Chapter 4

The collapse of Opes Prime

Acknowledgement of effect on clients

4.1 The committee acknowledges the devastating effect that the collapse of Opes Prime has had on a range of clients who entered into an Australian Master Securities Lending Agreement (AMSLA) with Opes Prime Stockbroking Limited. When Opes Prime was put into administration, these clients had no legal title over shares that many believed they still owned, and they had no opportunity to redeem their financial positions.

4.2 Media reporting about the collapse may have created a general impression that the majority of Opes Prime's clients were sophisticated, high-wealth individuals or corporations who understood the risk that they were taking in entering an AMSLA. However, evidence before the committee suggests that this is an erroneous oversimplification of the situation. According to Mr Robert Fowler:

> … they [Opes Prime's clients] are a disparate grouping, from corporate high flyers who knew exactly what AMSLA's were, went into dealing with Opes up to their ears in stock lending, down to the small retail investors who were put into Opes by their brokers who were anxious to scalp a half a per cent commission on the margin loan interest plus an introduction spiv.[1]

4.3 Following the collapse, the ANZ Bank has acknowledged the diversity of people caught up in it:

> Since the collapse of Opes Prime, ANZ has come to understand that Opes Prime's customer base was diverse … However, throughout ANZ's dealings with Opes Prime, Opes Prime consistently described its clients as high net worth individuals and sophisticated investors, as well as several stockbroking firms and fund managers. [2]

4.4 Although the committee has received far fewer submissions on Opes Prime than in relation to the collapse of Storm Financial (perhaps because more time has elapsed since the collapse occurred), the submissions that have been received paint a grim picture of the effect on individual clients.[3]

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1 Mr Robert Fowler, *Submission 120*, p. 8.

2 ANZ*, Submission 379*, p. 24.

3 See the following submissions for examples: *Submission 93, Submission 94*, *Submission 95*, *Submission 97*, *Submission 98*, *Submission 120*, *Submission 197,* and *Submission 271*.

4.5 The committee also received a number of confidential submissions that further detail distressing consequences of the decision to enter an AMSLA with Opes Prime, including loss of retirement savings, forced sales of family homes, breakdowns in personal relationships and ill health.

4.6 The committee sincerely thanks those submitters and witnesses who have contributed to its deliberations on the collapse of Opes Prime.

Limitations of the committee's inquiry

4.7 The committee's understanding of the Opes Prime business model, the company's collapse and the subsequent effect on clients has been informed by a range of sources, including:

- submissions from affected clients;
- a submission by the ANZ Banking Group;
- a submission by the regulator, the Australian Securities and Investments Commission;
- evidence taken at public hearings;
- media reporting; and
- other information in the public domain, including on relevant web sites.

4.8 The causes of the collapse of Opes Prime, and the consequential effect on unsecured creditors, are complex and contested. The committee's sources disagree in many details, including the true nature of the business conducted by Opes Prime, the relationship between Opes Prime and ANZ Bank, the obligation (if any) of ANZ Bank to Opes Prime customers, and the sophistication and understanding of clients who entered into AMSLAs with Opes Prime.

4.9 In the following sections, the committee summarises the range of information that has been put before it and comes to a view on the key lessons to be learned from this collapse.

4.10 It is important to emphasise that the committee is not a judicial body and has no power to make criminal findings or to make judgements in relation to individual claims that have been brought to its attention. It has also not been possible for the committee to resolve all the contradictions in the evidence put before it.

4.11 It should also be noted that the committee's terms of reference focus on financial products and services. A broader array of issues surrounding the collapse of Opes Prime, including market supervision aspects and the operation of the voluntary administration provisions, will not be reported on explicitly.

4.12 The committee's overall role, having regard to what it has learnt through the examination of this corporate collapse and others, is to make any necessary recommendations for legislative change or regulatory improvement to help guard against the occurrence of similar collapses in the future. The committee's deliberations on the need for regulatory or legislative change in Australia's financial products and services sector are discussed in further detail in Chapters 5 and 6 of this report.

The Opes Prime business model

4.13 Having considered all the information put before it, the committee understands the operation of the Opes Prime business model as set out in the following paragraphs.

4.14 Opes Prime provided securities lending (including equity finance) facilities to its clients. These facilities have been described to the committee as follows:

> In general terms, securities lending refers to the transfer of securities from one party to another in return for cash or other securities ("collateral"). The party who receives the securities is generally obliged to return them (or equivalent securities) either on demand or at the end of an agreed term, subject to repayment of the collateral.
>
> Equity finance is a particular subset of securities lending in which the value of the cash collateral advanced to the party providing the securities ("customer") is generally less than the value of the securities received by the party providing the cash collateral ("financier").
>
> The principal distinction (from a legal perspective) between margin lending and equity finance is that with the latter the customer transfers all legal and beneficial interest in the securities to the financier.[4]

4.15 Opes Prime Stockbroking offered clients a version of an Australian Master Securities Lending Agreement (AMSLA).[5] Under this agreement, beneficial ownership and interest in the securities passed from the original owner to Opes Prime in exchange for cash collateral.[6]

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4 ANZ*, Submission 379,* p. 22.

5 As noted by Justice Finkelstein in Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Limited [2008] FCA 594, at paragraph 14, 'The term "securities lending" under these agreements is factually incorrect. The transaction that is referred to as "lending" is in terms an outright disposal of the securities lent, linked to a subsequent acquisition of equivalent securities. In other words the agreements provide that title to the securities on loan, as well as to any collateral that is received by the lender, passes from one party to the other. On the other hand, the economic benefits of ownership are "manufactured" back to the lender by the terms of the securities loan agreements.'

6 This understanding of the AMSLA is supported by Justice Finkelstein's judgement; see Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Limited [2008] FCA 594.

4.16 Opes was then able to do what it wished with the shares. This included using some of them as collateral for finance, from ANZ Bank and from Merrill Lynch, but also lending stock on to hedge funds for short selling or shorting the stocks directly, thereby exerting downward pressure on stock values.[7]

4.17 A point of difference between Opes and other providers of similar facilities was that Opes did not restrict the range of stocks in which clients could invest:

> Opes Prime allowed clients to invest in more speculative shares than many other providers of loans for share purchases, thereby adding to the risk of the business.[8]

4.18 ASIC has characterised the product on offer from Opes as follows:

> The distinctive feature of the Opes business model was that it enabled retail clients to engage in securities lending, an arrangement that is usually only entered into between wholesale parties. From the clients' perspective the securities lending arrangement with Opes had the same commercial effect as a margin loan, that is, the clients accessed cash, using their securities as 'collateral'. However, the legal effect was quite different because title to clients' securities was transferred to Opes, rather than mortgaged in favour of Opes. The use of securities lending, by retail investors, as a means to access cash, using securities as collateral is not common.[9]

4.19 Under the terms of the AMSLA, when Opes Prime was put into administration, financiers of Opes Prime including ANZ Banking Group and Merrill Lynch sold down the securities that they were holding as collateral for the finance advanced to Opes Prime. The original owners no longer held the title to these securities and had no opportunity to redeem their financial position.

Events surrounding the collapse of Opes Prime

4.20 ANZ has portrayed the collapse of Opes Prime in the following terms. More details are contained in ANZ's submission to the inquiry.[10] These events are broadly in accordance with what has been reported by the Australian media.

4.21 In early 2008 ANZ implemented a revised loan to value ratio (LVR) model and put agreements in place with Opes Prime that they would migrate their accounts to reach this new standard, with the first milestone due to be reached in mid March. In March 2008 ANZ was advised that Opes Prime would not be able to meet the agreed milestone, due to two significant events:

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7 Michael West, 'Scramble of the despondent and the damned', *Sydney Morning Herald*, 2 April 2008.

8 Professor Ian Ramsay, 'Ope Prime: who understood?', *The Age*, 1 April 2008.

9 ASIC, *Submission 378*, p. 121.

10 Please see *Submission 379*, available online at the following link: http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sub379.pdf .

(i) the discovery of 'irregularities' in a major customer's account, whereby 'ANZ was told that it appeared that Opes Prime's records had been manipulated to make it seem that the customer was within margin, when in fact this was not the case';[11] and

(ii) a customer request for the redelivery of securities worth approximately $95 million.[12]

4.22 ASIC has explained that Opes was not well placed to withstand such demands:

> … Opes was not well capitalised and, as a result, when a number of its clients faced significant losses in the market downturn, it was not able to cover the shortfall.[13]

4.23 ANZ agreed to an emergency support plan to assist Opes Prime, including a $95 million loan and a seven-day 'stand-still' on margin calls. In return, amongst other conditions, ANZ appointed Deloitte as an investigative accountant to work with Opes's financial adviser, Ferrier Hodgson, in assessing Opes Prime's situation in detail. The documentation for this agreement was executed on 20 March 2008.

4.24 Once Deloitte and Ferrier Hodgson commenced their assessment, it became apparent that 'there were further issues and irregularities in Opes Prime's business'.[14] The directors of Opes Prime appointed Ferrier Hodgson as voluntary administrators on 27 March 2008. On the same day, ANZ appointed Deloitte as receivers and managers pursuant to a registered charge.[15]

4.25 Critically for those Opes Prime clients who had signed an AMSLA, ANZ's understanding of their position after the appointment of the administrators is as follows:

> Upon the appointment of administrators to Opes Prime, its customers lost the ability to recall securities that they had transferred to Opes Prime, and instead became unsecured creditors for any 'netted' amounts owed to them under their Equity Finance arrangements with Opes Prime.[16]

4.26 This understanding of the consequences of the AMSLA has been supported by a Federal Court test case, in which Justice Finkelstein found on 2 May 2008 that Beconwood Securities (a client of Opes Prime) did not have a legal claim to recover

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11 ANZ, *Submission 379*, p. 25.

12 See ANZ, *Submission* 379, pp. 25 – 26. See also: Katrina Nicholas and Andrew White, 'The Man Who Sank Opes Prime', *Australian Financial Review*, 12 April 2008.

13 ASIC, *Submission 378*, p. 6.

14 ANZ, *Submission 379*, p. 26.

15 ANZ, *Submission 379*, p. 26.

16 ANZ, *Submission 379*, p. 26.

its shares. His Honour found that the AMSLA in place was such that full title to the shares had passed from the original client to Opes Prime and that the Opes Prime client did not retain a beneficial interest in those shares.[17]

4.27 When Opes Prime went into administration, ANZ Bank and Merrill Lynch acted to protect their positions by selling the shares they held as collateral against the finance advanced to Opes Prime. Clients of Opes Prime who had AMSLAs subsequently discovered (if they were not already aware) that they no longer had any entitlement to the shares they had borrowed against and were not able to redeem their position.

4.28 Opes Prime was wound up and put into liquidation in October 2008.[18]

Client understanding and perspective

The nature of the lending agreement

4.29 In the immediate aftermath of the collapse, many clients seemed to be genuinely unaware that they had entered into a securities lending agreement with Opes Prime. They were under the belief that they had taken out a standard margin loan and that they, rather than any other party, retained beneficial ownership of all shares. This meant that when ANZ exercised its contractual right to sell the securities, clients believed that 'their' shares had been 'stolen' from them.

4.30 Some submitters noted that they were long-time successful users of margin lending arrangements to gear their portfolios and, when entering into arrangements with Opes Prime, were assured that they were entering a similar retail margin loan agreement and would retain ownership of their shares:

> …the broker stated that our previous Leveraged Equities Margin Loan account Manager … had moved employment to OPES PRIME STOCK BROKING and had assured us and broker that the OPES PRIME Margin Loan facility is a normal margin loan secured by equities… At all times we were assured we were beneficial owners of our shares.[19]

4.31 In this submitter's view, their savings have been 'confiscated' by the ANZ.

4.32 The committee has been told that the Opes Prime Stockbroking Financial Services Guide (FSG) and the Trader Dealer website advertised margin lending products at a favourable loan to value (LVR) ratio 5 to 10 per cent higher than those

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17 See Beconwood Securities Pty Ltd v Australia and New Zealand Banking Group Limited [2008] FCA 594.

18 Patrick Durkin, 'Hundreds left angry as Opes Prime is wound up', *Australian Financial Review*, 16 October 2008.

19 Name withheld, *Submission 95*, p. 1.

being offered by other providers.[20] The committee has also heard of financial advisers promoting Opes Prime as a provider of margin loans.[21]

4.33 Some submitters have acknowledged that they clearly did not sufficiently understand the product for which they signed up:

> I had read through the fine print of Opes Prime's lending facility terms at the back of their FSG before signing up, and although I found it to be quite complicated in parts I had not noticed anything particularly untoward. I now however realise that I had quite obviously not understood some critical parts of this agreement.
>
> … For example, there was absolutely no mention whatsoever about the Australian Master Securities Lending Agreement (AMSLA) at the rear of this FSG that we were all unwittingly signing, whilst thinking it was a fairly standard margin lending agreement instead.[22]

4.34 Other clients have made similar statements:

> I am an investor who has suffered significant financial loss as a result of the collapse of Opes. I am not a greedy person attracted by the promise of high returns …, rather I am an educated, financially literate person (at the time I entered into the Opes agreement I was working as a Licensed Adviser), who was misled and deceived by Opes personnel as to the true nature of their 'margin lending' product.
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> …
>
> … as far as I am aware, no effort was made by Opes personnel to inform or educate investors as to the unique differences and higher risk of their product versus the traditional margin lending arrangement. Opes would certainly have been aware that the majority of the retail clients transferring to them were moving their accounts from traditional margin lenders.
>
> Opes clients were not sufficiently apprised of the key features of the AMSLA that they were entering into, with the majority of Opes clients believing that they were entering into a standard margin lending arrangement.[23]

4.35 Submitters indicated that they did not become aware of the true nature of the agreement they had entered into until after Opes had been put into administration:

> We discovered that our securities, lodged through Opes into ANZ Nominees were not held in trust on our behalf but had been used as security for Opes to conduct an AMSLA arrangement with the ANZ. This information was never communicated to us at any time.

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20 Name withheld, *Submission 97*, p. 1.

21 Mr Patrick Loughnan, *Submission 271*, p. 1.

22 Name withheld, *Submission 97*, p. 1.

23 Name withheld, *Submission 197*, pp. 1-2.

> The news filtered out that this was an absolute transfer of title to the Bank and that our only claim was against Opes Prime stockbroking. My world had effectively ceased to exist.[24]

The role of the ANZ Bank

4.36 Submitters expressed their view of the ANZ's role in the collapse and, particularly, its aftermath:

> I … have been absolutely dismayed at the lack of regulatory response to the despicable nature of the banks in this Opes Prime affair. I have lost a substantial amount of money, some of it cash, lost a fiancé and lost my job over this. The lack of any empathy [from] ANZ has been bluntly disgusting … To then put a proposal forward where if successful, relinquishes the right of everyone seeking to prosecute the ANZ in the future is an outrage.[25]

4.37 Others acknowledged that they failed to sufficiently understand the nature of the arrangement they entered into with Opes but still consider the bank failed in its duty of care:

> My wife and I invested shares and capital in that agency [Opes] in the belief that it operated as a Margin Lending Business …
>
> OPES operated with the support of ANZ at a time when it was failing in its fiduciary duty to its clients.[26]

4.38 There has been strong criticism of the bank's quick action in selling off the securities held against the loans. There is some belief that the bank had a moral, if not a technical, obligation to the Opes Prime clients who viewed the bank's involvement as an endorsement of the Opes operation:

> Many investors were using the Opes product reassured by the prominence of ANZ in their marketing materials, replete with ANZ logo describing them as 'banker and custodian bank' …
>
> The precise role of ANZ i.e. that they were in the position of providing finance to Opes in exchange for Opes clients stock was never made clear.
>
> … ANZ … seized and indiscriminately sold down the Opes book, with no regard for the many underlying clients who would have re-financed their margin loans given the opportunity. This would then have left ANZ to pursue those Opes clients who should have been margin called and never were. I find it hard to believe that the outcome of a more orderly rundown of the Opes book by ANZ could have possibly resulted in a worse situation than the one in which they now find themselves; and it would certainly

24 Mr Robert Fowler, *Submission 120*, p. 3.

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

26 Name withheld, *Submission 94*, p. 1.

> have avoided the reputational damage, bad press and litigation that they have now incurred.[27]

4.39 It is the contention of some that they were intentionally misled:

> In short, Opes Prime and ANZ Bank duped us into believing that we maintained "beneficial ownership" of our shares brokered with them, only for the latter (along with Merrill Lynch) to swipe them when the circumstances suited and "fire-sale" them into the market back in March 2008, leaving our financial positions in tatters.[28]

The position of the ANZ Bank

4.40 It is ANZ Bank's clearly stated position that its relationship with Opes Prime was purely a business relationship, as a finance provider, and that it had no direct relationship with, or knowledge of, Opes Prime's customers:

> ANZ's own involvement with Opes Prime was limited solely to its capacity as a financier to Opes Prime. In respect of its dealings with Opes Prime, at no time did ANZ have any relationship with Opes Prime's customers.[29]

4.41 Furthermore, although ANZ recognises the difficult financial circumstances many former Opes customers now find themselves in, the bank does not consider it is responsible for these circumstances:

> ANZ acknowledges the hardship faced by many clients of Opes Prime as a result of their relationship with the stock broking firm advisory group and the impacts of the global financial crisis and the significant downturn in world debt and equity markets. While ANZ does not consider this to have resulted from its actions, ANZ recognises that at times there were deficiencies in the management of its equity finance business and its relationship with Opes Prime.[30]

4.42 When asked to explain what happened in the Opes Prime case, ANZ made the following statement:

> Customers of Opes Prime are understood to have signed agreements providing for the transfer of ownership of securities right at the outset. This had consequences for them when Opes Prime went into administration. Opes had in the meantime disposed of some of those securities to ANZ. To recover in part the funds advanced to Opes Prime ANZ sold the securities at the best price it could obtain. This is quite different from margin lending, where customers retain ownership of the securities and may sell them to

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27 Name withheld, *Submission 197*, p. 3.

28 Name withheld, *Submission 98,* p. 1; see also comments by Mr Robert Fowler, *Submission 120*, p. 1.

29 ANZ, *Submission 379*, p. 2.

30 ANZ, *Submission 379*, p. 2.

> recover their loan obligations. This difference was not widely reported and ANZ suffered considerable reputational damage as a result.[31]

4.43 The ANZ also made comment on this matter in its written submission to the committee:

> While customers of Opes Prime are understood to have signed agreements providing for the transfer of ownership of securities, when a broker such as Opes Prime becomes insolvent, ANZ is seen to be, and in fact is, holding the securities that Opes Prime's customers may have expected would be returned to them. In realising these securities to protect its position, ANZ is regarded by some (including customers of Opes Prime) as acting in its own interests and at the expense of the customers of Opes Prime.
>
> Some of Opes Prime's customers assert that they regarded their arrangements with Opes Prime as some form of margin lending. Some claim that they did not understand that theirs was a full transfer of legal and beneficial title in securities to Opes Prime, and that Opes Prime was then free to deal with these securities without restriction, including transferring them to ANZ.[32]

4.44 ANZ's ability to protect its own position by selling the securities was reduced due to the fact that Opes held many small, speculative stocks on its books (e.g. mining exploration companies). The ANZ acknowledged this problem in verbal evidence to the committee:

> … we did not cover ourselves in glory. We took stocks as security that were outside ASX200. Another one of the financiers to Opes Prime, Merrill Lynch, was able to liquidate the stocks it had as security much more quickly, as we believe, because they confined themselves largely to ASX200 stocks.[33]

4.45 The bank maintains that, because it had no direct relationship with Opes Prime customers who entered into securities lending agreements, it has no knowledge of the communication that occurred between Opes Prime and its customers:

> We do not know exactly what disclosures were being made between Opes Prime and its customers.[34]

4.46 Furthermore, the bank has told the committee that it did not receive information about who the Opes Prime customers were:

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31 Mr Graham Hodges, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 35.

32 ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 37.

33 Mr Bob Santamaria, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 50.

34 Mr Bob Santamaria, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 38.

> ANZ did not have a direct relationship with Opes Prime customers. ANZ was not party to the contracts between Opes Prime and its customers and, where securities were transferred to ANZ, ANZ was not provided with documents evidencing the identity of the person from whom Opes Prime obtained the relevant securities.
>
> ANZ's knowledge of Opes Prime's customer base was necessarily limited given that ANZ did not have a direct relationship with Opes Prime's customers. Given that Opes Prime held legal and beneficial ownership of the securities, Opes Prime was not obliged to inform ANZ of the identity of the person from whom they had obtained the securities that it transferred to ANZ.[35]

4.47 ANZ executives outlined to the committee the steps that the bank took following the Opes Prime collapse:

> ANZ undertook a review of the securities lending business, chaired by ANZ CEO Mr Mike Smith, who was assisted by respected company director David Crawford. … The review found that at times there were deficiencies in ANZ's identification and management of risks within the securities lending business. A remediation plan was instituted and six staff and two senior executives left the bank.[36]

4.48 The ANZ review has been made public at the bank's website and can be viewed online.[37]

4.49 ANZ Bank has admitted to making mistakes in relation to the business it conducted with Opes Prime:

> …our understanding of that business was less than it should have been within the bank …[38]
>
> … Our internal processes were inadequate … I do not think we properly studied and appreciated that in … a falling market this product would operate differently from margin lending.[39]

4.50 However, ANZ Bank also sought to put the Opes Prime collapse in the context of economic cycles and the circumstances leading up to the global financial crisis:

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35 ANZ*, Submission 379*, p. 24.

36 Mr Graham Hodges, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 35.

37 The Securities Lending Review is also published as part of the ANZ submission to this parliamentary inquiry – see http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sub379.pdf

38 Mr Graham Hodges, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 37.

39 Mr Bob Santamaria, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 40.

> The collapses of Opes Prime, Storm and other similar businesses followed 17 years of strong economic growth and booming equity and property markets. Cycles turn and people tend to lose sight of the fact that asset prices fall regularly as well as go up. Regulation will not change that.[40]
>
> My broad observation would be that clients of both Storm and Opes were very much caught up in the times and people were generally seeing everything going up and nothing going down in terms of value. I suspect people lost sight of the fact that markets are volatile, economies do go up and down and did not appreciate the risk they were getting into. In that sense … they were not alone. The world was caught up in that to a large extent.[41]

4.51 ANZ Bank executives also told the committee:

> There were various factors that led to Opes Prime's collapse. One was that the market was going down along with the value of the shares tendered as security. There were also perceived to be some irregularities within the Opes Prime business.[42]

4.52 ANZ does not believe that the Opes collapse is a result of regulatory failure:

> ANZ is not aware of any evidence that the collapse of Opes Prime stemmed from any deficiency in the regulatory framework.[43]

4.53 The bank does not take any responsibility for the degree of gearing Opes Prime clients engaged in:

> That was their model and what they were doing with their clients—not to do with the bank.[44]

4.54 Perhaps the starkest acknowledgement from the ANZ that its involvement in Opes Prime represented poor judgement is the bank's decision to withdraw from all securities lending:

> When you ask about our experience with this, it is summed up in one of the central conclusions of our published securities lending review: we are out of that business. We are not continuing to provide funding to that sort of business.
>
> …

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40 Mr Graham Hodges, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 36.

41 Mr Graham Hodges, ANZ Banking Group, Official Committee Hansard, Melbourne, 26 August 2009, p. 48.

42 Mr Bob Santamaria, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 39.

43 ANZ, *Submission 379*, p. 2.

44 Mr Graham Hodges, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, p. 42.

> We believe it is not the sort of business that a bank should be in. We have admitted very publicly that it was not. It was a type of model that was always, in retrospect, prone to misunderstanding. We have admitted we made a mistake there and we have quit that business. To the extent that we acted sloppily, we have imposed sanctions on the people who were involved in that and the sanctions were very serious right up to two of the direct reports to the managing director.[45]

4.55 During 2009, ANZ reached agreement with the liquidators to implement a scheme of arrangement between ANZ, Merrill Lynch, Opes Prime, and related parties and creditors. This scheme will return to creditors a portion of the amounts owed to them by Opes Prime, as a result of ANZ and Merrill Lynch contributing to a settlement fund in excess of $250 million. This scheme of arrangement, including the conditions attached to it and responses to it, is discussed further in subsequent sections.

The position of the regulator

4.56 ASIC has been constrained in the information and comment it has been able to provide to the public inquiry process:

> We are not able to go into a lot more detail because of the investigations. …We do want to assist the committee but at the same time we cannot risk prejudicing those investigations, in particular prejudicing retail investor actions or potential parties that could be involved.[46]

4.57 The committee acknowledges the paramount importance of ASIC being able to take unencumbered legal action if it has evidence to suggest that there is a case to be made against any of the parties to the Opes Prime stock lending operation. ASIC's investigations into the conduct of directors and officers of Opes Prime are continuing, as well as investigations into any other third parties that may have engaged in market misconduct before or after the collapse.

4.58 However, the committee notes the significant amount of time that has passed since the Opes Prime collapse and strongly urges ASIC, and in turn the Commonwealth Director of Public Prosecutions, to deal with any potential actions in a timely fashion.

4.59 ASIC has made the following general public comment in relation to the Opes model:

> … the securities lending and equity financing business operated by Opes Prime was based on a model traditionally used in the wholesale market in which participants are more sophisticated and have a clear understanding of their rights and obligations. Of concern to ASIC was that Opes took this

45 Mr Bob Santamaria, ANZ Banking Group, *Official Committee Hansard*, Melbourne, 26 August 2009, pp. 37-38.

46 Mr Tony D'Aloisio, ASIC, *Official Committee Hansard*, Canberra, 24 June 2009, p. 3.

> model to the retail market where some investors may not have been aware of their rights and obligations.[47]

4.60 ASIC has also countered public criticism that it did not act to prevent Opes Prime from offering AMSLAs to retail investors or to ensure the provision of an accurate and appropriately clear product disclosure statement (PDS) to clients. ASIC commented on recent legislative changes and their effect:

> The FSR regime regulates disclosure in relation to financial products. Margin lending and securities lending under an AMSLA are not defined as financial products and accordingly the disclosure requirements (such as the PDS requirements) do not apply to these types of arrangement.
>
> Under the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, margin loans (including securities lending) will be regulated as financial products under the Corporations Act. ASIC welcomes this Bill. When the Bill commences, a PDS will be required for margin loans (including security lending).[48]

Opes Prime scheme of arrangement

4.61 ASIC was involved in multi-party talks that led to a settlement offer put to, and ultimately accepted by, Opes Prime creditors (including customers who signed AMSLAs). The terms of settlement included an agreement by the regulator not to pursue ANZ and Merrill Lynch for an alleged contravention of the managed investment provisions of the *Corporations Act 2001* (Corporations Act). ASIC also agreed not to pursue directors of ANZ for civil penalty and compensation claims under section 181 of the Corporations Act.[49] In accepting the scheme of arrangement, the Opes Prime liquidators and clients also renounced all claims and legal proceedings against Merrill Lynch and ANZ.[50]

4.62 In August 2009 ASIC welcomed Federal Court approval of the scheme of arrangement, starting that:

> ASIC believes that the settlement accepted by the creditors and approved by the Court, achieves the purpose of the mediation and makes commercial sense. Importantly, it avoids the need for costly litigation by the liquidators and the clients of Opes Prime.[51]

4.63 The estimated dividend to creditors is 37 cents in the dollar.

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47 ASIC Media Release 09-37, 'Opes Prime: proposed settlement and ANZ enforceable undertaking', 6 March 2009.

48 ASIC, *Submission 378,* p. 177.

49 ASIC Media Release 09-37, 'Opes Prime: proposed settlement and ANZ enforceable undertaking', 6 March 2009; and 09-135, 'Opes Prime schemes of arrangement approved', 4 August 2009.

50 09-135, 'Opes Prime schemes of arrangement approved', 4 August 2009.

51 ASIC Media Release 09-135, 'Opes Prime schemes of arrangement approved', 4 August 2009.

4.64 The committee notes that not all parties are equally pleased with this outcome. In particular, it notes Mr Robert Fowler's unsuccessful appeal against Justice Finkelstein's decision to sanction the scheme.[52]

4.65 ASIC has also put in place an enforceable undertaking (EU) from ANZ. This includes an agreement from ANZ to improve compliance in various areas, including reconciliation processes, resourcing and risk management.[53]

Lessons to be learned

Inappropriate provision of a sophisticated product to retail investors

4.66 The following statement by a submitter sums up the committee's understanding of what has occurred:

> A situation existed where a product – the Australian Master Securities Lending Agreement (AMSLA) – designed and intended for use by sophisticated corporate investors operating in wholesale markets – was on sold to unsophisticated retail clients for whom this type of product was inappropriate and who did not have, or were not provided with, sufficient education or guidance to appreciate the unique terms and conditions and higher risks of the AMSLA.[54]

4.67 Consequently, it has been suggested that consideration be given to restricting the availability of complex financial products designed for market counterparties, on the basis that such products may not be appropriate for the retail market.[55]

Committee view

4.68 The committee agrees that the AMSLA was not appropriate for many of the individual retail investors who signed up with Opes Prime. However, the committee does not believe it is necessary to interfere with the financial products market to the extent of banning certain products from sale to retail investors. Instead, the committee considers that a range of factors in combination will lead to the same effect of such products not being made available to an inappropriate customer base in the future:

- increased investor awareness and scepticism following recent collapses;

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52 'Bid to thwart Opes deal', *The Age*, 28 August 2009; 'With his life savings up in smoke, retired investor faces hefty legal bill', *The Age*, 4 September 2009; 'Court rejects appeal against Opes deal', *Australian Financial Review*, 4 September 2009.

53 ASIC Media Release 09-37, 'Opes Prime: proposed settlement and ANZ enforceable undertaking', 6 March 2009; and 09-135, 'Opes Prime schemes of arrangement approved', 4 August 2009.

54 Name withheld, *Submission 197,* p. 1.

55 Name withheld, *Submission 197*, p. 1.

- increased caution from banks with regard to engaging in the securities lending business;

- the passage of the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, which amends Chapter 7 of the Corporations Act to capture products of this nature within the definition of a 'financial product', thereby extending the range of protections available to investors and the powers and responsibilities of ASIC; and

- increased obligations on financial advisers with regard to the standard of advice they give to their clients.

4.69 These matters are discussed further below and in Chapters 5 and 6 of this report.

4.70 The same submitter has questioned whether the personnel selling the Opes Prime product understood the product sufficiently:

> All investors and advisers relied on the Opes representatives who should be expected to know their product thoroughly. However they either did not – and so were unable to disclose the higher risk nature of the product – or they were fully cognisant of the higher risks but obscured them rather than jeopardise their sales commission.[56]

4.71 The concerns raised here go to such matters as the qualifications of advisers, the legislative obligations imposed on them with regard to the standard of advice they give, and the potential for commission-based remuneration arrangements to result in poor or conflicted advice being given. These issues, and proposed reforms to the obligations, licensing, remuneration and oversight of financial advisers, are discussed in detail in Chapters 5 and 6.

Ineffective disclosure

4.72 Some submitters have suggested that enhanced disclosure arrangements would have been of assistance, in that had they truly understood the product being offered by Opes they would not have entered into the AMSLA. For example:

> If a client had been required to sign a simple Risk Disclosure statement stating, for instance, that the client acknowledged that they had lost beneficial ownership of and legal title to their shares; and furthermore that their shares were being used as collateral by Opes for financing purposes – many people would not have signed.[57]

56 Name withheld, *Submission 197*, p. 1.

57 Name withheld, *Submission 197*, p. 2.

Committee view

4.73 The effectiveness of disclosure in enabling investors to make informed decisions about their financial affairs was a central and recurring theme of the inquiry. Many submitters to the inquiry raised the matter of whether risk was appropriately conveyed to, and in turn sufficiently understood by, clients of financial advisers. Some questioned whether financial advisers themselves had proper knowledge of the risks inherent in the products they were selling. Many commented that current disclosure documents are lengthy and confusing, and that they would gain clearer information from short-form, plain English documents. These matters are addressed in Chapters 5 and 6 of this report.

The need for federal regulation of margin lending

4.74 At the time of the collapse of Opes Prime, margin lending facilities and facilities of similar character to margin loans (including securities lending agreements marketed as being margin loans) did not fall within the definition of a financial product as set out in Chapter 7 of the Corporations Act. Consequently, these products did not lie within ASIC's regulatory oversight responsibilities and were not regulated at the national level. Because they were generally purchased for investment strategies, they also fell outside state-based consumer credit laws.

4.75 This regulatory gap has now been closed, following the October 2009 passage through parliament of the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009. This bill explicitly defines margin lending arrangements, as well as Opes Prime-style securities lending arrangements, as financial products for the purposes of the Corporations Act and sets out a range of requirements on financial product providers and advisers when selling these products to clients.

4.76 These measures are intended to increase protection for investors and to provide ASIC with powers to take action where these facilities are not offered or managed in accordance with the law.

Committee view

4.77 The committee welcomes the passage of this legislation and, through such mechanisms as its regular oversight hearings with ASIC, will monitor its implementation and effect in the marketplace, particularly its ability to protect investors from the inappropriate sale of complex securities lending products.