CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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General Manager
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The Treasury
Langton Crescent
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By email: safefinancialsector@treasury.gov.au

Dear Treasury

Strengthening APRA's Crisis Management Powers: Consultation Paper

Chartered Secretaries Australia (CSA) is the peak body for over 7,000 governance and risk professionals in Australia. It is the leading independent authority on best practice in board and organisational governance and risk management. Our accredited and internationally recognised education and training offerings are focused on giving governance and risk practitioners the skills they need to improve their organisations' performance.

CSA has unrivalled depth and expertise as an independent influencer and commentator on governance and risk management thinking and behaviour in Australia. Our members are all involved in governance, corporate administration, legal practice and compliance with the *Corporations Act 2001* (the Act) with their primary responsibility being the development and implementation of governance frameworks in public listed and public unlisted companies, private companies, and not-for-profit organisations.

CSA welcomes the opportunity to comment on the consultation paper *Strengthening APRA's Crisis Management Powers* (the consultation paper) and draws upon the experience of our Members in formulating our response.

General comments

It is vital that Australian maintains a strong financial sector which will be resilient in the face of external shocks such as those generated by the Global Financial Crisis (GFC). CSA supports the exploration of options for enhancing and streamlining financial services legislation in relation to the prudential supervision of authorised deposit-taking (ADI) institutions, insurers and registrable superannuation entities (RSE) that are regulated by the Australian Prudential Regulation Authority (APRA).

CSA is also cognisant that a well-built regulatory system requires regulators such as APRA and the Australian Securities and Investments Commission (ASIC) to keep a pulse on the operations of those within their ambit and intervene in circumstances which might adversely affect beneficiaries. We note that for APRA this means being able to identify ways to protect depositors, policyholders and other consumers of financial products against financial institution distress.

In this light, CSA provides feedback on the consultation paper but leaves it to other organisations in the financial services field to address the specific questions highlighted in the consultation paper.

The effective resolution of groups

Impact on non-regulated subsidiaries
CSA notes that disentangling a regulated entity's affairs from the rest of the non-regulated group during a crisis situation where quick and accurate actions are required can be challenging. Some company groups are very complex in nature with numerous administrative and business links, and contractual arrangements across the group, including with non-regulated entities.

Currently, APRA has the power to appoint a statutory manager (SM) or judicial manager (JM) to a regulated entity to replace the board of directors and take control of the regulated entity. Through the appointment of a SM or JM, APRA also indirectly controls all subsidiaries of the regulated entity through the capacity as shareholder to appoint directors.

The proposal to enhance APRA's powers is designed to allow APRA to also manage subsidiaries of the regulated entity, including any non-regulated subsidiaries. CSA notes that these powers are extensive, and include:

- the recapitalisation of the company
- a requirement for related parties to continue to provide what they deem to be essential services, and
- the ability to direct the sale of a business or part of a business of a subsidiary.

While CSA is cognisant that the intention to bring subsidiaries into the APRA action net appears to come from similar actions undertaken by the Financial Stability Board (FSB), CSA notes that the exercising of the power of APRA or the court to appoint an SM or JM has been rarely used, and it appears that the power being sought is somewhat disproportionate to the problem seeking to be solved.

Furthermore, CSA is concerned that the power being proposed allows APRA to control the non-regulated subsidiary, thereby resulting in significant implications for the liabilities and responsibilities of directors and officers of those non-regulated entities. CSA is also concerned that APRA has neither the expertise in complex corporate groups nor the resources to undertake such actions, and to be able to adequately assess the likely impact of their control of organisations which lie outside the regulated financial services industry.

CSA's concerns are explicitly demonstrated in three of the four options proposed in the consultation paper. CSA notes that option 'A', which grants power to APRA to appoint a SM or JM to a regulated entity and its subsidiaries, potentially creates problems for creditors and directors of subsidiaries because the SM or JM will be charged with primarily looking after the interests of the regulated entity, which could be to the detriment of the subsidiary. Similarly, option 'C', which enhances APRA's direction-making powers and is more palatable than the first option, also interferes with the operations of the subsidiary and potentially confuses the responsibilities of directors. Option 'D', which appears to be a mixture of options 'A' and 'C', will likewise result in similar inconsistencies and uncertainty.

CSA notes that directors of subsidiaries have the same legal obligations as directors of the parent company, in that they are required to exercise their powers in good faith, for a proper purpose and in the best interests of the company as a whole. They owe the same duties of loyalty and confidentiality as other directors and any attempt to modify these duties may be problematic and complex. Where the subsidiary is wholly-owned, a director may be permitted to take into account the best interest of the parent company, but only where the constitution of the subsidiary permits this and the subsidiary is not insolvent. Interference with the board of directors, either through directions or the appointment of a SM or JM, derails the undertaking of these responsibilities, with serious implications for the officers and directors involved.

In this regard, option 'B' appears to be the least intrusive intervention by APRA, as this provides some protection for creditors and shareholders by requiring a liquidator or receiver to consult with APRA.

Clawback of capital transfers
CSA is concerned with the proposal for APRA to be able to void the provisions of the *Corporations Act 2001* relating to the clawback of capital transfers. CSA does not believe that this kind of preferential treatment is justifiable.

CSA notes again that the impact will likely be felt by creditors and stakeholders, such as employees, who would be inadvertently disadvantaged if such capital transfers were not able to be recouped.

Enforcement and resolution powers

CSA appreciates that there may be times where APRA judges it necessary to use direct tools to rectify or manage prudential concerns. In these instances, APRA must be able to take specific action to address particular risks which have been identified and to act accordingly.

The key to enforcement and resolution powers, however, must rest with the identification of specific directions which APRA can use to assist the board or management of a regulated entity to implement effective resolution arrangements. CSA is concerned that the proposal to provide APRA with a 'broad "catch-all" directions power that gives it the flexibility to issue directions appropriate to any situation that may arise' is not consistent with the intention of the reform.

CSA's concerns about the inclusion of broad unchecked powers being granted to a regulator was raised recently in a consultation undertaken by the Council of Financial Regulators, as set out in the consultation paper, *Review of Financial Market Infrastructure Regulation*, in which there was a proposal granting ASIC the explicit power to:[1]

> direct a licensed market operator to make listing rules with specified content, with the consent of the Minister, where ASIC views that the making of that rule is appropriate and proportionate for the enhancement and/or protection of market integrity. Following a direction, a licensed financial market operator would be required to make the rules, and be responsible for monitoring and enforcing compliance with them.

CSA notes that CSA and other stakeholders who responded to the Council of Financial Regulator's consultation raised immediate concerns with the expansion of ASIC's powers to make listing rules as the powers being granted were not confined only to the circumstances of concern. We noted at the time that the proposal was a very wide power indeed, and did not take into account the sound knowledge of the market and of participant needs which is a key factor in ensuring that the listing rules achieve a balance between commercial needs and investor protection. We noted that a regulator's role is inherently different from that of a market operator — this necessary balance between commercial needs and investor protection cannot be achieved without consultation with stakeholders. We expressed concern that ASIC and the Minister would have the ability to influence the market operator, without any need to ensure that due and proper public consultation was undertaken with stakeholders to ensure that the impact of the proposals could be considered.

During this particular consultation, we recommended that the drafting of any legislation defining 'exceptional circumstances' be released for public consultation, to ensure that any direction from ASIC as to the making of listing rules achieves the necessary balance between commercial

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[1] The Council of Financial Regulators, *Review of Financial Market Infrastructure Regulation*, consultation paper, October 2011, pg 29

needs and investor protection. CSA noted that the 'devil is in the detail' in relation to drafting, and stakeholder feedback is necessary to achieve this balance.

CSA raises similar concerns in relation to the current proposal.

The power being proposed to be granted to APRA could potentially be exercised without due consideration of the impact on listed entities and other stakeholders, and CSA notes that this may result in unintended consequences.

CSA is also cognisant that broad catch-all powers will impact upon other stakeholders, including, for example, appointed administrators and receivers, who have various rights and obligations under Chapter 5 of the *Corporations Act 2001.* CSA is concerned that the expansion of APRA's powers will distort the priorities of stakeholders in the event of a winding up of a regulated entity, and change the established administration processes. This would result in further uncertainty for all parties involved and impose an additional regulatory burden.

CSA recommends, therefore, that the drafting of any legislation defining 'catch-all directions powers' be released for public consultation, to ensure that any directions from APRA are 'appropriate to any situation that may arise' and detail the limits of such directions power ensuring that clear and appropriate safeguards are in place to protect the directors of regulated entities and the entities themselves. It is important that the circumstances of APRA's capacity for intervention in a regulated entity's affairs are clear, so that the regulated entity can understand its rights and obligations in such circumstances.

Protection from liability when complying with an APRA direction

Officers and directors of corporate entities currently have wide-ranging duties and obligations across a variety of legal frameworks. A Corrs Chambers Westgarth analysis in 2011 of director liability provisions noted that there are 697 provisions in all Australian jurisdictions covering director liability[2]. CSA believes that the proposed protections from liability when complying with an APRA direction under the proposed APRA directions power constitute further regulation for officers and directors of corporate entities within the financial services sector.

While CSA supports the idea of protecting entities and their officers and directors from liability when complying with an APRA direction, we are of the view that this additional protection further adds to the inconsistencies associated with director liability provisions generally. There is a review of personal liability for corporate fault occurring currently in all states and the Commonwealth, as part of the director liability reform projects being undertaken by the Coalition of Australian Governments (COAG). The aim of this project is to establish a nationally consistent and principled approach to the imposition of personal liability on directors and other corporate officers for corporate fault, with the primary aim being the harmonisation of director liability across jurisdictions.

The project arose from the recommendations of the Corporations and Markets Advisory Committee (CAMAC) in its 2006 report on personal liability for corporate fault, which noted that there are:

> considerable disparities in the terms of personal liability provisions, resulting in undue complexity and less clarity about requirements for compliance[3]

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[2] Corrs Chambers Westgarth, *Directors' liability reform: Analysis of the application of COAG's directors' liability principles report*, 5 August 2011, p 13, available from http://www.coagreformcouncil.gov.au/reports/docs/sne-feb-2012/Directors_Liability_Reform_Report.pdf

[3] Corporations and Markets Advisory Committee, *Personal liability for corporate fault: Final report*, September 2006, p1, from http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2006/$file/Personal_Liability_for_Corporate_Fault.pdf

CSA has previously opposed the imposition of differing standards of director liability where the imposition of liability runs counter to the aim of the current COAG reform program.

CSA does not support the imposition of further director liabilities, even when accompanied by a defence, if the terms of both are not sufficiently clear and do not accord with the principles set out in the COAG director liability reform project. **CSA strongly recommends** that the drafting of any proposed liability and defence be open to consultation with stakeholder in order to ensure that officers and directors both receive adequate protection from liability in relation to the expansion of APRA's powers and that any new provisions relating to director liability accord with the COAG principles set out in the director liability project.

Suspending continuous disclosure requirements

CSA is concerned by the proposal to allow APRA to direct a regulated entity under its authority not to disclose material information to the Australian Securities Exchange (ASX) and the market in accordance with the entity's legal duty and obligation to do so under the *Corporations Act 2001*, and the ASX Listing Rules.

The continuous disclosure regime is fundamental to the integrity of the market. Timely disclosure to investors of information that is material to their investment decision-making is critical for maintaining confidence that securities markets are fair and are seen as an attractive place for people to invest. Entities must disclose materially price-sensitive information immediately upon becoming aware of it and no investor should be disadvantaged in comparison to any other investor.

CSA understands the government's and APRA's concern to ensure that, should a significant regulated entity find itself in financial distress, the impact on deposit holders' confidence can be mitigated through APRA having the capacity to achieve a resolution with the regulated entity that can be released to the market simultaneously with notice of the difficulties faced by the entity.

Nonetheless, the Corporations Act and the ASX Listing Rules impose serious legal obligations on listed entities and their officers in terms of continuous disclosure. The current proposals that APRA be provided with the power to direct an entity from making a material and timely disclosure will place listed entities and other disclosing entities and their directors in breach of their obligations under the Corporations Act and the Listing Rules.

If a listed entity fails to comply with the listing rules, ASX has the power to:

- suspend quotation of the entity's securities
- cause a temporary halt in trading of the entity's securities and
- remove the entity from the official list.

Where ASX believes that a breach of the Corporations Act has occurred, it will refer the matter to ASIC for investigation and/or enforcement.

The Corporations Act creates a civil offence if listed disclosing entities do not comply with the continuous disclosure provisions of the Listing Rules. Individuals who assist in the breach also commit an offence.

The courses of action available to ASIC for breaches of the continuous disclosure regime are:

- obtaining an enforceable undertaking
- instituting proceedings under the Corporations Act to obtain an order for compliance with the listing rules
- referring the matter for criminal prosecution — if the breach is also a contravention of the Corporations Act, it is a criminal offence. The entity is liable, as is anyone who aids, abets, counsels or procures the commission of the offence
- instituting legal proceedings under the Corporations Act for orders, including a civil penalty order of up to $1 million for the entity — there is no fault element to be

established — and a civil penalty order of up to $200,000 may also be made against a person involved in the contravention
- applying for a compensation order on behalf of a person who has suffered or is likely to suffer loss or damage
- issuing an infringement notice imposing a fine of up to $100,000.

Under the Corporations Act, directors have criminal personal liability for any breach of the continuous disclosure provisions. Australia has a federal class action regime. Furthermore, the High Court found in *Campbells Cash and Carry Pty Ltd v Fostif Pty Ltd (2006*) that it was not an abuse of process or against public policy to allow the concept of litigation funding. Litigation funders and law firms that specialise in class actions now play a prominent part in the continuous disclosure regime in Australia. They fund or bring actions on behalf of groups of plaintiffs who allege that due to a contravention of the continuous disclosure obligations by a disclosing entity they transacted in the securities of the disclosing entity and suffered a loss as a result of the alleged contravention.

Given the statutory and listing rule obligations imposed on regulated entities and their directors as set out above in relation to continuous disclosure, the proposal that APRA can direct a regulated entity under its authority not to disclose material information to ASX and the market causes considerable concern.

CSA understands that it is proposed that the legislation will contain specific relief for directors and companies from their statutory obligations under the Corporations Act and Listing Rules.

CSA recommends that the legislation needs to be explicit that any regulated entity and its officers and directors will not be in breach of their continuous disclosure obligations should they act in accordance with any such direction from APRA.

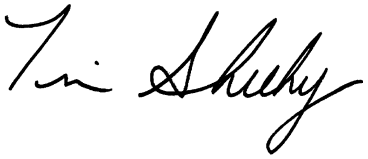
CSA also recommends that the legislation needs to be explicit that ASIC cannot issue an infringement notice to a regulated entity for complying with an APRA direction not to disclose material information to ASX and the market.

Conclusion

CSA has set out our concerns with some of the proposals in the consultation paper. The potential for these proposals to have unintended consequences is high.

CSA recommends that further consultation is undertaken with stakeholders, including on any draft legislation to enable the proposals set out in the consultation paper. We would welcome the opportunity to discuss any of our views in greater detail.

Yours sincerely



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