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

via email: ASICenforcementreview@treasury.gov.au

Dear Sir / Madam

ASIC's power to ban senior officials in the financial sector

Thank you for the opportunity to provide a submission on the ASIC Enforcement Review position paper titled 'ASIC's power to ban senior officials in the financial sector' (**Position Paper**), and for accepting it after the submission deadline.

The Australian Institute of Company Directors (**AICD**) is committed to excellence in governance. We make a positive impact on society and the economy through governance education, director development and advocacy. Our membership of more than 40,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

The AICD welcomes the Australian Government's aim of ensuring 'financial sector regulators have appropriate power to remove individuals whose actions have been contrary to the public interest and [to] prevent their continued involvement in the sector'.[1] Appropriate banning powers play an important role in protecting financial investors and consumers, and in supporting the integrity of the financial sector.

However, given the severe consequences that a ban can have on a recipient's professional reputation and livelihood, an administrative ban is only appropriate when necessary to protect investors or consumers, proportionate to the misconduct, and subject to procedural fairness and a right of appeal. These criteria have guided our assessment of the reforms proposed in the Position Paper. Our conclusions are summarised below in Section 1 and discussed in detail in Sections 2 and 3. Our concerns regarding the co-regulatory issues arising in relation to the reforms are set out in Section 4.

1. Summary

In regards to 'Position 1', the AICD supports the changes proposed to the 'scope' of the banning power, with one proviso. We recommend that the power to ban a person from performing 'any' function in a financial services business only enliven when it is in the public interest to do so.

In relation to 'Position 2', the AICD:

[1] Proposals Paper, p 1.

(a) Strongly opposes the proposal that ASIC be empowered to ban an individual for breaching a duty under ss 180, 181, 182 or 183 of the *Corporations* Act 2001 (**Corporations Act**);

(b) Supports replacement of the s 920A(1)(d) 'good fame and character' test with a 'fit and proper' test tailored to the role held by the individual;

(c) Opposes extending the banning ground of a reasonable belief that the person is not adequately trained or competent to provide a financial service to capture the performance of an officer role;

(d) Opposes banning on the basis of non-compliance with determinations of the Australian Financial Complaints Authority (**AFCA**); and

(e) Recommends that the proposal to facilitate banning of individuals involved in phoenixing activity be considered as part of the government's consultation on 'Combatting Illegal Phoenixing'.

The support we express in this submission for reform measures is predicated on procedural fairness mechanisms and the right to seek merits review applying to the measures, including that:

- ASIC may only make a banning order against a person after giving that person an opportunity to make submissions, and to appear or be represented at a private hearing, on the matter; and
- The recipient of a banning order has a right to apply to the Administrative Appeals Tribunal (**AAT**) for review of the banning decision.

A more detailed explanation of our views follows.

2. Changes to the scope of the banning power (Position 1)

The AICD understands that, in some instances, individuals who have been banned from providing a financial service have gone on to hold a senior position within, and be involved in the management of, a financial services business despite the banning. The AICD agrees that this enforcement gap needs to be addressed and so supports broadening the scope of the banning power to permit ASIC to ban a person from performing a specific function in a financial services business, including managing a financial services business. To ensure that financial sector workers (and their advisers) have clarity on the potential consequences of misconduct, we recommend that the legislation describe the specific functions from which an individual may be banned. Given the objective of consumer protection, these functions would presumably cover risk and compliance, in addition to management.

The proposal to permit a ban to extend to 'any' function in a financial services business would have the effect of banning an individual from the financial sector entirely. The AICD recognises that in some circumstances egregious conduct may warrant such a ban. However, given the potentially devastating impact that such a ban could have on an individual's employment prospects, we are concerned to ensure that such a ban only be imposed in the most serious of cases and when it is absolutely necessary to protect consumers. Accordingly, the AICD's support for the proposal to permit ASIC to ban an individual from providing 'any' function in a financial services business is conditional on the power being expressly limited to circumstances where it is in the public interest to do so. A similar constraint is imposed on ASIC's power to give directions under ss 794D and 798J.

In addition, the AICD believes it is appropriate for these expanded banning powers to similarly apply in respect of credit businesses.

3. Changes to the threshold for the exercise of the banning power (Position 2)

3.1 *Breaches of ss 180, 181, 182 or 183 of the Corporations Act* (**Statutory Duties**)

The AICD strongly opposes the proposal to permit ASIC to ban a person for a breach of their Statutory Duties.

ASIC's banning powers in s 940A are intended to protect consumers and investors in the financial sector from individuals who fail to meet requisite standards when providing financial services. In contrast, the AFSL licensing regime and related enforcement provisions within Chapter 7 are directed to the supervision and resolution of issues which relate to compliance, governance, training, and systemic conduct issues within financial services organisations.

Because of this, the AICD is concerned that the proposed expansion of the banning power misconceives the policy purpose of that power, and of the AFSL licensing regime itself. It is through the AFSL licence, and the conditions attached to that licence, that ASIC is empowered to address systemic issues within a financial services business. For this reason, Chapter 7 of the Corporations Act provides ASIC with wide-ranging powers to address issues with the performance and conduct of an AFSL licensee, including issues which relate to systemic misconduct, compliance, and customer service.

In addition, the AICD is concerned that the proposal would circumvent the long-standing regulatory framework applicable to corporate officers across all sectors. Fundamentally, the performance, supervision, monitoring and discipline of managers (whether within financial services or otherwise) is appropriately dealt with through existing provisions which relate to an entity's governance, including (but not limited to) s 180-183 of the Corporations Act.

Of course, where an officer is involved in a contravention of a financial services law, it is appropriate that they be subject to ASIC's administrative banning power. That is why changes were made to the banning power in 2012 to enable ASIC to ban a person who is involved in a contravention of financial services law. This provision has the advantage of requiring ASIC to establish causality between the breach of the law and the person who is to be banned. This is appropriate, given the devastating impact a ban can have on a person and their livelihood.

In any event, the AICD is of the strong view that determinations of a breach of the Statutory Duties should continue to be made by a court. Giving ASIC power to determine in the first instance whether a Statutory Duty has been breached would essentially reverse the onus of proof, with the accused forced to prove their 'innocence' in an appeal to the AAT. This would undermine the fundamental legal principle of 'innocent until proven guilty'.

Critically, a finding of a breach of a Statutory Duty can have severe consequences for an officer's reputation and career, regardless of the ban imposed.

Our concerns with this proposal are heightened in the context of the s 180 duty. As the Position Paper acknowledges, this duty requires an objective assessment of the care and diligence required in the particular circumstances of the officer and the relevant corporation. It may also require determinations of whether an officer has the benefit of the business judgment rule or has appropriately delegate to, or relied on, others. These

assessments are best made by judicial officers, who are very senior legal practitioners, within the confines of the long-established principles and processes associated with civil proceedings, including the rules of evidence and *stare decisis*.

This is particularly so given ASIC's increasing use of a 'stepping stone' strategy in pursuing officers for alleged breaches of s 180. Under this strategy, a corporate breach is held out as evidence that the company's officers have failed to act with the requisite care and diligence. It is essential that a court objectively determine the reasonableness of the officer's actions or inaction (as the case may be).

In this context, it is important to note that under s 920A, ASIC already has power to ban a person (such as an officer) who is involved in a contravention of a financial services law by another person (such as a corporation). Given this power, and the fact that a court may disqualify a person who has breached a Statutory Duty from managing a corporation, we believe there is no regulatory gap justifying the proposal for such breaches to trigger an administrative ban.

Furthermore, while the AICD considers that breaches of the Statutory Duties should continue to be determined judicially, we point out that a declaration of contravention by a court may be relevant to ASIC's assessment under s 920A of whether or not the officer is of good fame and character (or fit and proper, should that reform be implemented).

In our view, allowing breaches of s 180 to be administratively determined would lead to inappropriate corporate risk aversion, with negative consequences for innovation, entrepreneurship and the Australian economy in general.

3.2 *Replacement of 'good fame and character' with 'fit and proper person'*

The AICD agrees that the 'good fame and character' test in s 940A of the Corporations Act be replaced with a 'fit and proper' test, provided the test is contextualised to the individual's office and responsibilities. As the roles of officers are not generic, it is critical that an assessment of whether or not a particular officer is a 'fit and proper person' be made by reference to the particular responsibilities of, and office held by, the relevant individual within an entity in like circumstances. This approach is analogous to the approach taken in s 180(1) of the Corporations Act.

3.4 *Inadequate training*

On its face, the proposal to extend the banning power to individuals who ASIC believes are not adequately trained, or sufficiently competent, to perform the role of officer in a financial services business seems reasonable. However, it is very difficult to understand how this power would work in practice. By what criteria would an officer's training and competence be assessed?

Given the absence of an educational or training framework for officers and the differences in executive and non-executive roles, we fail to see how the training or competence of officers could be assessed with any degree of objectivity and consistency. In our view, this threshold is too vague and subjective, and would create unacceptable uncertainty and confusion within the financial sector.

In any event, we believe that replacing the 'good fame and character' test in s 920A obviates the need for the inadequate training banning trigger to be extended to the role of an officer.

It is again relevant to note in this context that officers (which include senior managers) are legally obliged to act with care and diligence, and a failure to do so could lead to a court-imposed disqualification, which in turn may be relevant in determining whether ASIC's power to make a banning order has been triggered.

3.5 *Non-compliance with AFCA determinations*

The AICD is concerned that the proposal to permit banning of officers, partners and trustees on the basis of a licensee's non-compliance with AFCA determinations would inappropriately conflate the financial disputes resolution regime with the enforcement regime.

Additionally, s 920A already addresses issues of serious and systemic non-compliance. The existing grounds for banning in that provision include non-compliance, or likely non-compliance, with a s 912A licensee obligation or a financial services law. They also empower ASIC to ban a person who has been 'involved' or is 'likely to become involved in the contravention of a financial services law by another person'. Accordingly, these powers permit ASIC to ban licensees for non-compliance, as well as any officers, partners or trustees who have been involved,[2] or are likely to be involved, in another's contravention of a financial services law.

Furthermore, as discussed in Section 3.1 above, ASIC is empower to address issues of systemic non-compliance through the AFSL licencing regime.

For these reasons, inclusion of a specific ground for non-compliance with AFCA determinations is inappropriate. In any event, depending on the circumstances, instances of systemic and material non-compliance within an entity may be relevant to a court's assessment of whether any Statutory Duties have been breached.

3.5 *Phoenix activity (s 533(1) reports lodged)*

As an anti-phoenixing measure, the Position Paper proposes a new ground for banning in cases where an officer, partner or trustee has, on more than one occasion being involved in a corporation that was wound up and a liquidator lodged a report under ss 533(1) of the Corporations Act about the corporation's inability to pay its debts.

The AICD is strongly supportive of effective measures to address phoenix activity in which the corporate form is misused to deny creditors access to an entity's assets to meet unpaid debts.

In recognition of the seriousness and complexity of the phoenixing problem in Australia, the government is currently consulting on a package of 'carefully targeted reforms' which seek to deter and disrupt negative phoenixing behaviour, while minimising any impact on honest business restructuring.

To ensure that this problem is addressed in a coherent, comprehensive and effective manner, the AICD believes the anti-phoenixing measure in the Position Paper should be considered as part of the package of reforms proposed by the government in its

[2] As defined in s 79 of the Corporations Act.

'Combatting Illegal Phoenixing' consultation. The AICD will be making a submission to that consultation.

4. Co-regulatory issues

The reforms proposed to ASIC's banning powers overlap with the new disqualification powers the government is seeking to confer on APRA under the proposed 'Banking Executive Accountability Regime' (**BEAR**). The fact that an individual's conduct could simultaneously trigger APRA's disqualification power and ASIC's banning power (as well as other administrative or legal action) gives rise to two significant issues.

First, an individual may be subjected to two regulatory actions and banning orders for the same conduct. Such an outcome is contrary to the fundamental legal principle that a person should not be vexed twice in respect of the one and the same cause.[3] Secondly, APRA and ASIC may take different or contradictory approaches to the exercise of their respective powers.

Managing these risks would require cooperation and careful coordination between the regulators. To promote confidence in the financial sector's regulatory framework, the arrangements made between the two agencies should be disclosed.

A failure to mitigate these risks could leave to unfair, unjust or inconsistent outcomes, and an incoherent and unduly complex regulatory framework for the financial sector. Ironically, these reforms may undermine confidence in the financial system.

As both the BEAR and ASIC's enhanced banning powers are not yet law, the AICD urges the government to reconsider the overlapping nature of the reforms. In our view, overlapping regulatory regimes promotes inefficiency and uncertainty, and may undermine regulatory responsibility for holding individuals liable for misconduct.

5. Conclusion

We hope our comments will be of assistance. If you would like to discuss any aspect of this submission, please contact Lysarne Pelling, Senior Policy Adviser, on (02) 8248 2708 or at lpelling@aicd.com.au, or Matt McGirr, Policy Adviser, on (02) 8248 2705 or at mmcgirr@aicd.com.au.

Yours sincerely

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[3] In the criminal context, this principle is known as 'double jeopardy'.