

ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

5 December 2017

By email: ASICenforcementreview@treasury.gov.au

Dear Sir/Madam

ASIC's Directions Powers

The Australian Finance Industry Association (AFIA) welcomes the opportunity to comment on the ASIC's Review Taskforce Positions and Consultation Paper 8 *ASIC's Directions Powers* (the Paper).

AFIA is uniquely placed to advocate for the finance sector given our broad and diverse membership of over 100 financiers operating in the consumer and commercial markets through the range of distribution channels (including digital access).

We note the Government's commitment to ensure that ASIC can respond effectively to address compliance failures within licensed financial services and credit businesses. To this end the ASIC Enforcement Review Taskforce (the Taskforce) in the Paper has proposed:

1. ASIC should have the power to direct financial services or credit licensees in the conduct of their business where necessary to address or prevent compliance failures.
2. The directions power should be triggered where a licensee has, is or will contravene financial services or credit licensing requirements (including relevant laws).
3. ASIC should be able to apply to the court to enforce the direction and take administrative action if a licensee does not comply with a direction.

We note that the Taskforce's underlying rationale for these proposals is that "*ASIC should be able to require compliance with AFS or credit licence obligations in real time, and that the regulator should be given powers to direct licensees to take or refrain from taking actions where appropriate for this purpose*".

AFIA, in principle, supports moves to ensure ASIC's enforcement toolkit is effective to deter poor behaviour in financial services. However, at this time and in the context of other proposed significant additions to ASIC's enforcement toolkit, AFIA does not support the positions outlined in the Taskforce's Paper. The positions proposed represent a substantial increase in ASIC's powers with limited substantiation of need or detailed analysis of the impact of other proposed additional enforcement options. For example, the proposal in the Paper to give ASIC powers that would allow it to direct licensees to cease taking on new clients or appointing authorised representatives has the potential to substantially harm a licensee. The significance of this risk warrants a process subject to greater oversight and scrutiny than a mere administrative power in the hands of ASIC or any regulator.

Further, ASIC currently has a large number of powers available to address inappropriate behaviour. These include the power to: vary, suspend or cancel a licence, ban certain individuals, apply to a court for an injunction, direct a licensee to provide information and to negotiate enforceable undertakings. In the last 12 months alone, each of these has been utilised by ASIC to address behaviour and the outcomes published to put the sector on notice and achieve behavioural change more generally.

The Government has also already announced an intention to enhance ASIC's powers; by committing to implement a product intervention power, for example. Other recommendations for increasing those

powers in earlier papers released by the Taskforce have included: proposals to strengthen the penalties for misconduct, a broader banning power, strengthening licensing powers and enhancing the regime for self-reporting breaches by licensees (with possible extension to credit licensees). Pending completion of the consultation on these, it is unclear what, if any, are to be supported by the Government.

AFIA strongly recommends that the Government should defer its consideration of whether a directions power for ASIC is warranted at this time until after the elapse of a reasonable period post-implementation of the other significant additional powers supported by the Government. This would enable the Government to fulsomely consider whether ASIC's enforcement toolkit was adequate to address poor conduct in the financial services sector. And, if determined more was required, would assist with a directions power better designed to address the identified shortcomings.

However, should the Government take forward the introduction of a directions power for ASIC at this time, AFIA wishes to work constructively to ensure that the power is effective, well-scoped and meets the Government's goals. To this end, we have considered the positions proposed in the Paper, and identified areas where we submit the proposals fall short of this. These are summarised below and explained in more detail in the attachment.

Our main concerns are:

- In the absence of adequate external review processes, directions may be made, or may operate, unfairly.
- The directions available to ASIC should be prescriptive rather than principles-based.
- The proposal to empower ASIC to direct a licensee to cease taking on new clients is not appropriate.
- The lack of clarity of the interaction between the proposed directions power and the proposed product intervention power needs to be resolved.
- The lack of detail on what circumstances will provide the basis for exercise by ASIC of its new directions power.

AFIA is particularly concerned to see included in the proposed framework adequate external review and procedural fairness in the exercise of a directions power. This would be especially important for directions made that could irreversibly harm, or effectively shut down a licensee; such as directions to cease appointing representatives, cease taking on new clients or to remediate customers. More detailed comment on this and the other areas identified is contained in the attachment.

In the absence of re-design of the proposed directions power to address our concerns, we believe it will be ineffective in deterring and preventing poor conduct by licensees and have adverse impacts on compliant licensees. We urge the Government to undertake further consultation to address AFIA and other stakeholder concerns to ensure when adopted the ASIC directions power would be effective.

At the broader level we note that any directions power should not be seen as alternative to other forms of enforcement. And, like any enforcement option, its use should be targeted and proportional to address evidence-based compliance concerns identified by ASIC. We also note, given its relative ease of use compared to other enforcement options, it has the potential to be the first option ASIC might adopt though not necessarily the best option. The potential for this is enhanced if there is not adequate external review processes to facilitate oversight and testing of the appropriateness of a directions order that has been imposed on a licensee.

We thank Treasury for granting us an extension to lodge this submission. We note concerns raised in earlier responses to this and other consultation being undertaken by Treasury and other areas of government. We remained concerned about timeframes for consultation on what are significant matters deserving considered feedback from stakeholders including AFIA. Industry should be given a timeframe to respond that allows consideration of the issues raised and feedback on key areas to inform the Government's consideration.

Further, timeframes for consultation should account for the fact that industry needs to consider the potential interactions with existing obligations and possible future obligations raised through the current high volume of regulatory proposals. They should also reflect the broad range and variation of participants (including within the AFIA membership) from large publicly listed entities through to small entities. All need to consider the potential implications of proposed reforms. Financial institutions' ability to consider regulatory proposals may be challenged by competing priorities and resources. It is essential that the finance industry has adequate opportunity to consider and inform public policy reform in our industry.

AFIA would also appreciate the opportunity to comment on the Taskforce's finalised positions as a package. This will allow industry to identify any potential further issues that may arise from the intersection of the components. Previous reviews have taken this approach by issuing an interim report for consultation. We encourage the Government to adopt a similar consultation process for this very broad and comprehensive review of ASIC's enforcement tools. And more generally ensure the process for consultation is followed so as to enable critical policy priorities to be achieved with implementation designed to minimise, if not avoid, unintended consequence.

AFIA looks forward to continuing to work with the Government and Taskforce on the Review of ASIC's enforcement powers.

If you have any questions regarding this submission please contact Alex Thrift, Economic & Policy Senior Adviser at alex@afia.asn.au or via 02 9231 5877.

Kind regards

A handwritten signature in black ink, appearing to read 'Helen M. Gordon', with a horizontal line underneath.

Helen Gordon
Chief Executive Officer

Attachments:

1. AFIA Feedback.

ATTACHMENT 1: AFIA DETAILED COMMENTS – ASIC's DIRECTIONS POWER

AFIA would like to provide the following detailed comments in response to the Paper.

The rate of compliance changes and increasing regulatory burden

As a general comment, AFIA wishes to draw to the Government's Taskforce's mind the extensive and complex range of regulatory reform proposals impacting our industry. Currently, the regulatory reform landscape includes:

- EDR reforms through the establishment of the Australian Financial Complaints Authority.
- The development of a product intervention power for ASIC.
- Additional regulation of credit cards and consumer leasing.
- The ASIC Enforcement Review (through eight Position Papers).
- Open Banking and mandatory comprehensive credit reporting
- APRA Reserve Powers
- Continuing work by ASIC (e.g. credit card data collection exercise).

Feedback from members highlights the challenge this is placing on their businesses to consider, and once adopted, implement to adapt to these changes within the timelines required by the Government. While banking and finance is a key priority of the Government, regulatory reform should ensure that it is consistent with the Government's commitment to reducing red tape and best-practice making regulation.

Position 1: ASIC should have the power to direct financial services or credit licensees in the conduct of their business where necessary to address or prevent compliance failures

The Taskforce has recommended that ASIC should have the power to direct financial services or credit licensees, where necessary to address or prevent compliance failures, to:

- a. Cease appointing authorised representatives.
- b. Cease accepting new clients.
- c. Conduct a review or audit of an authorised representative's records.
- d. Engage properly qualified compliance staff.
- e. Cease transferring business to another licence.
- f. Cease making specific representations about financial products or services.
- g. Appoint a person nominated by ASIC to review and report on compliance processes.
- h. Establish a program to assess claims for restitution or compensation to customers.

This is a major expansion of ASIC's existing directions power (where it can vary, suspend or cancel a licence, apply to a court for an injunction, direct the licensee to provide information or negotiate an enforceable undertaking). We acknowledge the view expressed in the Paper that expanding the existing powers would give ASIC more flexibility and allow it to respond more quickly to compliance breaches.

AFIA favours a prescriptive approach where ASIC's directions powers are set out in legislation in preference to it being broadly drafted. A prescriptive approach would provide certainty for licensees on what types of directions ASIC could give to a licensee. AFIA opposes a broadly drafted directions power that could effectively be utilised by ASIC in a wide range of circumstances with ASIC essentially becoming a rule making power. This would create an unacceptable level of uncertainty for licensees and the potential impacts on their business.

AFIA has serious concerns about an administrative power to direct a licensee to cease taking on new clients. This kind of direction may irreparably damage a licensee's business. This is effectively a licence suspension and should be dealt with accordingly. In an urgent case, ASIC would be able to obtain interlocutory orders halting potential misconduct on a temporary basis while ASIC completes surveillance and investigation.

We also oppose any directions order requiring a restitution or compensation program where there is a justiciable issue as to liability. Only once such an issue has been resolved should ASIC have the ability to use its power to direct a licensee to establish a compensation scheme. And it is critical that any direction relating to remediation be able to be reviewed.

We acknowledge a process to amend via regulation is simpler and faster than should a legislative amendment be required. However, we also note that allowing the scope of directions powers to be expanded through regulation would mean a process that is not open to the same level of scrutiny and testing by the Parliament if it were to be included in legislation. We note regulations have the ability to be made quickly (so they would be responsive to changes) while still being able to be challenged in Parliament. However, given the potential risk to the directed entity, in our view any proposal to expand the list of powers for ASIC is serious enough to warrant a process of legislative amendment and involve consultation with industry. This will ensure that there is adequate review and oversight before ASIC's directions power can be expanded.

AFIA also has the view that any directions order should be subject to conditions rather than have the potential to operate as an absolute order. For example, if ASIC directs a licensee to cease appointing authorised representatives it should be framed as a direction to cease appointments unless the licensee adopts appropriate compliance arrangements. ASIC's direction could specify what conditions that are applicable. Such an approach would allow ASIC to address poor behaviour or compliance failures while allowing the licensee to continue to trade if it addresses ASIC's concerns and abides by the conditions set out by ASIC.

AFIA seeks clarity around possible interactions with the types of directions ASIC could apply and the powers under the proposed product intervention power (PIP) as a priority. The Paper notes that "*the directions power is not intended to be inconsistent with or undermine the limits to be imposed on the exercise of the proposed PIP*". This provides very little certainty on how these two powers would interact with each other. For example, the proposed direction to stop licensees making representations about financial products seems likely to overlap with the PIP.

Our concerns also extend to the proposed design and distribution obligations that were consulted on with the PIP. There is no certainty or clarity on when a directions power, the PIP or ASIC enforcing design and distribution obligations would apply to breaches. Before proceeding with a directions power this issue should be addressed. Once this issue is resolved at a policy level, ASIC should then be required to provide further guidance on when it will utilise a directions power or the PIP.

AFIA recommends:

- 1) If adopted, the proposed ASIC directions powers should be prescribed in legislation.
- 2) ASIC's directions powers should only be expanded through amendment of legislation and be subject to consultation with industry.
- 3) A directions order requiring a restitution or compensation program where there is a justiciable issue as to liability is not appropriate.
- 4) Any directions order issued by ASIC should be subject to conditions.
- 5) The uncertainty and lack of clarity regarding the interaction between a directions power and a PIP should be resolved before proceeding.

Position 2: the directions power should be triggered where a licensee has, is, or will contravene financial services or credit licensing laws

The Paper recommends that the directions power should be enlivened where ASIC has reason to believe that a licensee has, is or will contravene either financial services or credit licensing requirements.

AFIA has serious concerns about this position. The Paper gives little detail on how the powers will be triggered in practice. Of particular concern, the Paper does not explain how ASIC will determine whether there will be future breaches. We question how ASIC will be able to determine this and how broad this will be.

Without clear guidance on how ASIC will trigger the powers for future possible breaches it will create a significant amount of certainty for industry. This may result in licensees becoming unduly risk adverse because it will be unclear whether and how ASIC will apply the powers to potential future conduct. In turn, this will impact market differentiation and competition.

The powers should only be triggered in respect of conduct relating to a licensee's obligations; that is whether they are meeting them or not. Tying the trigger of the powers to broader more nebulous public interest obligations or interests is unnecessary, means that the powers could be exercised in situations where licensees are meeting their legal obligations yet nevertheless be found to have fallen short of ASIC's expectations. Not knowing when ASIC may rely on its directions power in these circumstances creates uncertainty for licensees. These concerns are underlined because any public interest test will potentially be what ASIC believes is in the public interest; a potentially subjective view.

This is highlighted by the Taskforce in the Paper:

While this [a broadly drafted power] may maximise ASIC's flexibility it may be at the expense of clarity for licensees, which could create uncertainty and ultimately impact on a licensee's perception as to the appropriateness of a direction made and preparedness to comply. Accordingly, the Taskforce has instead adopted the approach outlined in preliminary position 2.

We support the Taskforce's view and oppose including a broad public interest consideration or objective for ASIC to determine when to exercise its powers.

AFIA recommends:

- 6) Greater clarity be given to how possible future breaches will be defined. This definition should be consulted on with industry.
- 7) ASIC should only exercise the directions power when a licensee has breached their obligations rather than applying a broader public interest test.

Position 3: ASIC should be able to apply to a court to enforce the direction and take administrative action if a licensee does not comply with a direction

The Paper sets out a proposed process for ASIC to exercise a directions power. This process requires ASIC to give the licensee a notice setting out its intention to make a direction and its reasons before utilising its directions power. The licensee would then have a reasonable time to respond. If the licensee's response does not adequately address ASIC's concerns then ASIC can make the direction.

The Taskforce notes that the proposed process balances the need for procedural fairness for the licensee and flexibility for ASIC. However, we believe that the right balance has not been struck. A licensee subject to a directions order must have access to an external merits based review of ASIC's decision to impose a directions order. For example, once ASIC makes a directions order, a licensee should have the right to apply to the AAT or court to challenge the decision before the order takes effect.

The proposed direction powers are substantial (see above) and, if applied, will substantially impact normal business operations. This includes allocating resources to comply with the order and the licensee's ability to continue to service its customers in the case where an order prevents a licensee from doing something. Ensuring that there is an appropriate merits based review mechanism is essential to ensure integrity in the process.

This issue is further highlighted if ASIC can apply to the court for an order to comply where a licensee has failed to comply with the order. Without adequate review of ASIC's decision to apply a directions order, a licensee may be subject to a penalty where there has been no underlying wrong doing.

Procedural fairness and effective review mechanisms are vital in relation to directions concerning compensation or remediation. In our view such directions are only appropriate where a licensee admits misconduct and there is a loss (e.g. following a breach report), ASIC makes an undisputed surveillance finding or there is a judicial finding of non-compliance.

However, once a court has determined a directions order is appropriate and the licensee does not follow it we agree with the Taskforce's view that ASIC should be able to seek penalties from a court for non-compliance. AFIA agrees that the penalty should be sufficient to deter breaches of the order. However, an offence for a breach of a directions order should not trigger administrative action (e.g. cancelling a licence) for minor or technical breaches of an order. For example, this may arise where a licensee is unable to comply with the directions within the timeframe ordered but makes all attempts to comply as soon as possible. We do not support making failure to comply with a directions order a criminal offence.

It may also be appropriate for ASIC to utilise its new Financial Services and Credit Panel as a source of review when ASIC makes a directions order. The Panel has been established to work alongside ASIC in relation to making banning orders against individuals for misconduct. The Enforcement Review Team's previous Positions Paper, *Strengthening Penalties for Corporate and Financial Sector Misconduct* sought feedback on potentially expanding the role of the Panel to other administrative functions.

As noted in our previous feedback to that Positions Paper, the Panel could be used as a review process before a decision to issue a directions order is made. As the Panel will be made up of industry (and this should include representatives from various business models, distribution channels [e.g. digital/fintech] and products) and ASIC representatives it would provide a source of peer review before any decision to apply a directions order is made. This would complement an avenue for a licensee to seek a merits based external review either through the AAT or court. However, review through the AAT or court proceedings should be seen as a last resort due to the time taken and expense incurred by both the licensee and ASIC when seeking AAT or court review.

Along with addressing these issues we also request that ASIC develop, in consultation with industry, guidance on its directions powers. This should include guidance on ASIC's views on its powers and when it will exercise them. ASIC should develop this guidance in close consultation with industry to ensure the powers meet their intended policy goals while still balancing the needs of industry, particularly around clarity of when the powers will be applied.

AFIA recommends:

- 8) That an external merits based review process for licensees to be able to challenge a directions order made by ASIC.
- 9) ASIC consult closely with industry to develop guidance on direction powers.
