

Chapter 2

Issues raised during the hearings

2.1 The hearing held on 13 September 2005 had as its primary focus ASIC's performance in relation to offences against the Corporations Act by Mr Stephen Vizard. The Committee's focus was not on the Vizard case specifically, but rather on the public policy issues which arose from the Vizard case. These include:

- the use of s.19 of the ASIC Act as an investigative tool;
- the operating relationship between ASIC and the DPP; and
- the appropriateness of current civil penalties for insider trading.

2.2 In addition, during the hearings the Committee considered other issues including:

- ASIC action against Lifecare Services Australia;
- appropriateness of advice under financial services reform and the superannuation choice scheme;
- the listing of persons banned from managing companies; and
- the Government's response to the Committee's report *Corporate Insolvency Laws: A Stocktake*

2.3 This chapter considers those issues in turn.

Matters relating to Mr Stephen Vizard

Background

2.4 Mr Stephen Vizard, a businessman and formerly a television presenter of public note, was appointed as a non-executive director of Telstra Corporation in 1996. As a member of the Telstra board, Mr Vizard was privy to market-sensitive information relating to Telstra, prior to Telstra disclosing that information to the market. This is, of course, perfectly normal and in fact a necessary element of corporate governance.

2.5 On three occasions¹ Mr Vizard improperly acted on information which he obtained as a director of Telstra. In the first instance he used his prior knowledge of a likely merger between Telstra and a company named Sausage Software, to buy

1 This paragraph summarises facts found by Finkelstein J in *ASIC v Vizard* [2005] FCA 1037. His Honour notes (at [4]) that he in turn is drawing on a statement of facts agreed by plaintiff and defendant.

Sausage Software shares just before news of the merger drove the value of the shares up. In the second instance he became aware that Telstra was to divest itself of a large shareholding in a company called Computershare Limited. Acting on this knowledge, he sold his own Computershare shares before the Telstra sale became public and the share price dropped as a result. In the final transaction, Mr Vizard used his knowledge of a proposed merger between Telstra and a company called Keycorp to purchase Keycorp shares before the merger announcement lifted the price.

2.6 When these matters came to ASIC's attention, ASIC undertook an investigation and announced on 4 July 2005 that it had commenced civil penalty proceedings against Mr Vizard. Finkelstein J of the Federal Court of Australia handed down his judgment on 28 July 2005. Mr Vizard was fined \$390,000 (being \$130,000 for each offence) and was disqualified from managing a corporation for ten years.

2.7 In his sentencing remarks, Finkelstein J expressed two notes of dissatisfaction relating to penalties. In the first instance, he noted that he would have preferred a higher pecuniary penalty:

The cases, including decisions of the Federal Court ... hold that I should not depart from the penalty recommended by the parties unless it is clearly out of bounds. The proposed penalty is certainly low. Left uninstructed I would have imposed a higher penalty, but not substantially different from that suggested. If this penalty is insufficient, Parliament should increase the maximum. The current amount has been in place for more than 13 years and may require review.²

2.8 In the second instance, his Honour stated:

... it is my view that a disqualification for five years is not sufficient ... a message must be sent to the business community that for white collar crime "the game is not worth the candle" ... In my view the appropriate period of disqualification is ten years. But for the factors requiring a "discount", a much longer period would have been in order.³

2.9 The announcement of the penalties gave rise to extensive public comment, much of which was critical of both ASIC and the DPP. The main criticisms were, first, that ASIC should have brought criminal charges against Mr Vizard⁴, not just civil charges; second, that in the civil case ASIC should have sought higher penalties⁵; and finally there was a suggestion that there may have been political pressure on ASIC

2 *ASIC v Vizard* [2005] FCA 1037 at [45]

3 *ASIC v Vizard* [2005] FCA 1037 at [47]-[49]

4 See, for instance, McCrann "Humiliation for ASIC" *Herald Sun*, 29/7/2005

5 See, for instance, Gluyas "Hanging judge did our crime-deaf watchdog's job" *Australian*, 29/7/2005 p. 4

and the DPP to treat Mr Vizard mildly⁶. The Committee discusses a number of these issues below.

2.10 In the Committee's view, public confidence in the performance of ASIC as regulator and enforcer of Corporations law is of the highest importance. Despite significant public disquiet about the level of penalties sought by ASIC, the Committee notes ASIC's evidence that the ten year disqualification handed down by Finkelstein J was higher than in preceding cases. The Committee welcomes indications by ASIC that the court's decision in relation to Mr Vizard will be taken into account in future.

2.11 It should also be emphasised that the Committee's task is to consider ASIC's performance and such public policy issues as arise from that performance. It is not the Committee's role to revisit the court's decision in relation to Mr Vizard or to sit in purported judgment of individual cases.

Suggestions of interference

2.12 The Committee can quickly dismiss any lingering suggestions that pressure was brought to bear on ASIC or the DPP to treat Mr Vizard leniently, and that this pressure resulted in criminal charges not being pursued. The Committee pursued this question very directly, as follows:

Mr Lucy—The commission would categorically state that there has been no influence from any state or federal government or from any business interests in respect of the Vizard matter.

Senator BRANDIS—Nor any individual politician?

Mr Lucy—Nor any individual politician.

Senator BRANDIS—Any suggestion to that effect is either ignorant or dishonest?

Mr Lucy—Correct.⁷

2.13 The Committee put a similar question to the Director of Public Prosecutions, Mr Damian Bugg QC, and received a response to the same effect:

Neither I nor any person in my Office was approached by any Parliamentarian, Political Officer/Activist or any person on their behalf either directly or indirectly in an attempt to influence the decision my Office made concerning the possible prosecution of Stephen Vizard.⁸

2.14 The Committee is satisfied that there was no political interference in decisions made by the DPP and ASIC in relation to Mr Vizard.

6 See, for instance, Eckermann "Big fish still slip through the net" *Independent Weekly*, 31/7/2005 p. 8

7 Mr Jeffrey Lucy, Senator George Brandis, *Transcript of Evidence*, 13 September 2005, pp. 23-24.

8 Mr Damian Bugg QC, Correspondence to the Committee, 2 December 2005.

Use of s.19 of the ASIC Act

2.15 In its evidence, ASIC advised that the reason criminal charges were not brought against Mr Vizard was as follows:

In this case, criminal charges were not pursued against Mr Vizard because the DPP was not satisfied that there was admissible, substantial and reliable evidence of the offence and therefore there were not reasonable prospects of securing a conviction.⁹

2.16 This evidence was consistent with a press release issued by Mr Bugg on 28 July 2005, which stated:

The policy which my Office follows does not permit the laying of charges on what we, or others, hope that a witness might say if and when called to give evidence but rather on the evidence which is available and admissible. To do otherwise would undermine confidence in the integrity of our system. Charges should not be laid without evidence which is available and admissible to prove the essential elements of the offence. A prosecution should not commence in the hope that critical evidence will later become available.¹⁰

2.17 In the same press release, Mr Bugg noted that the "missing link" in the evidential chain was the evidence of Mr Vizard's accountant, Mr Gregory Lay, who could have directly implicated Mr Vizard in the trades. Mr Bugg stated:

Evidence from this witness was crucial, for a criminal prosecution, as it would connect Mr Vizard to ... the trades and the timing of the trades.¹¹

2.18 Mr Lay was interviewed by ASIC several times but declined to provide a signed statement without first receiving an indemnity from prosecution for offences arising from that statement:

The main issue with Mr Lay was not so much about being prepared to cooperate with us and provide the necessary information we needed but rather that he was not prepared to sign a witness statement because of concerns about his own position. He indicated that for the first time when it came to the crunch in November 2004. I think it was really a period of six months, from November 2004 through to May, when we had a number of discussions with Mr Lay, his advisers and the DPP about satisfying him in relation to his own position.¹²

9 Mr Jeffrey Lucy *Transcript of Evidence*, 13 September 2005, p. 2.

10 Press Release, *Stephen Vizard*, Commonwealth Director of Public Prosecutions, 28 July 2005, pp. 2-3.

11 Press Release, *Stephen Vizard*, Commonwealth Director of Public Prosecutions, 28 July 2005, p. 2.

12 Mr Jeffrey Lucy *Transcript of Evidence*, 13 September 2005, p. 2.

2.19 The DPP provided a statement to Mr Lay to the effect that "what was contained in [Lay's] draft statement did not expose Mr Lay to the jeopardy of being prosecuted for any possible offence."¹³ This was insufficient to obtain Mr Lay's signature.

2.20 This left ASIC and Mr Lay at an impasse, because the prosecution could not be completed without Mr Lay's evidence, and Mr Lay would not sign a statement affirming what evidence he would give.

2.21 The Committee considered whether this impasse could have been overcome by the use of ASIC's powers under s.19 of the ASIC Act, which gives ASIC the power to require persons to attend an ASIC office to be cross-examined under oath. The section reads in part:

19 Notice requiring appearance for examination

- (1) This section applies where ASIC, on reasonable grounds, suspects or believes that a person can give information relevant to a matter that it is investigating, or is to investigate, under Division 1.
- (2) ASIC may, by written notice in the prescribed form given to the person, require the person:
 - (a) to give to ASIC all reasonable assistance in connection with the investigation; and
 - (b) to appear before a specified member or staff member for examination on oath and to answer questions.

2.22 Effectively s.19 would allow ASIC to compel Mr Lay to be subject to cross-examination under oath, just as if he were before the court. He would be compelled by his oath to give true and full evidence, without the need for an indemnity and regardless of his willingness to cooperate. The Committee asked officers of ASIC why it did not use its powers under s.19 to compel Mr Lay to give evidence. Ms Jan Redfern, Executive Director, Enforcement, stated:

Obviously a signed witness statement is far more cogent and reliable than a section 19 which is a question and answer session. What we do in those situations is try to bring a witness along and deal with the issues of concern. In this case one of the obvious mechanisms that we would employ would be an induced statement through the DPP. That was rejected on a number of occasions and particularly by May 2005. So the issue for us at that stage was what would have been the utility in May 2005 of 'section 19ing' Mr Lay in circumstances where he was not prepared to provide a signed statement, where there were real issues being raised about his credibility as a witness and where we had spoken to the DPP and they had indicated that

13 Press Release, *Stephen Vizard*, Commonwealth Director of Public Prosecutions, 28 July 2005, p. 2.

without a signed statement from Mr Lay it would be very unlikely that charges could be laid in the matter? That was the difficulty. There really would have been no point in 'section 19ing' Mr Lay at that point.¹⁴

2.23 Ms Redfern reiterated her point, stating that evidence obtained under s.19 "could not have been and would not have been used by the DPP as the foundation for laying a prosecution."¹⁵

2.24 Ms Redfern's evidence was contradicted by the letter from the DPP to the Committee, which the Committee has published at **Appendix 3**. While that letter agrees that a signed statement obtained from a cooperative witness is far more useful to prosecutors than is evidence obtained under s.19, Mr Bugg concludes:

Where a professional witness is unwilling to provide a statement but otherwise willing to tell the truth in a section 19 examination the process may be useful in determining what the witness will say when called to give evidence in court. In this case the DPP would be confident that even though the witness has not cooperated in providing a statement, that witness would give relevant and truthful evidence in court.¹⁶

2.25 In answer to questions on notice arising from the September hearing, ASIC recast the issue slightly, stating that "having provided ASIC investigators with his evidence voluntarily and on tape, [Lay's] refusal to verify the truth of those statements made his credibility – as opposed to the means by which that evidence could be secured – the critical issue."¹⁷

2.26 In relation to the decision not to obtain evidence under section 19 to support a criminal prosecution, the Committee makes the following comments. Committee members take the view that there appears to have been a lack of clear communication between the DPP and ASIC on the use of section 19 in order to obtain evidence from Mr. Lay. The Committee also considers that there is a difference of view between the DPP and ASIC as to the utility of section 19 for preparing criminal prosecutions. The Committee suggests that it would be constructive for these issues to be considered in the flagged revision of the operational relationship between the DPP and ASIC as defined by their Memorandum of Understanding. This is discussed further at paragraph 2.36.

2.27 In answer to questions on notice from the Committee, ASIC suggested that one way to overcome the impasse exemplified in the Vizard case was to amend s.49 of the ASIC Act "to enable ASIC to require certain witnesses to provide a statement in

14 Ms Jan Redfern *Transcript of Evidence*, 13 September 2005, p. 11.

15 Ms Jan Redfern *Transcript of Evidence*, 13 September 2005, p. 12.

16 Mr Damian Bugg QC, Appendix 3 to this report.

17 ASIC, answer to question on notice no. 3.

an admissible form."¹⁸ The result of such an amendment would be that ASIC could compel a witness such as Mr Lay, following a s.19 interview, to provide a statement.

2.28 The Committee has two concerns about this: a practical concern, and a concern of principle. The practical concern is that such an amendment to s.49 may not in fact have resolved the dilemma of Mr Lay's evidence. If Mr Lay were interviewed under s.19, then compelled to provide a statement under an amended s.49, he would still have been able to limit that statement to include only the evidence he was willing to give in court. He could, in other words, still have refrained from including in his statement any of the evidence which he felt would incriminate himself. Consequently, the amendment to s.49 may not have advanced ASIC's position.

2.29 The concern of principle is that an amendment such as that proposed to s.49 would be a substantial increase in ASIC's powers over a person (and not even an accused person) without any real accountability measures in place. It is doubtful that such an incursion into personal liberties is justified under these circumstances. During the 9 November hearing, Senator Murray suggested that ASIC be required to seek the Court's permission to require a statement to be made under s.49. This may well resolve the issue of principle, but the practical issue would remain.

2.30 The Committee has considered another option which may resolve the practical difficulties of using s.19 interviews in evidence, without increasing ASIC's powers unduly. The Committee's proposal is in two parts:

- First, s.19 of the ASIC Act should be amended so that ASIC can require a witness to provide, following a s.19 interview, a notice to the effect that they are willing to repeat the evidence given under s.19 in evidence in a court; and
- Second, s.19 of the ASIC Act should be amended to give the court discretion to allow limited portions of a s.19 transcript to be given in evidence, but only where there is a substantial difference between the evidence given under s.19 and the evidence given in court. The purpose of admitting portions of the s.19 transcript would be limited to questioning the witness about the inconsistencies in evidence.

2.31 This process would allow ASIC and the DPP to more confidently rely on information obtained under s.19 when considering the decision to prosecute.

Recommendation

2.32 The Committee's view is that the Government should consider both the option raised by Senator Murray – a compulsory statement subject to a court order – and the option raised in paragraph 2.30 of this report.

18 ASIC, answer to question on notice no. 6.

Operating relationship between ASIC and the DPP

2.33 The Vizard case, and the confusion noted above in relation to the use of evidence obtained under s.19 of the ASIC Act, led the Committee to consider the wider relationship between ASIC and the DPP.

2.34 The ASIC Act gives ASIC very broad powers, including a slate of investigative powers (see, particularly, Part 3 of the ASIC Act). The Act also gives ASIC the capacity to act as a prosecutor. Section 49(2) of the ASIC Act states that if, after an investigation, ASIC consider that an offence against corporations legislation has been committed, then "ASIC may cause a prosecution of the person for the offence to be begun and carried on." Section 50 of the Act gives ASIC the capacity to commence civil actions.

2.35 The office of the Director of Public Prosecutions was established by the *Director of Public Prosecutions Act 1983*, with the intention of providing a central, independent agency specialising in just prosecutions. While the power to commence prosecutions is not exclusive to the DPP, the DPP is able to take over prosecutions wherever it considers this appropriate. The DPP, and any other person or agency conducting prosecutions on behalf of the Commonwealth, is bound by the *Prosecution Policy of the Commonwealth*.

2.36 There is obviously an important and ongoing relationship between ASIC as (primarily) an investigator, and the DPP as the Commonwealth's specialist prosecutor. This relationship was formalised in a 1992 Memorandum of Understanding (MOU).

2.37 Mr Peter Wood, a former executive director of enforcement with ASIC and a former deputy director of the DPP, is uniquely placed to give an account of the MOU. Writing in the *Australian Financial Review*, he outlined the circumstances of the MOU's genesis:

There is a lot of history between ASIC and the DPP in relation to choice of remedies. Feelings ran so high in the early 1990s that the attorney-general at the time, Michael Duffy, was forced to intervene and give a written direction to Tony Hartnell, chairman of the then Australian Securities Commission (now ASIC) and Michael Rozenes, who was the DPP. At issue was the question of civil or corporate sanctions for corporate misconduct.

The direction made it clear that serious criminal misconduct in relation to corporations should be addressed by criminal prosecution. Moreover the ASC and DPP were directed to co-operate with each other in carrying out their respective roles in corporate regulation. It was a traumatic episode for both agencies which largely framed their present working relationship.¹⁹

19 Wood, P, "Independence must be seen" *Australian Financial Review* 20 July 2005, p. 63.

2.38 In the letter published at **Appendix 3**, the current DPP Mr Damian Bugg QC described the MOU in the following terms:

The MOU between the DPP and ASIC was first agreed in September 1992. Understandably some of the procedural concepts in the MOU are now dated. For example ASIC's investigatory techniques have changed and developed. However, many of the fundamental concepts contained in the MOU are still relevant to the relationship between ASIC and the DPP. The DPP regards it as important that there be full and early consultation between the regulator and the prosecutor as to potential criminal cases. We recognise that ASIC is the investigator and the decision to investigate and carriage of the investigation are matters for ASIC. However, where the DPP can assist ASIC by advising as to potential evidentiary difficulties or areas of potential criminality, we feel that we can add value to the process to assist in focussing the investigation and assist ASIC in producing a brief of evidence that is able to be successfully prosecuted.

The DPP and ASIC have recognised that the MOU requires updating and have commenced work on a project to produce a new MOU that both recognises the roles and responsibilities of each organisation as well as the principles of cooperation to be employed in achieving a proper and appropriate outcome in the area of corporate criminal enforcement.²⁰

2.39 In the Committee's view, it is disappointing that the relationship between ASIC and the DPP continues to occur in the context of an MOU concluded more than a decade ago to head off what was then imminent conflict between the two institutions. The Committee supports current moves to update the MOU. This should be a high priority task for both agencies and the Committee expects to learn of progress at the next oversight hearing.

Appropriateness of penalties for insider trading

2.40 As noted above, in sentencing Mr Vizard, Finkelstein J stated:

The proposed penalty is certainly low. Left uninstructed I would have imposed a higher penalty, but not substantially different from that suggested. If this penalty is insufficient, Parliament should increase the maximum. The current amount has been in place for more than 13 years and may require review.²¹

2.41 Although Justice Finkelstein's sentencing remarks clearly state that the penalty he would have imposed would be "not substantially different from that suggested", His Honour's invitation to the Parliament to consider the appropriateness of the penalties after 13 years was an entirely appropriate suggestion from the bench.

20 Mr Damian Bugg QC, Appendix 3 to this report.

21 *ASIC v Vizard* [2005] FCA 1037 at [45]

2.42 It is necessary for parliament to review penalties on a regular basis in order to ensure that they remain appropriate. Indeed, in the view of some Committee members, the entire body of law relating to insider trading is ready for review. The Government appears to have shared this view at some point: the Corporations and Markets Advisory Committee, which advises the Treasurer, was commissioned in 2001 to undertake a review of insider trading law. Its report, with 38 recommendations for change, was released in November 2003. Two years later, the Government has not responded to the CAMAC report with proposed changes to insider trading laws.

2.43 During the hearing on 13 September 2005, Committee members asked Mr Lucy to review the CAMAC report, and to consider whether in the light of that report and Finkelstein J's comments, changes to insider trading law are warranted. After such consideration, ASIC stated that it "does not believe the Vizard case has exposed a systemic weakness in the enforcement of either the insider trading prohibition or breaches of directors' duties."²²

ASIC Investigation of disclosure of information by Telstra Executives

2.44 During the September 13 hearing, the Committee raised with ASIC its investigation of Telstra and its continuous disclosure obligations. Mr Lucy stated that ASIC commenced its investigation following public comments about the performance of Telstra by Mr Phil Burgess, a senior executive of Telstra, and an announcement by Telstra with regard to an expectation of reduced future earnings.

2.45 Mr Lucy indicated that because the matter was the subject of ongoing investigation ASIC was constrained in its ability to discuss the progress of its investigation.

2.46 The Committee pursued questioning to determine whether ASIC's investigation would include consideration of all public statements by Telstra executives, Government Ministers and the Prime Minister in relation to Telstra's performance, as follows:

Senator SHERRY—And are you aware of the comments by the Prime Minister in parliamentary question time about talking up the share price?

Mr Lucy—I read them.

Senator BRANDIS—On a point of order, Mr Chairman, that is a false statement. The Prime Minister did not use the expression 'talking up the share price'.

Senator WONG—It was: 'talking up the interests of the company'.

22 ASIC, answer to question on notice no. 6.

Senator BRANDIS—He used the expression ‘talking up the interests of the company’, which is quite a different thing.

Senator SHERRY—Mr Lucy, have you checked to verify what the Prime Minister said in relation to this matter in question time?

Mr Lucy—All matters to do with this investigation are before us. We are looking at all areas, and at this stage we cannot comment any further.

2.47 The day after the oversight hearing, Mr. Lucy sought to clarify his evidence as it related specifically to public statements made by the Prime Minister and released a public statement in relation to the investigation. It said:

This morning I have spoken with our investigation team specifically in relation to those comments made by the Prime Minister. They have advised me that they are not relevant to our ongoing investigation of Telstra ...

I can categorically state that ASIC is not undertaking any investigation of the Prime Minister ...

2.48 The Committee will explore the progress of ASIC's investigation of Telstra and its continuous disclosure obligations in subsequent oversight hearings.

ASIC Action against Lifecare Australia

2.49 During the 13 September hearing, the Committee raised with ASIC its actions in relation to a company called Lifecare Services Australia Pty Ltd ("Lifecare Australia"). The Lifecare matter arises from four 2002 schemes which (purportedly) intended to develop aged care facilities in the Brisbane area. The schemes were allegedly promoted by Mr Brian Maher, Mrs Marie Maher and Mr Paul Rodda. As Mr Maher is an undischarged bankrupt, Mrs Maher and Mr Rodda were the directors of the schemes. They raised some \$7.25 million from investors.

2.50 ASIC alleges that Mrs Maher and Mr Rodda, as directors of the companies, loaned money to another company of which they were the directors ("Partnering Dynamics"); and that this company in turn loaned the money to "other companies and entities associated with Mr Maher, Mrs Maher and Mr Rodda". Partnering Dynamics is now in liquidation.

2.51 Lifecare Services Australia directors Mr Colin Francis and Mr David Stoyakovich have since taken over management of the four trusts in an effort to see the projects to completion and realise the investment of the investors. However, given that much of the investment proceeds were removed from the trusts, their effort faces obvious difficulties.

2.52 It is the view of ASIC that the four schemes are managed investments, and that as such they are not constituted lawfully. Deputy Chairman Mr Jeremy Cooper explained ASIC's involvement in the following terms:

It is a complex matter and I will, in very general terms, just explain why ASIC is here. The fact is that the scheme is wholly illegal. It is an unregistered scheme. It is a managed investment scheme that is not registered. None of the relevant parties have licences from us to deal in financial products, which these investments are. The funds have been raised without any formal product disclosure statement whatsoever. We also believe that a number of the statements that have been made in relation to this project are misleading or deceptive.

It is harsh on the current participants that they see the regulator intervening in a way that they might think is inconsistent with their interests but we do not have discretion to ignore very serious breaches of the law.²³

2.53 Mr Jan Redfern, Executive Director, Enforcement, stated that it is not ASIC's intention to cause further loss to investors:

It is hard to predict these things, but our stated position—and we spent a lot of time talking with the investors so that they understand the position—is that we do not want to cause difficulties for the project itself but simply have to make sure that the schemes, which are illegal, are regularised in some way that gives the investors protection. Investors may say now, ‘We are happy for these things to proceed,’ but the issue for us is that, in two years time, if there are problems they would be entitled to complain.²⁴

2.54 On 27 October, between the two oversight hearings held for this report, the Supreme Court of Queensland made orders following agreement between ASIC and Lifecare. The court ordered the schemes to be wound up, but deferred this winding up until the completion of construction. Investors will receive the return of their principal plus interest. Until winding up, the schemes will operate subject to supervision.

2.55 The Committee is pleased with the orders, which appear to be eminently sensible. They allow for the allegedly illegal schemes to be wound up, but do not leave innocent investors to carry massive losses. ASIC should be congratulated for this outcome.

2.56 However the Lifecare matter should emphasise to all potential investors the importance of ensuring that, before they invest in a project, they are certain that it is a lawful project within the framework of financial services legislation. The Parliament, and this Committee in particular, has spent recent years working towards a legal framework which provides investors with protection and confidence. However if investors place their money in schemes outside this legal framework, they place themselves outside the protection of ASIC and the laws it administers. Investors should seek advice from a licensed financial adviser before proceeding with any substantial investment.

23 Mr Jeremy Cooper *Transcript of Evidence*, 13 September 2005, p. 30.

24 Ms Jan Redfern *Transcript of Evidence*, 13 September 2005, p. 32.

Super Choice and Financial Services Reform (FSR)

2.57 The Super Choice regime commenced on 1 July 2005. During the hearing of 13 September 2005, ASIC gave the following assessment of progress during the early months of implementation:

I will now turn to super choice. ASIC is continuing to monitor compliance with this major policy initiative. As the committee would know, we have already conducted a review of advice given in late 2004 and early 2005 by financial advisers to more than 260 people—out of a sample of over 7,000 pieces of advice—thinking of switching superannuation funds. The super switching surveillance sought to test the readiness of advisers to give complying super-switching advice ahead of the implementation of super choice on 1 July this year. The findings highlighted some areas where licensees and advisers needed to lift their game. In particular, we identified instances of misconduct during the surveillance, some of which have already led to enforcement action. Various industry organisations, including the Financial Planning Association of Australia, have, without basis, criticised the methodology and timing of this review, perhaps because they do not like the surveillance results. The fact is, however, that some worrying patterns of misconduct were found that go beyond any fine judgment of the law as they involve cases of blatant misselling and flagrant disregard for the interests of the clients involved.²⁵

2.58 During the second hearing, officers of ASIC tabled at the Committee's request a report entitled *Report to the Parliamentary Joint Committee on late 2004 (and early 2005) superannuation switching advice surveillance*. The report, which appears as **Appendix 4** of this report, is a more detailed outcome including case studies of the surveillance mentioned above. The main findings were as follows:

- **Limited investigation of the 'from' fund.** Most advisers recommending a switch had made limited or no investigation of the fund that they advised the client to switch from (i.e. the 'from' fund);
- **Poor disclosure of the costs, loss of benefits and other significant consequences if the advice is followed.** As a result of limited or no investigation of the 'from' fund, most advisers in our surveillance did not comply with the specific obligations to disclose the costs, loss of benefits and other significant consequences of the recommended switch. In the [statements of advice] we reviewed, disclosure about the basis for the recommendation to switch was generally poor.
- **A tendency to recommend a fund related to the licensee.** Based on the statistics provided by licensees, there is a strong tendency among advisers to recommend switching to a fund related to the licensee. In these cases, there is a conflict of interest that must be carefully managed in order to avoid the

25 Mr Jeffrey Lucy *Transcript of Evidence*, 13 September 2005, p. 3.

perception that advice is inappropriate or is not given on a reasonable basis, or that the interests of the licensee are placed above those of the client.

- **A tendency to oversell life insurance.** There were a number of examples where advisers seemed to recommend life insurance to clients where there did not seem to be a reasonable basis for doing so.

2.59 The Committee is concerned at these findings, which indicate some advisers engaging in mis-selling and having insufficient regard for the interests of their clients. In particular and of great concern to the Committee is, as noted by Mr Cooper, that targeted groups of mis-selling appear to be low to middle income consumers. The Report includes seven real life examples of poor advice uncovered by ASIC, all of which should be considered carefully by both financial advisers and superannuation policy holders considering switching

2.60 The Committee continues to endorse the super surveillance policy. However, in light of suggestions that some of the examples were not factually correct, for the policy to work effectively, ASIC must ensure that its research is high quality, impartial, relevant, transparent and comprehensive. Without this approach, the credibility of super switching advice may be seriously undermined causing consumers to lose faith in the system. However, it is also important not to over-react to the results of ASIC's surveillance. The Committee is generally pleased with the professional improvements made by the industry in the face of a major program of regulatory change and notes ASIC's relatively optimistic view that the quality of super switching advice is likely to continue to rise:

... in many ways a lot of financial planners were moved, by legislation, effectively out of a sales culture into an advice one. That is why we call this a journey. We have not arrived yet. We are hoping to maintain some balance so this work is not all about fear. We do receive a lot of pressure to produce enforcement outcomes so we have to keep a balance between the educative and the prescriptive and the enforcement, and that is the exercise we are on.²⁶

2.61 Second, the fact that ASIC has undertaken this surveillance, that shadow shopping exercises are underway, and that ASIC is investigating with a view to taking action where necessary, demonstrates that the regulator is performing its required functions. If ASIC can maintain the balance noted by Mr Cooper above, then there is every reason to be confident that super switching can minimise the existing shortcomings evident in advice on superannuation choice.

2.62 The Commission provided detail on simplification of reporting requirements particularly documentation to be issued by product providers to consumers under FSR. This follows the announcements by the Parliamentary Secretary to the Treasurer,

26 Mr Jeremy Cooper *Transcript of Evidence*, 9 November 2005, p. 28.

the Hon Chris Pearce MP, on the need for provision of simpler documentation.²⁷ The Committee is generally satisfied that this will be of greater assistance to both consumers and industry. However it believes ASIC should maintain ongoing assessment to reduce documentation size wherever possible, consistent with the need to adequately inform. Further in the case of consumers this should be "tested" before finalisation.

Listing of persons banned from managing companies

2.63 On 18 October 2005, the *Age* newspaper reported that Mr Stephen O'Neill, jailed in 2001 for fraud and other offences, had managed the failed *Money for Living* company while banned from corporate activity. Mr O'Neill claims not to have understood that the ban was in effect, as he made a search on ASIC's register of barred persons and found that he was not listed.

2.64 This case raised the Committee's concerns. There are a number of ways in which people may be banned from corporate activity. They may be banned by ASIC itself or by court proceedings to which ASIC is party. In such cases, obviously, ASIC is aware of the ban and so the name of the banned person is registered. However, in addition, a person can become banned as a result of section 206B of the Corporations Act, after being convicted of indictable offences relating to their corporate activity, and in particular offences involving dishonesty.

2.65 The list maintained by ASIC does not generally include the names of people banned in accordance with s.206B. In evidence, ASIC stated:

The people that are on our register are people that we ban, or where we have taken proceedings against people. That enables us to administer a very accurate register of who, by our action, has been disqualified. The difficulty with the automatic banning under section 206B, is that not only does it apply when the person is released, but it also even applies to overseas convictions. Our internal view is that we do not have the power to create such a register but, even if we did, it would be a sizeable task to administer such a register.²⁸

2.66 The Committee recognises that the maintenance of a register would be complex, and may require either co-operative arrangements between ASIC, courts, and prison authorities; or alternatively detailed surveillance by ASIC. However in the absence of such a register, it may be impossible for investors, advisors and other market participants to find out whether companies in which they are investing, are led by proper people. If a person is banned by virtue of s.206B, but nobody can find out that this is the case, then they may as well not be banned at all.

27 The Treasury, *Refinements to Financial Services Regulation*, May 2005.

28 Mr Jeremy Cooper *Transcript of Evidence*, 9 November 2005, p. 11.

2.67 The Committee considers that the government should investigate a cost-effective means of enhancing the register of banned persons to include as many as possible of those persons banned under s.206B of the Corporations Act.

Government response to *Corporate Insolvency Laws: A Stocktake*

2.68 On 13 October 2005, the Government tabled its response to the Committee's 2004 report *Corporate Insolvency Laws: A Stocktake*. The government supported a substantial number of recommendations. Others it declined to support. There was a third category, however, which the government neither supported nor declined, but rather passed to ASIC, indicating in each case that "this recommendation is a matter for ASIC."

2.69 Such responses are somewhat troubling to the Committee. A Committee, when it tables a report, is entitled to a government response to each recommendation. ASIC, as a government agency, briefs the Treasurer and the Parliamentary Secretary, and could have been included in Treasury's process of formulating responses to the report. This did not occur.

2.70 Instead, by responding that some recommendations are "a matter for ASIC" the Government placed these recommendations in limbo. Formally, they received a response – that they were a matter for ASIC. However a response of this kind is of little utility. The Committee hopes that in future, similar cases, the Government might include ASIC's responses in its own response document.

2.71 In the final stages of preparing this report, the Committee received a response from ASIC in relation to the Insolvency report. This response will be discussed at the next oversight hearing, and reported upon in the next report.

Adverse comment by ASIC Official

2.72 On 25 August 2005, *Money Management* magazine reported that an ASIC official said of financial planners 'I just don't trust them'.

2.73 This raised the Committee's concerns. ASIC informed the Committee that it was aware of this comment, that it was made at a technical industry-arranged session designed for open dialogue between industry and the regulator, and that it had made considerable efforts to see off any potential long-term damage to its relationship with the financial planning industry. ASIC agreed with the Committee that these comments were an unfortunate reflection on ASIC's view of the financial planning industry and encouraged a view inconsistent with the public views expressed by it.

2.74 The Committee accepts ASIC's explanation that the reporting of these comments were taken partly out of context by the media, that they are confident comments of this nature will not be repeated, and that overall, ASIC and the financial planning industry enjoy a productive working relationship.

2.75 However, the Committee retains some concern that comments of this nature reflect a poor perception of financial planners on the part of ASIC and have the capacity to undermine public confidence in the financial planning industry. The Committee considers that ASIC should always approach the industry with its concerns first before voicing them in a public forum. ASIC should also set appropriate standards to be followed by its officials where they are required to comment publicly on ASIC's activities.

Senator Grant Chapman

Chairman

