

## Executive summary

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

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

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

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

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

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

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

Initially the committee found:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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