

## Scrutinising ASIC: Is it a watchdog or a dog with no teeth?

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It was a busy June day in 2010 when Jan Braund, a Sydney retiree, bundled herself and her frail husband Alan onto a train for their long-awaited shot at justice.

A year earlier, the Braunds had been left financially ruined after a Commonwealth Bank financial planner named Don Nguyen switched the couple's life savings from conservative to disastrously risky investments. He did it without their knowledge or permission, allegedly forging their signatures along the way.

Now, the Braunds had been summoned by Australia's corporate and market watchdog, the Australian Securities and Investments Commission, to give her account of how Nguyen had wreaked havoc with their finances and their lives.

Getting there was an ordeal. Alan, now deceased, had advanced dementia and couldn't be left alone. When the couple tried to leave the train, an exhausted and confused Alan tripped and fell after his leg dropped into the platform gap.

Jan, with a dossier of evidence of forgery and unauthorised transactions in hand, was determined to get to the meeting. She hoped it would lead to justice.

But two weeks later, she received a call informing her that ASIC would not be using her evidence.

It later emerged that ASIC was tipped off about Don Nguyen's activities 20 months before the Braunds travelled to Sydney's CBD for their meeting. It waited until 2010 to launch an official investigation, which culminated in an enforceable undertaking with the bank in late 2011 and the banning of seven planners, including Nguyen. Criminal charges were never laid and CBA managers were never held accountable.

Jan Braund's powerful account of that June day - and its aftermath - is set out in her submission to a landmark parliamentary inquiry that is scrutinising ASIC's performance.

She was one of many customers who received inappropriate advice from CBA financial planners and who were later compensated to the tune of \$51 million.

Hers is one of hundreds of submissions to the inquiry lodged by lawyers, unions, victims, former staff, lobby groups, professional bodies, whistleblowers, government bodies and financial institutions. Some defend and praise ASIC, but most are critical - and a few are tragic.

"Not since my daughter's death, aged six years, had I felt that awful, unpleasant, exhausting emotion and physical pressure," Braund writes.

"The sheer futility of my efforts and the accident to my husband is something that I will always have on my mind with my ASIC dealings.

"They have no empathy with victims; they are unwilling to take on big players and consider no one has any value other than someone that works at the organisation. It seems that there is an organisational arrogance and significant cultural issues that seemed not to be addressed by the current management."

Her criticisms of ASIC are echoed by many who have interacted with the regulator - in one way or another - during the two decades of its existence.

In recent years, ASIC has routinely been described as a toothless tiger, a dog with no bite and a keystone cop when it comes to enforcement.

It has been criticised for being too slow to act, lacking transparency, being captured by the big end of town and having a "glass jaw". But most of all its credibility has been questioned in relation to the court cases it has lost over recent years due to perceived bungling - AWB, One.Tel, Opes Prime and Westpoint. Professor Michael Adams, dean of law at the University of Western Sydney, says in the AWB case people were open to corruption and they got the "tiniest" slap on the wrist.

In the Reserve Bank currency notes scandal, it was missing in action.

This has been compounded by what seems to many to be a ruthless pursuit of a handful of small fry to build up the scorecard rather than taking on senior executives and directors in big companies over breaches of continuous disclosure.

Indeed a high-profile barrister argues that litigation funder IMF Australia has become the de facto public corporate enforcement arm - done with about 20 staff, compared with ASIC's estimated 1900. "IMF does not do enforceable undertakings in backrooms, nor take no prisoners. And they win," he says.

As CPA Australia chief executive Alex Malley says: "An effective regulator ... is the least investors should expect for their tax dollar. A review of functions, expectations and operations of ASIC is now well overdue and in the public interest."

The Senate inquiry, which was triggered by the CBA financial planning scandal and ASIC's belated investigation into a tip-off, was backed by all sides of politics.

And ASIC will also be scrutinised by the upcoming financial system inquiry, which will examine the role, objectives, funding and performance of Australia's financial regulators, as confirmed in its draft terms of reference this week.

They will both grapple with the big question that financially stricken investors have been asking for years - just what is wrong with ASIC?

Some say it has too much to do. In 22 years, its responsibilities have widened from financial markets and companies, to include regulation of financial services for retail investors, direct supervision of consumer credit licensing and Australia's business names register.

Malley, whose organisation represents 144,000 members, points to the fact that ASIC has only recently moved to put a staff member into the AFP's investigation into bribery and corruption allegations at Leighton Holdings.

"It reinforces the view that it is an organisation spread too thinly," he says. "The AFP investigation has been under way for two years, and allegations about Leighton were given extensive airing in the Australian media again months ago, and yet it appears that it wasn't until last month that ASIC even entered into an MOU [memorandum of understanding] with the AFP."

Some say it needs more funding.

ASIC's funding is projected to drop from \$357 million this year to \$352 million in 2016-17, according to Treasury's submission to the inquiry.

It is one of the few regulators that earns more than it spends, with the government pulling out more than \$350 million a year in revenue, which makes it a powerful fund-raiser at a time of federal budget constraints.

Its chairman, Greg Medcraft, has argued that its funding is insufficient to do everything expected of it, including keeping a focus on the small-business sector and pursuing cases involving large companies.

Sources say it is frequently outgunned in spending on lawyers in big court cases.

When asked this week by BusinessDay whether ASIC was adequately funded, Medcraft said ASIC was developing a user-pays funding model, and was briefing MPs on its proposal.

But some believe ASIC could be much smarter with its resources. The Institute of Chartered Accountants, in its submission, says there are "many examples" where ASIC launches action in an area of need, but fails to scale back its work once the issue's importance has diminished.

"It is the way Australian businesses are being challenged every day," says ICAA's chief executive Lee White - a former chief accountant at ASIC. "We are being asked to do more with fewer or more limited resources."

Some submissions suggest ASIC's culture has become highly process-driven and bureaucratic. Anne Lampe, a former employee of ASIC, lodged a submission criticising the regulator for "springing into action" when investor complaints reached "tsunami" levels.

"When small investors lost money, ASIC seemed incapable of action or didn't think it necessary. However, if a corporation or big fish reported a trading irregularity, backsides came off their seats quickly."

One former senior executive says there is "a level of circumspection that sometimes seems like inertia". But it is not that ASIC staff members don't grasp the urgency - it is that they are conscious of the impact of their actions. "If you suspend a licence quickly before you have got all the facts and it turns out you didn't have a proper case, you have done that licensee irreparable harm.

"For the most part ASIC's staff are very focused on public service and the greater good. They sweat it when people get hurt. There's a lot of grief and pain. There are a lot of people who care."

But ASIC's lack of transparency and openness are recurring themes.

Would-be whistleblowers complain of passing on reams of information and then waiting for a response that never comes.

For Lampe, a key issue is ASIC's decision to negotiate enforceable undertakings instead of taking legal action as the preferred course of action. "These undertakings were discussed and fought over, over months, by armies of lawyers in secret behind closed doors and few details ever emerged about how the damage to investors was done, how many investors were affected, or even whether the undertaking was adhered to. In some cases the companies involved undertook to write letters to affected clients asking them to come in and discuss their concerns. Whether these letters were sent, how they were worded, whether they were replied to, or what compensation was offered, stayed secret."

In the case of the CBA scandal, which resulted in the banning of seven planners who controlled hundreds of millions of dollars of clients' money, ASIC extracted a two-year enforceable undertaking in October 2011. CBA executives were never punished. Indeed, some continue to work there or are now in senior roles in other banks and wealth-management operations.

Concerns about ASIC's lack of transparency and reluctance to explain decisions have surfaced in everything from its reliance on enforceable undertakings, to its lack of a freedom-of-information officer to handle requests, to the most mundane interactions with the public.

In its submission to the inquiry, the Commonwealth Ombudsman sets out complaints about long delays in dealing with ASIC, and scant explanations from the regulator about its decisions.

Even complaining about ASIC to ASIC is difficult. "While ASIC's website contains a clear heading, 'how to complain', the subsequent list of links does not offer a clear and explicit opportunity to make a complaint about ASIC," the Ombudsman dryly observes.

Former ACCC chairman Allan Fels says a good regulator acts without fear or favour. Compared to the ACCC, he says ASIC's image is of a "far less pro-active enforcer", particularly when compared with the Securities and Exchange Commission in the US. "Over the years there has been a less than total full-blooded commitment to applying the law vigorously," he says.

It is a comment not lost on Professor Adams, who says the ACCC is tough on collusion, isn't afraid to take on the big players, as well as defend the small operators and consumers.

Fels also believes ASIC has relied too heavily on enforceable undertakings, to the detriment of public interest. "They have become too much of a substitute for basic legal action."

Not everyone agrees that ASIC's problems are deep-seated.

Bob Baxt, a lawyer and former chairman of the Trade Practices Commission, argues that the system is "quite sound".

Henry Bosch, who was the chairman of the predecessor to ASIC, the National Companies and Securities Commission, says he has a "good impression" of ASIC. "There is no industry that is perfect all the time but I think we are well served."

And Jeffrey Lucy, who was chairman of ASIC during the boom years of 2003 to 2007, points to ASIC's role, in 2008, in navigating Australia through the worst financial crisis since the Great Depression.

But the GFC revealed cracks in the regulator as companies such as Babcock and Brown, ABC Learning, Allico and others unravelled.

Thousands of retail investors were caught up in the collapses of Storm Financial, Timbercorp, Great Southern, Fincorp, Opes Prime, Trio and many others.

While Lucy may see the GFC as a triumph for ASIC, it prompted soul-searching within the regulator about its role and philosophy.

And it is here that some experts say the seeds of ASIC's problems can be found.

Since at least 1997's Wallis inquiry, corporate regulation in Australia has been guided by the efficient market hypothesis - the idea that market players will make their investment decisions on a rational assessment of risks and rewards on offer.

The emphasis was not on enforcement, or prevention of wrong-doing, but on disclosure - giving potential investors information about the risks and rewards of a particular venture.

And as Australia boomed in the mid-2000s, the light-touch approach seemed to be paying big dividends.

Negotiated settlements and enforceable undertakings became the enforcement tools of choice, with then chairman Lucy arguing they produced better results than taking corporate wrongdoers to court.

But the economic carnage wrought by 2008's global financial crisis threw the old certainties into doubt.

In 2009, with Australian losses from the GFC at \$73 billion and rising, then chairman Tony D'Aloisio said the disclosure-based regime and the efficient markets hypothesis meant ASIC did not have the equipment to prevent catastrophic corporate collapses.

"Inevitably ASIC will come in after a collapse has occurred. We are there, as an oversight body, to see if the law was complied with and, as such, we will arrive at the scene of the accident," D'Aloisio said.

It was a theme he returned to the following year, saying that "it might be better to prohibit certain products from being offered to retail investors".

And now, five years after the GFC, ASIC is still talking about the pros and cons of the efficient market hypothesis.

In its submission to the Senate inquiry, ASIC points out that international regulators are now "looking for a broader toolkit" in grappling with market problems - away from disclosure towards "regulatory interventions".

Lucy admits the adequacy of the disclosure-based regime is "a very vexed question".

"We took the approach that we assumed that people were in essence overwhelmingly responsible, honest people," he said.

"I can think of a number of instances - [WA property scheme] Westpoint, a number that I was involved with - where our remedies were not much more than being able to go to the court and seek directions from the court.

"The regulator in Australia doesn't have the right to shut businesses down."

Melbourne law school corporate law expert Pamela Hanrahan, who spent three years at ASIC under D'Aloisio, believes ASIC's problems go back to the late 1990s, when it was given oversight of Australia's new financial licensing regime.

She argues that the "big fundamental mistake" was that ASIC went about regulating financial advisers, stockbrokers, trustees and other financial service licence holders - many of whom are entrusted with the savings of retail investors - with the same disclosure-based approach as securities markets.

"ASIC started off as a corporate governance and securities and markets regulator, and that's a model which is all about the ambulance at the bottom of the cliff," Dr Hanrahan says.

The problem was that the community expected those newly licensed by the 2001 reforms to be supervised, "or at least that regulators would intervene quickly to cut problems off when they were identified.

"The design flaw was to try and transplant the ex-post, bottom-of-the-cliff approach from the corporations and securities regime to this new financial services space."

The two areas of ASIC's responsibility are "apples and oranges" in terms of regulatory approach, she says.

"ASIC's ongoing difficulty is that you have the apples and oranges in one basket and the current structure doesn't always appropriately distinguish the two."

Fast-forward to 2013, and Australia's recent corporate history is littered with the carcasses of collapsed investment spruikers, who flourished under the light-touch regulation model.

Among the most infamous are managed investments schemes, including Timbercorp, Great Southern Plantations, Banksia and Gunns, which have cost retail investors millions of dollars.

The crucial cogs in the MIS machines are the "responsible entities" - the companies charged with managing the schemes and protecting the interests of investors. They replaced trustees under laws brought in by the Howard government in 1998.

Managed investment schemes must be registered with ASIC but they are governed by the responsible entity, which is appointed by - and often closely related to - the company spruiking the MIS.

Niall Coburn, a former senior specialist adviser with ASIC's enforcement directorate from 2009 to 2012, says allowing the responsible entity to control the fund and where it invests is like putting the devil in charge of the angels.

"There is no safeguard for investors," he says.

Coburn says he started looking at Gold Coast mortgage fund LM Investments last year, and realised it had serious issues.

He said he told Medcraft directly, but little happened until LM went into administration in March. ASIC declined to comment on LM.

Coburn blames the lack of ASIC's criminal convictions partly on the limited skilled staff capable of handling complex cases and an inability to prioritise projects.

He says in the case of Australia's largest superannuation fraud, Trio, ASIC didn't pursue money that disappeared overseas. "We are too slow," he said. He said over the past few years more than \$1 billion has been lost in MIS and there hasn't been one prosecution. "LM, City Pacific, MFS, Timbercorp, Equitytrust, are just a few that have blown up," he said.

Perhaps one of the most complex cases of all was Babcock & Brown, dubbed a "mini-me" Macquarie Bank impersonator, which collapsed in March 2009, with debt totalling more than \$40 billion. It later emerged that the

company had compliance issues dating back to 2006 - and that ASIC had sat inside Babcock for more than two weeks after a whistleblower had warned it about alleged conflicts of interest.

After its spectacular collapse, a report by administrator Deloitte said directors "may" have breached their duties and the corporations law by operating the investment bank while it was insolvent, and failing to get shareholder approval for a \$40million loan to controversial broker Tricom Equities, which almost brought the ASX to a halt when it failed to settle shares.

A well-placed source told BusinessDay an investigation was still under way when D'Aloisio stepped down as chairman in 2011. But ASIC this week refused to provide any information on its progress since that time.

Babcock's collapse was one of Australia's biggest. But even the smallest failure can have a tragic impact on those caught up in it.

Dianne Mead, who invested through troubled West Australian financial adviser Wealthsure, said ASIC's failure to act "is nothing short of a modern-day holocaust".

While ASIC has said it is concerned that "Wealthsure's commitment to compliance is inadequate", and has "recurring compliance deficiencies, despite previous regulatory intervention in 2006", in September it allowed the group to continue operating with an enforceable undertaking.

Terry Gammel, a victim of Trio Capital, blasted ASIC's "failure" in investigating the \$180 million collapse.

Gammel said he provided ASIC with detailed files in November 2010, but did not hear from it for another eight months.

He claims that after a six-hour meeting, ASIC investigators promised they would give him a draft statement to sign in "around three weeks or so".

"It is now over two years later and I haven't heard one solitary word from ASIC despite my complete co-operation at all times, this extremely long meeting at my home and nor have I received any draft statement to edit and ultimately sign," he said in his Senate submission.

"If this is typical of the manner in which ASIC conducts its investigations then it is becoming abundantly clear as to why ASIC is still struggling with its investigations into the collapse of Trio and the ARP Growth Fund."

Dennis Chapman, a victim of the 2008 collapse of Gold Coast financier Octaviar, formerly known as MFS, said he had gone from "complete financial security as a self-funded retiree to being forced to live on the age pension in impoverished circumstances".

He told the Senate that while ASIC had taken action over MFS' main fund, it had shown no interest in MFS' MYF, a small fund of just \$2.1 million in which he had invested \$200,000.

An "ASIC staffer has stated to me in telephone conversations that the MYF case, quote 'is not in the public interest' and quote 'we are not in the business of getting your money back,'" Chapman said.

Medcraft declined an interview with BusinessDay, but responded to questions. He says that during his tenure, ASIC has improved its transparency, and has more clarity about its objectives.

He also says staff morale has improved.

D'Aloisio also declined to speak to BusinessDay.

But Lucy questioned some of the criticisms of ASIC being slow to act and defends the use of enforceable undertakings rather than legal action.

"Interestingly, I can recall on Ralph Norris' [the former boss of CBA] first day at work, I called him in relation to what we regarded as inappropriate selling within the Aboriginal community by representatives of the Commonwealth Bank, on commissions," Lucy says.

"He responded to that instantly and within a couple of weeks he came back to me to say that full restitution had been made, etc etc.

"So I think that to suggest that instances of complaints coming in that are not acted upon, are not acted upon, is just simply not the case.

"Prosecution, particularly white collar crime, is incredibly difficult.

"It's just very expensive, very time-consuming, and frequently it's difficult to get admissible evidence," he said.

The brutal reality is ASIC suffers from a dual personality. ASIC has to regulate and assist business and, at the same time, be a corporate watchdog. With a budget of \$357 million a year, or \$1 million a day, it is one of very few securities commissions that administer the corporate sector and are responsible for pursuing civil and criminal breaches of the law.

It regulates and enforces laws governing investments, superannuation, insurance, deposit taking, financial advice, buying and selling shares and managed investment schemes. It also oversees the management of companies, company financial reporting, the raising of money, the lodgement of prospectuses, and takeovers.

With the spotlight firmly on the inner workings, culture and calibre of staff, the words of D'Aloisio toasting the successes of its 20-year anniversary in 2011, will ring loud: "I believe the last 20 years have also seen the development of what I would call 'brand ASIC'. The perception of ASIC has, in my view, moved away from it being seen through a chairman or set of commissioners. ASIC is now a respected regulator with its own identity."

For the victims and the whistleblowers brand ASIC needs work. As Jeff Morris, one of the whistleblowers who alerted ASIC to the CBA financial planning scandal, said this week: "The Don Nguyen scandal may turn out to be the loose thread that unravels the whole ASIC garment.

"Over 300 submissions to this Senate inquiry almost universally critical of ASIC, with common themes of inertia and incompetence, should sound the death knell for this dysfunctional organisation, or at least its current leadership.

"The range of scandals, scams and frauds that has stripped so many ordinary Australians of their life savings is breathtaking and they all happened on ASIC's watch.

"My own experience as a whistleblower laid bare to me the yawning gulf between ASIC's high-flown rhetoric and the cold reality of their minuscule achievements. Hopefully, this inquiry will do the same for the Senate."

*This story was found at: <http://www.theage.com.au/business/scrutinising-asic-is-it-a-watchdog-or-a-dog-with-no-teeth-20131122-2y1s0.html>*