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## JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

**Reference: Statutory oversight of Australian Securities and Investments Commission**

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**JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES**

**Monday, 2 December 2002**

**Members:** Senator Chapman *(Chairman)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy and Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

**Senators and members in attendance:** Senators Brandis, Chapman, Conroy, Murray and Wong and Mr Byrne and Mr Griffin

**Terms of reference for the inquiry:**

Statutory oversight of the Australian Securities and Investments Commission

## WITNESSES

**Committee met at 6.37 p.m.**

**IGLESIAS, Mr Carlos, Executive Director, Infrastructure, Australian Securities and Investments Commission**

**JOHNSTON, Mr Ian, Acting Commissioner, Australian Securities and Investments Commission**

**KELL, Mr Peter, Executive Director, Consumer Protection, Australian Securities and Investments Commission**

**KNOTT, Mr David, Chairman, Australian Securities and Investments Commission**

**RODGERS, Mr Malcolm, Executive Director, Policy and Markets, Australian Securities and Investments Commission**

**WOOD, Mr Peter, Executive Director, Enforcement, Australian Securities and Investments Commission**

**CHAIRMAN**—I declare open this public hearing of the Parliamentary Joint Committee on Corporations and Financial Services. Today the committee is conducting its public hearing into the Australian Securities and Investments Commission. The Joint Committee on Corporations and Financial Services is required by statute to oversee the functioning of ASIC. This hearing is part of that oversight. I welcome to this hearing Mr David Knott, Chairman of ASIC, and other officers from ASIC.

Witnesses should note that evidence given to the committee is protected by parliamentary privilege and that the giving of false or misleading evidence to the committee may constitute a contempt of parliament. I also remind officers that an officer shall not be asked to give opinions on matters of policy but shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister—not that we have any ministers present tonight. Unless the committee should decide otherwise, this is a public hearing and, as such, members of the public are welcome to attend; but you may, as with all committee hearings, request to go in camera on any matter, and the committee would consider that request. Do you wish to make an opening statement?

**Mr Knott**—No, thank you.

**CHAIRMAN**—We shall proceed to questions. I noticed that on 26 November ASIC put out a press release headed 'ASIC halts fundraising documents due to inadequate disclosure'. The press release gives four examples, and in three of those you say that the interim stop order has been revoked. I wonder whether that might be a bit misleading to people. Would you consider it better to put out a separate press release dealing with each individual company, particularly when you have revoked a stop order, rather than to have a heading which says one thing when the body of the press release actually says something else?

**Mr Knott**—We used to have a practice where we would issue individual media releases on the issuing of interim stop orders. But in many cases the issuing of an interim stop order is followed by corrective disclosure to the offer document in a form that makes it acceptable to us,

and we then allow the issue to proceed. The original deficiency in disclosure is real; it is a deficiency that is corrected. We have adopted this more omnibus approach so that when we do make the publication of information those people who have corrected the deficiency in their disclosure are not prejudiced by the media release. That is something that we have been doing in more recent months and it does respond to issues raised by the marketplace.

**CHAIRMAN**—The Senate Economics Legislation Committee has recently had an inquiry into the Financial Sector Legislation Amendment Bill (No. 2) 2002. Some of the evidence to that inquiry raised the question of duplication of functions between ASIC and APRA in regard to the fit and proper person test for directors of approved deposit institutions. Particular evidence noted that presently corporations are required to notify ASIC of changes in the composition of the board of directors, after the event. The proposed legislation will require ADIs to notify APRA of any changes in advance. Do you regard that as unnecessary duplication?

**Mr Johnston**—There are a couple of ways in which ASIC should be notified of such matters and it depends whether or not it is a corporation notifying us under the Corporations Act in respect of any change of director, which applies to any type of company, of course. The other way in which ASIC might have to be notified is if they are a financial services licensee. That then goes to the requirements that we have to license and take note of who are the responsible and authorised officers of the licensee.

The new APRA legislation, which I do not think is actually in place yet, talks about prospective notification. It is the case that there is duplication, inasmuch as both parties would have to be advised, but it is for different reasons—particularly under the Corporations Act, where every company has an obligation to notify changes in directors. What we have said in a recent policy statement and guidance note is that in relation to new applications for licences we will accept the information that people provide to APRA for the purposes of our licensing. That would not change the obligation that is under the Corporations Act to notify about changes in directors of a corporation.

**CHAIRMAN**—As you might be aware, we have recently commenced our inquiry into banking and financial services in rural, regional and remote Australia. We do not yet have a submission from ASIC. Does ASIC intend to make a submission to that inquiry?

**Mr Johnston**—We have not discussed that at commission level yet. I will have to take that on notice.

**CHAIRMAN**—At the couple of hearings that we have already had, there have been some issues emerging in relation to rural and regional banking. CUSCAL submitted that constraints on the ease with which consumers can transfer funds between financial institutions act as a brake on competition and limit the capacity for non-bank ADIs such as credit unions to move into new markets. It has recommended to us that ASIC undertake further investigation into the effect that the barriers to switching bank accounts has on competition and choice in financial services, including measures to remedy this. Could you respond?

**Mr Knott**—Again, I would have to say that that is not an issue that has come to our notice for consideration. I am struggling a little to understand why it would be an ASIC issue.

**CHAIRMAN**—I am trying to recall it now. In a sense, we have not reached a conclusion on why they have directed that, but it was in their submission. I suppose they are regarding it as a consumer issue rather than an APRA issue.

**Mr Knott**—Perhaps we could take it on board, have a look at it and provide you with a written response. But, as I say, I am personally struggling to see what role we would play in inhibiting movements between financial institutions.

**CHAIRMAN**—Do you have any awareness of what impact the licensing requirements of FSR are having in rural and remote areas, in terms of finding and providing adequately trained financial advisers?

**Mr Johnston**—Is your question directed to ADIs, or are you talking about advisers generally?

**CHAIRMAN**—No, this is a separate issue. It obviously includes that issue, but it is about the general availability of financial advisers in rural and remote Australia as being impacted on by FSR.

**Mr Johnston**—In terms of availability of advisers generally, I do not think FSR should really make any difference because, whether the people at present are financial planners, insurance agents or advisers of some other type, there is already some sort of regime applying to them, and I do not think the licensing regime would make any difference to the availability of financial advisers. If we are talking about ADIs and their ability to train their staff in rural and regional areas, that is a different issue.

Yes, regarding the requirement for ADIs to be licensed and the requirement for people who might be giving financial product advice to retail clients to be trained to meet the requirements of policy statement 146, it has been put to us that that might be onerous because there is a cost involved in training those staff. Some of the ADIs in remote and rural areas have only a small number of staff, of course. They are concerned about the cost and the enhanced mobility, if you like, of those staff after they have gone through that training. What I would say in response to that, though, is that all of the ADIs have to train their staff, in any event. They do not simply have to train them for policy statement 146 or FSR purposes. I think that staff training is something that they already do and, while there might be an increased cost in training them to meet the FSR requirements, I do not see that that impacts on the availability or the number of people that need to be trained.

**CHAIRMAN**—Another issue that has been raised in the banking inquiry is financial literacy, particularly in some remote areas and in Indigenous communities. I note that, in July 1999, you commissioned a research project to find out what information and education sources were available to Australian consumers of financial services and products. In that, you found that some information on levels of financial literacy in Australia would be useful. Are you aware of whether any research has been undertaken in regard to levels of financial literacy?

**Mr Knott**—I would like Mr Kell to respond.

**Mr Kell**—Yes, there is some research on this issue currently under way, which is primarily being driven by the ANZ Bank, and ASIC is on the steering committee for that research project.

It is a quite substantial quantitative survey of financial literacy. We have been active participants in designing that work. We are expecting the results of that to be out in the first half of next year.

ASIC have been putting a fair bit of effort into looking at this issue. We released a report recently on best practice education in financial services for Indigenous communities. That was released around Australia, and it has highlighted the gap that exists in the areas that are more difficult to access when it comes to the provision of financial services educational material. It is certainly something that we have been looking at and providing information on. Similarly, we have been working jointly with other agencies such as the ACCC, ATSIC and fair trading agencies to ensure that material on the book-up issue gets out to those communities. It is something that we have been addressing actively of late. We are hoping that a report giving a more general overview of financial literacy across the community will come out next year. We have been working with ANZ and others on that report.

**Senator BRANDIS**—Mr Knott, I have a fairly general question, but other officers may care to respond as well. In your annual report, you make the observation that, in the main, Australian business leaders have acted with a degree of restraint and conservatism. You compare the Australian experience in the year under review favourably with the American experience, subject to a couple of notable exceptions. In your view, do Australia's corporate leaders still tend towards ethical behaviour and conservatism in decision making? Do you think the events with companies such as HIH and One.Tel are evidence that there has been a slippage in the year under review? If so, why do you think there may have been a slippage? I know it is a very general question; I want to invite you to be discursive about this.

**Mr Knott**—I stand by the comments I have made. I do have the benefit of being involved in international work which has exposed me to some of the experiences in the US particularly. I have said before that, while some of the structural problems that the US has experienced have translated to Australia, the degree is quite different. The most obvious example of that is the whole executive remuneration issue, which is, I think, at the heart of the difficulties that both countries have had. We came off a very long, sustained period of profitability. During that period, we came increasingly to accept in our boardrooms executive remuneration practices that became unrealistic and to some degree out of control. I do think that, by and large, Australian companies avoided succumbing to the worst excesses.

Structurally, I accept that there are problems. The options issue is an example of an obvious problem here, as it is there, but to nothing like the same degree. By and large—probably as a result of our experiences in the eighties, the pain we went through in this country in the early nineties and the reforms that we introduced during that time—we did not fall for the abuses and the excesses at the same rate as they did overseas. It is necessary to have a response and to look at the structural problems to try to change behaviour where it needs to be changed. I think that the response that the Australian government is putting in place is an overwhelmingly appropriate one.

**Senator BRANDIS**—Can I ask you about one other matter. Are you aware of a press statement issued by Senator Campbell—today, I think—in relation to the 100-member rule? That is the rule that enables a minimum of 100 shareholders of a company to call a special general meeting. Senator Campbell announced the government's intention to replace that with a

provision in the Corporations Law whereby a minimum number of shareholders by value could requisition a special general meeting. Are you familiar with that initiative, Mr Knott?

**Mr Knott**—Yes, I am.

**Senator BRANDIS**—Do you have any views about it?

**Mr Knott**—I am strongly supportive of the initiative. Some of our recent experiences suggest that allowing 100 members of a company to convene a meeting can easily lend itself to abuse, particularly in a large company. I think it has done so in at least one notable case. The alternative measure in the law at the moment of five per cent is an appropriate measure. It is my understanding that the government intends to make that the universal requirement.

**Senator BRANDIS**—Thank you.

**CHAIRMAN**—I noticed your press release of 21 November about Trendwest Resorts South Pacific Ltd having entered into undertakings in relation to their presentations on time shares. The press release describes a situation which I experienced last year. I think I raised it with you in an earlier hearing. Because of my position, I went along to see how they operated. Some of the concerns that are expressed in this press release are concerns that I had—not necessarily with this particular group—and raised with you at the time, as I recall. I have also recently received some representations from the timeshare industry—a group of them are meeting with me later in the week—expressing the view that the current regulation is inappropriate for timeshare operators as they are not really marketing a financial product. While they are not objecting to being regulated, they believe that they should be under a different regime. What is your response to that?

**Mr Knott**—Mr Kell, Mr Rodgers and Mr Johnston are very keen to comment on this issue. Mr Kell may want to start.

**Mr Kell**—We have also heard the argument that time shares are not a financial product and therefore should not fall under ASIC's jurisdiction. As the Trendwest matter illustrates very clearly, time shares are still marketed quite aggressively as an investment. In the case of the Trendwest investigation, ASIC officers went along to several promotional evenings. The representation of the holiday credits being promoted by Trendwest had all the characteristics of a promising financial investment. It was said that the resale price would remain stable or increase and that there was a strong secondary market. That was a core feature of the way that a major timeshare industry participant was marketing its product. From a consumer protection standpoint, there is still a very clear need to ensure that an investor protection regime applies.

**Mr Rodgers**—While it might be open to the legislature to change the rules here, it has been unquestionable in our view that time shares are regulated financial products under the current corporations legislation. We have been administering that in a way that is adapted, in some respects, to the differences of that industry but that makes sure that time shares continue to be aligned and regulated as a financial product. We think it is clear that that is what the law presently requires.

**Mr Johnston**—I have nothing to add to that.

**Senator MURRAY**—I assume, Mr Knott, that early in the new year you will start preparing your budget application for the budget itself. According to your annual report, you had about a seven per cent increase in total revenue last year. It seems to me that the pace and range of your activities as an institution keep increasing. Do you feel under financial stress, given the tasks and priorities that are before ASIC?

**Mr Knott**—The increased appropriation we received in this year's budget was very welcome and, we think, absolutely necessary in order to discharge our FSRA responsibilities. It was also a welcome increment to our general enforcement work. Presumably, we will have CLERP 9, in some form, in place to administer next year. There will definitely be some further budgetary implications for that. The whole financial reporting area, for example, will be raised under the CLERP 9 proposals. In short, we continue to be in dialogue with the government. We think the government is receptive to our position. We are conscious that there are, particularly right now, a huge number of competing claims on the budget, some of which, realistically, are higher priorities than the very important work we do. In all fairness, I have to acknowledge that. But we will be pursuing our dialogue with the government, particularly in relation to CLERP 9, to ensure that, whatever the outcome of that legislative reform, we are able to implement it efficiently.

**Senator MURRAY**—If you compare the 2002 accounts to those of 2001, on an accrued basis you lifted your revenues by $10 million but you lifted your expenditure by $16 million and moved into deficit. Frankly, that is a sign of stress in an agency—that your priorities were pushing you to spend money and you could not avoid it. Your big lift was in suppliers, which was principally to external legal advice and that sort of matter. Without wanting to be a pessimist, I cannot see the pressure coming off you, in the way that things are, until such time as new regulatory regimes bite. We do not yet have and will not have a government response to governance and audit problems until the royal commission has reported. These things have lags in lead time. I would expect that, if you found the government less than responsive to your case, you might take a leaf out of the Electoral Commission's book, make a special pleading to the JSCM and come back to this committee for a bit of assistance.

**Mr Knott**—We always welcome assistance, as you know.

**Senator MURRAY**—We can only give it if we are given the information.

**Mr Knott**—Can I make the point that we have been more active—particularly in the civil penalty area—in the last 18 months, as you would expect. We have used those sanctions in relation to a number of very large collapses. They are hugely expensive to run—perhaps more expensive than we realised when we started some of them. They are protracted. We are against very well resourced opponents, and often those opponents are quite content to have the proceedings extended and delayed. The longer that goes on, the more expensive it is.

I have said to the committee before, and I say it with reasonable confidence, that there is a huge commitment to this work and a huge commitment to the work continuing. I believe that, if we reach a stage where any of those types of proceedings are in jeopardy by reason of funding, we would receive a sympathetic hearing from government. The only other thing I would add is that the funding result for this year is also influenced by the fact that our special funding for HIH—which was in two tranches, whereas the expenditure was not—means that some of the overspend in the HIH area is reflected in the accounts.

**Senator MURRAY**—Mr Knott, there are a couple of items that I want to pick up on in the balance sheet. You seem to have had a creation of a financial lease of $2 million-plus, if I remember the accounts correctly. What was that?

**Mr Knott**—I will ask Mr Iglesias to give you the detail.

**Mr Iglesias**—The most significant lease costs in this year's balance sheet relate to the leasing of IT equipment, which we undertook in the 2001-02 financial year.

**Senator MURRAY**—Of what equipment?

**Mr Iglesias**—We replaced a lot of our information technology equipment under lease.

**Senator MURRAY**—Is that principally hardware?

**Mr Iglesias**—PCs, printers, desktop PCs and servers—yes.

**Senator MURRAY**—With a projected life of what?

**Mr Iglesias**—You will see in the notes that the useful life of that equipment is three years.

**Senator MURRAY**—The other item I wanted to ask you about was your employee provisions. Your employee costs going out are $85 million-plus. Your employee provisions on the liability side are $27 million-plus, which is a ratio of one to three—a little more than that, perhaps. The big item there is leave provision. Are you managing your staff badly? Are you not giving them leave? What is going on? Why is it so high?

**Mr Iglesias**—That leave provision is carried forward for all employees that ASIC employs. Some of those were previously with government organisations, state organisations. They came across to the ASC, as it then was, and remain with ASIC currently. So we carry a provision in our accounts for their leave and their long service leave.

**Senator MURRAY**—It is a really crude calculation, but if you divide the employees' $85 million by leave of $22 million you are pretty well getting three months leave outstanding per employee. That is not acceptable in any organisation, if that crude estimation is accurate.

**Mr Knott**—Can I intervene for a moment. We have to take out long service leave in terms of the assessment you are doing. I do not have that exact split.

**Senator MURRAY**—Yes, and I am doing a really crude calculation.

**Mr Knott**—I think it is, apart from anything else, that reason because there would be a very significant amount of long service leave in the organisation. Nevertheless, the overall comment is fair in that it has been a priority of this commission in the last 18 months to work hard at managing excessive leave accruals. We have only been partially successful to date. Part of the answer is industrial; it is a matter of what we can negotiate in our certified agreements in terms of carry-forward leave. I think I am right in saying that our benchmark on that is pretty much standard for the public sector. I do not think we are terribly out of kilter.

**Senator MURRAY**—So you will not be surprised to know that I have asked the same question elsewhere.

**Mr Knott**—As a management issue, I can assure you that the commission has been working on it with some commitment, as I say, for about the last 18 months. We are faced, of course, with the problem of trying to tackle this issue just at a time when we are under resourcing strains for our people that are unusual for the reasons that we have just discussed—the large cases and the like. It is not a good position to be in that people cannot afford to take leave because they are needed, but that is the situation particularly in the enforcement area, where a lot of this problem exists. So it is a matter that we continue to work on. I am hopeful that over time we will see that ratio change, but it will take some time. There is quite an inherited issue here.

**Senator MURRAY**—Through the chairman, I wonder if I could ask you, Mr Knott, if you would be kind enough to arrange for your department to give us a profile of leave and the kind of plan you have got to wind it back over time. You know why I raise it: it deals with issues of overwork, stress and their health consequences and of people leaving because they simply cannot cope anymore, which will not do anybody any good.

**Mr Knott**—Yes, we will do that.

**Senator MURRAY**—Thank you. The other area of time I want to deal with briefly, Mr Knott, is your own time. I am actually a bit of a fan of your wandering the world and being our man interconnecting, because of the benefits we get out of that. If you are going to deal with issues of accounting standards and corporate governance and so on, you need to be connected to the international network. So do not take me as negative on this, but it must take a great deal of your own time. I want to know whether it takes much of ASIC's time and resources as well. How are you managing that?

**Mr Knott**—When the opportunity to head IOSCO's Technical Committee became available, it was a matter that I considered quite carefully, and I also discussed it with the Treasurer. I made it clear that to do this job would probably take about 12 or 15 per cent additional time. That was based on an assessment from the person previously occupying that position. The Treasurer made it clear to me that he was enthusiastic for me to take the position and that he expected that it would make no difference to my availability to ASIC. I think so far I have managed to do that.

**Senator MURRAY**—You are not taking much leave then, I gather?

**Mr Knott**—No. When you look at the commission's remuneration and at the highest item there, it would look as if I have received some sort of increase of substance, but it is in fact just accruals, I am afraid to tell you, Senator.

**Senator MURRAY**—Just before I give up the questioning to Senator Conroy—who is dying to get into you, I am sure—

**Senator CONROY**—Oh, please!

**Senator MURRAY**—the issue of Chinese walls has been emerging as a serious issue. Where you have large conglomerates—I suppose you would call them that—with different sections of hugely important financial players in our market and where the Chinese walls break down is a real issue. I know the commission has been going after that, but you would have seen newspaper reports about the Telstra stuff, for instance, and the three finance houses. But it is much more general; it is across the professional and financial sector generally. How are you going to deal with that? It is a bit like insider trading, isn't it? It is terribly difficult to get at.

**Mr Knott**—Yes, to some extent CLERP 9 does address this issue in its own way in relation to analysts. You are right; it is extremely difficult to address, other than through a regime of licensing that imposes obligations, seeks to make those as transparent as possible and gives the regulator some means of enforcing compliance. Chinese walls can play an important part in a conglomerate organisation but will always have their limitations.

**Senator MURRAY**—Do you think that policy makers may one day have to consider as one of the options the break-up of such companies? In America, the auditors—and I think it was a recent act that was passed there—simply said you could not do certain things within an audit company and you had to break up some service groups that were formally attached. Do you think that ultimately we will have to split functions if we get a continuation of this problem, or to consider it anyway?

**Mr Knott**—It is always possible that legislators might reach that conclusion. The Americans went through Glass-Steagal almost 60 years ago and subsequently reversed it. I think we see a number of issues arising from vertical integration in the finance sector. Some of it is very positive.

**Senator MURRAY**—Here we are talking more about horizontal integration.

**Mr Knott**—It can be both. What I mean by vertical is simply, for example, large financial institutions taking over the origination and advisory sides and becoming vertically integrated in that sense. But you are right; functionally it can be horizontal as well. There are real advantages for consumers in critical mass. The question is how you deal with the inherent conflicts and disadvantages of that type of structure. I am quite sure that regulators and legislators will be mindful of that as market dynamics change—as they are. There are the particular issues of competition within sectors. As an example, we now have four big accounting firms and not five; five was already arguably too few. That potentially is going to raise some pretty significant policy issues over the next few years.

**Senator MURRAY**—Perhaps in the future—and it depends on the kind of analysis and response that ASIC give to the problems they are investigating at present—rather than legislature obliging an automatic separation, ASIC could be given the power to separate where they find that there is a problem in a particular firm or conglomerate. It would be a kind of reserve power that would act as a cautionary mechanism.

**Mr Knott**—All I can really say is that that would take a very significant change of approach to corporate and securities regulation in Australia, in the sense that we have never had a rule-making power. Some of our counterparts offshore have rule-making powers which would be the avenue for, in part, delivering that type of outcome. We have never had that type of power.

**Senator BRANDIS**—Mr Wood, page 26 of your report records that there were 19 custodial sentences and another 23 convictions in the year under review. Were there any acquittals—any unsuccessful criminal proceedings for ASIC, in other words—and how many were there?

**Mr Wood**—I am afraid I do not have the figures with me. Perhaps I could take that on notice. I rather suspect there were acquittals.

**Senator BRANDIS**—If you cannot tell me now, can you also take on notice that I am interested to know how many of the 42-odd convictions were a result of contested proceedings—in other words, not-guilty pleas—and how many were on pleas of guilty.

**Mr Wood**—I will have to take that on notice.

**Senator BRANDIS**—Thank you.

**Senator CONROY**—You will have to excuse my voice; unfortunately I was a bit raucous on the weekend. ASIC has appointed a new chief accountant. Is Mr Pound with us?

**Mr Knott**—Mr Pound is attending tonight, hopefully as an observer.

**Senator CONROY**—Is that Mr Pound back there? Welcome. When does he start?

**Mr Knott**—Mr Pound has started as ASIC's chief accountant and he is in his second week.

**Senator CONROY**—His second week. So he was appointed at the end of November?

**Mr Knott**—21 November.

**Senator CONROY**—It is a long period between when Mr Macintosh moved on and Mr Pound started. Was he playing hard to get?

**Mr Knott**—Seducing a man of his qualities is difficult, Senator.

**Senator CONROY**—Given the time between Mr Macintosh leaving and Mr Pound starting, has a backlog of investigations of accounting treatments developed in the absence of a chief accountant?

**Mr Knott**—No, I do not think so at all. We have had a very experienced and capable officer acting in the role, supported by the same group of people within ASIC. The very major work that we have undertaken in reviewing financial accounts of the listed sector that was announced in the middle of the year has been going ahead full steam.

**Senator CONROY**—You do not need him at all, then. You can just keep going with what you have got.

**Mr Knott**—Having someone of Mr Pound's capabilities and credentials added to our existing resource base must be seen as a positive.

**Senator CONROY**—I was remiss when I started; I wanted to congratulate you on the first of your outcomes in Waterwheel, where the chairman rolled over. Congratulations to you and Mr Wood. Is there any indication of when the Waterwheel case will be concluded? I notice that the judge has reserved his decision and will bring something down.

**Mr Wood**—We have not had any indications from the court.

**Senator CONROY**—ASIC has recently commenced an accounting surveillance program of company accounts. I think you mentioned this, Mr Knott. How does that differ from surveillance programs of the past?

**Mr Knott**—It differs in scale. We decided that, as a result of the decline in investor confidence following the American experiences and our own belief that the prime causes of accounting failure in America were unlikely to be manifold in Australia, we would effectively do a stocktake across the broad spectrum of the listed companies sector. In previous years we have targeted specific accounting issues and taken random analyses of a relatively small group of companies. This is a much bigger exercise.

**Senator CONROY**—What are you actually looking at?

**Mr Knott**—We are looking at three areas. The first is capitalisation of expenses, the second is nonconsolidation of controlled entities and the third is the nonrecognition of revenue. All of those matters were at the heart of what we call the Enron collapses, in which we include WorldCom and the spate of other collapses in the United States. Fundamentally, it is those three issues.

**Senator CONROY**—Are we any closer to solving the leasing issue? I know Mr Macintosh talked about it when he was with you. After he left you, I think he expressed in an article that he was very concerned about the leasing issue and the amount of time it has taken to get a standard that actually reflects reality as opposed to the mythologies that it reflects now.

**Mr Knott**—I cannot help you with the timing of the International Accounting Standards Board's work on leasing. I do know that it is one of their priority areas. I suspect you would have heard Sir David Tweedy talk on the subject.

**Senator CONROY**—A good man.

**Mr Knott**—We very strongly support the philosophical approach that he espouses. I am not sure exactly where it is in their work program, but I do know that it is a high priority.

**Senator CONROY**—If you were to come across a range of companies that have got a particular accounting treatment that you think is a little close to the edge, and it turns out that they have all got the same auditor, would you then go to the company and say, 'Look, we just want to talk to you about how you seem to be treating this as a company position'? Have you come across circumstances like that?

**Mr Knott**—I think it is perhaps useful to say that, in the project that we are now undertaking, of course one possibility has occurred to us that there may be recurring issues involving a single

firm. If that were to emerge—and it is too early to say whether it has or not—we would take a dual pronged approach: one directed to individual companies and the second directed to the firm.

**Senator CONROY**—On the subject of auditors, is it ASIC's view that auditors should provide other services to their audit clients? I am just trying to think whether I have heard ASIC put a view on that at any stage.

**Mr Knott**—Our preferred view would be that auditors should not be entitled to provide such non-audit services as would result in self-review in the audit. So we would not start from a philosophical position that says 'no services' but we would say that, if auditors are providing consultancy services in relation to transactions or issues that will find their way into the financial statements of the firm and will then be audited by the same auditors, that is the principle to which reform should be directed.

**Senator CONROY**—If you need to set up a self-review for this particular company because you have suddenly started consulting, then you should not be doing it in the first place. Is that too simplistic?

**Mr Knott**—It is so simplistic that I do not understand it.

**Senator CONROY**—I often do not express myself well.

**Mr Knott**—I think we are all suffering a little bit from colds and poor hearing, which is impeding our usual level of comprehension. An example would be that, if an audit firm were providing due diligence on an acquisition that was material to the balance sheet and the particular accounting treatments that came out of that transaction found their way into the balance sheet of the acquirer, we would say the auditor should not be the provider of that advice, because the auditor will be the party effectively reviewing the very advice that they gave.

**Senator CONROY**—I saw reported in the newspapers—somewhat unkindly, I thought at the time—that your surveillance program would have to employ outside contract accountants to review company accounts. I think someone described it as the 'Dad's Army' approach. Is that correct? Did you have to go out into the market?

**Mr Knott**—Yes, we did, but I should emphasise that that is not unusual and the people that we retain for the first stage of the work, which is the large-scale desk type review, are extremely competent people to do that work. We have done it before and we will do it again, not only with accounting surveillance but also with different types of surveillance that could lead to enforcement, where we need to bring in expert desk review people to help us progressively narrow it down to those companies on which we think further surveillance needs to be done. As it is narrowed down, the demand on external people reduces and ultimately, if perchance we are pursuing people for financial restatement or even enforcement, then we would expect that to have become, by that stage, a purely internal ASIC resourcing issue.

**Senator CONROY**—Obviously questions of conflicts, depending on who you hire, can potentially come up. What governance have you put in place to manage those conflicts?

**Mr Knott**—We did have quite specific governance procedures in place. I might ask Mr Rodgers, who has been helping to manage that project in the absence of Mr Macintosh, to expand on that for you.

**Mr Rodgers**—We have drawn from the outside profession but not from the major firms. Also, at the time that we took people on, we made sure that we fully understood their background so that we could make a decision as to whether there might be either a conflict with an individual company or a conflict because of some background within the accounting profession where they were looking at a firm with which they had been closely associated in the past. That necessarily narrows the field but it does not eliminate it altogether. We have drawn from those who have sufficient skills but we have specifically vetted each person who came in the door to understand where there might be a potential for conflict. That did not occur very often. Where it did occur, we made sure that the financial reports they looked at were outside that area of conflict.

**Senator CONROY**—I was wondering if you had been drawn into an investigation. There is a very prominent company that has been involved in some non-recognition of expenses—running trust accounts that are separate from the main body making payments. Have you been called into the Carlton Football Club over its accounting practices?

**Mr Knott**—No, we have not.

**Senator CONROY**—I cannot understand why. It has been all over the newspapers. It seems like an absolute prime example.

**Mr Knott**—The Carlton Football Club—

**Senator CONROY**—It is a proprietary limited company. Do you have a conflict, Mr Knott? Would you like me to ask someone else?

**Mr Knott**—It is currently the subject of an investigation by the Australian Football League in relation to salary cap payments. We think it is quite appropriate that that inquiry should be conducted by the league.

**Senator CONROY**—But, quite seriously, there do appear to be a number of breaches of accounting standards, given that they have the force of law. They do seem to be running a trust to pay Silvagni, Bradley and a few of the others some large amounts of money that are not consolidated into the main account. They have certainly not been recognising the overpayments to these players, who have confessed, as part of their accounts.

**Mr Knott**—It is of course possible with that club and indeed, I suspect, a number of others—a major league club in Sydney and a certain area of soccer come to mind. I think all I can say is—

**Senator CONROY**—You haven't outsourced to the AFL the investigation of the Carlton Football Club accounting practice issue?

**Mr Knott**—No, but we have asked the AFL to advise us if in the course of their investigation any matter arises that should be examined under the Corporations Act.

**Senator CONROY**—And you are confident that they have no conflict?

**Mr Knott**—We have also made our position plain to the auditors. I think that particular club balances at the end of the third quarter, so its financial accounts for last year are not yet due—but we will await them with interest. We have a lot of trouble with football clubs. The HIH royal commission had evidence about the Collingwood Football Club.

**CHAIRMAN**—A quarter of a million dollars for Mr Brad Cooper, isn't it?

**Mr Knott**—I forget the details.

**Senator CONROY**—You are not a Carlton fan as well, are you, Chair? Surely you are an Adelaide fan?

**CHAIRMAN**—Certainly.

**Senator CONROY**—I look forward to speedy resolution of those matters if they come to your attention, Mr Knott. Have you allocated someone else to deal with this, given that you are a member of the club, if it does come up? Are you dealing with the AFL personally on this?

**Mr Knott**—For the record, I am not a member of the Carlton Football Club—

**Senator CONROY**—I thought you had to be a member to wear one of those ties?

**Mr Johnston**—but I am a life-long supporter and therefore would not of course be involved in the investigation. Mr Johnston would manage that matter.

**Senator CONROY**—Who do you barrack for, Mr Johnston?

**Mr Johnston**—The Western Bulldogs.

**Senator CONROY**—There is no point in investigating their finances, is there?

**Mr Johnston**—Let us follow them through thin and thin!

**CHAIRMAN**—Do you have any further questions, Senator Conroy?

**Senator CONROY**—Yes, I will move on. On *Business Sunday* in August, Mr Knott, you said:

I frankly don't think it makes a lot of sense to have to run off to court on issues of accounting standards and we don't really have in place a good system for arbitrating the proper application of standards and we need to look at that very closely as part of the international development.

How many accounts have ASIC required to be restated because accounting standards have not been properly applied?

**Mr Knott**—I will have to take that question on notice to provide a precise number. But I think I am correct in saying that if we look retrospectively over the last three or four years the dollar number is in excess of $2 billion. And I believe I am right in saying that in previous annual reports we have given some information about numbers. But we will consolidate that for you.

**Senator CONROY**—What is the lapse in time between ASIC releasing accounts that have not been prepared in accordance with accounting standards and the accounts being restated? How are shareholders kept informed during that time?

**Mr Knott**—Again, that would vary from case to case. As with all investigations, we would pursue them in confidence until such time as they reached a definite status that had an outcome that was capable of being portrayed to the market. Each case would vary according to its complexity.

**Senator CONROY**—So it could be a year or two. I know some of them have run on for considerable periods of time. Do you feel the shareholders should be aware that there is a question mark over the company accounts?

**Mr Knott**—If we felt that it was material enough to be price sensitive—that we had a serious concern—I think we would push the company for disclosure or indeed make our own.

**Senator CONROY**—On that same *Business Sunday* program you proposed an arbitration system for resolving differences in the interpretation of accounting standards. How would you envisage that would operate?

**Mr Knott**—The word 'arbitration' may be indelicate. The type of procedure that we have in mind is a panel concept, as in the United Kingdom. How exactly that would work remains to be seen. We think it could, for example, operate under the umbrella of the Financial Reporting Council. It would be a place where, if we were uncomfortable with the interpretation in a set of accounts, we could go to present a case and seek a ruling in relation to the issue for that company. Inevitably, I think it would then be a matter of whether the company accepted that position or rejected it. We would hope that in those circumstances the issue would be transparent and public. If we thought the issue was such that it could then be litigated, we could always pursue litigation. My understanding is that in the UK that practice has been a successful one and that, by and large, companies accept the verdict.

**Senator CONROY**—A bit like the takeover panel style concept.

**Mr Knott**—There is some analogy, I think. The point that I was making at the time, which I have not changed my view about, is that the UIG as a group is most effective for systemic issues, issues across companies. It is not effective for an individual company and probably was never expected to be. There is nothing available in the case of a disputed interpretation other than litigation. Frankly, the courts are not well equipped to be judging accounting standard issues. It would be better to have an expert group that could do it and do it quickly.

**Senator CONROY**—Have you written formally to the minister suggesting this option? Is it part of any submissions you have made as part of CLERP 9 or CLERP 10?

**Mr Knott**—Yes. We have made a submission on CLERP 9 that includes this issue. We did that approximately a week ago. Out of courtesy to Treasury, we have made that a private submission but it is our intention to place that submission on our web site before the end of this week.

**Senator CONROY**—On that same episode of *Business Sunday* you also said that we need to review how the Urgent Issues Group work. I know there has been a degree of controversy. Can you outline your concerns? There has been a fair degree of public comment. I think the *Sunday* program itself dealt with a number of issues that had come before. Have you raised those issues with the Urgent Issues Group in terms of conflicts of interest and how they manage them?

**Mr Knott**—No. To be fair to them on the second point, I have not had any discussions with them on the issue. That is largely because as our thinking has developed it has gone down this track of a panel type concept which would deal with individual cases. We will strongly support the idea that systemic issues—that is, issues going to fundamental problems with the standards themselves—should go back into the international arena through the body that is set up in the international framework to deal with interpretive issues. That may mean—and I am speaking at the moment on the basis that we do not know which way CLERP 9 will end up—that there is not the role for the UIG that there has been in the framework.

**Senator CONROY**—Following the introduction of international accounting standards, how will differences in interpretation of the standards be handled? Is there going to be a local UIG equivalent? Is there going to be one big international body? What is the plan?

**Mr Knott**—The aspiration of the AISB is that matters which I have called systemic—that is, matters which go to material issues in standards—will go back to a specific group, IFRIC, that has been set up within the international framework. Do not ask me about the acronym!

**Senator CONROY**—I won't! I think it is better if we don't know.

**Mr Knott**—That is the group to which it is hoped that all countries who have adopted international accounting standards will refer material issues of interpretation so that, if necessary, the standards can be amended, amplified et cetera. The point that is made, I think properly, is that if every country around the world starts interpreting these standards in its own way—if regulators start making rules or giving very extended guidance—this will become de facto standard setting, and we will find that the international standards are simply no longer uniform. The whole point will be lost. I think that is a fair approach. In my mind, it does then immediately raise the issue of individual interpretations. We could have a problem with a particular company. It would not be a big enough issue to go back into the international arena for major change. We need to have a way of resolving it. That is why we have recommended the panel approach.

**Senator CONROY**—I understand that IOSCO is also looking at international accounting standards. Are you a representative on IOSCO, Mr Knott—vice president, in fact?

**Mr Knott**—I am chairman of the technical committee but we also have representatives on the working parties, including the group on accounting and disclosure.

**Senator CONROY**—Is that you?

**Mr Knott**—No, that is our chief accountant. Mr Pound will attend his first meeting in January.

**Senator CONROY**—What exactly is IOSCO's role in the development of international accounting standards? How are the two fitting together?

**Mr Knott**—The first thing that it is doing is providing input specifically to audit standards. That is potentially a process by which, subject to comments that IOSCO has for improvement, we as a group of international securities regulators will say, 'Yes, we endorse this for international usage.' You may recall there was such an endorsement given at the Sydney conference of IOSCO in 2000 in relation to international capital raising or cross-border fundraising.

**Senator CONROY**—Yes.

**Mr Knott**—It is an attempt by international securities regulators to generate a harmonisational standard approach to the way standards will be observed. Of course, that has taken on a whole new life as a result of the beefing up of the ISB, the commitment of Europe to 2005 and Australia's commitment to 2005. The second role that IOSCO is playing is looking very carefully at the moment at how accounting standards might be enforced. That goes to the sorts of issues that we have just been discussing.

**Senator CONROY**—I want to go back to an issue that I know you were talking about earlier with, I think, Senator Brandis. I would like to refer back to an article in the *Age* in April which indicated that ASIC was on the lookout for schemes that reconstructed executive option packages. The article indicated that these schemes included the payment of a cancellation fee that gives executives a payment for worthless options or the reissue of options at lower prices. Did you come across any?

**Mr Knott**—I will ask Mr Rodgers to respond to that.

**Mr Rodgers**—I am not aware of that particular article, although I know the issue has been occasionally referred to throughout the year in the press. We have taken an interest in executive options in a number of issues. They are issues we have discussed with you before in this committee on the way in which disclosures are made in financial reports about options and their evaluation. There is an issue too about the shareholders or a board of directors agreeing to issue options—in the case of shareholders, issuing them to directors; in the case of a board, issuing them to senior executives—as a way of aligning the interests of directors or executives with ordinary shareholders. The issue is: what is the position if those directors or executives deal with those options in a way that effectively removes that connection—for example, if they take a derivative position—

**Senator CONROY**—We will come to that next.

**Mr Rodgers**—The world expects that an executive or director holding shares in that way has the same interests as every other shareholder in the movements of the price, but that is not true, because of transactions. That clearly is a matter of concern to shareholders. In our view, it ought to be of concern to boards, particularly if they have been instrumental in deciding to grant executive options. I wrote last week to the ASX Corporate Governance Council—which, as you

know, have a number of items on their agenda, including, potentially, the treatment of executive options—drawing their attention to the latter issue—

**Senator CONROY**—This is on the derivatives pile?

**Mr Rodgers**—and asking them to consider what, if anything, might be done through that council to address that issue.

**Senator CONROY**—So you have written to the ASX, asking them to examine this.

**Mr Rodgers**—I have written to the ASX Corporate Governance Council, which has a number of items on its agenda that are intended to go towards best practice corporate governance issues.

**Senator CONROY**—Do you think it is ethical for people to receive options and then engage in a transaction that effectively takes the risk away from them when it applies to everybody else? The whole theory behind aligning management and shareholder interests is to ensure the best outcomes. If management have then entered into separate secret arrangements which take away the downside risk, do you think that is an ethical thing to do?

**Mr Rodgers**—I should begin by saying that I do not think it is illegal.

**Senator CONROY**—I asked if it was ethical.

**Mr Rodgers**—I think it is potentially undesirable. We are talking about possibly quite a large spectrum of transactions.

**Senator CONROY**—They seem very popular. They are very widely touted in the market.

**Mr Rodgers**—I think we are talking about the same recent media articles that talk about these issues. It would be undesirable if a connection that was intended to be created were subsequently removed. It would be unfortunate, therefore, if people continued to be under the impression that there was an alignment of interests when there was not. However, we have characterised it as, at least initially, a corporate governance issue. If boards make decisions to grant other options or shares to executives as remuneration and to ensure the alignment, it should be a cause of great concern to boards if those alignments which they have set out to create are broken.

**Senator CONROY**—I think it should be mandatory for these arrangements to be revealed by the relevant employee to the shareholders and to the board. Does ASIC have a view on this?

**Mr Knott**—What Mr Rodgers has attempted to explain is that, at this stage, we have referred the matter to the ASX Corporate Governance Council, requesting them to consider it from a governance perspective. Implicit in the letter we sent them was our view that the practice is undesirable. I think I am right in saying, Mr Rodgers, that the issue of disclosure is also mentioned in that letter. That is my recollection. If the listed sector were to adopt on a voluntary basis a practice under which, ideally, such treatment of options did not proceed—or at least, if it did, it was disclosed—that would be a very desirable outcome.

**Senator CONROY**—There is nothing stopping them from disclosing them now. They could voluntarily disclose them right now.

**Mr Knott**—That is true.

**Senator CONROY**—Do you think a voluntary code of conduct would be the solution, to encourage everybody who has voluntarily not disclosed them so far to suddenly voluntarily disclose them?

**Mr Knott**—I am not even sure whether, at the moment, company boards would be routinely aware of the degree to which executives are entering into derivative transactions in relation to their derivatives or shares. I think the appropriate course is that, in the first instance, the council should consider it and form a view. If their view is that the practice is undesirable and there should be a standard that says that as part of remuneration practice, when options are granted, the executives must hold the options on the normal course, that would be a good outcome. I think your solution of disclosure is a secondary outcome if the practice continues. Our preference would be to see the practice cease.

**Senator CONROY**—Do you have any powers to prohibit these schemes?

**Mr Knott**—Not to my knowledge, no.

**Senator CONROY**—In relation to remuneration, Stephen Bartholomeusz recently wrote that the US Federal Reserve research has shown a high correlation between share repurchases—buybacks—and the issuing of executive options. Are you familiar with that research?

**Mr Knott**—No, I am not personally familiar with it.

**Mr Rodgers**—No.

**Senator CONROY**—Are you aware if there is a similar correlation in Australia?

**Mr Knott**—No, I am not aware of it.

**Senator CONROY**—In his article, Mr Bartholomeusz said that the cynical explanation—and I know there are no cynics at the table—for the correlation found by the Federal Reserve was that the use of buybacks would put a floor under share prices, and therefore the value of options. I would probably characterise this as actually share manipulation. Are you aware of share buybacks being used in this way in Australia?

**Mr Knott**—I am not aware of it personally, no.

**Senator CONROY**—Do you believe it is worth while having a look at?

**Mr Knott**—I can understand how a cynic would form that view, and part of our role is to be cynical.

**Senator CONROY**—Are you in a position where you can begin looking at this?

**Mr Knott**—I can certainly give you an undertaking that we will take this on board to have a look at it. I could not undertake to tell you when and in what priority, at this stage,.

**Senator CONROY**—If we are lucky, the Reserve Bank might even be looking at this in a similar way to the Federal Reserve. You might want to have a chat with them to see if they have done any empirical work on it. Do you think shareholders are currently properly informed of the benefits that executives may receive from share buybacks, in terms of their downside suddenly vanishing?

**Mr Knott**—If it is clear from the share buyback terms that that is a consequence, one would argue yes. Again, that is part of the work we should undertake, following on from the earlier answer.

**Senator CONROY**—Just going back to these derivatives, the way that the market has been able to price options and develop a derivative when the accounting industry has just struggled so hard to be able to value options seems remarkable. Do you find that remarkable? I wish Mr Pound was here to give us his view at this point.

**Mr Knott**—Yes.

**Senator CONROY**—Are we constrained from inviting him to the table? Do we need dispensation from the Chair? Have you put him through the training program yet on how to handle Senator Conroy?

**Mr Knott**—He is undergoing the training program, as you see tonight, Senator.

**Senator CONROY**—Is he a Carlton fan?

**Mr Knott**—I hope so. I understand the background of your question, of course. I do not think there has ever been difficulty in valuing a traded option. On the issue more generally, I think we can give you some light at the end of this long tunnel. You are aware that the ISB has issued a standard in relation to executive options. That standard, if endorsed, will only apply to options issued after 2004; nevertheless, if it is adopted—

**Senator CONROY**—How can something that is an expense one day—but still carrying forward—not be an expense within a set of accounts?

**Mr Knott**—That is always the way when you introduce new rules. We always have implementation dates for standards. There will be transition arrangements as well. We will have this with a whole series of international standards. These standards will have a big impact on balance sheets. One can say, 'How could it have been right the day before if it going to look materially different the day after?' But that is the consequence of introducing new rules. If I can just complete the answer on the options standard, as part of that standard there is, we believe, sufficient guidance about valuation, such that our current practice note for interpreting the existing law can be amended. So even though the standard will not apply for accounting purposes until the 2004 year, or whatever it turns out to be, we ought to be able, in relation to the current financial year, to make it clear that in meeting the disclosure requirements of the Corporations Act—the requirements that you have raised with me previously—we now think the reference point is this standard.

**Senator CONROY**—You were right; there is light at the end of the tunnel.

**Mr Knott**—In those circumstances, we would expect to have a compliance campaign in relation to current financial year reports in terms of the valuing option.

**Senator CONROY**—Do you think we should go back and have everyone restate their accounts, given that the Corporations Law has been in since 1998? Is that too ambitious a task?

**Mr Knott**—It would be an ambitious task for us.

**Senator CONROY**—You are aware that, overwhelmingly, the submissions that have been put in about this draft standard have called for it to be deferred.

**Mr Knott**—Yes.

**Senator CONROY**—Do you have any views on the seeming reluctance of companies to enthusiastically uptake the challenge?

**Mr Knott**—I understand that the introduction of the application of the standard will have an impact and, in some cases, a reasonably significant impact. We support the approach taken by the standard. We believe that options are an expense, and they should be expensed in the company's accounts. We are supportive of the IASB in having that introduced from 2004.

**Senator CONROY**—Just to clarify, do you think, given the existing provisions of the Corporations Law, that in this financial year we could expect to see some disclosure in the annual reports now that we have an internationally accepted standard?

**Mr Knott**—It is very important that I be clear what I am saying.

**Senator CONROY**—Yes.

**Mr Knott**—There is a provision in the Corporations Act that requires companies to value executive options. We have been discussing the apparent difficulties of meeting that obligation for some time. The difficulty basically is that, in relation to at least some types of options, the methodology for valuation is obscure. The new IASB, which, if endorsed, will come into force, as I understand, in 2004, is in relation to the expensing of options in financial statements and, as part of the standard, there is some guidance as to how options will be valued. That is actually the expensing issue.

The endorsement of that standard gives us a reference point for companies to consult in meeting their existing disclosure obligation under the Corporations Act. It would be our intention to say, 'You have an obligation to disclose the value of options. You have said it has been too difficult to do that. We believe you should refer to this new accounting standard, even though it does not apply until 2004 for expensing purposes. We believe you should refer to that now for valuation purposes', and we will be applying the law as if that were the case.

**Senator MURRAY**—Excellent.

**Senator CONROY**—I concur with Senator Murray's comment—excellent. I was just talking in your absence, Senator Murray, about these latest schemes where people have been trading derivatives to reduce their downside options. You may have seen that in the newspapers recently. We were just discussing how remarkable it was that we could trade a derivative on something we could not value. The market is a very clever thing. I have never understood it myself.

**Senator MURRAY**—An intangible derivative.

**Senator CONROY**—An intangible derivative! I have a few questions on the Ramsay report on fees and charges disclosure. When was Professor Ramsay commissioned to undertake the report?

**Mr Johnston**—It was earlier this year. I cannot remember the exact time.

**Mr Rodgers**—It was about mid-December last year.

**Senator CONROY**—When did he report?

**Mr Johnston**—We got the final report about six weeks ago.

**Mr Rodgers**—I think we actually got it in its final form in August.

**Senator CONROY**—The report took a long time to be released.

**Mr Johnston**—It took a long time partly because of the process of putting the report together. He consulted widely across a number of industry and consumer groups. We were given some draft of the report while he was completing his final work and putting the final touches to the report. We then had a view that we really had to look at the report at the commission level before we would do anything with it. So, yes, it did take some time.

**Senator CONROY**—I want to clarify what Professor Ramsay was asked to do. Was he asked to make a statement or take a view on the suitability of the FSR regulations?

**Mr Johnston**—No. He was asked to look at disclosure more generally than that. Certainly FSR was part of the input, and probably the greatest input in terms of what he was looking at, but he was looking disclosure generally on financial products and mainly on comparability.

**Mr Rodgers**—I would like to elaborate on that. We adopted a policy during the course of last year which said that while we were not in a position to prescribe disclosures—and we had no intention of doing so—there were some areas that we thought particular attention should be paid to because they added to comparability and they were, in our understanding, important to consumers. One of those was fees and charges disclosures in product offer documents. As you know, Senator, there was a controversy in the industry—

**Senator CONROY**—And in the parliament.

**Mr Rodgers**—about some of the ways that those disclosures should be made. We asked Professor Ramsay to talk to industry and consumers and to see if he could identify options for concerted industry action in that area—for a coming together of views that otherwise looked as if they were going to stay poles apart. We were keen to see the work go forward. We thought that as the new legislation came into effect the work ought to be done by industry, as industry participants were readying themselves to comply with it. We asked Professor Ramsay to identify options both for industry and for us to seek to effect the debate and the discussion as it went forward. That was the purpose for which we asked Professor Ramsay to do that work.

**Senator CONROY**—What work is continuing on fees and charges disclosure following the release of the Ramsay report?

**Mr Johnston**—Since we received the report we have entered into discussions with ASFA, IFSA and the Australian Consumers Association. We are consulting them to see if we can find the common ground to which Mr Rodgers referred. We are using the Ramsay report as a catalyst for that, identifying what their views are on Ramsay and where they thought we could find some accommodation of views. We will not be in a position whereby we will come out and prescribe any standards. Rather, we will try to move the parties closer together in agreeing some common ground. The first round of discussions that we have had with them, which were held not as a roundtable but individually, have been quite encouraging in that regard.

**Mr Kell**—We will be picking up on some of those recommendations that ASIC can implement directly—notably, the introduction of a fees and charges calculator on our web site early in the new year.

**Senator CONROY**—That will be a welcome initiative, Mr Kell. Professor Ramsay is known to most of us in the room and is an eminent person in many areas of corporate law, but he seems an odd choice to help to get to the nitty-gritty of bringing people together on the calculation of fees and charges.

**Mr Johnston**—His task was not so much to bring them together but to look at what options might be available. He was certainly well skilled in doing that. He is not playing a role in the discussions that we are having to try to bring the parties closer together. That is a role that we are playing.

**Senator CONROY**—On page 212 of his report, Professor Ramsay states that he sees 'merit in ASIC facilitating industry discussion about the merits of a table, which would show the effect of fees on returns, being included in PDSs relating to all superannuation products.' Is that specifically what you are working on at the moment?

**Mr Johnston**—That is one of the things that we are discussing with the parties that we are talking to, yes.

**Senator CONROY**—What is ASIC's view on the need for the detailed disclosure and explanation of the long-term effects of fees on superannuation benefits?

**Mr Johnston**—We made our position clear quite early. Before Ramsay was commissioned, we made it quite clear that we favour explicit disclosure in superannuation in a way that lets

members know what the impact is on their investment and, on a periodic basis, on their individual balances.

**Senator CONROY**—From my recollection, Professor Ramsay also suggested that it should not be just on superannuation benefits.

**Mr Johnston**—He did look more broadly. He looked at managed funds as well as superannuation.

**Senator CONROY**—Do you have a view on that?

**Mr Johnston**—We can see the rationale for treating superannuation differently, because of the compulsory element. I think that the disclosure rules that are in place—

**Senator CONROY**—Professor Ramsay said that they should both be done.

**Mr Johnston**—He expressed a view that it should go across the board. The law at the moment does not provide for it to go across the board.

**Senator CONROY**—I did not know the law stopped it.

**Mr Johnston**—No regulations were proposed in respect of the disclosure of fees and charges in managed funds.

**Senator CONROY**—There are no regulations; therefore, can you point me to the law that does not provide for this?

**Mr Johnston**—The law provides in a general sense for what disclosure has to be there, but it does not provide for it in a very specific sense.

**Senator CONROY**—I get the impression that you are suggesting that the law stops this.

**Mr Johnston**—No, it does not stop it.

**Senator CONROY**—It does not stop the disclosure of both.

**Mr Johnston**—If you look back at the evidence given before this committee by IFSA, they said that they tended to treat disclosure as going across superannuation and non-superannuation business.

**Senator CONROY**—No. Certainly, members of IFSA are doing that now, but I have not yet seen IFSA cough up and say they support the uniform application across all products. I am sure I asked the questions at the time. If I have missed a particular reference, I am happy to have you point it out to me, Mr Johnston. ASIC released on 26 June 2002 *A guide to good disclosure of transaction banking fees*. What was the reason for issuing that guide?

**Mr Kell**—There were a handful of reasons why we put that out. One was that we had had concerns expressed to us by consumer and other groups about the way that fees and charges

were disclosed in relation to standard banking products. At that point in time, the various codes in the banking sector did not go into detail as to how those fees and charges should be disclosed to consumers. We saw that ASIC had a role there to facilitate a process that involved both industry and consumer groups to look at some models that would potentially provide for clearer and better understanding on the part of consumers as to how fees and charges were levied.

As you know, that was also the subject of a parliamentary committee inquiry chaired by Senator Chapman. Some of the findings of that inquiry certainly assisted us in coming up with a model agreed on between industry and consumer organisations. It was basically to address consumer concerns being expressed to us regularly that it was often difficult to understand the way that fees and charges were being expressed. We convened a roundtable of interested stakeholders to work on that.

**Senator CONROY**—What does the guide recommend?

**Mr Kell**—Among other things—I am looking here at a very brief summary in our annual report—it recommends that bank statements should have a summary of fees and charges so people can clearly see, at the time when they are looking at what transactions they have undertaken, which transactions have incurred fees and why. If necessary, they can change their banking behaviour. The guide requires that people using ATMs get a clearer indication of the fees that they will incur, particularly if they are using a so-called foreign ATM. It requires that ATM, phone or Internet banking users are warned if they are about to incur a fee by overdrawing an account. Those are some of the core elements. Off the top of my head, I cannot remember every single element. We are currently in discussions with ADIs about monitoring the impact, the progress and the implementation of that transaction fee disclosure model. That will be reported on at the end of next year.

**CHAIRMAN**—As chairman of the committee, I recently wrote to a number of financial institutions to see what progress was being made in implementing the report recommendations, particularly the real-time disclosure proposals. It seems that not much progress has been made on that issue.

**Senator CONROY**—We need you beating the drum again, Senator Chapman.

**Mr Kell**—I do not know the situation of individual institutions when it comes to the issue of real-time disclosure. That was a proposal that we did not recommend in the model, because of the arguments about cost and the technical changes that would be involved in implementing it. But it will certainly be one of the aspects that will be covered in our monitoring of this issue.

**Senator CONROY**—How has the disclosure of banking fees improved since the release of the guide? How are you monitoring that?

**Mr Kell**—As I said, we are currently developing a monitoring process. We are consulting with the relevant banks and other deposit-taking institutions about that process. We do not have a definitive answer right now, but we were certainly pleased to see early take-up by some of the larger institutions after the model was announced. I cannot remember all the institutions involved but, for example, Westpac were early adopters and NAB also had elements of the model in place fairly soon after it came out.

**Senator CONROY**—I have a few questions about superannuation. In his report on the disclosure of charges and fees, Professor Ramsay raises a number of concerns with the content of periodic member statements. Does ASIC share Professor Ramsay's concerns about the variability of fee disclosure in investor member statements? If so, would you like to elaborate on those concerns?

**Mr Johnston**—The provisions that were in the SI(S) Act and subsequent provisions in the regulations set out the requirements in terms of periodic statements. We think that it is a matter for government as to what is really prescribed to be in there rather than a matter for us, because we do not have the power, of course, to prescribe any form of disclosure in relation to those.

**Senator CONROY**—That is a bit of a cop-out. You are washing your hands of it.

**Mr Johnston**—It is not within our power and I think that it is a question of policy for government to determine.

**Senator CONROY**—You are the consumer protection organisation for financial services. Is that correct?

**Mr Johnston**—I can go back to an earlier answer where I said that ASIC has made it quite clear that we want there to be good, clear, concise, effective and helpful disclosure to not only superannuation members but consumers generally. We have been consistent in upholding that, but it is not for us to determine what the specific requirements are.

**Senator CONROY**—You can set out interpretations of legislation and what you think best practice is.

**Mr Johnston**—Yes, and we do. In our policy statements that we issue we set out how we interpret the law and how we intend to apply the law. I think that reference was made earlier this evening to our policy statement where we talked about the disclosure of product disclosure statements. In our draft statement we had been quite specific in relation to that, but in our final policy we pulled back, respecting the provisions of the law that are relatively general and accepting that there is a role for industry to develop those sorts of standards. Although, as I said earlier, in superannuation we also believe a level of prescription is necessary. But that is provided for either in the regulations or in the legislation itself.

**Senator CONROY**—You are an independent regulator, aren't you? You are not an arm of the government.

**Mr Johnston**—That is right.

**Senator CONROY**—In terms of the variability of fee disclosure, are you able to outline to us some of the best and worst examples of fee disclosure in these member statements?

**Mr Johnston**—Not off the top of my head.

**Senator CONROY**—Could you take that on notice and give the committee the flavour of the sort of problems?

**Mr Johnston**—What I can take on notice and come back to you on are some of those cases where we have taken action, because where we believe that disclosure is not effective we have taken action.

**Senator CONROY**—That would be very useful. Do you see a need for changes to the corporations regulations to address the issues raised by Professor Ramsay?

**Mr Johnston**—Our preferred course just now, working with the law as it stands, is to work with industry and, acting as an honest broker, see what we can achieve in terms of an agreed approach to consistency. It is a matter for government as to whether it would re-enact any regulations or pass any new regulations.

**Senator CONROY**—Could you refer me to the section of your act which talks about you being an honest broker on behalf of somebody? I thought that your act gave you laws to protect consumers.

**Mr Johnston**—That is a term that we use in terms of trying to achieve the outcome that we want to see, which is comparable disclosure. At the moment, everyone still has an obligation under the Corporations Act to disclose and to disclose properly, and we certainly take action where we think that does not happen. But the regulations were disallowed and, at the moment, the government has not seen fit to pass any further regulations.

**Senator CONROY**—But you do not operate in a vacuum or, rather, you do not ignore a vacuum. You are currently interpreting—and I will come to it a little bit later—socially responsible investing. You have a vacuum there on how the laws are being interpreted that you are working on at the moment. You do not need to sit back and do nothing just because the legislation—

**Mr Johnston**—But in that case it was specifically contemplated that ASIC might publish some guidelines.

**Senator CONROY**—Would you like us to pass some legislation each time so that you will specifically do some work?

**Mr Johnston**—I think the position is that, because the law provides for disclosure to be made, the regulations in respect of superannuation would be able to prescribe—

**Senator CONROY**—Senator Murray and I will probably both happily do that for you, if you would like. If you are only going to work to protect consumers when Senator Murray and I can cobble together the numbers in the Senate, we will work more diligently at it for you, if you like.

**Mr Johnston**—I do not think that that is the case.

**Mr Knott**—Senator, I really must intervene. I think that is a very unfair comment to make about the agency. The agency has been incredibly active in trying to promote consumer protection. I think the consumer groups themselves believe that, and have been complimentary about our work. The position is very simple. The disclosure requirements are in the act. If

people do not comply with them, and we can prove that they have not complied with them, we will take action against them. What we are talking about here is attempting to achieve a degree of consensus between the managed investments industry and the superannuation industry on whether some common form of disclosure could be agreed so that comparability can be enhanced. That is what it is about. You do not have to have that to comply with the act. The act is there and the act has its requirements, and we will enforce it.

The government has made it very clear, in relation to what used to be in the regulations, that it is not disposed to introduce any further regulation or requirement in the law until the end of the transition period. The government has encouraged us to work with industry to see if a consensus can be built. Frankly, we could walk away from it tomorrow and we would be doing our job, which is to enforce the provisions of the law that require disclosure, and we will do that. I honestly think that turning the attack on us is out of order, frankly.

**Senator CONROY**—It is back to that old discussion that I had with some of your officers who are not with us any more about being a bit of a dinosaur and whether or not you are an enforcer or you are an honest broker. The reason the discussion has taken the turn it has is the self-description that you are an honest broker. I just do not remember seeing in the legislation that ASIC was an honest broker between the industry and consumers. I thought your regulations about enforcing consumer protection were just that.

**Mr Knott**—And we will do it.

**CHAIRMAN**—I think that is what Mr Knott has just said.

**Mr Knott**—I have just explained that, Senator. The honest broker role we are attempting to apply is something above and beyond any requirement that we have under the law. We will enforce the law requiring disclosure in relation to superannuation and in relation to managed investments. It is in the law. We will enforce it.

**Senator CONROY**—Like you enforced the law on the valuing of share options to the extent that the market developed a derivatives market in something you could not find a value for.

**Mr Knott**—We enforce the laws as they are given to us by the parliament. If the parliament gives us a law that is incapable of being enforced in a court of law, on the best of advice we achieve, we are not going to waste the taxpayers' money instigating action.

**Senator CONROY**—Now you sound like the accounting industry, Mr Knott.

**Mr Knott**—No, Senator, that is a fact of life. We will enforce the requirements of disclosure that the parliament has given us. We are going further. That is the point I am trying to make. The honest broker role is not about an honest broker role to comply with the law. The honest broker role is about developing something beyond the law that will enable a consistent style of disclosure to be made so that consumers of superannuation and managed investment products can hopefully achieve greater comparability. That is not something that the law imposes. The industries could tell us to walk away tomorrow.

**Senator CONROY**—The problem is that I have to disagree with you. The law is quite clear. The interpretation of the law is unclear but, then, I thought that was your job. The law is quite clear about requiring disclosure to consumers. It is actually quite clear.

**Mr Knott**—Of course it is. There is a law. But it is not clear that says, for example, there will be an OMC or there will not be an OMC, or that there will be this model or that model. We are trying to develop a consistent model, but that does not mean that somebody who discloses it one way and somebody who discloses it another way do not both comply with the law. We will enforce the law as delivered to us by parliament. We want to do more but, frankly, if the industry tells us tomorrow, 'Go away, we are not interested in having further discussions', that will be the end of it. Or if we form the view that there is no chance of getting consensus between the industries, we will walk away and we will simply fall back to the law we have and enforce it as best we can.

**Senator CONROY**—So ASIC's official position is that, if industry tell you to go away, you will just go away?

**Mr Knott**—If the industry tells us it is not interested in working a voluntary basis of disclosure that goes beyond the requirements of the law, they are perfectly entitled to do it. We seem to be at cross-purposes about whether we are walking away from our obligation to enforce the law. We are not. I have made the point now three or four times. We will enforce the law.

**Senator CONROY**—I guess if we wait until an international standard comes along we might suddenly discover, four years down the track, that it was possible all along.

**Mr Knott**—I do not think there will be an international standard on disclosure for managed investments.

**Senator CONROY**—A lot of people did not think there would be any international accounting standards either.

**Mr Johnston**—The other thing we have done is put on our web site a question and answer facility in respect of this very issue, and we have reminded people that they still do have an obligation under the law. We have reminded them of what this is and that they have to abide by it. We have also, in response to queries that we have had, given them the view that if they want to use OMC or some other measure then they still need to take into account whether or not they are complying with the law in doing so and are making sure that they are not acting in a misleading or deceptive manner.

**Proceedings suspended from 8.30 p.m. to 8.40 p.m.**

**Senator CONROY**—A survey presented in July by the Financial Planning Association found that 38.5 per cent of clients did not know how they paid for financial advice or thought that it was free.

**Mr Johnston**—Yes, I saw that.

**Senator CONROY**—Is ASIC also aware of a study by CPA Australia, released in the last few days, which found that a majority of Australia's top 50 financial planning dealer groups

failed to spontaneously offer a copy of the compulsory advisory services guide on initial inquiry?

**Mr Johnston**—I did not see that one.

**Senator CONROY**—It was just released in the last couple of days. Does ASIC see the results of these surveys as a cause for concern about the quality of disclosure of commission by financial advisers and the level of compliance with the current regulatory regime?

**Mr Johnston**—Yes, we do, frankly. We have made it clear in a number of media releases and other information releases that we expect to see greater disclosure and improved standards of disclosure in the industry. A number of campaigns that we have under way have targeted that specifically, especially in relation to commission disclosure.

**Senator CONROY**—We have been talking about the serious problems in relation to superannuation fee disclosure today. In ASIC's view, will the $14 million in 2002-03 and 2003-04 that the ATO is allocating to education and communication functions for the 8.8 million fund members and 650,000 employers impacted by the government's choice of funds proposal be sufficient?

**Mr Johnston**—I do not know how many dollars would be sufficient. I think that there is a major task to be undertaken in terms of consumer education.

**Senator CONROY**—How much are you spending on those consumer education campaigns that you have just mentioned?

**Mr Johnston**—Those are not consumer educations campaigns; those are campaigns targeting distributors themselves, checking whether they are making the right disclosures and taking action if they are not.

**Senator CONROY**—How much are they costing you?

**Mr Johnston**—I do not know the figure. They are part of our usual regulatory—

**Senator CONROY**—How much do you spend on that sort of compliance? I hesitate to use the word 'education', because you are being careful about the word.

**Mr Johnston**—As to how much money we spend, I would have to take that on notice.

**Senator CONROY**—Would it be in the millions?

**Mr Johnston**—Yes, it would.

**Senator CONROY**—Can you give me a breakdown of what you do in that compliance area and how much it costs.

**Mr Johnston**—I can do that.

**Mr Knott**—To fully understand that work you also have to take account of enforcement action. You will see an area in the annual report in relation to banning investment advisers and the like. It is quite intensive work; you do not just roll up and ban them. There is investigation work, then there is a process and all the rest of it. This report says that 35 people were banned from offering financial services. That is a small number of people in terms of the total industry, but it is part of a whole series of measures that we undertake—surveillance measures, campaign measures, publicity measures, enforcement measures and consumer protection measures. They are all designed to meet the same types of broad goals of raising standards. Policy statement 146 and everything we have done there—with considerable opposition, as you know—is all about trying to raise the standards of financial advice and the conduct of people in the financial planning industry. That is necessarily a long road, and a continuous one.

**Mr Johnston**—The other thing we could refer to which directly touches on consumers is that we published a booklet, with the assistance of the Financial Planning Association, that helps people not only to choose a financial planner but also to understand what questions they should ask of their financial planner. Of course, that includes the receipt of an ASG or FSG and questions about disclosure of commissions et cetera.

**Senator CONROY**—You announced that you are conducting an investigation into stock analysts. Why did you decide to conduct that investigation?

**Mr Rodgers**—We have, for at least the last 18 months, been watching issues that have emerged in the US to do with analysts and their compliance. The issue for Australia is whether the same problems that have emerged in the US might be present in the marketplace and, if so, whether under the Australian law analysts are operating under the benefit—in almost all cases, I think—of an adviser's licence, what analysts are doing, whether there are any problems of the kind that emerged in the US and whether there was compliance with Australian law. So the activity that we are now engaged in is, in character, a fairly typical compliance surveillance activity, which is not starting from the presumption that there are problems but is having an active presence in the marketplace. It is looking at the activities of both larger and smaller analysts to see whether problems that have emerged elsewhere are here and to come to some kind of judgment about the degree of compliance with the rules that analysts operate under in Australia.

**Senator CONROY**—When did you commence your investigation?

**Mr Rodgers**—Technically speaking, it is not an investigation.

**Senator CONROY**—Are you doing a survey?

**Mr Rodgers**—We have been doing surveillance and compliance activities, which we routinely do in a large number of areas, that are not formal investigations.

**Senator CONROY**—I will amend my question. When did you commence this compliance activity?

**Mr Rodgers**—We had a round of conversations with a number of people, which were very preliminary conversations, from about the middle of last year until October or November.

**Senator CONROY**—Is that October or November of this year or last year?

**Mr Rodgers**—It was last year. The present activity, which is a much more structured compliance review, started, I think, towards the end of August or the beginning of September.

**Senator CONROY**—Was that September or August of this year?

**Mr Rodgers**—Yes, this year.

**Senator CONROY**—So for almost 12 months nothing happened from those preliminary discussions that finished in August or September last year through to you starting your increased compliance.

**Mr Johnston**—When you say 'nothing happened', in respect of any campaign that we run we look at data and what is happening in the marketplace and decide whether we should have a look at something specifically. It is possible to say that nothing happens on a number of issues before we run a campaign. That does not mean that there is not other activity in response to complaints received and in looking at individual matters. But as a concerted campaign we kicked it off in September this year. That involved us visiting a number of those entities and looking at their practices.

**Mr Knott**—In fairness to my colleagues, I should add that at commission level, when we looked at the priorities for this year and what was happening in the United States in relation to analysts, we felt that there was a lot of commonsense in allowing some time to pass to see where the US got to and the sort of issues they were uncovering, which, as you know, took on much greater significance through the second and third quarters—going back to the second quarter. I am as confident as I could be that the work we are now undertaking and our views about potential changes to the law will be significantly advantaged by having followed the US experience. The US is, after all, where these houses are based. We should not assume that everything that is happening there is happening here.

Nevertheless, in the way I answered previous questions about accounting and some of the practices that have been uncovered in the US, we expect we will see some similar issues here. We better understand what we are looking for now and we better understand now how to target our work. Given that CLERP 9 was always a process that would take through this year and would include analysts, I think our work will end up being reasonably timely.

**Senator CONROY**—The attorneys-general across the US gave up on the SEC because they were doing nothing and had not managed to conduct a serious investigation at all into this issue. You are aware that it has been the attorneys-general of the US—and Spitzer being the most prominent—who have actually taken the matter in hand.

**Mr Knott**—I understand he has been investigating criminal conduct.

**Senator CONROY**—You have the power to investigate criminal conduct, don't you?

**Mr Knott**—We would have power to investigate if we had reasonable suspicion to believe that an offence had been committed under the Corporations Act. We have power to investigate that, but we do not have power to do what he did. Nor do I think the SEC—

**Senator CONROY**—You have the power to commence the investigation, though?

**Mr Knott**—If we have a reasonable suspicion that the law has been broken, yes.

**Senator CONROY**—And Macquarie Bank promoting One.Tel as a buyer a month before it went under doesn't seem suspicious at all because it was trying to pick up its corporate work? Are you actually walking into any companies and looking at a correlation between their stock recommendations and the work they do in launching their IPOs? This is the core of the issue. We are not talking about laws and needing to be in charge. The financial services industry is the one truly global industry in this world. Global companies have global cultures.

**Mr Johnston**—Those are the issues that we are looking at in this current piece of work. The point that the chairman is making is that we need to have evidence of there being a breach of the law before we can launch a formal investigation into any entity. What we are doing just now is selecting a number of entities and going in and looking at their practices.

**Senator CONROY**—You are looking at practices. You are not looking at their dealings on individual companies. You are not going to find any criminal activity by asking them about their practices. I do not know a single company in this country that has put up its hand and said, 'Yeah, our practices are currently leading us to make misleading recommendations.' Have any of them coughed up that to you?

**Mr Johnston**—Senator, this is the way we usually conduct campaigns of this type. We go in—

**Senator CONROY**—I did not know it was a campaign.

**Mr Johnston**—We look at practices. We do look at individual cases—

**Senator CONROY**—I thought it was about compliance activity. I did not know it was a campaign.

**Mr Johnston**—That is our name for something that is targeted in a proactive sense in an area of activity rather than an individual entity. When we do that, we look at the practices. We look at individual cases. We do file reviews and where we identify that there has been any breach, we take action. That has happened as a result of many campaigns that we have run not just on this issue but on many other issues.

**Mr Knott**—Just for clarification in terms of a response to my answer—and I am not talking about any particular group; I make that clear—you should not assume that this sort of activity has not been investigated. You should not assume that there is no current investigation under way in relation to any particular group. You should not make those assumptions. What we are talking about is a broader based campaign looking at practices that may result in law reform or recommendations by us for further law reform or inform ways that we will interpret the existing

law. If we have reasonable grounds to suspect that the existing law has been broken, we will investigate it. I think it is implicit in what I have just said that we have. I think it is implicit in what I have just said that we are.

**Senator CONROY**—Have there been any cases—I am not asking you to name any names—for instance, where an IPO has been allocated to favoured clients of a company? Have you looked at cases like that? Do you consider that is something where our laws are deficient compared to the laws in the US?

**Mr Knott**—There are least a couple of questions in that.

**Senator CONROY**—There are two questions there.

**Mr Knott**—I invite my colleagues to inform me if I am wrong, but I am not aware that we have sustained any successful prosecution on such a matter. I am aware that we have looked at those issues and, as I have said to you, I am aware that there is at least one current investigation under way that raises these issues. Whether that will result in sufficient evidence to launch a successful proceeding I do not know yet. The second part, though, is about future approaches. The CLERP 9 has some proposals about analysts. We are hopeful that the work Mr Rodgers has described will assist us to suggest any additional approaches that might be taken either by us or by government. I have said to the industry—and I said it as recently as last week—I do not think this is an issue that is about to go away quickly. I do think we will be informed by the US experience. I think it helps us understand some of the practices. I agree with you completely that global enterprises are likely to have global cultures.

**Senator CONROY**—Are there Australian investors that have had any? Pick any of them—they are all in the middle of massive settlements. Have Australian investors had foisted on them by Merrill Lynch through the Merrill Lynch New York office recommendations to buy US stocks that were dogs?

**Mr Knott**—I cannot answer that question specifically about that firm in relation to Australian investors. I think that I would be more confident to say that the outcomes of the prosecutions in the US and the settlements that are being reached with the global houses will benefit customers of those firms wherever they might be. Informally I have been told by more than one of those firms that whatever is put in place in the US, whether that goes further than the current requirements of Australian law or not, will be adopted by the firm internationally.

**Senator CONROY**—I appreciate that they will have to make a response. There is a question I am trying to get to the heart of. Merrill Lynch have reached a settlement already—I pick on them because they have reached a settlement. They have reached a settlement because they foisted onto US investors companies that they privately knew to be dogs but they called them ‘house stock’. I struggle to believe that in these days of internationalisation and globalisation, with this industry in particular, some Australian investors were not recommended these stocks by their offices here in Australia, either deliberately as part of a portfolio where you just buy into a trust that then buys them or directly. What I am asking you is: do Australian shareholders or Australian investors of Merrill Lynch need to take their own class action or is somebody else going to do something about it?

**Mr Knott**—I think it is too early to answer that question. I have mentioned one inquiry that has the status of an official investigation. I think the work that Mr Rodgers has described may have that outcome if we discover what you suspect—

**Senator CONROY**—It would be extraordinary if it did not. They have got global house stocks and they will be globally recommending them to everybody who is a client of theirs, whether they live in the US or in Australia. I would be shocked if Australians have not been scammed in the same way the US investors have. Do you need someone to come forward to you or, given that you have highlighted a compliance campaign, are you going into these houses and asking to see whether they have made recommendations to clients? You could look at the stock—and at the moment I cannot remember what the stock is—that they had made settlements on in the US and walk into their houses here in Australia and say, 'Have you recommended these stocks to your Australian clients? On what basis? Is it on the basis that the US office told you to do it? If so, what are you doing to recompense the investors?'

**Mr Knott**—I think we have been at cross-purposes at bit, for which I apologise.

**Senator CONROY**—That is what I am talking about.

**Mr Knott**—The work that Mr Rodgers is describing is directed towards exactly that type of thing.

**Senator CONROY**—You are being too modest. Here is your chance; blow your bugle!

**Mr Knott**—I guess our view about playing any instrument is that it is best to ensure that you know the full piece first, that it is fully written and not an unfinished symphony. That is what we are doing. But, seriously, our approach is to achieve outcomes to the maximum extent we can. We would prefer not to blow trumpets ahead of achieving the outcomes—and we have some realistic prospect of achieving them. I think the industry is very well aware of what we are doing.

**Senator CONROY**—I find it extraordinary that they are not coming to you and saying, 'We'd like to make a settlement with our Australian investors.' If Merrill Lynch have made a settlement about recommendations on all these stocks I find it extraordinary they are not walking up and saying, 'We were recommending them for our Australian clients as well. To save time and a lot of legal fees, let's just sit down and work something out.'

**Mr Knott**—I cannot take it any further than to say that the areas of interest that you have expressed correlate quite closely with the areas of interest that we are pursuing.

**Senator CONROY**—Given that you are pursuing this, as I asked a little earlier, is there a deficiency in Australian law in helping you resolve this? Could that lead you to make some recommendations? I am not aware that there is a deficiency in the law at the moment but if there is I will be very disappointed. I know that a lot of Australian investors who have been scammed by this particular practice are probably disappointed as well. I am not aware of whether there was a potential design fault in the law or it was not contemplated. Do you foresee the need for a legal settlement? If answering that question is going to prejudice a potential case you are taking, I am happy to go in camera or we can talk about it privately.

**Mr Knott**—Even with that in mind, I can say this: we have noted what the government has said in CLERP 9 in relation to analyst conflict. We would like law reform to go further. We have made that point in our submission, which will be available publicly by the end of the week. That is probably the best way for me to leave that answer, on the basis that it will better inform you—

**Senator CONROY**—I accept the point you make. I will happily read it when it is on the web site and that might facilitate us being less at cross-purposes. In July it was announced ASIC was to release a discussion paper on socially responsible investing disclosure obligations. How is the development of that discussion paper going and when can I expect to see a copy released? I do not mind if you give me an advance copy. I note Ms Rickard is not with us tonight.

**Mr Kell**—You will be able to read it during your Christmas break, Senator, so very soon.

**Senator CONROY**—In the absence of the discussion paper, what disclosures have been made in the product disclosure statements for the last six or eight months?

**Mr Kell**—We have not undertaken a comprehensive review of SRI-type disclosures in PDS statements so far. We are aware that, for some investments that are specifically marketed as ethical or green investments, there have been some PDSs issued, but at this point in time there is a variation in approach. That is one of the matters that we will no doubt see addressed or discussed as part of the paper as we put out.

**Mr Johnston**—What we can tell you, Senator, is that under FSRA there have been about 220 opt-in notices—in other words, product disclosure statements that are out there.

**Senator CONROY**—You are up to 220 now?

**Mr Johnston**—Yes.

**Senator CONROY**—I had a figure of 102 on 16 September.

**Mr Johnston**—Yes, it is up to about 220.

**Senator CONROY**—Are they all in relation to new products or are some in relation to old products?

**Mr Johnston**—Some are in relation to old products but there are many new products in the marketplace.

**Senator CONROY**—Do you think they are generally meeting a reasonable level of disclosure of standards set out in the FSRA or is it too hard to call up this ball?

**Mr Johnston**—Are we talking generally, not just on SRI matters?

**Senator CONROY**—I am talking more about SRI matters.

**Mr Johnston**—I think it is too early to say because, as Mr Kell said, we have not had a close look at that aspect of their disclosure.

**Senator CONROY**—In general, what about PDSs?

**Mr Johnston**—Out of more than 200 that are in place, we have taken some sort of remedial action on disclosure in respect of about 16 of those. That would go from either being an interim stop order or a final stop order through to suggesting changes that needed to be made.

**Senator CONROY**—How many licences has ASIC issued under the new FSR regime?

**Mr Johnston**—It went up to about 250, Senator.

**Senator CONROY**—Are you expecting more by now?

**Mr Johnston**—It is not going as quickly as we would have wished, because the slower the uptake in the early part of the transition period the worse it will be for us at the end of the period. We did not have, though, a hard and fast budgeted participation rate because it was just too difficult to do. But one thing we have noticed with the early licences that have come through is that many of them are in fact for new products or new players.

**Senator CONROY**—I note that Ms Vamos is not with us tonight, who was recently voted the most powerful person in the financial services industry.

**Mr Johnston**—In the world, I believe.

**Senator CONROY**—It is a great pity we have not got her with us. Perhaps it is as well she is in Perth! How many licences do you expect to issue prior to the end of the transition period?

**Mr Johnston**—It is impossible for us to know exactly, but we think it will be somewhere between 7,000 and 10,000.

**Senator CONROY**—We are moving a little slow at first, are we?

**Mr Johnston**—People are not coming through quickly but there are a number of reasons for that. We are well aware that there are a large number, though, that will come through at different times in their transition period. For example, some of the industries are organising themselves on an industry basis so that the industry body is helping to facilitate the process. We know, for example, that a large number of insurance brokers will come through at a particular time. We know when some of the conglomerates are coming through. So we are certainly encouraging people to move early, but we are not overly concerned at this stage.

**Senator CONROY**—What extra resources have you employed to deal with the new FSR regime? Do you think they are sufficient? Do you think there is a case to say to government, 'We need a bit more to make this work properly.'

**Mr Johnston**—We put a case to government based on the number of licences that we thought we would issue. For every licence that we issue, we will have to deal with some applications for

relief from the law. We have an idea of what resources we will need for the flow-on work as a result of that. Of course, it increases the regulated population on which we carry out compliance and surveillance activities. But we had put the case to government and received funding in respect of the numbers that we put forward.

**Senator CONROY**—On 8 November, you issued revised policy statements in relation to licensing, PS 164, 166 and 167.

**Mr Johnston**—Yes.

**Senator CONROY**—What needed to be revised? What were the changes?

**Mr Johnston**—The biggest revision was policy statement 164. The main thing that we were looking at was making it easier for some people to satisfy us on who the responsible officers ought to be. That was a large focus of it.

**Senator CONROY**—For example?

**Mr Johnston**—I think reference was made very early in the hearing tonight to the potential for there to be duplication between us and APRA. We said in the rewrite of that policy statement that we will accept the same information that is provided to APRA and responsible officers. So it has mainly been about trying to help people through the transition period.

**Senator CONROY**—Do you expect to issue further revisions?

**Mr Johnston**—Yes, we have said that we would constantly review our policy statements. It is part of a bigger project we have under way to try to make sure we make it as easy as possible for people to obtain their licence from a process point of view while still protecting the integrity of a proper licensing system. So we will continually review those policy statements within that.

**Senator CONROY**—Some organisations have been complaining to me that they cannot apply for a licence until they know what the final policy statements are. What should those companies be doing?

**Mr Johnston**—That goes to a couple of things. Not only have we heard that comment; we have also heard the comment: 'Why would we come in earlier when we know that there are further regulations to come?' People are understandably delaying during the transition period until they see what the final regulations are. We believe that our policy statements are in final form. It is simply that if we believe there is a deficiency there at any time then we will update them. But we do not have a date by which we will say we have finished updating our policy statement.

**Senator CONROY**—Isn't that a catch-22 for companies? You need the applications to come in, I am sure, but not 7,000 on the last day. Isn't this a bit of a catch-22?

**Mr Rodgers**—I am not sure that is right. For policy statements to do the job that we want them to do, which is to help people understand where we are coming from and how we will approach a question and what we look to for them, they will be inevitably living documents.

They need to change over time. The changes that we have made do not alter the direction of any policy. Views have been expressed to us that they are not as clear as they should be in areas that will be helpful. We have changed them to make it clear exactly where we are coming from.

In those core policies that we adopted before 11 March this year, we are unlikely to suggest that we will change a fundamental direction in any policy, so that people cannot plan their compliance with the new legislation, waiting for us to do policy. But I would not want to tie our hands: if we can improve the communication that is embedded in the policies, then we ought to take the opportunity to do so.

**Senator CONROY**—Will it cause ASIC problems if the bulk of the organisations do not apply for the licences until almost the end of the transition period?

**Mr Johnston**—We have made it clear right from the beginning of the transition period that if people leave their applications until after mid-December 2003, it would be difficult for us to issue them a licence by the end of the transition period. But we work closely with the industry bodies. We have been meeting with the key industry bodies each month or, depending on the size of their population, each second month. We do have a reasonable idea of when people will come through. We know that we will have a big peak in March next year, for example, and then it will ramp up from there. But if people leave it too late then, yes, we will have significant problems; we simply will not be able to put them through in time. But we have made that known right from the beginning.

**Senator CONROY**—On another issue, the High Court recently held that the ACCC did not have the power under the Trade Practices Act to compel the production of documents protected by legal professional privilege. Does ASIC have a similar constraint on its powers under the ASIC Act?

**Mr Johnston**—I am happy to defer to someone else.

**Mr Wood**—No, we have not. We have acted for many years under the authority of Yuille's case, which found that we did have access to legally privileged material. In the light of the Daniels decision, we have reviewed our situation and taken the view that we should continue to administer the law as we have to date. While Yuille's case was considered in that matter, it was not expressly overruled. It was questioned but not overruled.

**ACTING CHAIR**—Has there been any threat or foreshadowed challenge to the authority of Yuille case, in view of Daniels? Are you anticipating somebody testing it?

**Mr Wood**—There has been no specific threat but I think one could reasonably anticipate that given the Daniels case there may be a threat. We have brought the situation to the notice of the department.

**Senator CONROY**—Do you think you are going to be okay at this point, subject to the vagaries of the High Court, of course?

**Mr Wood**—Pardon?

**Senator CONROY**—Subject to the vagaries of another decision?

**Mr Wood**—Far be it for me to describe the High Court as exercising vagaries.

**Senator CONROY**—I am being polite.

**Mr Wood**—We are proceeding on the basis that our legislation has not been considered by the High Court and that ruling has not been made in relation to it.

**Senator CONROY**—There was just a bit of commentary in the papers at the time of the ACCC decision that said that ASIC would have a similar problem, but do you think that was a little ill informed?

**Mr Wood**—It is reasonable to anticipate that someone seeing the decision in the Daniels case, and faced with our enforcement powers, would consider their position.

**Senator CONROY**—I would like to ask some questions on the regulation of credit. In a magazine I read that ASIC is worried about the use of margin loans by consumers and that consumers may not fully understand the risk. Is that correct?

**Mr Kell**—I am not aware of the article that is referring to this or the specific reference. We obviously are concerned to ensure that consumers do understand the risks that they take on when they invest through a margin loan, because obviously they are taking on additional risk in those circumstances. We are undertaking a project at the moment, which, amongst other things, will help indicate how widespread the promotion of margin loans is in the industry. Having said that, obviously if margin loans are used properly they can be a very useful tool for retail investors, as long as they are aware of the risks.

**Senator CONROY**—Mr Michael Dunn, head of communications at ASIC, is quoted in the article. What powers does ASIC have to regulate the provision of margin loans?

**Mr Kell**—Margin loans are a credit product. Credit is, in the first instance, covered by the ASIC Act provisions. Primarily there you have misleading and deceptive conduct provisions and unconscionable conduct provisions. The provision of credit is not covered under the licensing regime. Having said that, it would be safe to say that, if a margin loan was provided in conjunction with an investment, obviously there would be an expectation that the risk would be properly disclosed under the disclosure requirements relating to investments under the Corporations Act.

**Senator CONROY**—I have asked you questions previously about mortgage brokers. Are you in charge of them now? I know powers have been slowly transferring across.

**Mr Kell**—Again, as of 11 March this year, we have Commonwealth level consumer protection responsibility in respect of credit. That also covers, obviously, some aspects of the activities that mortgage brokers undertake. If they were to engage in misleading or deceptive conduct—

**Senator CONROY**—That would be advertising?

**Mr Kell**—It could be advertising in certain circumstances, and that may be covered by ASIC. However, I would also emphasise that credit is an area where the states have a key role. In particular, on consumer credit, the states have the uniform consumer credit code which provides for more prescriptive consumer protection regulation, which goes to things like how contracts should be constructed and the wording in those contracts and how interest rates should be disclosed. There is a level of regulation, both at the Commonwealth and the state level. Now that we have taken on that area, we obviously have intensified our interactions with the state agencies.

**Senator CONROY**—Have you intensified your supervision of mortgage brokers? Do they know you are in charge now?

**Mr Kell**—Again, I do not think we could characterise the current situation as ASIC being in charge. Do they know we have a regulatory role in this area? I think the answer to that is yes. We have commissioned a report that is looking at the mortgage broking industry. It is looking at some of the trends and developments in that industry, which has been growing very quickly, and looking at what areas ASIC might have to pay attention to. That report should be out early in the new year. The report has certainly generated considerable industry interest and people in the industry are quite keen to work with ASIC on improving standards.

**Senator CONROY**—I think I have raised the issue of the advertising that mortgage brokers are engaged in with some or all of you before. Does that ring a bell, Mr Kell, Mr Knott or Mr Johnston?

**Mr Johnston**—It is definitely a question for Mr Kell.

**Mr Kell**—A careful study of *Hansard* is probably warranted on this matter.

**Senator CONROY**—I am sure that some of you know I have had a bee in my bonnet for some time about what I consider to be fraudulent advertising by a number of mortgage brokers. eChoice is the one that comes to my mind most easily because it now advertises in prime time, when they fundamentally advertise a free product. Why are they still advertising a free product when we all know there is no such thing as a free lunch and, more importantly, when they are going to get a commission?

**Mr Kell**—Are you saying that they are suggesting that the credit is free?

**Senator CONROY**—They are saying, 'Come to us and we'll get your home loan and it is free.' It is an ad that shows during the nightly movies. It used to be shown when *The West Wing* was on, but it is such a profitable business now that it has moved into the mainstream 6 p.m. til 10 p.m. market.

**Mr Kell**—I think the way that many mortgage brokers construct their business activities is such that direct fees are not levied onto the consumer, but you are suggesting that that is happening in this case.

**Senator CONROY**—It actually states that it is free.

**Mr Kell**—There may not be a direct cost to the consumer, in the way that some mortgage brokers work, but we are happy to have a look at the eChoice ad. I am assuming it is still running; that is what you are suggesting.

**Senator CONROY**—Yes. So false and misleading can only apply if there is a direct cost. I will come back to this issue in a tick because this is a serious scam when you are trying to delineate between a direct cost and an indirect cost. I work on the basis of cost to consumer and I cannot, for the life of me, see how there is—

**Mr Kell**—I would emphasise that this relates not just to us but also to the states as they have a key role here and, in fact, in relation to some types of credit their role is more prominent than ASIC's. The primary concern that has been raised with us in relation to mortgage brokers goes to whether, as in other areas of financial service, commission payments are influencing the recommendation of the product. So whether one loan over another is being promoted based on the commission rather than the suitability for the client.

**Senator CONROY**—This could be breaking down a bit, because every two-bit spiv in the country is setting up a mortgage brokerage in the back of their car, with a computer and an electronic fax, so there is a bit more illicit competition now than there was previously. I have had people come to me regularly saying that in the banks they cannot get anything other than half a per cent because the mortgage brokers just will not cough up more than half a per cent; they just will not squeeze. So the banks have actually complained to me that they cannot get a decent deal out of a mortgage broker because they are in such a powerful position. That is very funny, I know. Given the level of competition in home loans there is possibly some truth in that, but I am trying to understand how people who are receiving an ongoing trail commission can represent themselves to customers as not charging them for a service. You have not yet started to explain to me the difference between this direct cost and the indirect cost.

**Mr Kell**—It is probably unwise for me to speculate further without having seen the ad in question. I have not seen the eChoice ads in Sydney, I have to confess. We are happy to have a look at that and respond to you, maybe in writing.

**Senator CONROY**—Is there anything under your powers that could require them to disclose that they are receiving a commission? I think we have said before it is not an FSR licensing issue.

**Mr Kell**—That is right.

**Mr Johnston**—They are not licensed by us, they do not have to meet the disclosure requirements of FSR and therefore they do not need to disclose their commissions under that piece of legislation.

**Senator CONROY**—Have you written to all the state ministers involved in this area of consumer affairs and asked them to do something about this? Have you written to the minister asking for it to be put on the COAG agenda?

**Mr Kell**—We have not written to all of them at this point in time. We have had meetings with most of the state agencies on the credit jurisdiction, and this has been an issue that has come up. We are again meeting with them later this week. We are seeing the report that is currently being

prepared for ASIC as a primary vehicle for outlining some of our concerns and ensuring that the states understand where we are coming from, the limitations of our capacity to act and the areas that we might usefully address and they might usefully address. So certainly it is very much an issue on our agenda at the moment. But, again, I think it is important to emphasise that we do not have the full responsibility in this area.

**Senator CONROY**—It is a question of trying to find the best way to fix it. In general, everyone wants to try and fix this area; it is just a question of getting enough desire to fix it. There are a lot of unsavoury practices creeping in now. Document fraud is now starting to be a regular occurrence, but I think that is a states issue rather than yours.

**Mr Kell**—Yes. Without going into detail, may I say that we will certainly use our misleading- and deceptive-conduct powers in this area if we see appropriate cases, and that is something we are looking at. As to the more detailed capacity to regulate, some of that does reside with the states. But it is an area that we have received complaints about and we have concerns about, and we would like to see it addressed.

**Senator CONROY**—I am not sure if you have seen this, Mr Knott, but the shareholder magazine *Equity* did an interview with Mr Richard Humphry recently.

**Mr Knott**—I have not seen that.

**Senator CONROY**—It was the October edition.

**Mr Knott**—It is not a publication I regularly see.

**Senator CONROY**—Broaden your horizons there on all those long plane flights.

**Mr Kell**—It regularly gives a bouquet to Mr Knott.

**Senator CONROY**—I have no doubt. In the interview in the October edition there is a question to Mr Humphry relating to deficiencies in Australia's regulatory framework, and he says:

> Yes ... the thing to me that's missing is that when we make a referral to ASIC for what we consider to be an inadequately informed market, unless there's been a transgression of some substance which would warrant criminal prosecution or significant civil action, it is very difficult for ASIC to take any remedial steps. We have some examples of that recently—we made 37 referrals to ASIC last year and a number of them have been addressed but not all of them.

Would you like to comment?

**Mr Knott**—I think I should start reading the magazine! I do not think this will surprise you, because I have previously commented on this issue, but the first thing is that there should be no surprise that there are a number of referrals that are investigated that do not result in enforcement action—after all, the ASX are referring to us matters that they think require investigation. So it is impossible to determine what percentage one might expect would result in some sort of proceedings.

The second point is that I have publicly made comments about the difficulty of enforcing the continuous disclosure regime. It is a very difficult regime to enforce. The evidentiary burdens are very significant and it is often quite difficult to obtain the sort of evidence that one needs to satisfy the tests. It is for that reason that we have supported as an alternative to formal legal proceedings a less formal finding regime, which is of course the subject of the CLERP 9 discussion paper. I do not know whether the article was written in that context; I have not seen it.

**Senator CONROY**—It was in the October edition, so I am not sure when it falls in terms of the time line.

**Mr Knott**—If it was October, or even earlier than that, it is quite likely that the CEO of the Stock Exchange had at least partly in mind this potential to move from the current, limited enforcement mechanisms into a finding regime.

**Senator CONROY**—Did the Reserve Bank consult you about the financial stability standard on clearing and settlement systems with relation to the ASX?

**Mr Rodgers**—Yes. We have a quite close working relationship with the Reserve Bank because we each have separate regulatory responsibilities for clearing and settlement. We have been working with them. We discussed standards with them quite early in the new regime, and we certainly saw those standards before they were publicly released in the last week or so.

**Senator CONROY**—Will it have any impact on your supervision of the ASX?

**Mr Rodgers**—We already have a separate responsibility as a regulator for the clearing and settlement of ASX. The Reserve Bank have a particular role under the Corporations Act, which is to promulgate the standards and monitor systemic stability on a whole of financial sector basis. The policy of the legislation is that, as well as ASIC having a conduct regulation role for clearing and settlement, there is such a connection between clearing and settlement facilities associated with major financial markets that it becomes a potential systemic stability issue. It is in that context that the Reserve Bank have issued those draft standards. As I understand it, they have had extensive consultations with ASX and SFE over the last six or eight months, in any case.

**ACTING CHAIR**—Senator Chapman indicated that he was going to put some questions on notice to you. Thank you for your attendance.

**Committee adjourned at 9.33 p.m.**