Min-it Software

Financiers Association of Australia

Joint Submission –

TREASURY Consultation –
ASIC Taskforce Paper 3: Strengthening ASIC licensing powers

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Background Information

This submission is made on behalf of the Financiers Association of Australia ("FAA") and Min-IT Software clients.

The Financiers Association of Australia ("FAA") and Min-it Software ("Min-IT") welcomes the opportunity to submit this submission on Treasury's consultation on extending unfair contract terms to small businesses.

The FAA, having been established since the 1930's, is an organisation for individuals and companies involved in the fields of finance and credit provision. The FAA's members are either non-ADI credit providers, providing loans up to $5,000 over terms of up to 2 years, mortgage financiers or business financiers.

Aside from the software produced in-house, specifically by or for franchised organisations, Min-IT Software is a leading loan management software supplier to the micro-lending sector of the Australian market. Additionally, it has a number of clients providing motor vehicle finance as well business loans and consumer leases.

The vast majority of Min-IT's clients are not affiliated with any industry association.

Introduction

We consider it somewhat ironic that almost 8 years after making earlier submissions to Treasury on the National Consumer Credit Protection Bill 2009, arguing the need for the holders of an Australian Credit Licence ("ACL") to be treated identically to those holders of an Australian Financial Services Licence ("AFSL"), the Taskforce now seeks to require uniformity between the two regimes whilst strengthening the requirements.

The Current Consultation

Position 1
ASIC should be able to refuse a licence application (or, for existing licensees, take licensing action) if it is not satisfied controllers are fit and proper.

There are a number of issues with this proposal.

Firstly, the "fit and proper person" test ASIC seeks to impose is a more onerous test than that applying to Australian Prudential Regulation Authority ("APRA") controlled entities. APRA has its own "fit and proper" requirements[1] but the difference is these entities are not 'approved' by that regulator as such. Instead, they are required to self-assess and if an individual no longer meets the requirements of CPS 520, report the matter. On this basis, we believe it would be more appropriate to have the test consistent with that of APRA than allowing ASIC to have its own test.

Secondly, there is the definition of "control" as expressed in the Consultation Paper ("CP")[2]. Paragraph 20 allows for ASIC to assess "the suitability of the individual or groups of individuals acting together who actually exercise control of a licensee." Ostensibly, there is a presumption throughout the CP that just one individual will be in control but given group dynamics, we are unsure how a "group of individuals acting together" will actually exercise control.

Group dynamics can be best summed up if one combines the characteristics of each individual in the group and then look at how the actions of every member of the group influence the group as a whole and how each individual's actions then affect each group member individually. Factors such as one of more individuals with

[1] APRA, CPS 520, July 2017..Available Online http://www.apra.gov.au/CrossIndustry/Documents/Prudential%20Standard%20CPS%20520%20Fit%20and%20Proper.pdf Viewed 24 July 2017.

[2] Paragraph 16, page 13 of the Consultation Paper

an assertive or charismatic personality affect the power relationships within the group, as do the social norms of the individuals and this can lead to just one or more notional controller(s) or no one really in control. How will ASIC determine this without actually observing the group over a period of time? For a new licence application for a new entrant to the industry, we would argue this is probably not possible until the entity has commenced engaging in credit activities.

If one member of a group of controllers were to be deemed not a fit and proper person, that individual may or may not be able to do anything without the rest of the group backing him or her. It is unclear what ASIC would determine necessary in such a situation and whether it would require or, at least, seek the removal of that individual as per ASIC Regulatory Guide 206 at RG206.32.

Although we are not aware of any ACL holder being controlled this way, we are aware ASIC is already investigating some of the larger financial entities that are regulated by the APRA for systemic breaches. This leads to questions of who was in control at the time and unless the individual has a controlling interest of 51% or more by share ownership, having ASIC's own test seems a superfluous requirement. We must therefore question what additional value, if any, it will provide.

Control, though, even with 51% or more of shares, may not vest in the individual shareholder that holds them. The investor may be passive and have appointed a Manager to do his or her bidding or be totally independent. Unless ASIC asks further rigorous questions, will ASIC simply adopt the main shareholder as being the one in control? Alternatively, as another example, if a parent were to become the predominant investor by shareholding but the company was to be physically managed and controlled by a sibling, is the shareholding even relevant? We would argue each entity needs to be examined individually and perhaps more questions

asked other than looking at shareholding as it would be almost impossible to establish who has or will have control from the outset of a licence application.

Having said this, we are of the opinion it is acceptable to refuse an application if the controller or controllers are not fit and proper on the proviso that before doing so, ASIC must have contacted the company's shareholders and given them the opportunity to replace the controller with an individual or group of individuals that meet the fit and proper person test. Given the time, energy and expense involved in making the application, applicants should not be disadvantaged purely because of the test result.

Enforcement inconsistency

The inconsistency in ASIC's enforcement has been raised in the past and it is generally far easier to take quick action against predominantly smaller licence holders than against those with substantial financial resources who could string the matter out.

We have seen instances in the past where, because of consumer disadvantage, we have felt ASIC should have suspended or cancelled an ACL but equally note this can punish the shareholders of the entity. Whilst it could be argued insufficient due diligence has been carried out, if an investor has recently bought into a company and the new investor was unaware of any non-compliance, that investment could be lost should a licence be suspended or cancelled. If the provision to allow ASIC to cancel or suspend a licence were introduced, it could provoke the withdrawal of investor funds and/or other unforeseeable consequences.

In our opinion, further consultation with stakeholders on this particular subject is warranted.

Responsible Managers

Finally, whilst the CP does not raise the issue specifically, it raises the oft-asked question of where does control sit with Responsible Managers. ASIC Regulatory Guide RG 105 covers organisational competence and at RG 105.21, it states "[t]he people you nominate as responsible managers must have direct responsibility for significant day-to-day decisions about your financial services. The only exception is for some responsible managers of small-scale, heavily automated businesses: see RG 105.26–RG 105.33.[3]"

Responsibility, however, is not control. As business ethicist Norman Bowie stated, "[a] responsible being is a being who can make choices according to his or her own insights. He or she is not under the control of others."[4]

We would therefore argue a Responsible Manager is unlikely to have control even though tasked with and being responsible for ensuring compliance under the NCCP Act. Table 1 of the CP does not mention Responsible Manager, so we assume ASIC regards this individual as a "Senior Manager".

If ASIC is more interested in taking action against those that control an entity, what ongoing knowledge must these individuals have? There is no mention of what might be required under Table 1 of ASIC Regulatory Guide RG 206 (RG206.29)[5] and in any case, we are seeing, first hand, that many potential entrants to the industry really do not know what they need in order stay compliant.

Although some might argue otherwise, we do not believe those in control who are not a Responsible Manager should be required to undertake a minimum of 20 hours

[3] ASIC Regulatory Guide 105 *Licensing: Organisational competence* (December 2016), page 8
[4] Norman Bowie, *Business Ethics* (Englewood Cliffs: Prentice-Hall, 1982), pages 95–96.
[5] ASIC Regulatory Guide 206 Credit licensing: C*ompetence and training* (July 2014), pages 9-10

per annum Continuous Personal Development education as though they were one in accordance with RG 206.64. However, if these requirements are to be introduced, then those in control will most certainly be required to do so and this may have far-reaching unintended consequences.

Also, as all of the Regulatory Guides make reference to the Responsible Manager rather than a controller and we take it all of these would have to be updated.

Position 2

Introduce a statutory obligation to notify change of control within 10 business days of control passing and impose penalties for failure to notify.

Control is not necessarily based on shareholding and if a licensee, for whatever reason, doesn't know there has been a change of control, how can it comply with the "within 10 business days" requirement? We not consider it appropriate that ASIC should be able to apply a penalty for failure to notify in such instances and regard the current situation of notifying ASIC "within 10 business days of the licensee becoming aware of the change" far more appropriate.

The CP mentions that "imposing penalties will deter deliberate non-compliance with the notification obligation" but the CP is remarkably remiss in providing any evidence this has occurred and if it has, how many instances. If any penalty were to be required, we consider it to be a civil and not a criminal matter.

The CP overlooks the existing regime with the Corporations Act and there may be conflict in the nature of the offence and the prescribed maximum penalty.

Position 3

Align the assessment requirements for AFS licence applications with the enhanced credit licence requirements.

We have no issue with this ideology but do question what ASIC looks at. Besides all the items detailed in Table 1 under point 1, we are aware ASIC also requests many other documents, sometimes repeatedly, for ACL applicants and from the author's discussions with other lawyers, the same occurs with AFSL applications.

Whilst there is justification in ensuring the industry has fit and proper persons in control of those that provide financial services, some industry specialist lawyers believe the application process has become so close to an approval process that whilst the services or products offered should not be advertised as "approved by ASIC" so as to breach s.12DB (1)(e) of the *Australian Securities and Investments Commission Act 2001 (Cth)* as one AFSL holder did[6], there would be some validity of stating the applicant has at least been "licensed by ASIC". However, back in 2011, ASIC specifically warned ACL holders against such use and then Commissioner, Dr Peter Boxall, stated "ASIC is concerned that use of the ASIC name and logo ….could cause consumers to believe the business or company is in some way endorsed or approved by ASIC.[7]"

These proposed changes are likely to reinforce the application process is in reality a full approval process.

Audit

We are aware of a number of clients that were granted an ACL subject to an audit but these were not consistently applied. Some applicants have been required to

[6] See *Australian Securities and Investments Commission v Huntley Management Ltd ACN 089 240 513 NSD1633/2016*

[7] ASIC Media Release 11-174MR, Credit licensees warned against misuse of ASIC name and logo, 17 August 2011. Available online http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2011-releases/11-174mr-credit-licensees-warned-against-misuse-of-asic-name-and-logo/ viewed 25 August 2017.

have a minimum of 3 quarterly audits whilst others were required to just have one audit after a year's trading. In our view, if an audit is required, regardless of whether it's an AFSL or ACL, the requirements should be applied consistently across all licence applicants.

In regard to an audit, though, we are aware of some compliance auditors being taken to task for either checking the wrong thing(s) or not finding an issue that was known to occur. In the latter instance, the event was found to occur in just over 1% of all transactions in just a relatively short period of time, well beyond most audit requirements unless a 100% audit occurred.

The current ASIC ACL licencing regime has not promoted new applicants being allowed to enter the industry and we have seen it become incestuous, with poor compliance knowledge being passed from company to company as new applicants have taken on staff from established lenders in the belief they will assist them be compliant. This does not just apply to Responsible Managers but operational line staff as well. Unfortunately, this has not always proven to be successful.

There are currently a number of prospective consumer rental companies owned by ex-franchisees of lessors that have acknowledged breaching the NCCP Act whom are seeking an ACL in their own right but whom are being knocked back by ASIC for not having sufficient experience in a regulated environment. In the author's view, these applicants could be given an ACL subject to satisfactorily passing an audit as if it was good enough for ASIC to grant the franchisor an ACL despite their non-compliance, these ex-franchisees should be accorded similar status and be able to continue providing such services subject to the audit results.

Position 4

ASIC to be empowered to cancel or suspend a licence if the licensee fails to commence business within six months.

The current long delays in ASIC reviewing and processing applications, the endless requests for information that may already have been supplied on at least one previous occasion caused by constant changes of analysts and the differing ways Responsible Managers have been assessed has led to the commodification of ACL's and AFSL's.

The application process for either an ACL or AFSL is relatively costly with no guarantee of success. By the time a full set of documents, the various manuals and contracts along with some training has been provided, the cheapest amount that we know of that has been charged by a non-lawyer compliance specialist is just over $11,000.00 (including GST) but invariably, this fee will be much more. For a lawyer to undertake the same work, I would expect the cost to be not less than around $25,000 with more complex applications considerably more.

On top of this, there are some particularly conscientious applicants that will look at fully training their staff so that they are ready to engage in credit activities from the time the ACL is issued who will spend at least $3,000 – $4,000 in the period between lodging an application and being granted an ACL.

For this reason, whilst the opportunity exists, we do not believe there will be many that choose to "warehouse" a licence. Even so, those licensees that have chosen not to commence immediately still have to have a Responsible Manager available pending the decision to commence trading which invariably adds further costs. Responsible Managers that can meet ASIC's requirements are in such short supply at present that they can command significant rates, even for dormant licences.

In our opinion, dormant licences are the direct result of ASIC's slow licensing processes. We have a number of prospective clients that have had applications in for almost 12 months as well as a number that abandoned their applications because of the delays. These applicants felt they had missed a marketing opportunity and were either not prepared to continue with the expense and uncertainty of their application or continue with their product development in the hope of getting a licence ultimately granted.

In our opinion, six months is not enough and applicants should be given at least another 12 months following the granting of a licence to commence engaging in financial services or credit activities.

Position 5

Align consequences for making false or misleading statements in documents provided to ASIC in the AFS and credit contexts.

Whilst in theory we don't have an issue with aligning consequences for making a false or misleading statement in an application for both licences, there is an argument that a simple mistake should not be dealt with harshly. The CP refers to "material omissions" but does not define these. We have an issue with this lack of definition as it allows subjectivity to creep in unless carefully addressed. The industry needs certainty and what may be considered a material omission to one analyst may not be to another if the same application were to be presented to both.

One issue we must mention here is the problem many licence holders have with the language used in the application and annual compliance statements. We presume the issue also exists in other ASIC documents. Instead of plainer English and using more words to describe what is being asked, double negatives and ambiguous language is used. We are of the opinion that ASIC could reduce the number of false or misleading statements applicants make by making it clearer what the regulator is requesting. We recommend ASIC should engage a consultant to assist it with rewording or rephrasing documents and have the documents tested for comprehension by other than lawyers prior to introduction.

We remain of the opinion that the criminal penalties imposed under the NCCP Act are inappropriate for all but any deliberate acts of intent to misled or deceive. We believe the current penalties in the NCCP Act should be amended to reflect this.

Position 6

Making a materially false or misleading statement in a licence application should be a specific basis for refusing to grant the licence.

When the NCCP Act was introduced, ASIC staff advised those attending its road tours that it was unnecessary for a lawyer to be involved in a credit licence application. We've never seen anything issued by ASIC that would otherwise refute this - until now.

The CP refers to making a "materially false or misleading statement" but does not define this. Again, we have an issue with this lack of definition as it allows subjectivity to creep in unless carefully addressed. The industry needs certainty and what may be considered a materially false or misleading statement to one analyst may not be to another if the same application were to be presented to both.

The Taskforce's position that providing information relating to the application (by statement or omission) or documents that accompany the application, which are false or misleading in a material particular, do create a presumption that their conduct cannot satisfy a reasonable belief that they will comply with their licence obligations avoids the real question of whether it was intentional or unintentional. In our opinion, unless a matter was deliberately false or misleading, such as the example given by supplying falsified bank statements, then we consider it extremely harsh for an applicant to have expended considerable funds for their application to see it denied or, for an existing business, look at the loss of losing their licence and ability to engage in credit activities or financial services because of an inadvertent error or momentary loss of concentration. Whilst we appreciate the need for accuracy, if the language used is ambiguous, then the applicant or existing licence holder should be given the benefit of some leeway.

If this is not to be the case, for this reason, we would have to recommend to our members and clients that prior to submitting any documents or completing any online form, any response should be reviewed by a lawyer, ideally one familiar with ASIC's culture and current approach to the drafting of documentation. This will ultimately cost consumers as any expenses incurred will inevitably be passed on and add further to the industry entry barrier.

The problem can only be solved in the manner in which any legislative or regulatory amendments are worded, whether there is any scope for remedy permitted and whether there is any ability to appeal a decision without initial recourse to the Administrative Appeals Tribunal.

Position 7

Introduce an express obligation requiring applicants to confirm that there have been no material changes to information given in the application before the licence is granted.

We would have no objection to an express obligation being introduced to confirm no change of details prior to the issuance of a licence but do have reservations about creating an ongoing obligation to notify as suggested in question 20. With applications taking so long to finalise, there are a number of documents that ASIC requests (and not listed in Table 1 of the CP) that could be subject to change, such as an entity's financials, contracts and other documents.

We note the phrase "material change" is used and again note its lack of definition. As ASIC has not published anything to our knowledge that states what it regards as a 'material change', there is uncertainty as to what this means. For example, if an applicant's financials change over the application processing period or who may be currently operating under a National Credit Code ("Code") exemption and submits a proposed contract that will meet the Code but then changes it after a change in legislation, how significant a change is required for it to become a 'material change'? Nothing may have actually changed other than this but the applicant has no way of knowing what ASIC's thinking is.

If ASIC were to speed up its application processing time, much of this becomes irrelevant.