



ASIC

Australian Securities & Investments Commission

ASIC Enforcement Review Position and Consultation Paper 8—ASIC's Directions Powers

Submission by the Australian Securities and Investments Commission

November 2017

Contents

Overview	3
ASIC's response to Taskforce positions	3
A Response to Position 1	5
Power to direct financial services and credit licensees	5
B Response to position 2	9
Trigger for exercise of the power	9
C Response to position 3	11
Procedural requirements and sanctions	11

Overview

- 1 We support the Australian Government's commitment to ensuring that the Australian Securities and Investments Commission (ASIC) has the powers and regulatory tools we need to proactively address misconduct in the financial services and credit sectors.
- 2 As Australia's corporate, markets, financial services and consumer credit regulator, we work to ensure that Australia's financial markets are fair and efficient with confident and informed investors and consumers. In order to effectively carry out our role, we need a broad and effective enforcement toolkit.
- 3 We welcome the release of the ASIC Enforcement Review Taskforce (Taskforce) Position and Consultation Paper 8 *ASIC's directions powers* (positions paper) on 8 November 2017, and are pleased to have the opportunity to respond to the proposals in the positions paper.

ASIC's response to Taskforce positions

- 4 We strongly support steps to strengthen ASIC's powers to direct Australian financial service (AFS) and credit licensees to take or refrain from taking actions where it is appropriate for ASIC to do so.
- 5 In this submission, we provide some observations on the preliminary proposals set out in the positions paper. These observations are informed by ASIC's regulatory experience and are provided for the Taskforce and government's consideration, as part of implementing any reforms.

Position 1 - power

- 6 We agree that ASIC should have the power to direct financial services or credit licensees in the conduct of their business, and that legislation providing for this power should specify the kinds of directions that can be made. There should also be flexibility to allow for additional types of directions by ensuring the legislated list is non-exhaustive and including a provision for regulations.
- 7 There are circumstances where it may be appropriate for ASIC to direct a licensee to cease conducting a specific financial service or credit activity. This is not currently covered by the proposals. We recommend that further consideration be given to whether these types of directions should be expressly addressed in the legislation, to the extent they do not impinge on the proposed product intervention power regime.

- 8 In respect of remedial programs, ASIC should be able to make directions about the nature and conduct of any program to assess claims for restitution or compensation.

Position 2 – trigger for exercise of the power

- 9 We are generally supportive of the proposed trigger for ASIC's exercise of the power, subject to two caveats. These caveats are:
- (a) The requirement should be that ASIC has reason to suspect (rather than believe) a licensee has, is or will contravene financial services laws or credit legislation.
 - (b) There should be an alternate test directed at a licensee's actions that ASIC has reason to suspect are likely to cause detriment to consumers.

Position 3 – procedural requirements and sanctions

- 10 In relation to the procedural requirements ASIC must follow before giving a direction, we support the Taskforce's position. However, we consider that ASIC should also have the option to give an interim direction without any notice in urgent matters, with a requirement to follow the usual process within a specified time.
- 11 We also recommend that ASIC have a range of options to use should there be a failure to comply with a direction. These options would include applying to court for an order securing immediate compliance with the direction, administrative action and/or commencing criminal / civil penalty action.

A Response to Position 1

Key points

We agree that ASIC should have the power to direct financial services or credit licensees in the conduct of their business, and that the legislation providing for this power should specify the kinds of directions that can be made. There should also be flexibility to allow for additional types of directions by ensuring the legislated list is non-exhaustive and including a provision for regulations.

There are circumstances where it may be appropriate for ASIC to direct a licensee to cease conducting a specific financial service or credit activity and this is not currently covered by the proposals. We recommend that further consideration be given to whether these types of directions should be expressly provided for in the legislation, to the extent they do not impinge on the proposed product intervention power regime.

In respect of remedial programs, ASIC should be able to make directions about the nature and conduct of any program to assess claims for restitution or compensation.

Power to direct financial services and credit licensees

- 12 Position 1 in the positions paper proposes that ASIC should be able to give a direction to an AFS or credit licensee in relation to the conduct of their business where necessary to address or prevent compliance failures.

Specifying the directions that can be made

- 13 The positions paper suggests that the legislation implementing a directions power for ASIC should set out the types of directions that can be made. It also suggests that additional types of directions could be provided by regulation, to ensure flexibility for new or unforeseen circumstances.
- 14 We support listing types of permitted directions in the legislation, but recommend that this be a non-exhaustive list (with provision for regulations). In our view, this is preferable to the alternative approach outlined in the paper, where the kinds of direction would be defined in broad terms in the legislation.
- 15 This is because a power to give a broadly defined range of directions may suffer from the same uncertainty that currently exists for ASIC's powers to impose additional license conditions. The positions paper identifies this uncertainty as a key issue with ASIC's existing administrative powers and Case Study 3 in the positions paper demonstrates the challenges this creates in practical terms.

- 16 This is also consistent with recommendations made by the Council of Financial Regulators (CFR) in relation to ASIC's existing directions power in relation to market infrastructure licensees. The CFR recommended that specific types of direction that could be issued by ASIC should be specifically provided for by legislation.¹
- 17 Therefore, legislating a list of specific directions that ASIC is clearly empowered to give will enhance legal certainty and reduce the risk of challenge to any exercise of the direction power by ASIC.
- 18 Nevertheless, it is important that the power retains sufficient flexibility to be 'future proof' for new or unforeseen circumstances. As suggested in the positions paper, this could be achieved by providing for additional matters to be included by regulation.
- 19 In addition to providing for additional types of direction by regulations, we recommend that the types of directions specified in the legislation be presented as a non-exhaustive list. This may enable ASIC to exercise the direction power in circumstances where the appropriate direction is not specified in the legislation. Regulations would also have a role, particularly where there might be uncertainty about whether the power would allow a particular type of direction.

Directions to cease engaging in particular specified financial services or credit activities

- 20 The positions paper says that the legislation would include a list of the permissible types of directions. This would include directions to:
- (a) cease appointing authorised representatives;²
 - (b) cease accepting new clients;
 - (c) conduct a review or audit of an authorised representative's records;
 - (d) engage properly qualified compliance staff;
 - (e) cease transferring business to another licensee;
 - (f) cease making specific representations about financial products and services;
 - (g) appoint a person nominated by ASIC to review and report on compliance processes; or
 - (h) establish a program to assess claims for restitution or compensation for customers.

¹ Letter from G Stevens (RBA Governor) on behalf of CFR to Hon Wayne Swan MP (Deputy Prime Minister and Treasurer) re Review of Financial Market Infrastructure Regulation, 10 February 2012, https://static.treasury.gov.au/uploads/sites/1/2017/06/CoFR_Letter_to_Deputy_PM-1.pdf

² We recommend that this also extend to all representatives.

- 21 The positions paper does not contemplate providing for directions to cease conducting a specific financial service or credit activity.
- 22 There are circumstances where such a direction may be appropriate. For example, ASIC may want to direct a licensee to cease a particular activity until some other activity (eg a review of compliance processes, or engaging properly qualified compliance staff) has been completed.
- 23 Accordingly, it is important that ASIC has a tool that allows it to make this kind of direction, whether as part of the directions power, or elsewhere in its toolkit.
- 24 We note that the Government has agreed to implement a product intervention power for ASIC, and that the positions paper acknowledges that the directions power is not intended to be inconsistent with or undermine the limits to be imposed on the exercise of the proposed product intervention power.
- 25 Desirably, the product intervention power would allow ASIC to make a broad range of interventions, including restricting certain kinds of conduct in relation to a specific product, or, in rare circumstances, banning a product entirely. Therefore, to the extent that the product intervention power could be used in relation to a specific licensee, it may allow ASIC to effectively direct that licensee to cease a particular financial service or credit activity (subject to ASIC satisfying relevant threshold conditions and procedural requirements). Without legislation specifying the scope of the proposed product intervention power, it is not possible to comment on whether the intervention power will provide ASIC with an effective tool to make these kinds of directions.
- 26 However, it is important that ASIC's regulatory toolkit is considered and designed holistically. So, we recommend that there be further consideration of whether ASIC's directions power should expressly contemplate directions to cease conducting a specific financial service or credit activity, once more is known about the precise design of the intervention power.

Directions in relation to remedial programs

- 27 We note that the position paper includes a direction 'to establish a program to assess claims for restitution or compensation for customers' as one of the specified directions.
- 28 We consider that ASIC's ability to make this kind of direction should extend to making specific directions about the nature and conduct of the program. For example, the legislation should clearly cover directions which would require the licensee to take proactive steps in relation to any program for restitution or compensation. This would include directions to proactively

notify customers about the program and to identify potential claimants and invite them to make a claim.

- 29 This is consistent with the types of terms that are typically agreed between ASIC and a licensee in an enforceable undertaking. If ASIC's directions power does not extend to making directions in relation to these issues, ASIC may have to determine these details by negotiation and agreement with the licensee. This will limit the effectiveness of the directions power and may have substantial consequences for consumers with a potential claim.

B Response to position 2

Key points

We are generally supportive of the proposed trigger for ASIC's exercise of the power, subject to two caveats. These caveats are:

1. The requirement should be that ASIC has reason to *suspect* (rather than *believe*) a licensee has, is or will contravene financial services law or credit legislation.
2. There should be an alternate test directed at a licensee's actions that ASIC has reason to suspect are likely to cause detriment to consumers.

Trigger for exercise of the power

- 30 Position 2 in the positions paper is that the trigger for exercise of the directions power should be that ASIC has reason to believe a licensee has, is or will contravene financial services or credit licensing requirements. This could be because the licensee is engaging or proposing to engage in unlawful conduct, or because the licensee has refused or failed to do an act or thing that the legislation requires a licensee to do.
- 31 We are generally supportive of this approach. However, we consider that the proposed trigger should be modified slightly to ensure it does not prevent ASIC from taking timely action. Specifically, we recommend that the requirement be that 'ASIC has reason to suspect' (rather than 'ASIC has reason to believe') that the licensee:
- (a) has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes, or would constitute a contravention of financial services laws or credit legislation; or
 - (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.
- 32 However, we note that, even with this modification, it is not clear that the proposed power would provide a useful tool for ASIC to deal with the scenario in Case Study 2 in the positions paper. The example below outlines the problems identified in Case Study 2 and the issue for ASIC in using the proposed directions powers to deal with the scenario.

Example**Case study 2 – AFS licensee under surveillance transferring business to newly acquired licence**

In this case study, the conduct that a directions power could have helped to address was the transfer of business to a newly acquired licence. ASIC was concerned that the licensee was moving assets and its financial services business to a new AFS licence and leaving a 'shell' behind. ASIC had intelligence to suggest this was to avoid responsibilities under the current licence in respect of a large number of complaints that were being made through the Financial Ombudsmen Service (FOS).

It is not clear that the act of transferring the business to avoid responsibility under prospective FOS determinations would constitute a breach of financial services laws or credit legislation. However, the substantial risk of consumer detriment suggests ASIC should be able to take action to prevent this.

- 33 Due to this limitation, we recommend that there be an additional trigger for exercise of the direction power where ASIC has reason to suspect that a licensee has engaged, is engaging or is proposing to engage in conduct that is likely to cause consumer detriment.

C Response to position 3

Key points

In relation to the procedural requirements ASIC must follow before giving a direction, we support the Taskforce's position. However, we consider that ASIC should also have the option to give an interim direction without any notice in urgent matters, with a requirement to follow the usual process within a specified time.

We also recommend that ASIC have a range of options to use should there be a failure to comply with a direction. These options would include applying to court for an order securing immediate compliance with the direction, administrative action and/or commencing criminal or civil penalty action.

Procedural requirements and sanctions

- 34 Position 3 in the position paper covers procedural requirements for exercise of the directions power, as well as enforcement arrangements and sanctions for failures to comply.

Procedural requirements before exercising the power

- 35 The positions paper proposes that the procedural steps for exercising the directions power would be that:
- (a) ASIC would provide the licensee with a notice setting out:
 - (i) its intention to make a direction;
 - (ii) reasons for making a direction; and
 - (iii) a reasonable period of time for the licensee to respond; and
 - (b) if the licensee's response does not adequately address ASIC's concerns, ASIC may give the direction.
- 36 We agree that this procedure would be appropriate in most circumstances. However, in urgent cases, this process may not allow for timely directions.
- 37 The Taskforce's position on this issue is similar to the approach used for ASIC's directions powers in relation to market infrastructure licensees. This has previously been the subject of criticism. The Council of Financial Regulators (CFR) has noted that the existing two stage process (whereby ASIC is required to first explain why the direction is required and second

give the licensee a reasonable time to respond) ‘may not allow for timely and targeted directions’.³ The CFR ultimately recommended that the Government streamline ASIC’s power to give these directions to facilitate more rapid and certain action by ASIC.⁴

- 38 Given this known limitation with the proposed process, we recommend that ASIC also have the option to give an interim direction for a specified period without following the procedure above. The usual process would then need to be followed in the specified period.

Enforcement and sanctions

- 39 The positions paper proposes that ASIC would be able to apply to court to seek an order requiring a licensee to comply with a direction, and failure to comply with the court order would give rise to serious, potentially automatic, sanctions.

- 40 The positions paper also says that failure to comply with a direction would be a breach of financial services law or credit legislation, thereby enlivening ASIC’s administrative licensing powers (subject to existing procedural requirements, including conducting a hearing).

ASIC position

- 41 We agree that ASIC should have the ability to apply to the court for an order requiring the licensee to comply with the direction. We also agree that the licensee’s failure to comply with the direction should be a breach of a financial services law or credit legislation, enabling ASIC to take administrative action.
- 42 We consider that, in addition to the above remedies, failure to comply with a direction should be a criminal offence and attract a civil penalty.
- 43 We do not agree with the Taskforce’s preliminary view that criminal prosecution may be a disproportionate response – this depends on the circumstances of the breach. In our view, ASIC should have the option to pursue criminal prosecution where the conduct is appropriately serious to warrant this.

³ Council of Financial Regulators: *Review of Financial Market Infrastructure Regulation*, Consultation Paper, October 2011 at 7.2 https://archive.treasury.gov.au/documents/2201/PDF/CFR_review_of_FMI_regulation_issues.pdf

⁴ Letter from G Stevens (RBA Governor) on behalf of CFR to Hon Wayne Swan MP (Deputy Prime Minister and Treasurer) re Review of Financial Market Infrastructure Regulation, 10 February 2012, https://static.treasury.gov.au/uploads/sites/1/2017/06/CoFR_Letter_to_Deputy_PM-1.pdf

- 44 We also do not agree that, if a failure to comply with a direction is to be a criminal offence, a licensee should be given a hearing before the direction is made – the above procedural steps are sufficient.
- 45 We support the Taskforce's proposal that a licensee's failure to comply with a court order that it comply with the direction should result in an automatic licence suspension/cancellation and automatic disqualification of the directors. In these cases, the licensee will have had the opportunity to make submissions first to ASIC, and then to the court (in respect of the application for an order to comply with the direction). Therefore, we do not think it is necessary or desirable for the licensee to be given another opportunity to address the issue before sanctions are imposed.
- 46 We consider that this range of options will enable an effective enforcement response. That is, ASIC could:
- (a) apply to the court for an order securing immediate compliance with the direction, and there would be serious consequences for the licensee and its directors in the event of non-compliance with this order;
 - (b) take administrative action for failure to comply with the direction; and/or
 - (c) commence criminal/civil penalty action to punish and deter serious non-compliance.