

Complainants typically state they have reported to ASIC what they believe to be a significant act of misconduct or breach of legislation by a director, other company official or a company itself. Following receipt of a letter

10 Australian Shareholders' Association, *Submission 151*, p. 2.

11 See also *Submissions 99, 100, 240 and 279*.

12 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 21.

13 Consumer Action Law Centre, *Submission 120*, p. 7.

14 Consumer Action Law Centre, *Submission 120*, pp. 5–6.

15 Consumer Action Law Centre, *Submission 120*, pp. 5–6.

from ASIC responding to the complainant's report of misconduct and advising that it will not investigate, the complainant contacts the Ombudsman because they consider ASIC is not meeting its responsibility as a regulator.¹⁶

15.16 A number of individuals made similar complaints to the committee about ASIC not pursuing reports of serious breaches.¹⁷ In their view, signs were present that clearly warranted ASIC's attention but simply did not register with the regulator. Submitters cited early indications of a company in trouble or company directors engaging in misconduct that went unnoticed. These examples included companies failing to lodge required returns or producing accounts; alterations to a company's registration without a director's knowledge; company name changes and turnover in board members; a history of associated entities in receivership and the issue of a stop order; and non-payment of employee superannuation entitlements.¹⁸

Individual experiences

15.17 Some of the evidence before the committee recounted experiences that have been raised during other parliamentary inquiries. For example, it appeared to Mr Lindsay Johnston, who reported on the activities of Mr Stuart Ariff, that:

...law enforcement agencies and regulators perform no investigation beyond the substance of the initial complaint. In respect of my complaints if the ASC [ASIC's predecessor] had acted and made requests for documentation it would have received at an early stage the documentation that was ultimately brought before the Court. Had the ASC and ASIC performed as a regulator as expected by the community, it is highly likely that by 1999 there would have been some disciplinary action taken against Stuart Ariff and a near certainty that sufficient evidence would have existed to ensure he was never to be admitted to practice as an insolvency practitioner.¹⁹

15.18 Ms Anne Lampe also questioned ASIC's management of complaints. While working at ASIC's media unit, she became aware that ASIC received frequent complaints about 'dodgy and suspect investment schemes as well as lost investments in failed companies'. Ms Lampe found that the complaints were 'dutifully logged and filed'; their recording was methodical; and records well kept. Her concern was that action stalled with the recording and filing of the reports and that 'too many complaints remained buried in the archives'. She explained further:

It was only when the volume of complaints and losses about a particular scam reached tsunami level, or investors with losses contacted a member of

16 Commonwealth Ombudsman, *Submission 188*, p. 6.

17 See for example, Mr Ben Burgess, *Submission 190* and Institute of Chartered Accountants Australia, *Submission 203*.

18 *Submissions 40, 42, 99, 223, 239, 240, 246, 260, 279, 324, 326, 330 and 376*.

19 Mr Lindsay Johnston, *Submission 130*, p. 2.

parliament, or triggered a media inquiry that ASIC seemed to spring into action.²⁰

15.19 She recalled writing articles after Storm's collapse when she learnt first-hand from other financial advisers about the lead-up to the failure. According to Ms Lampe the advisers had known what was happening at Storm and had:

...contacted ASIC well before its demise warning that Storm was over-leveraging elderly clients and had put them in a one-product-suits-all model rather than taking into account investors' individual needs to draw up an appropriate financial plan. The advisors reported that investors were at great risk. One lot of intel came from an internal Storm source.²¹

15.20 In Ms Lampe's opinion, ASIC could have taken on board the warnings and whistleblower complaints and used its power to review client files—a random sample to see 'whether Storm advisors were drawing up appropriate individual financial plans to meet the needs of its clients'. She suggested:

That would have shown whether each investment plan was different, or whether they were all stamped from the same template. Such an inquiry would have shown that there was a sameness and a high risk and alarmingly high borrowing component in each client file. In short it should take whistleblowers seriously, rather than shunning them as troublemakers with an axe to grind.²²

15.21 One person in the financial services industry stated that he knew for a fact that:

...many people in Queensland tried to warn ASIC about Storm but on all occasions these warnings were ignored. A far more pro-active approach by people who understood the true nature and risk of the Storm Financial methodology could, I believe, have saved an awful lot of time, money, anxiety for all concerned.²³

15.22 But there were many other submitters who wrote about their experiences of ASIC's inaction that are completely removed from Storm, Mr Ariff, or CFPL. Furthermore, they are drawn from many sectors of Australia's corporate world. They recounted their own personal experiences of making a complaint or reporting a possible breach of the law, or cited cases where ASIC should have paid attention to early alarm bells. They raised concerns that ASIC ignores or fails to take corrective action on early or advanced warning signs of dubious practices. Dr Peter Brandson referred to distressed victims of banking malpractice 'being fobbed off'—getting the 'run around'. He stated:

20 Ms Anne Lampe, *Submission 106*, p. 2.

21 Ms Anne Lampe, *Submission 106*, p. 3.

22 Ms Anne Lampe, *Submission 106*, pp. 3–4.

23 Mr Robert Bennetts, *Submission 393*, p. 2.

The aim seems to be to let the dissatisfied victim—who has had little help in actually seeing justice done—let off some steam and then be left to pick up the pieces of their shattered life while ASIC neatly files the complaint.²⁴

15.23 For example, some complained about ASIC's apparent indifference to indicators of misconduct by directors or companies in trouble, such as unpaid workers' entitlements or word of mouth intelligence about a company engaging in suspicious conduct.²⁵ One such witness stated that in his particular case, he believed the company was trading while insolvent:

ASIC appear to have ignored complaints made by numerous injured individuals as well as the findings (however preliminary) of professionals such as the company's administrator and latterly its liquidator. This is despite mounting evidence in support of the original complaints made and despite the fact the evidence gathering and investigation of the companies' affairs has been the result of other parties unrelated to ASIC and submitted to them in good faith.²⁶

15.24 In his view, the magnitude of losses could have been mitigated:

...if ASIC had intervened with a more timely investigation and possibly issued an enforcement order requiring company officers to undertake action to protect the interests of the various stakeholders.²⁷

15.25 Mr Peter Leech, another submitter, raised his concerns in the context of phoenix activity where four different individuals on four separate occasions complained about the same company. According to Mr Leech, his original complaint made very clear that 'if the Director as the Proprietor of the company cannot pay GST, PAYG and/or Superannuation obligations, then one could reasonably consider that the Director and the Company could not satisfy Part 1 of Sect 95A'. He stated further:

Given past history, it is foreseeable that the alleged non-compliance will occur again. Numerous employees and creditors have been left without due entitlements. In each complaint and subsequent review after review—ASIC have 'chosen not to proceed' simply asking us, the complainants, to give them more evidence. Yet it is the Commission that has the legislative authority, resources and mandate to pursue such evidence and we, as individuals, are specifically precluded from such data. If ASIC won't investigate—who will?²⁸

15.26 A submitter cited the case of Wellington Capital amending the constitution of the Premium Income Fund but, despite reports to ASIC, the regulator failed to take

24 Dr Peter Brandson, *Submission 232*, p. 7.

25 See for example, *Submissions 40, 94 and 132*.

26 *Submission 326* (Confidential).

27 *Submission 326* (Confidential).

28 Mr Peter Leech, *Submission 132*, p. 1.

action. According to the submitter the amendment was later overturned in the Federal Court but too late to reverse the consequences of the amendment.²⁹

15.27 Another submitter lodged a detailed complaint with ASIC about a renewable energy company but, in his words, 'to no avail'. He noted that the company in question raised approximately \$16 million through prospectuses but did not lodge its required returns for some time. According to the submitter, shareholders were 'certainly not kept informed'. Assets were transferred to a US entity and the submitter believes that the company was deregistered in November 2012. He also referred to a gold exploration listed company. In his view, ASIC chose to ignore the many warning signs in both cases, and 'could and should have done more to protect shareholders and question the discharge of management fiduciary responsibilities'.³⁰

15.28 Mr Roger Cooper related similar experiences with ASIC's slow response to his concerns about a questionable company. He informed the committee that by the time he contacted ASIC for guidance:

Micro Corp had become MCI Technologies Ltd who became Tomato Technologies Ltd who became Asian Pacific Ltd and they had drawn a lot of flak from disgruntled users and eventually in August 2012 they were suspended from the ASX.³¹

15.29 In Mr Cooper's words, with patience he tried 'every avenue possible to try and get some accountability happening'. At that time, Mr Cooper thought the ASX would be interested in the behaviour of Tomato Technologies, which was a listed company, and track its record with Consumer Protection Agencies. His letter to the ASX did not receive 'the dignity of a written reply but merely a wish[y] washy phone call'.³²

15.30 Mr Cooper noted that, at an early stage in December 2000, the *Australian Financial Review* provided a revealing and scathing account of Tomato Technologies Ltd and its modus operandi. The article referred to 'the dubious pedigree and track record of its founder and Board members', which, according to Mr Cooper, raised 'serious questions about the company way back then'. He informed the committee that:

Tomato Tech. remarkably expanded overseas into the UK, Canada and the USA. The UK Financial Services Authority and the UK Office of Fair Trading condemned the company. The BBC consumer TV program Watch Dog twice featured the company as a warning to consumers. How could all this be under the radar of ASIC?³³

29 Name withheld, *Submission 81*.

30 Mr Roger Cooper, *Submission 40*, p. 2.

31 Mr Roger Cooper, *Submission 94*, p. 2.

32 Mr Roger Cooper, *Submission 94*, p. 2.

33 Mr Roger Cooper, *Submission 94*, p. 4.

15.31 In his opinion, ASIC was aware of the fraudulent behaviour of the company he was dealing with and did nothing:

If organisations like ASIC were actually businesses with competitors they would go broke. Micro Corporation/Tomato Tech. Ltd had no institutional investors and even from a layman's vantage point the company structure and behaviour was suspect but apparently under the auspice of ASIC. Corporate Watchdog indeed. They were totally indifferent, disinterested and offered no help to victims whatsoever.³⁴

15.32 He wrote:

The company name changes and the incredible turnover of board members would I thought, attract attention, but no. At what stage do alarm bells go off at ASIC?³⁵

15.33 Yet another case involved LM Investment Management Limited (LMIM), the responsible entity (RE) for various registered and unregistered managed investment schemes, including the LM Managed Performance Fund (MPF). The Advisers' Committee for Investors (ACI) submitted that during the last quarter of 2012 ASIC investigated the MPF due to negative press and gave it a clean bill of health. In 2012, LMIM released MPF accounts, which had been audited in the previous June, showing an MPF asset value of \$377 million with future developed value of MPF's largest asset at \$1.5 billion for Maddison Estate. LMIM went into voluntary liquidation on 19 March 2013.³⁶

15.34 The ACI advised that it became increasingly concerned about the sequence of events that 'failed to protect the interests of investors both on a domestic and international basis'. It questioned 'the structure, organization and fairness of Australia's regulatory system'.³⁷ The investors' group asked that if ASIC had concerns about LMIM in May/June 2012, why did it let it continue to accept millions of dollars from unsuspecting investors without either warning investors or placing conditions on LMIM? It also questioned why ASIC allowed LMIM to continue to accept investor funds when ASIC's enquiries into the RE in 2012 should have revealed that LMIM did not obtain any independent valuations for properties it was purchasing with investor funds. The ACI noted that the 'requirement for independent valuations for the purchase of large assets is a requirement of many major countries in the developed world'. In its view, ASIC's failure to identify this crucial mistake by LMIM 'to obtain independent valuations (not only at purchase but also during the life of that asset) indicates that there are serious questions to be asked of ASIC by this inquiry'.³⁸ According to the ACI:

34 Mr Roger Cooper, *Submission 94*, p. 4.

35 Mr Roger Cooper, *Submission 94*, p. 4.

36 Advisers' Committee for Investors, *Submission 170*, p. 5.

37 Advisers' Committee for Investors, *Submission 170*, p. 1.

38 Advisers' Committee for Investors, *Submission 170*, p. 6.

...the reports to creditors issued by the voluntary administrators of LMIM (as early as April 2013) provide details of unpaid and undocumented loans from LMIM to Drake and his related entities and possible breaches of duty and other offences under the *Corporations Act 2001* (Cth). These facts reported on by the voluntary administrators were clear grounds for an earlier intervention by the regulator.³⁹

15.35 The ACI is concerned that by failing to act swiftly and decisively, ASIC has allowed further damage to occur to investors.⁴⁰ It argued that where breaches of the Corporations Act are identified, ASIC should 'act quickly to take steps to ensure those breaches are dealt with in a timely manner'. The ACI informed the committee that:

There are approximately 10,000 LMIM investors, worldwide, and 4,500 in the MPF alone including home based and expatriate Australians. These investors, some of whom will have no ability to recover from such a devastating loss, stand to lose a significant part if not all of their investment in the funds of this Australian company which is now in liquidation. Many of these investors will lose their life savings.

Although the ACI approached ASIC some months ago urging quick action, ASIC only took formal steps in the Federal Court to freeze the assets of the main director Mr Drake in September 2013 some 6 months after the company was placed into voluntary administration. Given that assets such as cash may be transferred quickly, why did the regulator in such a large corporate failure (one of the largest in Australia after the HIH collapse) fail to act immediately to obtain freezing orders of LMIM, Mr Drake and other related entities to ensure the status quo at that time was maintained and value preserved for investors?⁴¹

15.36 According to the ACI, ASIC's failure to take substantial, early steps to deal decisively with the causes and results of this corporate collapse contrast starkly with the quick action and early prosecutions after the Bernie Madoff scandal broke in the United States.⁴²

15.37 Another group of concerned investors, the Association of ARP Unitholders Inc, reminded the committee that:

It was the actions of an alert Industry participant who forced ASIC to take action in the Trio matter, yet any number of opportunities existed starting with the licensing of executives of Trio through to the failure to follow up serious valuation questions in conjunction with APRA.⁴³

39 Advisers' Committee for Investors, *Submission 170*, p. 6.

40 Advisers' Committee for Investors, *Submission 170*, p. 6.

41 Advisers' Committee for Investors, *Submission 170*, p. 7.

42 Advisers' Committee for Investors, *Submission 170*, p. 7.

43 Association of ARP Unitholders Inc, *Submission 173*, p. 1.

15.38 The committee received many other complaints that are too numerous to detail here about ASIC's supposedly inadequate response to complaints or reports of corporate misconduct. Some additional cases include a report from a compliance officer and internal auditor about an accounting practice providing a 'one shop' service including finance, taxation and financial planning advice. According to the submitter, ASIC took no action which has resulted in mounting client investor losses to a level of \$10 million to \$15 million.⁴⁴ The committee also received a confidential submission dealing with an agricultural managed investment scheme and the alleged misuse of funds. In this case, the liquidator reported the misuse of funds raised for the scheme to ASIC, alleging that funds had been used to 'prop up' previous projects operated by the responsible entity, which had significant cash flow problems. The submitter informed the committee that they had never been contacted by anyone at ASIC in relation to his complaint, 'apart from a boilerplate response, nor have I heard about any action against the directors of the company'.⁴⁵

Reports from industry professionals

15.39 Importantly, some of the people making reports or expressing concerns to ASIC come from people within the industry, such as registered ASIC agents and financial planners.

15.40 Mr David Pemberton, a CPA who holds a public practicing certificate and whose firm is a registered ASIC agent, wrote to ASIC on 5 June 2009 on his company letterhead. He drew to ASIC's attention his misgivings about the activities of a person with a history of failed enterprises who, in his view, should be investigated for insolvent trading under the Corporations Act. Mr Pemberton informed the committee that:

ASIC's bland & generic response of 6 July 2009 was the second and last contact I received from ASIC in this matter.⁴⁶

15.41 He believed that any complaint from a professional should have caused ASIC to investigate. He explained:

This complaint was very deliberately made to ASIC at its highest level because of the known issues of ASIC incompetence. ASIC Darwin has a sizeable office less than three kilometres from my office in Darwin. What is the price of a local call or for that matter an STD call?⁴⁷

44 Burke Bond Financial Pty Ltd, *Submission 98*, p. 2.

45 *Submission 100* (Confidential).

46 Mr David Pemberton, *Submission 279*, p. 3.

47 Mr David Pemberton, *Submission 279*, p. 3.

15.42 Mr Pemberton advised the committee that many professionals shared his views on ASIC and 'have ceased reporting suspect activity due to ASIC's chronic incompetence and inaction'.⁴⁸ In his view:

ASIC needs to be a Kelpie as opposed to being a Bassett Hound. It's about being proactive and fearless in directing the flock. It's about knowing when to be quiet, alert and watchful; knowing when to work out wide or get in close and knowing when to run, bark and if necessary bite.⁴⁹

15.43 One experienced financial planner, Mr Ben Burgess, took a complaint to ASIC on behalf of his client that involved an allegation that a bank had misled and coerced his client into 'investing into various high risk investments, despite requesting a much lower risk term deposit'. ASIC was provided with a complete copy of the client file as well as supporting documentation and calculations. He explained:

Six months later I had to call ASIC myself to find out what progress had been made, only to be told 'I'm sorry but ASIC does not handle individual complaints but only systemic problems'.

To date there has been no progress toward resolution of this case despite the vast amount of time; effort and expense incurred by the clients and I in fighting for this complaint and doing a large part of the work that ASIC itself should have done.⁵⁰

15.44 Mr Burgess concluded that ASIC failed 'in a most basic way by not even bothering to keep me or my clients informed'.⁵¹

15.45 An area of particular note, however, involved professionals that are required under statute to make reports of possible wrongdoing. These statutory reports are a valuable source of 'front line' information about possible breaches of the corporation legislation.⁵² Some such submitters commented on ASIC's tardiness in responding to reports of possible breaches of the law, including reports from auditors and liquidators.

Auditors

15.46 Under the Corporations Act, auditors are required to notify ASIC in writing of circumstances that they suspect, on reasonable grounds, amount to a contravention of the Act. They are also required, inter alia, to report circumstances that amount to an attempt by any person to unduly influence, coerce, manipulate or mislead a person

48 Mr David Pemberton, *Submission 279*, p. 3.

49 Mr David Pemberton, *Submission 279*, p. 6.

50 Mr Ben Burgess, *Submission 190*, p. 2.

51 Mr Ben Burgess, *Submission 190*, p. 1.

52 See for example, The Auditor-General, *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001*, Audit Report No. 18 of 2006–07, pp. 13–14.

involved in an audit. The same conditions apply to lead auditors for an audit of a compliance plan. BDO Australia explained further:

Under s311 and 601HG of the Corporations Act, an auditor is obligated to report to ASIC matters that they have reasonable grounds to suspect amount to a significant contravention of the Corporations Act or, in the case of matters that are not a significant contravention, the auditor believes that the matter will not be adequately dealt with.

An auditor who fails to comply with s311, 601HG or 990K (as applicable) is guilty of an offence.⁵³

15.47 BDO Australia referred to a section 311 report it produced in 2007. It stated that 'despite the extensive amount of work and costs involved in conducting the investigation, there would appear to have been no action taken by ASIC to investigate the matter' and that 'neither the audit partner who submitted the section 311 report nor any of the relevant parties have received any communication from ASIC in relation to the matter'. BDO was concerned, however, about one particular report, where the investigation involved an extensive amount of work and costs, but ASIC appeared to have taken no action.⁵⁴ This apparent lack of action, posed a number of questions for the auditor:

- Was the matter ever investigated by ASIC?
- If the matter was investigated, why were the parties who had the most knowledge of the alleged breaches of the Corporations Act not contacted by ASIC?
- If the matter was investigated, then why was there no communication to the audit partner that the matter had been investigated and finalised?

15.48 BDO Australia was of the view that, as a minimum, the whole process indicated a deficiency in communication to the underlying parties involved. Further, the audit partner questioned the ability of ASIC to assist registered company auditors to 'fulfil their supervisory roles and reporting responsibilities under existing legislation'. BDO surmised that:

If no action is taken when reported breaches are identified, auditors should not be burdened with the responsibility and cost of complying with sections of the legislation which are not going to be enforced.⁵⁵

15.49 In this regard, not only is ASIC failing to provide a good example for its gatekeepers but there is the potential to undermine confidence in the reporting system and act as a disincentive for reporting suspected corporate wrongdoing.

53 BDO Australia, *Submission 163*, p. 1.

54 BDO Australia, *Submission 163*, p. 1.

55 BDO Australia, *Submission 163*, p. 2.

15.50 A number of auditors shared this concern about ASIC's response to statutory reports of suspected breaches. For example, one auditor submitted that 'as an auditor, we were required to lodge the s.311 notice within 28 days of finding a breach yet there is no timeframe imposed on ASIC for at least appearing like they are doing something about it'. In confidence, the auditor informed the committee that her firm lodged a section 311 notice with ASIC in relation to one of its audit clients. In a letter to ASIC, the auditor reported the client's reluctance to assist in the conduct of the audit and resistance to providing information pertinent to the audit. The letter also noted instances of the client providing false and misleading information to the auditor and the possibility of fraud and misappropriation.⁵⁶

15.51 The firm issued a qualified disclaimer opinion for the year ended 2011 for the client. The client did not send the firm's opinion to ASIC with their Form 388 but instead had their solicitor, who was also an auditor, issue an unqualified opinion for the 2011 year. According to the submitter this 'was accepted by ASIC even though we were still the listed registered auditors for this client (which is a company limited by guarantee) for the 2011 year'. The submitter argued that ASIC allowed the client to 'opinion shop' and for someone who was not independent to issue an opinion. Moreover, the submitter informed the committee that this solicitor/auditor had already been accused of fraud by ASIC on another matter and yet ASIC allowed the client to utilise them.⁵⁷

15.52 The audit firm has had no response from ASIC regarding the status of its section 311 letter. In its view, it appears that this client has been able to get away with providing false and misleading information to the auditors, not assisting the auditor in its enquiries, falsifying information and lodging an unqualified opinion to ASIC from an auditor who was not the appointed auditor for the 2011 year.⁵⁸

15.53 Mr Peter Murray, a fellow of the Institute of Chartered Accountants, asked why ASIC's response to reported breaches was so bad. Like others, he questioned why there are rules and regulations if they are not enforced. According to Mr Murray, ASIC noted that it received 10,752 complaints, resolved 57 per cent of these and referred six per cent for formal investigation or surveillance. Further, ASIC has informed him that every complaint was 'registered on ASIC's confidential database, acknowledged, formally assessed and personally responded to'. ASIC notified him that it:

...encourages Institute members to continue to report alleged corporate misconduct, within ASIC's jurisdiction, to us. At the very least, your information will assist us in continuing to develop a significant intelligence tool which is used, for example, as part of our campaign and surveillance

56 *Submission 328* (Confidential).

57 *Submission 328* (Confidential).

58 *Submission 328* (Confidential).

targeting, licence and professional registration approval process and in the selection of subjects for formal investigation.⁵⁹

15.54 Mr Murray suggested that ASIC should 'classify the importance of allegations lodged with it (eg A, B, C, D) and, at a minimum, interview the submitting parties and the claims they make—before responding in a negative fashion'.⁶⁰

External administrators

15.55 The Corporations Act also places an obligation on liquidators, receivers and voluntary administrators (external administrators) to report suspected breaches of the Corporations Act to ASIC. For example, sections 422, 438D and 533 of the Corporations Act require external administrators to report to ASIC on the activities of past and present company officers or members that involve, inter alia:

- suspected breaches of the Corporations Act;
- misapplication or retention of funds; and
- any negligence, default, breach of duty or breach of trust.⁶¹

15.56 Reports made pursuant to these sections are referred to as statutory reports and are an important source of information about possible breaches of the law. Section 533 applies to liquidators who must lodge a report as soon as practicable and in any event, within six months from the time it appears to the liquidator that:

- (a) a past or present officer or employee, or a member or contributory, of the company may have been guilty of an offence under a law of the Commonwealth or a State or Territory in relation to the company; or
- (b) a person who has taken part in the formation, promotion, administration, management or winding up of the company:
 - (i) may have misapplied or retained, or may have become liable or accountable for, any money or property of the company; or
 - (ii) may have been guilty of any negligence, default, breach of duty or breach of trust in relation to the company; or
- (c) the company may be unable to pay its unsecured creditors more than 50 cents in the dollar.

15.57 Liquidators also have the discretion to lodge further reports if, in their opinion, it is desirable to draw the matter to ASIC's attention.⁶²

59 Mr Peter Murray, *Submission 164*, p. 11.

60 Mr Peter Murray, *Submission 164*, p. 5.

61 Section 533 (for liquidators); section 422 (for receivers); and section 438D (for voluntary administrators). See ASIC, *Insolvency statistics: External administrators' reports (July 2012 to June 2013)*, Report 372, October 2013, paragraph 4.

62 *Corporations Act 2001*, section 533(2).

15.58 In 2012–13, external administrators lodged 9,788 reports with ASIC. Of this number, initial external administrators accounted for 95 per cent or 9,254 reports. ASIC recorded that 81 per cent of the initial reports involved companies with fewer than 20 employees. The construction industry was subject to the highest number of reports accounting for just over 24 per cent. Of the initial external administrators' reports, receivers lodged one per cent under section 422; administrators lodged 3.8 per cent under section 438D; and 95 per cent of the reports were submitted by liquidators under section 533.⁶³

15.59 Importantly, external administrators alleged misconduct in more than two-thirds of reports (6,761) involving an overall possible 16,562 breaches. Although this number accounts for an average of between two and three breaches per report, almost 30 per cent of reports or 2,493 recorded no misconduct.⁶⁴ ASIC asked the external administrator to prepare a supplementary section 422, section 438D or section 533 report for 677 of the 6,761 reports that identified possible misconduct.⁶⁵ In its analysis of the statistics, ASIC explained that its request for an additional report is a function of its assessment of risk based on a number of factors, including, but not limited to:

- the nature of the possible misconduct reported;
- the amount of liabilities;
- the deficiency suffered;
- the availability of evidence;
- prior misconduct; and
- the advice of the external administrator that the reported possible misconduct warranted further investigation.⁶⁶

15.60 In a 2007 report, the Australian National Audit Office (ANAO) observed that given the large number of statutory reports received by ASIC each year that allege offences against the Corporations Act, it was appropriate that ASIC had systems in place to prioritise its regulatory action, through risk scoring. It found that ASIC's recording of statutory report information was accurate to a high degree.⁶⁷ The ANAO recognised that ASIC could use a wide variety of possible remedies to deal with offences identified in statutory reports or other deficiencies that warranted some sort of regulatory action. They ranged from warning letters to directors for the less serious

63 ASIC, *Insolvency statistics: External administrators' reports (July 2012 to June 2013)*, Report 372, October 2013, paragraph 32.

64 ASIC, *Insolvency Statistics*, Report 372, October 2013, paragraph 40.

65 ASIC, *Insolvency Statistics*, Report 372, October 2013, paragraph 41.

66 ASIC, *Insolvency Statistics*, Report 372, October 2013, paragraph 41.

67 The Auditor-General, *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001*, Audit Report No. 18, 2006–07, Australian National Audit Office, 2007, paragraph 23.

offences to prosecution and potentially imprisonment for more serious offences. It noted that where ASIC identified that a statutory report raised issues of regulatory significance, it sought further information about the matter from the external administrator.⁶⁸

15.61 According to the ANAO report, ASIC did not always obtain that additional information. Based on its sample, it found that in 40 per cent of instances, ASIC did not obtain additional information that it had requested.⁶⁹ The ANAO concluded:

...the small number of statutory reports subject to regulatory action by ASIC each year indicates that there is opportunity for greater regulatory action on these reports.⁷⁰

15.62 Mr David Lombe, President of the Australian Restructuring Insolvency and Turnaround Association (ARITA) was of the view that ANAO's 2007 findings were still relevant and applicable.⁷¹ He noted the thousands of reports lodged with ASIC each year but not acted upon. In Mr Lombe's view, there was a 'general perception within the business community that, if you do certain things at a certain level, there will be no effective review'.⁷² He explained further:

The difficulty that we have as official liquidators is that you get a matter off the court list and often that matter has no funds in it, so there are no available assets. Often that is a process by which directors have deliberately done that—it has been a deliberate course of action. If you report the matter to ASIC and there is no assistance from that space, there is not much you can do. If you felt really aggrieved by it or you felt that it was a matter that was of sufficient importance, you may be able to persuade a firm of solicitors to act on a pro bono basis, but that is very difficult. I found myself in that sort of situation with Babcock & Brown, where I had inadequate funds to be able to pursue a proper investigation. The only thing that was available to me was to ask creditors to fund me, which they did, which then allowed me to do a public examination, which brought out the conduct of directors and other stakeholders in that company. If you do not have funds in a matter, the courses are very limited.⁷³

15.63 By way of example, Mr Lombe expanded on his concerns citing the requirement to lodge a section 533 report, which deals with offences committed by directors. He explained that for the liquidator to understand what has happened, he or she needs to 'review the books and records, determine the transactions, try to find out

68 The Auditor-General, Audit Report No. 18, 2006–07, paragraph 24.

69 The Auditor-General, Audit Report No. 18, 2006–07, paragraph 24.

70 The Auditor-General, Audit Report No. 18, 2006–07, paragraph 26.

71 Mr David Lombe, President, Australian Restructuring Insolvency and Turnaround Association, *Proof Committee Hansard*, 2 April 2014, p. 35.

72 Mr David Lombe, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 30.

73 Mr David Lombe, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 31.

what assets are there, look at insolvent trading and look at preference payments and all those sorts of things'. The liquidator is required to file that report, which takes time. So, according to Mr Lombe, the reports involve both time and money, and often with official liquidations there are no assets at all and, if there are, creditors are effectively paying for the report. He noted that thousands of such reports are lodged with ASIC but most of them come back 'no further action'. In his view, it is frustrating for liquidators because they feel, 'Why am I bothering to do it?' Mr Lombe concluded that 'you can understand someone's frustration, where they have reported offences and nothing happens'.⁷⁴

15.64 When asked whether liquidators, in their statutory reports, could assist ASIC to distinguish the very serious breaches from the less so, ARITA indicated that it 'might be a useful reform'. After considering the matter further, ARITA informed the committee that if it were consulted, it could assist ASIC to determine a risk scoring profile. It explained further, however:

But we consider that the decision on how the information required by s533 is 'risk-scored' for action is ultimately one for the regulator and its decision and methods should not be publicly disclosed. For one thing, this would appear to give the 'green light' to the commission of certain offences that are deemed not serious enough to warrant action by ASIC.⁷⁵

15.65 ARITA also stated that 'a more co-operative approach between ASIC and liquidators should also be pursued'. The committee believes that ASIC and ARITA should work closely together to develop a more effective and efficient reporting mechanism that would assist ASIC to identify the alleged serious breaches from the less so.⁷⁶

Recommendation 17

15.66 The committee recommends that ASIC, in collaboration with the Australian Restructuring Insolvency and Turnaround Association and accounting bodies, develop a self-rating system, or similar mechanism, for statutory reports lodged by insolvency practitioners and auditors under the *Corporations Act 2001* to assist ASIC identify reports that require the most urgent attention and investigation.

15.67 Clearly, many people who lodge complaints and reports of suspected corporate wrongdoing with ASIC, including Australia's key gatekeepers, are dissatisfied with ASIC's response. ASIC has left many with the clear impression that the regulator is unresponsive and indifferent to their concerns. In the following chapter, the committee considers the likely reasons for this delay or inaction.

74 Mr David Lombe, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 34.

75 ARITA, *Submission 202.1*, p. 2.

76 ARITA, *Submission 202.1*, p. 2.

Chapter 16

ASIC's response to reports or other indications of wrongdoing

16.1 Many submitters recalled their own personal experience of making a complaint or reporting a possible breach of the law to ASIC, or cited cases where ASIC should have paid attention to early indications of brewing trouble. They raised concerns that ASIC ignores or fails to take corrective action on emerging trends involving possible unscrupulous practices or corporate misconduct. The sources of such complaints were various and included: consumers or investors registering complaints with ASIC; operators within the financial services industry such as financial advisers alerting ASIC to poor behaviour or unsafe products; accountants and auditors filing statutory reports of suspected wrongdoing or misleading or inaccurate information; and liquidators identifying problems with the management of a company or conduct of directors. A number of whistleblowers also highlighted their concerns about ASIC failing to act effectively on their reports of possible corporate wrongdoing. In addition, ASIC has its own surveillance and detection programs designed to detect problems in the financial services industry.

16.2 In this chapter, the committee considers some of the reasons behind the many complaints about ASIC's inadequate response to complaints or reports of corporate wrongdoing.

Power to investigate

16.3 One of ASIC's broad powers is to investigate corporate wrongdoing, or as the Governance Institute of Australia put it, 'the forensic gathering of evidence in respect of suspect breaches of the law'.¹ The Rule of Law Institute of Australia referred to ASIC's wide range of powers to investigate, examine persons, inspect books, require disclosure of information, require persons to comply with an examination order, and tap telephones for suspected serious offences.²

Adequacy of ASIC's investigative powers

16.4 Regarding its responsiveness to early warnings of market problems, unsafe products or unscrupulous advisers, ASIC informed the committee that it works proactively to identify potential market problems in a number of ways, including:

- gathering and using industry intelligence;

1 Governance Institute of Australia, *Submission 137*.

2 *Submission 211*. ASIC's investigation powers are listed in Chapter 3.

- considering every complaint made to ASIC to identify issues it needs to act on;
- using formal sources of intelligence to detect individual misconduct and trends; and
- conducting surveillance and proactive sectoral health checks.³

16.5 Section 13 of the ASIC Act confers general powers of investigation, allowing ASIC to 'make such investigation as it thinks expedient'. The investigative powers under section 13 are triggered when there is suspicion of a contravention of the corporations legislation, or of a law relevant to the management or affairs of a company or involving fraud or dishonesty. While section 15 allows ASIC to investigate suspected breaches of the corporations legislation after receiving reports from receivers and liquidators, the provision does not compel it to do so. There is no statutory obligation on ASIC to investigate, or to take action following those investigations.⁴

16.6 The Rule of Law Institute of Australia was of the view that ASIC's investigative powers were 'more than adequate' and there could be 'no excuse of lack of powers'.⁵ In its view:

The problem is not a lack of power by ASIC. The various pieces of legislation empower ASIC, yet it is the failure to exercise them properly that has given rise to the issues the subject of the Inquiry.⁶

16.7 Indeed, no one seriously suggested that legislative impediments prevented ASIC from performing its investigative functions adequately.

ASIC's complaints management process

16.8 Mr Greg Tanzer, a commissioner at ASIC, explained that ASIC receives information from a number of sources, including a member of the public lodging a complaint or concern and ASIC's own intelligence. He explained that ASIC assesses and records the report and makes 'sure that we track everything that comes into the place'.⁷ The Misconduct and Breach Reporting team, currently headed by Mr Warren Day, is responsible for recording and assessing every report.⁸ Each case is assessed on its merits following a process whereby:

3 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 2.

4 Helen Anderson, 'Corporate insolvency and the protection of lost employee entitlements: issues in enforcement', *Australian Journal of Labour Law*, 26:1 (2013): 82.

5 Rule of Law Institute of Australia, *Submission 211*, p. 3.

6 Rule of Law Institute of Australia, *Submission 211*, p. 4.

7 *Proof Committee Hansard*, 20 February 2014, p. 38.

8 *Submission 45.2*, p. 89. It is a national team that has 90 full-time equivalent staff from a diverse range of backgrounds, including law, arts, accounting, economics, mathematics and business.

It goes through an initial assessment by a specialist. There are triage arrangements for something that obviously appears to be very significant or very urgent. For certain types of market matters we have a standing triage arrangement where it just gets referred straight from Mr Day's team through to one of the specialist teams. A specialist team will look at that and any other complaint that has been through Mr Day's team and reaches, if you like, a reasonable threshold.⁹

16.9 According to Mr Tanzer, ASIC has a dedicated team that considers 'particular small cases', so some resources are quarantined to manage those matters.¹⁰ He explained that ASIC was making much greater use of this triage approach 'to try to focus on the most important matters, allocate resources to them and try to move them along'.¹¹

16.10 Clearly, under the leadership of its commissioners, ASIC recognises the importance of being proactive. ASIC's triage system for managing complaints also seems to be a sensible and correct approach. Yet as the previous chapter highlighted, ASIC is perceived by many retail investors and professional bodies closely associated with the financial services industry as being reactive rather than proactive. The committee now considers the possible reasons for ASIC's slow response.

Volume of misconduct reports

16.11 ASIC maintained that it takes reports of misconduct seriously and assesses each report of misconduct it receives.¹² It highlighted the large number of reports of misconduct that are made, which range from failure to lodge a form to serious criminality. ASIC stated that it was:

...not possible or appropriate for ASIC to launch an investigation into the significant majority of reports we receive. We endeavour at all times to resolve matters, or assist the public in other ways that are often more appropriate and timely compared to an investigation.¹³

16.12 A number of submitters also noted the large volume of reports and complaints lodged with ASIC. They were of the view that the regulator does not have the resources to investigate the thousands of complaints submitted to it every year. For example, as cited in Chapter 5, the Consumer Credit Legal Centre (CCLC) stated that:

9 *Proof Committee Hansard*, 20 February 2014, p. 38.

10 *Proof Committee Hansard*, 20 February 2014, p. 38.

11 *Proof Committee Hansard*, 19 February 2014, p. 40.

12 A number of submitters provided correspondence from ASIC as attachments to their submission, which contain an explanation of section 13 of the ASIC Act and ASIC's discretion in determining whether further enquiries or investigations are warranted.

13 ASIC, *Submission 45.2*, p. 87.

ASIC cannot be expected to resolve each individual consumer dispute, nor would it be in the public interest. ASIC should carefully consider how to respond to all potential breaches of the law, but should not necessarily undertake a formal investigation of every individual complaint that comes to its attention.¹⁴

16.13 The Association of Financial Advisers also noted that ASIC receives a steady flow of relevant and meaningful information from industry and consumers that ASIC can then readily act upon. In its view, the complication is ASIC most likely receives a huge volume of disparate data that is more complex to compile and analyse. As noted earlier, reports of possible misconduct come from many and various sources—in 2012–13, ASIC received and assessed 11,682 reports of misconduct. It also received and assessed 6,985 statutory reports (from auditors and liquidators alleging suspicious activity) and 900 breach reports that related to managed investment schemes and AFS licensees.¹⁵

16.14 The committee understands the very large number of reports and complaints ASIC receives and appreciates that ASIC cannot act on every one.

Due process

16.15 Mrs Karen Cox, CCLC, acknowledged that the amount of time ASIC takes to act on a matter could cause a lot of consumer harm. Even so, she stated:

...the current regulatory options available do not give a lot of scope for doing anything other than following the usual process of investigation, gathering evidence and then finally taking action.¹⁶

16.16 The Consumer Action Law Centre recognised that:

It is difficult from the outside to know about internal ASIC processes and how those things are progressed, but when matters are identified by the stakeholder teams we deal with, there can be some time between that and any sort of enforcement action. Of course, they have to go through appropriate investigations, and that may well be the reason for the delay, but understanding that would be helpful.¹⁷

16.17 Indeed, a lack of understanding of ASIC's processes, legal obligations and unrealistic expectations could likely explain what appears to some as ASIC inaction. For example, the need to remain silent on investigations is a major consideration for ASIC. In this regard, the Consumer Action Law Centre understood that ASIC must comply with the confidentiality provisions in section 127 of the ASIC Act, which are

14 *Submission 194*, p. 16.

15 *Submission 45*, p. 87.

16 Mrs Karen Cox, Coordinator, CCLC, *Proof Committee Hansard*, 20 February 2014, p. 40.

17 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 41.

'stricter in comparison to other consumer regulators such as the ACCC'. Nonetheless, it noted:

While confidential investigations are necessary for procedural fairness, confidentiality must be balanced with the public interest resulting from the public and consumers being confident that the regulator is responsive to complaints.¹⁸

16.18 The Governance Institute of Australia also referred to the confidentiality obligations placed on ASIC when conducting an investigation. In its view, this requirement may preclude 'public understanding of actions ASIC could be undertaking in relation to possible breaches by individuals and companies of duties and responsibilities'. It stated further:

ASIC is often viewed as acting tentatively in investigating and enforcing matters, yet under its legislative framework, ASIC will neither confirm nor deny that an investigation is underway unless it is in the public interest to do so. Confidentiality of surveillance and investigation is central to preserving the integrity of the market, but it results in external public parties being unable to objectively evaluate ASIC's actions.¹⁹

16.19 The Governance Institute noted the great deal of remedial action that occurs outside the public view.²⁰

16.20 The Law Council of Australia also cited the various comments or complaints from time to time about ASIC's approach to providing information about ongoing investigations. It referred to ASIC's Information Sheet 152, which outlines the regulator's position on making public comment. In that publication, ASIC's makes it clear that, in essence, ASIC's 'investigations should remain confidential unless the public interest requires some form of disclosure'. The Law Council pointed out that ASIC's usual practice is, therefore, 'not to make public comment about ongoing or potential investigations'. In its view:

ASIC's approach in this regard is undoubtedly the correct one in principle as a matter of policy and, for the most part, the correct one in practice. It would be, in the view of the Corporations Committee, quite inappropriate for a regulator of any kind to seek to use the mere fact of an investigation (when by definition no factual findings had been made and no decision had been taken to commence enforcement action) to achieve a broader regulatory outcome.

Moreover, the publication of mere allegations (that may or may not be ultimately proven) can be oppressive towards the individuals involved and damaging even if the allegations are not proven.²¹

18 Consumer Action Law Centre, *Submission 120*, p. 5.

19 Governance Institute of Australia, *Submission 137*, p. 4.

20 Governance Institute of Australia, *Submission 137*, p. 4.

16.21 Even so, the Law Council noted that, as a rule, it was true that ASIC 'should keep complainants informed of the progress of matters in respect of which a complaint has been made'.²²

Clarity in law

16.22 Ms Robbie Campo, Industry Super Australia, thought that the reason in part for systemic risks not being properly or adequately dealt with over the last few years was related to 'the fact that the problematic conduct is legal'. She explained:

The work that has been done more recently in terms of surveying the industry and understanding business models and drivers of conduct has meant that, particularly in relation to advice and super funds engagement with consumers, a much better job is being done. I think the key issue in past years is that it is hard for ASIC to engage in terms of systemic risk when the matters that are of most concern are actually allowed by the legal framework.²³

16.23 Mr David Haynes, Australian Institute of Superannuation Trustees, agreed that ASIC sometimes spends 'a disproportionate amount of time trying to work out whether particular behaviours are in fact proper and appropriate and requiring of investigation'.²⁴ He gave the following example of the promotion of low-fee and no-fee products, which, in his view were neither:

But ASIC seems to take a long time to actually come to a view about whether the manufacturers of those products are in fact operating appropriately within the regulatory framework or not. We say that there is, unfortunately, the opportunity for a lot of those products to be misrepresented for an extended period of time before there is any regulatory intervention.²⁵

16.24 Mr Haynes elaborated on his reasoning:

...it is more a matter of ASIC having some difficulties in understanding whether or not the claims of particular products are inside or outside of the law. They operate sometimes in a grey area. If people make money through buy-sell spreads or through money being invested in related companies

21 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 5.

22 *Submission 150*, p. 5.

23 Ms Robbie Campo, Deputy Chief Executive, Industry Super Australia, *Proof Committee Hansard*, 20 February 2014, p. 34.

24 Mr David Haynes, Executive Manager, Policy and Research, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 20 February 2014, p. 34.

25 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 20 February 2014, p. 34

where heavy fees are being paid, it is sometimes unclear whether those activities are outside of the law or not.²⁶

16.25 In his view, such products should clearly come under the law. He noted that 'there is then a policy question about whether the government needs to provide more clarity which would then assist ASIC in its enforcement'.²⁷

ASIC's investigative capabilities

16.26 Allowing for factors such as the volume of complaints ASIC needs to manage, many submitters still maintained that critical information escapes ASIC's attention. They argued that ASIC seems incapable of discerning from its databases the emergence of a potentially significant systemic or serious issue. A number of submitters argued that even when ASIC does take action, it is too late and the damage has already occurred.

Culture of receptiveness

16.27 Mr Lee White, the chief executive officer of the Institute of Chartered Accountants, noted that much of the work ASIC is undertaking to improve its ability to act effectively on complaints or reports of corporate wrongdoing was 'all around the mechanics and particularly the legal processes'. He understood that ASIC receives a lot of information from different sources but 'they are not joining up the dots as quickly as they should'.²⁸ Mr Alex Malley, chief executive officer of CPA Australia, agreed with this assessment suggesting further that:

...what is probably missing at the moment is there is not a sense that there is enough of that 'on the street'—having lived in business long enough—to know what a big issue is from a small issue; what a one-off issue is from a systemic issue.²⁹

16.28 Mr David Pemberton, a CPA who holds a public practicing certificate, argued ASIC needs to change its culture—not change its name or receive a bigger budget. In his words:

ASIC needs strong, active leadership. ASIC needs to credibly reconnect with professionals who are its best early warning system for the identification of domestic threats to Australia's economy.³⁰

26 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 20 February 2014, p. 34.

27 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 20 February 2014, p. 34.

28 Mr Lee White, Chief Executive Officer, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 47.

29 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 49.

30 Mr David Pemberton, *Submission 279*, p. 6.

16.29 Clearly, an important aspect of ASIC's investigatory function is simply being able to pick up on disquiet in the business world. Mr Justin Brand, who has experience in compliance and the operations management side of the financial advice business, also underscored importance of ASIC being receptive to the messages coming from the professional bodies. He stated:

ASIC often fail to recognise common interests and fail to engage effectively with licensees and advisers. The open engagement offered by ASIC seems to have traditionally been a lecture with a reluctance to tolerate dissent. On occasions, they don't even pretend to listen. In some circumstances, openness is inappropriate but care should be taken to ensure engagements are not exercises in antagonism and condescension.³¹

16.30 In respect of his particular case, Mr Peter Burgess, an experienced financial planner, attributed ASIC's failures to act and to keep him and his client apprised of its response:

...to a cultural lack of empathy and understanding as to what effect they can have to protect peoples' finances and why they ultimately do exist, which is to serve the public who contribute to their budget.³²

16.31 The Commonwealth Ombudsman, Mr Colin Neave AM, noted that all regulators confront the problem of developing appropriate priorities and internal systems. He referred to the triage system:

...whereby there is a responsibility within an organisation to have a look at what is coming through the door by way of complaints or contacts with the organisation and then having systems in place whereby the issue which is raised in correspondence, by a telephone call or however else it might be raised is sent down what could be described as the right path. If there are alarm bells ringing in relation to a particular issue, then that issue...might go down path A. If it is an issue about fees it might go down another path.³³

16.32 According to Mr Neave, a key issue is training staff to recognise when matters 'should be given attention and then sending them down that right path'. He explained:

One of the issues which I noticed over the years, both in the public and the private sector, is that sometimes the culture of an organisation will not necessarily be welcoming to a more junior officer wandering into the office of the commissioner and saying, 'By the way, I've just had this telephone conversation with someone and it really does worry me.' I think making sure that culture is present is also very important.³⁴

31 Mr Justin Brand, *Submission 129*, p. 2.

32 Mr Ben Burgess, *Submission 190*, p. 1.

33 Mr Colin Neave, Commonwealth Ombudsman, *Proof Committee Hansard*, 20 February 2014, p. 12.

34 Mr Colin Neave, *Proof Committee Hansard*, 20 February 2014, p. 12.

16.33 In his view, ultimately the following two critical elements are needed:

- the organisation has to be structured in such a way 'as to be able to deal with issues when they are, first of all, recognised'; and
- the organisation has to have a process whereby more senior people are readily available to deal with the issue once it is raised.³⁵

16.34 A former enforcement adviser at ASIC, Mr Niall Coburn, also underlined the importance of ASIC's culture, contending that ASIC appeared to lack 'a culture of urgency, proactivity and flexibility', with its processes driven by 'a management culture that has a wait-and-see attitude'.³⁶ He identified the need for ASIC to have the right attitude as well as the right skill set. He said:

...having the right individuals, in the right positions, who are experienced and know what to do if something crosses their desk. Complaints do elevate information quite fast. The issue I raise about complaints is in relation to serial issues. Do they combine those issues so that it comes up as a red flag? If it is a clear fraud—for example, Equity Trust was or LM was—then it goes to the top. It is escalated.³⁷

16.35 In Mr Coburn's words 'you do not send a chicken out to deal with a crocodile—ASIC are 'sending the wrong individuals to trace or deal with these wolves who have ripped off mums and dads and then escaped internationally'.³⁸ He observed further:

Often ASIC complaint staff are inexperienced in both commercial matters and understanding evidential issues. ASIC receives thousands of complaints and generally undertakes a perfunctory assessment resulting in the sending out of a standard letter which does not address the issues. There appears to be an inability to see red flags or to look at the serial offenders or individuals who may appear in the same group.³⁹

16.36 As an example, Mr Coburn suggested that if there were hundreds of complaints from individuals in a managed investment scheme, he doubted whether ASIC could pick up on the message or put it together and, if ASIC could, it would still fail to react.⁴⁰

35 Mr Colin Neave, *Proof Committee Hansard*, 20 February 2014, p. 12.

36 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 1.

37 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 4.

38 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 2.

39 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 1.

40 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 1.

16.37 Mr Justin Brand likewise questioned ASIC's capability to detect brewing problems in the corporate world:

ASIC do not appear to maintain an effective database of surveillances, findings and Notices—and certainly not one that allows interrogation and root cause analysis. ASIC do not retain, consider or exploit the information in their possession and they compound this failure with a difficulty in retaining corporate knowledge.⁴¹

16.38 Mr Peter Murray was of the view that ASIC needs to create within the organisation a 'hard hitting "Eliot Ness" compact action group...comprising expert experienced market players and those that can initiate serious action quickly and aggressively'.⁴²

16.39 The Association of Financial Advisers suggested that a dedicated complaints channel be made available to industry stakeholders and existing financial advisers to enhance the flow of information to ASIC. This would enable ASIC to respond to significant issues in a timelier manner.⁴³

Conclusion

16.40 ASIC relies heavily on others to watch out for, detect and report corporate wrongdoing; it then determines whether the information deserves closer attention. ASIC receives many thousands of complaints and reports and cannot possibly investigate them all. The committee understands that some complaints may simply be recorded on one of ASIC's databases. Further, the committee understands that ASIC must adhere to fundamental principles such as natural justice and follow due process, which means that ASIC cannot act precipitately.

16.41 The committee has considered the underlying reasons that give rise to the concerns held by many that ASIC ignores or fails to take corrective action on early warning signs of market or corporate misconduct, or on reports of such misconduct. ASIC has acknowledged that it needs to act in a more timely way and focus on the key issues. It is clear that any improvements in this area should come from within ASIC itself. ASIC should ensure that it has a receptive and open culture that encourages its personnel to report what they perceive as emerging problems and that its most senior staff welcome such an approach. ASIC also relies on those outside the organisation to alert it to problems. ASIC, together with the financial system gatekeepers, should be looking for better reporting systems that would assist ASIC to identify potential problems.

41 Mr Justin Brand, *Submission 129*, p. 2.

42 Mr Peter Murray, *Submission 164*, p. 5.

43 Association of Financial Advisers, *Submission 117*, p. 3.

Recommendation 18

16.42 The committee recommends that ASIC establish a dedicated channel for complaints from certain key professional bodies, industry bodies and consumer groups, as well as for accountants and financial advisers/planners.

Recommendation 19

16.43 The committee recommends that ASIC examine carefully:

- its triage system to ensure that the officers managing this process have the skills and experience required to identify complaints and reports of a serious nature requiring attention;
- its misconduct reports management system to ensure that once identified, a serious misconduct report is elevated and more senior people are available to deal with the issue; and
- its culture to ensure that those managing complaints and reports who wish to draw to the attention of senior officers what they perceive as a potentially serious matter are encouraged to do so; that is, for ASIC to foster an open and receptive culture within the organisation so that critical information is not siloed.

Recommendation 20

16.44 The committee recommends that ASIC look at the skills it needs to forensically and effectively interrogate its databases and other sources of information it collates and stores, with a view to ensuring that it is well-placed to identify and respond to early warning signs of corporate wrongdoing or troubling trends in Australia's corporate world.

Recommendation 21

16.45 The committee recommends that ASIC put in place a system whereby, after gross malfeasance is exposed, a review of ASIC's performance is undertaken to determine whether or how it could have minimised or prevented investor losses or consumer damage. Spearheaded by a small panel of independent, experienced and highly regarded people (with business/legal/academic/public sector and/or consumer advocacy backgrounds), together with all ASIC commissioners, this investigation would identify lessons for ASIC to learn and how to incorporate them into ASIC's mode of operation. The committee recommends further that their findings be published including details of any measures ASIC should implement.

Chapter 17

ASIC's enforcement decisions

17.1 The previous chapter considered how ASIC responds to and investigates reports of potential contraventions. This chapter examines the next step in the process: enforcement action. Concerns about ASIC's enforcement record and approach to enforcement were raised throughout the evidence received by the committee. Among other things, this chapter considers issues that may influence what enforcement remedy ASIC decides to pursue, the perceptions created by ASIC's decisions and how effective ASIC's enforcement action ultimately is.

ASIC's overall enforcement record

17.2 The following two tables present a statistical overview of ASIC's enforcement activities. Table 17.1 provides statistics on outcomes achieved over several financial years. Table 17.2 provides statistics on enforcement outcomes achieved in each of ASIC's broad areas of responsibility.¹

Table 17.1: ASIC's aggregate enforcement outcomes, 2006–07 to 2012–13

| <i>Type of action</i> | <i>2006–07</i> | <i>2007–08</i> | <i>2008–09</i> | <i>2009–10</i> | <i>2010–11</i> | <i>2011–12</i> | <i>2012–13</i> |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Litigation completed (total) | 430 | 280 | 186 | 156 | 202 | 179 | 144 |
| Litigation completed successfully | 97% | 94% | 90% | 91% | 90% | 92% | 95% |
| New litigation commenced | 148 | | | | 130 | 134 | 149 |
| Investigations commenced | | | | | 175 | 173 | 193 |
| Investigations completed | | | | | 184 | 183 | 187 |
| Criminal proceedings completed | 51 | 52 | 39 | 22 | 26 | 28 | 25 |
| Number of people convicted | 42 | 49 | 34 | 22 | 25 | 27 | 22 |
| Number of people jailed | 21 | 23 | 19 | 12* | 16 | 20 | 9 |
| Non-custodial sentences/fines | | | | | 9 | 8 | 13 |
| Civil proceedings completed | 76 | 44 | 35 | 30 | 34 | 24 | 15 |
| Illegal schemes shut down or other action taken | 105 | 80 | | | 30 | 1 | 39 |
| People disqualified or removed from directing companies | 110 | 66 | 49 | 90 | 72 | 84 | 72 |
| People/companies banned from financial services or consumer credit | 35 | 49 | 47 | 22 | 64 | 54 | 88 |

1 These statistics are only publicly available from 1 July 2011 onwards, following the first biannual enforcement report released by ASIC in March 2012.

| | | | | | | | |
|--|--------|--------|-------|--------|--------|-------|--------|
| Action against auditors/liquidators | 12 | 5 | 7 | 7 | | | |
| Number of enforceable undertakings | | 14 | 22 | 20 | | | |
| Negotiated outcomes | | 24 | 17 | 17 | | | |
| Recoveries, costs compensation, fines or assets frozen (nearest \$million) | \$140m | \$146m | \$28m | \$302m | \$113m | \$20m | \$222m |

* Includes the jailing of an individual for contempt of court (civil action).

Note: Outcomes for which data are not available are left blank.

Sources: ASIC annual reports, various years.

Table 17.2: ASIC's aggregate enforcement outcomes by stakeholder area, 1 July 2011 to 31 December 2013

| Area of enforcement | Criminal | Civil | Administrative remedies | Enforceable undertakings/negotiated outcomes | Public warning notices | Total |
|--|--------------|------------|-------------------------|--|------------------------|--------------|
| Market integrity | 29 | 3 | 32 | 4 | - | 68 |
| Insider trading | 26 | 1 | - | - | - | 27 |
| Market manipulation | 3 | - | 1 | 1 | - | 5 |
| Continuous disclosure | - | 1 | 11 | 1 | - | 13 |
| Market integrity rules | - | - | 20 | - | - | 20 |
| Other misconduct | - | 1 | - | 2 | - | 3 |
| Corporate governance | 36 | 18 | 10 | 15 | 1 | 80 |
| Action against directors | 34 | 14 | 2 | 2 | 1 | 53 |
| Insolvency | 1 | 1 | 2 | - | - | 4 |
| Action against liquidators | 1 | 3 | 6 | 4 | - | 14 |
| Action against auditors | - | - | - | 8 | - | 8 |
| Other misconduct | - | - | - | 1 | - | 1 |
| Financial services | 51 | 50 | 132 | 76 | 5 | 314 |
| Unlicensed conduct | 2 | 7 | - | - | - | 9 |
| Dishonest conduct, misleading statements, unconscionable conduct | 28 | 28 | 27 | 19 | 1 | 103 |
| Misappropriation, theft, fraud | 15* | 2 | 17 | 5 | - | 39 |
| Credit | 5 | 3 | 51# | 19 | 3 | 81 |
| Other misconduct | 1 | 10 | 37 | 33 | 1 | 82 |
| Small business compliance and deterrence | 1,172 | 57 | 167 | - | - | 1,396 |
| Action against directors | 1,144 | - | 164^ | - | - | 1,308 |
| Efficient registration and licensing | 28 | 57 | 3 | - | - | 88 |
| Total | 1,288 | 128 | 341 | 95 | 6 | 1,858 |

Notes: * Includes one outcome under appeal (as at January 2014); # Includes two outcomes under appeal (as at January 2014); ^ Includes 10 credit related outcomes.

Sources: ASIC, *ASIC enforcement outcomes: January to June 2013*, Report 360, July 2013, pp. 38–39; *ASIC enforcement outcomes: July to December 2013*, Report 383, January 2014, pp. 41–42.

17.3 As Table 17.1 indicates, ASIC has sustained a high success rate in its litigation. It is, however, worth considering the meaning and utility of this type of statistic. As litigants subject to heightened obligations that reflect community expectations, government agencies should be expected to maintain a high success rate. But what rate should be considered ideal for a regulator and law enforcement body such as ASIC? Statistics on overall litigation success can be interpreted and viewed in conflicting ways. While a low success rate would clearly attract criticism, a very high success rate may also be questionable: it could suggest a risk averse or even timid agency, one that only takes cases it is extremely confident it will win.² Related to this, litigation success rates also do not provide information on the types of cases being undertaken. For example, the statistic does not indicate whether relatively straightforward breaches are being pursued or if the regulator is testing more complex matters. It also is silent on the number of cases taken (and win–loss record) against major entities compared to those against less well-resourced individuals and entities, potentially disguising the agency's inclination or ability to take on large corporations. Regulators may also pursue matters where the law is untested or unclear, which could also have implications for their litigation success rate.

Overview of ASIC's enforcement toolbox and criteria for taking action

17.4 Following an investigation that indicates a breach or more serious misconduct, the options available to ASIC include punitive action (prison sentences, criminal or civil monetary penalties); protective action (such as disqualifying orders); preservative action (such as court injunctions); corrective action (such as corrective advertising); compensation action; and negotiated resolution (such as enforceable undertakings). ASIC can also issue infringement notices for certain alleged contraventions.

17.5 ASIC has published guidance on the factors it takes into account when deciding which enforcement remedy to use. Table 17.3 provides an extract of this guidance.

2 Such an outcome has been suggested about other regulators—soon after he commenced in the role, the current ACCC chairman, Mr Rod Sims, observed that the ACCC's success rate in first instance litigation of almost 100 per cent 'is frankly too high'. Mr Sims suggested that the ACCC may have been too risk averse and should 'take on more cases where we see the wrong but court success is less assured'. Rod Sims, 'ACCC: Future Directions', Address to the Law Council Competition and Consumer Workshop 2011, 28 August 2011, www.accc.gov.au/speech/accc-future-directions, pp. 5, 6 (accessed 2 September 2013).

Table 17.3: Factors ASIC may consider when deciding which enforcement remedy to pursue

| <i>Factors</i> | <i>Examples</i> |
|---|--|
| Nature and seriousness of the suspected misconduct | <ul style="list-style-type: none"> • Whether there is evidence that the contravention involved dishonesty or was intentional, reckless or negligent • The amount of any benefit and detriment caused as a result of the contravention • The impact of the misconduct on the market, including potential loss of public confidence • The amount of any loss caused to investors and consumers • Whether the conduct is continuing • Whether the misconduct indicates systemic compliance failures • Whether the subject has a poor compliance record (e.g. the subject has previously engaged in the misconduct) |
| Conduct of the person or entity after the alleged contravention | <ul style="list-style-type: none"> • When and how the breach came to the attention of ASIC • The level of cooperation with our investigation • Whether remedial steps have been taken |
| The strength of ASIC's case | <ul style="list-style-type: none"> • What evidence is available or is likely to become available, to prove the alleged misconduct • The prospects of the case |
| The expected level of public benefit | <ul style="list-style-type: none"> • Whether the case is likely to clarify the law and help participants in financial markets to better understand their obligations • The length and expense of a contested hearing and the remedies available compared with other remedies that may be available more quickly (e.g. improved compliance under an enforceable undertaking) |
| Likelihood that: <ul style="list-style-type: none"> • the person's or entity's behaviour will change in response to a particular action • the business community is generally deterred from similar conduct through greater awareness of its consequences | <ul style="list-style-type: none"> • The compliance history of the person or entity • Whether behaviour (of an entity or broader industry) is more likely to change if the person or entity suffers imprisonment or a financial penalty • Whether the compliance of the person or entity will improve if they give ASIC a public enforceable undertaking • Whether the behaviour is systemic or part of a growing industry trend |
| Mitigating factors | <ul style="list-style-type: none"> • Whether the misconduct relates to an isolated complaint and consumers have generally not suffered substantial detriment • Whether the misconduct was inadvertent and the person undertakes to cease or correct the conduct |

Source: ASIC, *ASIC's approach to enforcement*, Information Sheet 151, pp. 8–9.

17.6 Certain features of Australia's legal system and government enforcement policies influence ASIC's approach to court action and prevent some matters from proceeding further. They include the following:

- ASIC is bound by the government's Legal Services Directions. The Directions, which do not cover criminal prosecutions and related proceedings unless expressly stated,³ require ASIC to act as a model litigant and not start legal proceedings unless satisfied that litigation is the most suitable method of dispute resolution (and then only after receiving written legal advice that there are reasonable grounds for starting the proceedings).
- Although ASIC conducts the investigation, criminal prosecutions are generally conducted by the Commonwealth Director of Public Prosecutions (CDPP).⁴ The *Prosecution Policy of the Commonwealth* provides guidelines on decision-making in the institution and conduct of prosecutions. The CDPP must be satisfied that there is sufficient evidence to prosecute the case and that it is evident from the facts of the case, and all the surrounding circumstances, that the prosecution would be in the public interest.⁵ Under its MOU with the CDPP, ASIC is also obliged to consult with the CDPP before making an application for a civil penalty order.⁶
- In cases where ASIC has not taken action, access to justice may still be provided by private actions or representative proceedings (commonly referred to as class actions). In a journal article on class actions and investor protection, Jason Harris and Michael Legg noted the following relevant comments made by Finkelstein J in the *Centro* class action on the role investor class actions can perform in the regulatory framework:

It is often said that these actions promote investor confidence in the integrity of the securities market. They enable investors to recover past losses caused by the wrongful conduct of companies and deter future securities laws violations. According to the United States Supreme Court, they provide 'a most effective weapon in enforcement' of the securities laws and are a 'necessary supplement to [Securities Exchange] Commission action'.⁷

3 Legal Services Directions 2005, schedule 1, part 4.

4 With the exception of 'some minor regulatory offences'. ASIC, *ASIC's approach to enforcement*, Information Sheet 151, February 2012, p. 5.

5 See www.cdpp.gov.au/Publications/ProsecutionPolicy.

6 ASIC and CDPP, *Memorandum of Understanding*, 1 March 2006, www.asic.gov.au (accessed 17 October 2013), paragraph 4.1.

7 *Kirby v Centro Properties Ltd* (2008) 253 ALR 65; [2008] FCA 1505 at [8] citing *Bateman Eichler, Hill Richards Inc v Berner* 472 US 299, 310 (1985) and *J I Case Co v Borack* 377 US 426, 432 (1964); cited in Jason Harris and Michael Legg, 'What price investor protection? Class actions vs corporate rescue', *Insolvency Law Journal* 17:4 (2009): 190.

General observations about ASIC's approach to enforcement

17.7 Of the many objections put to the committee about ASIC's enforcement record, the most frequently recurring complaint was related to ASIC's discretion not to take enforcement action. Many aggrieved individuals argued that ASIC should have taken enforcement action in a particular matter. For example, Mr Ian Painter detailed boiler room scams operating out of Thailand that have 'fleeced Australians of many millions in the past and continue to do so due to the lack of action by not only ASIC but relevant authorities throughout the world'. Mr Painter argued Australia will continue to be 'ripe pickings' for criminals operating these scams unless action is taken.⁸ Ms Anne Lampe, a former ASIC employee and journalist, advised that although ASIC received frequent complaints about investment schemes and other lost investments, it was only when 'the volume of complaints and losses about a particular scam reached tsunami level, or investors with losses contacted a member of parliament, or triggered a media inquiry that ASIC seemed to spring into action'.⁹ This perception was commented on in relation to the Commonwealth Financial Planning (CFPL) matter, where it was observed that ASIC's enforcement activity stepped up when the story broke in the media.¹⁰

17.8 When ASIC did take enforcement action, submissions questioned the particular case that ASIC chose to pursue. For example, the committee received submissions about various managed investment schemes that had Wellington Capital Ltd was their responsible entity. ASIC has taken court action against Wellington Capital in relation to the Premium Income Fund, a matter that is currently before the High Court.¹¹ However, a submitter questioned why ASIC had decided to take action on behalf of those investors but not on behalf of investors in other managed investment schemes for which Wellington Capital was the responsible entity.¹²

17.9 A significant number of submissions referred to various aspects of ASIC's actions following the collapse of Storm Financial.¹³ A key area of complaint was ASIC's last minute settlement with the CBA instead of pursuing court proceedings; one submission characterised this act as 'the mother of all back-flips'.¹⁴ Another submission, from a husband and wife who requested that their name not be made public, stated that they feel 'ASIC has let us down when they worked a deal with the CBA without allowing the case to be shown for all of the facts'.¹⁵ ASIC's intervention

8 Mr Ian Painter, *Submission 167*, p. [8].

9 Ms Anne Lampe, *Submission 106*, p. [2].

10 *Proof Committee Hansard*, 10 April 2014, p. 70.

11 *Wellington Capital Ltd v Australian Securities & Investments Commission*, S275/2013.

12 See Mr Dennis Chapman, *Submission 249*.

13 *Submissions 18, 41, 42, 44, 82, 84, 87, 88, 90, 106, 149, 172, 236, 256, 278, 301 and 387*.

14 Mr Lucas Vogel, *Submission 41*, p. 4.

15 Name withheld, *Submission 18*, p. 1.

in an \$82.5 million settlement between former Storm Financial investors and Macquarie Bank brought about by a class action was also came under criticism.¹⁶ Further, investors were curious as to why ASIC initiated compensation proceedings against the Bank of Queensland, Senrac and Macquarie on behalf of two investors but not other clients:

They managed to make a deal with Macquarie for their client (Doyles) which ensured that no precedent was set for other investors who were treated equally poorly by Macquarie Bank. They (ASIC) then had the hide to appeal a decision, approved by the Federal Court, that saw a similar successful negotiation by the Class Action against Macquarie Bank overturned because ASIC believed that deal to be unfair. ASIC did not consider fairness when it negotiated a deal for the Doyles which left every other Storm Financial (Macquarie Bank) investor out of any consideration for compensation even though they suffered a similar fate to the Doyles.¹⁷

17.10 The prolonged nature of enforcement action was another subject raised. For example, Ms Dianne Mead advised that although ASIC issued a stop order against a prospectus issued by Neovest Ltd in 2005, an order to wind up the company was only obtained in February 2008. Ms Mead's October 2013 submission to this inquiry noted that the company was still being wound up and the assets were being 'squandered away on legal and liquidator's fees'.¹⁸

17.11 Submissions expressed disappointment at the penalties ASIC achieved. For example, a Darwin accountant, Mr David Pemberton, criticised at length ASIC's investigation of Carey Builders Pty Ltd, a company that went into liquidation in March 2010. Mr Carey received a three month sentence for managing a company while disqualified, however, Mr Pemberton noted that this was a concurrent sentence with a three year sentence given to Mr Carey for being an unlicensed builder.¹⁹

17.12 ASIC's enforcement priorities and the speed and urgency with which ASIC takes enforcement action was questioned. Ms Anne Lampe contrasted ASIC's response to Storm Financial and CFPL to the action it took following a hoax media release distributed by Mr Jonathan Moylan in January 2013:²⁰

16 Mr Peter Dunell, *Submission 90*, p. 1.

17 Name withheld, *Submission 88*, p. 4.

18 Ms Dianne Mead, *Submission 240*, p. 2.

19 Mr David Pemberton, *Submission 279*.

20 On 7 January 2013, Mr Jonathan Moylan distributed a fake media release purported to be from the ANZ. The media release was titled 'ANZ divests from Maules Creek Project' and advised that the bank had withdrawn a \$1.2 billion loan from Whitehaven Coal. On 9 January 2013 it was reported that ASIC had seized Mr Moylan's computer and mobile phone. On 25 January 2013 the *Australian Financial Review* reported that ASIC had interviewed Mr Moylan. See Jake Mitchell, 'ASIC questions Whitehaven hoaxer', *Australian Financial Review*, 25 January 2013, p. 10.

By contrast to its inadequate and far too late attention to Storm's gigantic loss scam, and the rogue CBA Financial Planning expose, ASIC sprang to action and manned all its guns when a young anti mining activist, Jonathan Moylan, put out a mischievous press release in relation to funding withdrawal for a Whitehaven Coal development. The mischievous release fooled the market for a few minutes and Whitehaven shares fell briefly before recovering.

The only people hurt by this face [sic] press release were speculators who sold at the short-lived lower price. Investors who did nothing suffered no loss.

Yet ASIC went ballistic and felt compelled to throw the rule book at Moylan. Moylan is an easy target as he has no funds to defend himself, and because he admitted sending out the release. Moylan is an easy head on a stick for ASIC. It has his admission, has the press release and has on record the brief market movement.

The result is that Moylan faces expensive court proceedings, a criminal record, a possible 10 year jail term and a fine of half a million dollars. Well done ASIC. Moylan will have his head spiked on a stick, but it's the wrong head. I could nominate 50 more suitable heads for a public spiking. But of course that would be a harder task for ASIC. The press release was a prank, but not one that lost billions of dollars of investors' or retirees' funds. Unlike rogue advisors and fund managers that have faced no charges, Moylan didn't gain from the prank, earned no bonus, hasn't thieved investors' money, didn't misappropriate or gamble with large chunks of retiree savings, didn't lend any investor money to himself or his own companies. Nonetheless he is being dealt with as if he had committed a capital offence, far more severely than any Storm advisor or director, or any rogue CBA advisors allowed to quietly resign.²¹

Does ASIC take on the 'big end of town'?

17.13 Various concerns were expressed and assertions made about ASIC's enforcement record against large companies or well-resourced individuals. It is evident that a perception that ASIC is reluctant to investigate and take action against big business exists. It was suggested that:

- ASIC is reluctant to take complex court cases, and instead prefers easier targets;
- ASIC does not have the resources to take on well-resourced firms or individuals; and/or
- where ASIC does pursue enforcement action against large businesses, the result achieved generally relies on less severe remedies such as an enforceable undertaking, rather than court action.

21 Ms Anne Lampe, *Submission 106*, pp. [4]–[5].

17.14 According to the Rule of Law Institute of Australia, the perception that ASIC does not investigate big business is most evident in insider trading and misleading information associated with takeovers. It argued that the pursuit of 'small fish' but not big businesses 'undermines the rule of law' and that 'the public's confidence in the system must be restored'.²²

17.15 CPA Australia told the committee:

Last month saw the release of the enforcement outcomes July to December 2013. They appear to indicate that there were three times the number of enforcement outcomes against small business in the last year than there were against the big end of town, reinforcing a perception, at least, that the regulator is targeting this sector in the context of a number of unresolved corporate behaviours.²³

17.16 Professor Bob Baxt remarked that 'ASIC just seems to be very, very reluctant to run...tough cases', and that ASIC 'has been too soft'. However, Professor Baxt observed that it 'was not always the case', as ASIC had taken 'a number of criminal cases earlier on in its life'.²⁴ He concluded that the problem is partly attributable to recent approaches to regulation that encourage regulators to avoid courts due to the expense and time involved. They instead resolve matters by using other enforcement remedies such as infringement notices, an enforcement tool he described as 'abominable'.²⁵ Professor Baxt added that, in his view, there was too much criticism of regulators such as ASIC when they lose a big, complex, case:

...that suggests that the regulator really stuffed it up—excuse the expression—and that somehow or other we need new regulators or new people in charge in order to deal with these matters. Having been a chairman of a small regulator in comparison to what the ACCC is now—I was chairman of the Trade Practices Commission—I can assure you that it is a very, very difficult task to balance the way in which these matters need to proceed.²⁶

17.17 ASIC rejected suggestions that it does not take on big businesses. While ASIC noted that this perception exists, ASIC countered it by claiming that there was a conflicting perception that ASIC only takes on the big end of town. In a written statement, Mr Medcraft commented that '[o]f course neither of these assertions are

22 Rule of Law Institute of Australia, *Submission 211*, p. 4.

23 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 43.

24 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 10.

25 Professor Baxt criticised the infringement notice powers available to regulators such as ASIC and the ACCC. Although infringement notices do not involve an admission of liability, in his view they create a perception of guilt that can only be disproven when prosecuted by the regulator. Professor Baxt outlined his objection to infringement notices in detail: see *Submission 189*, pp. 1–3 and *Proof Committee Hansard*, 21 February 2014, pp. 10–11.

26 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 9.

true', and that ASIC acts 'without fear or favour irrespective of the size of the organisation'. ASIC provided the results of a breakdown of its enforcement action by entity size undertaken in 2010 to defend its record (Table 17.4).

Table 17.4: Percentage of investigations commenced per market sector, 2009–10 financial year

| <i>Market segment</i> | <i>Investigations commenced</i> |
|--|---------------------------------|
| Micro (0–5 employees and/or turnover of less than \$500,000) | 33 (16%) |
| Small (not a micro entity, has 6–15 employees and/or turnover of \$500,000–\$25m) | 77 (37%) |
| Medium (not a micro or small entity, has 16–250 employees and/or turnover of \$25m–\$250m) | 41 (20%) |
| Large (not a micro, small or medium entity, has over 250 employees and/or turnover of over \$250m) | 56 (27%) |
| Total | 207 |

Source: ASIC, Opening statement to 10 April 2014 hearing, *Additional information 4*, p. 6.

17.18 Of course, such data provide limited insight into ASIC's enforcement record. For example, they do not indicate the severity of sanctions pursued.

Enforceable undertakings

17.19 ASIC's use of enforceable undertakings as a remedy for misconduct was an area that submissions and witnesses at the public hearings traversed in detail. A former enforcement adviser at ASIC expressed concern that ASIC had become too reliant on enforceable undertakings, particularly as a remedy for misconduct by large entities. In his view, often there was no correlation between the remedy and the nature of the misconduct:

Enforceable undertakings have been used in de facto criminal proceedings and enforceable undertakings were really only introduced for compliance purposes. For example, recently enforceable undertakings were given to BNP and UBS banks where they influenced the swap index rate in Australia for three years. ASIC only fined them a very small amount of money, \$1 million, which represents a very small amount compared to the crime. It flies in the face of their own guidelines where you are not supposed to give enforceable undertakings where there has been serious misconduct in relation to the market. Again, there are many other examples where there are inconsistencies.²⁷

17.20 Former ASIC media adviser Ms Anne Lampe told the committee that when she worked at ASIC '[n]egotiating enforceable undertakings rather than taking people

²⁷ Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 2.

or companies to court was a preferred course of action when complaints reached a crescendo'. Ms Lampe provided the following observations about the process for securing an enforceable undertaking and what generally occurred once one was entered into:

These undertakings were discussed and fought over, over months, by armies of lawyers in secret behind closed doors and few details ever emerged about how the damage to investors was done, how many investors were affected, or even whether the undertaking was adhered to. In some cases the companies involved undertook to write letters to affected clients asking them to come in and discuss their concerns. Whether these letters were sent, how they were worded, whether they were replied to or what compensation was offered stayed secret. Everything seemed to go silent after a brief but meticulously crafted press announcement was released by ASIC.²⁸

17.21 Aspects of ASIC's attitude to negotiating enforceable undertakings surprised the committee. The process leading to the CFPL enforceable undertaking indicates that ASIC may give excessive regard to the burden the undertaking could impose on a company that, after all, is the source of ASIC's serious concerns. In doing so, ASIC may be negotiating from a weakened position. The following exchange between the committee and ASIC, already outlined in Chapter 11, is repeated here as it is relevant to this issue and particularly revealing:

CHAIR: ...We had evidence from the lawyers from Maurice Blackburn, who handled 30 or 40 clients, to the satisfaction of all of their clients, that their costs per file were something like an average of \$35,000. What I am putting to you, Mr Kirk, is that the process of review, remediation, reconstruction of files, was in and of itself inadequate and necessarily led to poor outcomes. That is what I am asking you to address. Why were you satisfied with that process?

Mr Kirk: I think in the circumstances, where there was this problem with record keeping and inadequate files, the process put in place, in terms of a large, mass-scale thing, where 7,000 clients were looked at, had appropriate steps to try and address that problem. I am not saying that that is going to be perfect in every file. When documents do not exist, the situation is very difficult, no matter what process you adopt.

CHAIR: Yes, but, if the problem derives from the fact that the officers of Commonwealth Financial Planning at first instance, with any or all of the 7,000 clients, did not do their job properly, did not maintain records, falsified records, falsified signatures, so that nothing could be reconstructed properly, in terms of outcomes, bad luck for the Commonwealth Bank. It should have been instructed to do the job properly, as was done by this law firm in Melbourne, Maurice Blackburn. If that cost \$35,000 or \$40,000 per client, well, that is the penalty for not operating properly in the marketplace at first instance.

Mr Kirk: But doing that for 7,000 clients, at \$35,000 or \$40,000, would be a few hundred million dollars.

CHAIR: It would. That is not your concern. It is the concern of the shareholders of Commonwealth Bank, the concern of the directors of Commonwealth Bank. Let the directors go to the meeting and explain that the dividend has been reduced by 10c this year because of the incompetence that was allowed by the senior managers. It is not your concern. That is the point I am trying to make. Who cares?²⁹

17.22 While enforceable undertakings as an enforcement tool were described as a 'critical mechanism in the regulatory arsenal', after analysing undertakings accepted by ASIC between 1998 and 2013 Professor Justin O'Brien and Dr George Gilligan expressed a 'suspicion...that ASIC has been soft on the big end of town'. They also questioned whether the enforceable undertakings accepted by ASIC 'place sufficiently stringent conditions on organisations whose business strategies may be damaging to their clients' best interests'.³⁰ One example given to support this argument was an enforceable undertaking accepted from the Commonwealth Bank of Australia (CBA) in 2012. The enforceable undertaking was given in response to concern from ASIC about messages sent to CBA customers seeking their consent to receive credit card limit increase invitations. ASIC's media release announcing the undertaking explains the basis for ASIC's concern:

New laws commencing on 1 July 2012 prohibit card issuers from sending unsolicited credit limit increase invitations to their customers unless the customer has consented.

On 12 and 13 December 2011, CBA sent messages via its internet banking platform to customers notifying them of the changes to the law regarding credit limit increase invitations. CBA requested that customers provide their consent to continue to receive credit limit increase invitations. Approximately 96,000 customers provided their consent.

ASIC formed the view that the messages were misleading as they:

- suggested that if CBA's customers did not complete the electronic consent in response to the message they would lose the chance to receive credit limit increase offers
- suggested that if they did not consent, customers would miss out on opportunities to access extra funds should they need them, and
- created the impression that customers needed to act urgently, which may have led customers to respond without properly considering their options.

In fact, under the changes to the law, customers can provide or withdraw their consent at any time. Further, regardless of whether they have

29 *Proof Committee Hansard*, 10 April 2014, pp. 78–79.

30 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, p. [3] (emphasis omitted).

consented to being sent credit limit increase invitations, customers can request a credit limit increase from their financial institution at any time.³¹

17.23 Professor O'Brien and Dr Gilligan argued that the enforceable undertaking only precluded the CBA from taking advantage of the consents it obtained.³² The only other obligations contained in the undertaking were for the CBA to contact affected customers to correct any misleading impression and inform them of their rights, and for the CBA to cooperate with requests from ASIC to provide documents to allow ASIC to assess compliance with the undertaking. Another example was provided by Professor Dimity Kingsford Smith, who considered that the terms of the enforceable undertaking accepted from Leighton Holdings in 2012 were inadequate.³³

17.24 Submissions also argued that enforceable undertakings accepted by ASIC:

- do not always require an independent expert to be appointed to supervise the implementation of the undertaking's terms (it is argued that this makes it difficult to prove non-compliance with the undertaking);³⁴
- may call for the development of remedial action, but do not specify what form the remedial action should take;³⁵ and
- where the appointment of an external expert is required, the obligations of that expert, what constitutes expertise and how potential conflicts of interest should be resolved are not specified.³⁶

17.25 The issues of expertise and potential conflicts of interest were raised in the context of the CFPL enforceable undertaking as PricewaterhouseCoopers, the auditors of the CBA, were appointed as the independent reviewer required under the undertaking. One of the CFPL whistleblowers, Mr Jeff Morris suggested that the enforceable undertaking process was flawed as neither ASIC nor the independent expert understood the industry:

In their submission, ASIC say that the independent expert had relevant financial planning qualifications. That is not the same as being a financial planner. Working as a compliance person is not necessarily the same as

31 ASIC, 'ASIC accepts enforceable undertaking from Commonwealth Bank', *Media release*, no. 12-40, 7 March 2012.

32 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, p. [6].

33 Professor Kingsford Smith noted that the Leighton Holdings enforceable undertaking followed 'a \$40 million kickback, and breaches of continuous disclosure obligations (in conjunction with three infringement notices amounting to total fines \$300,000; 0.00075% of the bribe amount)'. Professor Kingsford Smith added that 'no compensatory obligations were imposed for the \$907 million reduction in market share value, though this may be because there is a class action in progress'. Professor Dimity Kingsford Smith, *Submission 153*, p. 17.

34 Professor Dimity Kingsford Smith, *Submission 153*, p. 17.

35 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, pp. [6]–[7].

36 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, pp. [6]–[7].

being a financial planner. If you actually look at the minimum requirement to be a financial planner, PS146, it is a ludicrously low standard.³⁷

17.26 In response to questions on the conflict of interest issue, ASIC explained that a tender process identified three firms and required that the firms had to address how conflicts would be managed. Under the terms of the undertaking, ASIC had the ability to veto the CBA's choice of independent expert but ASIC did not do as it was satisfied with the process. However, ASIC acknowledged the importance of independence and managing conflicts of interest, and suggested that it may act differently if faced with a similar situation again:

Senator WHISH-WILSON: I would have thought it was black and white that, if your independent expert was also the auditor for the entire organisation—and who knows how many millions that would be worth to them per year—you would have a very definite conflict of interest. We saw this during the GFC with ratings agencies, research houses and bonds and products. These were things that were really obvious but skipped the net.

Mr Medcraft: I would rather not go there at the moment. But you make a good point. I will last Mr Kirk to comment on that.

Mr Kirk: There is a difficulty with organisations as big as the Commonwealth Bank finding a major reputable professional services firms that does not otherwise do work for them. Given the size of the market and the size of those institutions, that is a real issue.

Mr Medcraft: But I think you make a good point, Senator; if somebody is the auditor and they want them to be the independent expert, essentially you should have a sceptical presumption about how they are going to manage the independence issue, the potential conflicts of interest. There should always be a presumption and questioning on this particular issue. I think that is an important point.

Mr Kell: And I suspect that we would take a different approach today compared to the approach we took back then.³⁸

17.27 Decisions made by ASIC about the remedy it will seek following an investigation are significant not only for the individual or organisation facing enforcement action, but also because of the signal they send to other regulated entities. Trends in ASIC's selections can, over time, either reinforce or weaken the overall regulatory model. A joint submission from academics at the University of Adelaide Law School argued that the effectiveness of the enforcement pyramid model can be undermined by the regulator excessively relying on certain regulatory options with other options not being exercised.³⁹ On enforceable undertakings, the submission

37 Mr Jeffrey Morris, *Proof Committee Hansard*, 10 April 2014, pp. 48–49.

38 *Proof Committee Hansard*, 10 April 2014, p. 88.

39 Dr Suzanne Le Mire, Associate Professor David Brown, Associate Professor Christopher Symes and Ms Karen Gross, *Submission 152*, p. 2. The enforcement pyramid was outlined in Chapter 4.

suggested that 'it is doubtful if the individual or the wider public is impacted by an undertaking as much as it would be by publicity following litigation'. It was also asserted that the consequences of breaching an enforceable undertaking are 'limited':

First, if the terms are not complied with, ASIC has further discretion whether to pursue this through the courts. It is clear...that they do not automatically pursue every default in compliance. Even if they do pursue it through the court, the court has a very limited range of sanctions. Failure to comply with an undertaking given to ASIC is not contempt of court in itself, and the court can order the promiser to comply, or to compensate someone who has 'suffered loss or damage as a result of the breach'. The aim of the court order is to put the parties in the pre-breach position (ie give effect to the promise). It is not the aim of the court order to set aside or annul the undertaking so that the original wrongdoing can be sanctioned as if it had been originally pursued through litigation.

What this means is that even someone who has breached an undertaking will be better off than if they had been pursued through the courts originally for the wrongdoing, because the court can make a much wider range of orders for contravention of the Corporations Act (and other legislation) than it can make for breach of an undertaking.⁴⁰

17.28 Mr Lee White of the Institute of Chartered Accountants Australia (ICAA) suggested that enforceable undertakings accepted by ASIC have a poor track record of effectiveness because they have lacked transparency and an admission that something wrong occurred. Mr White indicated that after ASIC announced an enforceable undertaking:

...everyone in the business community was left with the view, 'What's all that about?' because it did not say anything.⁴¹

17.29 However, Mr White added that ASIC appears to have recognised that the language used in the undertaking needs to be improved. The written submission provided by Mr White's organisation developed this further: it suggested that ASIC has taken steps to require a clearer admission of fault in enforceable undertakings. The ICAA concluded that 'greater transparency around ASIC's enforcement actions will have the effect of boosting confidence and stability in the marketplace'.⁴²

17.30 Asked if the process for accepting and monitoring enforceable undertakings was transparent, and in particular whether the reports to ASIC from the independent experts appointed as a condition of the undertaking should be made publicly available, ASIC told the committee that:

40 Dr Suzanne Le Mire et al, *Submission 152*, p. 4.

41 Mr Lee White, Chief Executive Officer, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 48.

42 Institute of Chartered Accountants Australia, *Submission 203*, p. 2.

...we have been having similar thoughts ourselves about trying to make that process more transparent—the reporting back on the implementation of the EU by the independent expert. Really the EU is a replacement for a court enforcement process, and a court enforcement process would be transparent and public. I think that, if we are expecting the general public to accept this alternative—which we think in many cases can get a lot more change and be more effective if it is done well—and have confidence in that, we need to consider how to make that more transparent and how we can not only have it working well but have it seen to be working well and have the public understand that.⁴³

17.31 Mr Medcraft agreed that there is value in considering a more transparent enforceable undertaking process through the publication of independent expert reports. Various ASIC commissioners and officials noted some potential complications, such as the need for the entity offering the undertaking to agree and the possibility that the publication of expert reports would discourage entities from entering into enforceable undertakings.⁴⁴ However, Mr Kell summed up ASIC's position as follows:

...I should note that our enforceable undertakings themselves are currently public. What we are talking about here, and what I fully agree with, is having the milestones about how those firms are complying with and implementing the requirements that come with that to be public as well, and the reports that come with that. I think that is what we are aiming for. That would be a good outcome.⁴⁵

Factors that may discourage ASIC from taking court action

17.32 As this chapter has already noted, the committee received evidence from insiders, key stakeholders and interested observers about ASIC's perceived lack of vigour in pursuing large companies and an inclination that ASIC may possibly have for resolving matters involving large companies by enforceable undertakings rather than through court proceedings. The committee was keen to test these views and, if they have merit, to consider the most plausible explanations.

Cost of court proceedings

17.33 An obvious challenge of enforcement action against large companies is the disparity in resources that a regulator could devote to the case compared to the targeted firm. It is clear that regulators can incur significant expenditures when undertaking complex legal action; for example, the Storm Financial case cost ASIC \$50 million.⁴⁶ However, ASIC was quick to dismiss concern that it did not have the

43 Mr Greg Kirk, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 70.

44 *Proof Committee Hansard*, 10 April 2014, p. 70.

45 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 71.

46 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 28.

funds to pursue large companies. In particular, ASIC's chairman highlighted the enforcement special account that is available to ASIC.⁴⁷ In February 2014, the special account had a balance of over \$30 million and receives \$30 million a year. ASIC is aiming to increase the balance to \$50 million.⁴⁸ Mr Medcraft explained how he uses the enforcement special account to promote ASIC's enforcement credentials:

I have made it very clear that the government provides us with the enforcement special account, and I made it very clear to big corporations that I have got money in there and that I will take on anyone. I am telling you I will—if I find it, it will not make me reluctant at all. It has to be the right case, but that special enforcement account is really important so that money is not the issue...I want the public to be confident that, if there is a big case and no matter who you are, we will take you on. I am passionate about that. All the bullying by the big end of town, if it does occur, does not affect us. We have the money. As I always say to them: we can do this the hard way or we can do it the easy way. At the end of the day it is about being feared.⁴⁹

17.34 The submission from Levitt Robinson Solicitors, which criticised various aspects of ASIC, noted that ASIC was second only to the Australian Taxation Office in expenditure on legal fees, with \$300 million spent by ASIC between 2008 and 2012.⁵⁰

Standard of proof required by the court

17.35 The joint submission from Adelaide Law School academics expressed concern about the effectiveness of the civil penalty regime for directors and officers. As noted in Chapter 4, the introduction of a civil penalty regime for directors and officers was influenced by the theory of responsive regulation's enforcement pyramid model of sanctions of escalating severity. However, the submission argued 'that the

47 A special account is an appropriation mechanism that notionally sets aside an amount of consolidated revenue to be expended for specified purposes. The enforcement special account was established to 'give ASIC the flexibility to conduct major investigations into, and bring legal and/or administrative proceedings against individuals and corporations in relation to, possible corporate or financial services misconduct when required, without the need to seek additional Budget funding'. It was intended that the investigations and proceedings 'would typically relate to matters for which ASIC could not absorb the costs without significantly prejudicing its existing general enforcement role, and/or those matters which are critical to continued public confidence in the corporate regulatory framework'. Mr Medcraft explained that once operational expenditure on a case goes above a certain level, ASIC can apply to government to move funding out of the enforcement special account. Explanatory Statement, *Financial Management and Accountability Act 1997: Determination 2006/31 to establish a Special Account*, pp. 1–2; Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 28.

48 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 28.

49 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 28.

50 Levitt Robinson Solicitors, *Submission 276*, p. 11. The figures are based on the Attorney-General's Department's *Legal Services Expenditure Report 2011–2012*.

current legislative framework and actions of the courts in relation to the civil penalty scheme have inhibited robust regulatory action'.⁵¹ To support this claim, the submission outlined the following points:

- the courts have demanded a standard of proof higher than the balance of probabilities (by requiring cases to be proved to the 'Briginshaw' standard⁵²);
- defendants are not obliged to specify their defences until ASIC's case has closed;
- ASIC has been criticised by a court for not acting in accordance with a duty of fairness as a model litigant—although this criticism was overturned by the High Court, the submission considers the obligation remains of 'uncertain dimensions';
- the legislation does not include a 'procedural roadmap' for civil penalty proceedings;
- when ASIC is successful in a civil penalty action, the penalties achieved have not been sufficient.⁵³

17.36 The joint submission from the Adelaide Law School academics argued that as a result of these factors, ASIC now was more reliant on enforceable undertakings. Although the submission accepted that enforceable undertakings were a legitimate enforcement tool, it expressed concern about ASIC's 'unfettered discretion' to accept an undertaking, explained only in broad terms in guidance published by ASIC, rather than to pursue the matter through the courts:

There are serious consequences of ASIC choosing an undertaking rather than litigation, and whilst it is understandable that resources have to be prioritised so that enforceable undertakings are the low-cost and quicker option, the danger is that cost factors, or cooperation with the regulator, may influence that decision to the detriment of consumers and investors, and to the public confidence in the market.⁵⁴

51 Dr Suzanne Le Mire et al, *Submission 152*, p. 2.

52 The Briginshaw standard refers to principles related to the civil standard of proof (on the balance of probabilities) expressed in the decision of the High Court in *Briginshaw v Briginshaw*. The Briginshaw standard is a general rule that as the gravity of the allegations increase, greater proof is required for the plaintiff to meet the civil standard of proof based on the balance of probabilities. In *Briginshaw*, Dixon J stated: "The seriousness of an allegation made, the inherent unlikelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved to the reasonable satisfaction of the tribunal. In such matters "reasonable satisfaction" should not be produced by inexact proofs, indefinite testimony, or indirect inferences". *Briginshaw v Briginshaw* (1938) 60 CLR 336 at 362 (Dixon J).

53 Dr Suzanne Le Mire et al, *Submission 152*, pp. 2–3.

54 Dr Suzanne Le Mire et al, *Submission 152*, p. 4.

17.37 Other witnesses alluded to the difficulties with the civil penalty regime and the incentive for ASIC to pursue a less severe enforcement remedy to secure an outcome:

Part of the problem ASIC faces is they go to counsel, and counsel say: 'Gee, I don't know; we mightn't be able to get a conviction here even though we're only going for a civil penalty. It's still going to be difficult, so maybe—'and they take the soft option. There are times when you have to take the soft option, and there are times when you have to go and get a ruling under the law. In my view, they do not do that enough. They have done it a little more in the last few years, but the history has not been littered with great successes here.⁵⁵

Time taken to get to court

17.38 Another issue the committee is aware of relates to the significant delays that often occur between when complaints are made to ASIC and enforcement action commences. One area where delays are particularly evident is the prosecution of criminal offences. In this regard, it is important to examine the relationship between ASIC and the CDPP, as it is the CDPP that decides whether to initiate prosecutions and conducts any such proceedings after receiving and assessing a brief from ASIC.

17.39 ASIC advised that, on average, between 2010–11 and 2012–13 it took the CDPP 42.6 weeks to assess matters referred by ASIC that ultimately led to a criminal prosecution being undertaken.⁵⁶ ASIC stated that delays can arise due to:

- (a) difficulties in scheduling trials (the complexity of ASIC matters and the number of witnesses required may require longer periods to be set aside for trial);
- (b) backlogs in the court lists generally due to existing caseloads;
- (c) availability of witnesses;
- (d) adjournments of trial and hearing dates, typically due to:
 - (i) case management issues, such as for a plea hearing, to obtain further disclosure or further evidence or where a late application has been made to cross-examine a witness;
 - (ii) the parties' readiness for trial;
 - (iii) changes to the legal counsel for the accused or for the accused to obtain legal advice; and
 - (iv) judicial processes such as preliminary hearings as to the admissibility of evidence or pre-trial examination of witnesses.⁵⁷

55 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 13.

56 ASIC, *Submission 45.2*, p. 129.

57 ASIC, *Submission 45.2*, p. 129.

17.40 ASIC's chairman told the committee that, as a non-lawyer, he 'was a bit shocked by how long things take'. He acknowledged that this 'is why often...we move to something like an enforceable undertaking, because we can get a timely outcome and actually deal with an issue'.⁵⁸ Similarly, a former ASIC enforcement adviser described the time taken by the CDPP to finalise charges as 'unacceptable'. The former ASIC officer advised that in ASIC's Kleenmaid case it took the CDPP one and a half years to lay charges, which was the same length of time it took ASIC to investigate the matter.⁵⁹ On 1 April 2014, ASIC announced that former directors of Kleenmaid had been ordered to stand trial; this milestone is several years after alleged misconduct took place (between 2007 and 2008).⁶⁰

17.41 Returning to perceived problems with the civil penalty regime for directors and officers, Dr George Gilligan directed the committee to a study by Melbourne Law School conducted five years after the regime was introduced. The interviews conducted as part of the study indicated that the relatively infrequent utilisation of the provisions at the time could largely be attributed to 'the reality that ASIC had to interact with the [CDPP] on the legitimate priorities that the DPP has in this area'. Dr Gilligan noted:

A lot of the public anger that gets directed against ASIC is usually because there are perceptions in relation to criminal behaviour and there is an assumption amongst the public that it should be ASIC that is acting against these individuals. That is really the rightful prerogative of the Director of Public Prosecutions.⁶¹

17.42 The CDPP's response to questions about another referral revealed a further example of a prolonged assessment process:

Senator WILLIAMS: ASIC gave a referral to the DPP on Dr Munro, who collected some \$100 million in an investment scheme—I don't know if it was registered or not. That money went down to about US\$65 million, I believe, during the Global Financial Crisis. I believe the DPP sought more information from ASIC and said there was no case to answer. Yet the Federal Court ruled in 2011 for Dr Munro to return the money to the appropriate investors. I find it amazing that here we are talking about \$65 million. I actually phoned Dr Munro to ask what he is going to do about the court order and money and he hung up on me. Would you please have a close look at this very issue of Dr Munro for me.

Mr Davidson: In May 2010 certain material was provided to the DPP in respect of Dr Munro. In October 2010 advice was provided to ASIC in relation to the material. In early December 2010 further material was

58 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 39.

59 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, pp. 2, 4.

60 ASIC, 'Former Kleenmaid directors ordered to stand trial', *Media Release*, no. 14-064, 1 April 2014.

61 Dr George Gilligan, *Proof Committee Hansard*, 19 February 2014, p. 55.

provided by ASIC to the DPP, including some of the same material that had previously been provided together with further material. Further material after that was provided to us on 24 December 2010. The DPP provided advice to ASIC on 6 April 2011 and further advice was requested by ASIC in August 2011 and further advice provided by the DPP, which ended our involvement in particular matter in August 2011. We do not have any open file in relation to Dr Munro at this stage.⁶²

17.43 The CDPP was asked about its resources. The deputy director, Mr Graeme Davidson, advised that the CDPP is 'very busy' but 'that is not to say that we are not dealing with the cases that are referred to us'. Mr Davidson added that it prioritises cases and develops timetables to address matters within acceptable time frames. While the CDPP stated that prosecution decisions are not based on these considerations, it referred to evidence given at Senate estimates that the CDPP expects to run a deficit in 2012–13.⁶³

17.44 The CDPP also responded to the statistics given by ASIC about the average length of time it takes the CDPP to assess a matter that ultimately proceeds to trial. The CDPP explained that, as it is not an investigative body and is required to bring an independent mind and judgement to a brief of evidence, the CDPP often has to ask ASIC for further investigative work to be undertaken. Mr Davidson remarked that there 'can be quite robust discussions between ASIC and the DPP about that'.⁶⁴

17.45 Although ASIC may have some concerns about the CDPP's processes and responsiveness, it should be noted that the integrity of ASIC's criminal prosecution decision-making process and, related to this, its relationship with the CDPP, has previously been reviewed by the Australian National Audit Office (ANAO) and found to have some deficiencies. Under the *Prosecution Policy of the Commonwealth* certain agencies can conduct their own summary prosecutions for 'high volume matters of minimal complexity'. ASIC is one of these agencies. In 2007, the ANAO issued the following finding about ASIC's handling of these minor cases:

In 1992, the CDPP and ASIC agreed a set of Guidelines under which ASIC was permitted to conduct prosecution of minor regulatory offences. In 2003 the two organisations reached agreement that ASIC could prosecute offences under a number of explicitly nominated sections of the Corporations Act. In its enforcement procedures, ASIC did not pay due regard to the clear terms of the agreement. As a result, on 26 occasions between 2002 and 2006 ASIC had, without consulting the CDPP,

62 Mr Graeme Davidson, Deputy Director, Commonwealth Director of Public Prosecutions, *Proof Committee Hansard*, 2 April 2014, p. 12.

63 Mr Graeme Davidson, *Proof Committee Hansard*, 2 April 2014, p. 12. See also Mr Robert Bromwich SC, Director of Public Prosecutions, *Senate Legal and Constitutional Affairs Legislation Committee Hansard*, Estimates, 24 February 2014, p. 94.

64 Mr Graeme Davidson, *Proof Committee Hansard*, 2 April 2014, pp. 15–16.

prosecuted offences for which it had no specific agreement to do so from the CDPP.⁶⁵

17.46 Once a matter is before the court, it is evident that it can take a significant time before a judgment is handed down. ASIC advised that for civil cases the average number of months between filing proceedings and a decision date has been steadily increasing, from 16.6 months in 2010–11, to 19.6 in 2011–12 and 24.8 in 2012–13. For criminal cases, the deputy director of the CDPP similarly observed that lengthy timeframes can occur as a result of the court process, although he added that the courts are 'very concerned about reducing those time frames'.⁶⁶

Committee view

17.47 The committee acknowledges the difficult decisions that ASIC can be required to take when selecting a particular sanction or remedy to pursue. The committee also recognises the diverse challenges ASIC faces in taking court action with the high rate of success expected of a government agency. Nevertheless, the committee is of the view that the public interest would be better served if ASIC was more willing to litigate complex matters involving large entities. There appears to be either a disinclination to initiate court proceedings, or a penchant within ASIC for negotiating settlements and enforceable undertakings. The end result is that there is little evidence to suggest that large entities fear the threat of litigation brought by ASIC. Other remedies such as enforceable undertakings may correct behaviour within a particular organisation, but they do not yield the wider and more significant regulatory benefits that are associated with successful court action.⁶⁷ Further, the public perception that 'the big end of town' is treated differently and less transparently to other regulated entities is inherently dangerous to ASIC's legitimacy as a regulator.

17.48 To ensure that threats of litigation are credible, ASIC's enforcement special account needs to be bolstered. At present, ASIC's enforcement special account appears inadequate for allowing ASIC to fund large and complex cases. To provide a greater deterrence effect and to ensure that ASIC is not limited in any way from taking major litigation, the committee believes the size of ASIC's enforcement special account needs to be significantly increased. The committee stresses that the government will need to exercise restraint to ensure this is effective; the government should not access the funds or reduce the funding given to ASIC because its enforcement special account has a healthy balance.

65 The Auditor-General, *ASIC's Processes for Receiving and Referring for Investigation Statutory Reports of Suspected Breaches of the Corporations Act 2001*, Audit Report No. 18 2006–07, p. 19.

66 On this issue, Mr Davidson advised that the CDPP seeks to assist the courts as far as it can. Mr Graeme Davidson, *Proof Committee Hansard*, 2 April 2014, p. 16.

67 For example, ASIC's chairman noted in late 2012 that ASIC 'has observed board engagement with disclosure has improved' as a result of the widespread publicity associated the James Hardie case.

Recommendation 22

17.49 The committee recommends that the balance of ASIC's enforcement special account be increased significantly.

17.50 The committee also recognises that there are issues outside ASIC's control that need to be examined. The enforcement pyramid model of sanctions of escalating severity is a sound foundation for enabling a regulator to address corporate misconduct. The application of this model to Australia's corporate laws has generally proven effective. However, the committee is concerned about the evidence received regarding the limitations of the civil penalty regime for directors' duties. This issue relates in part to the penalties available, which the committee will consider in Chapter 23. Nevertheless, the committee considers that the utility of these provisions should be examined further.

Recommendation 23

17.51 The committee recommends that the Attorney-General refer to the Australian Law Reform Commission an inquiry into the operation and efficacy of the civil penalty provisions of the *Corporations Act 2001* that relate to breaches of directors' duties.

17.52 The committee is also very concerned about the length of time it takes the CDPP to consider matters referred to it by ASIC. It is appropriate that the CDPP takes adequate time to carefully assess the evidence so that the highest standards are applied to the prosecutorial process. Delays in particular cases may also indicate that the CDPP has received a brief that is inadequate or that further investigative work by ASIC needs to be undertaken. However, ASIC advised that in recent years it has taken the CDPP 42.6 weeks *on average* to assess matters that ultimately led to a prosecution. This indicates a more widespread problem. The committee notes the evidence about the resource constraints the CDPP is facing. Although perceptions about ASIC's performance may be affected as a result of the CDPP, matters related to the resources, priorities and structure of the CDPP are otherwise beyond the scope of this inquiry. Accordingly, the committee has not developed recommendations on this issue but instead draws this matter to the government's attention. The committee urges the government to ensure that the CDPP has the resources necessary to ensure that financial and corporate crime is prosecuted efficiently and fairly.

17.53 Notwithstanding the earlier comments about court action, enforceable undertakings are a legitimate enforcement tool and an important remedy that ASIC should utilise. They are cost-effective for the regulator, can change behaviour within the entity and enable outcomes and remedies that are timely and that may not be achievable through the courts. As a remedy for misconduct, however, the acceptability of an enforceable undertaking to the general public and the ability of the undertaking to deter misconduct within or by other regulated entities can be damaged by various perceived deficiencies in the undertaking. These include a lack of transparency about the misconduct and remedial action required; concern about the independence of the expert appointed to oversee implementation of the undertaking's obligation; and

a belief that compliance with the undertaking will not be monitored effectively and the terms not enforced. The committee urges ASIC to do what it can to make the processes surrounding the acceptance and monitoring of enforceable undertakings more transparent.

Recommendation 24

17.54 As enforceable undertakings can be used as an alternative to court proceedings, the committee recommends that when considering whether to accept an enforceable undertaking, ASIC:

- require stronger terms, particularly regarding the remedial action that should be taken to ensure that compliance with these terms can be enforced in court;
- require a clearer acknowledgement in the undertaking of what the misconduct was;
- as its default position, require that an independent expert be appointed to supervise the implementation of the terms of the undertaking; and
- consider ways to make the monitoring of ongoing compliance with the undertaking more transparent, such as requiring that reports on the progress of achieving the undertaking's objectives are, to the extent possible, made public.

Recommendation 25

17.55 The committee recommends that ASIC should more vigilantly monitor compliance with enforceable undertakings with a view to enforcing compliance with the undertaking in court if necessary.

Recommendation 26

17.56 The committee requests that the Auditor-General consider conducting a performance audit of ASIC's use of enforceable undertakings, including:

- the consistency of ASIC's approach to enforceable undertakings across its various stakeholder and enforcement teams; and
- the arrangements in place for monitoring compliance with enforceable undertakings that ASIC has accepted.

Recommendation 27

17.57 The committee recommends that ASIC include in its annual report additional commentary on:

- ASIC's activities related to monitoring compliance with enforceable undertakings; and
- how the undertakings have led to improved compliance with the law and encouraged a culture of compliance.

Recommendation 28

17.58 The committee recommends that ASIC develop a code of conduct for independent experts appointed as a requirement of an enforceable undertaking. In particular, the code of conduct should address the management of conflicts of interest.

Chapter 18

ASIC's handling of enforcement matters

18.1 Most of the submissions that discussed ASIC's enforcement action generally criticised ASIC for not taking enforcement action, or if ASIC did take action, it was argued that ASIC did not do this quickly enough or that the sanctions imposed were inadequate. However, the committee also received evidence that presented a different perspective on enforcement. This evidence highlighted the importance of proper process and the need for a government agency to act fairly and properly when considering and pursuing enforcement action. The committee also received evidence that raised questions about the capabilities and expertise of ASIC in undertaking enforcement action. This chapter explores these issues.

ASIC's use of publicity

18.2 One case of particular interest to the committee was the experience of Dr Stuart Fysh. Dr Fysh was an executive with BG Group, an international energy company involved in the exploration and production of gas. Following an ASIC investigation, Dr Fysh was prosecuted for insider trading. A jury found that Dr Fysh purchased shares in Queensland Gas Company Ltd (QGC) between 2 and 8 December 2007 while in possession of inside information concerning QGC that was not generally available. On 14 November 2012, Dr Fysh was sentenced to three and a half years in prison with a requirement to serve a minimum term of 12 months. However, on 17 July 2013 the NSW Court of Criminal Appeal quashed the convictions and Dr Fysh was released from prison that day.

18.3 It is not the role of the committee to assess and judge the merits of this particular case that ASIC pursued and the CDPP prosecuted, and the comments in this report should not be construed as doing this. In particular, the following statement from Mr Robert Bromwich SC, the CDPP, is instructive:

The prosecution bore the onus of proof in proving the charges against Dr Fysh. The fact that Dr Fysh was acquitted of two counts does not mean that those charges should never have been brought against him. It is entirely contrary to our entire system of criminal justice that an acquittal of itself means that a case should not have been commenced in the first place, and I reject such a proposition.¹

1 Mr Bromwich also stated that he accepts the decision of the Criminal Court of Appeal (CCA), however, he added that it is important to note 'that the CCA's observations about the Crown's submissions on appeal are not a criticism of the manner in which the prosecution ran its case at trial' and that '[i]n respect of the criminal proceedings no court has held that the case against Dr Fysh was fundamentally misconceived or that there was no evidence of an element of the offences charged'. Mr Robert Bromwich SC, Commonwealth Director of Public Prosecutions, answer to question on notice, no. 14 (received 22 April 2014), pp. 5, 8 and 9.

18.4 Nevertheless, the case does at least serve as a general reminder that a tremendous imbalance can exist when ASIC investigates an individual and causes them to be prosecuted on behalf of the Commonwealth. As Dr Fysh suggested, it is 'a mathematical certainty' that some of the people ASIC investigates will be innocent.² Further, specific aspects associated with how this enforcement action was managed, such as ASIC's public comments, warrant scrutiny.

18.5 The case taken against Dr Fysh has, in his words, had the 'truly crushing impact of seeing my career and reputation destroyed'.³ In particular, Dr Fysh was critical of how his reputation was damaged by ASIC's public statements *prior* to the finding of guilt at trial. In 2008, ASIC issued a media release announcing that it had obtained an asset preservation order against Dr Fysh and that ASIC was investigating his share trading. Dr Fysh argued that the freeze order was obtained with his full cooperation and, although this fact was in his view 'implicit' in ASIC's media release, this was a distinction 'not drawn by any journalist, news agency or prospective employer'.⁴ It is important to note that, according to Dr Fysh, it was at the end of 2010 that the CDPP and ASIC announced that they would charge him.⁵ The trial took place in 2012.

18.6 Dr Fysh provided a number of pointed criticisms of what he described as ASIC's 'announce early and announce big' media strategy. First, Dr Fysh highlighted the irreversible consequences of a public statement about an individual by ASIC:

Considering the overwhelming asymmetry between ASIC's resources and those of an individual, and the enthusiasm with which the media picks up on the regulator's announcements, it is incontrovertible that ASIC merely announcing its intention to investigate a named individual, of itself amounts to an immediate and irreversible punishment. Indeed, in my own case and others I have followed, the sentencing judge noted the personal disruption, loss of professional standing and reduced earning capacity suffered throughout a lengthy (just short of five years in my case) investigation and pre-trial procedure.⁶

18.7 Dr Fysh also queried the regulatory benefits arising from the statement being issued, compared to the implications for the individual:

Can any possible (and, I respectfully submit, highly questionable) benefit, such as by way of heightened deterrence, that might flow from ASIC's precipitate publicity in respect of those who are ultimately proven guilty, warrant the crushing blow to one who is innocent?⁷

2 Dr Stuart Fysh, *Submission 128*, p. 3.

3 Dr Stuart Fysh, *Submission 128*, p. 3.

4 Dr Stuart Fysh, *Submission 128*, pp. 2–3.

5 Dr Stuart Fysh, *Submission 128*, p. 4.

6 Dr Stuart Fysh, *Submission 128*, p. 1.

7 Dr Stuart Fysh, *Submission 128*, p. 3.

18.8 The media release issued by ASIC was compared with the 'tone and tenor' of statements by the police to the media. Dr Fysh observed that the police would not name individuals they are contemplating laying charges against.⁸ To further develop his argument that ASIC should be more careful with its public statements, Dr Fysh suggested that ASIC's criminal cases are more complex than those undertaken by the police:

ASIC works in a more complex space than policing agencies dealing with criminal cases where, by virtue of apparent facts and physical evidence, there will usually be little doubt that criminal conduct has occurred. The judgements ASIC has to make in determining criminality are more subtle than identifying a victim or looking for fingerprint and DNA matches.⁹

18.9 Dr Fysh also compared ASIC's public statements in his case with ASIC's guidelines. ASIC policy on public comment is contained in Information Sheet 152 and includes the following statement:

Importantly, if a matter is still in the investigation stage and an enforcement action has not commenced, it is generally accepted that a regulator such as ASIC must balance the public interest benefits of making a statement against the rights of the individual subject to the investigation.¹⁰

18.10 Dr Fysh asserted:

Categorically—clearly—that was not done, in my case. Now what I see is an organisation that is doing things wrongly and then wallpapering itself with best-practice notes, saying 'We won't do that.'¹¹

18.11 Dr Fysh also presented his hypothesis that as a result of the pre-investigation publicity brought by ASIC, ASIC may have 'predisposed itself to continued pursuit of allegations that were not supported by the facts'.¹²

18.12 Following the conviction being overturned on appeal, some of ASIC's media releases about charges being laid and the finding of guilt at trial remained on its website without reference to the NSW Court of Criminal Appeal's decision. Internet search results ranked the initial media release and related media coverage higher than any coverage of the outcome of the appeal. The appellate court's reasons for judgment were published in November 2013. On 11 March 2014, ASIC issued a one sentence media release titled 'Former BG executives [sic] insider trading conviction quashed'

8 Dr Stuart Fysh, *Submission 128*, p. 4.

9 Dr Stuart Fysh, *Submission 128*, p. 5.

10 ASIC, *Public comment*, Information Sheet 152, February 2012, p. 1.

11 Dr Stuart Fysh, *Proof Committee Hansard*, 2 April 2014, p. 1.

12 Dr Stuart Fysh, *Submission 128.1*, p. 1.

with a link to the court's reasons.¹³ Dr Fysh is of the view that although he wrote to ASIC about the lack of an update, ASIC only issued this media release and updated its website because of his submission to the committee's inquiry.¹⁴ In any case, that ASIC issued a media release in March 2014, when the Court of Criminal Appeal's reasons for decision were released in November, does appear far from ideal.

ASIC's response

18.13 ASIC provided the committee with a detailed supplementary submission on the case taken against Dr Stuart Fysh that rejected each allegation made by Dr Fysh. On the use of media, ASIC provided the following summary:

ASIC's media releases about the investigation were fair and accurate reports of public court proceedings and outcomes. They were issued in accordance with ASIC's media policy outlined in Information Sheet 152 *Public comment* (INFO 152) and reflect the fundamental principle of 'open justice'.

...

ASIC issued an editor's note containing the outcome of Dr Fysh's appeal the day after the Court of Criminal Appeal (NSW) overturned his convictions. In addition, at Dr Fysh's request, it issued a new media release in March 2014 about this outcome providing a link to the Court of Criminal Appeal (NSW) (already publicly available) reasons for the decision.¹⁵

18.14 ASIC also responded specifically to Dr Fysh's comments about the media release issued by ASIC in 2008 about the asset preservation order:

On 2 December 2008, ASIC commenced civil proceedings against Dr Fysh in the Supreme Court (NSW) that were separate and distinct from the criminal proceedings subsequently brought against him. ASIC produced sufficient evidence to persuade the court (on an *ex parte* basis) to make short-term asset preservation orders against Dr Fysh under s1323 of the *Corporations Act 2001*. Dr Fysh was then provided with ASIC's evidence and afforded the opportunity of challenging any aspect of it and contesting the continuation of the orders, but he chose to consent to the continuation of the orders. Following this, ASIC issued 08-85AD on 15 December 2008,

13 ASIC, 'Former BG executives insider trading conviction quashed', *Media Release*, no. 14-042, 11 March 2014. The text of the media release simply stated: 'Dr Stuart Alfred Fysh's 2012 conviction for insider trading was quashed by the NSW Court of Criminal Appeal in 2013' and contained a link to the court's reasons with limited background information attached.

14 Dr Fysh advised that he wrote to ASIC 'and said, "Come on, guys. You have seen what I have written to the Senate committee. I am really unhappy. Could you not at least acknowledge this on your website—you have a dozen headings up there that I am a crook. That is all that anyone who ever wants to deal with me is going to see." ASIC has put something up on their website. I suggested, "Why don't you put a link through to the findings of the Court of Criminal Appeal." Blow me down, they have done it. But let us not kid ourselves that they did it because little Dr Fysh wrote to them'. Dr Fysh suggested that ASIC acted because the committee or someone influential 'has said something'. *Proof Committee Hansard*, 2 April 2014, p. 3.

15 ASIC, *Submission 45.4*, p. 3.

which was a fair and accurate report of the court proceedings and outcome...Further, the proceedings were in open court and a matter of the public record (no non-publication orders were sought by Dr Fysh or imposed by the Supreme Court (NSW)). The publication of the advisory was in accordance with the fundamental principle of 'open justice'.¹⁶

Evidence on ASIC's use of publicity from other stakeholders

18.15 The committee sought and received the views of key stakeholders about ASIC's use of publicity and the expectations that should be held of ASIC in this regard. Professor Bob Baxt noted the implications of a regulator accusing an individual of misconduct and emphasised that the principle of a person being innocent until the courts find the person guilty needs to remain paramount:

Regrettably, far too often the media seems to work on the different assumption that as soon as someone alleges that something bad has happened with a company or in relation to the way in which people have behaved, then somehow or other that person or that company is immediately guilty and the regulator should have acted yesterday in ensuring that the people go to jail or that some other terrible penalty is put on them.¹⁷

18.16 Professor Baxt used an example associated with the National Companies and Securities Commission, the predecessor to ASIC, to warn about the consequences associated of unsubstantiated allegations being made public:

There was one very famous case of a raid on the offices of a stockbroker for alleged insider trading as a result of media speculation. That person was arrested. Tremendous publicity surrounded that person's life. That person committed suicide. Later it was established quite clearly that that person had been completely innocent of any breach of the law. It is that kind of psychology and approach by regulators that we need to avoid. And I think by and large ASIC has been relatively good at making sure that it does not jump the gun and create impressions of guilt before any inquiry has been held.¹⁸

18.17 The Corporations Committee of the Law Council of Australia's Business Law Section advised that it considered the approach taken by ASIC in Information Sheet 152 is 'the correct one in principle...and for the most part, the correct one in practice'. It emphasised the damage that allegations can have on an individual's reputation:

It would be, in the view of the Corporations Committee, quite inappropriate for a regulator of any kind to seek to use the mere fact of an investigation (when by definition no factual findings had been made and no decision had been taken to commence enforcement action) to achieve a broader

16 ASIC, *Submission 45.4*, pp. 3–4.

17 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 9.

18 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, p. 9.

regulatory outcome. Moreover, the publication of mere allegations (that may or may not be ultimately proven) can be oppressive towards the individuals involved and damaging even if the allegations are not proven.¹⁹

18.18 The Law Council did express some concerns about ASIC's use of publicity with infringement notices, where payment is not an admission of liability. The chairman of its Business Law Section made the following observation:

...people may pay infringement notices for a variety of reasons quite apart from whether they consider the allegation justified. I hope I may be forgiven for saying that a company might quite rationally pay an infringement notice simply to avoid paying their lawyers more to contest the notice.²⁰

18.19 Nevertheless, the witnesses that the committee questioned on this issue generally considered that ASIC is conservative in its approach to publicity:

You can compare and contrast that with, for example, Eliot Spitzer when he was state Attorney-General in New York, or Benjamin Lawsky, who is a director of the Department of Financial Services in New York at the moment, who is quite happy to leak the results of their investigations and to be quite aggressive in his use of public relations. I think the record shows that ASIC has actually been quite restrained.²¹

* * *

In fact, from time to time ASIC is actually criticised for keeping investigations close to its chest.²²

Committee view

18.20 Public comment about ASIC's activities or matters relating to its functions is a key part of ASIC's role. Statements by ASIC can help promote compliance with the law and are in accordance with ASIC's statutory objectives regarding the confident and informed participation of investors and consumers in the financial system. It also can promote public confidence in ASIC, something that is currently lacking in some quarters. However, the committee expects ASIC to carefully consider the benefits of public comment compared to the damage that can be caused by its statements, particularly if the comments are premature or ill-timed, or there is little deterrence or regulatory benefit that can be gained by the comment. The policies in place appear to be appropriate, although ASIC must ensure that it is vigilant in ensuring that they are applied in all cases, and that any public comments are made with a clear regulatory objective in mind.

19 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 5.

20 Mr John Keeves, Chairman, Business Law Section, Law Council of Australia, *Proof Committee Hansard*, 20 February 2014, p. 2.

21 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 61.

22 Professor Dimity Kingsford Smith, *Proof Committee Hansard*, 19 February 2014, p. 62.

18.21 It is evident, however, that ASIC needs to be more alert and responsive to updating statements that have been previously published. The committee appreciates that ASIC maintains a useful historical record of its media releases. However, internet search engine results in particular can direct the public to out-of-date information and ensure ongoing reputational consequences for the individuals or organisations concerned. In the case of Dr Fysh, the timing of ASIC's media release advising of the appellate court's reasons for judgment, months after the reasons were published, gives the committee no reason to believe that ASIC would have updated its previous media statements about Dr Fysh had it not been prompted. ASIC should also change how the updates to past media releases are displayed—simple changes such as replacing the 'editor's notes' that are buried at the bottom of the online version of the media release with a more prominent warning that the information is out-of-date, perhaps immediately below the media release's heading, would seem more appropriate and helpful to readers.²³ ASIC should also put in place a procedure to ensure updates reflecting the outcome of an appeal are not overlooked. This issue does not appear isolated; the committee has found other examples.²⁴

Recommendation 29

18.22 The committee recommends that ASIC improve its procedures for updating past online media releases and statements to reflect recent court developments, such as the outcome of an appeal or when proceedings are discontinued. ASIC should ensure that these updates are made in a timely manner and published in a more prominent position than what currently occurs.

ASIC as a model litigant

18.23 The committee received submissions from individuals who have been subject to enforcement action by ASIC and were angry about ASIC's conduct. For example, one submitter told the committee:

I have grave concerns that ASIC has and is currently violating several of its obligations of rule-bound administration which has breached a multitude of serious principles including the allocation of rights and resources,

23 In this regard, ASIC may wish to consider the approach taken by the Australian Taxation Office, which publishes clear warnings designed to capture the reader's attention when legislative changes affect the interpretation of particular provisions of the tax law. For an example, see www.ato.gov.au/Business/Research-and-development-tax-concession/In-detail/Making-a-claim/175--Premium-research-and-development-tax-concession/.

24 For example, on 7 August 2013, ASIC issued a media release announcing that charges against a certain individual (named in the media release) had been discontinued. However, the editor's notes at the bottom of the 6 June 2012 media release announcing the charges do not reflect this—at the time of writing, the last entry in the editor's notes on the 6 June 2012 media release noted that the individual had been committed to stand trial. This is significant as the first result of an internet search on the individual was the 6 June 2012 media release, followed by media articles on the charges.

impartiality, distributive justice, rights of the individual and model litigant principles.²⁵

18.24 Mr Robert Catena, a former Citigroup stockbroker, provided the following statement:

In August 2008 I was advised that ASIC planned to have a hearing to institute a banning order against me. At the same time they also informed my lawyer that they had referred the matter to the...CDPP...for possible criminal proceedings. My lawyer then sought a stay of the proposed hearing until after the determination by the CDPP as to whether they would institute criminal proceedings against me. This was refused by the 'delegate'...(an employee of ASIC).

I was advised by my lawyer that her decision put me in a position where I would be denied natural justice, as anything I said to ASIC in my defence would be passed on to the CDPP. As I wanted to defend myself, my lawyer asked if ASIC would agree not to pass my testimony to the CDPP, but once again they refused. Therefore I was left in the insidious position of not being able to defend myself.

At this point I contend that...acting for ASIC denied me natural justice, engaged in PROCEDURAL UNFAIRNESS AND BREACHED THE MODEL LITIGANT RULES.²⁶

18.25 ASIC provided detailed answers to questions on notice in response to the allegations made by Mr Catena. In particular, ASIC noted that the Model Litigant Rules do not apply in criminal proceedings and that the CDPP conducted the prosecution. Nevertheless, ASIC believes that at all times both it and the CDPP 'acted honestly and fairly and adhered to all prosecutorial duties'.²⁷

18.26 There are examples of ASIC following its procedural fairness obligations, although they can raise further questions about the conduct of ASIC's investigations. For example, in May 2013, ASIC issued the following cryptic media release:

ASIC today provided an update on its proceedings against former Westpoint officers Norman Carey and Graeme Rundle.

ASIC alleged Mr Carey and Mr Rundle breached their duties as officers. The trial started in late April 2013...

During the course of the trial, ASIC located a document relevant to the charges. In accordance with ASIC's procedural fairness obligations, ASIC immediately disclosed the document and copies were given to Mr Carey and Mr Rundle, and the court.

Following an assessment of the document in the context of the prosecution's case, the Commonwealth Director of Public Prosecutions today advised the

25 Name withheld, *Submission 145*, p. 1.

26 Mr Robert Catena, *Submission 241*, p. 1 (emphasis in original).

27 ASIC, answer to question on notice, no. 10 (received 19 May 2014), p. 5.

District Court of Western Australia that the case should proceed no further and filed Notices of Discontinuance.²⁸

18.27 The Rule of Law Institute provided its view on the operation of the Legal Services Directions across all government agencies. It argued that the model litigant obligations need to be enforced by the Attorney-General:

It is not sufficient for breaches of the model litigant obligations to be paid for by way of costs orders made against government agencies in court cases, because ultimately it is the taxpayer who funds those costs. Government agencies must be subject to the law as much as individuals and organisations.²⁹

Use of expert witnesses

18.28 The evidence of particular experts relied on in prosecutions was also sharply criticised in some submissions. Individuals aggrieved by the enforcement action taken against them queried how ASIC and the CDPP could reasonably consider that the expert's evidence was suitable. For example, Mr Robert Catena relayed comments made by a magistrate in his committal hearing about the expert witness relied on by ASIC:

[Magistrate O'Day] states 'Unfortunately the expert evidence that was relied on with respect to the test of materiality in its present form, I don't think can be used by the court because it didn't adopt the test on materiality referred to in the Corporations Act, and therefore in my view cannot be relied on.'³⁰

18.29 Dr Stuart Fysh also outlined concerns about the expert witness relied on by ASIC and the CDPP in his case:

As the [NSW Court of Criminal Appeal] has accepted, most of ASIC's alleged 'inside information' was well known to the market, yet ASIC's so-called Expert asserted that every single piece of ASIC's alleged inside information was both unknown to the market and highly material. The Expert relied upon circular logic, namely that: 'As the companies' share prices hadn't risen prior to his trading, the information can't have been in the marketplace at that time'—which only makes sense if the information is material, one of the key issues the Expert was asked to opine on in the first place.

Well established requirements must be satisfied for an Expert to be accredited by the Court, in terms of relevant professional experience and transparent application of this experience to analysing the evidence forming the subject of their Expert Report. It was obvious that this Report was deeply flawed because it canvassed issues far outside the relevant area of expertise of the Expert. Unsurprisingly, the Trial Judge acceded to Defence

28 ASIC, 'Statement on ASIC action', *Media Release*, no. 13-105, 14 May 2013.

29 Rule of Law Institute of Australia, *Submission 211*, pp. 7–8.

30 Mr Robert Catena, *Submission 241*, p. 3.

requests to severely circumscribe the Expert's evidence—he was not allowed to be presented to the Jury as an Expert nor allowed to opine on the availability in the market of the alleged inside information.

Expert evidence doesn't have to be called in support of Insider Trading prosecutions but the [Court of Criminal Appeal] concluded that in my case, where the charges were technically and commercially complex, lack of Expert evidence regarding public availability and materiality left the Jury without a safe basis to reason its way to a conviction. The inadequacy of the Expert and his report were readily apparent to the Trial Judge and [Court of Criminal Appeal] Justices—and must surely have been clear to both ASIC and DPP. Why did ASIC persist when they had failed to commission an Expert Report that would materially assist them? ASIC needs to consider closely the commercial capabilities brought to bear when investigating me, and the quality of ASIC's decision-making.³¹

18.30 The former chairman of the Trade Practices Commission (now the ACCC), commented that regulators such as ASIC face restrictions about the money they can pay to secure and retain experts, both counsel and expert witnesses. He noted that the regulator faces strict guidelines about its resources, but can face defendants that do not face such limitations. He remarked that regulators are 'often prevented from hiring the best experts possible in order to conduct the relevant litigation'.³²

Staffing and organisational structure issues

18.31 As an agency that receives far more reports of misconduct than it could possibly investigate, and as a government body expected to act fairly and exercise its powers for the public good, ASIC has to exercise discretion and good judgement about what to investigate and how to do it. In doing this, ASIC relies heavily on the conduct and assessments of its employees, and the assessments that they make. This section examines evidence regarding the officers at ASIC that are responsible for managing enforcement action.

18.32 The committee received a small number of submissions that contained negative or unflattering comments about ASIC employees. Such evidence received by the committee can generally be categorised as questioning either the capabilities of the officers or their conduct and professionalism.

18.33 The committee recognises that the comments are of varying merit. As the committee is examining the performance of ASIC as an organisation, and the committee is aware that it is difficult for current or former public servants to respond to such claims, the committee has generally withheld the names of ASIC staff members in written submissions. Further, the following comment by ASIC's chairman should be noted:

31 Dr Stuart Fysh, *Submission 128.1*, p. 4.

32 Professor Robert Baxt AO, *Submission 189*, p. 7.

One of the disappointing things about some of the submissions was the inflammatory tone of criticisms made, particularly about ASIC's staff. ASIC has exceptional employees. They are men and women who work for the good of the community. That is because they believe in the public interest. They are skilled and they are committed to their work. Considering the difficult job they do, they should receive appropriate respect. Our people have diverse backgrounds. They have experience in law, accounting, financial services and other areas. Many have invaluable industry and consumer advocacy experience, and this means they understand how markets work and issues facing investors, consumers and wider industry. ASIC employees also undertake ongoing internal training and have access to industry secondment programs, which further develop their skills.³³

18.34 Nevertheless, the evidence received by the committee warrants consideration of how enforcement could be affected by staffing issues and the organisational structure within ASIC.

18.35 A strategic review of ASIC was undertaken following the appointment of Mr Tony D'Aloisio as chairman. That review, completed in 2008, recommended that the four directorates which ASIC then had (regulation, compliance, enforcement and consumer protection) be abolished. They were replaced by a larger number of 'outwardly-focused stakeholder teams covering the financial economy' and multiple enforcement teams each tasked with specific types of misconduct.³⁴ The clusters within which the enforcement and stakeholder teams are organised were introduced during 2011–12, in order 'to better reflect' ASIC's priorities.³⁵ This approach differs to that taken in other jurisdictions where dedicated enforcement divisions appear to be standard. For example:

- The US Securities and Exchange Commission (SEC) has five divisions and an additional 23 internal offices. One of the divisions is dedicated to enforcement; the remaining four are: Corporation Finance; Investment Management; Risk, Strategy, and Financial Innovation; and Trading and Markets. The SEC's regional offices report to both the Enforcement Division and the Office of Compliance Inspections and Examinations.³⁶

33 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 2.

34 ASIC, 'ASIC announces results of its strategic review', *Media release*, no 08-93, 8 May 2008; Pamela Hanrahan, 'ASIC review should make it smarter', *Australian Financial Review*, 12 May 2008, p. 63.

35 ASIC, *Annual Report 2011–12*, p. 2.

36 US Securities and Exchange Commission, www.sec.gov/divisions.shtml (accessed 20 August 2013).

- The new US Consumer Financial Protection Bureau (CFPB), which enforces federal consumer financial laws, has a Supervision, Enforcement and Fair Trading Division, which includes an enforcement office.³⁷
- The new regulator of the financial services industry in the UK, the Financial Conduct Authority (FCA), likewise has a dedicated enforcement section (the Enforcement and Financial Crime Division).³⁸

18.36 The Community and Public Sector Union (CPSU) advised that the 2008 changes were 'fairly traumatic on staff at the time and caused quite a lot of defocusing in certain areas'. Since the 2008 restructure there 'has been a move back to a more coherent approach in the enforcement division', although the evidence handling unit within ASIC, which services multiple enforcement teams, is under significant pressure.³⁹ Overall, the CPSU considered that morale 'crashed' following the changes, but that it may be now recovering:

Staff are very focused on their job, want to achieve the best outcomes they can for the Australian public and are very dedicated to that. They put in lots of long hours, sometimes horrendous hours, to achieve that. I think morale has to be on the way up for that to be happening.⁴⁰

18.37 Ms Anne Lampe, a former ASIC employee and financial journalist, told the committee:

Whilst I worked at ASIC I had nothing but the highest regard for the committed and hard-working investigators and lawyers in the enforcement section of ASIC. But there seemed to be some blockage at the top. Action seemed always to be taken too late.⁴¹

18.38 A former enforcement adviser also commented on the commissioners and senior management. He focused on the qualifications and expertise of the senior officers, and suggested that the current composition may be impacting ASIC's approach to enforcement and how enforcement matters are handled:

There seems to be a lack of experienced staff with direct experience in successfully investigating and prosecuting complex corporate fraud matters. For example, as of today, not one person at the ASIC commission level or, at best, one or two senior executives have actual experience in conducting a criminal investigation or giving evidence in a court themselves. In other

37 US Consumer Financial Protection Bureau, www.consumerfinance.gov/the-bureau (accessed 20 August 2013).

38 UK Financial Conduct Authority, www.fca.org.uk/static/fca/documents/fca-organisational-chart.pdf (accessed 20 August 2013).

39 Mr Alistair Waters, Deputy National President; Mr David Mawson, ASIC Workplace Delegate, CPSU, *Proof Committee Hansard*, 19 February 2014, p. 64.

40 Mr David Mawson, ASIC Workplace Delegate, CPSU, *Proof Committee Hansard*, 19 February 2014, p. 65.

41 Ms Anne Lampe, *Submission 106*, p. [2].

words, how can you expect your staff to conduct a complex investigation or lead one when you have never done one yourself?⁴²

18.39 Another former employee suggested that ASIC loses cases because of financial constraints and limits on how their employees can be utilised:

[ASIC] think that they can win court cases doing 38 hours a week, when the other side are doing 90 hours a week. When I put in for my overtime on Nomura, it was rejected, but they were happy with the result and it was these same people taking a lot of the credit. However, if I had not done the work, the case would have been a disaster.⁴³

18.40 ASIC is also required to compete with private sector firms for suitably qualified and talented employees 'with the disadvantage of not being able to pay market-equivalent salaries for people with cutting edge legal and financial expertise and experience'.⁴⁴ Another challenge to attracting and retaining talented enforcement employees could be the nature of the work that enforcement employees are required to do compared to the opportunities available elsewhere. Former ASIC employee Mr Niall Coburn stated:

In my team we used to mentor the younger staff coming in. Lots of young people at ASIC now think there is no future for them in terms of experience. They are not given the opportunity to go to court. They are not given the opportunity, say, if they were in a law firm.⁴⁵

18.41 The competence of particular ASIC officers or teams was commented on by individuals that had experienced enforcement action brought by ASIC. Dr Stuart Fysh argued that ASIC 'absolutely failed to bring to bear the right sort of commercial competence in establishing the facts against me'. He provided the following reasoning:

...the gentleman who investigated on behalf of ASIC was a part-time investigator who had been brought back. He said in court, very clearly, that if the alleged inside information was out there, unless he could find evidence that BG [Group] was aware of the alleged inside information, he just ignored it. Of course, that is not the test.

What was the professional competence of that person? The answer is not to criticise that guy; the issue for the senior management of ASIC is: what are the standards of competence; what is the job description of an investigator? I guess the issue, for me, is what governance structures exist within ASIC so that you do not have that end-to-end responsibility of one person with all the imbedded assumptions he has?⁴⁶

42 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 2.

43 Ocean Financial Pty Ltd, *Submission 248*, p. [1].

44 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 2.

45 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 6.

46 Dr Stuart Fysh, *Proof Committee Hansard*, 2 April 2014, p. 1.

18.42 Dr Fysh questioned the internal structures within ASIC and suggested that ASIC should employ someone 'whose KPI, whose bonus, depends on killing ASIC cases' so that ASIC do not take cases where 'they would have ended up looking silly'.⁴⁷

Committee view

18.43 The above paragraphs indicate some disquiet about the expertise that ASIC brings to enforcement, both in terms of the expertise it secures through expert witnesses and the capabilities ASIC possesses in house. Before proceeding further, the committee wishes to acknowledge that ASIC's employees have committed themselves to public service and to achieving the best results for the Australian community. The committee thanks ASIC's employees for their hard work and dedication. Although some concerns have been considered, the committee has not entertained allegations that appear vexatious or simply attempt to 'name and shame' particular employees, rather than engage in a constructive discussion about ASIC's performance.

18.44 Like other organisations, ASIC is dependent on the good judgement and conduct of its employees. There will be individual cases where trust is misplaced, expertise is lacking or where honest mistakes will be made. There will also simply be differences of opinion about particular matters. After reviewing both the public and confidential submissions received during his inquiry, it would be wrong for the committee to conclude that there is a significant or widespread problem within ASIC regarding its employees. At this time, the committee has no reason to consider that ASIC cannot manage any issues about the conduct of individual employees by regularly reviewing its supervision and performance management arrangements to ensure they are best practice and vigilantly applied. For the avoidance of any doubt, the committee is only aware of isolated complaints regarding ASIC's employees, and the committee is confident that the vast majority of ASIC's employees perform their duties appropriately and as effectively as possible.

18.45 There are other ways to improve the expertise and skillsets of ASIC's staff. Increasing the use of secondments to other law enforcement agencies will allow new ideas about enforcement to infiltrate and be adopted within ASIC. ASIC also needs to be more willing to acknowledge that mistakes will occasionally be made and to identify ways to learn from them. When ASIC is unsuccessful in a court action, particularly if the court criticises how the matter was pursued, ASIC's leadership should mandate that a two-step assessment process be undertaken. The first step would be an internal review of how the case was managed. The second would be an independent review of the case and what went wrong, undertaken remotely from any officers engaged in the matter. The commission and enforcement teams would then be briefed on the findings and lessons identified by the independent review. The two-step process would allow ASIC officers to reflect on the case while also ensuring that

47 Dr Stuart Fysh, *Proof Committee Hansard*, 2 April 2014, p. 1.

another informed perspective is sought. The independent review is particularly important; the committee does not believe that ASIC should rely only on its own self-analysis. However, by conducting an internal review in addition to the external review, ASIC's commissioners and senior management will be able to compare the findings of both and then consider whether the assessment offered by the internal review is frank, truly reflective and indicates a culture that is receptive to identifying and implementing improvements.

Recommendation 30

18.46 The committee recommends that when ASIC has been unsuccessful in court proceedings both an internal review and an independent review of the initial investigation and case must be undertaken.

18.47 Finally, the committee notes that ASIC's skillset may be strengthened by other less direct means. A possible way to convince a greater number of talented individuals to undertake at least part of their career at the regulator is by an enthusiastic and energetic leadership at ASIC pursuing more high-profile enforcement cases, particularly through the courts. Building a reputation of a tough and effective agency will make it easier for ASIC to attract, employ and retain talented and driven individuals.

PART IV

Communication and engagement

Overview of Part IV

An issue that most submitters had a view on during this inquiry was ASIC's approach to communicating with those that interact with it. This part examines ASIC's communication and engagement with its large number of diverse stakeholders.

One group of stakeholders examined is the regulated population. This part of the report examines the evidence received from the industry and professional associations regarding their perceptions about ASIC's performance and how effectively they consider ASIC communicates and engages with them. ASIC's performance in providing services that regulated entities and others may need to use is also examined.

The second type of stakeholders examined in detail are individuals that may contact ASIC seeking assistance and/or to report misconduct. Many expressed frustration with ASIC's poor communication or apparent inaction. This part examines why this is the case and considers the extent of the 'expectation gap' between what individuals may expect ASIC to do and what ASIC's functions, powers and resources enable it to do. ASIC's communication and engagement with the general public, including its financial literacy work and its website, are also considered.

Chapter 19

ASIC's performance: the perspective of key stakeholders

19.1 The committee received evidence from many organisations representing various gatekeepers and other professionals, as well as from individual entities regulated by ASIC. Reflecting ASIC's broad remit, the committee heard from bodies representing company directors, lawyers, financial advisers and planners, the superannuation industry, company secretaries, accountants, auditors and insolvency practitioners. Evidence was also received from consumer groups, firms and specific entities regulated by ASIC, such as the Australian Securities Exchange (ASX).

19.2 Given the opportunities available to these bodies to interact with ASIC and other government agencies, these stakeholders have a unique and valuable perspective on ASIC's performance. Importantly, they can also channel the views of the industry or professionals they represent. This chapter examines the evidence received from these stakeholders regarding how ASIC works with their organisation.

19.3 The committee received suggestions about how industry expertise can be better utilised by ASIC through co-regulation and secondments. Such proposals can encourage better regulatory outcomes, but they can also lead to concerns about regulatory capture or allegations of conflicts of interest within the regulator. This chapter also considers these issues.

Overall views on working with ASIC

19.4 The committee was interested in canvassing the views that professional bodies, industry groups and market operators had on how ASIC worked with their organisations. Most of the evidence received on this topic was, overall, positive. For example, the ASX informed the committee that it works closely with ASIC and that the processes set up with regular meetings and exchange of information 'work well'. The ASX advised that ASIC 'has shown a willingness to actively engage with ASX' on various issues. As an example of the benefits of this close relationship, the ASX pointed to improvements made by ASIC to the rulemaking process for listing and operating rule changes.¹

19.5 Superannuation industry bodies also expressed a generally favourable view on ASIC's performance and how ASIC works with them. Like the ASX, the Australian Institute of Superannuation Trustees described a 'close association' it has had with ASIC in past years.² Industry Super Australia considered that, based on its interaction with ASIC over recent years, ASIC is 'fulfilling its functions reasonably effectively'.

1 ASX, *Submission 122*, p. 1.

2 Mr David Haynes, Executive Manager, Policy and Research, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 19 February 2014, p. 31.

Industry Super Australia added that ASIC's capacity to regulate effectively depends on the legislative framework in place.³

19.6 The Governance Institute of Australia expressed its support for 'the manner in which ASIC has engaged with stakeholders as it seeks to strengthen the regulatory framework in place'. As an example of how it considers ASIC communicates effectively, it commended how ASIC kept stakeholders informed as the regulator's administrative and information management systems were improved.⁴

19.7 Two key accounting bodies were, however, sharply critical of ASIC. CPA Australia is of the view that ASIC, under its current management, has 'increasingly isolated itself from its key stakeholders':

Rather than collaborating in a genuine and constructive dialogue with potential partners in change, it is our view that ASIC is now defined by a combative, compliance focused approach which, on its Chairman's own admission, places a premium on "leveraging" media headlines over substantive outcomes...While this media driven approach is doubtless sometimes useful in creating a perception of action to paper over an otherwise unimpressive recent track record, it has unfortunately too often led to ASIC producing public communications that are confusing and which do little to tackle the risks faced in evolving capital markets and the corporate environment, such as insider trading and corporate failure.⁵

19.8 CPA Australia advised that it had raised its concerns with ASIC but that the response 'too often reveals a regulator with a glass jaw, content with shifting blame rather than responding in a considered or constructive way, or in the spirit of cooperation which previously defined the organisation's approach'.⁶ The Institute of Chartered Accountants of Australia (ICAA) also expressed concerns about ASIC's method of working with professional bodies. The ICAA's chief executive officer concluded:

We all share, ultimately, the same goals but in recent years it has not been an effective relationship.⁷

3 Ms Robbie Campo, Deputy Chief Executive, Industry Super Australia, *Proof Committee Hansard*, 20 February 2014, p. 30.

4 Governance Institute of Australia, *Submission 137*, p. 2.

5 CPA Australia, *Submission 209*, p. 1.

6 CPA Australia, *Submission 209*, p. 1.

7 Mr Lee White, Chief Executive Officer, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 42.

Processes for consultation and engagement

19.9 ASIC needs to engage with stakeholder bodies to be an effective regulator. Established processes for consultation and discussion can provide a useful means for matters that most concern industry to receive the regulator's attention and for industry associations to seek clarification of certain issues; the regulator's response can then be communicated to the members of those associations. In the same vein, these processes also provide an opportunity for ASIC to communicate any concerns it has about recent developments or certain behaviour. Importantly, engagement helps ensure ASIC is aware of, understands and accounts for industry developments when performing its statutory functions, including the function of providing advice to government.⁸ The ICAA also noted that the performance of regulators may be affected by the regulator's isolation from industry and that effective engagement and consultation can help avoid the negative implications of isolation:

That isolation on an individual or on teams over time does negate the manner in which you may perform your duties. It drives you to continuing to do things because that is what we have done. That is why I have reached out and we have used the example of the ATO and what Chris Jordan is starting to do in his culture change. We need to protect the independence of the organisation—there is no question about that—but somehow you need to make sure there are enough fresh sets of eyes coming in to alter—back to your question—the nature, so that there is sense of eagerness and desire to change things for the right reasons.⁹

19.10 There are at least two formal methods that ASIC utilises to consult with groups of stakeholder organisations. One is the ongoing general or industry-specific consultative committees that meet on a fixed basis. The other is by undertaking consultation on a specific regulatory issue.

Regular consultation with industry and consumer associations

19.11 ASIC currently has a number of external committees that provide it with a source of expertise and act as a means for stakeholder or industry feedback or concerns to be reported to ASIC. A consultative body that represents a cross-section of stakeholders is the External Advisory Panel. This panel currently comprises 17 members and includes senior members of the financial services industry,¹⁰ the legal profession and academia.¹¹ Other external consultative committees include the

8 *Australian Securities and Investments Commission Act 2001*, s. 12A.

9 Mr Lee White, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 47.

10 The current chair of the panel is Mark Johnson AO (chairman of Alinta Energy, former chairman of AGL Energy and deputy chairman of Macquarie Bank) and the deputy chair is Allan Moss AO (former managing director and CEO of Macquarie Group). For a current list of members, see www.asic.gov.au/asic/asic.nsf/byheadline/External+Advisory+Panel.

11 ASIC, *Submission 45.2*, p. 58; 'ASIC External Advisory Panel: Purpose, Governance and Practices Summary', March 2012, www.asic.gov.au (accessed 8 July 2013).

Consumer Advisory Panel, Market Supervision Advisory Panel and the Registry and Licensing Business Advisory Committee.¹²

19.12 ASIC advised that the External Advisory Panel meets on a quarterly basis with all of the commissioners. The other panels meet with selected commissioners, with the chairman attending on a periodic basis.¹³ ASIC's chairman informed the committee that he has strengthened the External Advisory Panel by expanding and rotating its membership. Mr Medcraft remarked that the senior business people on the panel act as 'ambassadors' for ASIC in the business community.¹⁴

19.13 As the inquiry progressed, it became evident that there are a number of additional regular formal meetings that ASIC conducts with some stakeholders. The Financial Planning Association advised that in addition to ad hoc meetings that may be required, it has a formal meeting with ASIC on a quarterly-basis. The chief executive officer of that organisation remarked:

To be quite honest, I feel like I could pick up the phone and call Peter Kell or Greg Medcraft at any stage, because I have dialogue with them as well.¹⁵

19.14 The chief executive officer of the Association of Financial Advisers similarly noted that his organisation meets with ASIC on a regular basis. He made some additional favourable comments on the working relationship that existed between senior ASIC representatives and his organisation:

We also have a regular ongoing schedule of meetings with Peter Kell and his team. That commenced early last year. In fact we have had Peter himself speak at our conferences and take part in the national road show that speaks to about 1,400 advisers nationally...The good thing we found was that conversations have been two-way. I think they are paying more respect now to the professional standing and to the knowledge and insight we can bring. Recent examples would be around the research into insurance switching advice.¹⁶

19.15 A representative of the Corporations Committee of the Law Council of Australia stated that when that committee has met in Melbourne, ASIC 'has been very good at sending along appropriate people and quite senior people, including at times commissioners, to those meetings on a regular basis, which the committee as a whole has very much appreciated':

12 ASIC, *Submission 45.2*, p. 58.

13 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 90.

14 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 90.

15 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Proof Committee Hansard*, 19 February 2014, pp. 71–72.

16 Mr Brad Fox, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 19 February 2014, p. 72.

It is useful because at each meeting ASIC can answer questions about their policy, consultation papers and things like that. That is very helpful for practitioners. ASIC can also hear criticism of things we do not like. That is something that the committee in Melbourne has very much appreciated and I think ASIC is to be commended for that because it is very useful, I think for both sides, in terms of identifying issues that are arising and addressing them quickly.¹⁷

19.16 Consumer groups also expressed support for ASIC's approach to engagement and consultation. The Consumer Action Law Centre wrote favourably about the Consumer Advisory Panel:

While we have some concerns with ASIC's ability to respond in a timely way to matters referred to it...we are overall pleased with ASIC's collaboration with consumer advocates, particularly through the Consumer Advocacy [sic] Panel (CAP). The CAP provides a direct line of communication between consumer advocates and senior ASIC officials including the Deputy Chairman Peter Kell and frequently the Chairman, Greg Medcraft...In our experience the discussions at CAP meetings are informative, frank and useful, which compares very favourably with the common experience of meeting with government or industry representatives who can be unwilling to respond openly to questions or concerns.¹⁸

19.17 The Consumer Action Law Centre also noted that ASIC was responsive to suggestions for improving how the advisory panels operate. Following a recommendation made by that organisation, a process is now in place for ASIC to regularly report to consumer organisations on the progress of complaints made by those organisations, within the bounds of ASIC's confidentiality obligations.¹⁹

19.18 Other organisations were less supportive of ASIC's current approach to engagement with stakeholders. In its submission, CPA Australia advised that there is currently 'no ongoing regular contact between ASIC and the financial services industry'. CPA Australia stated that in the past ASIC consulted with financial services industry associations and their representatives through regular forums; these forums were subsequently replaced by a Financial Services Consultative Committee (FSCC). According to CPA Australia, meetings of the FSCC 'have not been held for a number of years', and that engagement is now limited to consultation papers that ASIC releases.²⁰ At a public hearing, however, it was revealed that ASIC contacted CPA Australia about ways to open dialogue soon after CPA Australia's submission to the committee was published. Mr Alex Malley from CPA Australia explained:

17 Mr Bruce Dyer, Member, Corporations Committee, Business Law Section, Law Council of Australia, *Proof Committee Hansard*, 20 February 2014, p. 3.

18 Consumer Action Law Centre, *Submission 120*, p. 5.

19 Consumer Action Law Centre, *Submission 120*, p. 5.

20 CPA Australia, *Submission 209*, pp. 3–4.

I have been contacted—I think several days after this submission—to open the door to some dialogue. I thought that was interesting timing. Nonetheless, I look forward to the future. If we can improve that, we would certainly seek to, and I know my colleague Mr White would work with us in that process.²¹

19.19 In response to questions about the FSCC, ASIC advised that it was established in 2007 as a forum to 'deal with general financial services issues that were not specific to a particular industry/association'. However, the FSCC was disbanded in 2008. ASIC submitted that this followed the restructure of ASIC that occurred at that time as well as feedback from participants that suggested 'they did not feel comfortable raising regulatory issues in front of one another'.²² Nevertheless, ASIC stressed that regular consultation between ASIC and financial services industry bodies and firms occurs. It advised that ASIC's commissioners meet 'at least annually' with the boards of key industry groups with more regular contact undertaken at lower levels.²³ During 2012–13, 620 meetings between ASIC and industry associations took place.²⁴

Ad hoc consultation

19.20 ASIC also engages in consultation on specific issues as required. This takes place formally through the release of consultation papers or draft regulatory guides for public comment. ASIC also meets with stakeholders to discuss specific issues of concern or as legislative or regulatory changes are being implemented. ASIC reported to the committee that in 2012–13 it issued 33 consultation papers for public comment with stakeholders having, on average, seven weeks to prepare a submission.²⁵ As an example, ASIC pointed to the extensive consultation processes it engaged in as part of the introduction of the Future of Financial Advice (FOFA) and Stronger Super reforms:

It is no exaggeration to say that there were multiple meetings every week around those issues, around how we were going to implement the law and around the concerns of individual companies. Also, there were national public meetings around the country.²⁶

19.21 In relation to FOFA and Stronger Super, the Australian Institute of Superannuation Trustees advised that it has worked closely with ASIC over the past three years as the reforms were being designed and implemented:

Our experience has been that ASIC's commitment to consultation has been evident throughout. I think it has been a challenge for government agencies

21 Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 44.

22 ASIC, answer to question on notice, no. 6 (received 25 March 2014), p. 15.

23 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 23.

24 ASIC, answer to question on notice, no. 6 (received 25 March 2014), p. 14.

25 ASIC, answer to question on notice, no. 6 (received 25 March 2014), p. 14.

26 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 23.

to manage and coordinate relationships between ASIC, APRA, ATO and other relevant regulators on the one hand and the industry on the other. But ASIC has generally done so efficiently and accessibly. As we mentioned in our submission, we have found their staff to be of a high quality and responsive and helpful.²⁷

19.22 CPA Australia, however, criticised some aspects of ASIC's issue-specific consultation. On the FOFA consultation process, CPA Australia complained that ASIC did not initially consult with the accounting profession and that attempts to become involved were frustrated:

Our request to be invited into the discussion when it related to the accounting profession and the other financial advisers were filibustered and delayed. We knew from talking to others in the market that they were having meetings, whereas we were not at the table at the time. So we had to kind of force our way into the discussion, and it ended with front-page newspaper ads.²⁸

Comparison with other agencies and jurisdictions

19.23 CPA Australia and the ICAA were the two organisations that expressed the most concern about ASIC's consultation and engagement processes. The chief executive officers of both organisations were asked to identify the agencies that, in their experience, engage in more effective consultation. The responses given were the New Zealand Financial Markets Authority and the ATO (under the new Commissioner of Taxation, Mr Chris Jordan AO).²⁹ The following remarks were made about the approach taken by the ATO:

Mr White: ...the early engagement that both organisations are now having with Chris Jordan, the commissioner of the ATO, is a real breath of fresh air. His approach to smarter and more effective regulation is admirable, and we want to work much more with him.

Mr Malley: I would simply concur with that, because we have had the same experience with the tax office.³⁰

19.24 Consultation can also be built into the statutory obligations and structure of the regulator. For example, the UK Financial Conduct Authority (FCA) is required by statute to 'make and maintain effective arrangements for consulting practitioners and consumers on the extent to which [the FCA's] general policies and practices are

27 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 19 February 2014, p. 31.

28 Mr Paul Drum, Head of Policy, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 45.

29 *Proof Committee Hansard*, 19 February 2014, pp. 42, 44.

30 Mr Lee White, Institute of Chartered Accountants Australia; Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, pp. 44–45.

consistent with its general duties...³¹ These arrangements must include a Practitioner Panel and a Consumer Panel, and the FCA must have regard to any representations made to it by these panels.³² The FCA has also established a Smaller Business Practitioners Panel and Markets Practitioner Panel.³³ The consumer panel, which is known as the Financial Services Consumer Panel, is examined further in Chapter 20.

Collaboration and whether there should be greater co-regulation

19.25 Collaboration between industry and ASIC that leads to regulatory issues or areas of concern being promptly and effectively addressed, either without additional state-imposed regulation or by such regulation being better targeted and implemented, is clearly a desirable outcome. For example, on measures to improve consumer protection, CPA Australia noted that the best way to achieve results 'is to build a relationship with the stakeholders who actually deliver the product and service to the consumer'.³⁴ Industry and professions can also perform effectively some of the tasks that the regulator may otherwise have to undertake; in Australia, the existence of such co-regulation is evident through external dispute resolution schemes, codes of conduct and disciplinary bodies.

19.26 The chief executive officer of the ICAA, Mr Lee White, argued that Australia's financial services regulatory framework could be made more efficient and effective through greater co-regulation. In his view, a co-regulatory model 'is a wonderful goal that we could substantially do now, if we have the intent', and that co-regulation could result in matters being addressed 'in a much more timely manner than they are'.³⁵ He noted that New Zealand has elements of a co-regulatory model. The ICAA's submission concluded:

While there will always be a need to maintain a clearly delineated separation of function and accountability between ASIC and external stakeholders, we believe there is a pressing need for ASIC to engage in greater regular collaboration with industry and professional bodies in order to achieve the most effective and efficient regulatory outcomes possible. To date, ASIC has not maximized the opportunity that is presented by a strong working relationship with co-regulatory stakeholders. There has been an apparent lack of willingness on ASIC's part to work in an open and shared manner in order to secure the right outcomes in the marketplace.³⁶

31 Financial Services and Markets Act 2000 (UK), s. 8.

32 Financial Services and Markets Act 2000 (UK), ss. 9, 10.

33 Financial Conduct Authority, *Corporate governance of the Financial Conduct Authority*, April 2013, www.fca.org.uk/your-fca/documents/corporate-governance (accessed 20 March 2014), p. 4.

34 Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 47.

35 Mr Lee White, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 47.

36 Institute of Chartered Accountants Australia, *Submission 203*, p. 2.

19.27 Professor Dimity Kingsford Smith argued that co-regulation could perform a role, however, in her view 'clear regulatory messages from the state' are required so that professional and industry associations:

have external legitimacy for bringing their good values forward, too, and doing the kind of work that they do, whether that is disciplinary tribunals, codes of conduct or dispute resolution for disenchanted financial consumers, and so on.³⁷

19.28 Professor Kingsford Smith suggested that ASIC does not have adequate powers under the legislation it administers to engage with professional bodies to the degree it may want to.³⁸

19.29 Organisations representing financial advice professionals expressed either supportive or qualified views on co-regulation. The Financial Planning Association of Australia argued that legislation should facilitate the establishment of co-regulatory approaches, particularly as legislation such as the Corporations Act is overarching and not-industry specific, whereas professional obligations are industry specific and better address the roles, services and consumer interactions of participants in that industry.³⁹ The Association of Financial Advisers noted some of the benefits of associated with co-regulation, but it questioned whether greater co-regulation would lead to additional external dispute resolution that could leave financial advisers subject to several dispute and disciplinary procedures.⁴⁰

19.30 When questioned about suggestions for greater or more formal co-regulation, ASIC's deputy chairman, Mr Peter Kell, advised that ASIC does look at co-regulation in various sectors. As an example of co-regulation, he cited the external dispute resolutions schemes such as the Financial Ombudsman Service and Credit Ombudsman Service, organisations that are 'integrated into the way [ASIC] would approach retail financial services'. However, Mr Kell added that ASIC assesses the risks and desirability of co-regulation on a sector-by-sector basis, to ensure that co-regulation or self-regulation is relied on only in sectors where it is effective. Mr Kell suggested that the financial advice sector was one area that, in ASIC's view, is not ready for co-regulation at the moment.⁴¹

19.31 Others expressed some misgivings about the level of trust associated with co-regulation. Professor Justin O'Brien pointed to Australia's experience of surviving the global financial crisis relatively unscathed to warn that there is a 'danger of

37 Professor Dimity Kingsford Smith, *Proof Committee Hansard*, 19 February 2014, pp. 54–55.

38 Professor Dimity Kingsford Smith, *Proof Committee Hansard*, 19 February 2014, p. 55.

39 Financial Planning Association of Australia, *Submission 234*, p. 8

40 Mr Brad Fox, Association of Financial Advisers, *Proof Committee Hansard*, 19 February 2014, p. 72.

41 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 24.

succumbing to hubris'. He added that the global financial crisis demonstrated that 'it is no longer enough to rely on stated trust—it has to be warranted':

Yes, it is true, none of our major banks collapsed, but we have seen widespread bad behaviour within the marketplace. We have seen the failure of boutique investment companies; we have seen the failure of managed investment funds. We have seen identified problems in this marketplace and we are beginning to see through the LIBOR and the currency manipulation scandals basically also Australian banks being implicated in that process. So I think it is essential that we utilise a hearing like this to really think through what are the weak points in our regulatory system, to what extent we can professionalise that regulatory system and to what extent we can actually introduce responsibility and restraint within it so that self-regulatory or co-regulatory initiatives have the opportunity to work.⁴²

19.32 Professor O'Brien added that if 'industry really wants co-regulation, it has to actually accept its responsibility for the integrity of that co-regulatory structure rather than leave it simply to ASIC'.⁴³

Industry secondments

19.33 Secondments between the regulator and industry can be an effective way for the regulator to gain 'real world' expertise and awareness of industry developments and current thinking. Several industry associations and other key stakeholders highlighted the benefits of secondments and suggested that ASIC should utilise them more. Industry Super Australia recommended that ASIC adopt a formal secondment process with ASIC employees working in the industry. It argued that this would ensure that ASIC's employees have 'a deeper understanding of the industry which it regulates, including market developments and culture'. Industry Super Australia added that 'it may also assist the industry to better understand the approach taken and the challenges and opportunities facing the regulator'.⁴⁴ Finally, Industry Super Australia noted that the secondment program would ideally connect ASIC with graduate and leadership programs operated by major institutions.⁴⁵

19.34 A representative from another superannuation body, the Australian Institute of Superannuation Trustees, reported that he had seen 'continuous improvements' in ASIC's staff engagement with, and understanding of, the superannuation industry. Nevertheless, he suggested that ASIC should establish a formal process for ASIC employees to be seconded to superannuation funds 'so they get a better appreciation of

42 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 60.

43 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 58.

44 Industry Super Australia, *Submission 201*, p. 13.

45 Industry Super Australia, *Submission 201*, p. 13.

the practical and operational aspects of running funds, as well as a better appreciation of the member focus of the not-for-profit sector'.⁴⁶

19.35 CPA Australia suggested that a strengthened secondment program could address gaps in ASIC's industry knowledge and provide ASIC officers with ideas on how ASIC could engage with industry better:

...I think when you go into the organisation at various levels and talk to people that what is probably missing at the moment is there is not a sense that there is enough of that 'on the street'—having lived in business long enough—to know what a big issue is from a small issue; what a one-off issue is from a systemic issue. It is about being blooded in a market. So perhaps...we need a rotational model that says for two years some of the future leaders of ASIC go out and work in business on a secondment and learn about how that world looks and breathes and feels, so that when they come in they are informed by that behaviour and perhaps know how to deal with it and engage it better.⁴⁷

19.36 The ICAA and the Governance Institute of Australia noted that suitable secondment programs could improve decision-making within ASIC; in particular, they suggested that more consistent decisions could be a result of such programs.⁴⁸

19.37 The Corporations Committee of the Law Council of Australia's Business Law Section also supported secondments between ASIC and law firms. It argued that the Takeovers Panel utilises secondments with 'great success', and that in the United States a secondment with the Securities and Exchange Commission 'is viewed as valuable career stepping stone'.⁴⁹ The senior secondments used by the UK regulator

46 Mr David Haynes, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 20 February 2014, p. 33.

47 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, pp. 49–50.

48 The Governance Institute of Australia submitted that there 'is a lack of consistency in how ASIC staff may deal with matters, with sometimes variable approaches adopted in interpreting even the most basic processes. For example, when applying for an [AFS licence], Governance Institute of Australia members have experienced situations where different licensing conditions have been imposed for applications which are in all respects identical'. The Governance Institute also advised that company secretaries rely on advice or information from ASIC staff, however, 'there can be gaps between the advice being put forward and the reality of corporate governance practice' and that 'advice must be able to be practically implemented to ensure good governance outcomes'. The ICAA noted that inconsistent decision making 'can often be a source of frustration for investors and consumers'. See Governance Institute of Australia, *Submission 137*, pp. 7–8 and Institute of Chartered Accountants Australia, *Submission 203*, p.3.

49 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 6.

were also cited. However, ASIC's resource constraints were noted, with one of the Law Council's representatives observing that 'there is no free lunch'.⁵⁰

19.38 While industry groups and professional associations were supportive of increased secondments, the committee received submissions that expressed concern about such arrangements. Some were based on a perception that ASIC is too close to the industries that it is supposed to regulate, and that the movement of employees between ASIC and the private sector supports this contention.⁵¹ However, the committee also received evidence from a former ASIC employee alleging that conflicts of interest were not appropriately managed during a secondment.

Allegations of conflicts of interest influencing ASIC's actions

19.39 A former employee of ASIC, Mr James Wheeldon, gave evidence to the committee about the lead up to regulatory relief being granted for online superannuation calculators in 2005. Mr Wheeldon alleged that ASIC was unduly influenced by the wishes of a key industry organisation and that the process for providing the relief was outside ASIC's stated procedures and had a pre-determined outcome. According to Mr Wheeldon, the relief granted as a result allowed online calculators to be offered that did not comply with the reasonable basis for advice obligation that was in place in the Corporations Act at the time. In his view, the calculators could simply be used by firms 'as a marketing tool to get people into their financial adviser network', by gathering information and not reflecting the impact of fees. He used a calculator offered by one firm as an example:

...it had no capacity for modelling fees in it; it acted as if fees did not exist. In fact, it would ask the user a bunch of very intrusive questions: how old are you? How old is your spouse? What is your income? What are your superannuation savings? How long do you plan on working for? And so on. Then it would come up with a projection which would not really have much to do with reality at all. Then, on the next page, it would say, 'Put in your phone number and your email address and we'll have a financial adviser call you'.⁵²

19.40 Mr Wheeldon also advised that the individual he was required to report to was a secondee from a firm that was a member of the industry organisation. Although the individual disclosed a potential conflict of interest, Mr Wheeldon advised that ASIC kept the secondee on the calculator relief project. Mr Wheeldon stated:

I have looked high and low for information about ASIC's policy of accepting secondees. If you go to the website you cannot find anything. If you go through their annual reports, which I have done for the last 10 years, there is effectively zero disclosure of the secondees from industry coming

50 Mr John Keeves, Chairman, Business Law Section, Law Council of Australia, *Proof Committee Hansard*, 20 February 2014, p. 8.

51 For example, see Mr Gus Dalle Cort, *Submission 301*, p. [3].

52 Mr James Wheeldon, *Proof Committee Hansard*, 2 April 2014, p. 19.

to ASIC...I also note that Mr Medcraft spoke to the Joint Committee on Corporations and Financial Services on Friday and he said, 'We are very careful about secondments. If we do secondments clearly we have to be sure that they are not into an area where they are regulating their own firm, for example.' Mr Medcraft said that there were very strict rules governing secondments. That was absolutely not true when I was working there...I think having secondments into the policy branch—you just cannot do it that way. ASIC need to have their own people who are doing that. That cannot be the only way that you get the skill in. If they want somebody who has got experience working for an investment bank or a top law firm, they should hire somebody and they should become members of the Australian Public Service and bound by the Public Service code of conduct and owing a fiduciary duty only to the Public Service and to the Australian people. But instead you had a fellow who I assume owed a duty primarily to his employer and he was representing his employer's interests within ASIC, and ASIC tolerated it.⁵³

19.41 The class order made by ASIC was a disallowable legislative instrument; that is, it was a form of delegated or subordinate legislation made by the executive that either House of Parliament could potentially, within a limited timeframe, disallow. Mr Wheeldon questioned the explanatory statement associated with the class order that was tabled in Parliament. He advised that the reason given in the explanatory statement for the lack of public consultation prior to relief being granted was because the relief was of 'a minor and machinery nature'. Mr Wheeldon alleged that the statement was 'deliberately misleading'.⁵⁴

ASIC's response

19.42 ASIC responded at length to Mr Wheeldon's testimony.⁵⁵ It 'completely' rejected the allegations that Mr Wheeldon made. ASIC described online calculators as 'a common and popular tool' and stated that without the legal relief granted by ASIC, both retail and industry superannuation funds may have been unable to provide such calculators. ASIC described the situation as 'an unintended result of broader reforms to the financial services law implemented in 2002, which meant generic super calculators could be caught under the personal advice requirements':

So instead of being free and easily accessible, consumers wanting to use these online calculators would have to see a financial planner for personal advice, which can be expensive and time consuming. This clearly was not a sensible or desirable situation, and ASIC initially provided public guidance to the industry in May 2004 to help with the provision of these calculators.

53 Mr James Wheeldon, *Proof Committee Hansard*, 2 April 2014, p. 22.

54 Mr James Wheeldon, *Proof Committee Hansard*, 2 April 2014, p. 19.

55 See ASIC, 'Opening statement made by ASIC at a public hearing held in Canberra on 10 April 2014', *Additional Information 4*, pp. 7–9 and ASIC, *Submission 45.5*.

However, significant uncertainty remained, which the Government at that time publicly recognised in its 2005 consultation paper on *Refinements to Financial Services Regulation*. The Government noted ASIC would provide guidance or legal relief for the provision for online calculators to 'promote their use'.

In May 2005, ASIC announced it would grant legal relief to the whole industry (what we call class order relief), and in June that year we issued this relief for super calculators following consultation with a range of super industry bodies. We extended this relief to other investment calculators later that year following further public consultation.⁵⁶

19.43 ASIC emphasised that because every fund could use the legal relief irrespective of the industry association they belonged to, there was 'no special treatment'. The conditions attached to the relief required that the assumptions underpinning the calculators needed to be reasonable and that clear and prominent statements about the purpose and limitations of the assumptions were displayed. Further, ASIC argued that the law against misleading and deceptive conduct still applied.⁵⁷

19.44 In a supplementary submission, ASIC provided further information about the process associated with this class order. ASIC stated that the industry association was not required to lodge a formal relief application as formal applications are only required where an individual seeks relief from the law as it applies to them.⁵⁸ On how the secondee's potential conflict of interest was managed, ASIC noted that the secondee was bound by ASIC's general conduct requirements of employees, including the APS Code of Conduct. ASIC advised that there was 'awareness' of the potential conflict and that the secondee was not a decision maker, was closely supervised by a senior manager and worked on the issue as a member of a team.⁵⁹ ASIC emphasised that the decisions were made by senior officers:

Both the initial decision to grant relief applying to superannuation calculators and the subsequent decision to extend the relief were made by ASIC's Regulatory Policy Group, over a series of meetings in 2005. ASIC's Regulatory Policy Group meets approximately every fortnight and considers new or revised regulatory policy, law reform and novel applications for relief. Its membership comprises Commissioners and senior leaders from across ASIC. In other words, proposals for relief of this type are not decided only by the team directly responsible for developing the work.⁶⁰

56 ASIC, *Additional Information 4*, pp. 7–8 (emphasis omitted).

57 ASIC, *Additional Information 4*, p. 8.

58 ASIC, *Submission 45.5* pp. 4, 7–8.

59 ASIC, *Submission 45.5*, pp. 11–12.

60 ASIC, *Submission 45.5*, p. 7.

19.45 ASIC added that the examination of the relevant files to date does not enable it to confirm whether the employee amended internal issues papers or drafted emails to the industry body, although any internal papers or emails 'would have been settled by a senior ASIC officer'.⁶¹

19.46 When asked about Mr Wheeldon's assertion that the online calculators were primarily used as a marketing tool, ASIC dismissed the concerns:

No, it is a condition of the class order relief provided to superannuation funds that the calculators are not used to market particular products and that they must spell out the assumptions that are underpinning the calculations and the clear limitations of the calculators are also set out. We take that very seriously. It is also the case that firms providing these calculators to their fund members have to satisfy the ASIC Act requirements not to mislead or deceive. So we do not believe they are being used as marketing tools in that way. In fact, how we see them being used generally is as very useful tools to help consumers provide a guide for themselves about the sort of amount they will end up with in retirement.⁶²

19.47 However, ASIC was also questioned about a particular online calculator available after the relief was granted, but which was later removed from the firm's website. Specifically, ASIC was asked how the calculator modelled fees, how the effects of the fees were presented to the user and whether the calculator could be considered primarily to be a marketing tool to attract people to the firm's financial adviser network. ASIC's response was that it is not in a position to comment on the online calculator as it did not review it.⁶³

Committee view

19.48 It is evident that, overall, the industry associations and consumer groups that deal with ASIC on a regular basis are generally supportive of ASIC's approach to consultation. ASIC should be commended for this. In particular, the committee is pleased that ASIC has been responsive to suggestions for improving consultation and the flow of information between it and other groups, such as those made by the Consumer Action Law Centre. The committee acknowledges the consultative bodies ASIC currently utilises and recognises that ASIC has managed to secure the involvement of experienced and talented individuals as participants on these committees. The committee considers that these processes should provide ASIC with a valuable source of expertise and an effective means for two-way communication between the regulator and key stakeholders.

19.49 ASIC's relationships with all of the major professional and industry associations matter. When ASIC suggests that an industry needs to address a

61 ASIC, answer to question on notice, no. 12 (received 21 May 2014), pp. 18–19.

62 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 91–92.

63 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 20.

particular issue, the nature of that response—constructive or otherwise—can depend on whether that industry respects and has a sound relationship with ASIC. Within the accounting profession there were clearly strong concerns about ASIC's approach, although it must be acknowledged that the two accounting bodies the committee received evidence from are in the minority: most industry and professional associations gave favourable evidence about their engagement with ASIC. Nevertheless, the committee appreciates the frank evidence it received from CPA Australia and the ICAA. Given accountants are key gatekeepers in Australia's financial system, CPA Australia's and the ICAA's descriptions of the relationship they have with the regulator are troubling. The committee is not particularly interested in which side is at fault; the relationship between ASIC and the accounting bodies simply needs to be repaired.

Recommendation 31

19.50 The committee recommends that the accounting bodies and ASIC work to repair their relationship and commit to a more constructive approach to discussing regulatory issues. The committee requests that ASIC provide a written report to the committee in six months' time informing the committee of progress achieved in strengthening this relationship.

19.51 The evidence in support of greater co-regulation was of interest to the committee. Effective and low-cost ways to improve conduct in particular sectors should be identified and taken into account in regulatory design, and if it is demonstrated that co-regulation proposals meet this test, they should be considered. ASIC appears to be aware of the benefits and difficulties associated with co-regulation on a sector-by-sector basis. The committee does not consider that the case has been made during this inquiry for the ASIC Act to be amended to require greater co-regulation. The committee notes that this may be an issue that the Financial System Inquiry will consider, particularly as it is tasked with assessing the effectiveness and need for financial regulation and the roles of government and its financial regulators. Other recommendations made by the committee in this report may also support more effective self-regulation and co-regulation.

19.52 In addition to co-regulation, more practical and effective regulatory outcomes can also be promoted by providing ASIC employees with greater awareness of how the industries ASIC regulates actually function. Secondments are one way to achieve this, and the committee encourages ASIC to utilise them. However, the committee notes the concern in some segments of the community about the perception that ASIC is too close to the entities it is supposed to regulate, and that secondments can intensify suspicions about ASIC's conduct. ASIC needs to be careful to avoid undue influence being exercised on its actions as a result of the secondment process. Importantly, ASIC also has to be *seen* to be careful that the integrity of its decision-making is not undermined by secondments. ASIC needs to be more transparent about the secondment processes it has and the policies in place for managing possible conflicts of interest.

Recommendation 32

19.53 The committee recommends that ASIC publish on its website information about its secondment programs and the policies and safeguards in place that relate to these programs.

19.54 Finally, the committee wishes to comment on the allegations made by a former ASIC employee about ASIC being unduly influenced by an industry association as a result of a secondment.

19.55 The committee's comments will be of a general nature as it has considered this evidence in the context of broader questions about ASIC's performance and accountability. It would be more appropriate for the specific allegations to be considered by the Commonwealth Ombudsman, either after receiving a complaint from Mr Wheeldon or on an 'own motion' basis. The committee understands that the Commonwealth Ombudsman would be able to consider the allegations (other than the allegation that Parliament was misled), although as the allegations relate to events that occurred ten years ago, an investigation may face a number of practical impediments. The committee recognises that the Commonwealth Ombudsman is an independent statutory officer and that any investigation would be at the Ombudsman's discretion. The committee notes that, for future allegations, the *Public Interest Disclosure Act 2013* provides a process for public officials to report suspected wrongdoing in the Australian public sector. The committee's recommendation regarding greater transparency about ASIC's secondment processes should also help instil confidence that ASIC is aware of these issues and manages potential conflicts of interest appropriately.

Recommendation 33

19.56 The committee requests that the Commonwealth Ombudsman consider undertaking an own-motion investigation into the allegations related to the process that resulted in ASIC granting regulatory relief for generic online calculators in 2005. An investigation undertaken by the Ombudsman should, in particular, consider whether the process was undermined because ASIC did not adequately manage a conflict of interest identified by a person on secondment from a financial services firm.

19.57 The committee agrees with ASIC that online calculators are an important educational tool for consumers. However, the committee is concerned that after it made the class order granting relief, ASIC did not review the calculators the industry designed and published. This is a further example of ASIC not displaying sufficient scepticism of the industry it regulates and not monitoring compliance with an arrangement it has authorised.

19.58 ASIC's ability to grant exemptions or modifications to the operation of the Corporations Act and certain other legislation is a significant power that should be exercised carefully. It is essential that both the process leading to relief being granted and the compliance monitoring that occurs afterwards are sound. In future,

the committee urges ASIC to monitor more actively and assess compliance with the conditions of the relief it grants. It may assist the Parliament, regulated entities and other interested persons if the explanatory statement associated with class orders specifically advises that ASIC will be monitoring compliance.

Recommendation 34

19.59 The committee recommends that after exercising its discretionary powers to grant relief from provisions of the legislation it administers, ASIC should ensure that it puts in place a program for monitoring and assessing compliance with the conditions of the relief.

Chapter 20

Community expectations and financial literacy

20.1 Many submitters who expressed disappointment with ASIC's performance assumed that ASIC had the authority and the resources to act on their behalf. In this chapter, the committee examines the expectations that investors and other consumers of financial services hold when it comes to what ASIC can and cannot do. It seeks to establish whether there are gaps between community expectations of what ASIC can or should do and ASIC's actual statutory functions and powers.

20.2 The committee also takes the opportunity to consider financial literacy in Australia and the way in which ASIC disseminates information.

Expectation gap

20.3 A number of major institutions and academics expressed their concerns about the extent to which investors believe that ASIC is able to protect their interests. For example, the Financial Planning Association of Australia was concerned about the 'misalignment between consumer perception of the role ASIC should play in assisting them when things go wrong versus what ASIC can actually deliver'.¹ The Association of Financial Advisers shared this view, maintaining that only a limited proportion of consumers appreciated ASIC's role.² Along similar lines, the Corporations Committee of the Law Council of Australia's Business Law Section wrote:

It is possible that some financial consumers misunderstand the difference between a prudential regulator such as APRA and a conduct regulator such as ASIC. In other words, people may think that ASIC can give comfort to financial consumers in the same way APRA may be taken to protect the interests of depositors or policy holders.³

20.4 The Corporations Committee recognised that ASIC has 'neither the mandate nor the resources to perform such a role', and suggested that 'perhaps more needs to be done to ensure that an "expectation gap" does not exist in this regard'.⁴ Likewise, the Australian Institute of Company Directors stated:

...ASIC is often placed in a difficult position due to the unrealistic expectations of the government, media and general public. There seems to

1 Financial Planning Association of Australia, *Submission 234*, p. 6.

2 Association of Financial Advisers, *Submission 117*, p. 3. See also Mr Jason Harris, *Submission 116*.

3 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4.

4 *Submission 150*, p. 4.

be a general misunderstanding as to what ASIC can reasonably achieve as a regulator.⁵

20.5 With regard to unrealistic expectations, the Governance Institute referred to 'a strong public perception that the regulator should be proactive in stopping...corporate misconduct from occurring in the first place'. Mr Jason Harris from the University of Technology, Sydney (UTS) Faculty of Law, explained:

Criticisms based on a failure to prevent corporate scandals or collapses represent a misunderstanding of the focus of corporate regulation in Australia. Australia's corporate regulatory framework is based largely on the disclosure paradigm. Rather than vetting documents (such as prospectus documents and annual reports) ASIC is merely the body that receives copies of those documents. It is up to investors to read the information and make a complaint if they discover a problem. I'm sure ASIC does act proactively where it has reason to do so, but with over 2 million companies to deal with ASIC cannot read and assess every document.⁶

20.6 This expectation gap is evident in complaints lodged with the Commonwealth Ombudsman. Of the complaints he receives about ASIC, 'a frequent point of dispute appears to be the reporter's perception of ASIC's role as regulator and the expectation of a specific outcome from making a report, compared with ASIC's stated broader public benefit purpose'. The Ombudsman quoted from ASIC's published guidance on how it deals with complaints of misconduct, where ASIC advises that:

All reports of misconduct that we receive provide us with valuable information, but not every matter brought to our attention requires us to take action. Under the laws we administer, we have the discretion to decide whether to take further action on reports of misconduct that we receive. Generally we do not act for individuals and we will seek to take action only on those reports of misconduct where our action will result in a greater impact in the market and benefit the general public more broadly.⁷

20.7 As shown in previous chapters, a significant number of submitters held the expectation that ASIC should have investigated their complaint. The Ombudsman was of the view that 'early management of expectations about what ASIC can or will do and the provision of better explanations of decisions to complainants should lead to a decrease in the number of complainants seeking an internal review of decisions by ASIC, as well as the number of complaints to the Ombudsman about ASIC'.⁸

5 Australian Institute of Company Directors, *Submission 119*, p. 3. See also *Submission 150*.

6 Mr Jason Harris, *Submission 116*, pp. 1–2.

7 ASIC, *How ASIC deals with complaints of misconduct*, Information Sheet 153; cited in Commonwealth Ombudsman, *Submission 188*, p. 8.

8 Commonwealth Ombudsman, *Submission 188*, p. 16.

Licensed financial services providers, credit providers and registered companies

20.8 ASIC's licensing regime was one particular area where many people held a false notion about the extent of ASIC's power. Professor Dimity Kingsford Smith noted that:

Assessments of ASIC's performance are sometimes subject to misconceptions: perhaps the most common is that ASIC closely supervises the Australian Financial Services License (AFSL) holders it regulates.⁹

20.9 She noted that ASIC does a certain amount of surveillance of AFS licence holders when it is alerted to problems but observed further:

There is an expectation that licensing means that ASIC has some control over licensees' businesses. Likewise Australian investors expect that ASIC supervises licensees regularly. When losses occur there is anger and bewilderment that except in the limited area of market operators, participants and securities dealers ASIC does not have the power or the resources for ongoing supervision.¹⁰

20.10 In Professor Kingsford Smith's view, such expectations demonstrate that Australians mistakenly assume that ASIC has a regulatory toolkit with the types of tools that APRA has at its disposal.¹¹ Similarly, Ms Anne Lampe, a journalist and former employee of ASIC's media unit, referred to clients who often believe that, because advisers are licensed, they have passed some kind of integrity and competence screening process and that ASIC has provided a stamp of approval. She stated:

They couldn't be more wrong. The licensing process is simply a tick all boxes procedure and regulation of financial advisors and fund managers who invest the money appears to be ineffective.¹²

20.11 Indeed, ASIC argued that the relatively low threshold for obtaining an AFS licence and the relatively high threshold for removing a licence was not well understood by retail investors. It stated:

Licensing, therefore, may give retail investors a sense of security which is inconsistent with the settings of the regime. There is a perception amongst some consumers that an AFS licence means that the licensee has been approved by ASIC or that it signifies the high quality of the financial services provided by the licensee. For example, in submissions to the

9 Professor Dimity Kingsford Smith, *Submission 153*, p. 3.

10 Professor Dimity Kingsford Smith, *Submission 153*, p. 4.

11 Professor Dimity Kingsford Smith, *Submission 153*, p. 4.

12 Ms Anne Lampe, *Submission 106*, p. 1.

Inquiry, some former Storm clients have stated that 'Storm was approved by ASIC'.¹³

20.12 The matter of ASIC's licensing powers, including the effectiveness of ASIC's screening processes for licence applicants and its ability to cancel licences, is examined in chapter 24.

20.13 The committee took first hand evidence from people who thought that ASIC was in a position to provide sound advice and guidance about the integrity or competence of a financial service provider or the viability of a business. Many drew on their experiences of the Storm Financial collapse. For example, Mr Spencer Murray was of the belief that ASIC was appointed by the Australian government to prevent Australian citizens from fraud by financial institutions.¹⁴ Another submitter claimed that ASIC was the regulator who gave Storm Financial approval to run its business.

20.14 Mr Sean Mcardle stated that in 2006–07 and prior to becoming a signatory to the Storm Financial scheme, he sought ASIC's advice about any 'concerns it may have about this financial planning company'. He stated that he specifically sought 'to find out if there was anything that, as a retail investor, he should be aware of regarding Storm Financial'. This information included 'the strategy they were selling, or its director Emmanuel Cassimatis by way of complaints or anything else that as the regulator they knew and could warn me about in regards to investing with them'. Mr Mcardle informed the committee that he phoned ASIC twice and both times was advised that 'ASIC were unable to say anything about any company, its directors or the product, stating that if they did, they may get sued'.¹⁵

20.15 Mr Ron Jelich was also under the impression that ASIC had given its stamp of approval to the Storm Financial model:

Chief among the reasons for finally deciding to join Storm were (a) ASIC's 'green light' report into the operations of Storm and ASIC's endorsement of Storm's investment model; and (b) the fact that Storm's investment home loans, margin loans and the creation of exclusive Storm-badged funds were overseen by the Commonwealth Bank of Australia, the country's biggest and most highly respected bank.¹⁶

20.16 Mr Peter Rigby, who invested in Trio Capital on the basis that it was a 'Fund of Hedge Funds' and hence under the impression that it one of the safest and most diverse ways of investing, clearly thought ASIC should have prevented investor losses. He stated:

13 ASIC *Submission 378* to the PJCCFS Inquiry into Financial Products and Services in Australia, August 2009, p. 26.

14 Mr Spencer Murray, *Submission 23*, p. 1.

15 Mr Sean Mcardle, *Submission 87*, p. 1.

16 *Submission 172* and see also *Submission 18* (name withheld).

...these funds were regulated by the government watchdog ASIC, so it was reasonable to consider that the funds were being run and administered properly. If this is not the role of ASIC, what is it?¹⁷

20.17 There were also misunderstandings regarding managed investment schemes approved in principle as 'tax effective' schemes by the ATO and Treasury.¹⁸

20.18 The Australian Institute of Company Directors observed that, unlike some overseas jurisdictions, in particular the US, there was a pervading cultural bias in Australia against failure. It explained:

This bias has led to an expectation that the government can prevent corporate failures through greater regulation and that, where companies do fail, it is necessarily due to the fault of the company and/ or its directors and executives. This will inevitably impact negatively on ASIC's ability to properly prioritise its enforcement actions, as it is being constantly called on to investigate any and all corporate failures, notwithstanding the actual risks that they present or whether a breach of law is involved.¹⁹

20.19 ASIC informed the committee that its regulatory role 'does not involve preventing all consumer losses or ensuring full compensation for consumers in all instances where losses arise'. It stated:

Our underpinning statutory objectives, regulatory tools, and resources are not intended to prevent many of the losses that investors and consumers will experience. This is true of every financial market regulator.

This is a very important issue that goes to the heart of what financial market regulation is intended to achieve, and thus to expectations about ASIC's performance. Unlike prudential regulators, market conduct regulators such as ASIC do not have the same focus on preventing institutional collapse and the losses this may bring. In addition, our market-based system for investment and for capital raising, which has served Australia's development well, inevitably involves investors assuming an amount of risk in order to make a return.²⁰

20.20 Professor Justin O'Brien and Dr George Gilligan cited an interview related to ASIC's 2012 enforcement report during which Mr Medcraft, emphasised that 'you get what you pay for'. Mr Medcraft went on to stress that:

ASIC had only 26 staff to cover 25 investment banks; the 135 insurers are reviewed only once every seven years; although the big four audit firms are reviewed once every 1.5 years the remaining 72 audit firms are reviewed less than once a decade; and that although the top 20 financial planners are reviewed once every 1.7 years, for the next 30 largest it is only once every

17 Mr Peter Rigby, *Submission 364*, p. 1.

18 Burke Bond Financial Pty Ltd, *Submission 98*, p. 1.

19 Australian Institute of Company Directors, *Submission 119*, p. 3.

20 ASIC, *Submission 45.2*, p. 17.

3.8 years. This is the actuarial reality of contemporary Australian regulation.²¹

20.21 Mr Medcraft told the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) that Australia has a system that is 'based on self-execution and relies on people to do the right and it was about time people 'were realistic about what we do and what we cannot do'.²² In his view, it was important for ASIC to be 'transparent, to show Australians what we do in terms of engagement, surveillance, guidance and enforcement'.²³ As another example of ASIC's limited capacity, Mr Kell told the committee that ASIC simply cannot visit all financial advisers. A complete set of figures on the number of years it would theoretically take ASIC to cover the entire regulated population through 'high intensity' surveillances (those lasting more than two days), based on the number of surveillances conducted during 2012–2013, were outlined in Chapter 4.

20.22 This evidence clearly shows the limitations placed on ASIC's capacity to monitor and survey the people its licenses and regulates. But this message does not appear to be reflected in public expectations of ASIC's role. For example, a submitter advised that before subscribing to a trading information service he 'verified that the company is registered with ASIC in order to make sure if something goes wrong I have an official authority to protect my rights as a consumer/customer'. After further investigation, he alleged that the company was engaging in fraudulent phoenix activity. The submitter expressed concern that before a company registration occurs, ASIC does not check what products the company offers and whether these products are regulated by ASIC or not.²⁴

Financial literacy

20.23 The perception that ASIC is able to provide a guarantee about the soundness and integrity of a financial service provider, a company or a product is further complicated by the level of literacy and numeracy skills in Australia. Australia's National Financial Literacy Strategy defines financial literacy as:

...a combination of financial knowledge, skills, attitudes and behaviours necessary to make sound financial decisions, based on personal circumstances, to improve personal financial wellbeing.²⁵

21 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, p. 15.

22 Mr Greg Medcraft, Chairman, ASIC, *PJCCFS Hansard*, Oversight of ASIC, 12 September 2012, pp. 14–15.

23 Mr Greg Medcraft, *PJCCFS Hansard*, Oversight of ASIC, 12 September 2012, p. 15.

24 Mr Mustaffa Abu Sedira, *Submission 427*, pp. 1–2.

25 Financial Literacy Board, submission to the Financial System Inquiry, 28 March 2014, http://fsi.gov.au/files/2014/04/Financial_Literacy_Board.pdf.

20.24 According to the Financial Literacy Board, financially literate consumers are 'more likely to make informed financial decisions and less likely to choose unsuitable products, thus potentially reducing the degree of regulatory intervention required'.²⁶ Many organisations in the industry, however, cited the growing complexity of financial products over the past decade. For example, an OECD policy brief noted that the growing sophistication of financial markets means that:

...consumers are not just choosing between interest rates on two different bank loans or savings plans, but are rather being offered a variety of complex financial instruments for borrowing and saving, with a large range of options. At the same time, the responsibility and risk for financial decisions that will have a major impact on an individual's future life, notably pensions, are being shifted increasingly to workers and away from government and employers. As life expectancy is increasing, the pension question is particularly important as individuals will be enjoying longer periods of retirement.²⁷

20.25 The Consumer Action Law Centre referred to the current disclosure-based regulatory approach in Australia, which, in its view, 'fails to address many of the consumer problems in credit and financial services'. It suggested that more disclosure is often a bad thing and noted also that:

- credit and financial products are extremely complex and non-experts will frequently misunderstand even the most important elements;
- people do not necessarily choose between products 'rationally', they make quick decisions using mental shortcuts when dealing with unfamiliar topics or when limited by time; and
- people typically have trouble calculating costs and risks, especially when the cost or risk is temporally remote.²⁸

20.26 Professor Dimity Kingsford Smith also drew the committee's attention to research showing there were 'serious reasons to doubt the regulatory efficacy of disclosure when as much reliance is placed on it'. She maintained:

In essence the literacy and numeracy skills of the majority of Australians are not adequate for reading and analysing disclosure material for common retail financial products including superannuation. There are also indelible behavioural biases in financial decision making which can lead to unwise

26 Financial Literacy Board, submission to the Financial System Inquiry, 28 March 2014, http://fsi.gov.au/files/2014/04/Financial_Literacy_Board.pdf.

27 OECD, 'The Importance of Financial Education', *Policy Brief*, 2006, www.oecd.org/finance/financial-education/37087833.pdf. See also OECD, *Financial Literacy and Consumer Protection: Overlooked Aspects of the Crisis, OECD Recommendation on good practices on financial education and awareness relating to credit*, June 2009, www.oecd.org/finance/financial-markets/43138294.pdf.

28 Consumer Action Law Centre, *Submission 120*, p. 7.

decisions. Often disclosure documents seem more apt to protect the issuer or adviser than to inform the investor.²⁹

20.27 She underscored the important link between consumer behaviour and financial literacy:

The low level of financial literacy in Australia leads to an investor propensity to assess advice on 'the advisor's confidence, approachability, friendliness or professional manner' without looking too critically at the technical aspects or content of the statement of advice. This is one of the behavioural biases that can lead to unwise investment decision-making ...Senior citizens are seen as more vulnerable consumers, and account for up to 30% of investment fraud victims.³⁰

20.28 Many of the personal accounts before the committee, especially those drawn from the two case studies, demonstrate the harm that can result from investors or consumers placing too much trust in their adviser and in not asking questions or seeking second opinions. A former ASIC enforcement adviser, Mr Niall Coburn, suggested that ASIC needs to review how it responds to individuals and their expectations. In his view ASIC 'needs to get out into the community a lot more than it does and explain', before people invest, that they 'do not put 100 per cent in a managed investment scheme': they do not put all their 'eggs in one basket'.³¹ The Consumer Credit Legal Centre strongly recommended that:

...ASIC consider adopting a 'campaign approach' to enforcement like that used by the ACCC. In this approach, the regulator takes a multi-pronged approach to the issue by issuing media releases about concerns, guides about best practice conduct, investigations, negotiations with affected businesses and enforcement. We are aware that ASIC conducts all of these activities but suggest they could do more to coordinate them in a strategic and publicly overt manner to maximise the combined effect.³²

20.29 The Governance Institute of Australia observed that there was a wealth of useful information on the ASIC and MoneySmart websites, yet the messages were 'usually only understood by those who operate in corporate circles'. It noted that 'the expansion in the number of incorporated entities over the past 20–30 years, with which retail investors and consumers are involved through superannuation, securities trading, and employment, for example, means that ASIC is now just as relevant to them as the ATO is'.³³ It noted further that many in the broader community do not know what ASIC does because it does not widely advertise its functions. It therefore recommended that ASIC:

29 Professor Dimity Kingsford Smith, *Submission 153*, pp. 7–8.

30 Professor Dimity Kingsford Smith, *Submission 153*, p. 24 (footnotes omitted).

31 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 7.

32 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 13.

33 Governance Institute of Australia, *Submission 137*, p. 8.

...should consider engaging in a broader and more prominent marketing and advertising campaign to promote the regulatory framework which it oversees, the intellectual property which it creates to guide those who are regulated, retail investors, and consumers, and the other various services it provides in administering the regulatory framework.

ASIC's role as an educator for the private and corporate sector is pivotal to its ongoing functions and the effective regulation of the sector.³⁴

20.30 The Law Council suggested more should be done to correct the public belief that ASIC, by licencing financial services providers, is like APRA and can act to protect the interests of individuals.³⁵

Committee view

20.31 In Chapter 5, the committee recommended that ASIC consider adopting a multi-pronged campaign to educate retail customers about the care they need to take when entering into a financial transaction and where they can find assistance and affordable and independent advice when they find themselves in difficulties because of that transaction. The committee's findings in this chapter further underline the importance of ASIC's role in financial education, especially when considering the unrealistic expectations that many consumers have of ASIC's main functions. ASIC may licence persons, but it cannot endorse their business model nor their trustworthiness.

20.32 The committee has also recommended that ASIC review the information provided on the search results and extracts from its registers. To help avoid any misunderstanding about ASIC's role in approving the operations of various entities, on these documents ASIC should more clearly explain its role and what the extracts mean.

Recommendation 35

20.33 The committee recommends that ASIC include on all registry search results and extracts a prominent statement explaining ASIC's role and advising that ASIC does not approve particular business models.

Recommendation 36

20.34 The committee recommends that in bringing together the multi-pronged campaign to educate retail customers outlined in Recommendation 1, ASIC have regard to the fact that:

- **many retail investors and consumers have unrealistic expectations of ASIC's role in protecting their interests; and**

34 Governance Institute of Australia, *Submission 137*, p. 8.

35 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4.

- **financial literacy is more than financial knowledge but also incorporates the skills, attitudes and behaviours necessary to make sound financial decisions.**

20.35 Before concluding this chapter on expectations and financial literacy, the committee considers the role of the Consumer Advisory Panel (CAP).

Consumer Advisory Panel

20.36 Established in 1999, CAP's role is to advise ASIC on current consumer protection issues and give feedback on ASIC policies and activities. It also advises ASIC on key consumer research and education projects. The Consumer Credit Legal Centre informed the committee that it has an open and constructive working relationship with ASIC through its participation on the CAP.

20.37 The Consumer Action Law Centre was also pleased with ASIC's collaboration with consumer advocates, particularly through the CAP. It noted that the recent introduction of a CAP 'matters register' would enable progress of matters referred to ASIC from CAP members to be tracked at each meeting. Nonetheless, it suggested that consideration could be given to whether:

- ASIC could do more to prioritise the needs of vulnerable and disadvantaged consumers; and
- ASIC's consumer protection outcomes may be improved by enhancing the responsibilities of the CAP to more closely resemble the UK's Financial Services Consumer Panel.³⁶

20.38 Established under the Financial Services and Markets Act 2000 (UK), the Financial Services Consumer Panel (FSCP) is an independent statutory body set up to represent the interests of all groups of financial services consumers in the development of policy for the regulation of financial services. Its membership must be such 'as to give a fair degree of representation to those who are using, or are or may be contemplating using, services other than in connection with business carried on by them'. According to the FSCP, it works 'to advise and challenge' the Financial Conduct Authority (FCA) from 'the earliest stages of its policy development' to ensure it takes into account the consumer interest. It also takes a keen interest in broader issues for consumers in financial services where it believes it can help achieve beneficial change/outcomes for consumers'. Its duties include:

- meeting regularly with the FCA and being available for consultation on specific high-level issues;
- actively bringing to the attention of the FCA issues which are likely to be of significance to consumers;

36 Consumer Action Law Centre, *Submission 120*, p. 12.

- commissioning such research as it considers necessary in order to help it to fulfil its duties under these terms of reference;
- requesting access to information from the FCA which it reasonably requires to carry out its work; and
- requesting regular access to the FCA chairman, board, chief executive and senior executives of the FCA.³⁷

20.39 In its submission, the Consumer Action Law Centre noted that the FSCP describes its role as:

...bringing a 'consumer perspective to aid effective regulation', supporting or challenging the FCA where required and acting 'as an independent counter balance' to parallel boards which represent the interests of industry.³⁸

Committee view

20.40 The committee is of the view that ASIC could do more to prioritise the needs of consumer interests and should consider whether it could improve the work of the CAP by introducing some of the features of the Financial Services Consumer Panel.

Recommendation 37

20.41 Recognising the importance of giving priority to the needs of consumers when ASIC develops regulatory guidance and provides advice to government, the committee recommends that ASIC should consider whether its Consumer Advisory Panel could be enhanced by the introduction of some of the features of the United Kingdom's Financial Services Consumer Panel.

20.42 In this chapter, the committee considered public expectations and financial literacy with an emphasis on educating people so that they are in a stronger position to protect their interests. The committee also recognised the importance of ASIC giving priority to consumer protection and suggested a more involved CAP could help achieve this objective.

20.43 In the next chapter, the committee continues its examination of ASIC's engagement and relationship with retail investors and consumers by considering how ASIC converses with those who are making a complaint or seeking ASIC's assistance.

37 UK Financial Services Consumer Panel, www.fs-cp.org.uk/about_us/what_is_the_panel.shtml (accessed 12 May 2014).

38 Consumer Action Law Centre, *Submission 120*, p. 12.

Chapter 21

Communication and complaints management

21.1 The committee has referred to the many cases where submitters felt that ASIC simply did not listen to or did not care about their report of alleged misconduct and expressed extreme disappointment with ASIC's response to their concerns. Their complaints about ASIC centred on three broad areas: delays in response or failing to respond; inadequacy of response; and the tone of the response. In this chapter, the committee considers the way in which ASIC manages complaints lodged with it and communicates with retail investors and consumers seeking the regulator's assistance.

21.2 Paragraph (d) of the inquiry's terms of reference directed the committee to examine ASIC's performance in relation to its complaints management policies and practices. The term 'complaint' has been interpreted to include both misconduct reports, that is when a complaint potentially involves a contravention of the legislation ASIC administers, and complaints made about ASIC.

Timeliness

21.3 Delays in responding to requests and poor feedback, including a failure to keep a complainant informed of progress, were among the numerous concerns that submitters raised with the committee. Extracts from selected submissions are provided below to illustrate some of the objections the committee received about the timeliness of ASIC's handling of misconduct reports:

Unfortunately it is difficult to monitor what progress is being made, if any, with complaints forwarded to ASIC. Generally, it has been difficult to get ASIC officers to even acknowledge the receipt of complaints and to get responses to other matters presented.¹

* * *

On October 2007 I submitted 3 complaints against the Nab to ASIC. These complaints were forwarded to ASIC with all the printouts put on discs. ASIC later informed me that they have recorded the information in its confidential internal database and will be of assistance to them should they receive further similar complaints. On the 29th February 2008 I received an Email from ASIC that (Nab) has advised that the changing of my family's account type will be looked into and finalised by September 2008. Who is ASIC kidding, a further 7 months.²

* * *

1 Name withheld, *Submission 213*, attachment 1, p. 6.

2 Ms Muriel McClymont, *Submission 425*, p. [2].

There was no discernible response in my situation from ASIC until letters were written by Members of Parliament.³

* * *

(*the following is an extract of a letter to ASIC's chairman*) Furthermore it is obvious your staff do not respond to telephone calls that are made regarding this subject of systemic problems. I have been told by your staff members that the call I made was logged on and it would be replied to in 2 days. Two weeks have passed and still no answer!⁴

21.4 The Consumer Credit Legal Centre (NSW) was of the view that:

ASIC needs to respond to consumer complaints in a timely fashion and, where timeliness is not practical, keep consumers (and their advocates) informed in some appropriate way.⁵

21.5 Mr Gerard Brody, the chief executive officer of the Consumer Action Law Centre, informed the committee that his organisation makes around 40 or so detailed complaints a year to ASIC where it is acting for a client as well as less detailed complaints of an allegation of misconduct where the consumer is happy to talk to the regulator directly. The Centre was of the view that improved communication about complaints would 'encourage ASIC to be more timely in enforcement actions'. More broadly, this might also be improved with an enhanced consumer advisory role within ASIC.⁶

21.6 Mr Brody stated that the Centre encouraged regulators to consider 'providing better and timely feedback to those who make complaints about potential misconduct'. While he recognised that ASIC had limitations on what it can say about ongoing investigations, he noted that there was a danger in regulators not saying anything. In his view:

It can mean consumers and consumer organisations have reduced motivation to complain and that evidence that regulators need to take enforcement action is not forthcoming. We are pleased that ASIC has taken up this recommendation and is now reporting to consumer organisations about complaints and progress made.⁷

Clarity in response

21.7 Timeliness was not the only problem. The Commonwealth Ombudsman also informed the committee that complainants often say that even after ASIC informs

3 Mrs Jan Braund, *Submission 244*, p. 4.

4 Mrs M Woolnough, *Submission 346*, p. [3].

5 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 2.

6 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 39.

7 *Proof Committee Hansard*, 20 February 2014, p. 39.

them of its decision, they do not understand why ASIC arrived at its conclusion. According to the Ombudsman, this was particularly the case when the decision related to the exercise of ASIC's discretion, such as the discretion not to investigate a report of misconduct or waive late fees. In this regard, the Ombudsman noted that it accepted that ASIC was 'best placed to determine its priorities and what may be in the broader public interest'. Even so, the Ombudsman observed that complaints received by his office regarding ASIC's decisions not to investigate reports of misconduct were 'usually resolved only after a more detailed and better explanation of the decision has been provided'. The Ombudsman explained:

...where we do investigate a complaint, the remedy provided in the majority of cases is a further explanation of the decision by ASIC. In these cases, our investigations typically lead us to conclude that ASIC's decision was not unreasonable or administratively flawed, but that ASIC's decision simply required further and better explanation.⁸

21.8 He concluded:

Although ASIC is a specialist independent regulator with market knowledge and expertise which informs its decision making, the fact that complaints are usually resolved through ASIC's internal review process or where ASIC (or this office) provides a better explanation to the complainant suggests that ASIC could improve the explanations of its decisions in the first instance.⁹

21.9 The Ombudsman observed that the results of the 2013 ASIC stakeholder survey suggested that one of ASIC's perceived limitations was that it does not clearly communicate what it is doing. In the Ombudsman's view, early management of expectations about what ASIC can or will do and the provision of better explanations of decisions to complainants should lead to a decrease in the number of complainants seeking an internal review of decisions by ASIC and of complaints to the Ombudsman about ASIC. Such improvements would benefit ASIC by reducing its complaint handling workload, as well as reassuring staff and complainants that problems have been dealt with in the appropriate manner and have not been allowed to fester.¹⁰

Tone of communication

21.10 Many submitters expressed frustration with ASIC's poor communication or apparent inaction following a report about possible breaches or complaints. One of the lasting impressions that retail investors were left with from ASIC's response to their complaint was that ASIC does not care. Ms Anne Lampe, a former financial journalist and former employee of ASIC's media unit, referred to what she held to be ASIC's 'consistent failure to adequately protect, seemingly care, or bother to take action when

8 Commonwealth Ombudsman, *Submission 188*, p. 15.

9 Commonwealth Ombudsman, *Submission 188*, p. 16.

10 Commonwealth Ombudsman, *Submission 188*, pp. 15–16.

small investors and self-funded retirees are stripped of their life savings'.¹¹ Making a similar observation, Mr Bill Doherty stated:

The ASIC complaints handling procedure is a total failure. People do not wish to be told that their Complaint will be added to a data base when they contact ASIC at their wits end. They do not wish to be advised to get a lawyer when they are impecunious because of ASIC failings. I personally referred a complaint about Ariff about 6 mths after ASIC commenced Civil Action against him and I got the Robotic response yet again.¹²

21.11 Many investors and consumers who wrote to the committee believed that they had strong evidence of maladministration in lending or misconduct by advisers or directors but when they contacted ASIC for assistance, it failed to act on their complaint in any effective way.¹³ A number referred to their disappointment in receiving a 'flick letter' or generic response, 'scripted or form letter', 'a boilerplate or robotic reply'.¹⁴ Indeed a number of submissions referred to ASIC's insensitive or indifferent response to their circumstances. Submitters were particularly galled, in the face of financial ruin, by ASIC's advice to seek a lawyer.¹⁵ In this regard, one submitter described ASIC's response to his concerns about Storm as:

One of the best bits of advice, that ASIC have to offer, is for Bank Clients to get themselves a Lawyer, when they know, only too well, that affected victims have been reduced to being almost penniless by the deliberately orchestrated plan by Banks to gain control of the life savings of victims.¹⁶

Other concerns

21.12 Submitters also expressed frustration about the effort involved in preparing their complaint, compiling supporting documentation and answering queries from ASIC, all to no avail. In its ultimate response to a complaint from Mr Trevor Eriksson, ASIC wrote that it had limited powers in relation to commercial lending contracts and that ASIC did not generally intervene in private commercial disputes. Mr Eriksson advised, however, that when he initially discussed his complaint with ASIC officers, they were enthusiastic about investigating the matter and suggested that there could be contraventions. Ultimately, in the face of ASIC's apparent loss of interest, Mr Eriksson argued that 'ASIC should not have misled the writers of complaint; they should have known that they did not have the power to investigate and said so upfront'.¹⁷ ASIC's approach to investigating complaints from individuals, and how this

11 *Submission 106*, p. 1.

12 Mr Bill Doherty, *Submission 138*, p. [3].

13 See for example, *Submission 71*.

14 *Submissions 1, 21, 26, 106, 110, 213, 279, 365 and 400*.

15 *Submissions 82, 106, 131 and 138*.

16 Name withheld, *Submission 82*, p. 1.

17 Mr Trevor Eriksson, *Submission 212*, p. [4].

is reflected in ASIC's 'no further action' letters, was also objected to in other submissions:

(the following is an extract of a 2010 letter to ASIC's then chairman)
...ASIC is neglecting its responsibilities under s.12 of its Act for business to business unconscionability in financial services. Worse, it is persistently turning away supplicants whose complaints should be taken seriously. Frankly, it is difficult to take seriously the claims in some letters in response from ASIC staff that the complainant's case has been properly examined.¹⁸

* * *

On April 15th 2013, a response to my complaint was written and signed by Warren Day, Senior Executive Leader Stakeholder Services. I appreciate that some investigation was made regarding some my allegations. However, there was no effort to contact me in order to clarify matters. As a result, there is considerable presumption in their response. For instance, they presumed that the matter regarding the bank providing a loan based on 'house and land' value yet selling our property 'for land value only' on the grounds that the house was 'illegal', had been dealt with in court. If they had bothered to contact me, I could have explained that this was impossible as the hearings were all held before the bank sold our property. Of course, if they had thought about it, common sense would have brought them to that conclusion all by themselves.

ASIC pointed out that a few of my complaints can only be dealt with through other avenues, and I accept that. However, they are completely wrong in some of their other responses. The overall result is that though the letter appears to address my complaints, by the end of it, ASIC have successfully deflected every bit of responsibility toward any of the issues.¹⁹

* * *

I am not directly involved in a tangle with ASIC. The extent of my experience concerns the extreme time and energy I have put in trying to stop a friend from committing suicide...He turned to ASIC for help and was summarily dismissed. For whatever reason, ASIC was not interested in his case, giving him the impression that the sum involved was too low for ASIC to investigate. He was devastated by their response.²⁰

21.13 Submitters objected to receiving unsigned replies from ASIC.²¹ One submitter advised that after receiving such a letter they were unable to contact anyone to discuss the matter further:

18 Dr Evan Jones, *Submission 295*, attachment 1, p. 1.

19 Ms Susan Field, *Submission 75*, p. 2.

20 Mr Dan McLean, *Submission 105*, p. 1.

21 For example, see Name withheld, *Submission 20.2*, p. 1 and Mrs Caroline Baker, *Submission 49*, p. 1.

I later got a letter from ASIC with no name at the bottom and signed "Misconduct and Breach Reporting". When I called the phone number provided I was then repeatedly told no one knows anything about this matter.²²

21.14 One aggrieved individual concluded that the aim of ASIC's complaints processes 'seems to be to let the dissatisfied victim—who has had little help in actually seeing justice done—let off some steam and then be left to pick up the pieces of their shattered life while ASIC neatly files the complaint'.²³

Standards for handling misconduct reports and complaints

21.15 It is clear that ASIC receives a substantial volume of queries, complaints and misconduct reports. In 2012–13, ASIC's client contact centre received over 700,000 telephone calls. ASIC's annual report for that year notes that over 80 per cent of calls were answered on the spot with the remainder referred to specialist staff.²⁴ Also in 2012–13, ASIC received and assessed 11,682 reports of alleged misconduct, 11,320 statutory reports and 1,214 breach reports.²⁵

21.16 ASIC governs its complaints handling processes by a service charter. The charter sets targets for ASIC to provide various services or undertake certain functions. Table 21.1 summarises the service charter targets and ASIC's results in 2012–13 against these targets

22 Mr Owen Salmon, *Submission 368*, p. 3.

23 Dr Peter Brandson, *Submission 232*, p. 7.

24 ASIC, *Annual Report 2012–13*, p. 51.

25 ASIC, *Submission 45.2*, p. 4.

Table 21.1: ASIC's service charter results, 2012–13

| <i>Service</i> | <i>Service target</i> | <i>2012–13 performance</i> |
|--|---|--|
| General telephone queries | ASIC aims to answer telephone queries on the spot | Of telephone queries handled directly by the contact centre (716,382), 80.5% (576,513) were answered on the spot and 19.5% (139,869) were referred to specialist staff |
| General email queries | ASIC aims to reply to email queries within two business days | 77% (111,399 of 144,204) |
| General correspondence about the public database and registers (including fee waivers) | ASIC aims to acknowledge receipt within 14 days of receiving it, with full response within 28 days | 85% (17,387 of 20,478) |
| Registering a company | ASIC aims to complete company registrations within one business day | 98% (200,326 of 204,035) |
| Updating company information and status | ASIC aims to enter critical changes to company information in the corporate register within two business days | 98% (995,676 of 1,013,048) |
| Registering as an auditor | ASIC aims to decide whether to register an auditor within 28 days of receiving a complete application | 92% (123 individual applications and 16 authorised audit companies) |
| Registering as a liquidator | ASIC aims to decide whether to register a liquidator or official liquidator within 28 days | 100% of liquidator applications (37 of 37 applications) and 98% for official liquidators (44 of 45 applications) |
| Applying for or varying an AFS licence | ASIC aims to decide whether to grant or vary an AFS licence within 28 days | 79% of licences granted within 28 days (374 of 472 applications) 83% of licence variations decided in 28 days (649 of 784 applications) |
| Registering a managed investment scheme | By law ASIC must register a managed investment scheme within 14 days of receiving a complete application | 100% (205 of 205) |
| Applying for or varying a credit licence | ASIC aims to decide whether to grant or vary a credit licence within 28 days | 83% of licence applications (313 of 375) and 91% of licence variations |
| Applying for relief | For applications for relief from the Corporations Act that do not raise new policy issues, ASIC aims to give an in-principle decision within 21 days of receiving all necessary information | 71% of in-principle decisions (1,935 of 2,744 applications) |
| Complaints about misconduct by a company or individual | For reports alleging misconduct by a company or an individual, ASIC aims to respond within 28 days of receiving all relevant information (target: 70%) | 76% (8,828 of 11,682) |

Source: ASIC, *Submission 45.2*, pp. 71–72.

21.17 Although ASIC has set a target for responding to general correspondence about its public database and registers and misconduct reports, ASIC does not have a target set for responding to other general correspondence. ASIC's service charter provides the following explanation:

For other general correspondence, the exact timing and content of our response will depend on each case and the request.

In some cases, it may not be appropriate for us to fully respond to correspondence, or be reasonable to expect us to do so. For example, correspondence about surveillance, investigations and enforcement may involve sensitive and highly confidential matters that will restrict what we can say, or prevent us from replying at all.²⁶

21.18 The committee compared ASIC's approach to those adopted by other regulators and law enforcement agencies. The ACCC's service charter states that it aims to respond within 15 business days of receipt to letters or webforms that request a response.²⁷ APRA aims to reply to email queries from members of the public within two business days and all other correspondence within 15 business days.²⁸ The UK Financial Conduct Authority (FCA) aims to provide a substantive response to correspondence received from consumers and firms within 12 business days of receipt, for which it has set a target of 90 per cent. During the period 1 October 2012 to 31 March 2013, the FCA responded to 96.1 per cent of consumer correspondence and 94.1 per cent of correspondence from firms within the 12 business day timeframe.²⁹ The service charter of the AFP does not include timeframe targets, noting that the 'nature of investigating criminal activity makes it difficult to provide specific timeframes for completion of the investigations that we undertake'. However, the AFP does commit to advising relevant parties of the progress of investigations at 'reasonable intervals', except where the investigation may be jeopardised by doing so.³⁰

21.19 The Commonwealth Ombudsman informed the committee that complainants often report long delays when waiting for a response from ASIC about their complaint, which can 'be a source of frustration, especially when delay results in lost revenue'. The Ombudsman's *Better Practice Guide to Complaint Handling* states that

26 ASIC, *ASIC Service Charter*, September 2012, p. 4.

27 The ACCC's service charter adds: 'We receive a lot of contact from people simply providing us with information. In those circumstances, we will record your information but we may not provide a response'. ACCC, *Service Charter*, www.accc.gov.au/about-us/australian-competition-consumer-commission/service-charter (accessed 10 October 2013).

28 APRA, 'APRA Service Charter', www.apra.gov.au/AboutAPRA/Publications/Pages/APRA-Service-Charter.aspx (accessed 10 October 2013).

29 UK FCA, 'Our Performance: Communications', www.fca.org.uk/about/governance/our-performance/standards/communications (accessed 10 October 2013).

30 AFP, 'AFP service charter for the Australian community' www.afp.gov.au/about-the-afp/service-charters/afp-service-charter.aspx (accessed 10 October 2013).

once a complaint has been made to an agency, the complaint should be resolved as quickly as possible in order to prevent irritation or fatigue which 'can thwart successful complaint handling'.³¹

21.20 Service charters and quantifiable performance benchmarks are useful, but care should be taken in analysing the results. Further, some individuals who have interacted with ASIC expressed suspicion about how the performance targets could be met:

The email inquiry response service is useless for anything that is not 'routine'. My experience is to receive an automated response notification. Then, if I am very lucky, a proforma response weeks later. Invariably, that second response does not address the issue, or may promise that another area or officer will follow-up. In reality, that proforma response is sufficient for ASIC to mark the enquiry as concluded. Needless to say any promised follow-up does not materialise.³²

Assessment of ASIC's processes

21.21 In assessing ASIC's performance at managing misconduct reports and complaints, the committee has paid particular regard to the evidence from ASIC and the Commonwealth Ombudsman.

ASIC's response

21.22 ASIC advised that although it has 'a good record' of meeting its service charter targets, it has been 'making continual efforts to improve the way we handle reports of misconduct and our communication with persons who have made a report'.³³ ASIC has recently been publishing additional information about how it assesses complaints—in October 2012 and July 2013 ASIC released a number of information sheets on how it approaches commonly reported matters.³⁴ In its main submission, ASIC reported that over the past two years it has developed a 'customer engagement framework'. Key aspects of the framework include a protocol for handling reports of misconduct, clear communication objectives as the report of misconduct is handled and efforts to provide clear information about reporting misconduct on ASIC's website.³⁵ Under the customer engagement framework:

- personal telephone contact (or two attempts) is now made with the person who lodged the report of misconduct to ASIC within three business days of receipt for all reports (except for market matters, which are responded to

31 Commonwealth Ombudsman, *Better Practice Guide to Complaint Handling*, April 2009, p. 14.

32 Name withheld, *Submission 263*, p. 5.

33 ASIC, *Submission 45.2*, p. 88.

34 ASIC, 'ASIC releases new information sheets on dispute resolution and misconduct', *Media Release*, no. 13-181, 18 July 2013.

35 ASIC, *Submission 45.2*, p. 95.

immediately due to the sensitivities of the matters raised in these reports of misconduct);

- two new report-handling streams have been developed, as follows:
 - 'rapid handling'—for matters outside of ASIC's jurisdiction or are appropriate for rapid resolution by way of a telephone call and targeted information; and
 - 'expedited communication'—for matters within ASIC's jurisdiction and which ASIC will collect information on, but where ASIC cannot directly resolve the person's particular concerns;
- the 'how to complain' section on ASIC's website has been redesigned; and
- customer service principles have been adopted for the handling of reports of misconduct.³⁶

21.23 Mr Medcraft informed the committee that ASIC had taken significant steps to improve transparency and communication. He acknowledged, however, that despite all its efforts, ASIC officers have heard the clear message from the submissions—'we need to communicate more and we need to communicate more effectively about our work and our decisions'. He stated that this was 'an ongoing goal of the commission'.³⁷

21.24 It is also necessary to acknowledge another aspect of complaints handling. Government agencies such as ASIC are often contacted by distressed individuals who have few options for having the wrong, or perceived wrong, that they have suffered remedied. Guidance published by the Commonwealth Ombudsman observes that these complainants can exhibit unreasonable behaviour and be unwilling to accept decisions taken about their complaint. They can present employees with various difficulties:

These complainants often tend to be angry, aggressive and abusive to staff members. They threaten harm, they are dishonest or intentionally misleading in presenting the facts, or they deliberately withhold relevant information. They flood agency offices with unnecessary telephone calls, emails and large amounts of irrelevant printed material. These complainants tend to insist on outcomes that are clearly not possible or appropriate, or demand things they are not entitled to. At the end of the process they are often unwilling to accept decisions and continue to demand further action on their complaint.³⁸

21.25 The committee is aware of cases where ASIC is required to deal with individuals that have unrealistic expectations either about what ASIC can do or the degree of access that they should have to ASIC employees. Further, there is clearly

36 ASIC, *Submission 45.2*, p. 96.

37 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 20 February 2014, p. 2.

38 Commonwealth Ombudsman, *Better Practice Guide to Managing Unreasonable Complainant Conduct*, June 2009, p. 1.

scope for aggrieved individuals to take up a disproportionate amount of ASIC's resources.³⁹

Evidence from the Commonwealth Ombudsman

21.26 The Commonwealth Ombudsman advised that in 2012–13 it received 338 complaints about ASIC (representing 1.9 per cent of the total complaints received by the Ombudsman). By contrast, the Ombudsman received 55 complaints about the Australian Financial Security Authority, 35 complaints about the Australian Communications and Media Authority and 17 complaints about the ACCC.⁴⁰

21.27 The largest category of complaints received about ASIC in 2012–13 related to problems associated with the implementation of the new business names register. The Ombudsman advised that the remaining main areas of complaint about ASIC related to ASIC's discretionary decision to investigate a report of misconduct; ASIC's decision to not waive late fees; and accessibility, including difficulties making contact with ASIC, delays in receiving a response, and the usability of ASIC's online services.⁴¹ Another issue commonly raised in complaints is that there is uncertainty about how to complain to ASIC about ASIC:

While ASIC's website contains a clear heading, "how to complain", the subsequent list of links does not offer a clear and explicit opportunity to make a complaint about ASIC.⁴²

21.28 The Commonwealth Ombudsman, Mr Colin Neave AM, told the committee that ASIC has taken steps to improve its website and is working to increase the capacity of its call centre. However, he considers that there are further ways that ASIC could improve, including by simplifying the complaints process and making it more accessible, particularly by delineating the process for complaining about ASIC from misconduct reporting. Mr Neave noted that his office had been engaging with ASIC about these issues and that 'overall ASIC has been responsive and cooperative'.⁴³

39 For example, ASIC advised that just five individuals have sent it approximately 400 separate pieces of correspondence since 2009 regarding a particular complaint. Further, over 100 requests under the *Freedom of Information Act 1982* have been lodged or reviews of decisions made under that Act taken place. Involved at various times in assessing the correspondence, requests and reviews were members of ASIC's Misconduct and Breach Reporting team, its Investment Managers and Superannuation stakeholder team, Chief Legal Office, and the Senior Executive Leader responsible for Stakeholder Services. ASIC's actions in this matter have also been reviewed by the Commonwealth Ombudsman. ASIC, answer to question on notice, no. 12 (received 21 May 2014), pp. 38–39.

40 Commonwealth Ombudsman, *Submission 188*, p. 5.

41 Commonwealth Ombudsman, *Submission 188*, p. 3.

42 Commonwealth Ombudsman, *Submission 188*, p. 3.

43 Mr Colin Neave AM, Commonwealth Ombudsman, *Proof Committee Hansard*, 20 February 2014, p. 12.

21.29 The Ombudsman's *Better Practice Guide to Complaint Handling* suggests that when a decision has been made regarding a complaint, an explanation of the decision should be presented in a style the complainant can understand and should deal with each concern raised by the complaint.⁴⁴ Further, Mr Neave suggested that handling complaints only in writing 'is not always the best way' and that consideration should be given to explaining the organisation's decision orally as well as in writing:

...when someone is terribly upset about something having gone wrong, if the letter does not deal with reasonable precision with the elements of the complaint, that only makes it a lot worse for the institution, whether it is a private sector institution or ASIC itself. There are all sorts of reasons why this cannot happen. There might be some duty of confidentiality, there might be some privacy problems or there might be some other issue, but my recommendation to any organisation which is dealing with complaints is: if you get a chance to sit down with the person who is making the complaint and talk it through with them, the whole communication dynamic changes quite significantly.⁴⁵

21.30 Mr Neave was asked whether consideration should be given to conducting an external audit of ASIC's complaints-handling processes. In his view, recent initiatives following the problems associated with the business names register have improved ASIC's capacities and processes. Mr Neave provided the following testimony:

I think the progress which has been made recently, which we have been heavily involved with ourselves, has led to a point where it seems to be working quite well, but it is certainly something that we will be keeping a watchful eye on. When the business name issue arose, that is when the office became very interested in ASIC. We have been having meetings every couple of months with them ever since then in order to work on improving the complaint-handling processes. As I said before, we are also doing—and this goes across Commonwealth agencies and departments—doing surveys and investigation. There will be some recommendations coming out of that which I think will assist not just ASIC but all Commonwealth departments and agencies. There is quite a deal of work going on.⁴⁶

Committee view

21.31 The committee has received a significant number of submissions from individuals aggrieved by how ASIC managed their report of misconduct. There are examples where such reports were handled poorly, or could have been handled better. The committee does, however, recognise that it is only likely to be contacted by individuals who consider that their complaint did not receive sufficient attention or was otherwise not handled appropriately, not those satisfied with ASIC's performance

44 Commonwealth Ombudsman, *Better Practice Guide to Complaint Handling*, April 2009, p. 25.

45 Mr Colin Neave AM, *Proof Committee Hansard*, 20 February 2014, p. 14.

46 Mr Colin Neave AM, *Proof Committee Hansard*, 20 February 2014, p. 15.

in this area. Further, the committee acknowledges that, at times, ASIC also has to deal with unreasonable complainants.

21.32 Nevertheless, the committee does consider that ASIC needs to improve how it manages misconduct reports and complaints. In particular, ASIC must strive to be more responsive and sensitive to the concerns of consumers and retail investors, while adequately managing expectations about what it can do. The committee considers that ASIC should review how it manages and responds to misconduct reports from members of the public, particularly those from vulnerable and disadvantaged consumers.

Recommendation 38

21.33 The committee recommends that ASIC undertake an internal review of the way in which it manages complaints from retail investors and consumers with the aim of developing training and professional development courses designed to:

- **have ASIC officers more attuned to the needs of vulnerable and disadvantaged consumers and to enhance ASIC's consumer advisory role;**
- **devise strategies and protocols for responding to retail investors and consumers registering a complaint, many of whom are at their wits end and in desperate need of help;**
- **ensure that ASIC officers, when advising a consumer to transfer their complaint to the relevant external dispute resolution scheme, make that transfer as seamless and worry-free as possible while conveying the sense that ASIC is not discarding their complaint; and**
- **acknowledge the advantages of making a return call to the complainant and provide guidance for ASIC officers on the times when making a return call would be appropriate.**

Chapter 22

Service delivery and access to information

22.1 As Australia's corporate, markets and financial services regulator, ASIC is contacted by and provides services to a large number of varied stakeholders. In particular, ASIC's registry services, such as those for company documents and business names, effectively require the entire business community to deal with ASIC.

22.2 The committee received submissions critical of ASIC's registry services and approach to handling information. In fact, ASIC's performance at both ends of the information supply process was questioned; that is, stakeholders expressed displeasure at the processes for providing information to ASIC and the information ASIC makes available to the public. For example, industry participants and interested observers such as academics have an interest in accessing data held by ASIC so that they can better understand, consider and scrutinise industry developments. However, they outlined concern about the current impediments to accessing such data. This chapter considers these issues. The websites operated by ASIC, which perform a key role in the provision of ASIC's services as well as being an important source of information for members of the public and regulated entities, are also considered in this chapter.

ASIC's registries and client services

22.3 While most of the submissions that criticised ASIC's interactions with the public related to the handling of misconduct reports, the committee also received submissions regarding other aspects of ASIC's client services, such as the databases it is required to maintain. There are instances where miscommunication and inflexibility can lead to businesses suffering. One example was provided by Mr Graeme Hay, a director of a company based in Asia but also registered in Australia so that it can compete for government contracts. Section 201A of the Corporations Act requires that a proprietary company must have at least one director and that director must ordinarily reside in Australia. In his submission, Mr Hay advised that his sister was nominated as a director to satisfy this requirement. However, after his sister passed away, ASIC continued to address correspondence to her. Mr Hay submitted that letters sent to his address were not received because his address was entered into ASIC's database incorrectly by ASIC. Mr Hay provided a summary of how these events impacted his business:

In April 2013, [Sub-Sea and Pipeline Protection International (PPI)] had won a significant contract with Charles Darwin University. Our company required an additional business name, operating bank accounts, and internet domain names. In order to obtain these, I needed a corporate key for the ASIC portal. I contacted ASIC for a corporate key for the ASIC portal. Despite a number of attempts by phone and email, I was unable to speak to any living person. As matters became dire, I instructed my Australian consultants to do the best they could until I was able to ascertain the ASIC information.

It was around this time that I was able to contact ASIC, and I was informed that PPI had been listed for de-registration! I was really quite shocked and was in disbelief. Our company prides itself on its successful operations and high integrity. PPI does not even owe any money to any creditors anywhere in the world. To be informed that a government statutory body had deemed our company to be in default for any reason was a genuine surprise. Initially I assumed there had been a misunderstanding or clerical error. I later learned that ASIC, had sent important documents to my sister's address after her passing. ASIC had actual knowledge that my sister had passed away. As aforementioned, ASIC claimed to have sent these communications to our Thailand office. These were never received. My Bangkok address has remained the same since 1987. The same address was noted on our original ASIC registration. A data entry error by ASIC meant all correspondence were not received.¹

22.4 Despite paying the fee required by ASIC, Mr Hay was informed that a notice of ASIC's intention to de-register the company would be placed on the register, 'despite no de-registration occurring':

This notice remains on the public record. In 30 years of business, PPI has never had one mark against our good name or our international reputation. The only mark now is this notice by ASIC.

In May 2013 I was contacted by one of the world certification bodies. I was informed that there were concerns about PPI as PPI was "Under investigation by ASIC". This was untrue. I have since had ongoing trouble in business relations with long term vendors, accreditation organizations, international banks and a number of other institutions who, in the ordinary course of commerce have undertaken the usual prudent checks, only to find this unwarranted ASIC mark against our company's name. As the notice appears in the insolvency notices on the ASIC site, I am of the understanding that some credit reporting agencies have listed our company on their register. I am unable to find the words to describe how incredulous this makes me feel knowing that this is the result of (a) my sister's death, which was followed by a great period of family mourning, and (b) a clerical/administrative error of ASIC. It is very unreal.²

22.5 ASIC was questioned about this matter at a public hearing. It advised that the notice was removed from the website on 10 May 2014. ASIC's interpretation of events was given as follows:

...The background of the matter is that Mr Hay's company was listed for deregistration for not having paid its annual return fee that had been outstanding for over 12 months. The process is that we then publish a notice of deregistration as required by the law and separately write to all of the office holders at their home addresses that this is the process that is being undertaken. Mr Hay tells us that that is the first time that he heard about this

1 Sub-Sea & Pipeline Protection International, *Submission 404*, pp. [1]–[2].

2 Sub-Sea & Pipeline Protection International, *Submission 404*, p. [2] (footnotes omitted).

deregistration process. There would have been a previous notice both to remind of the need to pay the annual fee at the time that it was due and a subsequent reminder, but the registered office Mr Hay tells us had changed. We had not been informed of that change. Subsequently, however, we became satisfied that there were reasons that suggested that it was not appropriate to proceed with the deregistration. Chief among them was that he paid the annual return fee, but also that there had been some communication that the previous registered office was no longer the right registered office. In fact, the sole Australian director had died and their spouse had advised us that she was no longer accepting mail at that particular address but we had no other address to follow up. Therefore it has been removed.³

22.6 Another area of complaint about ASIC's registers related to how effectively they are integrated with other government databases. Mr David Pemberton, an accountant based in Darwin, questioned why ASIC's register of banned or disqualified persons does not include undischarged bankrupts. He advised that the response given to him by ASIC was that ASIC did not have the resources to update its registers with the details of individuals listed on the registers operated by the bankruptcy regulator, the Australian Financial Security Authority (AFSA).⁴

22.7 Based on their experiences of using ASIC's registry services and contacting ASIC, a small businesses owner suggested that ASIC has 'little, if any, understanding of small business'. The small business owner provided the following statement on their experience telephoning ASIC's call centre:

Telephone inquiries can result in a wait of some 30 minutes up to 90 minutes for connection. The call-centre operators I have encountered are disinterested in providing basic customer service, have little knowledge, read from prepared scripts, and have no interest in, or incentive to, providing a solution, provide no 'ownership' of an inquiry, or interest in any form of 'follow-up'.⁵

22.8 The small business owner contrasted ASIC's call centre with private sector call centres they have encountered. From their experience, they consider that ASIC's call centre staff are unable to respond to more complex inquiries that are beyond the standard call centre scripts. The small business owner also advised that ASIC's call centre employees are not tasked with 'ownership' of an enquiry:

I could relate numerous examples with a range of suppliers—particularly banks, share registries, and energy and internet providers—where such ownership has resulted in call-backs to keep me informed of the progress with an issue, a resolution and, often, a post-event call to gauge my

3 Mr Greg Tanzer, Commissioner, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 105.

4 Mr David Pemberton, *Submission 279*, p. 5.

5 Name withheld, *Submission 263*, p. 5.

satisfaction with that resolution. In my experience such a concept is alien to ASIC.⁶

22.9 The same submitter also argued that ASIC places 'the onus on small businesses to do ASIC's job':

An example; 'If you have not received your annual statement within 5 days after the review date you should contact us'. Could you [imagine] you[r] electricity supplier putting on their web site: 'If you haven't got you bill 5 days after it was due to be issued contact us'. Really.⁷

22.10 The Commonwealth Ombudsman, which receives and investigates complaints about Australian government agencies such as ASIC, addressed the issues faced by small businesses. The Ombudsman provided some examples of its investigations to illustrate the difficulties clients experienced. Two examples are outlined below:

Mr A attempted to register a business name online using ASIC Connect. His application was automatically rejected, as the name he was attempting to register was too similar to an existing registered business name. The existing registered business name was the name of Mr A's existing business and the purpose of his application for a new business name was to rename this business.

Mr A successfully contacted ASIC by phone to explain the situation and to seek advice. In response, ASIC sent an email to Mr A with a link to a form for an application for review of the decision to reject the application. Mr A claimed that the link in the email did not work, and that after searching ASIC's website, most of the relevant links on the website were also broken. Mr A emailed ASIC explaining that the links were broken and that he still required assistance. After waiting a further 9 days without a response, Mr A contacted ASIC by phone. Mr A claimed that ASIC told him it was still unable to provide a response and that he would need to wait. Following this, Mr A tried on several occasions to contact ASIC by phone to check the progress of his matter. Mr A claimed he was either told that he would need to wait up to 2 hours in the phone queue or received a "busy announcement" message which advised that he should call back later.

Three months after Mr A applied for the business name, Mr A complained to the Ombudsman that he had still not received a response from ASIC and that he was now unable to contact ASIC to discuss the matter. The Ombudsman transferred the complaint to ASIC pursuant to the complaint transfer agreement, and the matter was resolved.⁸

* * *

Ms G had a registered company. Ms G discovered that a competitor to her business registered a substantially similar business name to that of her company. Ms G believed that she had been losing revenue since this

6 Name withheld, *Submission 263*, p. 6.

7 Name withheld, *Submission 263*, p. 5.

8 Commonwealth Ombudsman, *Submission 188*, pp. 6–7.

occurred, as some customers were confusing the competitor's business with her own.

Ms G complained to ASIC about the registration of the substantially similar business name. Despite numerous phone calls to ASIC, the matter was still not resolved over 5 months later. Ms G complained to the Ombudsman that ASIC had not resolved the issue within a reasonable time period.

The Ombudsman investigated Ms G's complaint. ASIC cancelled the registration of the substantially similar business name, and apologised to Ms G for its delayed and insufficient communication. ASIC informed the Ombudsman that the delay in responding to Ms G was largely attributable to the high number of enquiries received by ASIC about business names following the introduction of the [business names register], and that systems and processes for dealing with business name conflicts and reviews were still in development.⁹

22.11 The Commonwealth Ombudsman noted the results of ASIC's 2013 stakeholder survey, which indicated that 23 per cent of small businesses that had interactions with ASIC considered ASIC to be 'very' or 'somewhat' difficult to deal with.¹⁰

Committee view

22.12 The committee is concerned by the evidence it has received about the experiences small businesses have had when dealing with ASIC. The committee notes that many of the issues relate to the implementation of the national business names register, and that ASIC has continued to improve the services related to that register. Nevertheless, the results of ASIC's own stakeholder engagement survey indicates that small businesses have the least positive view on how easy it is to deal with ASIC. There are also other examples of problems small businesses have had with ASIC. The committee urges ASIC to continue to improve its delivery of services to small businesses.

Access to information collected by ASIC

22.13 Given that ASIC gathers significant amounts of information and collects further information as a result of its regulatory activities, a number of witnesses were critical of ASIC's failure to publish much of this material. For example, a submission from several academics at the Adelaide Law School expressed concern about 'the relative lack of statistics and data for researchers, stakeholders and the wider public'. The group noted that ASIC receives and stores prescribed information under legislation and, while acknowledging that some of it cannot be made public, argued that anonymous and aggregate statistics could be made public if ASIC chose

9 Commonwealth Ombudsman, *Submission 188*, p. 14.

10 Commonwealth Ombudsman, *Submission 188*, p. 13 (footnote omitted).

to do so.¹¹ The group contrasted ASIC's approach to that of other government agencies, such as the AFSA and the ATO:

ITSA (now called AFSA) publishes far more information and interprets its received data in a way that provides a clear and detailed analysis of trends, for example in its Profile of Debtors. As another example the ATO makes 1% of its tax files available for research and analysis, on an anonymous basis of course. ATO even sets out on its website how this research benefits the ATO and the public.¹²

22.14 The group of Adelaide Law School academics was firmly of the view that ASIC's statutory functions 'go far beyond merely collecting mandatory information and storing it'. They argued that to promote 'informed participation' in the market, ASIC should make material accessible and present it in an informative way. As an example, they cited information relating to insolvency appointments, where such information would be of use 'not just to academics but to market analysts, economists, the business media, the insolvency and legal professions and professional bodies'.¹³

22.15 Other submitters also criticised ASIC for not producing instructive statistics. Mr Jason Harris, a senior lecturer in corporate law at UTS, informed the committee that the lack of data, particularly relating to enforcement and insolvencies, stifles debate as 'we are unable to determine exactly what it is that ASIC does aside from what it tells us; but, more importantly, we are unable to work out what it is ASIC is failing to do'. He stated further that ASIC's reports are 'almost marketing material', providing broad based percentages without producing real numbers. As an academic and a researcher:

...it would be useful to be able to look at exactly what ASIC does in that space...It talks about banning directors. It gives us numbers over a number of years. When you dig down into the enforcement reports, the detail is lacking. We do not know if ASIC is actually taking action against phoenix company directors even though insolvency practitioners will tell you they ...are seeing the same people coming back again and again with regard to insolvency. They are submitting reports to ASIC. We have well over 10,000 companies going under every year. We have something like 11,000-odd reports from liquidators and other insolvency practitioners going in every year, and the numbers of enforcement statistics that we are getting from ASIC just in terms of director bannings—they do not tell us what they are banning the directors for—are looking at a very small number. It is 20 or 30 directors across a very broad range of activity. They do not relate it back to, for example, insolvent companies.¹⁴

11 Dr Suzanne Le Mire, A/Prof David Brown, A/Prof Christopher Symes and Ms Karen Gross, *Submission 152*, p. 5.

12 Dr Suzanne Le Mire et al, *Submission 152*, p. 6.

13 Dr Suzanne Le Mire et al, *Submission 152*, p. 6.

14 Mr Jason Harris, *Proof Committee Hansard*, 2 April 2014, pp. 25–26.

22.16 Mr Harris provided some further examples, such as the discussion on non-compliance outcomes in ASIC's annual report. ASIC provides only the numbers of orders but does not publish the total numbers of non-compliance. Mr Harris made the following observation:

Obtaining 26 civil orders and 46 criminal convictions is an unhelpful statistic without knowing how many cases of non-compliance were involved. For example, if 5,000 companies failed to lodge their reports (a conservative figure based on the more than 2 million registered companies), then 72 orders seems a low figure.¹⁵

22.17 The figures published in ASIC's half yearly enforcement reports were also criticised for being general in nature. Mr Harris noted:

For example, the category of 'insolvency' is almost meaningless given Ch 5 of the Corporations Act (which covers insolvency) comprises several hundred provisions. Similarly the category of 'small business compliance and deterrence' is too vague. The report for July 2013–December 2013 includes 42 administrative remedies against directors and 181 criminal orders against directors, both for small business compliance and deterrence. No detail of what contraventions or what sanctions were imposed is included, neither is any information on how many matters were commenced/investigated/completed in this category. This is a very unhelpful statistic. The media releases provided in Appendix 2 do not include small business compliance and deterrence, which means the overwhelming majority of sanctions go unreported to the public. This is totally unsatisfactory. If there are privacy concerns then these can be addressed by removing personal information, but there is no reason why information concerning enforcement action is not made public.¹⁶

22.18 According to Mr Harris, ASIC was in possession of this information but needed to produce better statistics. Mr Harris provided further examples of information that he, and other academics he consulted, would like ASIC to release. He informed the committee that there was a team of academics happy to go in as free labour and extract that data and provide a usable database. Mr Harris informed the committee that academics had been discussing this matter for many years and have had meetings with 'very senior people inside ASIC'.¹⁷

22.19 The Australian Restructuring Insolvency and Turnaround Association (ARITA) also drew attention to the amount of prescribed information that ASIC receives and stores under legislation. ARITA explained that much of the material is supplied by insolvency practitioners in their reports and lodgements with ASIC'. According to that organisation 'much information is collected but less is published'.¹⁸

15 Mr Jason Harris, answer to question on notice, no. 8 (received 17 April 2014), p. 1.

16 Mr Jason Harris, answer to question on notice, no. 8 (received 17 April 2014), p. 2.

17 Mr Jason Harris, *Proof Committee Hansard*, 2 April 2014, p. 27.

18 Insolvency Practitioners Association (now ARITA), *Submission 202*, p. 5.

Mr Michael Murray, Legal Director, ARITA, also compared ASIC's statistics with those of the bankruptcy regulator:

[AFSA] produce good statistics which inform the law reform process in bankruptcy. We do not have that sort of information in corporate insolvency.¹⁹

22.20 According to ARITA, ASIC had improved its collection and publication of data but needed to do more. Mr David Lombe, President, ARITA, gave an example of the limitations imposed on researchers:

ARITA gives a research prize so that someone can do research. One of our prize-winners was looking at deeds of company arrangement. When you go into voluntary administration, there is a decision about whether you go into liquidation or a deed of company arrangement. He was trying to work out how many companies go into deeds of company arrangement and how successful those deeds of company arrangements are. He wanted to get access to information from ASIC to be able to do that very important research. It would have cost thousands of dollars and ASIC just said, 'We can't give that information to you.'²⁰

22.21 He noted, however, that ASIC may be prevented from waiving fees or giving out that information.²¹

22.22 Dr Suzanne Le Mire and her colleagues were of the view that ASIC has ample power to devote more resources to making information and data publicly available. They suggest that the ASIC Act could be improved by making this duty more explicit. As an example, they cited section 455 of the Insolvency Act 2006 (NZ), which places a specific duty upon the regulator to make insolvency statistics available for research purposes (for example, searching the insolvency index in New Zealand).²²

ASIC's response

22.23 The committee sought ASIC's views on whether the current approach to accessing and publishing information stored by ASIC promoted informed participation in the financial system. ASIC explained that the information it collected and how it was made available to the public, including the fees it charged, was prescribed by legislation. ASIC advised that it had 'little discretion' in administering the fees charged for accessing information on ASIC's registers, although certain information and statistical data could be accessed without charge on its website. ASIC also asserted that its annual report contained 'a wide range of statistical data'.²³

19 Mr Michael Murray, Legal Director, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 40.

20 Mr David Lombe, President, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 40.

21 Mr David Lombe, President, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 40.

22 Dr Suzanne Le Mire et al, *Submission 152*, p. 6.

23 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 14.

22.24 ASIC described how it handles customised requests for information from members of the public:

Any such request will be directed to the relevant business area. The request will be assessed as to whether the legislation will permit the release of the data, and whether ASIC's data storage systems can support such a request. If the customer's request can be provided, the fee is determined according to the accessibility of the data and the work involved in producing it. For example, if copies of documents are requested then the number of documents provided will impact the prescribed fee.²⁴

22.25 According to ASIC, in 2013 it provided customised data in response to 53 requests from customers including academics, information brokers, and government bodies. The cost incurred by these customers ranged from \$9 to \$1,100, with the average cost being \$276. ASIC reported that 41 other requests were not proceeded with due to the unavailability of the requested data, legislative restrictions or the customer deciding not to proceed with payment. ASIC stated that these customised requests for data were 'particular to the specific needs of the customer' and were 'usually one-off in nature'. ASIC informed the committee, however, that the statistical data it published was responsive to public demand, adding that:

If there were sufficient demand for certain types of statistical data, and its release satisfied legislative and technological parameters, ASIC would certainly consider making it readily available.²⁵

Committee view

22.26 The committee is of the view that ASIC should interrogate its databases and extract and publish critical information that would allow academics, professional bodies and interested members of the public to gain a greater understanding of what is happening in the financial world. This requirement to analyse the various databases would also provide ASIC employees with the means to develop and test their analytical skills and capability.

22.27 The issue of releasing data reaches beyond simply publishing statistics. As identified elsewhere in this report, ASIC does not respond promptly to warning signs of brewing trouble. A part solution to this problem could well reside in ASIC's ability to analyse its databases and other vital information that it gathers and records. In the committee's view, ASIC should do more than simply record, collate and publish such information. If ASIC were to undertake serious research and critical analysis of the information it receives, it would provide its employees with the opportunity to apply and further hone their skills. They would be well placed to interrogate ASIC's databases in order to discern any troubling trends or identify areas that appear to warrant close scrutiny. In addition, by making available a rich source of statistics and importantly its own analysis of that material, ASIC would benefit from allowing

24 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 14.

25 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 14.

academics and other stakeholders to subject its analysis to further scrutiny and in-depth analysis and to receive informed feedback.

Recommendation 39

22.28 The committee recommends that ASIC promote 'informed participation' in the market by making information more accessible and presented in an informative way.

ASIC's websites

22.29 ASIC operates its main website www.asic.gov.au and a consumer advice website MoneySmart www.moneysmart.gov.au. The MoneySmart website was launched in March 2011 as part of the National Financial Literacy Strategy. The website contains information on several consumer finance key topics. For example, it provides general guidance about what to take into account when considering credit, it explains how superannuation works, and highlights various finance-related scams. The website also contains several calculators and tools such as budget and retirement planners, and mortgage, superannuation and credit card calculators. ASIC provided the following information about the MoneySmart website's success:

- It regularly gets over 400,000 unique visitors a month and has been visited by over 6.9 million people since its launch.
- ASIC's research indicates that 89 per cent of users rate the site as 'useful', and 90 per cent of users said they had taken specific action with their finances as a result of visiting the website.
- The website was named 'best service delivery website' at the 2012 Excellence in e-Government Awards, and 'Best in Class' at the 2012 Interactive Media Awards in two categories (Government and Financial Information).
- In 2011, the International Organization of Securities Commissions (IOSCO) rated the website as 'outstanding' and gave it a five out of five rating.²⁶

22.30 Stakeholders commended ASIC for its work on the MoneySmart website. The Association of Superannuation Funds of Australia described the MoneySmart website as 'an excellent initiative' that contains 'exceptional information'.²⁷ State Super Financial Services Australia advised that it has taken ideas from the website to develop educational material to assist their clients to understand financial concepts.²⁸ The Consumer Credit Legal Centre (NSW) stated that while it often provides constructive feedback about certain parts of the website, 'overall it is a very comprehensive and useful resource for consumers—especially the numerous

26 ASIC, *Submission 45.2*, p. 36.

27 Association of Superannuation Funds of Australia, *Submission 155*, p. 3.

28 State Super Financial Services Australia, *Submission 126*, p. 1.

calculators and other practical information available to assist people consider their financial options'.²⁹

22.31 However, similar praise for the main website ASIC operates was not forthcoming. One small business owner described the homepage of www.asic.gov.au as an 'exercise in how not to design' such a webpage. The submitter added that it appears to be a website 'primarily to promote ASIC, not to access services':

Most of the ASIC home page is filled with a list of ASIC's actions/successes. As a small-business operator I don't go to the site for a news service to promote ASIC. The poorly thought-through home page is typical of the whole site that is shaped to serve ASIC's needs, not to be an efficient access portal for small business, or others, to access database services.³⁰

22.32 The small business owner also objected to the 'complicated' nature of the website and that the information on the website, once it has been located, supplies 'overwhelming detail in some areas and little or none in others'.³¹ They argued that the website should be completely reworked with a 'fundamental rethink' of the purpose of the website and who it is intended to serve undertaken.

22.33 Academics also commented on ASIC's website. Mr Jason Harris described the search engine of ASIC's website as 'totally inadequate...almost unusable and unhelpful, generating hundreds of hits with very little ability to refine searches'.³²

22.34 The Commonwealth Ombudsman suggested that ASIC's website could be improved. In particular, the Ombudsman identified a need to more clearly articulate ASIC's complaints process and to simplify the information provided to users. The Ombudsman noted that ASIC's 2013 stakeholder survey revealed that small businesses rated the website negatively.³³

22.35 ASIC has taken some steps to improve the useability of its website in relation to insolvency notices. In mid-2012, a standalone website for publishing insolvency notices commenced operation.³⁴ This website followed a 2008 recommendation by the Corporations and Markets Advisory Committee to limit the publication of notices in the print media.³⁵

29 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, pp. 3–4.

30 Name withheld, *Submission 263*, p. 5.

31 Name withheld, *Submission 263*, p. 5.

32 Mr Jason Harris, *Proof Committee Hansard*, 2 April 2014, p. 25.

33 Commonwealth Ombudsman, *Submission 188*, p. 13 (footnote omitted).

34 ASIC, *Annual Report 2012–13*, p. 50.

35 Corporations and Markets Advisory Committee, *Issues in external administration*, November 2008, p. 81.

Committee view

22.36 A great number of people visit and rely on ASIC's main website www.asic.gov.au for information about matters relevant to them. However, when compared to the website of other Australian government agencies or ASIC's international counterparts, in most cases ASIC's website appears cluttered and not user-friendly. Rather than providing easy access to the most requested information and services, ASIC's homepage heavily emphasises ASIC's recent media releases. Also, the information presented elsewhere is not tailored to its different audiences: members of the public are left to navigate the same webpages as regulated entities.³⁶ As this report has indicated elsewhere, there is a need for ASIC to improve how it communicates with consumers and other groups. In sum, ASIC's main website appears to be another symptom of this wider problem.

22.37 It is important that ASIC's website is functional and provides a satisfactory user experience. Although ASIC's website is likely targeted to those it regulates, it should provide useful information for members of the public. Given the confusion in the community about the respective roles of various government regulatory agencies,³⁷ the website should clearly describe ASIC's role, preferably on the homepage. ASIC should explain how it undertakes this work and provide general information about the regulation of the financial system to members of the public. As the website of a regulatory agency, it should provide easy access to relevant and up-to-date information that assists regulated entities to comply with their obligations. As a law enforcement agency, the website also needs to encourage people to come forward and report matters to it. At present, it does not appear that any group of users is particularly satisfied with ASIC's website.

Recommendation 40

22.38 The committee recommends that ASIC consider the aims and purposes of its website and redesign its website so that these aims and purposes are achieved. Particular consideration should be given to:

- **explaining ASIC's role clearly on the website's homepage;**
- **providing a 'for consumers' category of information; and**
- **redesigning the homepage to give greater prominence to key information and services and less prominence to recent media releases.**

36 The website of the UK's financial services regulator, the Financial Conduct Authority, provides clear links to information designed for consumers and information for firms on its homepage.

37 For example, consumers are often confused as to which agency has responsibility for financial services consumer protection: ASIC, APRA or the ACCC.

PART V

Directions for the future

Overview of Part V

An examination of ASIC's performance has necessarily been, to a large extent, retrospective. Parts II, III and IV of this report have examined past events or considered the regulatory regime as it is at present.

This final part of the report uses the evidence that committee has received and draws on the lessons from past experience to identify various changes that would encourage better regulatory outcomes in the future. These changes either relate to ASIC itself, the legislation it administers or the regulatory framework it operates in.

Some of the changes identified are complex and would require further careful consideration. It may be some time before all of the changes can be developed and introduced. However, the committee believes it is essential to start acting on these changes now. Without a fairer and more responsive regulatory system, the future will simply bring more stories of suffering and injustice with the same issues identified as the culprits.

Chapter 23

Options for encouraging better enforcement outcomes

23.1 Several chapters throughout Parts II and III of this report have focused on ASIC's approach to enforcement. Recommendations were made about steps ASIC could take to improve the enforcement outcomes it achieves. This chapter examines the evidence received by the committee that argued there were more fundamental problems with enforcement beyond ASIC's control, either because of the legislation that ASIC administers or due to the law enforcement framework of which ASIC is a part.

Civil and criminal penalties

23.2 The penalties available to ASIC was an issue discussed in several submissions and at the committee's public hearings. Overall, most considered that the current penalties were generally insufficient. For example, former ASIC enforcement adviser Mr Niall Coburn stated:

If thinking of lawbreakers is a tussle between fear versus greed, then we need penalties to amplify the fear and smother the greed. We need penalties that create a fear that overcomes any desire to take risks and break the law.¹

23.3 As discussed in Chapter 17, some academics and observers argued that ASIC faces a number of difficulties in pursuing remedies available through the civil penalty regime for directors' duties. Although several reasons were put forward as possible contributors to these difficulties, the current penalty amounts was often cited. A group of academics from Adelaide Law School argued that despite a recommendation by Finkelstein J in *ASIC v Vizard* that the \$200,000 upper limit on pecuniary penalties be reviewed,² this has not been addressed. The academics added:

More worryingly, recent cases show that the courts are paying considerable regard to reputational damage as a substitute for significant pecuniary penalties. So in *ASIC v Healey* the non-executive directors were not subjected to any pecuniary penalty at all despite being found to have contravened ss 180(1), 344(1) and 601FD(3) of the *Corporations Act 2001* (Cth) and the court 'taking into account the seriousness of the offences'. In the James Hardie litigation the Court of Appeal reduced the pecuniary

1 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 3.

2 On the maximum penalty of \$200,000 available for civil proceedings, Finkelstein J wrote: 'This is despite the fact that a contravention holds great potential for profit and may cause much harm. In a criminal prosecution (and after 13 March 2000 there could be both a civil and criminal prosecution for the same conduct: see s 1317P of the Corporations Law), the maximum penalty was more severe, namely imprisonment for a period not exceeding five years plus a fine not exceeding \$200,000'. *Australian Securities and Investments Commission v Vizard* (2005) 145 FCR 57 at 63–64 [27].

penalties imposed by the trial judge from \$30 000 to \$25 000 for the Australian directors and to \$20 000 for the US directors. The influence of the parity principle (that similar breaches should attract similar penalties) and the doctrine of precedent means that it is unlikely that the courts will feel free to depart from the approaches in these cases without legislative intervention to raise the upper limit of the pecuniary penalty for an individual above the current level of \$200 000.³

23.4 CPA Australia also advised it believed the upper limit of \$200,000 was insufficient. When asked what the limit should be, Mr Malley explained that, depending on the nature of the offence 'it has to be of such an ilk that it really does make people think twice':

You need to understand that, if you are dealing in markets where potentially people earn large amounts of money and the penalty in material terms is not material, perhaps that is not necessarily a deterrent. I think society deserves to be protected.

I would also add that there are many directors working in Australia under some very tough legislation. It is our view—and I should say this in balance—that there are elements of the Corporations Law that pertain to directors that are far more difficult here than they are in other countries and in some ways impractical. I think there needs to be a review of that. But, on the basis that there is a review, there should also be higher penalties if there is a fairer scenario for directors in the marketplace.⁴

23.5 ASIC argued that a holistic review of penalties across the corporations legislation is required. It advised that the current penalties have been in place for extended periods, with criminal penalties reviewed in a piecemeal way since they were enacted and civil penalties unchanged since 1992.⁵ ASIC concluded that the current civil penalties under the corporations legislation:

- have not kept pace with inflation (they are not linked to penalty units);
- regardless of the above, the penalties 'are proportionately low given the seriousness and impact of civil penalty matters', and when compared with the penalties available in other jurisdictions such as the UK and US; and
- are inconsistent with the penalties in other legislation ASIC administers, such as the *National Consumer Credit Protection Act 2009*.⁶

3 Dr Suzanne Le Mire, Associate Professor David Brown, Associate Professor Christopher Symes and Ms Karen Gross, *Submission 152*, pp. 2–3 (footnotes omitted).

4 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 48.

5 ASIC noted that the civil penalties were extended in 2004 to include bodies corporate, with a maximum penalty for a body corporate of \$1 million. ASIC, *Submission 45.2*, p. 169.

6 ASIC, *Submission 45.2*, pp. 169–70.

23.6 To illustrate its concern about the size of penalties available in Australia, ASIC pointed to the fines totalling over \$6 billion that JP Morgan received as part of the 'London Whale' trading scandal. These fines consisted of £138 million by the UK FCA; US\$200 million by the US SEC; US\$200 million by the US Federal Reserve; US\$309 million by the US CFPB; and US\$300 million by the US Office of the Comptroller of the Currency. However, ASIC advised that under the Corporations Act, the maximum penalty applicable for an offence is \$1 million. Further, due to the 'totality principle':

multiple offences arising out of the same course of conduct will not usually give rise to a substantially greater penalty than a single offence. Accordingly, multiple offences cannot attract remotely comparable civil penalties in Australia, even assuming that the maximum penalty is applied.⁷

23.7 On 20 March 2014, ASIC released a comparison of penalties available to ASIC and those available to its foreign counterparts, other Australian regulators and across the legislation ASIC administers. It concluded that:

- while ASIC's maximum criminal penalties are broadly consistent with those available in other countries, there are significantly higher prison terms in the US, and higher fines in some overseas countries for breaches of continuous disclosure obligations and unlicensed conduct—for example, the fine for individuals for unlicensed conduct in Australia is \$34,000, whereas in Hong Kong it is \$720,000; in Canada it is \$5.25 million; in the United States it is \$5.6 million; and in the United Kingdom there is no limit on the maximum fine;⁸
- there is a broader range of civil and administrative penalties in other countries, and the penalties are higher (see Table 23.1);
- the maximum civil penalties available to ASIC are lower than those available to other Australian regulators and are fixed amounts, not multiples of the financial benefits obtained from wrongdoing; and
- across ASIC's regime there are differences between the types and size of penalties for similar wrongdoing (for example, ASIC noted that providing credit without a licence can attract a civil penalty up to ten times greater than the criminal fine for providing financial services without a licence).⁹

7 ASIC, *Submission 45.2*, p. 170.

8 ASIC, *Penalties for corporate wrongdoing*, Report 387, March 2014, p. 17. The currency conversion to Australian dollars is based on the daily exchange rate published by the RBA as at 31 December 2013.

9 ASIC, 'ASIC reports on penalties for corporate wrongdoing', *Media Release*, no. 14-055, 20 March 2014; ASIC, *Report 387*, pp. 16–17.

Table 23.1: Comparison of civil and administrative penalties for individuals (\$AUD)

| Country | Insider trading | Market manipulation | Disclosure | False statements | Unlicensed conduct | Inappropriate advice |
|----------------|-------------------------------------|--|--|--|--|---|
| Australia | Civil: \$200,000 | Civil: \$200,000 | Civil: \$200,000 | – | – | Civil: \$200,000 |
| Canada | Administrative: \$1.05 million | Administrative: \$1.05 million | Administrative: \$1.05 million | Administrative: \$1.05 million | Administrative: \$1.05 million | Administrative: \$1.05 million |
| Hong Kong | Administrative: unlimited | – | Civil: \$1.12 million | – | – | Administrative: greater of \$1.4 million, or 3 times the benefit gained |
| United Kingdom | Civil and administrative: unlimited | Civil and administrative: unlimited | Administrative: unlimited | Civil and administrative: unlimited | – | Administrative: unlimited |
| United States | Civil: 3 times the benefit gained* | Civil: greater of \$111,000, or the benefit gained | Civil: greater of \$111,000, or the benefit gained | Civil: greater of \$111,000, or the benefit gained | Civil: greater of \$111,000, or the benefit gained | Administrative: \$83,850 |

Notes:

* For control persons, the maximum non-criminal penalty is the greater of \$AUD1.1 million or three times the benefit obtained.

The currency conversion to Australian dollars is based on the daily exchange rate published by the RBA as at 31 December 2013.

Source: ASIC, *Penalties for corporate wrongdoing*, Report 387, March 2014, p. 19.

23.8 In addition to its suggestion that civil penalties be set significantly higher to better reflect the seriousness of breaches, ASIC argued that the penalties should adopt the disgorgement feature of the civil penalties imposed in the UK and the US, where the benefit attributable to the commission of the breach is removed.¹⁰

23.9 ASIC concluded that a 'stronger' penalty regime would improve the cost-effectiveness of enforcement action by maximising the impact and deterrent effect of such action.¹¹ However, some witnesses suggested that reputational issues carry more weight than the size of the penalty. For example, the chairman of the Business Law Section of the Law Council of Australia made the following observation:

It is true that a person weighing up the risks of compliance and non-compliance would be thought to have regard for the size of the penalty. I find with the people I deal with that is not the way they think. The people we tend to be involved with, and there may well be some segmentation, are

¹⁰ ASIC, *Submission 45.2*, p. 171. For criminal matters, action can be taken under the *Proceeds of Crime Act 2002*.

¹¹ ASIC, *Submission 45.2*, p. 169.

more concerned about reputational issues than the size of a penalty. By and large, the vast majority of Australians involved in financial markets and business are trying to do the right thing. I use the example of continuous disclosure by listed companies, which is a very, very difficult area. There are judgements that have to be made, and it is very difficult sometimes to be certain what the right thing to do is because you have to juggle a number of interests—the interests of the investors in having the information but also making sure that the information is clear and understandable.¹²

23.10 The reputational aspect of deterrence was also noted by other witnesses who questioned whether larger financial penalties imposed on corporations would impact the reputation of the entity involved. Professor Justin O'Brien used the JP Morgan case to support his view that only imprisonment provides a deterrent based on reputational consequences:

...JP Morgan agrees to a settlement with the US regulatory authorities for \$13.5 billion; Jamie Dimon gets an 89 per cent pay increase. To what extent did that impact on his reputation? Well, arguably, you can make the point that he deserved that increase in his compensation because he reduced the actual litigation that he might have faced. So even in the United States where you have huge penalties it does not really have a reputational effect; what ends up happening is that it becomes part of the price of settlement, and it privileges what Judge Jed Rakoff, who we brought out to Australia last year, calls 'the facade of enforcement'. So what really will act as a reputational restraining force? The threat of jail.¹³

23.11 Others were not convinced that higher penalties were necessary. Although Professor Baxt acknowledged that there may be specific areas where an increase in penalties could be warranted, he rejected ASIC's call for greater penalties. In his view, ASIC 'is not even trying to get the penalties that it can get under the current law in a sufficiently aggressive and satisfactory way in many of the problem areas that exist'.¹⁴

Committee view

23.12 It is important that the penalties contained in legislation provide both an effective deterrent to misconduct as well as an adequate punishment, particularly if the misconduct can result in widespread harm. Insufficient penalties undermine the regulator's ability to do its job: inadequately low penalties do not encourage compliance and they do not make regulated entities take threats of enforcement action seriously. The committee considers that a compelling case has been made for the penalties currently available for contraventions of the legislation ASIC administers to be reviewed to ensure they are set at appropriate levels. In addition, consideration

12 Mr John Keeves, Chairman, Business Law Section, Law Council of Australia, *Proof Committee Hansard*, 20 February 2014, p. 9.

13 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 61.

14 Professor Bob Baxt AO, *Proof Committee Hansard*, 21 February 2014, pp. 11, 17.

should be given to designing more responsive monetary penalties, such as multiple of gain penalties or penalties combined with disgorgement.

Recommendation 41

23.13 The committee recommends that the government commission an inquiry into the current criminal and civil penalties available across the legislation ASIC administers. The inquiry should consider:

- **the consistency of criminal penalties, and whether some comparable offences currently attract inconsistent penalties;**
- **the range of civil penalty provisions available in the legislation ASIC administers and whether they are consistent with other civil penalties for corporations; and**
- **the level of civil penalty amounts, and whether the legislation should provide for the removal of any financial benefit.**

Addressing overlaps in jurisdiction and improving the working relationship with other enforcement agencies

23.14 The inquiry's terms of reference directed the committee to consider ASIC's collaboration, and working relationships, with other regulators and law enforcement bodies. To ensure the law enforcement framework works as it should, the working relationships between agencies need to be well-functioning and any overlaps in jurisdiction managed effectively. As the Institute of Chartered Accountants Australia noted, this is an issue that has received some attention:

In recent years there have been a number of cases where regulatory agencies are seen to lay responsibility for poor regulatory outcomes at the feet of other agencies, rather than being seen to operate as one cohesive group of law enforcement agencies. Effective regulation in today's modern cross-border business environment will require a much greater degree of engagement and collaboration between regulators than has perhaps been the case in the past.

23.15 The ASIC Act¹⁵ and the memorandums of understanding ASIC has entered into with numerous domestic¹⁶ and international¹⁷ agencies provides a legal and

15 Section 127 of the ASIC Act also allows for the sharing of confidential information with the minister and specified government officers or bodies, and allows for the ASIC chairman to authorise information sharing with other Commonwealth agencies or the government or agencies of a state, territory or foreign country.

practical framework for ASIC's working relationship with other regulators and law enforcement agencies. From the evidence the committee has received, it appears that the Australian Federal Police (AFP) is the agency ASIC is most likely to encounter overlaps in jurisdiction with. Mr Chris Savundra of ASIC explained:

We investigate serious financial crime where it pertains to our jurisdiction, so we are not limited to taking action under the Corporations Act; we can take action under state and federal criminal laws, and we do. Equally, the AFP takes corporations law action, such as insider trading. So, the AFP has previously taken action under the Corporations Act, for both insider trading and breaches of director's duties, and the reason is the difference in the use of powers and that issue we raised on the last occasion around the sharing of information.¹⁸

23.16 Foreign bribery is one area where ASIC has been subject to scrutiny and criticism regarding both its enforcement of relevant provisions in the Corporations Act and how effectively it works with the AFP. The AFP is responsible for investigating foreign bribery offences,¹⁹ although directors' duties under the Corporations Act can also be relevant. In particular, two of the principles expressed in the Federal Court's *Centro* decision²⁰ are pertinent to allegations of foreign bribery. These principles are scepticism (directors must question the information put to them) and accountability

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- 16 ASIC has entered into an MOU with: the Australian Charities and Not-for-profit Commission (June 2013); ACCC (December 2004); AFP (October 2013); APRA (May 2010); ASX (October 2011); ATO (May 2007); Chi-X Australia Pty Limited (October 2011); Clean Energy Regulator (1 June 2012); CDPP (September 1992); Financial Reporting Council (June 2004); Private Health Insurance Administration Council (October 2011); Members of the Council of Financial Regulators (joint MOU agreed to September 2008); and the RBA (March 2002). ASIC is also a party to the MOU on Standard Business Reporting (an MOU between various Commonwealth, state and territory departments and agencies). ASIC, www.asic.gov.au (accessed 19 September 2013).
- 17 ASIC has entered into a multilateral memorandum of understanding with IOSCO and bilateral agreements with the European Securities and Markets Authority and the securities regulatory agencies, companies registrar and/or auditing oversight bodies of 51 countries and dependent territories. See www.asic.gov.au/asic/ASIC.NSF/byHeadline/OIR%20-%20Memorandum%20of%20Understandings.
- 18 Mr Chris Savundra, Senior Executive Leader, Markets Enforcement, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 11.
- 19 The bribery of foreign public officials is made an offence by division 70 of the Commonwealth Criminal Code. As with other offences in the Criminal Code, extensions of criminal responsibility such as attempts to commit an offence apply (division 11), as does corporate criminal responsibility (division 12).
- 20 *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291.

and control (an obligation to ensure that systems, protocols and control exist to ensure sound corporate governance).²¹

23.17 Allegations that two subsidiaries of the RBA, Note Printing Australia Limited and Securrency International Pty Ltd, engaged in foreign bribery during the 1990s in attempts to secure polymer banknotes contracts have resulted in criminal charges being brought by the AFP against the companies and several employees. In March 2012, ASIC announced that it had decided not to proceed with an investigation into the Note Printing Australia/Securrency allegations. It released the following statement:

The Australian Federal Police (AFP) has provided ASIC with material relating to bribery allegations concerning Securrency International Pty Ltd and Note Printing Australia Limited.

ASIC considers a range of factors when deciding to investigate and possibly take enforcement action.

In line with its normal practice, ASIC has reviewed this material from the AFP for possible directors' duty breaches of the Corporations Act and has decided not to proceed to a formal investigation.

ASIC intends to make no further comment on this matter.²²

23.18 An episode of the ABC's *Four Corners* program broadcast on 30 September 2013, however, suggested that ASIC did not investigate the directors of these companies for corporate misconduct. In its response to *Four Corners*, ASIC stated that its decision not to investigate followed 'a thorough assessment of the information', with 'more than 10,000 pages of documents including several detailed witness statements' reviewed.²³ ASIC subsequently issued a clarification advising that its assessment only related to alleged conduct in Indonesia, Malaysia, Vietnam and Nepal, and that it would consider the Iraq allegations raised in the program. However, ASIC added that 'it must be stressed that a six-year statute of limitations applies to civil penalty cases'.²⁴ In an October 2013 interview, the ASIC chairman added that the two RBA subsidiaries were propriety companies and that ASIC does not 'normally' pursue contraventions of the Corporations Act that relate to propriety companies:

21 Greg Medcraft, 'Setting the record straight: ASIC, bribery and enforcement action', Address to the AmCham Business Leaders Lunch, 11 October 2013, www.asic.gov.au (accessed 14 October 2013), p. 4. The third principle expressed in the Centro decision relates to accounting knowledge.

22 ASIC, 'Statement on Securrency International and Note Printing Australia', *Media Release*, no. 12-47, 12 March 2012.

23 ASIC, 'ASIC's response to ABC TV's Four Corners' questions', 30 September 2013, http://abc.net.au/4corners/documents/RBA2013/ASIC_response.pdf (accessed 1 October 2013), p. 1.

24 ASIC, 'ASIC clarification – 1 October 2013' www.asic.gov.au/asic/asic.nsf/byheadline/ASIC+clarification+-+1+October+2013?openDocument (accessed 2 October 2013).

Our focus is on listed public companies where in fact, you know, if we see lots of people losing lots of money into retail investors and there is a significant market impact, that is where we give priority, where in fact there is a significant impact on the market or on significantly on retail investors losing a lot of money.²⁵

23.19 Another alleged instance of foreign bribery has also recently been a matter of public interest. In February 2012, Leighton Holdings Limited announced that it was aware of possible contraventions of Australian laws relating to payments that may have been made in connection to work on facilities for Iraq's crude oil exports, and that it had alerted the AFP.²⁶ A series of media articles published in October 2013 alleged that internal documents of Leighton Holdings revealed a corporate culture that resulted in bribery, corruption and cover-up being 'rife' and known to certain directors and senior management.²⁷ In response, Leighton issued a statement advising that it continues to cooperate with the AFP and that it was 'not aware of any new allegations or instances of breach of our ethics'.²⁸ The Leighton allegations have resulted in commentators questioning the approach taken by ASIC and how effectively it works with the AFP, particularly given the concerns about this relationship in the context of the Securrency/Note Printing Australia matter.²⁹

23.20 The Organisation for Economic Co-operation and Development (OECD) Working Group on Bribery conducts a cycle of reviews to monitor and assess the structures established by parties to the OECD Anti-Bribery Convention, such as Australia. The most recent report on Australia was released in October 2012. The Working Group concluded that it had 'serious concerns that overall enforcement of the foreign bribery offence to date has been extremely low' in Australia. It provided the following reasoning:

Only one foreign bribery case has led to prosecutions. These prosecutions were commenced in 2011 and are on-going. Out of 28 foreign bribery referrals that have been received by the Australian Federal Police (AFP), 21 have been concluded without charges.³⁰

25 Greg Medcraft, *ABC Lateline*, 11 October 2013, www.abc.net.au/lateline/content/2013/s3867665.htm (accessed 14 October 2013).

26 Leighton Holdings, 'Leighton cooperating fully with AFP on possible breach of Code of Ethics', *Media Release*, 13 February 2012.

27 Nick McKenzie and Richard Baker, 'Wal King "approved Iraq bribe"', *Australian Financial Review*, 3 October 2013, p. 1.

28 Leighton Holdings, 'Response to allegations in newspaper articles in Fairfax media', *Media Release*, 3 October 2013, p. 1.

29 See, for example, Malcolm Maiden, 'ASIC must act fast on graft claims', *Sydney Morning Herald*, 4 October 2013, p. 28.

30 OECD, *Phase 3 Report on implementing the OECD Anti-Bribery Convention in Australia*, October 2012, www.oecd.org/daf/anti-bribery/Australiaphase3reportEN.pdf (accessed 4 October 2013), p. 5.

23.21 The OECD Working Group also expressed concern about communication between the AFP and ASIC, suggesting that miscommunication 'may have left important aspects of foreign bribery cases uninvestigated'.³¹ It recommended that the AFP and ASIC should develop a clearer written framework that outlines each agencies responsibilities and how the agencies would work together on foreign bribery cases:

The AFP has MOUs with other agencies (e.g. the CDPP) but not with ASIC that would apply to the referral of foreign bribery cases. At various points in [the] on-site visit, the AFP stated that the Securrency/NPA was referred to ASIC because these matters were "better managed by ASIC", that they were "better fit" for ASIC, or that ASIC could obtain "a better outcome". Why referral was "better" was not explained in concrete terms. In any event, these statements by the AFP and ASIC at the on-site visit about case referral and acceptance are not clearly reflected in written policies or agreements between the two bodies.³²

23.22 The OECD Working Group made recommendations regarding ASIC, noting that ASIC is 'in a prime position to interact with companies that may commit foreign bribery' and that 'its experience and expertise in investigating corporate economic crimes' should be utilised to assist the AFP to prevent, detect and investigate cases of foreign bribery.³³ In a submission to this inquiry, Associate Professor Kath Hall of the Australian National University's Faculty of Law argued that ASIC should take a more active role in corporate corruption, noting that ASIC has stronger powers in relation to directors' duties than the US or UK regulators.³⁴

23.23 Since the OECD report, ASIC has signed an MOU with the AFP that addresses investigations of alleged foreign bribery.³⁵ Also, in a speech given in October 2013, the ASIC chairman responded to concern about ASIC's role in investigating allegations of foreign bribery. The chairman described much of the media reports as being 'ill-informed in describing ASIC's role'³⁶ and emphasized that ASIC would not act in a way that would jeopardise an AFP criminal investigation. In his speech, the ASIC chairman:

31 OECD, *Phase 3 Report on implementing the OECD Anti-Bribery Convention in Australia*, p. 26. However, ASIC observed that the report did not provide evidence of miscommunication. See Mr Greg Medcraft, ASIC, *Senate Economics Legislation Committee Hansard*, Estimates, 20 November 2013, p. 25.

32 OECD, *Phase 3 Report on implementing the OECD Anti-Bribery Convention in Australia*, p. 26.

33 OECD, *Phase 3 Report on implementing the OECD Anti-Bribery Convention in Australia*, pp. 5, 20.

34 Dr Kath Hall, *Submission 123*, p. 1.

35 Greg Medcraft, 'Setting the record straight: ASIC, bribery and enforcement action', Address to the AmCham Business Leaders Lunch, 11 October 2013, www.asic.gov.au (accessed 14 October 2013), p. 4.

36 Greg Medcraft, 'Setting the record straight', p. 3.

- stated that directors' duties investigations would ordinarily occur after any criminal investigation given that defendants in prosecutions have a 'right to silence' which is protected by courts delaying any civil proceedings until the criminal case is completed;
- argued that the prison term and fine available under the Criminal Code (along with the automatic ban from being a director that comes with conviction) is a greater deterrent than proceedings initiated under the Corporations Act; and
- noted that parallel investigations are difficult to manage.³⁷

23.24 However, Mr Medcraft did outline the circumstances in which ASIC would run a parallel bribery investigation examining alleged breaches of directors' duties. In addition to the factors ordinarily considered when deciding whether to take enforcement action—namely the extent of the harm or loss, the cost versus the regulatory benefit and the available evidence—specific factors ASIC would consider when assessing whether to proceed with a bribery investigation are:

- if there is a risk the six year time limitation for civil proceedings will prevent ASIC bringing proceedings;
- the impact of the conduct on the market and retail investors, including whether the conduct is ongoing or the relevant directors are still on the board;
- if the bribery materially damages the company;
- if the bribery involves a publicly listed company;
- if ASIC's investigation will not adversely impact AFP's criminal investigation; and
- whether ASIC considers that AFP action alone is an appropriate response.³⁸

23.25 Mr Medcraft told the committee that in his view, the problem with pursuing foreign bribery cases is not the particular agency that pursues the matter, but obtaining the evidence in the foreign jurisdiction.³⁹

37 Greg Medcraft, 'Setting the record straight', p. 5.

38 Greg Medcraft, 'Setting the record straight', p. 6.

39 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 13.

Proposal for a Serious Fraud Office

23.26 One proposal that provoked discussion at the committee's public hearings was the suggestion that a Serious Fraud Office be established in Australia.⁴⁰ Serious Fraud Offices exist in the United Kingdom and New Zealand, and it was pointed out that a similar model could be adopted here. Potentially, a Serious Fraud Office could address the overlap in responsibilities between ASIC and the AFP and, given the AFP's priorities in other areas of law enforcement, could ensure that white collar crime cases receive sufficient attention from specialist staff.

23.27 When questioned about the proposal, Mr Greg Tanzer of ASIC identified that an advantage of the Serious Fraud Office model is that resources are quarantined to target a particular activity, instead of an agency with diverse responsibilities being required to prioritise its resources. However, Mr Tanzer suggested that the framework could lead to 'hand offs', where cases are referred between various law enforcement agencies.⁴¹ Mr Medcraft added that establishing another agency creates the risk of fragmentation and that, assuming additional funding is not available, the funding for the new organisation would have to come from the existing agencies such as ASIC.⁴² ASIC's preferred model is a whole-of-government response using existing agencies, such as Project Wickenby.⁴³

23.28 The potential adverse consequences associated with fragmentation were also addressed by other witnesses. During her appearance before the committee, Professor Dimity Kingsford Smith concentrated on how ASIC's enforcement role can inform its other regulatory tasks:

Very often a regulator can lead with new policies, new supervision, new focuses, and risk-weighting of which kind of financial organisation needs more scrutiny. That can come from the data they collect from complaints and their experience of enforcement. If there was to be restructuring of ASIC's enforcement activity it would have to be, very carefully, on the basis that the learning that ASIC can obtain from the undertaking of investigations and the execution of enforcement is not lost to them.⁴⁴

23.29 Other academics also mulled over Australia's framework of law enforcement agencies for financial crime. Professor Justin O'Brien acknowledged that there are

40 Although the proposal was generally not specifically raised in written submissions, in its submission the Governance Institute of Australia presented the committee with a list of several options that could be considered further to increase the efficacy of white collar crime investigations and prosecutions. One of these options was the formation of a separate prosecutorial body dedicated to pursuing white collar crime. Governance Institute of Australia, *Submission 137*, p. 5.

41 Mr Greg Tanzer, Commissioner, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 12.

42 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 13.

43 Mr Chris Savundra, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 39.

44 Professor Dimity Kingsford Smith, *Proof Committee Hansard*, 19 February 2014, p. 57.

examples of protocols that have not been effective, however, in his view there is not necessarily a problem with different agencies having overlapping responsibilities if effective protocols can be developed.⁴⁵ He also noted that following the Libor scandal in the UK it has been recognised that the Serious Fraud Office did not have the 'expertise or the competence' in financial markets matters. As a result a process of secondments between the Financial Conduct Authority and the Serious Fraud Office has commenced.⁴⁶

23.30 As this inquiry progressed, the creation of a Serious Fraud Office was also discussed in other forums. In a paper presented in October 2013, Justice Mark Weinberg of the Supreme Court of Victoria's Court of Appeal, and a former Commonwealth Director of Public Prosecutions, expressed his view that the creation of a Serious Fraud Office would be 'an entirely retrograde step':

The [Serious Fraud Office] both investigates, and prosecutes, cases involving serious or complex fraud, bribery and corruption. Its record in that regard is somewhat mixed. It has always seemed to me to be highly desirable that the investigative and prosecutorial functions be kept entirely separate from each other...My experience as a former Commonwealth Director was that even the most able of investigators could find themselves caught up in the fervour of a case, with which they may have had close involvement for months and perhaps years, and therefore unable to consider objectively the prospects of a successful prosecution. I should add that, in my opinion, prosecutors seldom make good investigators.⁴⁷

Committee view

23.31 The committee is pleased that the AFP and ASIC have entered into a new memorandum of understanding. While these agreements may simply reflect existing arrangements, they promote public confidence by demonstrating that a formal framework designed to foster a sound and cooperative relationship between these agencies now exists, and that both agencies, through the process of developing the memorandum of understanding, have considered how they can work together more effectively.

23.32 Proposals for changing the current institutional framework for investigating and prosecuting certain offences were contemplated by the committee. Such proposals need to be studied carefully: fragmented and unclear arrangements can create further overlaps in jurisdiction and undermine established acceptable principles associated with prosecutions. The creation of a Serious Fraud Office could have some benefits,

45 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 56.

46 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 56.

47 Justice Mark Weinberg, 'Some Recent Developments in Corporate Regulation – ASIC from a Judicial Perspective', Paper presented to the Monash University Law School Commercial CPD Seminar, Melbourne, 16 October 2013, <http://assets.justice.vic.gov.au/scv/resources/8ba39daa-0868-4e5f-b9ef-8bd2469ae95a/recentdecorpregcpdseminar.pdf> (accessed 15 April 2014), p. 2.

particularly if doing so resulted in a more effective law enforcement response to serious or complex fraud, bribery and corruption. It is evident, however, that even with a Serious Fraud Office appropriate protocols and frameworks for sharing expertise and staff still need to be in place. It appears to the committee that the problems identified with the current framework that relate to the resources and priorities of the existing agencies are not issues that the creation of an additional agency would solve.

23.33 As the committee has been tasked with the examining the performance of one agency, ASIC, the committee is not recommending the establishment of a Serious Fraud Office. This proposal would require the entire law enforcement institutional framework to be considered. Nevertheless, the committee is of the view that there needs to be a shake-up of how complex fraud, bribery and corruption is addressed in Australia. There has been considerable public discussion about the perceived failure of ASIC and the AFP to address such cases effectively. Instead of having a deterrent effect, the committee is concerned that the current arrangements send the wrong message about the likelihood of these cases being pursued. It is essential that the law enforcement framework promotes confidence in Australia's corporate and financial institutions. Australia's growing pool of superannuation savings provides an attractive target for fraud and the amounts involved can be significant: the Trio Capital fraud alone resulted in losses of around \$176 million.⁴⁸ The current size and likely growth of Australia's financial sector, the importance of this sector to all Australians and the complexity and time-consuming nature of serious fraud and corruption investigations compared to other criminal cases means that it is imperative that the government clearly demonstrates that it has zero tolerance for financial crime.

23.34 The committee urges the government to consider these issues further and, in the interim, to ensure that relevant enforcement agencies, the CDPP and the courts are adequately resourced to meet the community's expectations of law enforcement and to facilitate the swift delivery of justice. The establishment of a Project Wickenby-type multi-agency taskforce might be an ideal start.

48 Treasury, *Review of the Trio Capital Fraud and Assessment of the Regulatory Framework*, 2013, p. 9.

Chapter 24

Financial advisers and planners

24.1 As indicated by the Commonwealth Financial Planning Limited (CFPL) case study outlined earlier in the report, issues related to financial advice featured prominently during this inquiry. This was recognised by ASIC, which advised that it 'has long been concerned about the quality of financial advice provided to consumers and about conflicts of interest in the financial advice industry':

ASIC's concerns were not limited to a few 'bad apples' in the industry, or even a few bad firms. Instead, they reflected broad systemic problems with the financial advice industry, driven by conflicted remuneration structures and compounded by weaknesses in the regulatory system.¹

24.2 ASIC informed the committee that it continues to have concerns about the sector, which others also share. The 2013 survey of ASIC's stakeholders found that only 23 per cent of respondents agreed that financial advisers act with integrity. In ASIC's view, although the Future of Financial Advice (FOFA) reforms 'should go a considerable way in improving the long-term quality of advice provided to investors', there were still some regulatory gaps that limited ASIC's ability to promote high standards in the industry and fulfil its statutory objectives.²

24.3 In its main submission, ASIC outlined certain recommendations that it considered would address these regulatory gaps. This chapter considers these recommendations and other issues related to the regulation of the financial advice industry. The committee's findings are outlined at the end of the chapter.

Proposal for a national financial adviser examination

24.4 ASIC argued that the current system for training and assessing advisers is inadequate and that standards need to be lifted. ASIC advised that the Corporations Act requires Australian financial services (AFS) licensees to ensure that their representatives are adequately trained and are competent to provide financial services, and that ASIC publishes regulatory guidance on minimum training standards in Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146). Despite this, ASIC reported that its surveillances 'have consistently found that many advisers are not adequately trained or competent to deliver financial advice to investors'.³

1 ASIC, *Submission 45.2*, p. 142.

2 ASIC, *Submission 45.2*, p. 153.

3 ASIC, *Submission 45.2*, p. 154.

24.5 The training standards outlined in ASIC's RG 146 specify different requirements depending on whether the adviser gives general or personal advice and the products on which advice is given. RG 146 proceeds on the basis that advisers who provide advice on Tier 1 products (which are, broadly speaking, more complex products) must meet the standards at a different educational level from those advisers who provide advice on Tier 2 products (simpler products).⁴ Despite this framework, ASIC advised that there:

...are numerous and fragmented approaches to interpreting and implementing the requirements in RG 146 and training courses vary significantly in terms of content and quality. There is no consistent measure of adviser competency.⁵

24.6 To help address this issue of competence, ASIC proposed a new framework for the assessment and professional development of advisers based on a national examination. ASIC argued that a national examination would be 'the most transparent and effective' way to demonstrate whether an adviser had met a minimum standard of competency.⁶

24.7 A national exam was first proposed by ASIC in 2011. At a public hearing, Mr Medcraft indicated that the idea was informed by his experience in the United States. After returning to Australia, Mr Medcraft observed that:

...the training regime here...was really fragmented. Frankly, we should not be micro-managing training. It should not be our job. My view is that we should focus on outcomes...if you get through the national exam, whether you have got there through no study or an e-learning module, or some training course, that is fine; at least you sat that exam. Everyone in America has that confidence that you have sat the series 7 and you have passed a six-hour exam. I learnt more about muni securities than I ever wanted to, but it was really important. You learnt about client account dealing et cetera. That is really where I got the idea of proposing it. I proposed it about four or five years ago. I have been endeavouring to socialise the idea because I do think it is a far more efficient and a far more equitable system.⁷

24.8 ASIC's deputy chairman commented that the national examination proposal seeks to address two key issues regarding competency and educational levels:

One is: what is the level that needs to be set? The second is: how do you test that? Our proposal, which we have been consulting on with industry very extensively in the last few months, is that there should be a requirement that anyone providing personal advice has a tertiary

4 ASIC, *Submission 45.2*, p. 154.

5 ASIC, *Submission 45.2*, p. 154.

6 ASIC, *Submission 45.2*, p. 155.

7 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, pp. 15–16.

qualification and that, in addition to that, to help ensure that you have demonstrated your ability to do that, you would sit at a national exam. So there is the level, which is a tertiary qualification, and the exam supporting that.⁸

24.9 Some academics supported the proposal. Professor Dimity Kingsford Smith remarked that the national exam was 'a very good example of a fine, well-thought-out proposal as far as the regulator could do so without really any powers to push that proposal forward—except in a policy proposal'. She remarked further that for no good reason she could discover, the proposal 'came to nothing'. She added:

My very diligent students have assembled a table...which shows you that every other respectable regulatory jurisdiction has a national exam and some of them have, every three years or so, a renewal of the exam.⁹

24.10 Industry groups did not support the proposal. The Financial Planning Association (FPA) questioned the benefits that would flow from the exam:

We are not supportive of the proposal for the three-year examination, mainly because we think it is overreach of a regulator to be providing and certifying education which does not happen in any other profession. ASIC's resources are already stretched. We are not sure that they have the expertise or the resources to be able to deliver such an examination.¹⁰

24.11 CPA Australia also argued against the proposal. Its chief executive officer, Mr Alex Malley, noted that the proposal was based on the model adopted in the US despite there being no evidence that the model 'had been a roaring success':

In 2011 ASIC proposed a new national exam for all financial planners. It was presented as a concept that would be introduced because it had been adopted in the United States, a market that has not fared well compared to our domestic economy. When quizzed about the reasoning, the process to be followed and the communication plan to be laid out, it became evident there was little substance behind the commentary. Needless to say, it has not been implemented, and ASIC communication has paused for some time.¹¹

24.12 Mr Malley added that he has 'no issue in and of itself with exams; it is those who perhaps have no qualification to set them or understand what they are trying to achieve that I have an issue with'.¹²

8 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 16.

9 Professor Dimity Kingsford Smith, *Proof Committee Hansard*, 19 February 2014, p. 59.

10 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Proof Committee Hansard*, 19 February 2014, p. 69.

11 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 43.

12 Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 44.

24.13 Although the FPA does not support the proposed national examination, it submitted that planners 'should have to go through proper certification and education and experience'. The FPA subsequently indicated that the minimum education standards set by RG 146 are the problem:

Under RG146, a person can undertake a short course to gain 'generic knowledge on products and markets' and be able to become an Authorised Representative permitted to provide personal financial advice to consumers.

The minimum standards required under RG146 are inadequate for the delivery of quality advice and therefore create a risk of consumers acting on information provided by providers who are not appropriately or professionally qualified, may not have the skills required to explain complex concepts, and may pass on inappropriate advice without consideration of the principles of financial planning.¹³

24.14 The FPA has recently called for the introduction of a requirement that financial advisers and planners must meet minimum education standards consisting of a relevant university degree and three years' experience over a five year period. It also envisaged minimum continuing professional development requirements. According to the FPA, it is unclear how ASIC's proposed national examination would improve education in the absence of an enhanced education framework.¹⁴ The FPA added that, if an examination was being considered for new entrants, then the exam:

...should be left to the professions that have the practical knowledge and know-how and are experienced at running educational programs to run them.¹⁵

24.15 ASIC was questioned about how a national examination would operate. ASIC proposed that the examination would be 'industry-driven':

The questions are practical and really deal with issues that you would face as an adviser. So it should be driven by the industry. It can be delivered across the country in testing stations at \$300 a head. That is what I am envisaging. Frankly, I think it would really help a great deal. For \$300, it is well worth it for what we have in terms of the savings of our country.¹⁶

24.16 Mr Medcraft suggested that a further benefit in introducing a national examination would be in facilitating greater mutual recognition between the US and

13 Financial Planning Association, *The Future of the Financial Planning Profession: White Paper of the Financial Planning Association of Australia*, May 2014, <http://fpa.asn.au>, p. 3.

14 Financial Planning Association, *The Future of the Financial Planning Profession: White Paper of the Financial Planning Association of Australia*, May 2014, p. 4.

15 Mr Mark Rantall, Financial Planning Association, *Proof Committee Hansard*, 19 February 2014, p. 70.

16 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 16.

Australia 'which would mean it would try and streamline that access between two countries in terms of the US capital markets'.¹⁷

Reference checking and employee adviser register

24.17 ASIC argued that there were currently insufficient controls on 'bad apple' or problem advisers that have not otherwise come to ASIC's attention. Two problems related to this were identified. The first stems from inadequate reference checking—ASIC advised that problem advisers 'typically change employment when they are identified, moving from one AFS licensee to another'. According to ASIC, this is achieved because in many cases the new licensee either failed to conduct a proper reference check or the former licensee did not provide accurate and honest feedback.¹⁸

24.18 The second problem related to practical difficulties ASIC experiences in tracking problem advisers. ASIC argued that its current financial services registers should include all individuals authorised to give personal advice on Tier 1 products, not just AFS licensees and authorised representatives. The following reasoning was provided:

Under the current financial services regulatory regime, authorised representatives must be registered with ASIC; however, there is no central register for employee representatives. This means that ASIC has no direct oversight of employee adviser representatives, including those who provide personal advice, and must rely on licensees to ensure the competence and integrity of these representatives. This can result in very real difficulties in ASIC's ability to locate and take action against bad apples in the financial services industry...ASIC has had considerable practical difficulties in tracking problem advisers, following the collapses of several financial planning businesses. Where the advisers have moved to new financial planning businesses as employee representatives, we are unable to track them because they do not appear on our register.¹⁹

24.19 ASIC also noted that the lack of such a register makes it difficult for investors to ensure that they are dealing with properly authorised advisers:

Given the complexities of the financial services industry, it is important that ASIC can emphasise certain consumer messages. One of our traditional messages has always been that investors should only obtain advice from properly licensed or authorised advisers. Before the commencement of the *Financial Services Reform Act 2001*, we could tell investors that before dealing with a purported adviser, they should check the person's name on the licensees and representatives register.

17 Mr Greg Medcraft, Chairman; Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 16.

18 Or did not agree to provide feedback at all—ASIC noted that this is 'sometimes out of apprehension of liability for making defamatory statements'. ASIC, *Submission 45.2*, p. 156.

19 ASIC, *Submission 45.2*, p. 158.

This simple message is no longer possible. Investors cannot easily check whether someone holding themselves out as a financial adviser is properly able to do so. They may be an employee of a licensee and the only person that can verify that is the relevant licensee.²⁰

24.20 Mr Medcraft remarked that he believed 'industry very much welcomes the idea of, say, having a national register of all employer representatives'.²¹ Mr Medcraft added that the US equivalent provides an effective means of tracking advisers and holding them accountable; he noted that the US register receives 16 million hits a year from consumers and employees.²²

24.21 ASIC's evidence was generally supported by other witnesses. For example, the CBA argued that ASIC and AFS licence holders should:

...have visibility at all times of where licensed financial planners are practising. CFP believes there is a risk that financial planners who do not adhere to appropriate standards of advice enter the industry, or move within it between [AFS licence] holders, and for professional misconduct not to be taken fully into account.²³

Recognition of financial advisers and planners

24.22 The FPA argued that the regulatory system should be designed 'to encourage the establishment of professional bodies to impose appropriate and enforceable professional standards that exceed the law, on financial product providers, research houses, and other industries in the gatekeeper space'.²⁴ It noted that financial planners should be subject to 'a series of inter-locking obligations' based on regulatory requirements, licensee requirements and professional requirements. The FPA has binding professional obligations through a code of conduct and rules of professional conduct, supported by a public complaints system, an investigation process and an active professional disciplinary panel.²⁵ Even so, it argued that:

Without formal recognition and encouragement of adherence to professional obligations, there is a gap in the regulatory design as applied to individual providers of financial services to consumers, and consumer

20 ASIC, *Submission 45.2*, p. 159.

21 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 15.

22 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 16.

23 CBA, *Submission 261*, p. 16. As another example, Mr Mark Rantall of the Financial Planning Association stated that 'We think that having a register of advisers is important—there is not one at the moment...' Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Proof Committee Hansard*, 19 February 2014, p. 69.

24 Financial Planning Association, *Submission 234*, p. 31.

25 Financial Planning Association, *Submission 234*, pp. 33, 35–37.

protection becomes reliant on the limitations of regulatory and licensee obligations alone.²⁶

24.23 Accordingly, the FPA maintained that the terms 'financial planner' and 'financial adviser' should be restricted to 'only those that have the highest level of education, competency, ethics and standards, and are a member of a regulator prescribed professional body'. It argued that this would strengthen consumer protection and facilitate a more effective regulatory framework 'based on cooperative co-regulation'.²⁷ The FPA noted that a precedent for this exists, as the use of the terms stockbroker, futures broker, insurance broker, general insurance broker, and life insurance broker are currently restricted under section 923B of the Corporations Act. In the FPA's view:

...it is unclear why some expressions are restricted by s923B and not others. Why do such terms carry more weight under law than that of financial planner/adviser considering the role financial planners play in assisting consumers with vital financial matters?

24.24 The FPA provided additional reasoning to support its case for legislative amendments to restrict the use of the terms financial planner and financial adviser:

The terms financial planner/advisers are increasingly being used in marketing and promotional material by persons who provide non-traditional ancillary services, such as realtors, property spruikers, sales agents of various investment vehicles, and other unlicensed advisers. Consumers are continuing to be influenced by advice provided by those outside the Regulator's reach. This issue has become evident in the SMSF sector with many property spruikers influencing the use of SMSFs to purchase property. It has also been exacerbated by the commentary on financial matters provided by media outlets who are exempt from licensing obligations under section 911A(2) of the Corporations Act yet play a highly influencing role in consumer decision making.

A lack of restrictions on the use of the terms financial planner/adviser is, among other things, a significant gap in consumer protection. It leaves trusting consumers open to influence by individuals incorrectly representing themselves to consumers as financial planners/advisers without holding the specific competency, training, license, professional standing required. This significantly erodes consumer protection. The lack of constraint on individuals calling themselves financial planners puts consumers at risk of receiving poor advice from incompetent providers. A key role of effective regulatory design should be to enable consumers to be able to clearly identify providers they can trust in the marketplace.²⁸

26 Financial Planning Association, *Submission 234*, p. 8.

27 Financial Planning Association, *Submission 234*, p. 14.

28 Financial Planning Association, *Submission 234*, pp. 14–15.

24.25 Further, the FPA noted that ASIC was already relying on professional associations to improve training and competence in the sector, at least among the members of these associations:

RG146 states that ASIC has 'set minimum training standards only and encourage industry and professional associations to build on the training standards. [ASIC] recognise[s] industry's important role in the development and promotion of best practice relating to training and competence'. The fact that ASIC's minimum standards are intended to drive the financial sector to establish higher standards gives further support to the recommendation to make membership of a professional body mandatory for financial planners.²⁹

24.26 In 2013, the previous government introduced a bill that would have restricted the use of these terms or terms of like import 'in relation to a financial services business or a financial service, unless the person is able under the licence regime to provide personal financial advice on designated financial products'.³⁰ The explanatory memorandum identified property spruikers who represent that they are genuine providers of financial product advice as a group that would be targeted by the amendments.³¹ However, the bill lapsed at the end of the 43rd Parliament.

ASIC's licensing tests

24.27 A matter related to raising standards in the financial advice industry is the licensing process. ASIC argued that one of the regulatory barriers or gaps it faces were the tests currently in legislation for determining whether an AFS licence or credit licence must be granted. As ASIC issues AFS and credit licenses, it is understandable that the licensing powers should enable the regulator to, as ASIC put it, 'prevent those that do not warrant [public] trust from operating within the industry'. Licensing regimes will not prevent all undesirable businesses or individuals from operating, particularly those that demonstrate competence but 'go rogue'. However, in ASIC's view licensing processes should:

...provide an effective screening process to exclude persons who do not have the appropriate skills, experience and qualifications to provide services with honesty and integrity, or who are not of good character, from operating within the financial services and credit industries.³²

29 Financial Planning Association, *The Future of the Financial Planning Profession: White Paper of the Financial Planning Association of Australia*, May 2014, p. 4.

30 Replacement Explanatory Memorandum, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, paragraph 2.9.

31 Replacement Explanatory Memorandum, Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, paragraphs 2.8, 2.11.

32 ASIC, *Submission 45.2*, pp. 164–65.

Recent developments

24.28 During the 2009 Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) inquiry into financial products and services, ASIC raised concern about its ability to protect consumers by restricting or removing from the industry participants who might cause or contribute to investor losses. It informed the PJCCFS that once a licence was granted, ASIC only had the power to suspend or cancel a licence in limited circumstances. At that time, ASIC could only suspend or cancel a licence immediately on application by the licensee or where the licensee was insolvent, ceased to carry on the business, was convicted of serious fraud, or was incapacitated. ASIC could suspend or cancel a licence after a hearing where:

- the licensee had not complied with its obligations;
- ASIC had reason to believe the licensee would not comply with its obligations in the future;
- ASIC was no longer satisfied that the licensee was of good fame or character;
- a banning order was made against the licensee or a key representative of the licensee; or
- the application was materially false or misleading or omitted a material matter.

24.29 At that time, ASIC was of the view that the government should assess whether the following modifications to ASIC's licensing and banning power would enhance ASIC's ability to protect investors:

- minor changes to the licensing threshold so that ASIC can refuse or cancel a licence where a licensee may breach (rather than will breach) its obligations;
- clarification that ASIC can ban individuals who are involved in a breach of obligations by another person; and
- 'negative licensing' of individuals so that ASIC can ban individuals who are not fit and proper and may not comply with the law.³³

24.30 The PJCCFS noted ASIC's concerns and recommended that:

- section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry; and
- sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there was a reasonable belief that the licensee 'may not comply' with their obligations under the licence.

33 ASIC *Submission 378* to the PJCCFS Inquiry into Financial Products and Services in Australia, August 2009, p. 24.

24.31 The then government supported both recommendations and in April 2010 indicated that it would introduce a reform package to strengthen ASIC's powers in relation to the licensing and banning of individuals from the financial services industry. In announcing proposed legislative changes, the then government stated:

In relation to licensing, ASIC will be able to take into account a broader range of matters when determining whether to issue a licence, or whether to cancel or suspend a licence. ASIC's powers to remove persons from the industry will also be enhanced, as it will be able to take into account a wider range of matters at the banning stage.³⁴

24.32 The legislation implementing this reform received the royal assent on 27 June 2012. In summary, the new law made the following amendments to ASIC's licensing and banning powers:

- the licensing threshold was changed so that ASIC can refuse or cancel/suspend a licence where a person is likely to contravene (rather than will breach) its obligations;
- the statutory tests were extended so that ASIC can ban a person who is not of good fame and character or not adequately trained or competent to provide financial services (in essence they are not a fit and proper person);
- ASIC can now consider any conviction for an offence involving dishonesty that is punishable by imprisonment for at least three months, in having a reason to believe a person is not of good fame and character for licensing and banning decisions.
- the banning threshold was changed so that ASIC can ban a person if they are likely to (rather than will) contravene a financial services law; and
- it was clarified that ASIC can ban a person who is involved, or is likely to be involved, in a contravention of obligations by another person.³⁵

24.33 It should be noted that ASIC's powers remain subject to:

...the broader principles of administrative law that would underpin the exercise of its powers. This includes that the decision must be within its power, and that only relevant considerations must be taken into account. Further, the exercise of ASIC's powers must be for a proper purpose and not in bad faith, with facts based on sufficient evidence, and any decision taken by ASIC must be reasonable and with procedural fairness afforded.³⁶

34 The Hon Chris Bowen MP (Minister for Financial Services, Superannuation and Corporate Law), 'Overhaul of Financial Advice', *Media Release*, no. 36 of 2010, 26 April 2010.

35 Revised Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2012, paragraph 1.26.

36 Revised Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2012, paragraph 1.28.

24.34 The committee is aware that many of the cases contained in submissions predate the enactment of the FOFA reforms that enhanced ASIC's banning powers.

24.35 While ASIC welcomed the amendment made by the FOFA reforms, it outlined the problems it sees with the 'negative assurance test' that requires ASIC to grant a licence unless it has material 'that would form the basis for ASIC having the necessary belief about future misconduct by the applicant':

The legislation does not provide significant guidance to allow us to take into account all relevant factors in coming to this belief about the applicant. An important aspect of our licensing assessment involves consideration of whether the applicant and its responsible officers are of 'good fame or character'. Section 913B(3) sets out some of the matters that are relevant to considering whether an applicant is of good fame or character. While a non-exhaustive list, it nominates convictions, suspensions or cancellations of a licence or banning or disqualification order against the person as being relevant to consider.

However, often we may have concerns about an applicant that do not relate to recorded convictions, cancellations or banning orders, but to their past conduct more broadly, particularly their involvement in financial services businesses where misconduct has occurred—for example, as an employee representative with a significant role in the business, or otherwise as a manager, director or officer of the licensee. Nevertheless, without the legislation indicating an intent that such matters are relevant for consideration in the licensing process, our decision to refuse a licence according to such criteria may be more likely to be reversed on merits review.³⁷

24.36 These issues could also be relevant to credit licences, as ASIC noted that the tests in place for credit licences under the *National Consumer Credit Protection Act 2009* are very similar to the tests for AFS licences.³⁸

24.37 ASIC outlined a number of changes that could strengthen its licensing tests. These included:

- changing the 'no reason to believe' test to one where ASIC grants a licence where it is 'satisfied' that the applicant would not be likely to contravene the AFS/credit licensee obligations;³⁹

37 ASIC, *Submission 45.2*, pp. 165–66.

38 ASIC, *Submission 45.2*, p. 166.

39 According to ASIC, this 'would place the onus on applicants to provide ASIC with sufficient material to satisfy us that they will have appropriate people, systems and resources at their disposal in order to ensure that they will provide financial services or credit services efficiently, honestly and fairly, and otherwise comply with their obligations as licensees. This change would provide greater facility to ASIC to refuse applicants where these elements of the business are not up to standard...' ASIC, *Submission 45.2*, p. 166.

- amending the licensing test to insert additional criteria to the 'good fame and character' test, such as whether ASIC has a reasonable belief that the applicant held a material role in the management of a financial services business that:
 - had its licence cancelled; and
 - did not pay determinations made by an approved external dispute resolution scheme of which it was a member;
- replacing the 'ASIC *must* grant a licence if...' test to an ASIC *may* grant a licence test, or otherwise providing ASIC with the discretion not to grant a licence.⁴⁰

Banning and disqualification

24.38 In some cases, the reports of corporate wrongdoing made to ASIC are of such a serious nature that deferring action could result in further harm to investors and consumers. A quick and effective means of putting a stop to corporate misconduct or the availability of unsafe products is to suspend or ban the wrongdoer or the product. The committee has referred to ASIC's slowness in responding to problems. There are many instances, especially from the perspective of the retail investor, where ASIC should have stepped in much sooner to prevent consumer losses. ASIC has a range of administrative actions available to it, including powers to:

- ban a person from acting as a director for up to five years;
- ban (including permanently ban) a person from providing financial or credit services;
- issue a stop order for defective disclosure documents (e.g. prospectuses and Product Disclosure Statements); and
- give a direction to a market to suspend dealing in a financial product if it is necessary or in the public interest.⁴¹

24.39 In this section, the committee considers the options for banning a financial service provider.

24.40 A number of submitters referred to the harm caused by rogue advisers. For example, Mr Peter Francis, who works as an expert witness in stock markets and market related transactions, cited a particular case where people had lodged complaints with ASIC about a particular adviser but did not receive a satisfactory response. He explained that about ten years ago he started to get cases about this

40 ASIC noted that an alternative drafting approach would be to include a catch-all discretion under the 'must grant a licence' requirement, such as 'ASIC must grant a licence if the following conditions are met... unless there is any other reason which in ASIC's reasonable opinion justifies the refusal of the application'. ASIC, *Submission 45.2*, p. 166.

41 ASIC, *Submission 45.2*, p. 118.

adviser, which over the next years amounted to over 50 cases from more than ten different lawyers. According to Mr Francis:

In that time this advisor had moved from Epic Securities to Macquarie Securities to BNP Paribas to Citigroup Wealth Management to Tricom Securities...From these 50+ cases, all were eventually settled by the Defendants once the correct documentation was discovered and an Expert Opinion produced.⁴²

24.41 He informed the committee that the adviser was subsequently found guilty of fraud and convicted. Mr Francis noted, however, that:

...over the six years many 1,000s of people had lost a good proportion of their savings or superannuation funds in some instances as a result of this one advisor.⁴³

24.42 This case was not an isolated one. The committee has referred to the financial planners at CFPL, who continued to practice in the industry even after ASIC became aware of their wrongdoing. With regard to the unscrupulous conduct of a financial adviser or planner, ASIC was asked about its powers to stop them from working in the industry. In response, ASIC outlined the banning powers it currently has, although to ban someone it must establish proof and conduct a hearing. The hearing, which includes the cross-examination of witnesses, allows the adviser or planner to be heard and respond to the evidence.⁴⁴ ASIC was asked about the merits of it being given the power to suspend a financial planner immediately where substantial evidence of wrongdoing existed. Mr Medcraft did not think the suggestion was unreasonable, subject to natural justice.⁴⁵ Mr Medcraft noted that the law already reflects situations where protective action is necessary to stop damage to individuals.⁴⁶

24.43 In a written question on notice, ASIC was asked to reflect further on this proposal. ASIC responded by observed that there 'would clearly be benefits for consumers if ASIC had the ability to quickly remove advisors that were engaging in serious misconduct, most particularly in preventing further loss or damage'. ASIC added, however, that there were a number of complicating factors when considering such a power, including:

- a person's right to be heard before a significant decision is made;
- the need to carry out information gathering and investigative work and then adequately brief a person authorised to exercise ASIC's powers, a process that would affect 'the immediacy with which the power could be exercised'; and

42 Ocean Financial Pty Ltd, *Submission 248*, p. 2.

43 Ocean Financial Pty Ltd, *Submission 248*, p. 2.

44 Mr Greg Kirk, Senior Executive Leader, Strategy Group, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 19.

45 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 19.

46 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 19.

- the type of conduct the power should be used for—ASIC noted that the power could be useful for misuses of client funds, but less useful 'where the conduct involved complex factual and legal questions about whether advice provided was above or below the necessary legal standard'.⁴⁷

24.44 Clearly concerned about the impact individual rogue advisers can have on public perceptions of the overall financial advice/planning industry, the FPA recently called for ASIC to be given a suspension power:

ASIC should have suspension powers for financial planners/advisers suspected of material and systemic breaches of the best interests duty. ASIC must have a justifiable position and the financial planner/adviser has the right to appeal at the AAT.⁴⁸

Banned advisers remaining active in the industry

24.45 One particular aspect of ASIC's banning powers that the committee believes warrants closer attention goes to banned advisers continuing to be involved in businesses providing financial advice.

24.46 Concern about financial advisers remaining active in financial services while banned is not a new issue. In June 2012, in response to a question about the activities of Peter and Anne-Marie Seagrim, Mr Kell informed the PJCCFS that the couple had been banned from providing financial services for a period of three years. He acknowledged that there had been some media commentary around the couple, for example, describing their business as operating in a manner that was 'business as usual'. He explained that from ASIC's perspective the ban was currently in force and the Seagrims were banned from providing financial advice to clients or dealing in financial products on behalf of clients. They had lodged an appeal. Mr Kell emphasised that although the ban was in place in relation to their ability to provide financial advice or deal in financial products, the law did not prevent them from acting as directors.⁴⁹ He went on to state, however, that:

...the Corporations Act does not prevent the Seagrims from acting as directors of a corporate authorised representative of a financial services licence holder. In that capacity they may still undertake activities. However, we have been very clear that business as usual certainly does not mean that they are able to provide that financial advice or deal in financial products on behalf of clients.⁵⁰

24.47 This matter of a banned adviser still allowed to manage a company was raised during this current inquiry. For example, Professor Dimity Kingsford Smith noted:

47 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 56.

48 Financial Planning Association, *The Future of the Financial Planning Profession: White Paper of the Financial Planning Association of Australia*, May 2014, p. 19.

49 *PJCCFS Committee Hansard*, 22 June 2012, p. 8.

50 *PJCCFS Committee Hansard*, 22 June 2012, p. 7.

Even if a person is banned they may continue to be influential in a licensed firm as a director, officer or a significant shareholder. The tests for bans and director/officer disqualification are different, and consideration should be given to prohibiting a banned person acting as a director or officer. Similarly, consideration should be given to empowering ASIC to exclude from management a shareholder who is banned. ASIC should have express power to consider the fitness for a license of a firm where a banned person has a significant shareholding.⁵¹

24.48 The committee asked ASIC whether any impediments existed to extending the ban on advisers to being a director of, or a person occupying a position of influence in, a financial services company. ASIC informed the committee that while it has powers to cancel an AFS license or credit licence, or to ban a person from providing financial services or credit services, 'a missing element was a power to prevent a person from having a role in managing a financial services business or credit business'.⁵² It explained that the law as currently drafted means that ASIC can have 'difficulty in removing these managing agents who do not themselves provide a financial service but are integral to the operation of a financial services business'. ASIC explained that it had:

...seen instances where we cancel the AFS licence of an advisory business due to poor practices or other misconduct, but those responsible for managing the business move to another licensee's business, or apply for a new licence with new responsible managers.

If such managers are not themselves directly providing financial services or credit services in that new role, ASIC may not be able to prevent them from continuing to operate in the industry, even where there were serious failings in the previous business.⁵³

24.49 In its main submission, ASIC recommended amending the law to provide ASIC with the power to ban a person from managing a financial service business or credit business. The FPA advised that it supports this recommendation. It provided the following reasoning:

If you have been banned as a financial planner there are usually very good reasons for it, and if you were then to be supervising and managing financial planners or a financial planning company we would see it as inappropriate—depending on the circumstances, of course. Obviously it would need to be a serious breach, not a minor breach.⁵⁴

51 Professor Dimity Kingsford Smith, *Submission 153*, p. 8.

52 ASIC, *Submission 45.2*, p. 160 and answer to question on notice, no. 12 (received 21 May 2014), p. 13.

53 ASIC, *Submission 45.2*, p. 160.

54 Mr Mark Rantall, Financial Planning Association, *Proof Committee Hansard*, 19 February 2014, p. 69.

Committee view

24.50 The committee recognises that steps need to be taken to improve standards in the financial advice sector and perceptions about that sector. Doing so would provide several benefits. Higher barriers to entry and better mechanisms for dealing with problem advisers will assist ASIC in its regulation of the sector. In turn, the improved reputation of the sector that should result will encourage more Australians to seek financial advice; encouraging investors to become more informed about their circumstances and investment options appropriate to them will assist ASIC to achieve its statutory objectives.

24.51 The committee emphasises two points. Firstly, to ensure the measures are as effective as possible, they should be developed by ASIC working closely with industry. Secondly, the measures for improving standards should be funded by the industry and to the extent possible operated by the industry. The committee notes that the national examination would require amendments to the Corporations Act that stipulate that representatives of AFS licensees must have passed the national examination to be deemed competent.

24.52 The committee appreciates ASIC's evidence about the need to ensure that the licensing tests specified in legislation set an appropriately high bar to entry. A licensing process that works as effectively as is reasonably possible to prevent people from entering the financial services and credit industries who should not be in these industries is clearly a desirable regulatory goal. The changes proposed by ASIC would make ASIC more responsible for carefully screening people seeking to enter these industries. The changes would also provide ASIC with a better chance of meeting existing community expectations about the people that should be trusted with such licences.

24.53 ASIC's proposed amendments to the AFS and credit licensing tests were not addressed in detail in the evidence the committee received from key stakeholders. The committee is of the view that the government should assess these proposals and initiate a targeted public consultation process limited to this issue, ideally with draft legislative amendments available for stakeholders to comment on.

24.54 The committee considered a proposal for ASIC's powers to be strengthened to immediately suspend financial advisers and planners suspected of egregious misconduct causing widespread harm to clients. This report has identified that ASIC is often slow to react and to exercise the powers it already has. The CFPL matter is a stark, but not isolated, example. The committee is also mindful of the need to ensure procedural fairness. Sound decision-making usually requires the decision-maker to have both sides of the story; enabling ASIC to make a decision that prevents an adviser or planner from working without providing them with the opportunity to respond to the evidence would be a significant departure from current practice. On the other hand, the current options for preventing a problem adviser from causing continued harm may be deficient.

24.55 Should ASIC be given the power to suspend an adviser suspected of malfeasance that, if allowed to continue, would cause detriment to his or her clients or potential clients, the committee believes that robust safeguards must be in place. The committee considers that the suspended adviser or planner would:

- need to be informed of the complaint against them;
- have the right to reply to the complaint;
- have the right to appeal ASIC's decision to the AAT;
- the suspension would not be publicised until a subsequent banning order was made; and
- the decision to issue the suspension would be taken at a senior level in ASIC.

24.56 The power should also only be available in limited cases that do not involve complex questions of law, such as where client funds are clearly being misused.

Recommendation 42

24.57 The committee recommends that financial advisers and planners be required to:

- **successfully pass a national examination developed and conducted by relevant industry associations before being able to give personal advice on Tier 1 products;**
- **hold minimum education standards of a relevant university degree, and three years' experience over a five year period; and**
- **meet minimum continuing professional development requirements.**

Recommendation 43

24.58 The committee recommends that a requirement for mandatory reference checking procedures in the financial advice/planning industry be introduced.

Recommendation 44

24.59 The committee recommends that a register of employee representatives providing personal advice on Tier 1 products be established.

Recommendation 45

24.60 The committee recommends that the *Corporations Act 2001* be amended to require:

- **that a person must not use the terms 'financial adviser', 'financial planner' or terms of like import, in relation to a financial services business or a financial service, unless the person is able under the licence regime to provide personal financial advice on designated financial products; and**

- **financial advisers and financial planners to adhere to professional obligations by requiring financial advisers and financial planners to be members of a regulator-prescribed professional association.**

Recommendation 46

24.61 The committee recommends that the government consider whether section 913 of the *Corporations Act 2001* and section 37 of the *National Consumer Credit Protection Act 2009* should be amended to ensure that ASIC can take all relevant factors into account in making a licensing decision.

Recommendation 47

24.62 The committee recommends that the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.

Recommendation 48

24.63 The committee recommends that the government consider legislative amendments that would give ASIC the power to immediately suspend a financial adviser or planner when ASIC suspects that the adviser or planner has engaged in egregious misconduct causing widespread harm to clients, subject to the principles of natural justice.

Chapter 25

ASIC's responsibilities and funding: problems with the current framework and suggested changes

25.1 This chapter considers two issues fundamental to ASIC's performance as a regulator: its functions and responsibilities and the resources available for it to perform these tasks. Successive governments have given additional responsibilities to ASIC at various times since it was established. In recent years there has been a marked increase in the functions ASIC has acquired.¹ This chapter considers the implications of this and, in light of the issues raised in previous chapters, the extent to which ASIC's growing list of functions and responsibilities has affected the agency's performance.

25.2 When considering the responsibilities given to ASIC, it is helpful, indeed necessary, to examine the resources given to ASIC to perform these tasks. Accordingly, this chapter also considers the amount of funding ASIC receives and whether the mechanism in place for funding ASIC should be changed.

Is ASIC overburdened and underfunded?

25.3 There is clearly a correlation between the list of responsibilities ASIC has, the funding it receives and the outcomes it can achieve. ASIC's submission contained the following statement on this relationship:

What we are able to achieve also depends on our level of funding. Ensuring ASIC has adequate resources affects the strength and integrity of the financial system and the confidence of investors.

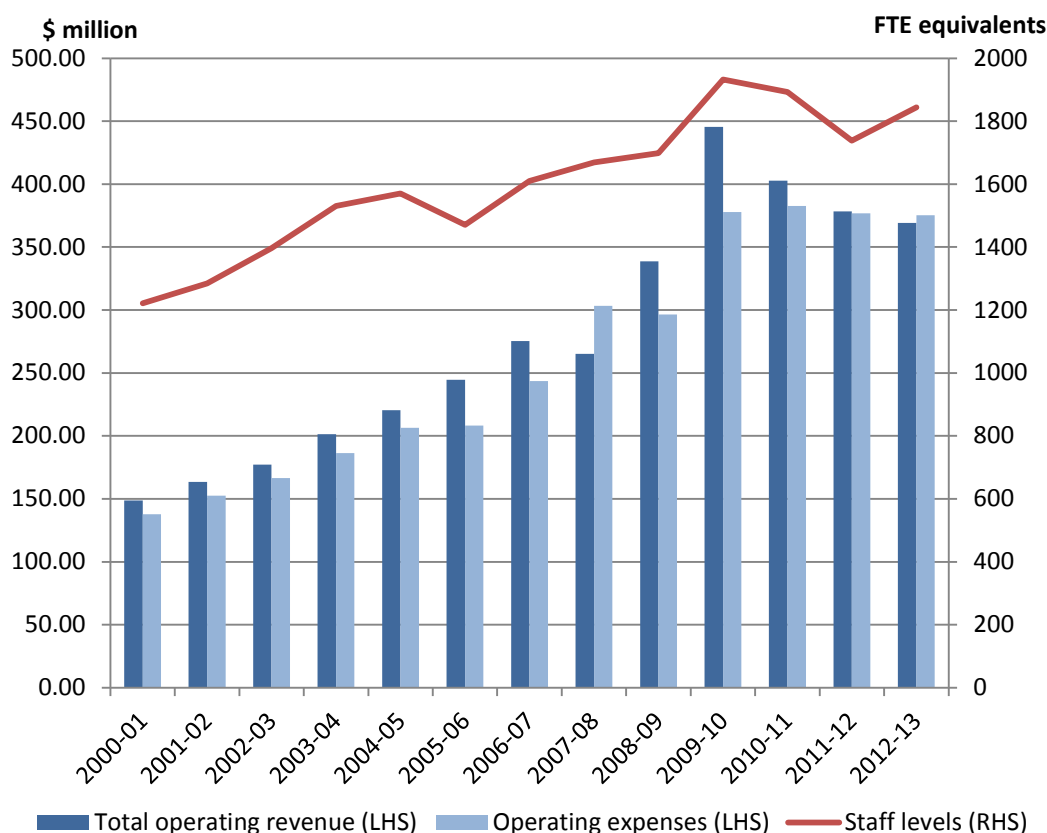
ASIC can only achieve what it is resourced to do. Funding levels should be set by reference to Government and community expectations of what ASIC should deliver and, as a result, what level of resilience they want in the financial system.²

25.4 Figure 25.1 outlines ASIC's operating revenue, expenses and staff numbers since the 2000–01 financial year. Between 2000–01 and 2012–13, ASIC produced an operating surplus for eleven of the 13 financial years, averaging a \$16.7 million surplus each year.

1 See Appendix 4 for a timeline of changes to ASIC's responsibilities.

2 ASIC, *Submission 45.2*, p. 11.

Figure 25.1: ASIC's operating revenue, expenses and staff levels, 2000–01 to 2012–13



Source: Figures for operating revenue and expenses taken from research prepared by the Parliamentary Library, based on cash flow statements contained in ASIC's annual reports, various years. Figures for staff levels are taken from ASIC's annual reports, various years.

Note: Total operating revenue includes appropriation revenue and other cash received.

25.5 A 2012 report prepared by staff of the International Monetary Fund (IMF) argued that ASIC 'has rightfully earned its reputation as an effective and credible enforcer of market regulation, but would benefit from increased resources and budgetary flexibility'. The IMF staff argued that:

...ASIC is hampered in its ability to fully carry out proactive supervision because of the lack of budgetary resources. A significant amount of ASIC's funding is non-core funding earmarked for specific projects, and the share of non-core funding has been increasing in the last few years. To supervise a large number of financial services licensees, ASIC uses desk-top, rather than on-site, reviews for initial risk-based assessments, reflecting in part its resource constraints. In determining the target and intensity of its supervisory actions, ASIC relies heavily on its initial risk-based assessments, self-reporting of breaches of regulatory requirements and third

party notifications. It is important that ASIC be given more resources and flexibility over its operational budget.³

25.6 Many individuals and organisations agreed that ASIC is currently underfunded. A view also frequently expressed was that ASIC's expanded regulatory remit had negatively affected ASIC's performance. This was either as a logical consequence of ASIC having a longer and more diverse list of responsibilities, or because the additional funding provided to supplement specific new responsibilities has been insufficient. The following extracts from the evidence taken by the committee illustrate some of the concerns:

In recent years, two trends regarding ASIC have emerged. Firstly, ASIC has been given increasing responsibility for important areas of corporate and financial regulation, including stock market regulation, financial services licensing, consumer protection in financial services, business names registration and credit regulation. These matters add to ASIC's already full regulatory brief covering general corporate regulation and administrative matters (document lodgments, searches and maintenance of registers). During this time while ASIC's funding has increased, much of the funding has been tied to particular projects (such as key investigations into HIH and other high profile matters), and the numbers of staff working at ASIC has only increased from 1221 in 2000 to 1738 in 2012 (according to ASIC's Annual Reports). The increases in funding and staffing are wholly inadequate to account for exponential increase in ASIC's responsibilities.⁴

* * *

...the increase in ASIC's mandate over the last decade has not been matched by financial appropriations and has stretched its personnel.⁵

* * *

...the constant accrual of functions and services by ASIC has played some part in reducing the ability of ASIC to devote resources to its legislative, surveillance and investigative responsibilities.⁶

* * *

Our sense is that the problem ASIC has is complexity of legislation, huge areas of responsibility and resources that are too limited. It is not a lack of powers, it is a lack of resources, really, and the practical ability to make things happen.⁷

3 International Monetary Fund, *Australia: Financial System Stability Assessment*, IMF Country Report, no. 12/308, November 2012, pp. 25–26.

4 Mr Jason Harris, *Submission 116*, p. 1.

5 Professor Dimity Kingsford Smith, *Submission 153*, p. 5.

6 Governance Institute of Australia, *Submission 137*, p. 6.

7 Mr Bruce Dyer, Member, Corporations Committee, Business Law Section, Law Council of Australia, *Proof Committee Hansard*, 20 February 2014, p. 6.

* * *

In our view, any deficiencies in ASIC's performance and effectiveness are more likely to be caused by a lack of adequate funding and resources to allow ASIC to fulfil its role as a corporate regulator. Being well-funded and resourced is essential for a regulator to be able to effectively use its powers and discharge its duties. Relevantly, being adequately resourced allows a regulator to be more pro-active and therefore maximise the chances of ASIC being able to properly enforce existing legislation. Company Directors has long called for and supported moves to provide appropriate funding to ASIC and other regulators to meet the increasing demands that they face, and we continue to believe that this is the best way to increase ASIC's performance as a regulator.

This lack of funding is likely, at least in part, to be due to the fact that ASIC's role as a regulator has been increased significantly over time and its resources have been stretched as a result. In addition to increasing the existing funding and resources of ASIC, going forward ASIC's roles should only be added to or extended where there is also a commensurate increase in ASIC's funding and resources.⁸

* * *

The finance world is increasingly complicated with emerging risks and challenges. It is essential that ASIC is adequately funded and resourced to carry out its duties. We would not support any proposals to cut ASIC's funding.⁹

25.7 Members of the public that had dealt with ASIC also called for ASIC to receive more funding:

ASIC needs more funding to go after criminals and credit providers. ASIC should have enough funding that it can anticipate rorts and take steps to protect people...There is a perception in the community that ASIC is reluctant to take a stand possibly because of lack of funding.¹⁰

25.8 Others were less sure. Levitt Robinson Solicitors argued that 'ASIC's failures cannot be blamed on budgetary constraints, given ASIC's apparent profligacy in the deployment of public money spent on, or in outsourcing legal services'.¹¹ CPA Australia noted that ASIC is possibly overworked, but it considered other problems with ASIC's approach were more significant:

8 Australian Institute of Company Directors, *Submission 119*, p. 2.

9 Industry Super Australia, *Submission 201*, p. 12.

10 Name withheld, *Submission 135*, p. 1.

11 Levitt Robinson Solicitors, which criticised various aspects of ASIC, noted that ASIC was second only to the ATO in expenditure on legal fees, with \$300 million spent by ASIC between 2008 and 2012. The figures are based on the Attorney-General's Department's *Legal Services Expenditure Report 2011–2012*. Levitt Robinson Solicitors, *Submission 276*, p. 11.

I think there has been a lot of commentary by ASIC to say that they are very stretched with their resources and there is more to do. There may be an element of truth in that argument. I think the bigger issue is that their sense of priority needs to be revisited.¹²

25.9 The Institute of Chartered Accountants Australia (ICAA) noted that all organisations face financial pressure and need to ensure they use the resources they have as efficiently as possible. The ICAA argued that ASIC is currently undertaking work which 'generally has very little effect but consumes quite a lot of resources'.¹³ On this issue, the Community and Public Sector Union (CPSU) acknowledged that every organisation needs to focus on and review whether it is undertaking activities in the most efficient way. However, the CPSU argued:

...if you are not actually reinvesting in the work that is needed to be done, and having that investment being made then you are likely to see the services slip. And I think we sometimes confuse at the moment conversations about productivity and effectiveness with cuts.¹⁴

25.10 It is evident that funding issues are not just relevant to ASIC; rather they are something that all regulators encounter. The former chairman of the Trade Practices Commission, the predecessor to the ACCC, argued that there 'is a fundamental flaw in the way in which our regulators are funded':

Having acted as chairman of the Trade Practices Commission (TPC)...I can say with complete confidence that the level and nature of funding provided to the TPC at the time to conduct its various activities was well below what was needed to properly and adequately undertake its tasks. This was certainly the case in the context of community and media (and some politicians') expectations of the role of the regulator. The apparent unwillingness of the TPC to undertake certain investigations or to pursue certain court actions was often misunderstood, because the critics did not appreciate the problems that the regulator faced due to its inadequate and restricted use of its funding.¹⁵

12 Mr Alex Malley, Chief Executive Officer, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 46.

13 Mr Lee White, Chief Executive Officer, Institute of Chartered Accountants Australia, *Proof Committee Hansard*, 19 February 2014, p. 46. In its submission, the ICAA argued that 'there are many examples where ASIC initiates a specific regulatory program that targets particular areas of focus in the marketplace, but then continues to allocate resources to the same program even when many would argue that the impact (or relevance) in the marketplace of the work that continues to be done has significantly diminished'. The ICAA used ASIC's accounts surveillance program as an example; in the ICAA's view that program 'was initially very effective in lifting the standard of financial reporting in Australia. However, many stakeholders in the capital markets would question whether ASIC's work continues to have a major impact on the quality of financial information in the marketplace, given that many of ASIC's initial objectives have now been met'. *Submission 203*, p. 3.

14 Mr Alistair Waters, CPSU, *Proof Committee Hansard*, 19 February 2014, pp. 63–64.

15 Professor Bob Baxt AO, *Submission 189*, pp. 6–7.

25.11 Professor Baxt added that regulators also have 'inadequate' resources to bring cases that challenge well-resourced defendants that 'usually enjoy deep pockets and are not burdened by significant restrictions in the way in which they operate in defending the relevant matter'.¹⁶

25.12 Whether ASIC has sufficient resources to adequately supervise the entities it regulates can also be considered by reviewing the number of staff ASIC allocates to each group of the regulated population. As noted in Chapter 4, ASIC publishes figures on the number of staff members allocated to each of its stakeholder teams, the number of regulated entities they oversee and the number of years it would theoretically take to conduct surveillance on every regulated entity. These figures highlight the challenges ASIC faces in fulfilling its regulatory responsibilities with its current resources. For example, ASIC has 29 staff members that oversee 3,394 AFS licensees authorised to provide personal advice as well as 1,395 AFS licensees authorised to provide general advice. Approximately 65 staff members oversee: 173 authorised deposit-taking institutions; 141 insurers; 641 licensed non-cash payment facility providers; 13 trustee companies; and 5,688 non-ADI credit licensees with 28,201 credit representatives. These figures were outlined in full in Chapter 4 (refer to Table 4.1).

25.13 However, striking figures on supervision coverage and an imbalance between the regulator's financial resources and those of the large firms it regulates are not unique to ASIC. For example, in recent fiscal year budget requests to the United States Congress, the Securities and Exchange Commission (SEC) has given the following bleak assessments of its resources and capacities:

...during the past decade, trading volume in the equity markets has more than doubled, as have assets under management by investment advisers, with these trends likely to continue for the foreseeable future. A number of financial firms spend many times more each year on their technology budgets alone than the SEC spends annually on all its operations. Similarly, SEC enforcement teams bring cases against firms that spend more on lawyers' fees than the agency's annual operating budget.¹⁷

* * *

Currently, the average transaction volume cleared and settled by the seven active registered clearing agencies is approximately \$6.6 trillion a day. Yet the SEC only has approximately sixteen examiners devoted to them, with limited on-site presence in only three of the seven.¹⁸

* * *

Seven years ago, the SEC's funding was sufficient to provide nineteen examiners for each trillion dollars in investment adviser assets under

16 Professor Bob Baxt AO, *Submission 189*, pp. 6–7.

17 US Securities and Exchange Commission, *FY 2014 Congressional Budget Justification*, www.sec.gov/about/reports/secfy14congbudjust.pdf, p. 4 (accessed 19 September 2013).

18 US Securities and Exchange Commission, *FY 2014 Congressional Budget Justification*, p. 6.

management. Today, that figure stands at ten examiners per trillion dollars.¹⁹

How do ASIC's responsibilities compare with foreign regulators?

25.14 The breadth of responsibilities entrusted to ASIC compared to regulators in other jurisdictions was noted by witnesses and used to argue that a review of ASIC's responsibilities was warranted:

At the moment ASIC has an incredibly broad remit in comparison to most securities regulators globally. If there was that reduction in supervisory capacity or its responsibilities perhaps it would allow it to focus more specifically on some of the issues which concern so many of the people who made submissions to the inquiry and the members of this committee.²⁰

25.15 Even a cursory comparison of Australia's framework of regulators and those of other key jurisdictions indicates that the breadth of ASIC's responsibilities is significantly greater than those of its foreign counterparts. In the UK, for example, ASIC's securities and markets regulation functions are undertaken by the Financial Conduct Authority (FCA). The FCA also has responsibility for market supervision and governance (through the UK Listing Authority, a division of the FCA). The FCA also is tasked with financial products and services regulation and credit and financial services licensing. However, the FCA does not have responsibility for matters relating to the corporations law generally, such enforcing directors' duties or regulating auditors and insolvency practitioners. Company registration is performed by Companies House, an executive agency of the Department for Business, Innovation and Skills.

25.16 In the US, ASIC's securities and markets regulatory counterpart is the SEC, with some functions also performed by the Federal Commodity Futures Trading Commission (CFTC) and state authorities. However, the Consumer Financial Protection Bureau (CFPB) is tasked with financial products and services regulation, and credit and financial services licensing is undertaken by state authorities. The regulation of auditors is carried out by the Public Company Accounting Oversight Board (PCAOB), although this is overseen by the SEC. Reflecting the chapter 11 bankruptcy and reorganisation system in place in the US, corporate insolvency is dealt with by specialist bankruptcy courts with an office in the Department of Justice (the US Trustee Program) responsible for overseeing the administration of bankruptcy cases.

25.17 In Canada, provincial and territorial regulators are responsible for securities and markets regulation and market supervision. The Financial Consumer Agency of Canada (FCAC) supervises financial institutions' compliance with consumer

19 US Securities and Exchange Commission, *In Brief: FY 2013 Congressional Justification*, www.sec.gov/about/secfy13congbudgjust.pdf, p. 2 (accessed 19 September 2013).

20 Dr George Gilligan, *Proof Committee Hansard*, 19 February 2014, p. 52.

protection obligations and promotes increased financial literacy. Financial advice is regulated by provincial and territorial agencies. The federal registration of companies is administered by Corporations Canada with provincial agencies registering other companies. The Canadian Public Accountability Board deals with auditors.

Should ASIC lose some of its functions?

25.18 Following on from the previous discussion, this section examines the evidence received by the committee that questioned the wisdom of one agency being given numerous important regulatory and law enforcement functions as well as other administrative responsibilities. During the course of the inquiry, various possible changes that could be considered were suggested or noted by stakeholders. These options, which are discussed in the following paragraphs, include:

- transferring ASIC's corporate and business name registry functions to another government agency, or privatising these functions;
- splitting ASIC into smaller regulators along the lines of its broad business areas; and
- transferring responsibility for consumer protection to the ACCC or creating a new consumer protection agency.

Corporate registration and other administrative functions

25.19 Since ASIC was established it has been responsible for the administration of corporate registration. However, in 2012 ASIC also gained responsibility for the registration of business names after this function was transferred from the states and territories to the Commonwealth. ASIC also maintains a register of SMSF auditors. Stakeholders questioned whether it was necessary for these functions to be performed by a regulator such as ASIC.

25.20 The devolution of ASIC's registry function to another body was noted by the Governance Institute of Australia as a possible change that could allow ASIC to devote resources to its other legislative, surveillance and investigative responsibilities. To facilitate this, an equivalent of the UK's Companies House could be established in Australia.²¹

25.21 The committee is not aware of an example of an advanced economy where the company registration function is undertaken by the securities and markets regulator. In a newspaper article published in 2010, former ASIC chairman Alan Cameron was reported as identifying Pakistan as the only other country where these roles are combined.²² When asked about ASIC's registry responsibilities, the current ASIC chairman described them as a 'technology business' and 'not really a regulatory business'. Mr Medcraft also considered there were a number of opportunities

21 Governance Institute of Australia, *Submission 137*, p. 6.

22 Stuart Washington, 'ASICs powers put to the test', *The Age*, 5 June 2010, p. 4.

to leverage economies of scale and to create a better user experience by transforming ASIC's registry function. As an example, he referred to merging ASIC's corporate register with other government registries:

The Siebel system we have has, currently, six million names on it. Verizon use the Siebel system in the States for telephones. They have 70 million customers on it. So I think there are huge benefits in actually separating out that registry business and merging it with other government registries to leverage the economies of scale from the Siebel management system. Basically, it has enormous capacity.

What that also means from a consumer perspective is that you end up with a one-stop shop for financial services and even other registry things you go to. If you want to update, you want to go to one place et cetera. And you have to think about the massive opportunity for extracting revenue from the metadata that actually comes from that.²³

25.22 Mr Medcraft explained that although ASIC has its newest registers²⁴ operating on the more advanced system, ASIC does not have the resources to invest in the corporate register. Mr Medcraft opined that there 'is cash there for somebody'.²⁵

...at the moment we have only two registers on the Siebel management system. We have the business names and we have the self-managed super funds. We have not got the capital to invest to bring the corporate register onto that. If I were in the private sector, I would finance it as a banker because that \$70 million, by moving those registers onto Siebel, would allow things like person search so every Australian could log on and check everything a person has to do with ASIC—whether they are deregistered or whatever. It also allows for online company registration. That \$70 million, if you were in private enterprise, you would invest because the cash flow you would get out of it would pay back. It is 10-year payback in simple, straight cash. It removes all the duplication across the registers.

There are economies of scale. Potentially, an investment in that could eventually yield \$350 million of benefits to small businesses outside of that. So I think the registry is one that probably would be better moved out, aggregated with other registries to provide a one-stop shop for Australians.²⁶

25.23 A small business owner similarly observed that ASIC's corporate and business names registers do not appear to have a regulatory role 'beyond maintaining up-to-date information and not registering conflicting names'. After expressing criticism about the fees levied on small businesses to fulfil their obligations to provide information, the fees imposed to access information, and ASIC's performance at managing

23 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, pp. 33–34.

24 The registers for business names and SMSF auditors.

25 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 38.

26 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, pp. 33–34.

the register, the small business owner concluded that a commercial enterprise could undertake ASIC's registry functions for less than 'one tenth of the fee ASIC charges'.²⁷ Other submissions also noted the cost of accessing information on ASIC's register, such as \$18 to obtain each current and historical extract of a company.²⁸

25.24 The Governance Institute of Australia observed that ASIC's registry and other administrative functions, including its call centre, do not utilise senior or experienced ASIC staff; in fact it indicated that 'call centre staff appear to be trained only to the extent of referring callers to the ASIC website in situations where there is uncertainty about the interpretation of specific provisions'. The Institute argued that:

...there may be service efficiencies to be gained by ASIC outsourcing its administrative function in a bid to broaden its educative function. That is, it might be cost-effective for ASIC to use a commercial operator to run its administrative function rather than maintaining these responsibilities inhouse.²⁹

25.25 The CPSU was asked about the possibility of certain functions being separated from ASIC and privatised. The CPSU argued that, as the registries raise 'a reasonably significant source of income and would appear to be a monopoly service', it would be in the public interest for an Australian government body to be tasked with the function, rather than the function being privatised.³⁰

25.26 Academics also commented on how privatising ASIC's registry function could affect the provision of information for research purposes. Mr Jason Harris, in consultation with other academics, recommended that if ASIC's registry was privatised, that this only occur with a requirement that information continue to be provided for research and accountability purposes.³¹

25.27 In May 2014, as part of the 2014–15 Budget, the government announced that a scoping study would be undertaken into future ownership options for ASIC's registry function.³²

Split along clusters or tasks

25.28 Stakeholder organisations and academics also identified other possible changes to Australia's framework of regulatory institutions. One of the options for consideration identified by the Governance Institute of Australia was dividing ASIC into smaller agencies with specific tasks:

27 Name withheld, *Submission 263*, pp. 3, 8.

28 See Mr Jeffrey Knapp, *Submission 274*, pp. 3, 6, 8 and 9.

29 Governance Institute of Australia, *Submission 137*, p. 6.

30 Mr Alistair Waters, CPSU, *Proof Committee Hansard*, 19 February 2014, p. 64.

31 Mr Jason Harris, answer to question on notice, no. 8 (received 17 April 2014), p. 4.

32 Australian Government, *2014–15 Budget—Budget Paper No. 2*, May 2014, p. 117.

[A] number of smaller regulators could be established to manage the wide range of regulatory functions currently allocated to ASIC, leaving ASIC focused solely on its original regulatory functions or more limited regulatory functions than it is currently tasked to manage.³³

25.29 CPA Australia suggested that thought could be given to restructuring ASIC and setting clear priorities:

I think it is worth a conversation and some questions perhaps around splitting ASIC into some segments that can focus on particular things. When you have a regulator on Monday chasing a corporate, on Tuesday charging a small business and on Wednesday giving marriage cost advice, that says that perhaps we need to pause for a moment, set the agenda for the year, tell the public what they can expect and let's see how accountable you are, because that is what you keep telling others they have to be.³⁴

25.30 Associate Professor David Brown noted the committee's 2010 report that recommended that ASIC's insolvency functions be transferred to the Insolvency & Trustee Service Australia (ITSA), since renamed the Australian Financial Security Authority. Professor O'Brien added that:

...a lot of the rules for that body would come from the best practice of ITSA, which had shown itself to be a more effective regulator in that area, because 'insolvency' was in its title as opposed to it being one of the many functions of ASIC...³⁵

Consumer protection responsibilities

25.31 Some witnesses suggested that the division of consumer protection responsibilities between ASIC, which has responsibility for consumer protection in financial products and services, and the ACCC, which has responsibility for consumer protection in the remaining sectors of the economy, should be reviewed.³⁶ Other submissions outlined different proposals. For example, many individuals dissatisfied with their treatment by ASIC and external dispute resolution schemes called for the creation of an agency dedicated to consumer protection in financial services.³⁷ A former ASIC employee argued that ASIC has too much work and that this detracts from ASIC's ability to protect retail investors:

These are the working Australians—the millions of people who are putting the money into the superannuation system and are least empowered to protect themselves. They are the ones who need the most protection. I think they are the ones who have been let down the most by ASIC, and I think the

33 Governance Institute of Australia, *Submission 137*, p. 6.

34 Mr Alex Malley, CPA Australia, *Proof Committee Hansard*, 19 February 2014, p. 51.

35 *Proof Committee Hansard*, 19 February 2014, p. 55.

36 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, pp. 55–56.

37 For example, see *Submissions 51.1*, p. 1; *199*, p. 1; *254*, p. 1; *351*, p. [3].

only way that you can really get them protected is with an agency that is dedicated to nothing but protecting retail investors.³⁸

25.32 In reaching its recommendation that responsibility for consumer protection in financial services should be transferred from the ACCC to the agency that ultimately became ASIC, the Wallis Inquiry considered alternative approaches. In particular, the Wallis Inquiry noted concerns put to it that without a dedicated consumer protection agency for financial services 'consumer protection would otherwise become subservient to other objectives'. However, the report concluded that:

...this risk is more likely to arise where consumer protection is combined with the functionally different task of prudential regulation. The tasks of consumer protection, market integrity and corporations regulation are more complementary than conflicting.³⁹

25.33 The approach taken following the Wallis Inquiry was queried at the time⁴⁰ and more recently. In 2008, the Productivity Commission found that the financial services carve out from the general consumer law occasionally leads to uncertainty about whether the ACCC or ASIC had jurisdiction. The Productivity Commission recommended that the economy-wide jurisdiction of the ACCC for consumer protection be restored but with ASIC continuing to be the primary regulator for financial services.⁴¹ Around the time of the Productivity Commission inquiry, a former ACCC chairman and a former editor of the *Australian Financial Review* wrote in various newspaper opinion articles that '[t]he natural home of financial consumer protection is the ACCC, not the carve-out to ASIC created by Wallis';⁴² ASIC had a 'noted lack of consumer zeal to date'; and the government should consider making the ACCC the sole consumer regulator, including for financial services as '[c]arving out these powers for ASIC has not worked'.⁴³ Concerns about the current framework remain; for example, in late 2013 a Monash University forum on the government's upcoming review of competition policy suggested that the review

38 Mr James Wheeldon, *Proof Committee Hansard*, 2 April 2014, p. 23.

39 Financial System Inquiry, *Final Report*, March 1997, p. 244.

40 A research paper produced soon after the Wallis Inquiry report was released surveyed the arguments opposing some of the key conclusions and recommendations. See Phil Hanratty, 'The Wallis Report on the Australian Financial System: Summary and Critique', *Parliamentary Library Research Paper*, no. 16 1996–97, www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/RP9697/97rp16 (accessed 20 August 2013) (footnotes omitted).

41 Productivity Commission, *Review of Australia's Consumer Policy Framework*, vol. 1, report no. 45 (30 April 2008), p. 24.

42 Allan Fels and Fred Benchley, 'Consumer watchdog tipped to get more bite as Rudd revolution gains pace', *The Age*, 5 April 2008, p. 2.

43 Fels and Benchley, 'Consumer watchdog tipped to get more bite as Rudd revolution gains pace', p. 2; 'Rudd's consumer activism over the top', *Sydney Morning Herald*, 21 March 2009, p. 4.

should consider whether the ACCC's and ASIC's consumer law functions 'should be jointly administered by a single separate body'.⁴⁴

25.34 It is noteworthy, however, that recent reforms undertaken in other countries have not resulted in responsibility for financial services consumer protection being taken from the securities regulator and given to the general consumer protection agency. For example, in the United Kingdom the opposite has occurred.⁴⁵

Proposal for a user-pays funding model

25.35 In addition to suggestions that some of ASIC's responsibilities be transferred to other bodies, the committee explored how ASIC is funded and whether the current funding model encourages better regulatory outcomes.

25.36 Although ASIC collects fees, charges and fines on behalf of the Commonwealth, this substantial revenue (\$717 million in 2012–13) is returned by ASIC to consolidated revenue.⁴⁶ With the exception of some cost-recovery arrangements,⁴⁷ the majority of ASIC's funding has no relationship with the revenue collected by ASIC.⁴⁸ Nevertheless, the fact that ASIC collects significantly more revenue than its operating expenses was noted in submissions.⁴⁹ Further, although the growth in revenue from Corporations Act fees appears steady, Treasury's submission, received in October 2013, noted that ASIC's funding was projected to decline.⁵⁰ In May 2014, the government announced that it would achieve savings of \$120.1 million over five years by reducing funding given to ASIC, with ASIC's funding reduced in the first year by \$26 million. The impact of the savings announced by the government and the termination of various measures are outlined in Table 25.1.

44 Monash Business Policy Forum, *Agenda for National Competition Policy Inquiry (2013)*, November 2013, www.buseco.monash.edu.au/mbpf/agenda.pdf (accessed 21 November 2013), p. 18.

45 On 1 April 2014, responsibility for the regulation of consumer credit was transferred from the Office of Fair Trading, the UK's general consumer protection regulator, to the Financial Conduct Authority. Further, in the US, the creation of the CFPB consolidated the administration of federal consumer financial protection laws, a responsibility previously shared by various agencies such as the Federal Trade Commission.

46 As required by section 81 of the Constitution.

47 Operators of domestic licensed financial markets regulated by ASIC and some market participants are subject to an annual levy. Levies collected by the APRA and the ATO also cover some of the costs of ASIC. See APRA, *Annual Report 2013*, p. 81; Treasury, *Submission 154*, p. 4.

48 Treasury, *Submission 154*, p. 4.

49 For example, see Industry Super Australia, *Submission 201*, p. 11.

50 Treasury, *Submission 154*, p. 4.

Table 25.1: Projected funding for ASIC, 2013–14 to 2017–18 (\$ million)

| (\$ million) | 2013–14 | 2014–15 | 2015–16 | 2016–17 | 2017–18 |
|-------------------------------------|---------|---------|---------|---------|---------|
| Changes announced in 2014–15 Budget | 3.0 | –26.0 | –32.5 | –32.1 | –32.4 |
| Total annual department expenses* | 366.28 | 321.25 | 306.04 | 303.40 | 306.29 |

* This funding relates to ASIC's annual departmental expenses under for its main functions (in the Budget papers, this is Programme 1.1 under Outcome 1). That is, ASIC's expenses for the administration of unclaimed money from banking and deposit taking institutions and life insurance institutions are not included.

Source: Australian Government, *2014–15 Budget: Budget Related Paper No. 1.16*, Treasury Portfolio Budget Statements, May 2014, p. 159.

25.37 The committee reviewed the funding arrangements in place for foreign regulators. As with ASIC, the US SEC collects fees and has funding linked to government appropriations. However, the arrangement is different in that there is more of a direct link between revenue raised and funding.⁵¹ Another US agency, the CFPB, primarily receives its funding from the Federal Reserve. Subject to statutory rules and limits, the CFPB determines the amount of funding necessary to fund its operations. The funding is not subject to review by Congress.⁵² While these arrangements attract some controversy,⁵³ it does provide the CFPB with a relatively stable source of funding.

25.38 An alternative model of funding a regulator already utilised in Australia and prevalent internationally is based on cost-recovery levies. In Australia, industry levies are used to fund APRA and, as noted earlier, a small proportion of ASIC's functions. ASIC's chairman noted that, internationally, levies are the predominant means by which regulators are funded.⁵⁴ Examples of foreign regulators that receive funding

51 The fees collected by the US SEC offset the appropriation it receives, and in recent years total fees have been a similar amount to the funding the SEC receives through appropriations resulting in most appropriated funds being returned. US SEC, *Fiscal Year 2012 Agency Financial Report*, November 2012, www.sec.gov/about/secpar/secafr2012.pdf (accessed 18 September 2013), p. 36.

52 The CFPB can also request from Congress discretionary appropriations if the amount received from the Federal Reserve is insufficient, however, it has not yet needed to make such a request. See US CFPB, *Fiscal Year 2013: CFPB budget in brief*, <http://files.consumerfinance.gov/f/2012/02/budget-in-brief.pdf> (accessed 19 September 2013), p. 1.

53 These funding arrangements have been criticised by some members of Congress: see US House of Representatives Committee on Financial Services, 'CFPB Lacks Oversight and Accountability', *Media Release*, 18 June 2013, <http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=339512> (accessed 19 September 2013).

54 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 29.

from industry levies include the UK FCA⁵⁵ and the New Zealand Financial Markets Authority. ASIC also identified that regulators in Canada, France, Hong Kong and Malaysia are funded through various forms of levy arrangements.⁵⁶ Other foreign professional bodies such as the US Public Company Accounting Oversight Board, which oversees audit standards and quality, are similarly funded through levies imposed on main accountancy firms based on their market size.⁵⁷

25.39 While not necessarily advocating that ASIC should be funded by industry-based levies, Industry Super Australia outlined some of the benefits and disadvantages it considered such arrangements would have:

It would ensure that the cost of the regulatory framework is borne by those who give rise to the greatest regulatory burden, so that the funding is not just borne out of general revenue. That is obviously a clear advantage. ASIC raises a reasonable amount of revenue in its activities, particularly in markets. In terms of the disadvantages I suppose it changes the nature of the relationship that ASIC has with industry. If there are parts of industry that are providing a greater level of funding, it might alter the perception of the independence of the regulator from those parts of the industry.⁵⁸

25.40 ASIC was questioned about its funding patterns and alternative funding models such as a levy-based arrangement. Mr Medcraft outlined how, in his view, ASIC's expanding responsibilities had created a 'problem' with ASIC's funding model. He explained that when ASIC was established as a corporate regulator, the fees collected and costs incurred were 'reasonably correlated'; that is, in the early 1990s it cost ASIC around \$127 million a year (in nominal terms) to regulate corporations but it collected around \$189 million in revenue on behalf of the Commonwealth. However, over time this connection has become weaker. ASIC's costs for regulating corporations have fallen in real terms to about \$142 million, largely as a result of technological advancements. The revenue from company regulation and business names registration is now around \$680 million, 80 per cent of which comes from small businesses.

25.41 Reflecting the expansion in ASIC's responsibilities since it was established, ASIC now allocates the majority of its financial resources to its non-registry

55 The estimated amount required to fund the FCA's budgeted costs for the year ending 31 March 2014 is £432.1m which is the figure used when determining the fees that will be charged. FCA, *Business Plan 2013/14*, www.fca.org.uk/static/documents/business-plan/bp-2013-14.pdf, pp. 53, 55 (accessed 17 September 2013). The New Zealand Financial Markets Authority is funded by a mixture of cost recovery fees and direct government funding. NZ Financial Markets Authority, 'How we are funded', www.fma.govt.nz/about-us/who-we-are/how-we-are-funded (accessed 24 March 2014).

56 See *Proof Committee Hansard*, 19 February 2014, p. 33 and ASIC, *Submission 45.7*, p. 8.

57 Professor Justin O'Brien, *Proof Committee Hansard*, 19 February 2014, p. 53.

58 Ms Robbie Campo, Deputy Chief Executive, Industry Super Australia, *Proof Committee Hansard*, 20 February 2014, p. 32.

functions. ASIC's overall costs are currently around \$350 million. The approximately \$260 million in costs that do not relate to corporate regulation are attributable to three areas of responsibility ASIC has gained over time: financial services; consumer credit; and markets. Mr Medcraft explained that of these three growth areas, ASIC has only received additional revenue associated with the markets function (about \$30 million), and even then only ASIC's frontline costs are recovered.⁵⁹ Therefore, despite the significant financial services and markets functions ASIC now performs, it could be considered that the revenue streams from Corporations Act fees effectively results in the burden of funding ASIC disproportionately falls on small business.

25.42 To further bolster its argument that the current framework may not be fairly allocating the burden associated with funding ASIC's regulatory functions, ASIC's chairman advised that:

- auditors cost ASIC about \$6 million a year to regulate but only pay \$425,000 in fees (also, regardless of any difference in the allocation of resources necessary to regulate large audit firms compared to small firms, both large and small firms pay \$146);⁶⁰ and
- AFS licensees cost ASIC \$108 million a year to regulate but only pay \$3.7 million in fees.⁶¹

25.43 The following diagrams summarise ASIC's evidence about how the revenue it collects on behalf of the government and the cost of performing particular regulatory activities have changed over ASIC's history.

59 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, pp. 29, 30.

60 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, pp. 31–32.

61 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 33.

Figure 25.2: Revenue and costs—companies, business names and searches 1991–2013 (nominal terms)

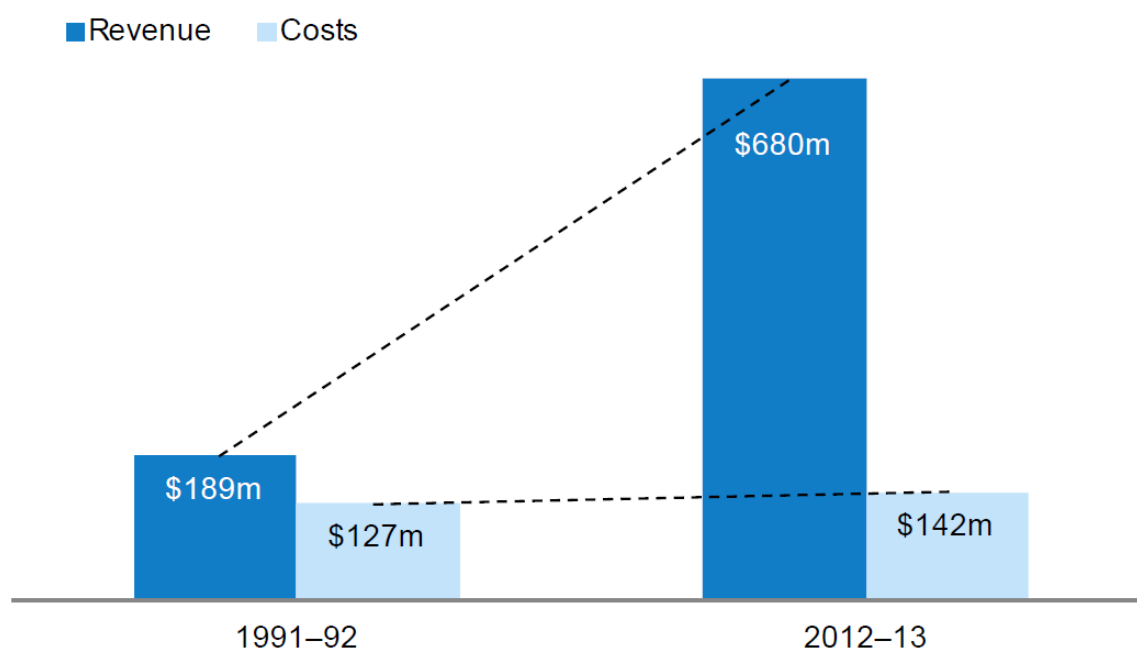
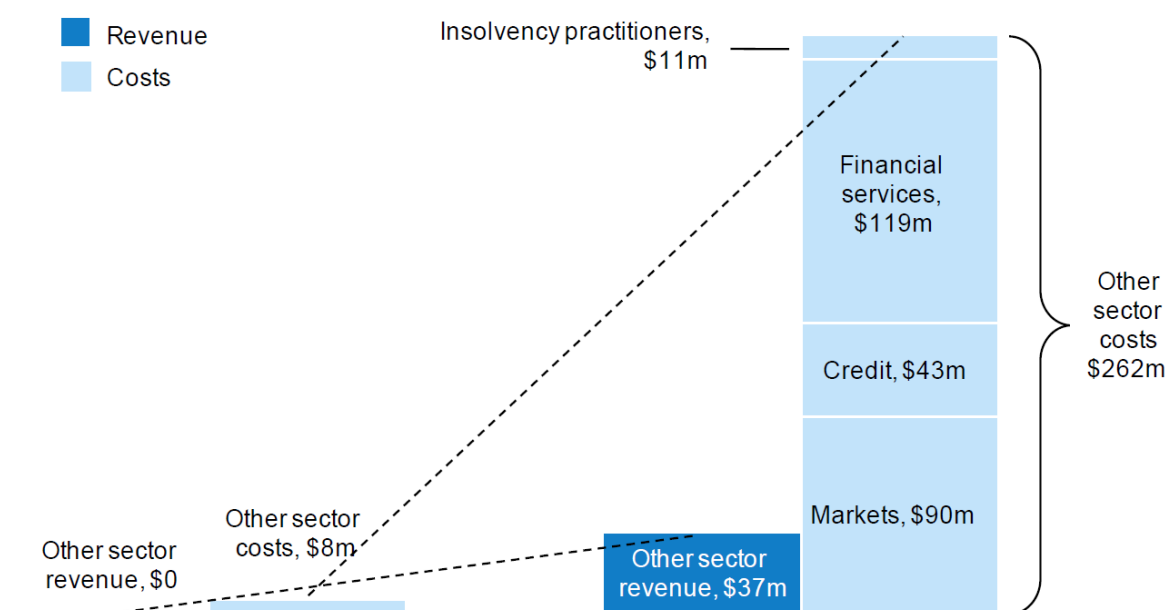


Figure 25.3: Revenue and costs—all other sectors 1991–2013 (nominal terms)



Note: Figures are estimates only, and are not adjusted for inflation. Costs include depreciation. In Figure 25.2, revenue is from companies, business names and searches; costs are from regulating companies, including administering business names and searches. In Figure 25.3, 'Other sectors' includes insolvency practitioners, AFS licensees, credit providers, exchange market operators, market participants and consumers. 'Financial services' includes financial advisers, insurers, responsible entities, superannuation fund trustees, deposit takers, investment banks, consumers and custodians.

Source: ASIC, *Submission 45.7*, pp. 2–3.

25.44 Mr Medcraft stated that he is 'a very big believer in user-pays'. After reflecting on his evidence about how ASIC's costs and its responsibilities have changed over time, Mr Medcraft observed that 'those that generate the need for regulation should pay for that regulation', and that user-pays systems are 'far more transparent'.⁶² In addition to arguments based on fairness and accountability, ASIC's chairman also argued that a user-pays levy model could lead to better outcomes for the financial system. According to Mr Medcraft, a well-designed levy system could encourage better self-regulation and lead to more efficient regulatory outcomes:

The fundamental concept here—from my days in banking—is that frankly if you provide somebody with the free option, they will take as much of it as they can get. That is why I think we have to put an incentive into the system to discourage the use of our resources and that drives an efficient outcome.⁶³

25.45 ASIC subsequently expounded on the argument that a sector-based user-pays system designed to discourage the use of ASIC's resources could lead to better outcomes:

At present, there are also no economic incentives (price signals) in the market for the use of ASIC's resources. Stakeholders acting rationally will seek to efficiently allocate their own resources and may choose low-cost or no-cost ASIC services over other, more costly, alternatives available in the market (e.g. private legal advice).

Price signals associated with the use of ASIC's resources would allow business to identify the cost of regulation required to achieve the desired regulatory outcome. If industry can deliver the Government's desired policy outcomes more efficiently and effectively through co-regulation or self-regulation, and therefore require less use of ASIC's resources and cost less to regulate, they would have an incentive to allocate resources to undertake part or all of the regulation themselves. This would ensure that the desired policy outcomes are delivered in the most economically efficient way. However, these price signals are not currently in place.⁶⁴

25.46 Mr Medcraft observed that the financial incentive such a framework creates also 'incentivises industry groups':

...I know from running an industry group that one of the biggest challenges you have is demonstrating your value as an industry group to your members. If an industry group can actually say to its members, 'Look, if you sign onto our industry standards and you do a good job and we enforce the industry standards, we should end up with a lower cost from ASIC because actually we are achieving the outcomes that government desires.'⁶⁵

62 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 29.

63 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, pp. 31–32.

64 ASIC, *Submission 45.7*, p. 4.

65 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 32.

25.47 The committee explored how a levy-based system would operate. Mr Medcraft outlined a model of levies that would be sector-based and adjusted periodically. Any adjustment would be based on the costs incurred by ASIC in regulating that sector to achieve an outcome determined by the government. Mr Medcraft provided the following reasoning:

If you want to have a system that works you really want to have it such that it is at a sufficiently granular level that, if the industry does a good job, it should be adjusted both downwards and upwards. Let's take the audit sector, for example. The government might say, 'We want to make sure that at least no more than five per cent of audits are poor quality. If the sector is not achieving that then it needs more effort from ASIC, therefore more resources.'⁶⁶

25.48 ASIC put forward a proposal where \$286.55 million (based on its 2012–13 costs) would be recovered from industry through a combination of:

- fees for service of \$37.84 million, where charges are directly linked to the cost of ASIC delivering a particular service, such as takeover approvals; and
- sector-based levies of \$248.71 million, where sector participants pay an annual fee based on 'volume-related metrics'.⁶⁷

25.49 The equity argument put forward by ASIC found some support. Dr Suzanne Le Mire remarked that ASIC's point on equity 'is well made' and that a levy system 'has some appeal'. Dr Le Mire noted that the development of levies for ASIC could be informed by the WorkCover model:

...where you could increase levies for those who step out of line. Using a model whereby levies are higher for those who break the rules and lower for those who are consistently compliant would have some appeal and perhaps give ASIC some purchase that it does not currently have without pursuing more serious options.⁶⁸

25.50 Dr George Gilligan was relatively supportive of the concept of introducing a levy-based funding system, although he indicated that the mechanism for determining the levies would require careful consideration:

I think from the perspective of equity that it was a fairly powerful argument when it stated the proportion of the fees that were generated by lower-scale firms and the amount of regulatory activity or attention that those firms actually require or receive from the regulator. So there is the sense that

66 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 31.

67 For example, ASIC envisaged that for financial advisers, the cost of regulatory activities would be recovered 'as part of an AFS licence sector levy based on the size of financial adviser groups as determined by the number of authorised and employee representatives. Tiered models would be used to distribute the industry levy between industry participants'. ASIC, *Submission 45.7*, pp. 6–7.

68 Dr Suzanne Le Mire, *Proof Committee Hansard*, 19 February 2014, p. 53.

there should be greater proportionality, one would have thought, in terms of the user pays model. Philosophically, it would be hard to argue against that. The mechanics may be a little more problematic but, certainly, one would have thought that there could be different scales of registration or licensing fees, for example, for the different actors who participate within the industry, depending on the size scale and, of course, the profits that they generate from the privilege of having the licence to operate in the industry.⁶⁹

25.51 Professor Dimity Kingsford Smith also recognised that a user-pays levy would support a regulatory regime that was self-executing. However, Professor Kingsford Smith cautioned that it was necessary to ensure the public interest was reflected in any changes:

If you have the entire regulatory revenue coming from levies, particularly in a concentrated market such as Australia where a lot of the levy income might come from a very few players, you have to watch out for undue influence coming from those who pay.

I also would encourage us to do a little bit more research into the notion that big players always cost more in regulatory resources. I have had some experience in the UK as well, and there, with their user pays system, particularly at the compensation-fund end, the big players are always complaining that it is the smaller players who are having the compensation payouts from the fund and that because they are big players they pay the levies but the moneys go out to the clients of the smaller players, who are a bit harder to keep in line compliance-wise.

So it is not an open and shut case by any means. But having some of ASIC's income derived from levies could be something very seriously to consider.⁷⁰

Committee view

25.52 This report has highlighted specific instances where ASIC could have performed better and considered ways that ASIC could undertake its tasks more effectively in the future. Some of the problems identified were linked to ASIC's approach to enforcement, failures to utilise evidence to establish links and problems with complaints management and stakeholder communication. The committee considers these are matters that ASIC can largely address on its own initiative. However, ASIC's long list of regulatory tasks and the resources available to ASIC to perform these tasks clearly act as constraints on its ability to meet expectations the public and stakeholders may have. Neither of these matters are in ASIC's control; they are matters determined by the government and the Parliament. To the extent that a problem with ASIC relates to its funding, it would be unfair to criticise ASIC.

69 Dr George Gilligan, *Proof Committee Hansard*, 19 February 2014, p. 52.

70 Professor Dimity Kingsford Smith, *Proof Committee Hansard*, 19 February 2014, p. 53.

25.53 Evidence before the committee strongly indicates that ASIC is unfocused and over-stretched with an evident weakness in consumer/investor protection. ASIC has always had a significant role in the Australian corporate world, however, over many years successive governments have entrusted ASIC with additional important functions. ASIC is now firmly established as one of Australia's key financial regulators. However, one outcome of this is that it is increasingly difficult to identify, articulate and prioritise what ASIC's key regulatory functions and priorities should be. ASIC would have a clearer mandate if it was relieved of some of its functions.

25.54 The committee noted earlier that in the 2014–15 Budget, the government announced that it would fund a scoping study to consider options and provide recommendations on the optimal ownership arrangements for ASIC's registry function. The scoping study is intended to inform the government on key strategic policy and implementation issues for consideration before commencing a sale, licensing or external management process.

25.55 The committee has independently considered suggestions of re-positioning the function elsewhere. Although these ideas were developed in parallel (one through a public inquiry process and the other through confidential budget processes), they both point towards a common point that the operation of a sophisticated IT database is a mere enabling function for ASIC and not core to its regulatory role.

25.56 The committee does not consider that it would be appropriate to make a final decision on where those IT functions should go before the findings of the scoping study are known. The purpose of scoping studies on government assets is generally to identify the most efficient and effective ways of delivering a service to the public, without a predisposition for any particular model. The committee fully endorses the work of the scoping study that is examining future ownership options for ASIC's registry function as an important first step toward relieving ASIC of its registry function.

Recommendation 49

25.57 The committee recommends that the scoping study examining future ownership options for ASIC's registry function take account of the evidence that has been presented to the committee.

25.58 The amount of funding allocated to ASIC through the annual appropriations process was considered by the committee. For the health of the financial system it is clearly necessary that ASIC receives an amount of funding that enables proactive regulation and meaningful law enforcement. However, governments have competing priorities and the committee recognises the difficulties associated with increasing ASIC's funding due to the present fiscal circumstances. In any case, the issue is not limited to the quantum of funding; it is also apparent that the current model for funding ASIC is outdated and does not promote efficient outcomes. ASIC regulates many different sectors of the financial system but its funding does not account for differences in the cost of regulating each sector. It does not provide an incentive

through a price signal for sectors to take action to limit the amount of resources ASIC allocates to regulating them.

25.59 The committee considers that ASIC should be funded on a user-pays principle like many of its international counterparts. To implement this, a framework of sector-based levies should be introduced to provide the majority of ASIC's funding. By making regulated entities more accountable for the cost of regulating their sector, a clear incentive would be provided for these entities to minimise the number of problems that the regulator has to deal with. This feature of a well-designed levy system could, over time, promote more efficient regulatory outcomes through better self-regulation, resulting in more resources being available, within existing financial constraints, for the regulator to investigate misconduct reports and deliberate non-compliance. The levies would be reviewed periodically to ensure they are set at appropriate levels and to provide greater transparency of how ASIC manages its resources. ASIC would need to justify why it requires the amount of funding it proposes and industry would have the opportunity to respond to ASIC's assessment. However, as ASIC would no longer be funded through the Budget process, the levies should ensure that ASIC's core funding is more stable on a year-by-year basis and that ASIC has sufficient resources to undertake proactive regulatory activities.

25.60 A further advantage of a levy model for funding ASIC is that it could provide a revenue-neutral means for the government to reduce the fees charged for lodging and inspecting information and documents. The committee considers that the fees currently charged to the public for accessing information held by a government body are too high. These fees effectively act as a barrier to accessing information and potentially counteract efforts to inform the marketplace and promote the confident and informed participation of investors and consumers in the financial system. The public interest would be better served if the size of these fees were significantly reduced. Increased efficiencies resulting from the committee's recommendation regarding the transfer of ASIC's registry responsibilities to another agency could also allow the fees to be reduced further.

Recommendation 50

25.61 The committee recommends that the current arrangements for funding ASIC be replaced by a 'user-pays' model. Under the new framework, different levies should be imposed on the various regulated populations ASIC oversees, with the size of each levy related to the amount of ASIC's resources allocated to regulating each population. The levies should be reviewed on a periodic basis through a public consultation process.

25.62 The government should commence a consultation process on the design of the new funding model as soon as possible.

Recommendation 51

25.63 Following the removal of ASIC's registry responsibilities and the introduction of a user-pays model for funding ASIC outlined in Recommendations 49 and 50, the committee recommends that the government reduce the fees prescribed for chargeable matters under the *Corporations (Fees) Act 2001* with a view to bringing the fees charged in Australia in line with the fees charged in other jurisdictions.

Chapter 26

Accountability and governance structure

26.1 As an independent Australian government statutory authority entrusted with significant powers, it is essential that ASIC is subject to robust accountability processes. The accountability framework must also require the regulator to exercise its powers fairly and transparently. As Professor Dimity Kingsford Smith observed that ASIC's legitimacy as a regulator:

...comes partly from ASIC being transparent and accountable in a number of ways: financially, procedurally, and substantially. Ultimately, ASIC is a *public* institution, which works best when its decisions and processes are seen by the public.¹

26.2 It is also essential, however, that the accountability framework applied to ASIC recognises, and safeguards, the autonomy needed for ASIC to have legitimacy among the regulated population and in the broader community. The importance of accountability to agencies such as ASIC is recognised in the terms of reference for this inquiry, which directs the committee to examine the accountability framework to which ASIC is subject, and whether this needs to be strengthened. The means for applying external accountability to ASIC is one of the issues considered by this chapter.

26.3 ASIC's performance can also be influenced by its internal governance framework. To ensure high-quality public governance, efficiency and good decision-making it is essential that ASIC's internal governance framework is appropriate and works effectively. This chapter considers the model of governance currently applied to ASIC by the ASIC Act and possible alternatives.

ASIC's lines of accountability

26.4 ASIC is subject to several formal and informal accountability mechanisms. The following paragraphs describe these processes.

Relationship with government

26.5 As is the case with other independent statutory authorities, the government, through an assigned minister,² retains responsibility for the administration of ASIC. The relationship between the government and ASIC is evident in several ways, but perhaps most notable are that the government appoints ASIC's statutory office holders

1 Professor Dimity Kingsford Smith, *Submission 153*, p. 11.

2 Currently, the Assistant Treasurer is responsible for the administration of ASIC.

(i.e. the chairperson, deputy chairperson and other commissioners)³ and that ASIC relies on funds appropriated by the Parliament. The ASIC Act also outlines the following specific areas where ASIC and the minister may interact:

- ASIC has the function of advising the minister if ASIC considers that changes to the corporations legislation (other than the excluded provisions)⁴ or other legislation that confers on ASIC functions and powers are needed to overcome, or to assist in overcoming, problems that ASIC has encountered while performing or exercising its functions and powers;⁵ and
- sections 12 and 14 of the ASIC Act enable the minister to give ASIC a written direction relating to ASIC's policies or priorities, or directing that a particular matter be investigated.⁶

26.6 As a prescribed agency under the *Financial Management and Accountability Act 1997* (FMA Act), ASIC's management of finances and property are governed by the framework provided for by that Act.⁷ In particular, as a chief executive of an FMA Act agency, the chairman of ASIC must manage the affairs of ASIC in a way that promotes proper use of the Commonwealth resources.⁸ Further, under the FMA Act both the responsible minister and the Finance Minister may request any reports, documents and information that they may require.⁹

3 ASIC's chairperson, deputy chairperson and commissioners are appointed by the Governor-General on the advice of the minister: *Australian Securities and Investments Commission Act 2001*, ss. 9, 10.

4 The excluded provisions are section 12A and division 2 of part 2 of the ASIC Act. Section 12A outlines ASIC's other functions and powers, including ASIC's functions and powers under legislation other than the ASIC Act and the Corporations Act (e.g. the *Insurance Contracts Act 1984*) and its monitoring and promoting market integrity and consumer protection functions in relation to the Australian financial system and the payments system. Division 2 of part 2 deals with unconscionable conduct and consumer protection in relation to financial services. *Australian Securities and Investments Commission Act 2001*, s. 5.

5 *Australian Securities and Investments Commission Act 2001*, ss. 11(2)(b), 12A(5).

6 Section 12 directions relate to policies that ASIC should pursue or priorities it should follow in performing or exercising any of its functions or powers under the corporations legislation (other than the excluded provisions). Section 14 directions may be given where, in the minister's opinion, it is in the public interest that particular matters be investigated (although the minister cannot give a direction about a particular case). See *Australian Securities and Investments Commission Act 2001*, s. 14(2). Only one ministerial direction has been given to ASIC—in 1992 a direction was given regarding collaboration and consultation between ASIC and the CDPP. International Monetary Fund, *Australia: IOSCO Objectives and Principles of Securities Regulation—Detailed Assessment of Implementation*, IMF Country Report, no. 12/314, November 2012, p. 33; Australian Government, 'Statement of Expectations for the Australian Securities and Investments Commission', 20 February 2007, p. [5].

7 On 1 July 2014, the *Public Governance, Performance and Accountability Act 2013* will replace the FMA Act.

8 *Financial Management and Accountability Act 1997*, s. 44.

9 *Financial Management and Accountability Act 1997*, s. 44A.

Parliamentary oversight

26.7 Two key mechanisms for ongoing parliamentary oversight of ASIC are the scrutiny associated with proposed government expenditure through the budget process and the requirement that an annual report on ASIC's activities be presented to the Parliament. This dedicated inquiry into ASIC demonstrates another way that ASIC is responsible to Parliament for its operations. Further, the Auditor-General, an independent officer of the Parliament supported by the Australian National Audit Office (ANAO), audits financial statements of government agencies and conducts performance audits. These reports assist the Parliament to perform its functions.¹⁰

26.8 ASIC is subject to ongoing parliamentary oversight via two committees:

- the Senate Economics Legislation Committee, which examines all Treasury portfolio agencies including ASIC as part of Senate estimates (generally three times a year) and reviews the annual reports of these agencies; and
- the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS)—a committee established under the ASIC Act charged with inquiring into the activities of ASIC and the operation of the corporations legislation, as well as reviewing the annual reports of bodies established under the ASIC Act.

Parliamentary Joint Committee on Corporations and Financial Services

26.9 The PJCCFS was established by the *Australian Securities Commission Act 1989*. The decision to create a dedicated parliamentary committee to oversee ASIC and the corporations legislation followed concern about the complexity of the corporations legislation and ASIC's power to modify or suspend the application of legislation to individuals or classes.¹¹ In 1989, a parliamentary joint select committee concluded that a permanent committee should be established to 'monitor the work and activities' of the bodies now known as ASIC and the Takeovers Panel. That committee wrote:

10 In its submission, the ANAO outlined the financial and performance audits of ASIC it has undertaken, advising that ASIC has been involved in seven performance audits since 2005 (five were cross-agency and two related specifically to ASIC). The ANAO is currently conducting a performance audit of the administration of the business name register which includes ASIC and will be tabled in late 2013–14. ANAO, *Submission 114*, p. 2.

11 In a submission to a parliamentary committee considering the Australian Securities Commission Bill 1988, the National Companies and Securities Commission (NCSC), which was subsequently replaced by the ASC and then ASIC, advised that 'the main rationale for making specific statutory provision for such a Parliamentary Committee can be found in the extensive nature of the legislation, the established need for frequent amendment of it, the powers of the ASC to modify or suspend the impact of the legislation on individuals or classes and the implications of the adjudicative decisions of these bodies so far as future legislation is concerned'. Joint Select Committee on Corporations Legislation, *Report*, April 1989, p. 71.

The Committee believes that if the powers of such a Parliamentary Committee are carefully drafted and imaginatively employed they will enable the Committee to identify important issues and inquire into and report on these matters and make a positive contribution to the efficiency and effectiveness of the ASC and its associated bodies.¹²

26.10 The PJCCFS's duties are outlined in section 243 of the ASIC Act. Among other things, the PJCCFS's tasks include inquiring into the activities of ASIC and examining its annual report.¹³ In fulfilling these statutory duties, the PJCCFS conducts regular public hearings with ASIC.¹⁴ The PJCCFS also conducts wider inquiries that gather written and oral evidence and lead to detailed reports. Particularly notable inquiries conducted in recent years include those into the Franchising Code of Conduct, financial products and services (also known as the Ripoll Inquiry after committee's then chair Mr Bernie Ripoll MP), and the collapse of Trio Capital. The PJCCFS has also been tasked with reviewing significant legislative changes, such as the 2012 Future of Financial Advice (FOFA) legislation.

Other accountability mechanisms

26.11 A number of other formal and informal accountability mechanisms exist. Certain decisions made by ASIC under the ASIC Act, Corporations Act and other Acts can be reviewed by the AAT or the Takeovers Panel.¹⁵ Decisions can be subject to judicial review. ASIC is also required to comply with other legislation or policies that are applied to government bodies generally, including:

- the *Freedom of Information Act 1982*;
- the Legal Services Directions 2005, which includes a requirement to act as a model litigant in the conduct of litigation, as well as policies on the procurement of Commonwealth legal work;¹⁶

12 Joint Select Committee on Corporations Legislation, *Report*, April 1989, Parliamentary Paper No. 117/1989, p. 72.

13 *Australian Securities and Investments Commission Act 2001*, s. 243(a)(i) and (b).

14 In recent years, ASIC has been called up to four times a year to give evidence.

15 The Takeovers Panel may review decision made by ASIC to exempt a person from the provisions of chapter 6 of the Corporations Act, or modify the application of that chapter to that person. During a takeover bid, the Takeovers Panel may also consider decisions by ASIC under chapter 6C. Chapter 6 contains the takeover provisions of the Corporations Act and chapter 6C requires information to be provided about the ownership of listed companies and managed investment schemes. ASIC's regulatory guidance states that the discretionary power is intended to address cases where a proposed acquisition does not fall within the terms of the exceptions already provided for in the Corporations Act. ASIC, *Takeovers: Exceptions to the general prohibition*, Regulatory Guide 6, June 2013, p. 7.

16 Appendix F of the Legal Services Directions 2005 specifies that an FMA Act agency may use only approved providers of Commonwealth legal work. The approved list (the Legal Services Multi-use List), of external legal providers is determined by the Office of Legal Services Coordination within the Attorney-General's Department.

- the Commonwealth Procurement Rules; and
- as ASIC's staff must be employed under the *Public Service Act 1999*, ASIC is bound by that Act, including the directions about employment matters made by the Australian Public Service Commissioner. ASIC's employees must also abide by the Australian Public Service (APS) Code of Conduct and Values.¹⁷

26.12 The Commonwealth Ombudsman, which investigates complaints alleging unfair or unreasonable treatment by an Australian government department or agency, can investigate complaints about how ASIC has handled a particular administrative matter. Effective informal scrutiny of ASIC's activities can also be provided by the media and academics.

Upcoming and possible changes to the current accountability framework

26.13 Some changes to the whole-of-government accountability framework are already scheduled to be implemented and further changes that specifically relate to ASIC may also be under consideration. The *Public Governance, Performance and Accountability Act 2013* (PGPA Act) will reform the financial framework that applies to all Commonwealth entities. The PGPA Act will replace the FMA Act and the *Commonwealth Authorities and Companies Act 1997* on 1 July 2014.

26.14 In March 2014, the parliamentary committee with responsibility for oversight of the Australian Commission for Law Enforcement Integrity (ACLEI) commenced an inquiry into the jurisdiction of ACLEI. Among other things, that inquiry will consider the desirability and feasibility of extending the jurisdiction of the ACLEI to include oversight of ASIC (and certain other government agencies).¹⁸ This follows concern expressed by the Parliamentary Joint Committee on Law Enforcement in 2013 about ASIC being able to gain access to a national repository of criminal intelligence without being subject to ACLEI oversight.¹⁹

17 These are outlined in sections 10 and 13 of the *Public Service Act 1999*. Under section 14, agency heads and statutory office holders (subject to any regulations) are bound by the code of conduct in the same way as APS employees.

18 See Parliamentary Joint Committee on the Australian Commission for Law Enforcement, 'Inquiry into the jurisdiction of the Australian Commission for Law Enforcement Integrity: Terms of Reference', [www.aph.gov.au/Parliamentary_Business/Committees/Joint/Australian Commission for Law Enforcement Integrity/Jurisdiction of ACLEI/Terms of Reference](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Australian_Commission_for_Law_Enforcement_Integrity/Jurisdiction_of_ACLEI/Terms_of_Reference) (accessed 11 March 2014).

19 Parliamentary Joint Committee on Law Enforcement, *Inquiry into the gathering and use of criminal intelligence*, May 2013, Parliamentary Paper No. 119/2013, p. 93.

Views on the current accountability framework

26.15 Several submissions from aggrieved individuals and other observers argued that ASIC is not being held accountable. Some examples are below:

There is no accountability when a regulator does nothing in the face of years of evidence of bad loans. There is nothing in ASIC's annual reporting obligations that requires it to explain actions it has taken to prevent and put an end to corrupt and immoral business practices. Banks should be required to disclose the number and value of loans they have foreclosed, the number and value of properties they have repossessed, and the number of customers they have placed in bankruptcy. Where these exceed a very low threshold, ASIC should be required to automatically investigate, and all these statistics should be reported to Parliament.²⁰

* * *

ASIC is subject to no accountability whatsoever. There is the razzmatazz of Senate sub-Committee hearings, and the formal reporting requirements—but these are just going through the motions. ASIC's Annual Report is annually an exemplar of managerialist blah, a box-ticking waste of paper.²¹

26.16 Others suggested that there appears to be sufficient oversight of ASIC, but that 'whether it is effective depends upon the powers and performance of the overseers'. With the exception of dedicated inquiries such as that being conducted by this committee, it was argued that the Commonwealth Ombudsman is best placed to oversee ASIC on an ongoing basis.²²

26.17 Organisations and stakeholders that engage with ASIC on a regular basis, and academics, had few concerns with the current accountability arrangements. For example, the Association of Financial Advisers stated that oversight of ASIC by the Australian Parliament is the most appropriate accountability mechanism, and it does not consider there is a need for any significant change.²³ The Law Council's Corporations Committee similarly considered that the current accountability mechanisms are 'satisfactory and effective'. It suggested that 'an evidence-based case would need to be made to suggest additional mechanisms or structures'.²⁴ The Australian Shareholders' Association advised that it has no evidence that suggests there is a need to strengthen ASIC's accountability framework.²⁵ Dr Marina Nehme also argued that the overall accountability framework does not need to be changed.

20 Mr Stephen Tyrrell, *Submission 179*, p. 1.

21 Dr Evan Jones, *Submission 295*, p. 5 (footnote omitted).

22 Mr Adrian Cox, *Submission 91.3*, p. 4.

23 Association of Financial Advisers, *Submission 117*, p. 2.

24 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 7.

25 Australian Shareholders' Association, *Submission 151*, p. 1.

Dr Nehme highlighted the principles underpinning the current system and the risks associated with any potential amendments:

[The framework] currently provides a good balance between ensuring the accountability and the independence of ASIC. It is essential that the independence of this regulator is not eroded in any way to enable it to achieve its objectives efficiently.²⁶

26.18 ASIC addressed the issue of accountability in its main submission. While it noted the criticism in some submissions about ASIC not being held accountable, ASIC countered that it is accountable 'for all aspects of our work', and that the current accountability framework is 'extensive, multi-layered, and rigorous', and works well in practice.²⁷

26.19 While there was minimal support for significantly altering ASIC's accountability framework, some minor enhancements that could be considered were identified. Dr Nehme and CPA Australia commented on a past practice of the government issuing ASIC with a public statement of expectations and requiring ASIC to respond with a public statement of intent.²⁸ CPA Australia called for the practice to be reinstated; it argued that the process had the effect of making ASIC accountable and constrained by the statement of intent it made:

By articulating an annual plan and agreement with the government, a regulator such as ASIC can ensure that it works towards meeting the Government's expectations and appropriately manages its resources...This requirement is not only good policy but increases the transparency and certainty for the market, consumers and government. Good regulatory policy is based on outcomes, not on the volume of rules a regulator produces.²⁹

26.20 In April 2014, the government issued a new statement of expectations to ASIC.³⁰

Committee view

26.21 The committee notes that the government has recommenced the practice of issuing statutory agencies such as ASIC with statements of expectations. However, to ensure this framework is as effective as possible, consideration should be given to how adherence to the statement of intent could be monitored. Given that ASIC is subject to ongoing oversight by the PJCCFS, that committee may be well-placed

26 Dr Marina Nehme, *Submission 140*, p. 9.

27 ASIC, *Submission 45.2*, p. 57.

28 Dr Marina Nehme, *Submission 140*, p. 9; CPA Australia, *Submission 209*, p. 1.

29 CPA Australia, *Submission 209*, pp. 1–2.

30 The April 2014 statement of expectations can be viewed here: www.asic.gov.au/asic/asic.nsf/byheadline/Statement-of-expectations--April-2014?openDocument.

to review these statements and question ASIC about them on a regular basis. This process could inform the development of the next statements.

26.22 The committee has not received compelling evidence that suggests the mechanisms currently in place for providing external oversight of ASIC's activities need to be reviewed. Undertaking external oversight of an agency such as ASIC will be inherently difficult regardless of the model in place for doing so. Over the years, the PJCCFS has performed its challenging task commendably, with a number of landmark inquiries such as the Ripoll Inquiry leading to substantial reforms and continuing to influence policy discussions today.

26.23 The PJCCFS may wish to consider whether it can pivot its oversight function towards emerging risks. It is evident that many PJCCFS inquiries have reacted to a number of events, such as Storm Financial, Opes Prime and Trio Capital. Sadly, inquiring into collapses such as these that lead to personal misery and significant financial losses has been a necessary function of parliamentary committees, particularly in the wake of the global financial crisis. However, in addition to undertaking inquiries that assess what went wrong after the fact, the PJCCFS could place greater pressure on ASIC about emerging issues and industry developments with a view to limiting the number of minor issues that become major scandals. It may be necessary for the PJCCFS to question ASIC about the matters raised by individual complaints, as this committee has done with a number of submissions. As a first step, the PJCCFS may wish to consider dedicating one of its ASIC oversight hearings each year to emerging issues and early warning signals that, if appropriate and timely action were taken in response, could limit the potential for widespread investor losses or major fraud. The PJCCFS would also be well-placed to develop inquiries into the lifting of professional, ethical and educational standards in the financial services industry, a recurrent theme in this review of ASIC

Recommendation 52

26.24 The committee notes that the Parliamentary Joint Committee on Corporations and Financial Services could be well-placed to monitor ASIC's performance against the government's statement of expectations and ASIC's statement of intent. The committee recommends that the Parliamentary Joint Committee consider this as part of its statutory ASIC oversight function.

Recommendation 53

26.25 The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services consider how it could undertake its statutory duties in a way that places a greater emphasis on emerging issues and how action could be taken to pre-empt widespread investor losses or major frauds. As a first step the Parliamentary Joint Committee could, on an annual basis, reserve a public hearing to emerging issues, taking evidence from both ASIC and relevant experts.

Recommendation 54

26.26 The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services inquire into the various proposals which call for a lifting of professional, ethical and educational standards in the financial services industry.

ASIC's governance structure

26.27 As is the case with large organisations generally, having in place a governance structure that encourages good decision-making with the most appropriate people involved is fundamental to ASIC fulfilling its objectives. Given the independent status ASIC enjoys and the significant powers it is entrusted with exercising, a sound governance structure is needed to promote stakeholder and public confidence in ASIC's operations and protect against inappropriate conduct.

26.28 The commission that governs ASIC is comprised of a chairperson, a deputy chairperson and between one and six other members. The commission meets on a monthly basis, although more frequently if required, to make decisions about matters 'within ASIC's regulatory functions and powers that have strategic significance', to provide input about matters of significance and to oversee and to ensure that ASIC's statutory objectives are being met. The commission also oversees the management and operations of ASIC as a Commonwealth agency.³¹ Specific commissioners are allocated executive responsibility for groups of ASIC's stakeholder and enforcement teams.³² Senior Executive Leaders (SELs) manage these teams and exercise various powers and functions delegated to them by the commission.³³ A number of internal and external committees and bodies assist the commission to carry out its functions.³⁴ The ASIC Act includes procedures for ASIC's chairman and commissioners to disclose and manage conflicts of interest.³⁵ However, unlike other regulators such as the ACCC,³⁶ ASIC does not publish a code of conduct for its commissioners.

26.29 It is evident that there are different models in place for governing regulatory agencies. Like ASIC, the ACCC is similarly governed by a commission. However,

31 ASIC, *Submission 45.2*, p. 14.

32 ASIC, *Submission 45.2*, p. 14.

33 ASIC, *Annual Report 2012–13*, p. 142.

34 Internal bodies include the Enforcement Committee, Emerging Risk Committee and the Regulatory Policy Group. External bodies include the External Advisory Panel, Consumer Advisory Panel, ASIC's Audit Committee, Market Supervision Advisory Panel and the Registry and Licensing Business Advisory Committee. The external panels were discussed in Chapter 19. ASIC, *Submission 45.2*, p. 58; 'ASIC External Advisory Panel: Purpose, Governance and Practices Summary, March 2012', www.asic.gov.au (accessed 8 July 2013).

35 *Australian Securities and Investments Commission Act 2001*, ss. 123, 124.

36 See www.accc.gov.au/system/files/Code%20of%20Conduct%20for%20Commission%20Members%20and%20Associate%20Members%202012.pdf.

while the ACCC's commissioners may chair internal committees that relate to particular areas of the ACCC's remit, they are not formally aligned with particular work areas and teams. The ACCC's commission also appears to be collectively involved to a significant extent in decision-making; according to its published guidance, the commission usually meets on a weekly basis to make decisions about investigations and regulatory matters.³⁷ The ACCC previously had a separate chairman and chief executive officer, however, the chief executive officer position has been recently abolished.³⁸

26.30 APRA is governed by an executive group comprised of the chairman and the other members appointed (in total, the executive group consists of between three and five members). APRA's executive group meets at least on a monthly basis but also meets with senior management weekly 'for high-level information sharing and decisions on more routine supervisory and organisational matters'.³⁹

26.31 Board structures can be used as a governance structure for regulators, although they are more common in other countries. The RBA has two boards: the Reserve Bank Board and the Payments System Board. The Governor of the RBA chairs the boards and has responsibility for managing the RBA. The UK's Financial Conduct Authority is governed by a board of executive and non-executive members, with separate chairman and chief executive officer positions. The New Zealand Financial Markets Authority has a non-executive board.

Views on ASIC's governance structure

26.32 The public perception of an agency's performance, accountability and legitimacy can be affected by the governance model in place and the composition of the governing body's members.⁴⁰ Aggrieved borrowers in particular criticised recent appointments made to ASIC; for example, one submission objected to past and present chairmen and commissioners having banking backgrounds or entering the banking sector after leaving ASIC.⁴¹ Levitt Robinson Solicitors suggested that the United States system of Senate confirmations for certain executive appointments should be adopted in Australia for ASIC office-holders.⁴²

37 ACCC, 'Decision making processes', www.accc.gov.au/about-us/australian-competition-consumer-commission/decision-making-processes (accessed 23 April 2014).

38 See Mr Rod Sims, Chairman, ACCC, *Senate Economics Legislation Committee Hansard*, Estimates, 26 February 2014, p. 74.

39 APRA, 'APRA's governance', www.apra.gov.au/AboutAPRA/Pages/Governance.aspx (accessed 23 April 2014).

40 Demonstrating this, the committee received several submissions opposed to the composition of the boards that govern FOS and COSL because the boards include directors with financial services industry backgrounds. For example, see *Submission 26*.

41 Mr and Mrs Neil and Deb Toplis, *Submission 6.1*, p. 1.

42 Levitt Robinson Solicitors, *Submission 276*, p. 1.

26.33 The committee sought views on ASIC's governance structure and tested the advantages and disadvantages of different governance models. Professor Dimity Kingsford Smith highlighted how the accountability of a regulator can be shaped by the governance structure by reviewing various foreign regulators:

In the US the Securities Exchange Commissioners are overtly political non-executive appointments: the GFC suggests that this model may make a commission more susceptible to political or industry influence. In New Zealand the Financial Markets Authority has a CEO and a non-executive board from industry and related groups. In the UK the Financial Conduct Authority has an executive chair and CEO and a non-executive board from industry and consumer groups. These models rely on individual executives being expert in a broad range of financial activities, immune to industry influence through board composition and fearless 'lone-wolf' decision-makers.⁴³

26.34 Professor Kingsford Smith concluded that the commission-based models adopted by agencies like ASIC are 'more robustly independent and provide a better spread of expertise'. However, she added that ultimately the structure of an organisation 'is less influential than the calibre of personnel appointed'.⁴⁴

26.35 When asked about ASIC's governance structure, Mr Douglas Gration of the Governance Institute of Australia identified two issues: ASIC's ability to draw on industry experience and the independence of those overseeing ASIC. Mr Gration observed that the existing model allowed ASIC to gain industry experience, as ASIC's past and present chairmen and commissioners have had private sector experience at senior levels. However, Mr Gration remarked that the issue of independence is not addressed in the current structure:

[ASIC] is like a company that is composed entirely of executive directors. The ASX corporate governance principles that we have been heavily involved with others in developing very much value the presence of independent directors on a corporate board. It is not obvious why ASIC would not benefit similarly from the expertise of having commissioners who were not, in effect, full-time executives and employees of ASIC as well.⁴⁵

26.36 Mr Gration concluded that the lack of expertise from outside the organisation could result in ASIC 'very much living in its own world and in its own cocoon'.⁴⁶ He also highlighted how ASIC could suffer as a result of the governance framework not encouraging the contestability of ideas:

43 Professor Dimity Kingsford Smith, *Submission 153*, p. 5.

44 Professor Dimity Kingsford Smith, *Submission 153*, p. 5.

45 Mr Douglas Gration, Director, Governance Institute of Australia, *Proof Committee Hansard*, 10 April 2014, p. 64.

46 Mr Douglas Gration, *Proof Committee Hansard*, 10 April 2014, p. 64.

Undoubtedly, the private sector recognises that there is value in having independent directors, independent non-executive directors, on the board of a company who are not employees. It is an odd arrangement that you have the chair of the commission, and in one sense all the other commissioners are beholden to the chair. It makes it quite difficult to have an independent line of thinking there. If you have got a terrific chair, that is okay; but even a terrific chair can benefit from that sort of independent thinking.⁴⁷

26.37 Other witnesses also commented on the influence of ASIC's chairman in ASIC's current governance structure. Dr Stuart Fysh, an individual prosecuted as a result of an ASIC investigation and later acquitted, pointed to the changes in approach that have occurred as a result of the latest change in chairmanship. Dr Fysh concluded that 'the organisation is too imprinted with the stamp of the guy at the top' and as a result 'the culture of the organisation swings around'.⁴⁸ Dr Fysh commented on his experience at BG Group, an international energy company involved in gas exploration and production, to demonstrate the benefits that a board structure at ASIC could provide:

For example, in BG Group they would largely be functions of the group executive, which of course exist in—but half a dozen times a year human-resource policy would be discussed with the board. If we had killed somebody because we had an incompetent operator in place—which is kind of what ASIC has done—the board would want to understand: 'Was that just an accident? Was this guy some sort of nut? How did he get through our system?' They would spend a day looking at the core competencies that we want in investigators or gas operators... If I were on the board of ASIC I would be saying to them, 'Look we've just lost this Fysh case. Could you chaps just come in—and don't just bring in all your senior people; bring some of the junior people in, so we get a look at the horseflesh in the organisation—and run me through the flow chart of how a prosecution happens. I want to spend a couple of hours with you really kicking it around. I want to know what went wrong.'... That is what I think a board would do.⁴⁹

26.38 Dr Fysh added:

In any large enterprise we all benefit from someone standing back and advising us. I do not think anyone is quite as good as they would need to be to be doing a great job. Look at the brittleness in ASIC. I have referred to it; you have seen it. We have the chairman's bloody travel schedule on the web site of our national regulator. Don't tell me it is not a brittle organisation!⁵⁰

47 Mr Douglas Gration, *Proof Committee Hansard*, 10 April 2014, p. 64.

48 Dr Stuart Fysh, *Proof Committee Hansard*, 2 April 2014, p. 4.

49 Dr Stuart Fysh, *Proof Committee Hansard*, 2 April 2014, pp. 3–4.

50 Dr Stuart Fysh, *Proof Committee Hansard*, 2 April 2014, p. 5.

26.39 ASIC was questioned about its governance structure. Mr Medcraft noted that with 30 years' experience in investment banking, he has had significant exposure to the private sector approach to governance. Mr Medcraft emphasised that ASIC has access to independent experts through its External Advisory Panel. Mr Medcraft provided the following testimony regarding that panel:

We use that external advisory panel as a key reference body. We tell them what we are doing, but we also get their views. The external advisory panel are people taken from across the sectors that we regulate. For example, one member is the current CEO of Google because I was keen that we have somebody in technology. We can provide you a list of the external advisory panel members. They include people such as David Gonski. We have established an arrangement with the Business Council of Australia that whoever is the chairman—it was Tony Shepherd—is a continuing member of the external advisory panel so that we have that strong connection with the Business Council. We are basically across the sectors. We essentially have very senior people and it includes key consumer representatives as well. That external advisory panel is actually quite important. In addition to all the other governance mechanisms we have, that is quite important.⁵¹

26.40 ASIC commissioner Mr Greg Tanzer noted that APRA previously had a board structure, but that this was removed following the royal commission into the collapse of HIH Insurance. Mr Tanzer also noted that the non-executive advisory board utilised by the UK Financial Services Authority, the predecessor to the FCA, did not prevent criticism of the agency's performance through the global financial crisis.⁵²

Committee view

26.41 In theory, a commission-structure of governance such as that applied to ASIC by the ASIC Act appears sound. A commission approach to governance encourages collective decision-making and responsibility. It can lead to better decision-making by drawing in the opinions and scrutiny of others and limiting the power of individuals. It potentially filters from the decision-making process the inclinations, peculiarities and flaws that an individual decision-maker could possess. However, the committee is concerned that the current governance framework has led to ASIC operating in silos with individual commissioners performing executive functions. ASIC's commission sets ASIC's priorities and strategic objectives, but the same commission, and individual commissioners, are also responsible for exercising ASIC's powers. As a result, any internal monitoring of ASIC's performance or challenge to how ASIC operates relies on the willingness and ability of the commissioners to scrutinise the decisions they have made. Although ASIC engages external persons through groups such as its External Advisory Panel, these groups focus on current areas of interest that relate to ASIC's regulatory work. They are not well-placed to scrutinise ASIC's performance or how the agency operates.

51 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 89.

52 Mr Greg Tanzer, Commissioner, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 89.

Conclusion and recommendation

26.42 One suggestion discussed during the public hearings was that ASIC be governed by the equivalent of an executive and non-executive board. The committee has taken particular care when contemplating possible recommendations about ASIC's governance structure. The committee wishes to avoid disruptive changes that could potentially destabilise ASIC and distract it from its core functions. The committee is of a firm view, however, that ASIC's governance structure is not serving the agency well.

26.43 Over time, ASIC's performance may well be improved by replacing its commission structure of governance with an executive and non-executive board to which management would report. Introducing a board as the governing body for ASIC would create a stronger foundation for internal oversight. The board would provide leadership to the agency and assess management's performance. A board could provide ASIC's management with access to a range of experienced individuals and allow this informed group to scrutinise cases where things went wrong, particularly if they had access to ASIC's employees and internal policies. A chief executive officer would assume executive responsibility for ASIC's operations, although the board would provide guidance and challenge the chief executive officer where necessary. The responsibilities of the chairman and chief executive officer would not be performed by the same individual.

26.44 However, the committee has made a number of recommendations in this report that are intended to:

- improve the overall regulatory environment and allow ASIC to focus on areas of most concern;
- encourage ASIC to become more of a self-evaluating and self-correcting organisation; and
- provide insight into the conduct and draw on the knowledge, experience and expertise of people in the corporate world.

26.45 The committee considers that these recommendations should be adopted, monitored and allowed time to work before any further consideration of ASIC's governance framework takes place. A fundamental restructure of ASIC would be a major reform and require extensive consultation. By the end of two years, the committee's recommendations and ASIC's internal reform process should have had time to take effect. At that time, if the need for further reform is apparent, ASIC's governance arrangements and the extent to which they affect the agency's performance should be revisited.

Recommendation 55

26.46 The committee recommends that at the end of two years, the government undertake a review of the *Australian Securities and Investments Commission Act 2001* that would consider ASIC's governance arrangements, including whether ASIC should be governed by a board comprised of executive and non-executive members.

26.47 Should the government decide that the governing body of ASIC be changed from a full-time commission to an executive and non-executive board, the word 'commission' would need to be removed from ASIC's name. This would also be an appropriate time to consider whether ASIC's current name suitably describes its responsibilities. As ASIC's chairman observed, ASIC is a financial services and markets regulator. In his view ASIC's current name, the Australian Securities and Investments Commission, 'means nothing to the average person'.⁵³ A possible new name is the Financial Services and Markets Authority.

26.48 Although the committee has concluded that its other recommendations should have had time to take effect before ASIC's governance arrangements are considered further, the committee does urge ASIC to take steps to increase the transparency of its internal accountability arrangements. Simple changes such as publishing internal policies and guidelines on matters such as the management of conflicts of interest could strengthen public confidence in how these issues are addressed and demonstrate that they are taken seriously within ASIC.

Recommendation 56

26.49 The committee recommends that ASIC publish a code of conduct for its statutory office-holders.

53 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 33.

Chapter 27

Unresolved matters

27.1 This chapter addresses two important but unrelated questions the committee has encountered during this inquiry and previous inquiries. The first question is whether the current approach of products being available to unsophisticated retail investors regardless of the suitability of these products for those individuals is appropriate. The second relates to the regulation of the insolvency profession and the current laws governing corporate insolvencies; in particular, whether Australia's framework is appropriate for restructuring a large business and minimises value destruction.

27.2 These issues strike at fundamental aspects of Australia's financial services and corporate law frameworks. Addressing them in detail in this report would be beyond the scope of an inquiry focused on the performance of ASIC. Nevertheless, ASIC's performance and perceptions about its performance are clearly influenced by the laws in place. The submissions that have expressed the most dissatisfaction with ASIC's performance often relate to financial products that should not have been available to retail clients or badly managed liquidations. Similarly, other inquiries the committee undertakes often attract submissions that lead to these issues being discussed. Addressing the matters raised in this chapter could potentially lead to better outcomes for the entire economy and help protect individuals from suffering and distress.

27.3 Another important matter considered in this chapter relates to boiler room investment scams.

Unsafe financial products

27.4 In Chapter 20, the committee discussed some of the implications of the low levels of financial literacy in Australia. When this is combined with Australia's current disclosure-based regulatory approach, retail investors and consumers may be further disadvantaged when deciding on a financial product. In this context, the Consumer Action Law Centre cited a number of further complicating factors that pose a risk to the consumer. These included:

- extremely complex credit and financial products that non-experts would frequently misunderstand (including even the most important elements);
- people not necessarily choosing between products 'rationally', instead making quick decisions using mental shortcuts when dealing with unfamiliar topics or when limited by time; and

- people typically having trouble calculating costs and risks, especially when the cost or risk is temporally remote.¹

27.5 The experiences of many of the investors or borrowers who wrote to the committee indicated that they had not been properly informed of, or understood, the complexity, or inherent high risk of their investment or loan.

27.6 The Financial Planning Association (FPA) noted that ASIC does not have legislative obligations for regulating financial products, only for the oversight of product providers. This responsibility focuses on 'matters of corporate governance and disclosure, and in the main not on the design and other issues related to the products they sell to consumers'. It suggested that:

Problems with products should be addressed through product regulation. Legislation must enable ASIC to effectively and proactively regulate product providers and the products they develop and sell to consumers. Product providers should be held accountable for failing to deliver on product benefits due to dishonest conduct, fraud or insolvency, or if there are fundamental flaws in products.²

27.7 The Australian Shareholders' Association gave the example of the issuing of prospectuses where ASIC considers whether all relevant and required information is provided. According to the Association, it does not appear that ASIC checks or tests the information contained in the document 'resulting in outcomes which disadvantage investors'. It explained further:

If claims are made in a prospectus or an advertisement we believe they should be tested and justified. ASA accepts that investors are responsible for their decisions but have less opportunity to carry out investigative work. It would appear that ASIC waits for complaints before it acts. While it is difficult to measure, ASA has the impression that overseas regulators are able to act more quickly to assess a situation, take action and reach a conclusion than in Australia where it seems litigation, or the threat of such, delays these steps. It appears actions such as withdrawing a product or suspending/banning an individual take too long.³

27.8 The Australian Shareholders' Association argued:

If, in the view of ASIC, any matter which comes to their attention would impact on or influence investors or intending investors then that should be made known. Simply announcing that ASIC had asked for more information or was investigating a product or distribution channel would aid investors.⁴

1 Consumer Action Law Centre, *Submission 120*, p. 7.

2 Financial Planning Association of Australia, *Submission 234*, p. 26.

3 Australian Shareholders' Association, *Submission 151*, p. 2.

4 Australian Shareholders' Association, *Submission 151*, p. 2.

27.9 Mr David Haynes, Australian Institute of Superannuation Trustees, referred to low-fee, no-fee products. He believed that ASIC should step in and be able to stop the promotion of such products. He explained:

...because they [the fees] are hidden and they are significant, and because they involve a misrepresentation of the product to consumers, who think that they are getting something for nothing when clearly that is not the case.⁵

27.10 In his view, the appropriate response by ASIC to such products would be to say, 'We do not believe that the promotion of these products is consistent with the spirit of the law or appropriate consumer protection and should make representations along those lines up the tree to government'.⁶

27.11 The Consumer Credit Legal Centre (NSW) would like some sort of recognition of an essentially unsafe product. Mrs Cox explained that other areas of consumer protection have such recognition but not so in credit and financial services-type products.⁷ She stated that one matter that was particularly discouraging over the years was the need 'to argue misleading and deceptive conduct':

...when the problem is that the actual product is so poor that you would have to be misled to enter into it. I find it quite frustrating that we do not have more sophisticated tools for dealing with that situation.⁸

27.12 Mr Brody of the Consumer Action Law Centre very much agreed that unsafe products should be identified. He stated that in addition 'to having a blackout system, there could be a system to restrict access to particular types of challenging products'.⁹

27.13 The consumer advocacy associations agreed that unsafe products should be identified and 'there could be a system to restrict access to particular types of challenging products'.¹⁰ The Consumer Action Law Centre favoured an approach that would empower ASIC to regulate financial and credit products, which in its view would give ASIC more power to respond quickly to emerging problems before widespread consumer detriment occurred. The Law Centre was of the view that investment lending has been instrumental in facilitating some spectacular investment failures with catastrophic results for many consumers. It suggested that ASIC could play a role in identifying the extent to which problems in this area persist, in order

5 Mr David Haynes, Executive Manager, Policy and Research, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 20 February 2014, p. 25.

6 Mr David Haynes, *Proof Committee Hansard*, 20 February 2014, p. 35.

7 Mrs Karen Cox, Coordinator, Consumer Credit Legal Centre (NSW) Inc, *Proof Committee Hansard*, 20 February 2014, p. 41.

8 Mrs Karen Cox, *Proof Committee Hansard*, 20 February 2014, p. 40.

9 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 20 February 2014, p. 41.

10 *Proof Committee Hansard*, 20 February 2014, p. 41.

to inform any future reform program.¹¹ It referred to the UK Financial Conduct Authority (FCA) model which allows the FCA to suspend or ban potentially harmful products.

27.14 Professor Dimity Kingsford Smith cited the Westpoint and Storm collapses and the associated investor losses from transactions that were relatively complex when analysed in full. In her view, 'in some other countries they would have been limited to sophisticated investors but in Australia they could be offered to consumers'.¹² She explained further:

In particular, the Westpoint documentation contained omissions and inferences that only detailed further investigation could have uncovered the significance of, and which took legal training to fully understand. The Storm Financial statements of advice were very long and contained financial worksheets which were not easy to follow. In both cases the benefits of the investment were given much greater prominence than the risks. In both cases, as in the Opus [sic] Prime matter which involved a stock broker offering margin borrowing and stock-lending services, the types of transactions involved were traditionally seen as sophisticated or professional investor transactions, and not those usually recommended to retail investors. The risk levels, the complexity, the consequent opacity of the advice and the fact that investors did not really understand the significance of the recommendations for their longer term financial welfare, all diminished the capacity of investors to make good investment decisions with properly informed consent.¹³

27.15 Professor Kingsford Smith also cited the FCA. She noted that ASIC's powers were directed to regulating the conduct of licensees while the FCA was empowered to regulate financial and credit product themselves. In her submission, Professor Kingsford Smith noted that:

In Britain the 'Treating Clients Fairly' program of the Financial Conduct Authority allows the regulator to intervene in the design of the product, not just place a stop order on disclosure. We think there is also room for ASIC to exercise powers to prohibit the issue of certain products in retail markets, if it is thought they are too complex, risky or leveraged to be appropriate.¹⁴

27.16 With the same idea in mind, the Law Council of Australia suggested that:

... 'merits' regulation of financial products for unsophisticated investors may need to be considered in Australia. That is, unsophisticated investors might need to have a limited range of investment choices that are limited to

11 *Submission 120*, p. 8.

12 Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', *Company and Securities Law Journal* 29:5 (2011), p. 336.

13 Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', p. 336.

14 Professor Dimity Kingsford Smith, *Submission 153*, p. 8.

investments that are appropriate to their needs and circumstances or that have been approved by a regulator such as ASIC.¹⁵

27.17 The Rule of Law Institute of Australia argued that it is 'insufficient for government regulators to tell consumers and investors to be careful and self-educate themselves in the complex area of financial services, particularly when the ASIC Act itself was nearly 400 pages in length'. It also referred to the information asymmetry between vulnerable consumers and large financial corporations, which in its view, was 'too great for this kind of approach'.¹⁶

27.18 The Financial Planning Association recommended that the laws be amended 'to oblige ASIC to take a larger role in the regulatory oversight of financial products before they are released for consumer investment'.¹⁷

27.19 Finally, Mr Richard St. John's report on compensation arrangements for consumers of financial services noted the new focus by the international regulatory community on the adequacy of conduct and disclosure regimes. He noted the consideration being given 'to the possibility of a more interventionist approach with product issuers'. In his words, the aim would be 'to catch problems early on in a financial product's life cycle as a means of preventing widespread detriment to consumers'.¹⁸ He stated:

More fundamentally, it may be timely to review the adequacy of the underlying conduct and disclosure approach to the regulation of financial product issuers as the means of protecting consumers. There has now been some ten years' experience of the current approach which relies largely on the disclosure of information to consumers and sets some standards for the quality of that information. Any additional measures would be aimed at reducing the risk to consumers that they acquire financial products that are not suited to their needs. They would be preventative measures that aim to reduce consumer loss, and the eventual need for consumer compensation.¹⁹

27.20 Mr St. John suggested that:

As a matter of strategic approach, it would be timely to review the present light-handed regulation of certain product issuers, in particular managed investment schemes, including the possible need, in accord with

15 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4.

16 Rule of Law Institute of Australia, *Submission 211*, p. 7.

17 *Submission 234*, p. 31.

18 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 104.

19 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, p. 104.

developments at the international level, to move to a somewhat more interventionist approach.²⁰

27.21 In his view, it would make sense in the course of any such review 'to direct more attention to the responsibilities of licensees who provide financial products for retail clients. He recommended that as a first step, consideration might be given to measures along the following lines by which product issuers would be expected to assume more responsibility for the protection of consumers of their products:

- Subject product issuers to more positive obligations in regard to the suitability of their product for retail clients. Such obligations might be applied in particular to managed investment schemes in issuing products to the retail market, and would apply at each stage of a product's life cycle including its distribution and marketing.
- Among other things, the product issuer might be required to state the particular classes of consumers for whom the product is suitable and for whom the product is unsuitable, and the potential risks of investing in the product.
- Consider the development of standardised product labelling so that financial products, particularly managed investment schemes, are described on a consistent and more meaningful basis.²¹

ASIC's response to product regulation

27.22 Mr Medcraft recognised the problem of innovation outstripping regulation. He noted that this innovation was in complex products that are often manufactured overseas and then distributed worldwide.²² He said that ASIC would continue to take a harder line on operators that pushed complex products onto unsophisticated retail investors. In his view, the regulator would also be forced to take a more vigilant approach to market regulation as the complexity of the market had increased significantly with the advent of market competition.²³

27.23 With regard to acting quickly to stop an unsafe product, Mr Medcraft explained that ASIC issues stop orders on prospectuses, where it determines that: 'Look, this isn't good enough. I'm sorry; you want to raise money but it is not good enough until you fix it'.²⁴

20 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, p. 123.

21 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, pp. 113–14.

22 *Proof Committee Hansard*, 19 February 2014, p. 36.

23 Thomson Reuters, *Special Report: ASIC: The Outlook for Enforcement 2012–13*, p. 10.

24 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 19.

27.24 ASIC accepted that there were inherent limitations in a regulatory approach that relies solely on disclosure to address some of the problems investors face in financial markets. The effectiveness of disclosure can be undermined because:

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

27.25 ASIC noted that, internationally, regulators were looking for 'a broader toolkit' to address problems associated with the marketing of unsafe products to retail investors. For example, in some cases, action could involve 'merits' regulation of financial products. In this regard, ASIC understood that the UK FCA would continue with initiatives begun by its predecessor, the Financial Services Authority, towards 'product intervention'. The FCA would 'periodically review particular financial services market sectors and examine how products are being developed, and the governance standards that firms have in place to ensure fairness to investors in the development and distribution of products'. To assist this process, the FCA has a spectrum of temporary 'product intervention' powers, to address problems seen in a specific product. These may include rules:

- requiring providers to issue consumer or industry warnings;
- requiring that certain products are only sold by advisers with additional competence requirements;
- preventing non-advised sales or marketing of a product to some types of consumer;
- requiring providers to amend promotional materials;
- requiring providers to design appropriate charging structures;
- banning or mandating particular product features; and
- in rare cases, banning sales of the product altogether.²⁵

27.26 According to ASIC, while these tools range in degrees of intervention and, in serious cases, could include a ban on products or product features, it understands that the use of the most interventionist tools is likely to be rare. According to the FCA, the extent and intrusiveness of the rules it would make would 'be based on finding the type of intervention best fitted to the problem' it identified. It would look to find a proportionate response to the problem, based on the perceived risk to:

- consumers;

25 Rules could apply to specific products, or a class of products, and may remain in place for 12 months. ASIC, *Submission 45.2*, pp. 55–56.

- competition failings; and/or
- market integrity issues.²⁶

27.27 Having access to this range of different types of regulatory approaches, however, allows the FCA to design and implement targeted responses that are suited to achieving a particular market outcome. In ASIC's view, having a broader and more flexible regulatory toolkit would 'enhance its ability to foster effective competition and promote investor and consumer protection'. It noted that regulating product suitability was 'one type of approach that has been adopted internationally'. ASIC concluded:

As the FCA's regulatory approach is relatively new, at this stage, it is difficult to draw any settled conclusions about the positive or negative aspects of such an approach. However, the Government may wish to consider whether such a broader regulatory toolkit would be appropriate in the Australian financial regulatory system.²⁷

27.28 ASIC cited recent reforms to the Australian system of financial regulation, whereby the national consumer credit regime requires credit providers and intermediaries to assess the suitability of credit for consumers before lending takes place. A similar requirement applies under the financial services regime to margin lending facilities. ASIC suggested that the government may wish to consider extending such an approach more broadly, to encompass other financial products.

Committee view

27.29 The committee fears that Australia is out of step with international efforts to implement measures that would address problems associated with the marketing of unsafe products to retail investors. The evidence before the committee suggests strongly that urgent attention should be given to providing ASIC with the necessary toolkit that would, in Mr St John's words, 'catch problems early on in a financial product's life cycle as a means of preventing widespread detriment to consumers'.²⁸

Recommendation 57

27.30 The committee recommends that the government give urgent consideration to expanding ASIC's regulatory toolkit so that it is equipped to prevent the marketing of unsafe products to retail investors.

27.31 As a first step in this staged process, the committee notes that the current Financial System Inquiry may have a role.

26 ASIC, *Submission 45.2*, p. 56.

27 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 11.

28 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 104.

Recommendation 58

27.32 The committee recommends that the Financial System Inquiry (FSI) carefully consider the adequacy of Australia's conduct and disclosure approach to the regulation of financial product issuers as a means of protecting consumers. In particular, the FSI should:

- consider the implementation of measures designed to protect unsophisticated investors from unsafe products, including matters such as:
 - subjecting the product issuer to more positive obligations in regard to the suitability of their product;
 - requiring the product issuer to state the particular classes of consumers for whom the product is suitable and the potential risks of investing in the product;
 - standardised product labelling;
 - restricting the range of investment choices to unsophisticated investors;
 - allowing ASIC to intervene and prohibit the issue of certain products in retail markets; and
- assess the merits of the United Kingdom's Financial Conduct Authority model which allows the Authority to suspend or ban potentially harmful products.

Wholesale and retail clients

27.33 The previous discussion about unsafe financial products being available to unsophisticated retail investors also highlights the importance of retail investors being classified appropriately. Professor Kingsford Smith suggested there is an 'urgent need to review the definitions of "wholesale investor", "sophisticated investor" and "retail investor" under the legislation, so that any changes to ASIC's toolkit in the retail area can be directed at the right class of investor'.²⁹ Professor Dimity Kingsford Smith also noted:

Using wealth as a proxy of financial literacy is suitable in some cases but not in others. For example, individuals who suddenly acquire inheritance money or superannuation lump sums could be placed in a position where they might be legally classified as sophisticated clients, irrespective of their financial experience.³⁰

29 Professor Dimity Kingsford Smith, *Submission 153*, p. 8.

30 Professor Dimity Kingsford Smith, *Submission 153*, p. 19.

27.34 In April 2014, Ms Joanna Bird of ASIC told the committee that there was 'significant legal uncertainty' about what constitutes 'wholesale'.³¹ Indeed, more recently the Stockbrokers Association of Australia informed the Senate Economics Legislation Committee that the definitions of retail and wholesale clients are crucial to 'the whole structure of the regulation of financial services and financial advice'. It registered its concern that three years after submissions closed on an options paper, no final or interim proposals from the 2011 review have been announced.³²

27.35 The committee sought ASIC's advice on the requirement for a consumer to be informed of their classification as either a retail or wholesale investor and the consumer protections that go with their classification. ASIC informed the committee that a client's awareness of such a status was an issue raised in Treasury's 2011 options paper *Wholesale and Retail Clients Future of Financial Advice*. ASIC suggested that this issue 'should be considered in any changes the government may make to the law in this area following the conclusion of this review'.³³

Recommendation 59

27.36 The committee recommends that the government clarify the definitions of retail and wholesale investors.

Recommendation 60

27.37 The committee recommends that the government consider measures that would ensure investors are informed of their assessment as a retail or wholesale investor and the consumer protections that accompany the classification. This would require financial advisers to ensure that such information is displayed prominently, initialled by the client and retained on file.

Insolvency laws

27.38 Concerns about various aspects of the insolvency profession have been brought to the committee's attention during this inquiry and previous inquiries. Issues commonly raised relate to the independence of practitioners; their competence; the fees charged and whether they represent value for money; and concerns about related transactions. The committee conducted a comprehensive inquiry into the profession in 2010.³⁴ Particular liquidations and receiverships were also examined in the

31 Ms Joanna Bird, Senior Executive Leader, Financial Advisers, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 97.

32 Stockbrokers Association of Australia, *Submission 4* to the Senate Economics Legislation Committee's Inquiry into the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 [Provisions], p. 4.

33 ASIC, answer to question on notice, no. 12 (received 21 May 2014), p. 12.

34 Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, September 2010, Parliamentary Paper No. 179/2010,.

committee's 2012 inquiry into the post-GFC banking sector. However, concerns were again raised in this inquiry, this time coupled with concern about ASIC's approach to investigating allegations of misconduct. For example, the submission from Dorman Investments Pty Ltd alleged that a particular liquidator 'acted improperly' and asserted that ASIC's investigation was inadequate:

All ASIC asked us for was correspondence between us and the liquidator...This limited amount of correspondence could in no way highlight the failure to follow procedure which resulted in the liquidator auctioning property which belonged to us and giving the proceeds to creditors.³⁵

27.39 Of all the various groups of gatekeepers in the financial system, in a 2013 survey of ASIC's stakeholders insolvency practitioners received the lowest rating for perceived integrity.³⁶ The survey noted that small businesses 'were particularly negative about the integrity of insolvency practitioners'. When asked how well ASIC is holding insolvency practitioners to account, only 26 per cent rated ASIC positively. The survey results note that while there was a substantial 'don't know' response to that question (30 per cent), the 'poor' or 'very poor' rating was also the second highest.³⁷

27.40 The committee received evidence on developments since the 2010 inquiry. In its main submission, ASIC outlined some of its recent activities that relate to the insolvency profession. In 2011 and 2012, ASIC completed 180 transaction reviews, 32 reviews of a registered liquidator's entire practice, 146 reviews of declarations of relevant relationships and 64 reviews of remuneration reports. An industry-wide review of professional indemnity insurance policies held by registered liquidators was also undertaken to assess compliance against ASIC regulatory guidance. Further, ASIC has commenced publishing a series of annual reports on ASIC's regulation of registered liquidators.³⁸ ASIC also summarised its enforcement action. During this period it has obtained court orders prohibiting a Melbourne liquidator from being registered as a liquidator for five years; taken action to cancel another liquidator's registration; and has accepted four enforceable undertakings from registered liquidators.³⁹

27.41 The Australian Restructuring Insolvency and Turnaround Association (ARITA), previously known as the Insolvency Practitioners Association (IPA), also provided the committee with an update on the work it has undertaken since the committee's 2010 inquiry:

35 Dorman Investments Pty Ltd, *Submission 246*, p. [1].

36 Susan Bell Research, *ASIC Stakeholder Survey 2013: Report to the Australian Securities and Investments Commission*, September 2013, www.asic.gov.au (accessed 7 May 2014), pp. 47–48.

37 Susan Bell Research, *ASIC Stakeholder Survey 2013*, p. 53.

38 ASIC, *Submission 45.2*, p. 43.

39 ASIC, *Submission 45.2*, pp. 29, 43, 119–120.

...we have this year (2013) conducted a second major review of our IPA Code of Professional Practice, which was first issued in 2008, and which was reviewed for its second edition in 2011. This review for the 3rd edition followed an extensive consultation with our members, AFSA and ASIC, and the ATO, and other government and industry stakeholders. The Code continues to provide detailed guidance on remuneration, independence, communications, timeliness etc, which apply to all our members whether they work in corporate or personal insolvency or both. We had particular regard to recommendation 16 of the Committee's 2010 report, and have revised our remuneration report template and otherwise continued to refine our guidance to members on remuneration claims.⁴⁰

27.42 KordaMentha advised the committee that it believes there is adequate regulation and scrutiny of registered liquidators at present. However, it added that it would support changes to ASIC's powers to act on complaints against registered liquidators or to enhance the registration process if there were identified limitations to or inadequacies with these processes.⁴¹

27.43 The committee received submissions that called for more fundamental changes to how large corporate insolvencies are undertaken. Levitt Robinson Solicitors argued that Australia should adopt the US framework known as chapter 11⁴² that 'puts recovery ahead of burial'. Levitt Robinson provided the following description of the process:

Under the US Bankruptcy legislation, using Chapter 11, the directors of an insolvent company may submit a Plan of Reorganisation to the unsecured creditors to be approved by the US Bankruptcy Court. The Court then supervises compliance with the Plan. So long as the security of the secured creditors is protected, the secured creditors (usually banks) are bound by the Plan of Reorganisation and have to stand back.

Where the Plan of Reorganisation fails, a trustee may be appointed in Chapter 7, to assume a role like that of a liquidator. Even then though, the trustee is more regularly and genuinely accountable to the Courts than an Australian liquidator is in practice.⁴³

27.44 The chairman of ARITA, Mr David Lombe, noted that the previous government considered some reforms intended to harmonise regulation and give more powers to creditors. However, he commented that the proposal did not deal with significant issues, such as whether a chapter 11 framework should be considered in Australia, or ipso facto clauses in contracts that can prevent an insolvent business

40 Insolvent Practitioners Association (now ARITA), *Submission 202*, p. 2.

41 KordaMentha, response to *Submission 276*, correspondence to the committee dated 10 December 2013, p. 2.

42 Chapter 11 refers to chapter 11 of the United States Bankruptcy Code, which provides for the reorganisation of a corporation or partnership.

43 Levitt Robinson Solicitors, *Submission 276*, p. 1.

from being sold or restructured.⁴⁴ In his view, major insolvency reform proposals 'could be higher on ASIC's list of things that they are looking at'.⁴⁵

27.45 At a Senate estimates hearing conducted while this inquiry was underway, ASIC was asked about the chapter 11 framework. Mr Medcraft described chapter 11 as 'a very good system':

Having lived for a decade in the United States and worked as a banker, I will say that basically the difference between our current regime, fundamentally, and chapter 11 is that chapter 11 retains management with the company, as opposed to handing the management to an insolvency expert. It also means that basically everything is frozen—labour contracts, financial contracts—such that the company's management can go away and negotiate and try to put the company back on a solid footing...frankly, I believe it is a very good structure. I have always been a supporter of it, because I think it significantly mitigates the loss of value that results from essentially going in and just selling up whole entities. Also, I think it is far less harmful in terms of job losses and general destruction of value...But the most important thing is that you retain the management. Often we see with companies that the issue is its financial structure, not necessarily its management. And I know from my time as a banker that often the company may be being lumbered with too much leverage or contractual commitments. This gives a chance for that to be sorted out.⁴⁶

27.46 Mr Medcraft added that an impediment to considering a framework based on chapter 11 in Australia was the court system, as the courts would need judges with 'good commercial experience to be able to undertake this'.⁴⁷ The chairman of ARITA, however, disagreed with the assessment about the court's expertise:

I would refer you to a matter that I was involved in. The organisation was called United Medical Protection, which was a medical insurer who insured about 60 per cent of Australian doctors. Basically, medical services ceased at that particular point. In relation to that matter, it was a chapter 11 in Australia, being run by me as a provisional liquidator using the provisional liquidation regime and being carried out by a Supreme Court judge, Justice Austin. That was very much a situation where, effectively, for all intents and purposes you had a chapter 11 running in Australia...I have found first hand, in dealing with Justice Austin, that our judges are very capable of

44 Mr Lombe explained that ipso facto clauses in contracts can 'cause the liquidator or the voluntary administrator to lose the power to have a lease in respect of a store or a property, which then means that you cannot sell the business or restructure it'.

45 Mr David Lombe, President, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 31.

46 Mr Greg Medcraft, Chairman, ASIC, *Senate Economics Legislation Committee Hansard*, Estimates, 26 February 2014, p. 30.

47 Mr Greg Medcraft, Chairman, ASIC, *Senate Economics Legislation Committee Hansard*, Estimates, 26 February 2014, p. 30.

dealing with it. In the US they have a separate bankruptcy court, but I do not believe that that is a major issue.⁴⁸

27.47 ARITA outlined some of the arguments commonly made against a chapter 11 framework, with its chairman noting that chapter 11 was 'not necessarily a popular thing' in Australia's insolvency profession. Potential problems include that the chapter 11 process can be very expensive. Also, different attitudes to corporate failure in Australia compared to the US may make it difficult to leave a company in the hands of the existing management or directors, the people clearly associated with the company's difficulties, while restructuring occurs.⁴⁹ However, in Mr Lombe's view, the process could work effectively in Australia and that 'we do not need to adopt holus-bolus the situation in the US'.⁵⁰

27.48 Possible options for improving the operation of the current regulatory regime were also suggested. ARITA argued that inconsistencies in the approach of the two regulators most relevant to its members, ASIC and the Australian Financial Security Authority (AFSA), should be addressed. ARITA provided the following insight into insolvency practitioners' experience in dealing with ASIC and AFSA:

In daily practice, around 200 of our members are regulated by AFSA in relation to personal insolvency, and around 600 of our members are regulated by ASIC in relation to corporate insolvency. A significant portion of these members are regulated by both ASIC and AFSA. Each regulator has its own guidance and regulatory requirements, which are not necessarily consistent, or at least which are issued without reference to the other. Our members are the subject of separate file audits and review by each of ASIC and AFSA.

While this is to an extent dictated by the separate laws that Australia has for personal and corporate insolvency, many of the regulatory issues are common to both, for example remuneration, independence and communications with creditors. It is also a regulatory burden on our members.⁵¹

27.49 Another issue raised was the fees charged by liquidators. Mr Medcraft recently suggested that there is 'a lot of logic' to capping fees charged in relation to small businesses. He explained:

At the big end of town it is about basically trying to avoid destruction of value. I think at the small end of town it is about making sure small creditors are protected...[I]t is a matter of policy for government...But I think some form of scaled fees should be something that should be considered, because, when you think about it, any bankruptcy is a function

48 Mr David Lombe, President, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 32.

49 Mr David Lombe, President; Mr Michael Murray, Legal Director, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 32.

50 Mr David Lombe, President, ARITA, *Proof Committee Hansard*, 2 April 2014, p. 32.

51 Insolvency Practitioners Association (now ARITA), *Submission 202*, p. 3.

of the size of assets, the number of employees. If you look at it, there is clearly correlation between what should be the activity that is undertaken and what you have to deal with. So I think there should be some analysis, and I think if you have scaled-free arrangement, then you have swings and roundabouts for insolvency practitioners. They might not make a lot of money on one, and they might make money on the other. But at least that gives some certainty to creditors that there is some form of rationale to the fee. And I think also it encourages efficiency in terms of the process. And we have scaled fees in other areas, so I do think it is something that is worth examining. Frankly, it is not rocket science. You should be able to work out a scaled fee based on the main metrics related to the work. It is sort of common sense.⁵²

Committee view

27.50 Clearly, the conduct of liquidations in Australia is still subject to strident criticism and the source of much dissatisfaction. In response to a 2010 inquiry into insolvency practitioners conducted by this committee, the previous government prepared draft legislation aimed to modernise the current regulatory framework. The committee urges the current government to progress these reforms and to consider whether further legislative changes are required.

27.51 In addition, the committee is of the view that further consideration should be given to the overall structure and intent of Australia's corporate insolvency laws and whether the current laws are appropriate for encouraging turnarounds and restructuring in large corporate insolvencies. Particular consideration should be given to elements of the chapter 11 regime in place in the United States that could work in the Australian environment, and whether it would be desirable to adopt some of that framework here.

Recommendation 61

27.52 The committee recommends that the government commission a review of Australia's corporate insolvency laws to consider amendments intended to encourage and facilitate corporate turnarounds. The review should consider features of the chapter 11 regime in place in the United States of America that could be adopted in Australia.

52 Mr Greg Medcraft, Chairman, ASIC, *Senate Economics Legislation Committee Hansard*, Estimates, 26 February 2014, p. 31.

Boiler room scams

27.53 The committee received a number of submissions from victims of boiler room scams that operated from overseas jurisdictions. One victim, Mr Ian Painter told the committee:

My funds were lost as part of a scheme run by a Group known as the Brinton Group which operated very successfully until they were subject to a raid by Thai SEC authorities on 26 July 2001. Official estimates of losses for the Brinton Group scam alone were in excess of \$100 million. Based on the work done by me the number is much greater than this and is, in my view, probably well in excess of \$200 million.⁵³

27.54 The Brinton Group were cold calling victims in Australia and selling them non-existent shares. Payment for the shares were made to an account in Hong Kong.⁵⁴ Most of these victims never saw their money again.

27.55 ASIC was first made aware of the Brinton Group in 1999 and did take a number of steps to warn the public about this and other boiler room scams. These included issuing 18 media releases between 1999 and 2002, attending investment expos and working with overseas authorities in Thailand, Hong Kong and the United States to encourage them to take action against those responsible for the scams.⁵⁵

27.56 Despite these measures there is a perception among some victims that ASIC could or should have done more to assist in the investigation and the recovery of lost funds. These concerns were discussed during the committee's public hearing on 10 April 2014:

Senator XENOPHON: What my constituent told me, and I think he spent a lot of time on this, is that he managed with a group of private individuals who were scammed in the Brinton scam to get the funds frozen in Hong Kong and he ultimately received some of the lost funds back, along with the group of people who worked together. I guess their complaint that has been put to me, and I want to put this fairly to you, is that they managed through their own efforts to recover some of the funds but they felt that ASIC was unwilling or unable to do so. That is the nature of the criticism. I wanted to put that to you so that you could have a chance to respond to it.

Mr Mullaly: I think perhaps the critical word that you used there is 'unable' as opposed to 'unwilling'. Our view and the view on advice that we received was that we were unable recover the funds from Hong Kong. That has been the case in other matters as well. As I say, we investigated another quite sophisticated cold-calling scam between January 2006 and March 2007 in which the perpetrators opened up seven different entities to undertake the

53 Mr Ian Painter, *Submission 167*, p. 1.

54 Mr Adrian Cox, *Submission 91*, p. 3.

55 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 99.

fraud. In that matter we were able to freeze money in Australia and we were able to get people arrested in various countries, including in Hong Kong. We were able to recover some money from Singapore and from Malaysia but we were not able to recover the funds that were frozen in Hong Kong.⁵⁶

27.57 ASIC explained that a major impediment to it taking action to recover money on behalf of the victims is the requirement that only parties to a contract have standing to bring a civil action in Hong Kong.⁵⁷

27.58 It is understandable that victims, particularly those of the Brinton Group, would be frustrated to see ASIC recovering funds in some instances but not in others. Victims were further frustrated that no attempts were made to extradite those responsible for the fraud so that they would face criminal or civil charges in Australia.⁵⁸ As expressed by Mr Painter:

I have corresponded with many authorities worldwide in my pursuit of the Brinton Group (and others) and there is a common theme that due to the cross jurisdictional issues and a lack of desire for the authorities to work together in the pursuit of these perpetrators, it seemed to be just too hard for the various authorities to pursue prosecution.⁵⁹

27.59 ASIC also told the committee 'it is very difficult to take effective enforcement action in these matters because the acts occurred in a number of different jurisdictions'.⁶⁰

27.60 Victims and ASIC alike appear to be frustrated by the difficulties in pursuing those responsible for fraud when multiple jurisdictions are involved. However, given the increasing ease with which financial transactions can take place between different countries, it is likely more Australians will fall victim to scams such as the Brinton Group in the future. Mr Painter sounded this ominous warning:

...until ASIC or some other Australian authority takes action to pursue the perpetrators of cold calling and other scams, Australia will continue to be ripe pickings for such criminals.⁶¹

Committee view

27.61 Greater consideration must be paid as to how ASIC can improve its ability to assist victims of international fraud by way of fund recovery and extradition.

56 Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement, ASIC, *Proof Committee Hansard*, 10 April 2014, pp. 100–01.

57 Mr Peter Kell, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 101.

58 Mr Adrian Cox, *Submission 91*, p. 6.

59 Mr Ian Painter, *Submission 167*, p. 3.

60 ASIC, answer to question on notice, no. 11, received 21 May 2014, p. 16.

61 Mr Ian Painter, *Submission 167*, p. 8.

Chapter 28

Concluding comments

28.1 Given the important roles that ASIC undertakes, an inquiry into its performance is overdue. The committee is pleased that ASIC constructively engaged with this inquiry and recognised the value of it, as the following statement by its chairman demonstrates:

...we welcome the inquiry into ASIC's performance. This has been a rigorous inquiry and it has allowed many Australians to have their say. It is an inquiry that ASIC has taken very seriously, and it is one to which we have devoted substantial resources. We are grateful that so many people have provided submissions to the inquiry, and we have closely considered all of the submissions in an effort, most importantly, to learn as much as we can from them.¹

28.2 In performing its regulatory roles, ASIC seeks to promote confident and informed investors and financial consumers, fair and efficient financial markets, and efficient registration and licensing. These are challenging tasks, particularly given the complex and difficult environment ASIC operates in. The committee appreciates that a regulator like ASIC is always going to disappoint someone. It will never have the resources necessary to act on every allegation of misconduct. Nevertheless, it is vital that participants in the financial system consider that the same rules will apply to everybody. Appropriate regulations enforced by a tough and responsive regulator will help promote public and international confidence in investing in Australia.

28.3 As a final chapter, the committee considered it would be useful to provide some additional comments about the recommendations that specifically relate to how ASIC operates. The majority of the committee's recommendations are designed to help ASIC become a self-evaluating and self-correcting organisation: a harsh critic of its own performance with the drive to identify and implement improvements. The recommendations recognise the need for ASIC to become a far more proactive regulator, ready to act promptly but fairly. With this aim in mind, the recommendations are intended to strengthen ASIC in several key ways.

28.4 A main objective is to improve ASIC's understanding and appreciation of Australia's corporate environment and those it regulates, and to ensure that ASIC has access to independent, external expertise. ASIC needs to be alert to emerging business models or new financial products and to match the inventiveness and resourcefulness of those in the industry who seek to circumvent the law. In this regard, the committee considers that ASIC should more effectively tap into the experience, knowledge and insight of retired and highly respected business people, legal professionals, academics

1 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 10 April 2014, p. 67.

and former senior public servants to help it identify and minimise risks that have the potential to cause significant investor or consumer harm.

28.5 Recommendations are also aimed at encouraging more information to be provided to ASIC, and for this information to be utilised more effectively. Building the analytical skills within ASIC necessary to discern early warning signs of unhealthy trends or troubling behaviour is a key goal. Australia needs a corporate and financial services regulator that has the analytical and investigative skills required to identify and act on problems early. ASIC should establish an internal system and encourage a receptive internal culture that will ensure that misconduct reports or complaints indicative of a serious problem lodged with ASIC are elevated to the appropriate level and receive due attention. The committee also believes that the corporate whistleblowing regime needs to be strengthened to encourage whistleblowers to come forward. Informed individuals need to be confident that they can report alleged misconduct, potentially unsafe products or dubious practices in Australia's corporate world.

28.6 Given the resource constraints and knowledge gaps that a body like ASIC will always encounter, the committee has also designed recommendations intended to make the regulatory system more self-enforcing, allowing ASIC to concentrate on key priorities and trouble areas. To achieve this, first ASIC needs to work effectively with other industry and professional bodies that share ASIC's goals. In particular, ASIC needs to ensure it has strong, constructive and cooperative relationships with all of the financial system gatekeepers. ASIC could also work with companies to strengthen their internal compliance regimes and their systems for reporting non-compliance to ASIC. Finally, ASIC should be primarily funded through a user-pays system of industry levies designed to reflect the cost associated with regulation and incentivise sectors to minimise the attention the regulator needs to devote to them. Again, more effective self-regulation will allow ASIC to focus on and more effectively deal with egregious misconduct.

28.7 ASIC's communication with members of the community needs to improve. In particular, the evidence taken by this committee reveals that ASIC must be more responsive and sensitive to the concerns of retail investors and consumers. Expectations about what ASIC can do also need to be appropriately managed. In this regard, steps to improve the level of financial literacy in Australia will, in the long-term, help to limit the number of people that encounter difficulties and turn to ASIC. The committee acknowledges ASIC's existing work in this area and urges ASIC to intensify its efforts.

28.8 ASIC's enforcement role is one of its most important functions. ASIC needs to be respected and feared. It needs to send a clear and unmistakable message, backed-up and continually reinforced by actions, that ASIC has the necessary enforcement tools and resources and is ready to use them to uphold accepted standards of conduct and the integrity of the markets. However, the resolution of a particular matter through enforcement action is not the end of the process—ASIC needs to ensure that a culture of compliance results from the enforcement action. For example,

when ASIC accepts an enforceable undertaking, it needs to have a mechanism in place that will provide assurances to the public that the desired changes have indeed taken place and that the entity has introduced safeguards that would prevent similar misconduct from recurring. The transparency associated with enforceable undertakings should also be enhanced; in particular, the report of an independent expert appointed as a result of an undertaking should be made public. On the other hand, when ASIC is unsuccessful in enforcement action it needs to reflect and learn what it can from the case.

28.9 The cases of misconduct in the financial advice industry and ASIC's evidence regarding the regulatory gaps in that industry have convinced the committee that various changes need to occur. The recommendations seek to improve the overall standards in the sector and provide ASIC with greater information and powers regarding problem advisers. For example, ASIC should be able to ban someone from managing a financial services business if ASIC has already banned them from directly providing financial services.

28.10 The committee also considered ways for ASIC to become more accountable and transparent. Increased transparency of its operations and how its functions are performed would be appropriate and may avoid accusations of the regulator being captured by big business. Some of the changes are straightforward, such as ASIC publishing more of its internal policies. ASIC also should keep the business and academic worlds better informed about developments and trends in corporate Australia by providing and disseminating information it receives from a range of sources, as well as ASIC's analysis of this information.

28.11 Finally, the committee considered the range of tasks ASIC performs. It is overburdened and charged with tasks that do not assist its other regulatory roles. The committee is of the view that ASIC's registry function should be transferred elsewhere to allow ASIC to concentrate on its core functions.

28.12 The recommendations developed by the committee are intended to address gaps in the legislative and regulatory framework and to encourage ASIC to consider how its performance can be improved. The committee strongly believes that these recommendations will allow ASIC to fulfil its legislative responsibilities and obligations more effectively. However, many of the issues with ASIC's performance cannot be addressed by anyone other than ASIC. In the committee's opinion, ASIC has been in the spotlight far too frequently for the wrong reasons. It is acknowledged that not all of the criticisms levelled at ASIC are justified; ASIC is required to perform much of its work confidentially and to ensure natural justice. It is also constrained by the legislation it administers and the resources given to it for this purpose. Nevertheless, the credibility of the regulator is important for encouraging a culture of compliance. That ASIC is consistently described as being slow to act or as a watchdog with no teeth is troubling.

28.13 This inquiry has provided many with the opportunity to have their say on ASIC's performance. It has made possible many valuable discussions about corporate

and financial services regulation in this country. The recommendations developed by the committee will lead to a more effective regulator. In addition, the committee believes that this inquiry has been a wake-up call for ASIC. The committee looks forward to seeing how ASIC changes as a result.

Senator Mark Bishop
Chair

Additional Comments (Dissenting Report) by Deputy Chair, Senator David Bushby

1.1 I recognise that the complaints, misconduct and policy issues raised in the course of the inquiry are serious matters of public importance and warrant detailed analysis and response.

1.2 The confidence in Australia's corporate, markets and financial services regulator—ASIC—is vital to the economic wellbeing of the nation. ASIC's key role is to make certain Australian financial markets are fair and transparent, and that Australian investors and consumers are kept well informed so as to support investor decision making and to maintain confidence in those markets.

1.3 The balance for government and parliament is to ensure regulation is sufficient to protect consumers and maintain confidence in the market but not so onerous as to deter informed risk-taking investment and thereby harm economic activity.

1.4 On balance, I do not agree that the majority report has got this balance right and the conclusion drawn cannot be supported in full.

1.5 Whilst some of the recommendations are sensible—indeed corresponding improvements have already been undertaken independently by ASIC or are under contemplation—some of the recommendations cannot be supported or require significant further consideration.

1.6 These additional comments (dissenting comments) do not seek to address every recommendation in the main report. It will address three central areas where I consider that the recommendations of the majority cannot be supported in part, or in full, in their current form.

General recommendations surrounding the operation of ASIC

1.7 The report makes a number of recommendations regarding the operation of ASIC. I believe that these recommendations should be informed by the wider inquiry that has been announced by government into the financial market system—the Financial System Inquiry (FSI). The FSI will have the resources of government, will be able to consider the impact of regulation in a holistic fashion, will be able to look at the interaction of regulators and any weaknesses revealed since the last significant inquiry in 1997.

1.8 The FSI terms of reference are comprehensive:

The Inquiry is charged with examining how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth.

Recommendations will be made that foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, public confidence and capacity to meet the needs of users.¹

1.9 In particular the terms of reference deal directly with the question of regulation:

2. The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including:

1. balancing competition, innovation, efficiency, stability and consumer protection;
2. how financial risk is allocated and systemic risk is managed;
3. assessing the effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry and among users;
4. the role of Government; and
5. the role, objectives, funding and performance of financial regulators including an international comparison.²

1.10 In addition it was clear from the evidence given by ASIC that some of the changes recommended by the committee majority have already been commenced or are being considered.

1.11 In these circumstances, I believe it is prudent to examine the further changes already underway within ASIC in the context of the wider FSI, and for parliament to consider changes presented by the government following the FSI.

Cost recovery charging by ASIC

1.12 Considerable thought needs to be given to any changes to the manner in which ASIC is funded, noting that changes potentially have broader consequences and could vary significantly from current practices. Despite this, there are clear advantages in considering change as canvassed in the majority report, from two key perspectives.

1.13 First, enabling ASIC to levy its fees to reflect the effort involved by ASIC in performing its regulatory functions is good practice, more equitable and fosters appropriate rational responses from regulated entities consistent with regulatory aims.

1.14 Secondly, if changes to ASIC's funding extended to enabling it to set its fees to cover its costs, without the need for it to rely on the government's annual budgetary process, it would introduce a degree of independence from government that could also deliver various desirable outcomes, helping ensure that the executive of the day could

1 Financial System Inquiry, <http://fsi.gov.au/terms-of-reference/> (accessed 23 June 2014).

2 Financial System Inquiry, <http://fsi.gov.au/terms-of-reference/> (accessed 23 June 2014).

not utilise funding ties to influence corporate regulatory outcomes for political reasons.

1.15 However, for these advantages to be realised, careful consideration is required to address a number of challenges.

1.16 The government—through the parliament—is currently responsible for setting the budget for agencies funded through taxes or levies.

1.17 If the government were simply to adopt a cost recovery model for ASIC, its appropriation would continue to be determined by the government and be subject to government budget policies and processes, including NPPs, efficiency dividends, and gross spending limits.

1.18 Cost recovery would merely facilitate the way in which revenues are determined to match the appropriation.

1.19 If an agency were possibly able to self-determine its own funding envelope through another funding mechanism, it could act on self-interest to expand its own regulatory reach and would be less accountable for its level of intrusion into community life and the economy. For that reason, any such approach would of necessity require appropriate third party assessment and approval of ASIC budgets.

1.20 Such an approach would also conflict with the long-accepted right of the government, acting under the scrutiny of parliament, to determine the scale and scope of an agency and its activities, in this case the costs incurred by business as a result of interactions with that agency.

1.21 As such, I consider any movement to a full cost-recovery model should be considered as part of the FSI.

1.22 The funding model of ASIC is in scope for review in the Financial System Inquiry.

Whistleblower protections

1.23 It is clear that the current protections afforded to private sector whistleblowers can be improved.

1.24 ASIC has stated that it could have responded better to whistleblowers who came forward in relation to the Commonwealth Financial Planning Limited matter, and has since taken action to update its procedures to improve the way it identifies and communicates with potential whistleblowers.

1.25 The Corporations Act protects employees, officers and contractors where they report suspected breaches of the corporations legislation to either ASIC, the company's auditor, or internally within the company.

1.26 ASIC has undertaken an internal review and updated its existing approach to dealing with whistleblowers in order to improve the way it identifies and communicates with potential whistleblowers:

...in particular I would like to mention our plans for dealing with whistleblowers. We have been working on dealing with our whistleblowers. Changes we are implementing include: establishing whistleblower liaison officers within all ASIC teams; staff will soon be receiving training in misconduct and breach recording and on awareness, whistleblower protections and handling whistleblower complaints; providing better, clearer and more regular communication to whistleblowers during investigations; and conducting a stocktake of matters involving whistleblowers to ensure they are getting appropriate priority.³

* * *

Yes, we certainly do recognise that whistleblowers may be vulnerable in certain situations and that there are some protections for them under the law. Our submission advocates an expansion of who qualifies for protection as a corporate whistleblower and also when we must produce documents in court revealing whistleblowers' identities. We are advocating additional protections there, in part because we do recognise the particular difficulties that whistleblowers face. We have also just announced some changes to our internal processes that are clearly aimed at improving the sort of interaction, communication and support that we can provide whistleblowers.⁴

1.27 ASIC's enhanced approach to whistleblowers encompasses its dealings with 'insiders' who seek to provide information to ASIC but who are not corporate whistleblowers (e.g. because they are no longer an employee of the company involved at the time they make the disclosure, or because they do so anonymously).

1.28 Given that the approach of ASIC has changed, but that specific protections may be required, I specifically endorse recommendation 14 of the report, whilst noting that recommendations 12, 13, 15, 16 should be considered as part of a government initiated review of whistleblower protections.

Further Inquiry, Judicial Inquiry or Royal Commission

1.29 There is no doubt that there was a failure of governance when it came to operations of certain advisors related to the Commonwealth Bank of Australia (CBA).

1.30 In fact CBA in its evidence clearly made such an admission:

Commonwealth Financial Planning Limited acknowledges that in the past a small number of its Advisers, none of whom remain with CFP, provided inappropriate advice to some customers.

3 Mr Greg Medcraft, Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 2.

4 Mr Peter Kell, Deputy Chairman, ASIC, *Proof Committee Hansard*, 19 February 2014, p. 25.

CFP deeply regrets that some of its customers were impacted in the past by poor advice they received from those Advisers.

CFP has no tolerance for behaviour that prejudices the financial wellbeing of its customers.

CFP acknowledges that a number of customers suffered financial losses as a result of inappropriate advice they received from certain Advisers.

These regrettable events are firmly in the past and CFP has taken decisive action to:

1. Investigate the quality of advice provided to customers;
2. Compensate customers who were adversely affected commencing in 2010;
3. Work closely with the Australian Securities and Investment Commission (ASIC) to remediate customers;
4. Have the remediation verified by an independent accounting firm;
5. Assist in funding independent legal or qualified financial advice for affected customers with respect to compensation;
6. Co-operate with ASIC, which took action to ban seven Advisers;
7. Enter into an enforceable undertaking with ASIC; and
8. Fundamentally transform its financial advice business.⁵

1.31 In response to its acknowledged problems CBA has made significant restitution:

Compensation payments totalling \$51 million have been paid to 1,127 customers. The remaining customers reviewed either received appropriate advice or suffered no loss from the inappropriate advice they received.⁶

1.32 Compensation payments totalling \$51 million have been paid to 1,127 customers. The remaining customers reviewed either received appropriate advice or suffered no loss from the inappropriate advice they received.

1.33 The governance failures linked to CBA were exacerbated by the fact that ASIC did not apply two important aspects of the compensation arrangements relating to Commonwealth Financial Planning Limited (CFPL) and Financial Wisdom Limited (FWL) to **all** affected clients.

The specific aspects related to:

- not all clients being initially consulted regarding compensation; and
- not all clients being offered \$5,000 to obtain independent advice.

5 Commonwealth Bank of Australia Group, *Submission 261*, p. 4.

6 Commonwealth Bank of Australia Group, *Submission 261*, p. 9.

1.34 As a result, ASIC has announced that it will impose specific license conditions on CFPL and FWL to address concerns around these issues.

1.35 A Royal Commission is primarily intended to undertake a fact-finding mission, however, the issues proposed to be examined here have already been extensively reviewed—including by ASIC, the CBA, the police and the committee.

1.36 Although a Royal Commission might recommend improved practices, existing institutions have already been at work exploring and driving wide-scale reform in the financial sector. ASIC's investigation into CFPL also predates the substantial changes to the regulation of financial advice under the Future of Financial Advice (FOFA) reforms, which have imposed strong obligations on advisers to prioritise their clients' interests over their own and to act in their clients' best interests. In addition, ASIC's actions have greatly transformed the practices, culture, compliance and quality of advice provided through CFPL as well as delivering \$51 million in compensation to date, with the potential for additional compensation to over 4,000 people under the new license conditions.

1.37 Given these circumstances, and given that the law has changed and will possible change again following the FSI, a Royal Commission or any other inquiry will incur significant cost to taxpayers without delivering any greater level of understanding or financial restitution. A fresh review of files and individual cases could protract the emotional strains on victims of malpractice over a longer time period, without the advantage of offering additional remedies beyond those that are already being worked through.

1.38 In fact it could raise false hopes that further compensation may become available.

1.39 On this basis I do not support recommendation 7 of the report.

Senator David Bushby
Deputy Chair

Additional Comments by the Australian Greens

1.1 The Australian Greens agree with the vast majority of recommendations and direction taken by the committee's inquiry into the performance of the Australian Securities and Investment Commission (ASIC).

1.2 It is important to note that the inquiry's recommendations call for an increase in activity by ASIC across their roles and responsibilities. This inquiry report comes after the recent Federal Budget which cut funding to ASIC. The Government should implement most of the recommendations in the report and ensure ASIC is appropriately resourced.

1.3 The Australian Greens are keenly interested in the results of the Government's scoping study into privatisation of ASIC's company registry. The Greens will not support any registry model which limits transparency and makes it more difficult and expensive to search a company's shareholders and directors and in the case of public companies, access financial details in annual returns loans and offer documents.

1.4 The Australian Greens disagree with recommendation 41 concerning the commissioning of an inquiry into the current criminal and civil penalties available across the legislation ASIC administers. This inquiry into the performance of ASIC has been extensive and it is clear from ASIC's evidence that they believe penalties are insufficient. On 20 March 2014, ASIC released a comparison of penalties available to ASIC and those available to its foreign counterparts, other Australian regulators and across the legislation ASIC administers. It concluded that:

- while ASIC's maximum criminal penalties are broadly consistent with those available in other countries, there are significantly higher prison terms in the US, and higher fines in some overseas countries for breaches of continuous disclosure obligations and unlicensed conduct—for example, the fine for individuals for unlicensed conduct in Australia is \$34,000, whereas in Hong Kong it is \$720,000; in Canada it is \$5.25 million; in the United States it is \$5.6 million; and in the United Kingdom there is no limit on the maximum fine;
- there is a broader range of civil and administrative penalties in other countries, and the penalties are higher (see Table 23.1);
- the maximum civil penalties available to ASIC are lower than those available to other Australian regulators and are fixed amounts, not multiples of the financial benefits obtained from wrongdoing; and
- across ASIC's regime there are differences between the types and size of penalties for similar wrongdoing (for example, ASIC noted that providing

credit without a licence can attract a civil penalty up to ten times greater than the criminal fine for providing financial services without a licence).¹

Recommendation 1

1.5 The Australian Greens believe a new inquiry across the current criminal and civil penalties is not needed; instead the government should immediately consult with ASIC and bring forward legislation that strengthens Australia's civil and criminal penalties which at minimum should bring them into line with global benchmarks.

Senator Peter Whish-Wilson

1 ASIC, 'ASIC reports on penalties for corporate wrongdoing', *Media Release*, no. 14-055, 20 March 2014; ASIC, Report 387, pp. 16–17.

Appendix 1

Submissions received

| Submission Number | Submitter |
|--------------------------|---|
| 1 | Confidential |
| 2 | Mr Peter Mair <ul style="list-style-type: none">• response received from NRMA Insurance |
| 3 | Ms Ann Marie Delamere <ul style="list-style-type: none">• 2 supplementary submissions |
| 4 | Confidential |
| 5 | Confidential |
| 6 | Mr and Mrs Neil and Deb Toplis <ul style="list-style-type: none">• supplementary submission |
| 7 | Mr Timothy Chapleo |
| 8 | Mr and Mrs Graeme and Nat Powell |
| 9 | Mr Ken Powell <ul style="list-style-type: none">• 2 supplementary submissions |
| 10 | Name Withheld |
| 11 | Confidential |
| 12 | Name Withheld |
| 13 | Name Withheld |
| 14 | Name Withheld |
| 15 | Ms Hifumi Robbie |
| 16 | Name Withheld <ul style="list-style-type: none">• supplementary submission |
| 17 | Name Withheld |
| 18 | Name Withheld |

19 Name Withheld

20 Name Withheld

- 3 supplementary submissions

21 Name Withheld

22 Name Withheld

23 Mr Spencer Murray

- supplementary submission

24 Mr and Mrs Robert and Belinda Hunter

25 Name Withheld

26 Name Withheld

- 2 supplementary submissions

27 Name Withheld

28 Name Withheld

29 Name Withheld

30 Ms Mary Green

31 Name Withheld

32 Name Withheld

33 Name Withheld

34 Name Withheld

35 Name Withheld

36 Confidential

37 Name Withheld

38 Name Withheld

39 Name Withheld

40 Name Withheld

41 Mr Lucas Vogel

42 Name Withheld

- 43 Name Withheld
- 44 Mr and Mrs Alan and Jo-Anne Harding
- 45 Australian Securities and Investments Commission
- 8 supplementary submissions
- 46 Name Withheld
- 47 Name Withheld
- 3 supplementary submissions
- 48 Mr Boris Sharff
- 49 Mrs Caroline Baker
- supplementary submission
- 50 Mr Mark-Andrew Pearson
- response received from ING Direct
- 51 Name Withheld
- supplementary submission
- 52 Confidential
- 53 Confidential
- 54 Confidential
- 55 Name Withheld
- supplementary submission
- 56 Name Withheld
- supplementary submission
- 57 Confidential
- 58 Confidential
- 59 Confidential
- 60 Name Withheld
- 61 Name Withheld
- 2 supplementary submissions

62 Name Withheld

- supplementary submission

63 Ms Jean Andersen

64 Name Withheld

- supplementary submission

65 Name Withheld

66 Name Withheld

67 Confidential

68 Confidential

69 Confidential

70 Confidential

71 Mr and Ms Dale and Faith Burns

72 Name Withheld

73 Name Withheld

74 Name Withheld

75 Ms Susan Field

76 Name Withheld

77 Name Withheld

78 Name Withheld

79 Ms Jenny Christophers

- supplementary submission

80 Mr and Ms Greg and Janice Ellen Cadwallader

81 Name Withheld

82 Name Withheld

83 Confidential

84 Mr and Ms John and Beverley Ellison

85 Mr Tom Azzi

86 Confidential

87 Mr Sean Mcardle

88 Name Withheld

- response received from Ms Denise Brailey

89 Mr Maxwell Morris

90 Mr Peter Dunell

91 Mr Adrian Cox

- 4 supplementary submissions

92 Mr and Mrs Stuart and Cindy Cortis

- response received from RHG Home Loans

93 Name Withheld

- supplementary submission

94 Mr Roger Cooper

95 Mr Martin McParland

96 Mr Stephen Lake

97 Mr Paul Penberthy

98 Burke Bond Financial Pty Ltd

99 Global Metal Exploration Action Group

100 Confidential

101 Name Withheld

102 Name Withheld

103 Mr and Mrs Ray and Christine Blackman

104 Mr Graham Filmer

- 3 supplementary submissions

105 Mr Dan McLean

106 Ms Anne Lampe

107 Mr Ray Bricknell

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|-----|---|
| 108 | Name Withheld |
| 109 | Name Withheld |
| 110 | Name Withheld |
| | • supplementary submission |
| 111 | Ms Florence Lunn |
| 112 | Mr H. van de Berg |
| 113 | Name Withheld |
| | • supplementary submission |
| 114 | Australian National Audit Office |
| 115 | Mr John Donkin |
| 116 | Mr Jason Harris |
| 117 | Association of Financial Advisers |
| 118 | Australian Financial Security Authority |
| 119 | Australian Institute of Company Directors |
| 120 | Consumer Action Law Centre |
| 121 | Professor Justin O'Brien and Dr George Gilligan |
| 122 | ASX Group |
| 123 | Dr Kath Hall |
| 124 | Name Withheld |
| | • 2 supplementary submissions |
| 125 | Community and Public Sector Union |
| 126 | State Super Financial Services Australia Ltd |
| 127 | Mr Frazer McLennan |
| 128 | Dr Stuart Fysh |
| | • supplementary submission |
| 129 | Mr Justin Brand |
| 130 | Mr Lindsay Johnston |

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|-----|---|
| 131 | Mr David White |
| 132 | Mr Peter Leech |
| 133 | Name Withheld |
| 134 | Name Withheld |
| 135 | Name Withheld |
| | <ul style="list-style-type: none">• 2 supplementary submissions• response received from Redland City Council |
| 136 | Australian Institute of Superannuation Trustees |
| 137 | Governance Institute of Australia |
| 138 | Mr Bill Doherty |
| | <ul style="list-style-type: none">• supplementary submission |
| 139 | Mr Andrew Fetz |
| 140 | Dr Marina Nehme |
| 141 | Name Withheld |
| 142 | Name Withheld |
| 143 | Name Withheld |
| | <ul style="list-style-type: none">• supplementary submission |
| 144 | Name Withheld |
| | <ul style="list-style-type: none">• supplementary submission |
| 145 | Name Withheld |
| 146 | Name Withheld |
| 147 | Mr and Mrs A. and L. Pashley |
| 148 | Dr John Goldberg |
| | <ul style="list-style-type: none">• supplementary submission |
| 149 | Name Withheld |
| 150 | Corporations Committee, Business Law Section, Law Council of Australia |

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|-----|---|
| 151 | Australian Shareholders' Association |
| 152 | Dr Suzanne Le Mire, A/Prof David Brown, A/Prof Christopher Symes and Ms Karen Gross |
| 153 | Professor Dimity Kingsford Smith |
| 154 | The Treasury |
| 155 | The Association of Superannuation Funds of Australia |
| 156 | Banking and Finance Consumers Support Association (Inc) <ul style="list-style-type: none">• 2 supplementary submissions |
| 157 | Name Withheld |
| 158 | Name Withheld <ul style="list-style-type: none">• 2 supplementary submissions |
| 159 | Name Withheld |
| 160 | Name Withheld |
| 161 | Ms Sylvia Blayse |
| 162 | Australian Manufacturing Workers' Union |
| 163 | BDO Australia |
| 164 | Mr Peter Murray |
| 165 | Blueprint For Free Speech |
| 166 | Mr John Holligan |
| 167 | Mr Ian Painter |
| 168 | Mr Robert Smith Novak |
| 169 | Ms Maggie Rose |
| 170 | Advisers' Committee for Investors <ul style="list-style-type: none">• supplementary submission |
| 171 | Mr Paul Topping |
| 172 | Mr Ron Jelich |
| 173 | Association of ARP Unitholders Inc. |

- 174 Mr Hans-Ulrich Laser
- supplementary submission
- 175 Mr Steven Hancock
- 176 Ms Sharon Romano
- 177 Ms Joy Prins
- 178 Mrs Lyn Hume
- supplementary submission
- 179 Mr Stephen Tyrrell
- 180 Ms Kirsty Torrens
- 181 Mr Mike Gilligan
- 182 Name Withheld
- 183 Name Withheld
- 184 Name Withheld
- supplementary submission
- 185 Name Withheld
- 186 Name Withheld
- 187 Name Withheld
- 188 Commonwealth Ombudsman
- 189 Professor Robert Baxt AO
- 190 Mr Ben Burgess
- supplementary submission
- 191 Name Withheld
- 192 Name Withheld
- 193 Financial Ombudsman Service
- 194 Consumer Credit Legal Centre (NSW) Inc
- 195 Mr and Mrs Glenn and Linda Pascoe
- supplementary submission

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| 196 | Name Withheld |
| 197 | Mr Bruce Keenan |
| 198 | Mr Robert M Bass |
| 199 | Mr and Ms Michael R and Evelyn M Bass |
| 200 | Maurice Blackburn Pty Limited |
| 201 | Industry Super Australia |
| 202 | Insolvency Practitioners Association (now Australian Restructuring Insolvency and Turnaround Association) <ul style="list-style-type: none">• 2 supplementary submissions |
| 203 | Institute of Chartered Accountants Australia |
| 204 | Mr Peter Keenan |
| 205 | Mr Robert Brown |
| 206 | Ms Margery Zillmann |
| 207 | Mr Jeff Beal |
| 208 | Ms Diana Simpkins |
| 209 | CPA Australia |
| 210 | Hon Bob Katter MP |
| 211 | Rule of Law Institute of Australia |
| 212 | Mr Trevor Eriksson <ul style="list-style-type: none">• supplementary submission |
| 213 | Name Withheld <ul style="list-style-type: none">• 3 supplementary submissions |
| 214 | Ms Kerry Budworth |
| 215 | Mr Ellis Eyre |
| 216 | Australia and New Zealand Banking Group Limited <ul style="list-style-type: none">• supplementary submission |
| 217 | Name Withheld |
| 218 | Name Withheld |

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|-----|---|
| 219 | Mr Rex van Heythuysen |
| 220 | Ms Julie Wignall |
| 221 | Mr and Mrs Bob and Margaret Waterhouse |
| 222 | Mr Chris Dowling |
| 223 | Laharum Bulk Handling |
| 224 | Ms Michelle Matheson |
| 225 | Mr Mark Booth |
| 226 | Name Withheld |
| 227 | Mr Dennis Fahey |
| 228 | Mr John McClymont |
| 229 | Name Withheld |
| 230 | Welcome Australia Limited |
| 231 | Ms Fiona Howson |
| 232 | Dr Peter Brandson |
| | • supplementary submission |
| 233 | Ms Maureen Nathan |
| 234 | Financial Planning Association of Australia |
| 235 | Name Withheld |
| 236 | Mr and Mrs Bernie and Bernardine Frawley |
| 237 | Mr Scott Goold |
| 238 | Mr Terry Gammel |
| 239 | Mr Bernard Wood |
| | • supplementary submission |
| 240 | Ms Dianne Mead |
| 241 | Mr Robert Catena |
| 242 | Name Withheld |
| 243 | Name Withheld |

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| 244 | Mrs Jan Braund |
| 245 | Mr Terence Moore |
| | • 3 supplementary submissions |
| 246 | Dorman Investments Pty Ltd |
| 247 | Mr Francis Colosimo |
| | • supplementary submission |
| 248 | Ocean Financial Pty Ltd |
| 249 | Mr Dennis Chapman |
| 250 | Dr Barry Landa |
| 251 | Mr Kevin Jenner |
| 252 | Mr Neville Hughes |
| 253 | Name Withheld |
| 254 | Mr and Mrs Rodney and Meryl Jones |
| 255 | Ms Caroline McNally |
| 256 | Mr and Mrs Bruce and Muriel Duncan |
| 257 | Ms Sandy Phillips |
| 258 | Mr and Mrs Ned and Michelle Cvetkovic |
| 259 | Mr Errol Opie |
| | • supplementary submission |
| 260 | Mr Darren Hithersay |
| 261 | Commonwealth Bank of Australia Group |
| | • response received from Unhappy Customers Pty Ltd |
| 262 | Mr Terry Murphy |
| 263 | Name Withheld |
| 264 | Mr Mark McIvor |
| 265 | Mr Edmund Schmidt and Ms Cynthia Lawrence |
| 266 | Name Withheld |

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| 267 | Confidential |
| 268 | Confidential |
| 269 | Confidential |
| 270 | Confidential |
| 271 | Confidential |
| 272 | Confidential |
| 273 | Confidential |
| 274 | Mr Jeffrey Knapp <ul style="list-style-type: none">• 5 supplementary submissions |
| 275 | Ms Loraine McElligott |
| 276 | Levitt Robinson Solicitors <ul style="list-style-type: none">• response received from PPB Advisory• response received from ASIC• response received from KordaMentha• response received from the Commonwealth Bank of Australia |
| 277 | Mr Phillip Sweeney <ul style="list-style-type: none">• 2 supplementary submissions |
| 278 | Mr Victor Ainslie |
| 279 | Mr David Pemberton |
| 280 | Mr Rob Fowler |
| 281 | Confidential |
| 282 | Mr Niall Coburn |
| 283 | Confidential |
| 284 | Name Withheld |
| 285 | Ms Rosie Cornell <ul style="list-style-type: none">• supplementary submission |
| 286 | Name Withheld |

287 Name Withheld

- 2 supplementary submissions

288 Name Withheld

289 Name Withheld

290 Name Withheld

291 Name Withheld

292 Mr and Mrs Robbie and Cheral Stimpson

293 Mr David Bone

294 Mr Gary White

- response received from Resi Mortgage Corporation
- supplementary submission

295 Dr Evan Jones

296 Mr James Kwok

297 Confidential

298 Confidential

299 Mr James Howarth

300 Mr and Mrs Merv and Robyn Blanch

301 Mr Gus Dalle Cort

302 Ms M Bartlett

303 Name Withheld

304 Mr Luke Quintano

305 Mr Gerard O'Grady

306 Name Withheld

307 Confidential

308 Confidential

309 Name Withheld

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339 Confidential

340 Confidential

341 Name Withheld

342 Name Withheld

343 Professor AJ Brown

344 Name Withheld

345 Name Withheld

- 2 supplementary submissions

346 Mrs M Woolnough

347 Mr Neville Ledger

- supplementary submission

348 Commercial Asset Finance Brokers Association of Australia Limited

349 Mr Ken Winton

350 Mr and Mrs Richard and Barbara Wright

351 Name Withheld

- 2 supplementary submissions

352 Lord Michael Fraser

353 Confidential

354 Ms Dulcie Balliana

355 Mr Peter Monahan

356 Ms Evelyn Serridge

357 Mr Andrew Maher

358 Mr Douglas Layton

359 Mr and Mrs Scott and Naomi Baines

360 Mr Ross Bush

361 Ms Susan Hoskings

362 Mr Ray Baker

363 Kelgon Development Corporation Pty Ltd

364 Mr Peter Rigby

365 Mr Henry di Suvero

- response received from Sandhurst Trustees

366 Ms Una Robinson

367 Mr Simon Grundel

368 Mr Owen Salmon

369 Mr Tony Rigg

370 Mr Gilbert Crawford

- response received from Mr Jim Downey, JP Downey and Co

371 Mr Levis Campagnolo

372 Ms Alana Smith

373 Name Withheld

374 Name Withheld

375 Confidential

376 Confidential

377 Confidential

378 Name Withheld

- supplementary submission

379 Name Withheld

380 Mr Gordon Nelson

381 Name Withheld

382 Mr Peter Bates

383 Ms Kay Gal

384 Commonwealth Director of Public Prosecutions

385 Mrs Taryn Berry

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| 386 | Confidential |
| 387 | Mr Emmanuel Cassimatis |
| 388 | Confidential |
| 389 | Name Withheld |
| 390 | Mr and Mrs Michael and Irene Gander |
| 391 | Mr Jim Martinek |
| 392 | Mr Mark Hoddinott |
| | <ul style="list-style-type: none">• response received from PPB Advisory |
| 393 | Mr Robert Bennetts |
| 394 | Ms and Mr Claire and Chris Priestley |
| | <ul style="list-style-type: none">• response received from the National Australia Bank |
| 395 | Ms Marilyn Swan |
| 396 | Mr John Telford |
| | <ul style="list-style-type: none">• response received from Mr Stephen Jones MP |
| 397 | Mr Chris Priestley |
| | <ul style="list-style-type: none">• response received from the National Australia Bank• supplementary submission |
| 398 | Name Withheld |
| 399 | Mrs Frith Santalucia |
| | <ul style="list-style-type: none">• supplementary submission |
| 400 | Name Withheld |
| 401 | Name Withheld |
| 402 | Mr A. Walton |
| 403 | Mr Peter Howie |
| 404 | Sub-Sea and Pipeline Protection International |
| 405 | Ms Maria Rigoni |
| 406 | Australian Crime Commission |

407 Transparency International Australia

408 Name Withheld

409 Name Withheld

410 Mr Phillip Ruge

411 Mortgage and Finance Association of Australia

412 Dr Peter Bowden

- supplementary submission

413 Name Withheld

414 Confidential

415 Confidential

416 Mr and Mrs Glenn and Sonja Tandy

417 Name Withheld

418 Credit Ombudsman Service Limited

419 Dr Vivienne Brand and Dr Sulette Lombard, Flinders University

420 Ms Karen Carey

- response received from KordaMentha
- response received from ASIC

421 Mr Jeffrey Morris

- 7 supplementary submissions

422 Name Withheld

423 Mr Anthony Brownlee

424 Mr Christopher Dobbys

- response received from David Jones

425 Ms Muriel McClymont

426 Mr Andrew Carr

427 Mr Mustaffa Abu Sedira

428 Mr Charles Phillott

429 Mr Peter Wrobel

430 Mr Tony Vernuccio

431 Confidential

432 Confidential

433 Confidential

434 Confidential

435 Confidential

436 Confidential

437 Confidential

438 Confidential

439 Confidential

440 Confidential

441 Name Withheld

442 Confidential

443 Name Withheld

444 Name Withheld

445 Name Withheld

446 Mr Paul Friedberg

447 OFS Spain Ltd

448 Financial Page International

449 Mr Wayne Styles

450 Confidential

451 Mr Martin Vink

452 Name Withheld

453 Name Withheld

- response received from Chimaera Capital

454 Name Withheld

- 455 Mr Michael Linnell
- response received from KordaMentha
 - response received from BRI Ferrier
 - response received from Chimaera Capital
 - supplementary submission
- 456 Mr Patrick Healy
- 457 Name Withheld
- 458 Associate Professor Michael Legg, Faculty of Law,
The University of New South Wales
- 459 Confidential
- 460 Confidential
- 461 Mr Yoav Nachmani
- 462 Name Withheld
- 463 Confidential
- 464 Financial Resolutions Australia Pty Ltd
- supplementary submission
- 465 Confidential
- 466 Confidential
- 467 Confidential
- 468 Confidential
- 469 Confidential
- 470 Confidential
- 471 Confidential
- 472 Confidential
- 473 Confidential
- 474 Confidential

Appendix 2

Tabled documents and additional information received

1. Additional information: opening statement made by ASIC at a public hearing held in Sydney on 19 February 2014.
2. Additional information: opening statement made by Professor Dimity Kingsford Smith at a public hearing held in Sydney on 19 February 2014.
3. Additional information received from Financial Ombudsman Service Limited on 27 February 2014, relating to the public hearing held in Sydney on 20 February 2014.
4. Opening statement tabled by ASIC at a public hearing held in Canberra on 10 April 2014.
5. Documents tabled by Ms Merilyn Swan at a public hearing held in Canberra on 10 April 2014.
6. Document tabled by Mrs Janice Braund at a public hearing held in Canberra on 10 April 2014.
7. Additional information received from ASIC on 30 April 2014, relating to the public hearing held in Canberra on 10 April 2014.
8. Additional information received from Mr Gerard Brody, Chief Executive Officer of the Consumer Action Law Centre, on 21 February 2014.
9. Correction to evidence given at a public hearing held in Canberra on 2 April 2014, provided by Mr Jason Harris, Senior Lecturer, Faculty of Law, University of Technology Sydney on 17 April 2014.
10. Letter received from the Commonwealth Bank of Australia Group on 16 May 2014.
11. Additional information received from the Commonwealth Ombudsman on 20 May 2014.
12. Additional information received from the Australian National Audit Office on 23 May 2014.
13. Additional information received from ASIC on 3 June 2014.
14. Additional information received from National Australia Bank on 11 June 2014.
15. Additional information received from ASIC on 20 June 2014.

Answers to questions on notice

1. Answer to a question on notice asked at a public hearing held in Sydney on 19 February 2014, received from the Institute of Chartered Accountants Australia on 11 March 2014.
2. Answer to a question on notice asked at a public hearing held in Sydney on 20 February 2014, received from Credit Ombudsman Service Limited on 3 March 2014.
3. Answer to a question on notice asked at a public hearing held in Sydney on 20 February 2014, received from Financial Ombudsman Service Limited on 6 March 2014.
4. Answer to a question on notice asked at a public hearing held in Canberra on 21 February 2014, received from the Treasury on 18 March 2014.
5. Answer to a question on notice asked at a public hearing held in Sydney on 20 February 2014, received from the Corporations Committee of the Business Law Section of the Law Council of Australia on 21 March 2014.
6. Answers to questions on notice asked at a public hearing held in Sydney on 19 February 2014, received from ASIC on 25 March 2014.
7. Answer to a question on notice asked at a public hearing held in Canberra on 21 February 2014, received from Professor Bob Baxt AO on 17 April 2014.
8. Answer to a question on notice asked at a public hearing held in Canberra on 2 April 2014, received from Mr Jason Harris, Senior Lecturer, Faculty of Law, University of Technology Sydney on 17 April 2014.
9. Answers to questions on notice asked at a public hearing held in Canberra on 10 April 2014, received from the Commonwealth Bank on 24 April 2014.
10. Answers to written questions on notice and questions on notice asked at a public hearing held in Canberra on 10 April 2014, received from ASIC on 19 May 2014.
11. Answers to questions on notice asked at a public hearing held in Canberra on 10 April 2014, received from ASIC on 21 May 2014.
12. Answers to written questions on notice, received from ASIC on 21 May 2014.
13. Answers to written questions on notice, received from ASIC on 22 May 2014.
14. Answer to a question on notice asked at a public hearing held in Canberra on 2 April 2014, received from the Commonwealth Director of Public Prosecutions on 22 April 2014.
15. Answers to written questions on notice, received from ASIC on 2 June 2014.
16. Answers to written questions on notice, received from ASIC on 2 June 2014.

17. Answers to questions on notice asked at a public hearing held in Canberra on 10 April 2014, received from ASIC on 2 June 2014.
18. Answers to written questions on notice, received from the Commonwealth Bank of Australia on 6 June 2014.
19. Answers to written questions on notice, received from the Commonwealth Bank of Australia on 6 June 2014.

Appendix 3

Public hearings and witnesses

SYDNEY, 19 FEBRUARY 2014

ARMOUR, Ms Cathie, Commissioner, Australian Securities and Investments Commission

BACON, Mr John, General Manager Professional Standards, Financial Planning Association

BINEHAM, Mr Marc, Vice President, Association of Financial Advisers

BROWN, Associate Prof. David, Adelaide Law School, University of Adelaide

DAY, Mr Warren, Senior Executive Leader, Stakeholder Services, and
Regional Commissioner for Victoria, Australian Securities and Investments Commission

DE GORI, Mr Dante, General Manager Policy and Conduct, Financial Planning Association

DRUM, Mr Paul, Head of Policy, CPA Australia

FOX, Mr Brad, Chief Executive Officer, Association of Financial Advisers

GILLIGAN, Dr George, Private capacity

KELL, Mr Peter, Deputy Chairman, Australian Securities and Investments Commission

KINGSFORD SMITH, Prof. Dimity, Private capacity

KIRK, Mr Greg, Senior Executive Leader, Strategy Group, Australian Securities and
Investments Commission

LE MIRE, Dr Suzanne, Senior Lecturer, Adelaide Law School, University of Adelaide

MALLEY, Mr Alex, Chief Executive Officer, CPA Australia

MAWSON, Mr David, ASIC Workplace Delegate, Community and Public Sector Union

MEDCRAFT, Mr Greg, Chairman, Australian Securities and Investments Commission

O'BRIEN, Prof. Justin, Private capacity

PRICE, Mr John, Commissioner, Australian Securities and Investments Commission

RANTALL, Mr Mark, Chief Executive Officer, Financial Planning Association

SAVUNDRA, Mr Chris, Senior Executive Leader, Markets Enforcement,
Australian Securities and Investments Commission

TANZER, Mr Greg, Commissioner, Australian Securities and Investments Commission

WATERS, Mr Alistair, Deputy National President, Community and Public Sector Union

WHITE, Mr Lee, Chief Executive Officer, Institute of Chartered Accountants Australia

SYDNEY, 20 FEBRUARY 2014

BRAILEY, Ms Denise, President, Banking and Finance Consumers Support Association

BRODY, Mr Gerard, Chief Executive Officer, Consumer Action Law Centre

CAMPO, Ms Robbie, Deputy Chief Executive, Industry Super Australia

COX, Mrs Karen, Coordinator, Consumer Credit Legal Centre Inc. (NSW)

DAM, Ms Allison, Head of Policy and Compliance, Credit Ombudsman Service

DYER, Mr Bruce, Member, Corporations Committee, Business Law Section,
Law Council of Australia

FIELD, Mr Philip, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service

GOODISON, Mr Scott, Head of Dispute Resolution, Credit Ombudsman Service

HAYNES, Mr David, Executive Manager, Policy and Research,
Australian Institute of Superannuation Trustees

KEEVES, Mr John, Chairman, Business Law Section, Law Council of Australia

NEAVE, Mr Colin, Commonwealth Ombudsman

TREGILLIS, Mr Shane, Chief Ombudsman, Financial Ombudsman Service

VENGA, Mr Raj, Chief Executive Officer and Ombudsman, Credit Ombudsman Service

VOLPATO, Ms Karen, Senior Policy Adviser,
Australian Institute of Superannuation Trustees

WATTS, Mr Richard, Policy and Legal Counsel, Industry Super Australia

CANBERRA, 21 FEBRUARY 2014

BAXT, Professor Bob, Private capacity

BROWN, Ms Diane, Acting General Manager, Corporations and Capital Markets Division,
Department of the Treasury

COBURN, Mr Niall, Private capacity

FRASER, Mr Bede, Acting General Manager, Retail Investor Division, Markets Group,
Department of the Treasury

CANBERRA, 2 APRIL 2014

DAVIDSON, Mr Graeme, Deputy Director, Commonwealth Director of Public Prosecutions

FYSH, Dr Stuart, Private capacity

HARRIS, Mr Jason, Private capacity

JENSEN, Mr Rod, Principal Legal Officer, Commercial,
International and Counter-Terrorism, Commonwealth Director of Public Prosecutions

LOMBE, Mr David, President,
Australian Restructuring Insolvency and Turnaround Association

McCANN, Mr Michael, Deputy President,
Australian Restructuring Insolvency and Turnaround Association

MURRAY, Mr Michael, Legal Director,
Australian Restructuring Insolvency and Turnaround Association

WHEELDON, Mr James, Private capacity

WINTER, Mr John, Chief Executive Officer,
Australian Restructuring Insolvency and Turnaround Association

CANBERRA, 10 APRIL 2014

ARMOUR, Ms Cathie, Commissioner, Australian Securities and Investments Commission

BERRILL, Mr John, Lawyer and Principal, Maurice Blackburn Lawyers

BIRD, Ms Joanna, Senior Executive Leader, Financial Advisers,
Australian Securities and Investments Commission

BOWDEN, Dr Peter, Private capacity

BRAND, Dr Vivienne, Senior Lecturer, Flinders Law School, Flinders University

BRAUND, Mrs Janice, Private capacity

BROWN, Mr Adrian, Senior Executive Leader, Insolvency Practitioners and Liquidators

BROWN, Professor AJ, Professor of Public Policy and Law,
Centre for Governance and Public Policy, Griffith University

COHEN, Mr David, General Counsel and Group Executive, Group Corporate Affairs,
Commonwealth Bank of Australia

DAY, Mr Warren, Senior Executive Leader, Stakeholder Services,
Australian Securities and Investments Commission

GRATION, Mr Douglas, Director, Governance Institute of Australia

KELL, Mr Peter, Deputy Chairman, Australian Securities and Investments Commission

KIRK, Mr Greg, Senior Executive Leader, Deposit Takers, Credit and Insurance Providers

LOMBARD, Dr Sulette, Senior Lecturer, Flinders Law School, Flinders University

MEDCRAFT, Mr Greg, Chairman, Australian Securities and Investments Commission

MORRIS, Mr Jeffrey, Private capacity

MULLALY, Mr Tim, Senior Executive Leader, Financial Services Enforcement,
Australian Securities and Investments Commission

PERKOVIC, Ms Marianne, Executive General Manager, Wealth Management Advice,
Commonwealth Bank of Australia

PRICE, Mr John, Commissioner, Australian Securities and Investments Commission

SAVUNDRA, Mr Chris, Senior Executive Leader, Markets Enforcement,
Australian Securities and Investments Commission

SHEEHY, Mr Tim, Chief Executive, Governance Institute of Australia

SPRING, Ms Annabel, Group Executive, Wealth Management,
Commonwealth Bank of Australia

SWAN, Mrs Marilyn, Private capacity

TANZER, Mr Greg, Commissioner, Australian Securities and Investments Commission

WOLFE, Mr Simon, Head of Research/Legal, Blueprint for Free Speech

Appendix 4

Timeline of ASIC's changing responsibilities

| Date | Development |
|---------------|---|
| 1991 | The Australian Securities Commission (ASC) commenced operation. |
| 1993 | The civil penalty regime for the enforcement of directors' duties is introduced. |
| 1997 | The final report of the Financial System Inquiry, chaired by Mr Stan Wallis (Wallis inquiry), was released in March. One of the recommendations was that a single agency be established to provide Commonwealth regulation of corporations, financial market integrity and consumer protection. Also in March, the government announced the Corporate Law Economic Reform Program (CLERP), a policy framework intended to reform key areas of corporate regulation. CLERP was gradually enacted over several years. |
| 1998 | The ASC becomes ASIC. Consumer protection responsibilities for insurance, superannuation and deposit-taking transferred from the ACCC to ASIC. Managed investments schemes became regulated by ASIC. |
| 2002 | The <i>Financial Services Reform Act 2001</i> (also known as CLERP 6) introduced a new regulatory regime for the provision of financial services. ASIC is given the responsibility for overseeing market conduct and consumer protection issues relating to credit, such as product disclosure. Providers of financial services must obtain an AFS licence issued by ASIC. |
| 2004 | Following the Ramsay Report, the collapse of HIH Insurance and the HIH Royal Commission, audit reform is introduced by legislation known as CLERP 9. Measures that directly relate to ASIC include continuous disclosure requirements and the power for ASIC to issue infringement notices for alleged contraventions of these requirements, as well as whistleblower protections for employees that report breaches to ASIC. |
| July 2005 | The Choice of Fund reforms commence, requiring employers to offer a choice of superannuation fund to all eligible employees. The reforms are jointly administered by ASIC, APRA and the ATO. |
| March 2008 | COAG agrees in principle that the states would transfer responsibility for regulating consumer credit to the Commonwealth. |
| November 2008 | The government announces that, effective 1 January 2010, ASIC will require all credit rating agencies to hold an AFS licence. |
| May 2010 | ASIC assumes responsibility from the states and territories for the regulation of trustee companies. |

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| June 2010 | The Super System Review (Cooper Review) delivers its final report to the government. The government's response to the review, the Stronger Super reforms, led to responsibilities for ASIC related to the implementation of the MySuper default superannuation product and the regulation of self-managed superannuation fund (SMSF) auditors. |
| July 2010 | The <i>National Consumer Credit Protection Act 2009</i> commences. This Act replaces the Uniform Consumer Credit Codes administered by the states and territories and makes ASIC the national regulator of consumer credit. Entities that engage in credit activity generally need to obtain a credit licence from ASIC. |
| July 2010 | The provisions of the Australian Consumer Law relating to unfair terms in consumer contracts for financial products and financial services take effect. ASIC is also given new enforcement and consumer redress powers. |
| August 2010 | ASIC takes over responsibility for the supervision of real-time trading on domestic licensed equity, derivatives and futures markets. |
| September 2010 | The Senate Economics References Committee completes an inquiry into liquidators and administrators. The report recommended that ASIC's corporate insolvency responsibilities be transferred to a new agency, however, the government did not adopt this recommendation. |
| March 2011 | After being asked by the government to develop it, ASIC releases the <i>National Financial Literacy Strategy</i> . |
| January 2012 | ASIC's register of company charges closes as part of the personal property securities reform (a new Personal Property Securities Register commences which is administered by the Insolvency and Trustee Service Australia). |
| May 2012 | The administration of business names is transferred from the states and territories to ASIC. |
| July 2012 | The Future of Financial Advice (FOFA) reforms commence, although compliance is only mandatory from 1 July 2013. Included in FOFA is a prospective ban on conflicted remuneration structures, a statutory fiduciary duty that financial advisers must act in the best interests of their clients, an opt-in obligation regarding clients' agreement to ongoing fees and strengthened enforcement powers for ASIC. |

Appendix 5

Key enforcement matters

A5.1 This section contains summaries of selected key enforcement matters that ASIC has been involved in or that relate to ASIC's responsibilities.

A5.2 The summaries are not a detailed critique of the particular cases; rather, they are intended to provide basic information on major cases or investigations and to highlight the varied nature of misconduct or alleged misconduct ASIC may need to pursue. This section is also not an exhaustive historical record of ASIC's enforcement activities. With some exceptions, the cases selected generally were finalised in the past five years.¹ During this period, ASIC has had notable successes and certain cases it has pursued have resulted in judgments that clarified responsibilities and provided greater certainty, particularly regarding directors' duties. However, there are a number of matters where ASIC's approach has been widely questioned.

A5.3 The summaries are predominately based on material already on the public record, not evidence received and tested by the committee. Matters that have been discussed extensively in the body of the report, such as the Commonwealth Financial Planning matter, are not included here.

James Hardie

A5.4 ASIC was ultimately successful in the long-running James Hardie civil action; a case initiated in the NSW Supreme Court in February 2007 that ultimately ended up in the High Court.² It was found that the non-executive directors, and the general counsel and company secretary, breached their duty of care and diligence in that they knew or should have known that the compensation fund for victims of asbestos-related disease did not have sufficient reserves to meet the likely claims.³ The High Court also vindicated ASIC's conduct of the case as a model litigant after rejecting the NSW Court of Appeal's criticism of ASIC for not calling a particular witness.

1 Some particularly noteworthy historical cases outside this timeframe include: ASIC's investigation into the 2001 collapse of One.Tel and its unsuccessful court proceedings against One.Tel's former joint managing director, Mr Jodee Rich, and its former finance director, Mr Mark Silbermann; the action against Mr Rodney Adler (a former director of collapsed insurer HIH); and ASIC's unsuccessful insider trading case against Citigroup.

2 *Australian Securities and Investments Commission v Hellicar* (2012) 247 CLR 345. ASIC had considered criminal proceedings, however, it concluded that there was an insufficient basis to commence any criminal proceedings against non-executive directors, and the CDPP decided that there was an insufficient basis to commence criminal proceedings against other individuals. ASIC, 'James Hardie Group civil action', *Media Release*, no. 08-201, 5 September 2008.

3 Market announcements claimed that the compensation fund would be fully funded.

A5.5 ASIC's chairman noted in late 2012 that ASIC 'has observed board engagement with disclosure has improved' as a result of the widespread publicity associated with this case.⁴

Australian Wheat Board

A5.6 The judicial inquiry into certain Australian companies in relation to the United Nations (UN) Oil-For-Food Programme (Cole Inquiry) examined transactions between the Australian Wheat Board (AWB) and the Iraqi Grain Board and how those transactions related to UN-imposed sanctions and Australian law. It found that there were circumstances where it might be appropriate for authorities to consider criminal or civil proceedings against AWB and various persons.⁵ A taskforce consisting of ASIC, the Australian Federal Police (AFP) and Victoria Police was established in response to the findings of the Cole Inquiry. The AFP discontinued its investigation following legal advice.⁶ ASIC did not pursue criminal proceedings, although it instituted six civil proceedings relating to directors' duties.⁷ In a media release announcing the proceedings, ASIC advised that civil proceedings were preferred due to statute of limitation considerations.⁸

A5.7 Four of ASIC's proceedings have been concluded. ASIC ultimately settled the proceedings against the former managing director of AWB, Mr Andrew Lindberg. The Supreme Court of Victoria agreed to a proposed fine of \$100,000 and that Mr Lindberg be disqualified from managing corporations until 15 September 2014. The court also found that AWB's former chief financial officer (CFO), Mr Paul

4 ASIC, 'Decision in James Hardie penalty proceedings', *Media Release*, no. 12-275, 13 November 2012.

5 Terence RH Cole, *Report of the Inquiry into certain Australian companies in relation to the UN Oil-for-Food Programme*, vol. 1, November 2006, pp. xi, lxxxii.

6 AFP, 'AWB Task Force investigation', *Media Release*, 28 August 2009.

7 ASIC, 'ASIC's response to ABC TV's Four Corners' questions', 30 September 2013, http://abc.net.au/4corners/documents/RBA2013/ASIC_response.pdf (accessed 1 October 2013), p. 1.

8 A relevant extract from the media release is as follows: 'Investigations into civil penalty proceedings was given more priority by ASIC because of the statute of limitation periods which apply to those actions and which do not apply to possible criminal proceedings (which investigations by ASIC continue). Commissioner Cole examined 27 contracts between AWB and the Iraqi Grain Board (IGB). The Corporations Act limits the time for the commencement of civil penalty proceedings to six years. The time limit had expired for 20 of the contracts when the Cole Inquiry concluded in November 2006 and two expired in February and June 2007'. ASIC, 'ASIC launches civil penalty action against former officers of AWB', *Media Release*, no. 07-332, 19 December 2007.

Ingleby, had breached his duties.⁹ On 23 December 2013, ASIC announced that it discontinued proceedings against two former executives 'after forming the view that it was no longer in the public interest to pursue its claims'. Proceedings against the former chairman of AWB and another executive are ongoing.¹⁰

Centro

A5.8 The global financial crisis limited the availability of debt funding and led to property values coming under pressure. Shopping centre owner and operator Centro nearly collapsed in December 2007 after it could not rollover its debt. It subsequently emerged that the 2007 annual reports of two Centro companies failed to disclose \$2 billion of short-term liabilities (those liabilities were instead classified as non-current) and guarantees of short-term liabilities of an associated company valued at US\$1.75 billion.¹¹

A5.9 In October 2009, ASIC instituted civil penalty proceedings against then-serving and former directors and a former chief financial officer (CFO). The Federal Court found that the directors had breached their duties when they signed off on the financial reports.¹² The managing director and former chief executive officer (CEO) was fined \$30,000 and the former CFO was disqualified from managing corporations for two years.¹³ In November 2012, ASIC accepted an enforceable undertaking from the former lead auditor of Centro that prevents the auditor from practising until 30 June 2015.¹⁴ Some financial redress for shareholders was achieved as the result of a class action, with a \$200 million settlement reached with Centro and its auditors, PricewaterhouseCoopers.¹⁵

9 ASIC successfully appealed the amount of the penalty imposed on Mr Ingleby by the Supreme Court of Victoria. ASIC and Mr Ingleby had recommended penalties of a disqualification of 15 months and a pecuniary penalty of \$40,000, however, Justice Robson set the pecuniary penalty at \$10,000. On appeal, the Court of Appeal increased the penalty to \$40,000. See ASIC, 'ASIC to appeal permanent stay on second AWB case', *Media Release*, no. 09-260, 17 December 2009; and ASIC, 'ASIC appeal upheld', *Media Release*, no. 13-055, 19 March 2013.

10 ASIC, 'Update on ASIC's proceedings against former directors and officers of AWB Limited', *Media Release*, no. 13-363, 23 December 2013.

11 *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 at 297 [9].

12 *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291.

13 *Australian Securities and Investments Commission v Healey (No 2)* (2011) 196 FCR 430 at 433 [3]–[5].

14 ASIC, 'Former Centro auditor suspended', *Media Release*, no. 12-288, 19 November 2012.

15 *Kirby v Centro Properties Ltd (No 6)* [2012] FCA 650 (19 June 2012).

A5.10 ASIC considers that the Centro investigation is an example of how ASIC has improved the conduct of its investigations as the civil penalty proceedings against Centro were initiated within 13 months of the investigation commencing.¹⁶

Andrew Forrest and Fortescue

A5.11 ASIC was ultimately unsuccessful in the case it brought against Andrew Forrest and Fortescue Metals Group (Fortescue) related to ASX announcements and other statements made in 2004 and 2005 on agreements entered into with three state-owned entities of the People's Republic of China. ASIC's case was dismissed at trial in 2009. Its appeal to the Full Court of the Federal Court was successful in 2011; however, in 2012 the High Court upheld the appeals of Fortescue and Mr Forrest.

A5.12 The High Court criticised how ASIC's case was pleaded. Specifically, the court disapproved of how ASIC set out the case it sought to make¹⁷ and how the allegations put by ASIC at trial changed on appeal. A relevant extract of the judgment follows:

The task of the pleader is to allege the facts said to constitute a cause of action or causes of action supporting claims for relief. Sometimes that task may require facts or characterisations of facts to be pleaded in the alternative. It does not extend to planting a forest of forensic contingencies and waiting until final address or perhaps even an appeal hearing to map a path through it. In this case, there were hundreds, if not thousands, of alternative and cumulative combinations of allegations. As Keane CJ observed in his judgment in the Full Court:

'The presentation of a range of alternative arguments is not apt to aid comprehension or coherence of analysis and exposition; indeed, this approach may distract attention from the central issues.'

As already noted, ASIC's allegations were taken, at trial, to be allegations of fraud. Yet on appeal to the Full Court of the Federal Court, and again on the appeals to this Court, ASIC advanced its case on the wholly different footing that the impugned statements should be found to be misleading or deceptive. That is, whereas the case that was presented at trial focused upon the honesty of Fortescue, its board and Mr Forrest, the case which ASIC mounted on appeal focused on what it was that the impugned statements would have conveyed to their intended audience.¹⁸

16 Tony D'Aloisio, 'Responding to the global financial crisis: the ASIC story', address to the Trans-Tasman Business Circle, 30 November 2010, www.asic.gov.au (accessed 3 October 2013), p. 14.

17 The reasons for judgment stated that ASIC's statement of claim did not identify the case it sought to make 'and to do that clearly and distinctly', adding that '[t]his is no pleader's quibble. It is a point that reflects fundamental requirements for the fair trial of allegations of contravention of law'. *Forrest v Australian Securities and Investments Commission* (2012) 247 CLR 486 at 502 [25].

18 (2012) 247 CLR 486 at 503 [27]–[28].

ABC Learning

A5.13 Childcare provider ABC Learning Centres Limited entered voluntary administration in November 2008. After an ASIC investigation, criminal charges were laid against Edmund Groves and Martin Kemp, two former executive directors of ABC Learning Centres Ltd, for alleged breaches of their duties as directors.¹⁹ Mr Kemp was found not guilty in June 2012.²⁰ Following this verdict, the CDPP decided not to proceed further with the prosecution against Mr Groves.²¹ More recently, a criminal prosecution has commenced against the former CFO for allegedly authorising false or misleading information.²² ASIC also investigated the auditor of ABC Learning and in August 2012 accepted an enforceable undertaking that prevents the auditor from practising for five years.²³

A5.14 ASIC's investigation was questioned or criticised by various commentators, particularly after the charges against the founder of ABC Learning were dropped.²⁴

Collapsed property finance schemes, mortgage funds and debenture issuers

A5.15 Over the past decade, several high-profile collapses have resulted in significant losses for retail investors, leading to criticism of ASIC and the introduction of regulatory changes. These collapses include Westpoint (2005), Fincorp (2007), Australian Capital Reserve (2007), Provident Capital (2012), Banksia (2012), Wickham Securities (2012) and LM Investment Management (2013).

A5.16 Westpoint in particular was a high-profile collapse that attracted some criticism of ASIC.²⁵ Westpoint's activities gained ASIC's attention in 2002.²⁶ In May 2004, ASIC instituted proceedings against a Westpoint company to seek a determination by the court on whether certain promissory notes offered should have

19 ASIC, 'Former ABC directors charged', *Media Release*, no. 11-16, 28 January 2011.

20 ASIC, 'Former ABC director found not guilty', *Media Release*, no. 12-117, 5 June 2012.

21 ASIC, 'Former ABC directors charged', *Media Release*, no. 11-16, 28 January 2011.

22 ASIC, 'Former ABC Learning CFO charged', *Media Release*, no. 13-104, 10 May 2013.

23 ASIC, 'Former ABC Learning Centres auditor prevented from auditing companies for five years', *Media Release*, no. 12-186, 8 August 2012.

24 See, for example, James Thomson, 'ASIC and Eddy Groves: Not as easy as ABC', *Business Spectator*, 10 September 2012, www.businessspectator.com.au/article/2012/9/10/education/asic-and-eddy-groves-not-easy-abc (accessed 9 October 2013); Adam Schwab, 'ASIC nails "getaway driver" in ABC Learning debacle' *Crikey*, 14 August 2012, www.crikey.com.au/2012/08/14/asic-nails-getaway-driver-in-abc-learning-debacle (accessed 9 October 2013); Michael Evans, 'ASIC's move as Groves "off the hook"', *Sydney Morning Herald*, 9 July 2012, p. 1.

25 Although ASIC defended its actions: see Mr Jeffrey Lucy, Chairman, ASIC, *PJCCFS Hansard*, Statutory oversight of ASIC, 13 June 2006, p. 3.

26 The Hon Peter Costello, *House of Representatives Hansard*, 21 May 2007, p. 137.

been offered as debentures or financial products under the Corporations Act.²⁷ At that time, ASIC 'was not aware of the apparently large scale involvement of licensed financial planners advising on Westpoint products'. Independently audited statements of other Westpoint companies filed with ASIC during 2004 did not raise any concerns.²⁸ Following Westpoint's collapse, ASIC took representative action against KPMG, the directors of nine Westpoint mezzanine companies, seven financial planners and State Trustees Limited.²⁹ ASIC ultimately settled the cases and obtained \$97.2 million in compensation.³⁰ Criminal proceedings against two former Westpoint officers were discontinued.³¹ Ultimately, 31 individuals were either banned by ASIC or gave ASIC an undertaking that they would not engage in financial services.³²

A5.17 The Westpoint matter led to ASIC imposing a regulatory obligation that requires additional disclosure if one of eight benchmarks set by ASIC for unlisted notes is not met.³³ The collapse of Banksia and other debenture issuers led to the previous government announcing that ASIC and APRA would consult on further reforms, such as capital requirements.³⁴

Opes Prime

A5.18 Opes Prime Stockbroking Ltd was a provider of securities lending facilities that was placed in administration in March 2008.³⁵ An ASIC investigation following the collapse that led to two directors and founders of Opes Prime being jailed (although recently another director and founder was found to be not guilty). ASIC also helped facilitate a scheme of arrangement that resulted in ANZ and Merrill Lynch, the major financiers of Opes Prime, paying \$226 million to the Opes Prime liquidators. With other assets paid or recovered, approximately \$253 million was paid to Opes Prime's creditors.³⁶ This settlement is the largest compensation outcome achieved by

27 ASIC, 'ASIC acts on mezzanine financing', *Media Release*, no. 04-157, 25 May 2004.

28 The Hon Peter Costello, *House of Representatives Hansard*, 21 May 2007, p. 139.

29 ASIC, 'Actions to obtain compensation for the benefit of investors', <https://westpoint.asic.gov.au/wstpoint/wstpoint.nsf/byheadline/Summary+of+claims?opendocument> (accessed 2 September 2013).

30 ASIC, *Submission 45.2*, p. 118.

31 ASIC, 'Statement on Westpoint action', *Media Release*, no. 13-105, 14 May 2013.

32 ASIC, *Submission 45.2*, p. 27.

33 This is termed 'if not – why not' disclosure. The requirements are outlined in ASIC's Regulatory Guide 69.

34 The Hon Bill Shorten MP (Minister for Financial Services and Superannuation), 'Roadmap to a sustainable future for finance companies', *Media Release*, no. 93 of 2012 (22 December).

35 More detail about the collapse, see chapter 4 of Parliamentary Joint Committee on Corporations and Financial Services, *Financial products and services in Australia*, November 2009, Parliamentary Paper No. 321/2009.

36 ASIC, *Submission 45.2*, p. 106; ASIC, 'Opes Prime schemes of arrangement approved', *Media Release*, 09-135, 4 August 2009.

ASIC for consumers.³⁷ In a 2009 report, the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) provided the following helpful summary of the settlement:

The terms of settlement included an agreement by the regulator not to pursue ANZ and Merrill Lynch for an alleged contravention of the managed investment provisions of the Corporations Act...ASIC also agreed not to pursue directors of ANZ for civil penalty and compensation claims under section 181 of the Corporations Act. In accepting the scheme of arrangement, the Opes Prime liquidators and clients also renounced all claims and legal proceedings against Merrill Lynch and ANZ.³⁸

A5.19 This agreement was criticised. For example, in 2010 Fairfax journalist Adele Ferguson concluded that following a collapse that 'unleashed havoc on the sharemarket, when ANZ and Opes Prime's other financiers, including Merrill Lynch, began selling down the broker's \$1.4 billion securities lending portfolio to recover secured loans', it was not 'a good look' for ASIC to have entered into an enforceable undertaking that allowed ANZ to sign a '\$226 million cheque in return for legal indemnity' before ASIC had completed its criminal investigation into Opes Prime.³⁹ Individuals aggrieved by the Opes Prime collapse also lodged submissions to this inquiry.⁴⁰ However, ASIC has previously rejected criticism about its actions relating to Opes Prime.⁴¹ ANZ also told the committee that at no time did it have a relationship with Opes Prime's customers, and that while it acknowledges the hardship that Opes Prime's collapse caused, it does not believe this hardship resulted from ANZ's actions.⁴²

Storm Financial

A5.20 Storm Financial was a financial advisory firm that collapsed in 2009. Clients, many being retirees or nearing retirement, invested through a high-risk model offered by Storm but many did not understand the level of risk involved. Approximately 3,000 investors were arranged by Storm to be double-gearred with loans against equity in their homes as well as margin loans.⁴³ When the share market experience a downturn in 2008, many investors received margin calls that they were unable to meet. How

37 ASIC, *Submission 45.2*, p. 24.

38 PJCCFS, *Financial products and services in Australia*, November 2009, p. 64 (footnotes omitted).

39 Adele Ferguson, 'An inconvenient deal and a forgotten \$226m', *Sydney Morning Herald*, 12 January 2010, p. 20.

40 For example, see Mr Rob Fowler, *Submission 280*.

41 See ASIC, *Submission 378* to the PJCCFS inquiry into financial products and services in Australia, August 2009, p. 3.

42 ANZ, *Submission 216*, p. 5.

43 Australian Government, *Compensation arrangements for consumers of financial services: Report by Richard St. John*, April 2012, p. 55.

appropriate the advice the clients received has been the subject of dispute.⁴⁴ ASIC estimates that investors who borrowed from financiers to invest through Storm lost in total approximately \$830 million.⁴⁵

A5.21 ASIC commenced an investigation into Storm in December 2008 and commenced negotiations on an enforceable undertaking.⁴⁶ Storm was placed into administration by the Commonwealth Bank of Australia (CBA) in January 2009. ASIC's legal proceedings against various banks and the directors of Storm (Emmanuel and Julie Cassimatis) commenced between November and December 2010. ASIC and the CBA settled in September 2012 with the CBA providing up to \$136 million in compensation for investors in addition to approximately \$132 million already provided by the CBA.⁴⁷ Compensation proceedings against the Bank of Queensland (BoQ), Senrac Pty Limited (Senrac) and Macquarie Bank on behalf of two former Storm investors were settled in May 2013. As the time of writing, judgment had not been given for the proceedings brought by ASIC against Storm, BoQ and Macquarie in relation to the unregistered managed investment scheme. Further, the proceedings against the Cassimatises are expected to continue in 2014.⁴⁸ ASIC did, however, successfully appeal against court approval of the \$82.5 million settlement between former Storm Financial investors and Macquarie Bank brought about by a class action after ASIC considered 'the differential distribution of the settlement funds resulted in a lack of fairness to the majority of the members of the class'.⁴⁹

A5.22 The collapse of Storm Financial was considered by the PJCCFS as part of its 2009 inquiry into financial products and services. During that inquiry, ASIC rejected criticism of how its investigation of Storm was conducted.⁵⁰ Although the PJCCFS noted that ASIC may have recognised earlier that Storm's practices were problematic if ASIC's risk-based auditing processes were more effective,⁵¹ ASIC's performance was not a central issue in the PJCCFS's report. Rather, that committee developed

44 In its proceedings against the founder, ASIC is alleging that the Storm model provided 'one size fits all' financial advice, rather than advice related to each investor's individual financial circumstances. ASIC, 'Civil penalty proceedings against the Cassimatises', <http://storm.asic.gov.au> (accessed 18 March 2014).

45 ASIC, 'ASIC and CBA Storm Financial settlement', 8 March 2013, www.asic.gov.au (accessed 18 March 2014), p. 2.

46 ASIC, *Submission 378* to the PJCCFS inquiry into financial products and services in Australia, August 2009, p. 16.

47 ASIC, response to *Submission 276*, received 11 December 2013, p. 2.

48 See <http://storm.asic.gov.au>.

49 See <http://storm.asic.gov.au> and ASIC, 'ASIC successful in appeal against Storm settlement deal', *Media Release*, no. 13-214, 12 August 2013.

50 ASIC, *Submission 378* to the PJCCFS inquiry into financial products and services in Australia, August 2009, p. 3.

51 PJCCFS, *Financial products and services in Australia*, November 2009, p. 44.

proposals for legislative amendments that led to the previous government's FOFA reforms.

A5.23 This committee has received submissions that have criticised ASIC's performance in the context of the Storm Financial matter.⁵² Among these were submissions from Levitt Robinson Solicitors, a law firm that instigated class actions on behalf of Storm investors, and from Storm Financial's former CEO Mr Emmanuel Cassimatis. ASIC addressed the Storm Financial matter in a written response to the Levitt Robinson submission.⁵³

Stuart Ariff

A5.24 Stuart Ariff was an insolvency practitioner who was banned from the profession for life in August 2009 and jailed in December 2011 after being convicted on 19 criminal charges brought by ASIC. ASIC's actions, however, were subject to significant criticism. A key concern was that ASIC only acted once concerns about Mr Ariff were raised in the media in 2007.⁵⁴ However, ASIC had received numerous complaints from 2005 onwards. This committee, in its 2010 report on liquidators and administrators, was sharply critical of ASIC's 'lack of responsiveness':

The committee queries why both ASIC and the [Insolvency Practitioners Association of Australia (IPAA)]...took so long to identify Mr Ariff as a practitioner that should be investigated...[T]hese agencies received numerous complaints on the matter from several parties, including:

- Mr Bernard Wood, who complained to ASIC twice in early 2005;
- Carlovers, which complained to ASIC three times between 2005 and 2007;
- the Armidale Dumaresq Council, which received acknowledgement of a complaint related to the YCW League Club, but has not heard from ASIC since;
- Mr Ron Williams, who lodged a complaint but was told by ASIC to refer the matter to the Office of Fair Trading or get legal advice; and
- Mr Bill Doherty, who complained to ASIC on three occasions and to the IPAA, CPA and [the Institute of Chartered Accountants in Australia] 'more than 50 times'.⁵⁵

A5.25 Among other things, the committee recommended that ASIC's corporate insolvency responsibilities be transferred to the government agency that regulates

52 See *Submissions 18, 41, 44, 82, 84, 87, 88, 90, 172, 236, 278 and 301*.

53 ASIC, response to *Submission 276*, letter dated 11 December 2013.

54 Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, September 2010, Parliamentary Paper No. 179/2010, p. 52.

55 Senate Economics References Committee, *The regulation, registration and remuneration of insolvency practitioners in Australia*, p. 70 (footnotes omitted).

personal insolvency practitioners (then known as the Insolvency and Trustee Service Australia, but now called the Australian Financial Security Agency). The previous government's response to the report did not accept that recommendation; however, it did undertake a consultation process on possible reforms.⁵⁶ Following this consultation process, an exposure draft of proposed insolvency law amendments was released but a bill to give effect to these changes was not introduced into the Parliament.

Trio Capital

A5.26 Trio Capital was a superannuation fraud that resulted in \$176 million in superannuation funds being lost or missing.⁵⁷ The PJCCFS, which conducted a dedicated inquiry into Trio Capital, was critical of ASIC's (and APRA's) 'slow response' to the fraud. The PJCCFS expressed surprise that 'there appears to have been very little follow up activity by APRA, ASIC and other authorities such as the AFP, to seek to recover outstanding moneys or to bring to justice those who have committed crimes which have led to great suffering on the part of Australian investors'.⁵⁸ In evidence to this inquiry, a former ASIC described the investigation of Trio Capital as 'example of what you would not do in an investigation'.⁵⁹

A5.27 ASIC's enforcement action following the collapse of Trio Capital has resulted in 11 people being jailed, banned, disqualified or removed from the industry for a combined total of more than 50 years.⁶⁰ However, the PJCCFS considers that ASIC's enforcement action targeted a 'local foot soldier', but not those responsible for developing and implementing the scheme.⁶¹ ASIC announced in June 2012 that it had formed the view that there was insufficient evidence to prove that Mr Jack Flader, the individual who was 'allegedly the ultimate controller of the Trio group', had broken Australian law.⁶² ASIC has maintained this position since that announcement; in October 2013 ASIC issued a statement announcing that, despite its attempts to obtain extra evidence, ASIC was finalising its investigation into Mr Flader because of insufficient evidence.⁶³

56 Australian Government, *Government response to the Senate Economics References Committee report—The regulation, registration and remuneration of insolvency practitioners in Australia: the case for a new framework*, June 2011, p. 1.

57 PJCCFS, *Inquiry into the collapse of Trio Capital*, May 2012, Parliamentary Paper No. 138/2012, p. xvii.

58 PJCCFS, *Inquiry into the collapse of Trio Capital*, May 2012, p. xx.

59 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 3.

60 ASIC, 'Response to ABC TV's Four Corners' questions', 30 September 2013, http://abc.net.au/4corners/documents/RBA2013/ASIC_response.pdf (accessed 1 October 2013), p. 1.

61 PJCCFS, *Inquiry into the collapse of Trio Capital*, May 2012, p. xxi.

62 ASIC, 'ASIC provides update on Trio', *Media Release*, no. 12-116, 5 June 2012.

63 ASIC, 'Update on Trio investigation', *Media Release*, no. 13-294, 29 October 2013. See also Mr John Price, ASIC, *PJCCFS Hansard*, Oversight of ASIC, 15 March 2013, p. 14.

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