

Subject: Westpoint update from Senator Sherry
From: "May, Shane \ (Sen N. Sherry)" <Shane.May@aph.gov.au>
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BCC:

Greetings

I would like to update you on the latest representation for you at Senate estimates.

Senator Sherry took the opportunity to once again question ASIC on Westpoint proceedings.

Senator Sherry focused on seven main issues:

1. The \$50,000 or greater promissory note loophole and why the government has not fixed this, despite Mr Lucy stating publicly it is a problem.
2. FICS and ASIC's ability to deal with Managed Investment Schemes, especially in light of FICS ongoing court action.
3. Increasing the monetary limit on FICS complaints. Even after Mr Lucy has stated at a meeting with the Westpoint Investors Group that this should be increased
FICS this month have released their new guidelines and this increase was once again ignored and deferred.
4. Having more than one investment with a Financial Advisor counts as a total instead of individual investments and so the \$100,000 monetary limit applies to the total
invested not the individual investments.
5. The ability of FICS to enforce compensation/rulings if ASIC has already removed a planners financial license.
6. The issue of Insurance, over four years since the government was to mandate adequate PI insurance for financial Advisors their is still no
requirement for FP's to have any insurance.
7. FICS ability to deal with Westpoint claims

The transcript from the questioning is below.

The government is continuing to ignore the need for greater investor protection and amazingly has failed to fix one problem that has been highlighted by the Westpoint collapse.

Senator Sherry will continue to place pressure on the Government, ASIC and FICS to ensure this tragedy will not happen to future investors and to ensure Westpoint investors get a fair go.

If you need any issues raised please do not hesitate to contact Senator Sherry or myself. There is an oversight of ASIC this week and we are hoping to continue questioning on this matter.

Kind regards

Shane May
Advisor to Nick Sherry
Labor Senator for Tasmania
Shadow Minister for Superannuation, Intergenerational Finance, Banking & Financial
Phone - Electorate Office: (03) 6424 8241
Parliament House: (02) 6277 3128

STANDING COMMITTEE ON ECONOMICS
Australian Securities and Investments Commission
Discussion

02nd November 2006

Westpoint Questions

Loophole? - \$50,000 or greater promissory note exemption under Corporation Act

Senator SHERRY—That brings me to a number of aspects of Westpoint that I want to take up

Senator SHERRY— On the issue of the promissory note and the \$50,000 exclusion zone, or the \$50,000 figure which we have touched on other occasions, I refer to your public statement in the *Australian Financial Review* that, whilst any change was up to government, adding an extra zero or two to the \$50,000 benchmark could be a simple way to give unsophisticated investors more protection from any copycat schemes. Where is this at? I have to say that, surprisingly, I have heard of no action from the government in this regard.

Mr Lucy—I am not able to speak on behalf of the government.

Senator SHERRY—I understand that, but have you had liaisons with them? Given your public statements, you must have had some communication with the government or the department on this issue.

Mr Lucy—We have with the department.

Senator SHERRY—Can you indicate to me approximately when you raised this issue of the promissory note exclusion?

Mr Lucy—We have had discussions more than once. It really has been an ongoing dialogue. But certainly to the best of my knowledge the most recent would be perhaps a month ago.

Senator SHERRY—Can you recall—again I do not want the exact date—when you first raised this issue with the department?

Mr Lucy—Around the time of that press comment that you refer to.

Senator SHERRY—One of the reasons I raise this is that in Senate question time Senator Coonan, representing in the Senate, claimed in her response—in terms of the issue of the \$50,000 and increasing it—there was no loophole.

Mr Lucy—I am aware of that. The truth is that this is an extraordinarily complex legal issue, frankly. I guess the discussions and the matters which we have had before the court really identify just how complex it is. I do not think that the \$50,000 or some greater figure could ever be described as a loophole, and I think that the government is correct to say that there is no legislative loophole. My observation regarding the increase to the cap, as I said, is not under the heading of a loophole or otherwise; it is just simply a mechanism of addressing one part of it—that is, the sophisticated or investor part.

Senator SHERRY—Senator Coonan claimed in question time that ASIC has always had sufficient power to deal with promissory notes under chapter 5C of the Corporations Act.

Mr Lucy—I guess that again has been before the court and, indeed, this week it is again before the court in a matter regarding FICS.

FICS and ASIC's power to deal with Managed Investment Schemes

Senator SHERRY—I understand that that will be handed down today.

Mr Lucy—Certainly this week. I cannot say that it will be today, to be honest. But this is an area that

is extremely complex. For our part, we are anxious not to get into too much dialogue about the interpretations of some of these legal issues because we do not want to be in a position that will prejudice some of the actions that we are now taking.

Senator SHERRY—But you have expressed general concern on a number of occasions about at least potential limits to your power to act early in respect of Westpoint.

Mr Lucy—That was more to do with the issue of the intelligence we were getting regarding whether or not the business was insolvent and/or having financial difficulties as far as their business model is concerned. The issue was regarding the promissory notes we took to the courts in 2004, from recollection. It was before the Western Australian Supreme Court and then went on to appeal, and we heard the outcome of that appeal earlier this year.

Senator SHERRY—But that was part of it. Part of your general difficulties with Westpoint, certainly as you have argued, has been this issue of the \$50,000 promissory note.

Mr Lucy—Because of the complexity of it; that is quite so.

Senator SHERRY—Yes.

Mr Lucy—But the complexity has not gone away; it still exists.

Senator SHERRY—I know. I want to get to some other complex issues or new issues I have been made aware of. Do you consider this issue—the \$50,000 level—as part of the overall difficulties of Westpoint, an important issue and one that does need to be dealt with?

Mr Lucy—Frankly, I think that as time has gone on it has become less crucial. Initially, we thought that many of the investors might have been involved because of direct marketing and/or being advised by unlicensed advisors. We are now in a position to know that the overwhelming majority of investors went in through licensed advisers. So in that sort of an environment the \$50,000 and/or the issues to do with the promissory note probably are not quite so relevant.

Senator SHERRY—But they are still an issue.

Mr Lucy—They certainly are not so acute.

Senator SHERRY—But they are still an issue.

Mr Lucy—They are an issue as far as ultimate enforcement action goes. But as for the decisions by people to invest, they are probably not so relevant.

Senator SHERRY—How do you justify then the appeal in respect of the WA Supreme Court decision on this matter?

Mr Lucy—Do you mean the first appeal?

Senator SHERRY—Yes.

Mr Lucy—It was because we disagreed with the decision.

Increasing FICS caps from the current \$100,000

Senator SHERRY—You mentioned FICS in an earlier response. I understand that you met with some members of the Westpoint investors group and indicated to them that the issue of lifting the cap—it is \$100,000—that FICS has in respect of its ability to award compensation was under consideration by FICS.

Mr Lucy—I do recall that discussion. I think that it was more of a recommendation to FICS that they

might seek from the advisers an increase in the amount.

Senator SHERRY—Did you specifically mention any figure?

Mr Lucy—Not to my recollection.

Senator SHERRY—Are you aware that FICS has released its new rules?

Mr Lucy—I am not.

Senator SHERRY—Are you aware of the special edition, issue 41, from 26 October?

Mr Lucy—My office almost certainly is, but I am not.

Senator SHERRY—Are you aware of that, Mr Cooper?

Mr Cooper—No.

Senator SHERRY—Unfortunately the Westpoint people are in for a bit of a disappointment because, right at the end of it, it says:

Consideration of any increase to FICS' monetary limits has been deferred pending a separate consultation—albeit that this issue had been part of the consultations that led to this.

Mr Lucy—Yes.

Senator SHERRY—It continues:

The current monetary limits have been retained in the new Rules pending that consultation—

Mr Lucy—I note that you referred to the fact that they have deferred it. I am obviously not able to talk about the reasons that they have deferred it as distinct from making a decision. It can, of course, still be increased with the consent of the parties. So, to the extent that the parties agree to extend it, they can.

Senator SHERRY—But I think that is hardly likely the way things are going.

Mr Lucy—It is still early days. One of the consequences of our investigations is that the level of tension being applied to a number of these parties is certainly increasing, and it may well be that in the fullness of time some those parties therefore, because of that tension, decide that FICS might still be the appropriate mechanism for dealing with these issues.

Senator SHERRY—But the fact is that there is \$100,000 limit.

Mr Lucy—Yes.

Senator SHERRY—You believe it should be increased.

Mr Lucy—We have suggested that, where parties have amounts greater than \$100,000, they should seek an increase. So, yes, we are certainly on the record for saying so.

Senator SHERRY—FICS carried out a review of their rules, including the \$100,000 limit. They have finished the consultation, published new rules, amendments to FICS rules, but they have decided to defer this decision of the \$100,000 limit. Can you—not necessarily you personally—take this issue up with them?

Mr Lucy—I will.

Senator SHERRY—It is certainly causing concern amongst some of those people who would wish to apply for compensation through FICS and are unable to do so. Do you have any specific regulatory power over FICS other than giving the general authorisation for it to be a dispute resolution process?

Mr Rodgers—No.

Senator SHERRY—You can withdraw recognition of it if you do not believe it is operating adequately, can't you?

Mr Rodgers—Theoretically we could.

Senator SHERRY—It seems to me you are in a position to apply some guidance to FICS.

Mr Rodgers—I think 'encouragement' would at least be a fair description.

Senator SHERRY—I use the word 'guidance'. 'Thumbscrew' might be another.

Mr Lucy—Our dialogue with FICS has been constructive and helpful. We will take the point that you raise on notice and go back to them.

Having more than one investment still being capped by FICS \$100,000 limit

Senator SHERRY—One of the problems that has been drawn to my attention with this \$100,000 limit is the example of a Ms Lawrence, who, through Brighton Hall Financial Services, sought financial advice. She invested \$102,000 in Cinema City and then went back to Brighton hall and was convinced to invest \$85,272 in Ann Street. One amount was over \$100,000.

Mr Lucy—Yes, \$102,000.

Senator SHERRY—The other amount was under \$100,000. Clearly there are two separate transactions, though, and not contrived in any sense. But FICS are taking the view that they cannot deal with the transaction under \$100,000. Is that your understanding of the way FICS operates?

Mr Lucy—That specific example I would have to take on board because, again, many of these issues are quite complex because the description of that matter for that lady that you referred to is not uncommon in that we have a number of people who have multiple investments, but it is not automatic as to whether or not they are separate advances and so therefore should be treated separately by FICS. I will certainly take on board that particular example.

Senator SHERRY—Yes, because there are, as you say, a number of people in these circumstances with clearly two separate occasions, two separate investments and two separate entities, but—

Mr Lucy—Indeed many go well beyond two.

Senator SHERRY—Yes, but in this case they argue that they cannot deal with the one that is under \$100,000.

The ability of FICS to enforce compensation/rulings if ASIC has already removed a planners financial license.

Senator SHERRY - There is another issue with respect to FICS's jurisdiction—and I must say I was surprised to hear this. I understand that, if ASIC bans a financial adviser with respect to Westpoint, or anything for that matter, and the issue and the compensation has not been determined by FICS at that point, FICS no longer has legal authority to handle the dispute because the planner has been banned. Is that correct?

Mr Lucy—I will ask Mr Rodgers to respond to that.

Mr Rodgers—I think that is correct in the sense that the obligation to remain a member of FICS flows from the holding of a licence or being a representative. So that obligation drops away once they cease effectively to be a person regulated through the Corporations Act.

Senator SHERRY—Doesn't that present FICS and you with somewhat of a dilemma if you justifiably remove the licence from a planner before FICS has determined compensation for these Westpoint victims?

Mr Rodgers—The case you are talking about will apply where you have an individual planner who holds a licence in their own right. It is the obligation of the licensee—and, of course, a banning order applies against an individual rather than a licensee. So taking a large firm with 100 advisers, the fact that we ban one of those advisers will not disable FICS from making compensation orders in relation to the licensee, because the licensee, of course, is responsible for the conduct of all of its then advisers.

Senator SHERRY—Unless, as you say, it is an individual, not paid under licence.

Mr Rodgers—Yes. It is being a licensee that commits you to being a member of a dispute resolution scheme like FICS and it is true that we understand that removing a licence has the potential to disconnect that compensation route. You can be confident that we are well aware that consequence.

Senator SHERRY—So this matter has been discussed with FICS?

Mr Rodgers—It is an operation of the Corporations Act rather than FICS, I think.

Senator SHERRY—Yes, but I understand from the concerns that I have had referred to me that it is an issue of concern in FICS.

Mr Lucy—If it has not been discussed with FICS, I will ensure that it will be.

Senator SHERRY—But it is almost a catch-22 here.

Mr Rodgers—It is the voluntary surrender of a licence that creates the problem area.

Senator SHERRY—At least some of the Westpoint victims have raised this issue—naturally, where it is found to be appropriate by ASIC wanting action taken against a particular planner, if that is found to be appropriate after you have completed your investigation. But the difficulty for some at least is that that then removes their ability to receive compensation. That is causing them some concern and distress. But you seem to be aware of the issue and presumably you will be able to take that into account, at least in your timing on these matters.

Mr Rodgers—We are well aware of the issue.

PI Insurance

Senator SHERRY—Another difficulty about compensation and FICS is the issue of PI insurance. Are you aware of some of the issues concerning lack of or insufficient PI insurance?

Mr Lucy—That is on compensation more generally, so again I will ask Malcolm to respond to that.

Mr Rodgers—There is no current obligation under the act for people to hold PI insurance. I do not speak as an expert on this, but my understanding of the information that we have gathered through Westpoint is that it is not universally true that all advisers hold PI insurance. It is true that the terms of some of the PI insurance that advisers currently hold look problematic if you are looking for PI as a source of investor compensation.

Senator SHERRY—We could end up in the situation where, because of lack of PI insurance—whether it is not sufficient or, in fact, does not apply at all—even if fault is found and even if you do take action and withdraw their licence, some of the investors may not end up with anything.

Mr Lucy—I think that is a big assumption. Before one looks at the levels of insurance, for example, there is a question of what is returned by the administrators, liquidators and so on. Therefore, in the

final analysis, which is the point you are raising, quite so; it may well be that in the end that top-up that people are looking for to be provided under the PI cover may not be available.

Senator SHERRY—It may not be there, yes.

Mr Lucy—Correct.

Senator SHERRY—I thought the issue was that PI insurance was to be a requirement. What has happened?

Mr Rodgers—The general provision in the Corporations Act that requires a licensee to have arrangements for compensation came into effect on the enactment of the financial services regime.

Senator SHERRY—Which was when? Can you remind me of the date?

Mr Rodgers—It was 11 March 2002, I think. At that stage, as you would be aware, the market for general insurance products in Australia was in some disarray following the collapse of HIH. As I understand it the government undertook to examine in more detail the use of a requirement that contemplated rather than necessarily expressly required that the obligation would be met by PI insurance. The government issued consultation papers a couple of times, but the final form of the obligation—in effect, the regulations that sit under the Corporations Act provision—is not yet settled.

Senator SHERRY—Here we are in November 2006 and PI insurance has not been finalised for, in this case, planners. And again this is potentially a difficulty in respect of Westpoint, and other people for that matter, because they have either insufficient PI insurance or none at all. Is ASIC concerned about this lack of PI insurance, given that it was supposed to apply from March 2002? I accept the difficulties with HIH and the fallout and all that, but here we are in November 2006 and the PI insurance still has not been settled. This will be an issue for other investors in terms of any difficulties they have outside the Westpoint matter.

Mr Lucy—Potentially.

Senator SHERRY—Yes, potentially it will, won't it? So are you concerned that this matter has not been settled yet?

Mr Rodgers—I think it would be fair to say that we would welcome the finalisation of what has been a difficult area to develop.

Senator SHERRY—Yes, I understand that it has been difficult, but it seems to me that, in the case of at least some of the Westpoint investors, when all this is concluded, the lack of PI insurance will be an issue for at least some of them.

Mr Lucy—That is likely.

Senator SHERRY—If this matter of PI insurance were settled tomorrow—I know that it is not going to happen tomorrow, even though we are more than four years on and it should have been settled—would that have any effectively retrospective application to the cases currently before FICS? When would it effectively apply from?

Mr Lucy—My understanding with PI insurance is that, firstly, it is an extraordinarily complex area because it requires people to give undertakings and to give full disclosure. It is also a question of whether or not it is on a claims-made basis. So one could imagine that, if I was taking out PI insurance with a prospect of being sued, on a claims-made basis I am not going to get insurance cover.

Senator SHERRY—Or you will get it at some extraordinary cost.

Mr Lucy—Precisely. So it is a very difficult area and it is also made difficult when you seek to cover illegal acts, because any act that is within the capability of the insured to trigger—that is, trigger essentially the collapse of the cover or make the cover void—is very difficult to manage. For example,

even the most basic obligation of the insured to give notice of when a claim is likely can just simply be set aside either deliberately or inadvertently by the insured.

Senator SHERRY—Indeed, I am told, not just by people who are claimants in respect of Westpoint but also by at least some of the compliance people who operate in this area, that this is a significant difficulty—the lack of PI insurance in settling or at least attempting to settle some of these issues.

Mr Lucy—Our observations would be that it is too early for us to form that view because we are not at that point, frankly, so I could not support that comment at this stage.

Senator SHERRY—Let me take the converse. Where a person has PI insurance, isn't it generally true that they cannot settle a dispute with a client, Westpoint or not Westpoint, without the agreement of the PI insurer and, if they do settle, it is highly likely that they will not receive the PI insurance from that company?

Mr Lucy—You are talking generally. Certainly it is my experience that, when an insurer is obliged to, in essence, stand behind their cover and they look as to whether or not there are opportunities to step aside from the obligations, they often stand in the shoes of the party to see whether or not they can mitigate or reduce any such responsibilities and negotiate. So I think that is likely down the track.

FICS ability to deal with Westpoint claims

Senator SHERRY—Are you also aware that on 12 September FICS sought a declaration in the Federal Court regarding its ability to deal with complaints and hence financial advisers in respect to Westpoint?

Mr Lucy—I believe that is the matter before the court at the moment.

Senator SHERRY—Does ASIC believe FICS have sufficient powers to deal with issues on promissory notes?

Mr Lucy—I do not think we should comment on that because that is before the court and that is very much the heart of the issue.

Senator SHERRY—Did you make any submission at the hearing?

Mr Lucy—I understand that we did take an intervening role in that proceeding, yes.

Senator SHERRY—Can you indicate in what way?

Mr Lucy—Supportive of FICS.

Senator SHERRY—I understand that to date FICS have now received 240 complaints, so a substantial number are now entities before FICS in respect to Westpoint.

Mr Lucy—I cannot verify that number, but it is consistent with my expectation.

Senator SHERRY—On another matter—and I have raised this with you before on at least two occasions—have you kept the tax office informed in respect to self-managed superannuation funds where there was a Westpoint investment?

Mr Lucy—Yes, we have. Indeed that liaison and discussion is literally ongoing. I am aware of further discussions held this week.

Senator SHERRY—I will pursue it with the ATO. I accept what you say, but when I have gone to the tax office and raised this matter with them there has been no action—nothing.

Mr Lucy—I am personally aware of ongoing discussions, again including this week.

Senator SHERRY—The discussion is fine, but I have asked the ATO, ‘What have you done about investigating the self-managed superannuation funds structures?’ They have regulatory responsibility for this. Certainly as at the last estimates, which was the second time I raised it with them, nothing had been done.

Mr Lucy—That is a matter for them of course.

Senator SHERRY—I accept that it is a matter for them.

Mr Lucy—All I am saying is that there is very effective dialogue in all sorts of areas between ASIC and ATO.

Senator SHERRY—Okay. In terms of alternative disputes, are there any other dispute mechanism that exist if FICS did not exist?

Mr Lucy—Are you talking about the Westpoint environment?

Senator SHERRY—No, generally.

Mr Rodgers—There is the statutory dispute mechanism, the Superannuation Complaint Tribunal. I cannot be certain of the exact number, but there are four or five, perhaps six schemes that we have approved under our powers under the act.

Senator SHERRY—Could you take that on notice and provide me with just a brief overview of them?

Mr Rodgers—Yes.

Senator SHERRY—In terms of super, for example, that is fine, but a lot of the FICS is nonsuper.

Mr Rodgers—That is correct.

Senator SHERRY—Probably the majority, I think from our previous discussions.

Mr Lucy—I am not sure about that. I think you are right in saying that a significant amount is from super.

Senator SHERRY—I think you have given us a figure of approximately a third.

Mr Lucy—Again, I am not sure whether that is referring to the dollars or the actual transactions.

Senator SHERRY—Whatever it is.

Mr Lucy—Whatever it is, it is a lot.

Senator SHERRY—It is a lot, but there is a lot nonsuper as well.

Mr Lucy—Correct.

PI Insurance continued

Senator SHERRY—I will return briefly to the issue of PI insurance. Have ASIC been in dialogue with the department on the matter of the lack of PI insurance?

Mr Lucy—The whole issue of PI insurance is part of the ongoing dialogue, and I am aware that certainly the insurance industry has also been involved in those sort of discussions.

Senator SHERRY—What should investors do at the moment? Is there any formal disclosure to

investors that when they go to a licensed planner they do not have sufficient PI insurance at the present time?

Mr Lucy—It is a broad question.

Senator SHERRY—I know it is.

Mr Lucy—Step one is whether or not the adviser is licensed.

Senator SHERRY—Yes.

Mr Lucy—I think whether or not the adviser has forms of compensation in place, and the nature of those forms and what that compensation might be, might be quite a legitimate question. Again, advice regarding PI insurance does not automatically mean that there is a level of cover that, at the end of the day, is going to be there to provide.

Senator SHERRY—I accept that.

Mr Lucy—So therefore right now, without this formal platform being in place, one has got to be very careful that you do not mandate it because otherwise an investor might quickly conclude a level of comfort that may indeed be unreliable.

Senator SHERRY—Sure, but at least there is a possibility of something. If there is no cover, there is nothing.

Mr Lucy—Yes.

Senator SHERRY—If there is cover, there is at least a possibility of cover.

Mr Lucy—That is true, but then again that is a question of the quantum of the cover and the level of claims. It is a very complex area.

Senator SHERRY—I accept that it is complex. It is intended that PI insurance should be provided.

Mr Lucy—That is one alternative.

Senator SHERRY—So you are suggesting that perhaps there may be no PI insurance coverage at all after all these consultations are finished.

Mr Lucy—It is not for us to make that observation. All we are saying is that PI cover by itself may not be the total answer. It may be that it is a very key plank of any response, but it may not be the entire answer.

Senator SHERRY—I accept that it is not the entire answer and that it is complex. Are consumers being informed at the moment that there is no PI coverage requirement? What are they being informed about in this area, if anything?

Mr Lucy—I think it is a matter that is generally known in the community.

Senator SHERRY—Do you think so?

Mr Lucy—Yes. The licensed advisers—

Senator SHERRY—In the adviser community?

Mr Lucy—Yes.

Senator SHERRY—Yes, I am sure that is the case.

Mr Lucy—They are the people who are giving the advice.

Senator SHERRY—I am sorry; when you said the community, I thought you were referring to the general consumer.

Mr Lucy—I think that it has received a fair level of press in any event but, in particular, the licensed adviser community would be very well aware of it.

Senator SHERRY—I accept that the licensed provider community would; there is no doubt about that. But you certainly would not contend that the average punter on the street is aware that financial planners do not have PI insurance.

Mr Lucy—I think the likelihood is that the average punter, as you refer to them, would not understand the issue of compensation, frankly, at all, let alone whether or not it is provided by PI or any other form.

Senator SHERRY—I think that is probably right. But, given that more than four years ago it was indicated that PI insurance would be required and there is no requirement as of today, some consumers would at least expect that there is insurance coverage of financial planners in this country.

Mr Lucy—I cannot speak on behalf of those consumers but the facts are that this is a matter that is before the government and I am sure that they are working on it.

Senator SHERRY—Yes, they have been working on it for more than four years and it is still not concluded. As you say, that is not your fault.

Mr Lucy—It is not our responsibility.

Senator SHERRY—But you are responsible for consumer protection information generally; you have significant responsibilities in that area.

Mr Lucy—Quite so, but this is not an issue that people are blind to. This is an issue that is very complex. There has been a high level of stakeholder engagement on it and at this stage the government is still yet to conclude their position.

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