

27 November 2017

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

By email: ASICenforcementreview@treasury.gov.au

Dear Sir/Madam

ASIC Enforcement Review - ASIC's Directions Powers

The Law Council is grateful for the opportunity to make a submission in regard to Position and Consultation Paper 8 of the ASIC Enforcement Review, *ASIC's Directions Powers*.

Please find attached the Law Council's submission which incorporates input from Law Firms Australia, the Business Law Section's Corporations Committee and Financial Services Committee and the Legal Practice Section's Superannuation Committee.

Should you require further information or clarification, please contact:

- Ms Rebecca Maslen-Stannage, Chair, Corporations Committee on (T) 02 9225 5000 or at (E) rebecca.maslen-stannage.hsf.com.
- Ms Henrietta Thomas, Chair, Financial Services Committee, at (E) henriettathomas@gmail.com; or
- Mr Luke Barrett, Chair, Superannuation Committee, on (T) 03 9910 6145 or at (E) luke.barrett@unisuper.com.au.

Yours sincerely



Jonathan Smithers
CHIEF EXECUTIVE OFFICER



Law Council
OF AUSTRALIA

ASIC's Directions Powers

ASIC Enforcement Review Position and Consultation Paper 8

The Treasury

27 November 2017

Table of Contents

About the Law Council of Australia	3
Acknowledgement	4
Business Law Section	4
Corporations Committee	4
Financial Services Committee.....	4
Legal Practice Section.....	4
Superannuation Committee	5
Introduction	6
Part A: Corporations Committee & Financial Services Committee	7
General comments	7
Position 1: Creation of the directions power	7
Position 2: Trigger for the directions power.....	8
Position 3: Enforcement and administrative action for the directions power.....	9
Part B: Superannuation Committee	10
ASIC Directions to AFS Licensees	10
The extent of APRA regulation for superannuation trustees necessitates a curtailing of ASIC's proposed new direction-giving power	10
ASIC's powers should be appropriately controlled notwithstanding constraints on the 'utility' of such powers	11
Incorrect statement of law	11
Consultation questions and response.....	12

About the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2017 Executive as at 1 January 2017 are:

- Ms Fiona McLeod SC, President
- Mr Morry Bailes, President-Elect
- Mr Arthur Moses SC, Treasurer
- Ms Pauline Wright, Executive Member
- Mr Konrad de Kerloy, Executive Member
- Mr Geoff Bowyer, Executive Member

The Secretariat serves the Law Council nationally and is based in Canberra.

Acknowledgement

The Law Council is grateful for the contributions of Law Firms Australia, the Business Law Section's Corporations Committee and Financial Services Committee and the Legal Practice Section's Superannuation Committee in the preparation of this submission.

Business Law Section

The Business Law Section was established in August 1980 by the Law Council of Australia with jurisdiction in all matters pertaining to business law. It is governed by a set of by-laws passed pursuant to the Constitution of the Law Council of Australia and is constituted as a Section of Law Council of Australia Limited.

The Business Law Section provides a forum through which lawyers and others interested in law affecting business can discuss current issues, debate and contribute to the process of law reform in Australia, and enhance their professional skills.

The Section has a current membership of more than 1,100 members. The Section has 15 specialist Committees, all of which are active across Australia.

Current Office Holders on the Business Law Section's Executive Committee are:

- Ms Teresa Dyson, Chair;
- Ms Rebecca Maslen-Stannage, Deputy Chair; and
- Mr Greg Rodgers, Treasurer.

Corporations Committee

The Current Chair of the Corporations Committee is:

- Ms Rebecca Maslen-Stannage
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Financial Services Committee

The current Chair of the Financial Services Committee is:

- Ms Henrietta Thomas
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Legal Practice Section

The Legal Practice Section of the Law Council of Australia was established in March 1980, initially as the 'Legal Practice Management Section', with a focus principally on legal practice management issues. The Section's has since broadened its focus to include areas of specialist practices including superannuation, property law, and consumer law.

The Section has a current membership of approximately 400 members. The Section has 8 specialist Committees, all of which are active across Australia.

Current Office Holders on the Legal Practice Section's Executive Committee are:

- Mr Philip Jackson SC, Chair
- Ms Maureen Peatman, Deputy Chair; and
- Mr Michael James, Treasurer.

Superannuation Committee

The Superannuation Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Superannuation Committee makes submissions and provides comments on the legal aspects of most proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

The current Chair of the Superannuation Committee is:

- Mr Luke Barrett
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Introduction

1. The Law Council welcomes the opportunity to provide this submission to the Treasury regarding the Position and Consultation Paper 8 of the ASIC Enforcement Review: *ASIC's Directions Powers (the Consultation Paper)*.
2. This document encompasses two separate submissions in response to many of those issues identified within the Consultation Paper.
3. Part A of this document contains a combined submission of the Corporations Committee and Financial Services Committees of the Business Law Section of the Law Council (**the BLS Committees**).
4. Part B of this document contains a submission from the Superannuation Committee of the Legal Practice Section of the Law Council, specifically addressing the application of the proposals to superannuation trustees.
5. The BLS Committees and Superannuation Committee oppose the introduction of the proposed directions power, which is considered unnecessary in light of the strength and breadth of ASICs existing regulatory powers. The BLS Committees consider that if such a power is introduced, it should be much more limited than the power proposed in the Consultation Paper. The Superannuation Committee considers that the power should not be extended to an Australian Financial Services (**AFS**) licensee that is an Australian Prudential Regulation Authority (**APRA**) regulated superannuation trustee.

Part A: Corporations Committee & Financial Services Committee

General comments

6. The BLS Committees understand the Australian Securities and Investments Commission's (**ASIC**) concern with maintaining public confidence in the financial sector and are broadly supportive of the proposal contained in the ASIC Enforcement Review's Positions Paper 7 on strengthening penalties for corporate and financial sector misconduct.
7. However, the BLS Committees consider the powers proposed in the Consultation Paper to be excessive and risk creating an arbitrary regulatory framework which lacks the checks and balances necessary for an accountable regulator. In particular, the BLS Committees are concerned that the proposed directions power would create an unnecessary extension of ASIC's existing powers, would constitute a disproportionate response to the 'gap' in the existing regulatory regime identified by the Consultation Paper, and, if implemented, would lack adequate appeal mechanisms and oversight.
8. The remainder of the BLS Committees' submission responds to the three positions set out by the Taskforce in the Consultation Paper.

Position 1: Creation of the directions power

9. The BLS Committees recommend that the proposal to grant ASIC the power to direct Australian financial services (**AFS**) or credit licensees in the conduct of their business, not be adopted. In the view of the BLS Committees:
 - (a) the proposed directions power is not necessary, given ASIC's current powers for regulating AFS and credit licensees; and
 - (b) the scope of the proposed power is disproportionate to the risks associated with the operation of AFS and credit licensing, or the gaps the Consultation Paper identifies in the current regulatory regime.
10. First, the BLS Committees consider that ASIC's current powers are adequate to fulfil its functions. As noted in the Consultation Paper, ASIC currently has wide powers to vary, suspend or cancel an Australian Financial Services Licence (**AFSL**), apply to a court for an injunction, issue infringement notices, direct an AFSL holder to provide a written statement and agree an enforceable undertaking. The Consultation Paper also refers to ASIC's product intervention power, which is currently being developed and could afford ASIC broad powers to restrict or ban the sale and marketing of products distributed by licensees.
11. These existing powers are extensive and afford ASIC with a wide-ranging and flexible set of regulatory mechanisms to address contraventions of financial services legislation and consumer risks relating to the provision of financial products.

12. The Consultation Paper argues that ASIC's administrative powers are limited by procedural fairness requirements, including the need to gather evidence, provide hearings or advice, and allow the licensee time to respond. While these delays are no doubt constraining, in our view they are necessary to ensure proper exercise of regulatory power and maintain procedural fairness, and are designed to avoid arbitrary regulatory intervention, including decisions concerning the variation, suspension or cancellation of an AFSL. Although the BLS Committees recognise that administrative efficiency and responsiveness are important concerns, these aims should not be pursued at the cost of procedural fairness and accountability. There is a real risk that removal of these procedural safeguards would damage trust and undermine public confidence in the regulatory system.
13. The Consultation Paper also refers to the recommendation of the Financial System Inquiry (**FSI**) that ASIC should have increased capacity to 'impose conditions requiring licensees to address concerns about serious or systemic non-compliance with licence obligations (including expert reviews)'. The BLS Committees consider that ASIC currently has the ability to impose additional licence conditions (including expert reviews) and that the FSI's recommendation does not suggest or require the introduction of powers as extensive as those proposed by the Consultation Paper.
14. Secondly, the BLS Committees consider that the examples of directions that ASIC could make (as suggested at Section 5 of the Consultation Paper) are excessive and extend far beyond equivalent powers afforded to other regulators. In particular, the BLS Committees are concerned by the proposed power to direct licensees to cease accepting new clients, engage alternative staff, appoint an ASIC nominee to report on compliance processes, and establish a compensation program for customers. Moreover, the suggestion that the scope of the directions power may be expanded by regulation is highly problematic and risks granting ASIC (as an unelected regulator) an unlimited power to control licensees without any restraint or oversight by the legislature.
15. For these reasons, the BLS Committees believe that the ASIC directions power proposed by the Consultation Paper should not be adopted.
16. However, if a directions power is granted to ASIC, the available directions should be considerably more limited than those proposed and should be specifically listed (rather than broadly described) in the enabling legislation. In addition, the BLS Committees propose that directions only be able to be made in situations of urgency and that any directions made by ASIC should be limited in their operation to a period of no more than three to six months (with tightly circumscribed opportunities for extension or renewal).

Position 2: Trigger for the directions power

17. The Consultation Paper's proposed mechanism for triggering the directions power does not afford satisfactory clarity or procedural fairness and a different trigger should be formulated if a directions power is introduced.
18. The Taskforce proposes that the directions power should be triggered where ASIC has 'reason to believe' that a licensee has engaged, is engaging or is proposing to engage in conduct contravening financial services or credit laws. The Consultation Paper states that the legislation 'will broadly define the circumstances in which the power to make a direction will be enlivened'.

19. The BLS Committees consider that merely having ‘reason to believe’ that a licensee has, is or proposes to contravene the relevant legislation is an insufficiently clear and unduly low threshold, particularly given the scope and immediacy of the proposed directions power. In particular, requiring reasonable belief alone to trigger the directions power risks allowing ASIC to pursue action against a licensee without locating adequate evidence or conducting sufficient investigations, which may lead to inappropriate action being taken.
20. As an alternative, ASIC’s ‘reason to believe’ could be qualified by requiring imminent danger to the financial viability of the licensee or significant loss to a licensee’s clients, such that the power is only triggered where critical intervention is required. Although the Consultation Paper notes at Section 5.12 that the proposed directions power addresses ‘a range of circumstances *including* matters where urgent action is required’ (emphasis added), in the view of the BLS Committees, the power should be limited exclusively to situations where urgent action is required, for example to prevent objectively serious consequences for consumer outcomes, or the future viability of the licensee.
21. If, contrary to our preferred position, an ASIC directions power is introduced, a stringent requirement of urgency should be reflected in the enabling legislation.

Position 3: Enforcement and administrative action for the directions power

22. The BLS Committees consider that ASIC’s enforcement powers as described in Position 3 of the Consultation Paper should be revised to incorporate a right to review decisions made under the power.
23. The Consultation Paper proposed that ASIC should be able to apply to a court to obtain an order requiring an AFS or credit licensee to comply with the direction, or take administrative action if a licensee does not comply with a direction made by ASIC. The Consultation Paper outlines a process whereby ASIC would give reasons for making a direction, but this process does not incorporate a right to request review of ASIC’s decision before a court order is sought to require the licensee to comply with ASIC’s direction.
24. It is an essential component of the rule of law that an AFS or credit licensee has the ability to challenge ASIC’s grounds for making a direction, or the nature of the direction made under the power. For example, ASIC’s directions should be subject to merits review by the Administrative Appeals Tribunal (in line with the position in respect of the Australian Prudential Regulation Authority’s directions power). In the BLS Committees’ view, this is consistent with views expressed by parliamentary inquiries and the Australian Law Reform Commission that regulatory decisions should be subject to public accountability and the oversight provided by an appeal or review process.



Part B: Superannuation Committee

ASIC Directions to AFS Licensees

25. The Superannuation Committee submits that ASIC should not be able to give a direction to an **AFS** licensee that is an APRA-regulated superannuation trustee (a Registrable Superannuation Entity (**RSE**) licensee). The reasons for this submission are set out below, together with the 10 consultation questions included in the paper and the Superannuation Committee's response to each of them.

The extent of APRA regulation for superannuation trustees necessitates a curtailment of ASIC's proposed new direction-giving power

26. The Taskforce's main justification for its proposal to give ASIC much more significant powers of direction is that 'the time, resources and procedural burden faced by ASIC to take administrative action against a licensee or seek an injunction from a court can result in a delay in ASIC exercising its existing powers'. The case studies set out in Section 4 of the Consultation Paper suggest that the Taskforce has in mind AFS licensees that carry on the business of providing personal advice to retail clients, perhaps in the context of particular licensees that operate at the margins.

27. The Superannuation Committee considers that, whatever force this justification may have in the context of a poorly-run financial planning business, it has little or no force in the case of APRA-regulated bodies such as RSE licensees. The nature and extent of the regulation and supervision that applies to RSE licensees is well-known. The requirements imposed on superannuation trustees by s 52(2) of the *Superannuation Industry (Supervision) Act 1993* (Cth) are far more demanding than the requirements imposed on AFS licensees by s 912D of the *Corporations Act 2001* (Cth) (**Corporations Act**). The supervision of superannuation trustees by APRA is significantly more hands-on than the supervision of AFS licensees by ASIC.

28. The special considerations that apply when an AFS licensee is also an APRA-regulated body are already reflected in Chapter 7 of the Corporations Act. Most relevantly for present purposes, s 915I sets out special procedures that ASIC must follow when it wishes to suspend or cancel the AFS licence of an APRA-regulated body. Under that section, ASIC cannot suspend or cancel an RSE licensee's AFS licence if doing so would, in ASIC's opinion, have the result of preventing the RSE licensee from being able to carry on all or any of its usual activities (being activities in relation to which APRA has regulatory or supervisory responsibilities), unless ASIC has first consulted APRA about the proposed action. The section recognises that APRA has the primary supervisory responsibility for RSE licensees and that ASIC's powers should be limited accordingly.

29. The Superannuation Committee submits that similar considerations apply in the context of the Taskforce's proposal to grant ASIC significant new powers to give directions. It is one thing for ASIC to be able to direct an RSE licensee to give ASIC a written statement containing specified information about the financial services

provided by the RSE licensee (as is currently the case under section 912C). It would be another thing altogether to give ASIC the power, as is proposed, to direct an RSE licensee to 'cease accepting new clients' or to 'cease transferring business to another licence'. The Superannuation Committee submits that ASIC should not have such powers when such matters are effectively regulated under another regime for RSE licensees.

30. The Superannuation Committee's submission is made in a context where APRA's very broad existing powers in relation to RSE licensees are proposed to be expanded, to give APRA a practically unrestricted power to give directions.¹

ASIC's powers should be appropriately controlled notwithstanding constraints on the 'utility' of such powers

31. The Superannuation Committee is concerned by the apparent ambivalence shown in the Consultation Paper towards procedural fairness and the control of government agency action. The discussion (in Section 3.1 of the Consultation Paper) of ASIC's powers to give directions to financial market infrastructure bodies – market licensees, clearing and settlement facility licensees and derivative trade repository licensees – is illuminating. The Consultation Paper notes the quite limited procedural fairness requirements that apply to the exercise of those powers – which are very similar to those ultimately proposed by the Taskforce in relation to AFS licensees – but then expresses concern that even those quite limited procedural fairness requirements may impose limitations on the 'utility' of the powers. The Consultation Paper also notes that a direction remains effective for a maximum of 21 days and, again, sees this as a constraint on 'utility'.
32. In the end, the Taskforce appears to see the burden of ASIC having to prepare a case to the required standard as inappropriate. An alternative perspective supported by the Superannuation Committee is that, the greater the power to be given to ASIC, the heavier the burden on ASIC should be, and the higher the required standard should be.

Incorrect statement of law

33. Finally, the Superannuation Committee is concerned that the Consultation Paper contains a statement about the law that is wrong. On page 4 it is stated that the Corporations Act imposes a number of specific obligations on AFS licensees including an obligation to 'act in clients' best interest'. Sections 912D-F are cited. However, the statement on page 4 is not true – an AFS licensee does not have any statutory obligation to act in anyone's best interests. Rather an individual adviser who provides personal advice has an obligation to act in a client's best interests. Further, sections 912D, 912E and 912F concern, respectively, breach reporting, ASIC surveillance and the citation of AFS licence numbers in specified documents. The Superannuation Committee is concerned that a proposal for significant law reform has been formulated on the basis of an incorrect understanding of the existing law.

¹ See Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Cth), sch 5 (currently before the Senate).

Consultation questions and response

Q1. Should ASIC be able to give a direction to a financial services or credit licensee requiring them to take or refrain from taking specified action in the conduct of their business where necessary to address or prevent compliance failures?

Where the AFS licensee is an RSE licensee, ASIC should not be able to give such a direction.

Q2. Should the directions ASIC can make be prescribed in the legislation (with an ability to extend the list by regulation)? If so, is the above list appropriate?

If ASIC is to have such a power then the types of directions should be prescribed in the legislation, it should not be a general power to give directions. As for the appropriateness of the list proposed by the Taskforce, as noted earlier, ASIC should not have the power to direct an RSE licensee to 'cease accepting new clients' or to 'cease transferring business to another licence'.

Q3. Alternatively, should a directions power be drafted broadly to allow for a wider variety of directions?

No.

Q4. Should the directions power be triggered if ASIC has reason to believe that a licensee:

- a. has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes, or would constitute a contravention of a law relevant to the provision of services by the licensee?
- b. has refused or failed, is or is proposing to refuse or fail to do an act or thing that the legislation requires a financial services or credit licensee to do?

The Superannuation Committee does not see the work to be done by paragraph (b) that is not already done by paragraph (a). The power should require ASIC to 'reasonably consider' that the relevant state of affairs exists, it is not enough for ASIC to 'have reason to believe' that it exists.

Q5. Alternatively, should broad public interest considerations or objectives provide the basis for ASIC making a direction? If so, are the objectives outlined above appropriate?

Broad public interest considerations and objectives should not be a basis for enlivening any such power; the relevant concept should be contravention of relevant law.

Q6. Should ASIC be able to apply to a court to seek an order requiring a licensee to comply with the direction?

Yes.

Q7. If so, should there be sanctions, in addition to those relating to contempt, for a licensee and/or its directors if the licensee breaches the court order?

No – a court order should be enough, and the court should be free to deal with a contravention of its order as the court sees fit.

Q8. Should failure to comply with an ASIC direction be a:

a. criminal offence?

No.

b. civil penalty provision?

No.

c. breach of a financial services law or credit legislation and therefore a basis for administrative action? *Answer:*

No – if the licensee does not comply with the direction then ASIC should take the matter to court.

Q9. Should ASIC be required to give written notice to a licensee before making a direction setting out: its intention to make a direction, reasons and a period of time for the licensee to respond that is reasonable in the circumstances?

Not applicable (see answer to question 10). ASIC should have to give the affected licensee meaningful procedural fairness; prior written notice is insufficient.

Q10. Alternatively, should ASIC be required to offer the affected licensee an opportunity to appear, or be represented at a hearing and to make submissions on the matter before making a direction? If so, should ASIC also be able to make an interim direction without providing a hearing and be required to provide a hearing within a certain time frame?

ASIC should be required to give the affected licensee meaningful procedural fairness.