Min-it Software

Financiers Association of Australia

Joint Submission –

Position and Consultation Paper 8: ASIC's Directions Powers

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Lodged by email: ASICenforcementreview@Treasury.gov.au

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Contents

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 make this submission on the Government's draft National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2017.

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 note that whilst Paper 8 refers to ASIC's powers in regard to both ACL and AFSL holders, all the case studies included in it refer only to those holding AFSL's. This would imply that the majority of instances where ASIC believes it needs extra powers are in relation to the Corporations Act 2001 ("Corporations Act") but we understand that ASIC is seeking to hold similar powers over both classes of licence holders.

Position 1:

ASIC should have the power to direct financial services or credit licensees in the conduct of their business where necessary to address or prevent compliance failures

As the paper states, the Taskforce's preliminary position is to increase its powers of directions and allow it to:

a. cease appointing authorised representatives;
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 licence;
f. cease making specific representations about financial products or services;
g. appoint a person nominated by ASIC to review and report on compliance processes; and
h. establish a programme to assess claims for restitution or compensation to customers.

At paragraph 3, we note that the power to make these expanded directions "would not replace or reduce the existing utility of enforceable undertakings and other negotiated agreements between ASIC and licensees" and "would instead support the effectiveness of negotiated outcomes while clarifying the scope of ASIC's powers for licensees and consumers."

Whilst we appreciate there is a need to sometimes quickly protect consumers and investors, there is widely held industry view that ASIC hasn't actually used its already widespread powers to bring some of these non-compliant entities to heel quickly enough. A classic example of this is its actions against Storm Financial Ltd ("Storm Financial") where it took a great deal of adverse media comment and a class action against the company by Slater & Gordon that finally got the regulator involved. ASIC had the power at that time to intervene, investigate and vary Storm Financial's AFSL but chose not. There are a number of other instances where class actions have been raised, such as ones by Maurice Blackburn, and still the regulator did not get involved in those actions.

The powers sought for the directions have the ability to cripple a company's operations financially and affect its ability to exist, even in the short-term. The problem we have is in balancing the need to minimise the risks involved to consumers and investors against the ability of the regulator to bully an entity into submission simply because, although possibly legal, the regulator doesn't like what the entity is doing. The regulator should not be able to apply directions simply for its own ease of regulation. There is a huge resource imbalance between a typical ACL holder and the regulator and, given ASIC's current powers, we've already seen a number of instances whereby the regulator has

used what can only be described as tactics of abuse to force ACL holders to capitulate, agree to an Enforceable Undertaking ("EU") or be prosecuted.

If these powers are adopted, we recommend that both the Corporations Act and the National Consumer Credit Protection Act 2009 ("NCCP") be amended with either a review or sunset period and for any affected entity to have the ability to seek a review of ASIC's directions. It is an untenable position for ASIC to hold power of regulator, prosecutor and executioner simultaneously. This could be achieved by an expansion of the current opportunities for referral to the Financial Services and Credit Panel, the Administrative Appeals Tribunal ("AAT") and also, by creating an inherent right of appeal to take a matter to a Court.

As the alternative suggestion at paragraph 4 notes, the Taskforce seeks comment on ASIC's ability to make regulation-making powers that would give it "sufficient for unforeseen kinds of directions". We are of the opinion that legislation should be made by the Government and not by bureaucrats or regulators.

Answers to Questions 1 to 3

1. 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?

We believe this could assist ASIC protect consumers and investors but only if the directions are those specified in any legislation rather than those made by

regulation. Furthermore, the direction-making power assumes that there will be compliance failure. Much of what it may rely on could be circumstantial. ASIC may not know the facts and it therefore requires prejudgement. It is unclear how this would be established unless an investigation was first performed and as this could take some time, we can only envisage some of these bullying powers being used in the first instance. For this reason, we see it as imperative that any affected ACL or AFSL holder have the ability to seek a review of ASIC's directions with the Financial Services and Credit Panel as suggested above, the AAT and on appeal, to a Court at the earliest opportunity.

2. 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?

One consideration that appears to have been overlooked in the list of directions that could be sought, particularly applying to AFSL holders where there is the possibility of fraud or misappropriation, would be a direction to cease accepting further funds from clients. In some cases, this may be warranted but equally, there may be instances where this could exacerbate consumer or investor detriment because of the type of lending that has been granted.

For example, we have a number of clients that have reported unlicenced car leasing ('rent –to-buy' vehicles) and lending to ASIC but the regulator has declined to act in every instance. In such cases, such a direction should bring an errant credit provider to heel but we would have great concern if that same provision were used to stop a product being offered simply because an ASIC officer "did not like it" for some reason.

The main issue we envisage for AFSL holders, based on past occurrences, is where investors have sought out the maximum return rate possible then cried poor after losses are incurred. They want to repudiate the loan previously granted based on the risk having increased but there is no such thing as a free lunch. Investors should be willing to take the good with the bad and ASIC should not necessarily be the upholder of the law only when it's going well for investors. Investors should assess the amount of risk they are willing to accept when they take on or accept a particular financial service. Ultimately, it is their greed that's partly responsible for their adverse financial predicament and the old adage "if it looks too good to be true, then it probably is" applies. If there has been a miss-selling or other dishonest action involved, only then may it be appropriate for ASIC to become involved.

As ASIC can represent a class of consumers, it may be appropriate for it to be granted the right, in appropriate circumstances, to lodge a form of hardship claim on their behalf with any affected credit providers that limits any loss to the amount due at that time. We would see this being used judiciously.

Parliament must be the one, though, that lists what ASIC can and cannot do and there should be no additional powers to extend this via regulation. Providing the legislation contains the ability to seek review of ASIC's directions as we suggest, our main concern is then with the direction power to "establish a programme to assess claims for restitution or compensation to customers". In our view, only a Court should have the power to determine compensation unless the powers of restitution are limited.

In the case of ACL holders, that would be solely to any fees or charged by the credit provider. We cannot comment on what is appropriate for AFSL holders. If there is a need for tort claims, then ASIC must request the Court to make such decisions.

A consumer should not be put into a more advantageous position than it was prior to obtaining the credit. It must be remembered that the consumer will have, of their own volition, sought the credit from the credit provider in the first instance and the credit provider will, in all likelihood and assuming they have been compliant in meeting responsible lending and loan suitability requirements, not have coerced the consumer into accepting that credit.

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

We do not believe this should be the case. If Parliament decides which powers ASIC should have, then it should also make any amendments by way of legislative amendment and not by the wording of any 'catch-all' direction powers.

Position 2:

The directions power should be triggered where a licensee has, is or will contravene financial services or credit licensing requirements (including relevant laws)

At paragraph 5, the Taskforces "adopts as its preliminary position that the power to make a direction should be triggered where ASIC has reason to believe that an AFS or credit 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 the 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."

The problem we have with this is ASIC already takes the view that an entity that may have breached legislation previously will do so again because 'leopards don't change their spots'. So, if there has been even a minor breach beforehand, it's more than likely ASIC will form a view that the entity has again breached a legislative or regulatory requirement. This attitude can be manipulated and so it is possible to make vexatious claims to the regulator with a view to crippling the entity financially. We would assert they have already done so with some External Dispute Resolution ("EDR") 'complaints' we are aware of. Consequently, in our view, a direction relating to an entity "proposing to refuse or fail to" do something requires more of a warning rather than a penalty.

At paragraph 7, the Taskforces has suggested an alternative in the form of the "public interest" test. This concerns us greatly as the meaning of the term can be subjective and can be applied inappropriately without sufficient checks and

balances being made. The Ombudsman of New South Wales has a website page devoted to this very subject.[1]

Given ASIC's ability to bully by way of the directions it could give as part of its tactics, it would be very easy for its officers to act with impunity in the belief they do so under a public interest test of their own making. There is a general feeling in the industry that the regulator, despite now 7 years of regulatory experience, still doesn't fully understand the lending sector sufficiently. Consequently, we would argue the ability to apply such a test will further diminish industry's confidence in the regulator's actions and lead to greater uncertainty.

We will refrain from commenting in detail on the Product Intervention Power sought as we have yet to see any draft wording but given the stifling legislation and regulation applying to the types of credit offered by our members and clients, we see it will have little likelihood of ever being used on ACL holders.

Answers to Questions 4 to 5

4. 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?

[1] Ombudsman, New South Wales, 2012. "Public interest". Available online, https://www.ombo.nsw.gov.au/__data/assets/pdf_file/0014/3713/FS_PSA_16_Public_interest.pdf viewed 18 November 2017.

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?

As stated above, we do not believe ASIC should be able to use the directions powers for a proposed future event. Furthermore, the proposed non-compliance should be more than a suspicion it may be non-compliant. Consequently, ASIC should require some form of evidence, and not merely past evidence of a breach, that it could use to form an opinion it had 'reasonable belief" this new event would be non-compliant.

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

With already onerous legislative and regulatory requirements under the NCCP and NCC, we do not believe a public interest test would ever be able to be used against those lending in the non-mortgage markets or in the home appliance leasing sectors. Consequently, the objectives outlined are hypothetical.

Position 3:

ASIC should be able to apply to a court to enforce the direction and take administrative action if an AFS or credit licensee does not comply with a direction

At paragraph 10, the Taskforce has stated its preliminary position as ASIC having the ability to "apply to a court to obtain an order requiring an AFS or credit licensee to comply with the direction and/or take administrative action if a licensee does not comply with a direction made by ASIC." At paragraph 11, the Taskforce has set out what it believes to be an "appropriate process" and at paragraph 12, it claims this "affords procedural fairness".

Unfortunately, we cannot agree and are of the opinion the process is framed very much in favour of the regulator to the point that it creates the impression ASIC is always correct. Furthermore, as we have stated above, just because a process is "efficient" for ASIC doesn't necessarily make it appropriate. The regulator must be made to apply some of the same standards it expects of EDR providers – fairness, accessibility and accountability – before acting.

As stated above, we have no issue with this process in general provided that equally, the affected ACL or AFSL holder has the ability to seek a review of ASIC's directions, at a minimum, both via the AAT and on appeal, to a Court. The presumption that the regulator is always correct is an inappropriate stance to take as ASIC has found to its cost in some of the cases it has taken to Court[2].

If the legislation were to grant ASIC the power to enforce a directions order via a Court , then the legislation must also provide for the Court's ability to review ASIC's decision-making processes, determine whether the information used is accurate and the direction order appropriate in the circumstance. For that reason, we consider the suggested process as outlined inappropriate.

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[2] As examples, Australian Securities and Investments Commission v Teleloans Pty Ltd [2015] FCA 648 and Lewski v Australian Securities & Investments Commission (No 2) [2017] FCAFC 171

At paragraph 14, the Paper states the Taskforce considers that “if an AFS or credit licensee’s failure to comply with a direction was a criminal offence the following procedural requirements would be appropriate:

a. before making a direction the affected licensee should be given an opportunity to appear, or be represented at a hearing and to make submissions on the matter, as ASIC is required to do before exercising its powers to suspend, cancel or vary conditions on a licence; and
b. in urgent matters ASIC could make an interim direction without providing a hearing, but would be required to provide a hearing within a certain time frame.”

As far as we are aware, notwithstanding ASIC’s prosecution, it is only a criminal offence if a Court finds it so. Just because the legislation allows a for a criminal offence to be applied should not be a trigger to turn what would ordinarily be a civil matter into something far more serious if ASIC is not prepared to prosecute.

Whilst there is an internal review process that ASIC exercises when using its administrative powers (such as offering the licensee a hearing and ability to make submissions), in light of what we have seen occur up to now, the problem is that they may not be truly independent. For example, we’re unaware of any decision that has been referred to it being overturned. We hope the members of the Financial Services and Credit Panel will be more so when that Panel starts to act. It is imperative from both an industry and consumer perspective that the regulator should not be put in a position of being, or even perceived to be, a Kangaroo Court.

In our opinion, ASIC's recent establishment of the Financial Services and Credit Panel should be expanded so that directions order can be considered by the Panel. Furthermore, it needs to allow any licencee a mechanism to take an intended directions matter to the Panel as soon as practicable and not have to wait for ASIC to determine if it would seek some criminal penalty. In our view criminal penalties are inappropriate except in the instance of manifest dishonesty and theft.

Answers to Questions 6 to 10

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

As stated above, yes, but only if the affected ACL or AFSL holder has the ability to seek a review of ASIC's directions, both via the AAT and on appeal, to a Court.

7. 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?

If sanctions are to be applied, then a Court should be the one that imposes them. We consider that ASIC should not have the ability to apply them.

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

- ***a. criminal offence?***
- ***b. civil penalty provision?***
- ***c. breach of a financial services law or credit legislation***

and therefore a basis for administrative action?

Having carefully considered this, we are of the opinion that only civil penalties should be able to be applied for a failure to comply with a directions order. Having said that, though, we can envisage there may be some entities that would seek to abuse the process and so the Corporations Act and NCCP legislation should be amended to give a Court the power to make penalties for contempt.

In our opinion, if the matter against an ACL or AFSL holder is deemed so serious from the outset that it warrants criminal penalties, then ASIC should prosecute the entity rather than provide a directions order.

9. Should ASIC be required to give written notice to a licensee before making a direction setting out:

a. its intention to make a direction,

b. reasons, and

c. a period of time for the licensee to respond

that is reasonable in the circumstances?

Whilst we agree this should be done, the determining question here will be what is to be deemed “reasonable in the circumstances”? Based on the experience of some members, clients and non Min-IT clients, ASIC appears to have an internal policy of requiring responses from ACL holders within set periods of time (usually no more than 14 days). For some of these directions orders, we could envisage this may be insufficient time to properly respond with all the facts. For this reason, although ASIC needs to allow for such extensions as

appropriate without being necessarily over-generous, we would not want to see any set time period defined in legislative or regulatory amendments.

10. 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?

As ASIC would have to substantiate the reasons as to why it was seeking a directions order and what those directions would be, we can see this suggestion is likely to have some appeal to an affected ACL or ASL holder. Furthermore, it would give the affected entity some insight for defence should the matter go before the AAT or a Court as we propose be required. Given ASIC would want to take action as soon as practicable to prevent consumer or investor detriment, though, it would inevitably mean some delay, however slight, before the regulator could do so. We consider that a period of no more than 21 days from notification of the directions order for a hearing ought to be sufficient.

If the hearing were to validate ASIC's direct ions order, it could mean the entity cease business entirely pending an AAT or Court appeal. If notice of appeal is lodged, ASIC should be required to do everything possible to assist the matter be brought to the AAT or Court as soon as practicable. Should ASIC not be successful at an AAT or Court hearing, we consider ASIC should be required to make restitution and/or compensation and where appropriate, issue appropriate apologies as the entity will have been forced to incur expenses in order to defend itself.

We are of the belief that directions orders of the types contemplated are a serious step. As these orders are to be used as part of an arsenal of negotiating tools, ASIC should be limited in its ability to make any interim direction where no hearing is provided to a limited range of directions, such as:

a. cease accepting new clients;
b. cease accepting further funds from clients (where the circumstances are relevant);
c. being required to conduct a review or audit of an authorised representative's records; and
d. cease making specific representations about financial products or services.