

ASIC Enforcement Review: Consultation Paper on ASIC's Directions Powers

SUBMISSION

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ABOUT INDUSTRY SUPER AUSTRALIA

Industry Super Australia is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members. Please direct questions and comments to:

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KEY POINTS

- ISA supports ASIC having broad, principals-based directions powers
- The use of these powers should not be limited to when a financial services or credit law is breached, but should apply to broader consumer protection and compliance issues that are in keeping with ASIC's regulatory objectives
- ISA supports broader powers on the basis that in addition to procedural fairness, the licensee has the right to an external independent review prior to proceedings
- Consideration needs to be given to the overlap between ASIC and APRA's proposed directions powers for superannuation licensees, particularly to ensure the current proposal doesn't undermine of the 'twin peaks' approach with respect to conduct, compliance and governance

1. Executive Summary

Observing ASIC's regulatory outcomes since the Global Financial Crisis it is clear that there are regulatory and enforcement tools missing from ASIC's regulatory tool box. Limitations in ASIC's regulatory suite were first highlighted by the CBA and Macquarie Bank Enforceable Undertakings (EU). More recently we have seen issues in the regulation of data collection in life insurance, supervision of platform and financial advice remediation programs, and phoenix(ing) licensees. ASIC needs the ability to compel licensees to undertake particular activity for consumer protection, risk management and compliance purposes and to be able to do this quickly and efficiently.

Well-crafted directions powers could address these gaps by giving ASIC an intermediate method of directing licensees without relying on more heavy handed enforcement tools (license variations or EUs) or public proceedings. ISA is generally supportive of ASIC having principles-based directive powers. However, that support is qualified and we would like to see some caveats imposed. Further consideration must be given to better defining the circumstances in which directions powers can be used. The power to direct entities to act or not to act are typically reserved for the judiciary or law makers – providing them to a regulator can be appropriate, but their use should be extraordinary and clearly circumscribed. The risks of misuse of these extraordinary powers are real. In addition to rights of procedural fairness in the consultation paper, ASIC should also afford licensees reasonable opportunity to respond to ASIC's concerns **before** the formal directions process is applied. ASIC should also demonstrate a reasonable basis that a direction is needed. There must be a statutory safe harbour for licensees that comply with the directions power and a statutory right of indemnity should be created when acting under direction. Finally, licensees should have a right to seek an independent review, for example, to the Administration Appeals Tribunal. We accept an alternative truncated review process may need to be considered given timeliness of some of the regulatory issues that ASIC might be needing to use directions power on.

In short, there needs to be a balance between the expediency of a power to direct or compel, on one hand, and the risks of arbitrary or capricious use of regulatory power or inadequate procedural safeguards. These matters should not have to get to the stage where it is court enforced with penalties imposed if the licensee objects to the direction.

We also note that APRA has directions powers proposed for Registered Superannuation Entities. Superannuation funds are dual regulated as part of the proposed Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017. In proposals for both APRA's directions power and ASIC's directions power, a driving factor seems to be using these powers in the areas of risk management, compliance and governance. This will cause overlap for dual-regulated superannuation funds and risks undermining the 'twin peaks' model.

We firstly make some general comments before addressing the specific questions in the Consultation Paper.

2. General comments on ASIC's regulatory 'tool box'

ISA agrees largely with the Consultation Paper's general discussion of existing ASIC powers. Indeed our following observations and commentary are broadly an argument in favour of ASIC having some form of directions powers.

1. *License cancellation/suspension* – License cancellation or suspension is what is known in the industry as the nuclear option. A license suspension/cancellation is not suited to regulatory or supervisory activity that is focused on making sure a licensee resources an activity adequately or undertakes to fix an issue effectively. Cancellation/suspension is not taken lightly, and ASIC generally reserves this for serious misconduct or consumer/investor detriment that is irrevocable. This option involves administrative checks and balances, with ASIC staff required to present an application to cancel or suspend a licensee to an internal Enforcement Committee, generally Commission level involvement/governance, and an internal delegate to form an independent view. The decision to suspend/cancel a license is also subject to appeal at the AAT.
2. *Enforcement of general license obligations* – both the Corporations Act and NCCP Act have a general set of obligations which go to the high level conduct of the licensee. For example, to 'act efficiently, honestly, and fairly'. In the past ASIC has tried, via Regulatory Guidance, to interpret these general obligations in specific contexts (Remediation by Financial Advice licensees, risk management systems for Responsible Entities etc, as well as financial resource requirements). While Regulatory Guidance is helpful in establishing good practice, ASIC has not, as far as we are aware, ever undertaken enforcement action in relation to breaches of general license obligations. This unfortunately means the case law on general obligations is thin. This is an area that should have been further explored.
3. *Additional license conditions* – ASIC can and does vary the license obligations based on the severity of the regulatory issue they have been dealing with. License variations involve a private hearing and are subject to AAT review if requested. More recently ASIC has started to develop very prescriptive license variations. This has coincided with the Regulator seemingly losing some confidence in EUs as a mechanism forcing remediation or compliance action on a licensee. For example, a recent license variation proposed on Macquarie Bank, which the bank subsequently objected to, took what was essentially a set of conditions around an EU (use of independent expert, specified compliance and remediation action, and time frames) and inserted these prescriptively into a license condition, presumably to make it more binding than an EU. We are not convinced that turning license conditions into a more formal form of EU is the best approach. License conditions are designed to improve the way a licensee operates on a more permanent basis. Prescriptive license conditions related to a specific regulatory issue is a bit like taking a sledge hammer to crack a nut. This probably provides further justification for directions powers because it will allow ASIC to direct on these issues rather than go through a complex process of drafting license unwieldy and prescriptive conditions.
4. *Enforceable Undertakings* – until recently this has been the most used tool in ASIC's regulatory tool box for the type of compliance, remediation, and preventative action that directions powers would be used for. Most of ASIC's EUs are deployed in supervision of vertically integrated retail banking conglomerates, because the reputational damage to these large institutions provides sufficient incentive to agree to a negotiated EU with the regulator. EUs are a problem area for ASIC and a key concern with the granting of directions powers, is that these powers will supplement rather than complement ASIC's approach to EUs. In short the issues with EUs still need to be fixed. We are concerned this is unlikely to happen if the regulator has alternative directions powers to fall back on. Current issues with the EU process include: they are difficult to enforce strictly (unless turned into license conditions), they rely too heavily on the big four accounting firms to supervise as the independent expert, and there may be questions around the level of independence of the expert. There is also a lack of transparency.

3. Comments on specific solutions

3.1. Position 1 – ASIC should have the power to direct financial services or credit licensees or prevent compliance failures

The activities listed are a mix of different regulatory issues with varying purposes. **Currently this reads as grab bag of ‘nice to haves’ for the regulator. There needs to be clearer specification of the rationale for each type of direction, its scope, why it’s required and for what purpose.** The use of these powers must avoid, and be seen to avoid, arbitrary or capricious application.

Type of direction	Tactical consumer protection (further harm prevention)	Prevent continuance of business (until issue is addressed)	Forced compliance /remediation or meet basic license obligations	Does a similar power exist and if so what?
1a Cease appointing ARs	YES	YES	N/A	No –injunction only
1b Cease accepting new clients	YES	YES	N/A	No – injunction only
1c Conduct review of audit (access to records)	N/A	N/A	YES	ASIC has other discovery powers, but this could force an ASFL to audit the issue themselves This could be a condition of an EU
1d Engage qualified staff	N/A	N/A	YES	No
1e Cease transfer or license	YES	YES	N/A	No
1f Cease representations regarding a product	YES	YES	No	Misleading conduct provisions and infringement Notices

1g Appoint a person nominated by ASIC to review	N/A	N/A	YES	EU or License condition
1f Establish process for remediation and compensation	YES	No	YES	EU or License condition

The examples of the proposed directions listed in the consultation paper seem to conflate consumer protection, compliance and review functions, and at times reproduce existing powers.

We do not agree that the directions powers will support negotiated EU-style outcomes. ASIC has recently demonstrated a reluctance to use EUs, instead preferring to insert EU-style conditions into license variations. Given how resource intensive the supervision of EUs are, in practice, we consider that over time there is a significant risk of reliance on directions in place of EUs as the main tools for compliance rectification, consumer redress and governance changes. If this happens, ASIC is then likely to structure these into license variations on the basis of discovery through their directions.

One option to mitigate this risk may be to require ASIC to consider, and then rule out, the appropriateness of an EU or license variation prior to seeking a direction, where those directions are likely to replace an EU-style regulatory action. Under such an approach, a factor ASIC should establish is that a direction is necessary due to exigency and irreparable harm, or recalcitrance.

It is only appropriate therefore that there be a greater form of procedural fairness than what is proposed in the consultation paper. ASIC should in most cases be required to afford licensees a reasonable opportunity to respond and submit argument prior to the formal direction being applied. Before the power is exercised a reasonable basis that a direction is needed should be established by the regulator either that a breach is likely to occur or that the basis of the directions power is in-keeping with ASIC's public interest function. It is important that the licensees complying with ASIC directions powers are also protected. To that end there needs to be a statutory safe harbour for licensees that comply and there needs to be a statutory right of indemnity when acting under a direction. This is an important point, ASIC may direct a licensee to an action that harms classes of investors or service providers or businesses, over which they may be eligible to seek remedy. Consideration needs to be given to statutory indemnification.

It's significant that the consultation paper makes no mention of the use of the AAT, but what is required here is an AAT type of review, undertaken on a time critical basis, before any directions are enforced via court proceedings or sanctions are imposed.

ISA's preference is that the directions powers are clearly listed in the Corporations Act or ASIC Act. These should not be subject to variation via regulation – regulation is not subject to parliamentary scrutiny. ISA supports drafting broad directions powers provided procedural fairness is enhanced and there is an appeal or external review mechanism in place. In fact, given some of the conflation of regulatory purposes as seen in the list above, the best approach may be to assign ASIC broad principles-based powers with a stronger external independent review or administrative appeal mechanism.

There should also be consideration of the issue of remedies if AISC over-reaches on the use of the direction.

3.2. Position 2 – the directions powers should be triggered where a licensee has or will contravene financial service or credit licensing requirements

Two approaches are listed in the consultation paper. The first option essentially says ASIC can use directions where the regulator believes a licensee has or will contravene the law or license obligations. The second option is broader and employs a public interest test attached to the core functions of ASIC as outlined in the ASIC Act.

These two options will have a significant impact on how ASIC uses directions powers. The first option will limit the power to straight enforcement actions and tend to limit the powers to clearer cut breaches of the financial services and credit laws. The second option is much broader and will mean ASIC can use directions for a broader range of compliance, sectoral issues (for example, the life insurance review), and where ASIC believes an issue or action is likely to harm investors or consumers but may not necessarily result in a clear breach of license obligations or laws. The power to direct entities to act or not to act is typically reserved for the judiciary or law makers – providing them to a regulator could be appropriate, but their use should be extraordinary and clearly circumscribed. If principles-based directive powers are drawn from the ASIC Act we would anticipate that these are tied to ASIC's consumer protection functions, provided the procedural fairness and independent review issues are better addressed. ASIC would then demonstrate the use of the powers are reasonable based on the issue in the licensee and given ASIC's consumer protection mandate. It would be undesirable for a situation to develop, for example, where ASIC issued directions on relatively trivial regulatory issues or on the basis of a survey or data collection exercise that is not related to a significant consumer protection issue. This is discussed further below.

3.3. Position 3 – ASIC should be able to apply to a court to enforce the direction and take administrative action if an AFS or credit licensee does not comply with a direction

We agree with the process outlined in paragraph 11 is an efficient process for issuing and complying with a direction. It affords some procedural fairness but the further procedural fairness issues we identified should be considered.

For the reasons previously discussed a relatively efficient form of independent review should be available to licensees, particularly if the licensee can be sanctioned for non-compliance with a direction. Ideally this would be a form of external independent review that would consider ASIC's original notice and any response from the licensee, then make a determination as to whether the direction is an appropriate use of ASIC's powers. We accept some consideration may need to be given to expedience. However, the advantage of having an independent review process is that the directions powers can then be broader allowing the regulator the ability to protect consumers or investors before a law is broken and also address wider compliance issues rather than limiting action to when a financial service or credit law is breached.

Turning to sanctions for failure to adhere to a court order to comply with ASIC's direction, ISA agrees with the consultation paper that criminal sanctions are disproportionate to the severity of non-compliance. Civil proceedings and/or administrative proceedings are appropriate provided the regulator articulates the severity of non-compliance and the appropriate sanction for it.