

## Chapter 2

### Matters considered at oversight hearing

2.1 The committee inquired into several areas of ASIC's activities. These included the Commission's:

- ongoing regulatory response to the collapse of Trio Capital;
- implementation of the Future of Financial Advice (FOFA) reforms;
- regulatory activities affecting Australia's superannuation industry;
- supervision of Australia's domestic licensed markets;
- oversight of funds frozen as a result of the global financial crisis; and
- resources and regulatory approach.

#### ASIC's ongoing regulatory response to the collapse of Trio Capital

2.2 The committee tabled its report into the collapse of Trio Capital in May this year. However, the committee continues to closely monitor ASIC's ongoing response to the corporate collapse. While the government has yet to present its response to the committee's recommendations, the committee obtained from ASIC a broad update on the Commission's relevant activities.

2.3 ASIC noted that it is continuing the forward work plan outlined in its submission to the Trio Capital inquiry.<sup>1</sup> The Commission has released a report on the custodian industry, a consultation paper on the regulation of research houses, and anticipates the release of regulatory guidance to improve disclosure by hedge funds.<sup>2</sup>

2.4 The measures that the Commission has undertaken also include amendments to capital requirements to increase the financial resources required of responsible

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1 Mr John Price, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 15. ASIC's forward work plan is available in *Submission 51* for the committee's inquiry into the collapse of Trio Capital, pp 710, which can be obtained from the committee's website [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporate\\_ctte/trio/submissions.htm](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporate_ctte/trio/submissions.htm) (accessed 25 September 2012).

2 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, pp 15-16. Regulatory guide 240 - *Hedge funds: Improving disclosure* was released in 18 September 2012, and can be obtained from ASIC's website: [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg240-published-18-September-2012.pdf/\\$file/rg240-published-18-September-2012.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg240-published-18-September-2012.pdf/$file/rg240-published-18-September-2012.pdf) (accessed 20 October 2012).

entities to operate managed investment schemes.<sup>3</sup> ASIC has also undertaken surveillance of 12 responsible entities, which found that risk management arrangements appear to be stronger for APRA-regulated entities compared with entities that operate outside the APRA framework.<sup>4</sup>

### ***Communication between regulatory bodies***

2.5 As part of its inquiry into the collapse of Trio Capital, the committee found that communications between ASIC and the Australian Prudential Regulation Authority (APRA) regarding key material relevant to Trio Capital were lacking. ASIC maintained its previously stated position that the Commission has 'a good working relationship with APRA'.<sup>5</sup> However, ASIC confirmed that it is considering measures to improve information sharing with the prudential regulator.<sup>6</sup> The committee was not provided details of the measures under consideration.

2.6 The committee was further informed that ASIC is updating its Memorandum of Understanding with the Australian Taxation Office. Matters under review include general liaison and information sharing protocols.<sup>7</sup>

### ***Enforcement activity***

2.7 ASIC's investigations into individuals connected with Trio Capital, including the ARP Growth Fund and the Astarra Strategic Fund, are continuing. ASIC advised that 'we continue to devote very considerable resources to the investigation of the Trio matters on an ongoing basis'. However, ASIC further stated that 'it is too early to say at this stage' whether investigations will result in successful enforcement actions.<sup>8</sup>

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3 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 16. The committee understands that from 1 November 2012 responsible entities must prepare 12-month cash-flow projections for at least quarterly approval by directors. Responsible entities (RE) must hold the greater of \$150,000, 0.5% of the average value of scheme property (capped at \$5 million), or 10% of the average RE revenue (uncapped). In addition, a liquidity requirement has also been introduced where an RE must hold at least 50% of the required capital in liquid assets.

4 Mr Greg Tanzer, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 19.

5 Mr John Price, Senior Executive Leader, Australian Securities and Investments Commission, *Committee Hansard*, 22 June 2012, p. 3; Mr Price, Australian Securities and Investments Commission, *Proof Committee Hansard*, 12 September 2012, p. 16.

6 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 21.

7 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 21.

8 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 18.

2.8 ASIC reiterated its previously stated view that the losses suffered by investors in the ARP Growth Fund ultimately resulted from investment decisions rather than fraudulent activities.<sup>9</sup>

### *Committee view*

2.9 The committee acknowledges the devastating financial, emotional, and social consequences of the collapse of Trio Capital for investors. The committee queries ASIC's view on the legitimacy of the schemes in which the ARP Growth Fund invested. The committee requests that ASIC continue to appraise the committee of the liquidator's success in recovering funds for ARP Growth Fund members. The committee would also appreciate advice regarding whether the liquidator encountered any difficulties in fulfilling its responsibilities.

2.10 While awaiting the government's response to its recommendations, the committee acknowledges the work the Commission has undertaken to respond to the Trio collapse. In particular, the committee is interested in actions ASIC is taking to strengthen the regulatory framework for research houses and custodians and will seek ASIC's further advice regarding these developments at future oversight hearings.

### **ASIC's implementation of the Future of Financial Advice (FOFA) reforms**

2.11 Legislation to introduce the Future of Financial Advice (FOFA) reforms received Royal Assent on 27 June 2012, and commenced on 1 July 2012.<sup>10</sup> However, prior to 1 July 2013 Australian Financial Services Licensees (AFSLs) may choose whether to adopt the FOFA requirements.<sup>11</sup>

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9 Mr Price, Australian Securities and Investments Commission, *Proof Committee Hansard*, 12 September 2012, p. 17.

10 Further details of the *Corporations Amendment (Future of Financial Advice) Act 2012* and the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* are available at Parliamentary Joint Committee on Corporations and Financial Services, 'Information about the Bills', [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate\\_Committees?url=corporations\\_ctte/future\\_fin\\_advice/index.htm](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/future_fin_advice/index.htm) (accessed 25 September 2012).

11 An explanation of the FOFA reforms ASIC's related regulatory responsibilities is available at Australian Securities and Investments Commission, *Future of Financial Advice*, <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Future%20of%20financial%20advice> (accessed 25 September 2012).

### *Industry guidance*

2.12 In reviewing the draft legislation, the committee recommended that ASIC issue guidance material on aspects of the reforms.<sup>12</sup> ASIC confirmed that it is issuing guidance in relation to the opt-in requirements, ASIC's additional licensing powers, the best interests duty, the scaled advice test, and conflicted remuneration.<sup>13</sup> ASIC had previously advised that finalised guidance material would be published in September this year.<sup>14</sup> The committee received an update on the status of the guidance material. ASIC advised that the Commission:

- will shortly release a consultation paper detailing the opt-in requirements;
- has issued finalised guidance on ASIC's additional licensing powers;
- has released a consultation paper regarding the best interests duty, with submissions due by 20 September 2012;
- has released a consultation paper on scaled advice, with submissions due by 20 September 2012; and
- anticipates that it will release a consultation paper on conflicted remuneration within the coming months.<sup>15</sup>

2.13 ASIC may exempt a person or a class of persons from the opt-in requirements where satisfied that they are bound by a code of conduct that 'obviates the need' for the opt-in provisions.<sup>16</sup> Separate to the FOFA reforms, ASIC has existing powers to approve codes of conduct.<sup>17</sup> ASIC has publicly stated that its current expectations for codes of conduct will form the basis of consultations on codes of conduct for the purposes of the opt-in FOFA requirements.<sup>18</sup> In evidence to the committee, ASIC

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12 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, Recommendation 6 and Recommendation 12, pp xiii–xiv.

13 Mr Price, Australian Securities and Investments Commission, *Proof Committee Hansard*, 12 September 2012, p. 8.

14 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 21 March 2012, p. 16.

15 Mr Price, Australian Securities and Investments Commission, *Proof Committee Hansard*, 12 September 2012, p. 8.

16 Australian Securities and Investments Commission, *Future of Financial Advice*, <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Future%20of%20financial%20advice> (accessed 25 September 2012).

17 *Corporations Act 2001*, s.1101A.

18 Australian Securities and Investments Commission, *What ASIC is doing*, <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Future%20of%20financial%20advice> (accessed 11 September 2012).

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confirmed this approach.<sup>19</sup> At present, ASIC expects that, at a minimum, approved codes of conduct will:

- address specific industry issues and consumer problems not covered by legislation;
- elaborate upon legislation to deliver additional benefits to consumers; and/or
- clarify what needs to be done from the perspective of a particular industry or practice or product to comply with legislation.<sup>20</sup>

### ***Enforcement approach***

2.14 ASIC has publicly announced that the Commission will initially adopt a 'facilitative' approach to monitoring and enforcing compliance with the FOFA requirements.<sup>21</sup>

2.15 The Commission explained that this approach is 'fairly common' for major reforms. It was also clear that ASIC is intending to act proactively to promote compliance with the legislative reforms:

**Mr Kell:** It is our aim to assist them to comply, to get across the line, so that they can get in shape for the new laws, rather than taking a very strict and inflexible approach from day one.

**Mr Price:** ASIC policy development...is in addition to quite interactive discussions we are having with industry, sometimes on a daily basis, about various issues that they are seeing. The connections between ASIC and industry around how to implement FOFA are well and truly already made.<sup>22</sup>

### ***Committee view***

2.16 The committee thanks ASIC for its continued advice about the implementation of the FOFA reforms. Noting that AFSLs may choose to adopt the reforms prior to 1 July 2013, it is necessary for guidance material to be issued within the coming months and with some urgency. The committee will seek ASIC's advice regarding the extent to which AFSLs have adopted the reforms and any difficulties licence holders have encountered in implementing the new financial advice requirements. The committee anticipates that early adoption will provide ASIC the

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19 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 7.

20 Australian Securities and Investments Commission, *Regulatory Guide 183*, March 2005, p. 3.

21 Australian Securities and Investments Commission, *What ASIC is doing*, <http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Future%20of%20financial%20advice> (accessed 11 September 2012).

22 Mr Kell, Australian Securities and Investments Commission, Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 8.

opportunity to consider whether additional guidance is required, and to ensure that this guidance is in place prior to 1 July 2013.

### **Australia's superannuation industry**

2.17 ASIC has previously advised that the continuing growth of the superannuation industry will strongly influence Australia's financial markets in the coming 12 months, and, indeed, the coming decade. Accordingly, ASIC has further advised that the superannuation industry is an area of 'high focus' for the Commission.<sup>23</sup>

#### ***Self-managed superannuation funds***

2.18 In response to the collapse of Trio Capital, ASIC amended the MoneySmart website to advise that compensation is not available to self-managed superannuation fund (SMSF) investors in the event of theft or fraud.<sup>24</sup> The committee had made this recommendation in its report.<sup>25</sup> Further to this, the committee was informed that ASIC has now established an SMSF task force to examine currently available advice and options to more effectively engage with investors and consumers. It was noted that the task force was established relatively recently. Therefore, the Commission undertook to provide the committee updates regarding the work of the task force.<sup>26</sup>

#### ***Implementation of the SMSF auditor reforms***

2.19 The committee explored with ASIC activities the Commission is undertaking to establish a register of SMSF auditors. The government intends that from 1 July 2013 registration will be a mandatory precondition for operating as an SMSF auditor.<sup>27</sup> ASIC advised that it expects registration to be available from 31 January 2013. It is anticipated that at minimum 6000 practitioners will register.<sup>28</sup>

#### ***Committee view***

2.20 The committee agrees with ASIC's assessment that the continued growth of Australia's superannuation industry will affect the financial services landscape in the

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23 Mr Greg Medcraft, Chair, Australian Securities and Investments Commission, *Committee Hansard*, 22 June 2012, p. 13.

24 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 2 March 2012, p. 26.

25 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, Recommendation 3, paragraph 7.6.

26 Mr Kell, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 14.

27 The Hon Bill Shorten MP, 'New form of licence expands financial advice', Media release 036, 23 June 2012.

28 Mr Tanzer, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 20.

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coming years. The collapse of Trio Capital highlights the need for strong regulation and practitioner standards to protect the superannuation industry from fraud and mismanagement.

2.21 The committee is particularly interested in the work of the SMSF task force. The committee looks forwards to ASIC's continued advice regarding the task force's work, and will closely monitor developments in this area. The committee considers that a task force to guide SMSF regulation is particularly necessary, and should be comprised of representatives from other regulators concerned with SMSF activity. The committee will seek ASIC's advice regarding the task force's collaboration with the Australian Taxation Office and the Australian Prudential Regulation Authority.

2.22 The committee draws ASIC's attention to its previous discussions regarding misuse of the ASIC logo and Australian Financial Services Licences.<sup>29</sup> The committee is similarly concerned with any confusion regarding the significance of SMSF auditor registration. It would be inappropriate for SMSF auditors to claim, on the basis of their registration, that their services, or their audit findings, were 'ASIC endorsed'. The committee considers that it would be appropriate for ASIC to proactively attempt to dispel any such confusion or misuse of the auditor registration system, through providing the industry and investors guidance on the significance of auditor registration. Such guidance could usefully be included on the MoneySmart website.

### **ASIC's supervision of Australia's domestic licensed markets**

2.23 Following the transfer of responsibility for the supervision of real-time trading on Australia's domestic licensed markets to ASIC in August 2010, the committee has routinely inquired into market integrity matters. Matters under inquiry include ASIC's response to internalised/non-transparent trading known as 'dark pools'.<sup>30</sup>

2.24 On the basis of information previously provided, the committee understands that dark pools traditionally operated to reduce the risk that large transactions could cause price volatility on the lit market. Accordingly, dark pools were originally intended to promote market stability.<sup>31</sup> However, the nature and purpose of the dark pools market is shifting. Technological advances have broadened market access to dark pools and increased the use of dark pools for smaller amount transactions. As

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29 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, August 2011, pp 11–13.

30 See, for example, Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, August 2011, p. 7.

31 Dr Carole Comerton-Forde, Professor of Finance, Australian National University, *Committee Hansard*, 15 June 2011, p. 11.

ASIC has previously advised, these developments suggest that dark pools are no longer primarily a vehicle to minimise the risk of unintended market volatility.<sup>32</sup>

2.25 ASIC confirmed its previous advice that the value of dark pool trading has grown significantly in recent years, with the market accounting for five per cent of trading value as of March 2012. This value has increased since June 2011, in which dark pool transactions accounted for three per cent of trading value.<sup>33</sup>

2.26 ASIC further explained that dark pools operate without the safeguards applying to licensed markets:

These venues are not licensed. If they were licensed they would have obligations to maintain a fair, orderly and transparent market. They would have things monitoring volume of sales. They would have some monitoring for integrity, insider trading and so on.<sup>34</sup>

2.27 ASIC is considering whether additional safeguards are needed to ensure parity between the lit market and the unlicensed market:

The big issue is that there should be a level playing field. If it looks like the market, feels like market, it probably is a market.<sup>35</sup>

2.28 ASIC told the committee that it has established a task force to investigate the extent to which the unlit and unlicensed market is undermining the integrity of the lit market.<sup>36</sup> It is anticipated that the task force will issue a consultation paper for comment in February 2013. ASIC advised that matters under consideration include whether to impose a minimum size for dark pool transactions.<sup>37</sup> The task force's work will build on measures ASIC has already undertaken, which include additional draft market integrity rules. ASIC advised that the Commission is exploring rules requiring 'kill-switches' for automated trading systems, which would enable trading algorithms to be immediately disabled:

[I]n August we proposed rules and guidance on automated trading that cover high-frequency trading. Our proposals really build on confidence that

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32 Australian Securities and Investments Commission, answer to question on notice, 20 June 2012 (received 26 July 2012).

33 Australian Securities and Investments Commission, answer to question on notice, 20 June 2012 (received 26 July 2012); Ms Belinda Gibson, Deputy Chair, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 5.

34 Ms Gibson, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 3.

35 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 5.

36 Ms Gibson, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 3.

37 Ms Gibson, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 3.



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we are trying to achieve in equity markets. We have proposed, for market participants, among other things, a kill-switch which will be required in relation to algorithms in high-frequency trading; algorithmic testing, a process of certifying and reviewing annually; and we have also provided guidance on stress testing of order flows. So, essentially, we have tried to put more controls around making sure that systemic risk is protected with respect to high-frequency trading.<sup>38</sup>

### ***Committee view***

2.29 The committee has previously stated that it is concerned to ensure that the transfer of responsibility for supervision of real-time trading on Australia's domestic licensed markets from the Australian Securities Exchange to ASIC results in measurable improvements in market integrity.<sup>39</sup> It is evident that trading in the unlit market may affect the stability of the lit market. Indeed, the global financial crisis demonstrated the interdependency between the lit market and unregulated markets. In the committee's view, market integrity requires transparency and accountability in both the lit and unlit markets. The committee notes advice provided by Dr Carole Comerton-Forde, Professor of Finance, Australian National University, that it is 'very important' for dark pools to be regulated in their own right.<sup>40</sup> The committee draws this viewpoint to ASIC's attention. The committee will monitor developments in this area with interest.

2.30 The growth of dark pools raises the matter of ASIC's capacity to respond to innovation. The committee would be interested in ASIC's perspective on the Commission's current regulatory capacity to predict, and pre-emptively respond to, market developments.

### **Frozen funds**

2.31 The committee has continued to monitor the effect of the global financial crisis (GFC) on Australia's economy and financial markets. This includes

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38 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 5; Australian Securities and Investments Commission, answer to question on notice, 20 June 2012 (received 26 July 2012).

39 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, May 2011, p. 7.

40 Dr Comerton-Forde, Australian National University, *Committee Hansard*, 15 June 2011, p. 11.

developments regarding the significant number of illiquid managed investment schemes frozen in accordance with requirements under the *Corporations Act 2001*.<sup>41</sup>

2.32 The Commission advised that as of July 2012, \$10.96 billion in funds remain frozen. Of this, \$6.36 billion are frozen and inactive with the remaining funds, with an accumulated value of \$4.6 billion, in the process of winding up or restructuring.<sup>42</sup> At the height of the GFC the value of frozen funds totalled \$25.36 billion.<sup>43</sup> Accordingly, as of July 2012, 43.2 per cent remain frozen. ASIC advised that it is estimated that it will be two to five years before all funds frozen as a result of the GFC are realised.<sup>44</sup>

2.33 The committee was informed of the policy intent underlying the requirement in the Corporations Act for illiquid funds to be frozen. While acknowledging that suspending investors' rights to redeem their investments could cause financial difficulties, Mr Price explained that the requirement to freeze illiquid funds was intended to protect investors:

[T]he provisions around frozen funds were put there after the collapse of Estate Mortgage and various other funds many, many years ago. Possibly equally as damaging to investors is a situation where assets are sold in a very volatile market at fire sale prices. So what the legislature wanted to do was put in place a mechanism whereby there could be some sort of freeze until normality came back to the markets and you could realise those assets at a more reasonable price.<sup>45</sup>

2.34 ASIC advised that its administration of the frozen funds provisions in the Corporations Act seeks to appropriately balance long-term market correction and investors' immediate financial needs. It is this balance that prompted ASIC to

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41 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, February 2011, pp 911; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, May 2011, pp 1617; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, February 2011, pp 911; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, August 2011, pp 1314; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, November 2011, pp 1011; Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, March 2012, p. 18.

42 Mr Tanzer, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 20.

43 Mr Tanzer, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 20.

44 Mr Tanzer, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 20.

45 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 21.

introduce conditional relief, in the form of hardship payments, from the frozen fund requirements.<sup>46</sup> As of July 2012, 6345 applications for hardship payments have been approved, with payments totalling in excess of \$155 million.<sup>47</sup> This figure has increased since January 2011, in which 4300 applications had been approved and \$144 million returned to investors through hardship payments.<sup>48</sup>

2.35 ASIC's statutory responsibilities include advising the Minister about options to amend the Corporations Act to improve the Act's operation.<sup>49</sup> In November 2011, ASIC disclosed that the Commission has advised Treasury of options to amend the criteria prescribed by the Corporations Act to determine whether a scheme is liquid.<sup>50</sup> The committee heard that the proposed options seek to support investors through providing an objective basis on which to determine liquidity:

One of the key issues in terms of the definition of the assets of illiquid or not at the moment is that, to some extent, it depends on the judgement of the relevant responsible entity, the relevant people who operate the fund. The nature of our suggested amendments is more about putting a more objective framework around judging where assets are liquid or not.<sup>51</sup>

2.36 It is evident that the definition of liquidity, and responsible entities' understanding of the definition, is integral to the operation of the frozen fund scheme. The committee was informed that investors' and responsible entities' understanding of liquidity is an area of concern:

The problem with many of these funds is that they were sold as liquid investments, or nearly liquid, whereas the underlying assets were not liquid. That is the fundamental problem.<sup>52</sup>

### *Committee view*

2.37 As the committee has previously noted, Australia's economy has received international recognition for its resilience during the GFC.<sup>53</sup> However, the GFC's

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46 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 21.

47 Mr Tanzer, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 21.

48 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 11 March 2011, p. 40.

49 *Australian Securities and Investments Commission Act 2001*, paragraph 11(2)(b).

50 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 25 November 2011, p. 20.

51 Mr Price, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 21.

52 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 22.

ongoing significance for investors is evident in the substantial proportion of funds that remain frozen following the period of global economic and financial instability. The committee notes that as of July 2012 only 57 per cent, that is, a little over half, of the funds originally frozen have been realised.

2.38 Frozen funds impact both investors and the economy. For investors, the inability to access investments may affect financial security. For the economy, every year funds remain frozen represents a year of lost opportunities. Frozen funds cannot contribute to national, or individual, economic growth. The committee will continue to monitor developments in this area, and seek ASIC's advice regarding whether steps can appropriately be taken to support, and accelerate, the process of returning to pre-GFC frozen funds status.

2.39 The committee particularly notes ASIC's advice regarding investor and responsible entities' understanding of the operation of the frozen funds scheme. It is of concern to the committee that there is uncertainty regarding the liquidity requirements. The committee has previously noted the importance for investors to be informed of the potential for funds to be frozen as a result of illiquidity.<sup>54</sup> The committee seeks ASIC's advice regarding whether improvements can be made to product disclosure statements to clarify the liquidity requirements. Furthermore, the committee seeks ASIC's advice regarding activities the Commission can undertake to improve financial literacy among responsible entities. The committee will also continue to seek ASIC's advice on whether amendments are required to the Corporations Act to improve the operation of the frozen funds scheme.

### **ASIC's resources and regulatory approach**

2.40 The committee routinely questions ASIC regarding its enforcement strategies and allocation of resources. The committee was advised that the Commission expects gatekeepers in Australia's financial services system 'to act honestly, to be competent, to be diligent, and to manage conflicts of interest properly'. ASIC's enforcement action is focused on these four areas.<sup>55</sup>

2.41 The committee was provided a detailed analysis of the Commission's allocation of its resources to undertake surveillance activities. In summary, the Commission considers that Australia's financial services system 'is based on self-

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53 Organisation for Economic Cooperation and Development, *OECD strategic response to the financial and economic crisis: contributions to the global effort*, 2009, p. 3, as cited in Parliamentary Joint Committee on Corporations and Financial Services, *Access for small and medium business to finance*, April 2011, p. 18.

54 Parliamentary Joint Committee on Corporations and Financial Services, *Statutory oversight of the Australian Securities and Investments Commission*, August 2011, p. 14.

55 Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 2.

execution and relies on people doing the right thing'.<sup>56</sup> Accordingly, the Commission 'takes a risk based approach' to 'try and get the best bang for our [ASIC's] buck'.<sup>57</sup> ASIC candidly stated the Commission's view regarding the extent of ASIC's enforcement capacity:

ASIC is not a prudential regulator, not a conduct and surveillance regulator. The system we have is based on gatekeepers doing the right thing and it is self-executing. It is quite important in understanding what we are currently resourced to do. We are not resourced to be looking in everybody, and that is a very important message.<sup>58</sup>

2.42 An overview of outcomes of this approach to enforcement is provided in ASIC's Report 299 *ASIC enforcement outcomes: January to June 2012*. For the period of 1 January 2012 to 30 June 2012, ASIC undertook a total of 303 enforcement actions, which comprised 209 criminal proceedings, one civil action, 59 administrative remedies, 24 enforceable undertakings or negotiated outcomes, and one warning notice.<sup>59</sup> The majority of actions related to small business compliance and deterrence matters, with 196 actions taken against directors for summary offences such as the failure to keep proper books and records. In addition, ASIC commenced proceedings against nine directors for what it reported as 'more serious breaches of the law'.<sup>60</sup> The committee was informed that the report demonstrates ASIC's proactive, deterrence-based enforcement strategy:

So it is about enforcement but is also about proactive regulation, saying "here are the key areas you should focus on and here are some examples of where we have taken action". So it is meant to be preventative, going forward.<sup>61</sup>

2.43 It was also evident that ASIC considers investor and gatekeeper education to be a necessary part of a proactive, deterrence-based enforcement methodology.<sup>62</sup>

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56 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 14.

57 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 15.

58 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 15.

59 ASIC, Report 299, September 2012, Appendix 1, p. 2.

60 ASIC, Report 299, September 2012, p. 20.

61 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 22.

62 Mr Medcraft, Australian Securities and Investments Commission, *Committee Hansard*, 12 September 2012, p. 15.

***Committee view***

2.44 The committee appreciates ASIC's candour regarding its interpretation of its statutory duty to enforce the standards required under the Corporations Act and related legislation. The committee is also appreciative of ASIC's frank disclosure of the resources available to undertake surveillance activities.

2.45 ASIC is required under the ASIC Act to undertake whatever action it can take, and is necessary to take, to enforce the laws of the Commonwealth that confer functions and powers on it. While the 2012–13 federal budget allocated specific purpose funding to ASIC for the Stronger Super reforms and the FOFA reforms, the committee reiterates its previously stated view that the Commission must be properly resourced to take all necessary and appropriate action to promote fair, efficient and safe financial markets.

2.46 However, enforcement and surveillance is only one part of an appropriate regulatory model. Proactive education is a necessary aspect of a well-balanced, effective regulatory framework. The committee is therefore pleased with the measures ASIC has taken, and will continue to take, to issue guidance material to gatekeepers. The committee also concurs with ASIC's view on the importance of investor and consumer education. The committee would appreciate receiving from ASIC an overview of the Commission's financial literacy and investor education strategies.

**Ms Deborah O'Neill MP**  
**Chair**