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

By email: ASICenforcementreview@treasury.gov.au

Dear Taskforce Members

AFA Submission – Consultation: Strengthening Penalties for Corporate and Financial Sector Misconduct

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

As a high level principle, the AFA supports strong penalties for serious misconduct. We are also particularly well aware of public concern about the perceived light touch that has been applied to financial advisers who have been caught doing the wrong thing. We believe that some context needs to be provided with respect to this view:

- The Future of Financial Advice reforms commenced on 1 July 2013, which dictate the primary obligations that apply to financial advisers in terms of the quality of the financial advice. In a very recent case, which represented the first judgement under the Best Interest Duty obligation (961B), the offending company was fined $1m. We consider this to be a substantial fine, that has been taken very seriously by the financial advice sector. It is important to note that many of our members are small business operators and a fine of $1m and all the negative publicity, would most likely destroy their business.

- ASIC has traditionally taken the approach of banning financial advisers who commit serious breaches of the law. A ban instead of a fine or a prison sentence may seem to be a light touch, however a ban of more than three years is most likely to have significant ongoing consequences in terms of being unable to find work in the financial services industry and particularly coming back to a financial advice role. The personal, financial and emotional consequences can also be substantial in terms of the impact of being excluded from the industry that they have worked in and having their reputation seriously impacted. These consequences are actually substantial, and with licensees increasingly reluctant to employ or appoint any individual who has been banned for any period of time, any adviser who has ever been banned is becoming more likely to be practically excluded from the industry on a permanent basis as a result.
- Whilst ASIC already has significant powers to pursue action against individuals and corporates who breach the financial services laws, this action does not always eventuate, or there may be a delay in enacting. ASIC naturally needs to make a judgement call with respect to a range of actions that they can pursue, and the normal processes of investigation and natural justice means that this takes longer than some people expect.

We have absolutely no tolerance for acts of fraud and dishonesty and people caught committing such offenses should be subject to appropriate prison terms, and permanently removed from the sector. Equally cases of forging signatures for financial benefit are equally appalling. We are pleased to note that ASIC is regularly having success in initiating action against a small number of advisers for this type of conduct.

In this submission we will focus our comments on the penalties that apply to financial advisers.

Focus upon Large Corporations, not Small Corporations

Whilst many stakeholders may view this matter from the perspective of penalties that are applied to large corporations, the important reality is that a substantial majority of financial advisers are either small business operators or employees in small businesses. These reforms are not simply a matter of making sure that the big guys pay for doing the wrong thing. The implications on small businesses can be substantial and they often do not have the capacity to pay. Whilst this might mean that action is appropriately taken against some members of the firm, it may also have the consequences of the loss of jobs for other people in the business who were doing the right thing.

Whilst the consultation paper refers to a view expressed by the Financial System Inquiry (FSI) that some penalties are too low to act as a 'credible deterrent', we question whether this position was direct at the small corporate businesses that we represent.

In particular we refer to page 250 of the FSI final report, which specifically stated:

*"The maximum civil and criminal penalties for contravening ASIC legislation should be substantially increased to act as a credible deterrent for **large firms**."*

We also note the comment on page 252 with respect to the application of existing penalties.

"Stronger enforcement of the current framework can reduce demands for new rules and regulations. This is a particularly important issue for ASIC given the breadth of its responsibilities."

We note that the offences for which penalties are being increased have never or rarely been prosecuted, meaning that in many cases the existing penalties have never been applied. Given this is the case, we question the extent to which it is possible to attribute the lack of effect of these penalties to the nature of the penalties themselves, or the lack of the penalties ever having been applied.

Confused Penalty Regime

The most recent legislation that has had broad implications for financial advice is the Future of Financial Advice legislation from 2012. This legislation which focuses amongst other things upon the core financial advice obligation to act in the best interest of your clients, is based upon a civil penalty regime. A failure to comply with the best interests duty is a very serious breach, and one that should be up the higher end of the scale for penalty. The Financial Services Reform Act of 2001, includes a number of criminal offence provisions. There is a major disconnect between these two regimes, that should be addressed before proposals are brought forward to increase some of the criminal penalties. We are bemused by suggestions to increase the maximum prison term for something like failing to provide a Financial Services Guide when the more serious breach of failing to comply with the Best Interests Duty is a civil penalty offence.

We believe that there needs to be much greater clarity in the overall framework for penalties and a more genuine level of consistency across the financial advice penalties regime, rather than what appears to be adhoc changes in certain areas.

Application of the Funds from Penalties

We note that the proposals in this paper involve significant increases in some of the pecuniary and civil penalties/fines that will apply and question how the funds from this action will be treated, including whether they will be used to offset the costs of ASIC and therefore result in a reduction to the ASIC Funding levies. This part of the model needs to be transparent and equitable.

Response to Positions and Questions Raised in the Consultation Paper

Position 1 – Increase in the Maximum Imprisonment Penalties for Criminal Offenses

On the imprisonment penalties our views are as follows:

- We support the increased penalties for providing financial services without being licensed or authorised and for holding out to be licensed.
- We are cautious about increasing penalties where the breach may be based on a matter of timing or judgement. As an example, failing to comply with an ASIC notice within the nominated time or failure to submit a section 912D breach notice within time or on the basis of a well-founded judgement seems harsh.
- The consequences of failure to provide a Statement of Advice, when an adviser may have genuinely thought that a Record of Advice was satisfactory may also seem harsh.

Position 2 –Maximum Pecuniary Penalties for Criminal Offenses Calculated by Formula

Whilst the AFA accepts the rationale for a standardised conversion formula, we remain cautious that this should apply in all cases.

The AFA does not agree that the pecuniary penalties for corporations should automatically be 10 time the penalty that applies to an individual. While we acknowledge this is the maximum penalty, and therefore may not always be applied, once again, the assumption appears to be that this is action against large corporations and that they have a much greater capacity to pay. This might equally be action against a one adviser corporate Australian Financial Services Licensee, where a lower penalty would have a similar impact. On the stated basis, the failure to provide a single Statement of Advice (5 year Maximum) could result in a pecuniary penalty of $1,260,000 for a single adviser corporate AFSL. Whilst not seeking to underplay the importance of the matter, this level of penalty would undoubtedly be excessive.

The AFA would instead support the creation of a small business category or, alternatively, a large business category, so that penalties can be crafted appropriate to the scale of the business penalised, in order to maximise the deterrent effect. We would also suggest that small or large business thresholds be determined by reference to revenue or profit rather than the number of employees. This is because 20 employees is usually the cut-off for determining a small business, but there is generally still substantial difference between a business employing 25 people and a large banking institution.

Position 5 – Remove Imprisonment for Strict and Absolute Liability offences

The AFA supports this proposal. We agree that individuals should not be imprisoned for inadvertent breaches of the law or offences where there is no mental element or other criminality.

Position 6 – Introduction of an Ordinary Offense to Complement Strict and Absolute Liability Offences

The AFA supports the basis for this proposal. We note that this allows for a greater scale of penalty where it is committed deliberately and with intent. This also provides ASIC with greater flexibility. The consultation paper refers to a specific current example of this arrangement in the failure to provide an FSG or an SoA (Section 952C). Whilst these matters are clearly breaches of the law, it may be that there are relevant circumstances such as an inadvertent failure to provide the current copy of the FSG or an incorrect but honestly held belief that a Record of Advice was sufficient in the circumstances.

In our view, as discussed above, the issue with Section 952C highlights other issues, such as the fact that the penalty regime for the Future of Financial Advice reforms is civil penalties only, yet other breaches of the Corporations Act such as Section 952C, which are of a potentially less serious nature, could involve prison sentences.

Position 7 – Minimum Strict and Absolute Liability Offence Penalties

The AFA is supportive of the minimum pecuniary penalty for strict and absolute liability offences being 20 units, however once again opposes the automatic multiple of 10 times applying to corporations. While we note this multiple only produces a maximum, we consider that a better approach would be a separate tier for large corporates, so that suitably large fines can be imposed to deter businesses of this size, without disproportionately penalising small corporates.

We note that the question on page 40 of the consultation paper refers to a minimum of 30 penalty units for individuals and 300 penalty units for corporate bodies. This is directly inconsistent with Position 7 on page 38, which refers to 20 units for individuals and 200 units for corporations. We assume 20 and 200 is the correct amount, as it is otherwise referenced throughout.

Position 8 –Strict and Absolute Liability Offences Subject to Penalty Notice Regime

The AFA is supportive of the use of a sensible penalty notice regime in the right circumstances, however questions why the consultation paper has suggested these penalties should be set at 50% of the maximum, when the Attorney-General's Department's *Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers* recommends 20%. It is important that there is integrity in the system and that justice is seen to be done, however we do not consider that the removal of the imprisonment penalty for strict liability offences justifies allowing ASIC to impose a penalty notice at 50% of the maximum rate.

This is because a criminal penalty notice, or a sentence of imprisonment, would ordinarily be made by a court of law taking into account the circumstances and any mitigating factors. The mere fact that a court no longer may impose imprisonment as a penalty does not logically support the conclusion that ASIC should be able to automatically impose a penalty notice at a higher rate, given that no discretion will be exercised in determining the amount of that penalty notice, and any relevant circumstances will not be accounted for. Given that, the AFA considers that allowing a penalty notice of 50% of the maximum penalty would lead to injustice.

Providing ASIC with significantly greater powers under a penalty notice regime may not be well received by a range of industry stakeholders. If this is intended to be a quick mechanism to obtain a judgement that reduces the administrative complexity for all involved, then it needs to be subject to a sensible balance, and the AFA would be more supportive of the 20% recommended by the Attorney-General's Department.

We would also suggest that penalty notices should not be capable of being applied to a breach which the licensee has reported under the breach notification requirements. This is because otherwise licensees may fail to report breaches for fear of being penalised. Penalty notices should only apply to offences brought to ASIC's attention through other means than a report by the offending licensee.

Position 9 – Maximum Civil Penalty Amounts in ASIC administered Legislation should be Increased

We note that the penalties that apply for breaches of the Future of Financial Advice reform legislation of $200,000 for individuals and $1,000,000 for corporations were put in place in 2012, so the argument that they have been left unchanged for a long time is less relevant.

As discussed above, in the context of the much smaller scale of corporations in the financial advice sector, we do not support the proposed increase in the maximum civil penalties for corporations to the greater of 50,000 penalty units ($10.5M), 3 times the value of benefits or 10% of annual turnover. Whilst the second two measures may in some cases be more reasonable, the prospect of a small corporation being subject to a penalty of $10.5M is very concerning. We believe that there is a risk that such penalties could act as a serious disincentive to invest and participate in the sector. This would have a detrimental impact upon competition in the sector and consumer access to financial advice.

It needs to be considered that the penalties that apply need to reflect the nature of the business. Whilst large corporates may be able to impact a large number of clients in a quick timeframe in a light touch manner, in most cases a financial advice business, which is based upon high touch, cannot so easily impact so many clients in a short period of time. Where the majority of clients are average Australians, the ability to cause significant financial detriment is also necessarily somewhat limited. For this reason, we would suggest that a penalty amount of the higher of 3 times the value of benefits or 10% of annual turnover would be preferable. The penalty will then be sufficiently linked to the scale of the business and the offence to be appropriate, proportionate and a deterrent.

It also needs to be understood that in some areas the clarity on the breach of the law is much more black and white. In the case of financial advice, and particularly with the Best Interests Duty, the difference between compliant and non-compliant advice may in some situations not be so clear, and is often a question of judgement. The introduction of huge fines might have a detrimental impact upon the advice that is provided in terms of being very cautious or result in additional costs being incurred, that need to be passed on to consumers. This could inadvertently result in advisers breaching the best interests duty as a result of attempting to comply through conservatism. We caution against wide sweeping changes without consideration of the consequences.

Position 10 – Disgorgement Remedies Should be Available in Civil Penalty Proceedings

Whilst we recognise that there is a risk of financial advisers committing fraud and stealing money from their clients, the reality is that in most cases where a financial adviser breaches their obligations, the financial benefit is the receipt of fees for advice that may not be in the best interest of their clients, or otherwise there is no financial benefit (e.g. there is no financial benefit in failing to give an FSG that was otherwise prepared, signed-off, and was available for provision). Because of this, we would suggest either that the types of offences that disgorgement orders be available for should be limited, or that disgorgement orders should only be available for the ordinary offence i.e., where there was some intent, and presumably therefore some motivation, to not comply, as opposed to strict liability offences, where the breach is more commonly an oversight with no benefit.

We understand why this power is required in other settings, such as where non-compliance with insider trading rules might provide substantial benefits.

Position 11 – The Corporations Act Should Require Courts to Give Priority to Compensation

The AFA supports changes to the Corporations Act to require courts to give priority to the payment of compensation to consumers above the payment of civil penalties. It is important that consumers who have suffered loss as a result of poor advice have priority in terms of compensation.

Position 12 – Civil Penalty Consequences should be Extended to a Range of Conduct Prohibited in ASIC-Administered Legislation

The AFA supports the extension of civil penalties to offenses involved with operating without a financial services licence (Section 911A), the failure to report a significant breach to ASIC (Section 912D) and the failure to provide a PDS when providing personal advice (Section 1012A).

We note that these offenses already involve potential prison terms and therefore question whether it is proposed that the civil penalties would replace the criminal penalties or were intended to supplement them. We do not support the application of a prison term and a civil penalty for the failure to report a significant breach to ASIC. Likewise, with the failure to provide a PDS, we would see this as an alternative to criminal action. We refer back to the point we made above about the problems and complications with a confused penalties regime for financial advice.

Position 15 – Infringement Notices be Extended to an Appropriate Range of Civil Penalty Offences

Whilst the AFA does not oppose the introduction of an infringement notice regime for appropriate breaches of the Corporations Act, we do caution the potential unintended consequences of such a regime. As with penalty notices, if it became common practice for licensees to receive an infringement notice as a result of breaches that they report to ASIC under a Section 912D significant breach notice, then there is a greater risk that they may avoid submitting significant breach notices. The negative cultural consequences of this need to be taken into account. We believe that it would be counter productive for the infringement notice regime to apply to self-reported breaches.

However, we consider it more appropriate to issue an infringement notice for breaches that a licensee wilfully fails to report altogether. A licensee who reports late should not be fined, as this would also deter reporting.

Position 16 – Infringement Notices Should be Set at 12 Penalty units for Individuals and 60 Penalty Units for Corporations for any New Infringement Notice Provisions

Subject to the recommended exclusion for self reported breaches, we support the position. We hold the view that the fine payable under the infringement notice regime should be on the basis of a significant discount to the full civil penalty.

Should such a regime be established, then any fines paid should be paid to ASIC and used to offset the costs of ASIC in the relevant sector. In this manner, they would serve to reduce the ASIC Levy that the participants in that sector would otherwise be required to pay. We would strongly oppose these penalties going directly to consolidated revenue.

Financial Services and Credit Panel

ASIC has now announced the members of the new panel. The AFA supports the creation of this panel.

It is difficult to give a definitive view on whether the panel should be involved in infringement notices and enforceable undertakings. The panel has particular industry skills and should be utilised in a manner that most effectively employs those skills. Being involved in infringement notices may not fully utilise this capability. Being involved in enforceable undertakings may add value, however it is something where ASIC would need to take the lead. They may be more a reference point. We believe that the panel should be limited to industry participants, however have appropriate access to additional skills such as lawyers where required.

Concluding Remarks

The AFA is supportive of sensible strengthening of the penalty regime, however it is important to ensure that it is not excessive, that the risk of negative consequences is taken into account and that there is no additional deterrent for self reporting. We make the point that there needs to be a clearer overall framework that addresses the current confused state of a combination of criminal and civil penalties for financial advice breaches.

The AFA welcomes further consultation with the Taskforce should it require clarification of anything in this submission. If required, please contact us on (02) 9267 4003.

Yours faithfully

Philip Kewin
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Association of Financial Advisers Ltd