



**Australian Government**

# **ASIC Enforcement Review**

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Position and Consultation Paper 3

Strengthening ASIC's Licensing Powers

28 June 2017

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## EXECUTIVE SUMMARY

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- I. A person who carries on a financial services business in Australia must hold an Australian financial services (AFS) licence, subject to certain exemptions, including where the person provides a financial service as a representative of an AFS licensee.<sup>1</sup> Similarly, a person must not engage in a credit activity unless the person holds an Australian credit licence, or engages in the activity as a credit representative or as an employee or director of a credit licensee or related body corporate.<sup>2</sup>
- II. Applications for AFS and credit licences are made to, assessed by and granted by the Australian Securities and Investments Commission (ASIC). ASIC must grant a licence if the applicant and application meet the requirements specified in the *Corporations Act 2001* (Corporations Act) and *National Consumer Credit Protection Act 2009* (Credit Act).<sup>3</sup> ASIC may refuse to grant a licence after offering the applicant an opportunity to appear or be represented at a private hearing and make submissions.<sup>4</sup>
- III. ASIC is required to have regard to a range of factors when deciding whether to grant a licence, including making an assessment of the applicant's competence and confirming that there is no reason to believe the applicant is likely to contravene its obligations as a licensee.
- IV. ASIC has, over a number of years, made submissions seeking to strengthen its licensing powers, including to the Financial System Inquiry, which recommended that ASIC be provided with stronger regulatory tools. In response, the Government stated that it would develop legislative amendments to strengthen ASIC's enforcement tools in relation to the financial services and credit licensing regimes. These included enabling ASIC to:
  - (a) approve changes of licensee control;
  - (b) consider a broader range of factors in determining whether an applicant satisfies the 'fit and proper' test to be granted a licence; and
  - (c) impose conditions on firms to address concerns about internal systems relating to serious or systemic conduct (including external reviews).<sup>5</sup>
- V. This led to the terms of reference for the ASIC Enforcement Review to include consideration of:

*"The adequacy of ASIC's powers in respect of licensing of financial services and credit providers, including the threshold for granting or refusing to grant a licence ..."*

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1 Corporations Act s.911A.

2 Credit Act s.29. A 'credit activity' is defined in s.6(1).

3 Corporations Act s.913B and Credit Act s.37.

4 Corporations Act s.913B(5) and Credit Act s.41.

5 Improving Australia's financial system - Government response to the Financial System Inquiry, Oct 2015 at page 24.

- VI. The concerns that have been raised by ASIC and considered by the Enforcement Review Taskforce include:
- (a) The fitness and propriety of controllers of licensees is not required to be assessed by ASIC when assessing a licence application or on a change of control.
  - (b) While disclosure about controllers is relevant to ASIC's licence application assessment,<sup>6</sup> the only express reference to controllers of licensees relates to an obligation on the licensee to notify ASIC within 10 business days of the licensee becoming aware of a change in control and there are no penalties for failing to comply with the obligation.
  - (c) There are different assessment powers and thresholds for assessment of AFS licence applications and credit licence applications.
  - (d) ASIC can suspend or cancel an AFS licence if a licensee ceases to carry on a financial services business but not if it does not commence carrying on a business. The Credit Act enables ASIC to suspend or cancel a credit licence if the licensee does not commence operations as well as if it has ceased carrying on the business.
  - (e) Inconsistencies between the consequences for making false or misleading statements in documents provided to ASIC in the AFS and credit contexts.
  - (f) Lack of a power to refuse a licence application on the grounds that it is false or misleading in a material particular.
- VII. The Taskforce considers that, to the extent practicable, there should be uniformity between the licensing regimes for AFS and credit licences. Licence applicants in similar circumstances should be subject to the same assessment criteria and requirements.
- VIII. The Taskforce has developed preliminary positions on a set of reforms aimed at enhancing the current regimes and achieving greater uniformity between the two regimes. These positions are:
- Position 1:** ASIC should be able to refuse a licence application (or, for existing licensees, take licensing action) if it is not satisfied controllers are fit and proper.
  - Position 2:** Introduce a statutory obligation to notify change of control within 10 business days of control passing and impose penalties for failure to notify.
  - Position 3:** Align the assessment requirements for AFS licence applications with the enhanced credit licence requirements.

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<sup>6</sup> ASIC requires a new applicant to identify any controller on its application form which then enables ASIC to consider the controllers and take into account any past conduct in determining whether ASIC believes the applicant will be able to comply with its obligations as a licensee. See s913B(1), s1308(8), ASIC's requirement that the applicant provide an organisational chart and since the Future of Financial Advice reforms, in ASIC licensing application FS01.

- Position 4:** ASIC to be empowered to cancel or suspend a licence if the licensee fails to commence business within six months.
- Position 5:** Align consequences for making false or misleading statements in documents provided to ASIC in the AFS and credit contexts.
- Position 6:** Making a materially false or misleading statement in a licence application should be a specific basis for refusing to grant the licence.
- Position 7:** Introduce an express obligation requiring applicants to confirm that there have been no material changes to information given in the application before the licence is granted.
- IX. The Taskforce has prepared these positions on a preliminary basis, and now seeks industry and community feedback prior to reaching its final conclusions and preparing recommendations to Government.
- X. The background and detailed reasons for the Taskforce's adoption of the positions set out above are described below.
- XI. The Taskforce has analysed some comparative regimes in other countries. This analysis is set out in Attachments A and B.

# 1. INTRODUCTION

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## 1.1 THE LICENSING REGIME

1. Part 7.6 of the *Corporations Act 2001* (Corporations Act) governs licensing of financial services providers. A person who carries on a financial services business in Australia must hold an Australian financial services (AFS) licence, subject to certain exemptions.<sup>7</sup> Those exemptions include where a person provides a financial service as representative of an AFS licensee, whose licence covers the provision of the service.<sup>8</sup>
2. Applications for AFS licences are made to, assessed by and granted by ASIC. ASIC must grant<sup>9</sup> an application for an AFS licence if the applicant and application meet the requirements of s 913B of the Corporations Act. Similarly, ASIC must not grant an application for an AFS licence unless those requirements are met. ASIC may refuse to grant an application for an AFS licence after offering the applicant an opportunity to appear or be represented at a private hearing and make submissions.<sup>10</sup>
3. ASIC is required under s913B of the Corporations Act to have regard to a range of factors when deciding whether to grant a licence, including making an assessment of the applicant's competence and confirming that there is no reason to believe the applicant is likely to contravene its licence obligations and financial services laws.
4. In addition, in order to grant an application for an AFS licence, ASIC must be satisfied, amongst other things, that there is no reason to believe that:
  - 4.1. if the applicant is a natural person, the applicant is not of good fame or character; or
  - 4.2. if the applicant is a body corporate, any of the applicant's responsible officers (meaning an officer who would perform duties in connection with the holding of the licence) are not of good fame or character; or
  - 4.3. if the applicant is a partnership or the trustees of a trust, any of the partners or trustees who would perform duties in connection with the holding of the licence are not of good fame or character; or
  - 4.4. if ASIC is not satisfied of the matters in 4.2 or 4.3 above that the applicant's ability to provide the financial services covered by the licence would nevertheless not be substantially impaired.<sup>11</sup>

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7 Corporations Act s.911A.

8 Corporations Act s.911A(2)(a).

9 Corporations Act s.913B also provides that ASIC must not grant such a licence unless those requirements are met.

10 Corporations Act s. 913B(5).

11 Corporations Act ss.913B(2) and (3) and the definition of 'responsible officer' in section 9. *Regulatory Guide 105: Organisational Competence* (RG 105) refers to the requirement that a licensee's responsible managers be nominated for assessment of organisational competence at the time of applying for an AFS licence or for variation of a licence and that ASIC be notified of any change in responsible managers (RG 105.14). However, a responsible manager is not necessarily a 'responsible officer' as defined in section 9 of the Corporations Act.



5. ASIC may suspend or cancel a licence if it is no longer satisfied of these matters.<sup>12</sup>
6. Chapter 2 of the National Consumer Credit Protection Act 2009 (Credit Act) governs the licensing of persons who engage in credit activities. A person must not engage in a credit activity unless the person holds an Australian credit licence, or engages in the activity as a credit representative or as an employee or director of a credit licensee or related body corporate.<sup>13</sup> As for AFS licences, applications for credit licences are made to, assessed by and granted by ASIC. Equivalent requirements to those described in paragraph 2 above apply in s37 of the Credit Act.
7. In order to grant an application for a credit licence, ASIC must, amongst other things, have no reason to believe that the applicant is not a fit and proper person to engage in credit activities. For that purpose, ASIC must have regard to a number of matters, including:
  - 7.1. whether a banning order has ever been made against the applicant under the Credit Act or the Corporations Act;
  - 7.2. if the applicant is a body corporate, whether ASIC has reason to believe that any of the directors, secretaries or senior managers<sup>14</sup> of the body corporate who would perform duties in relation to the credit activities to be authorised by the licence is not a fit and proper person to engage in credit activities;
  - 7.3. if the applicant is a partnership or the trustees of a trust, whether ASIC has reason to believe that any of the partners or trustees who would perform duties in relation to the credit activities to be authorised by the licence is not a fit and proper person to engage in credit activities.<sup>15</sup>
8. ASIC may also suspend or cancel a licence if ASIC has reason to believe that the licensee is not a fit and proper person to engage in credit activities, for which purpose ASIC must have regard to a number of matters including those set out in paragraph 7 above.<sup>16</sup>

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12 Corporations Act s.915C.

13 Credit Act s.29. A 'credit activity' is defined in s.6(1).

14 Section 5 of the Credit Act defines 'senior manager' as having the same meaning as in section 9 of the Corporations Act, where it is defined in relation to a corporation to mean a person who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation, or has the capacity to affect significantly the corporation's financial standing (and in similar terms in relation to a partnership, trust and joint venture).

15 Credit Act s.37. *Regulatory Guide 204: Applying for an varying a credit licence (RG 204)* refers to the requirement that an application for a credit licence or for variation of a licence identify a licensee's 'fit and proper people', being the people involved in the management of the credit business, and indicate which of these people are responsible managers, being the people relied on to demonstrate competence to engage in credit activities: RG 204.16 and Table 1; RG 204.34.

16 Credit Act ss. 55(1)(c) and (2)(a) and (b).

## 1.2 CONCERNS REGARDING THE LICENSING REGIME

9. ASIC has over a number of years, made submissions seeking to strengthen its licensing powers. A number of AFS licensing reforms were most recently implemented in the Corporations Amendment (Future of Financial Advice) Act 2012.<sup>17</sup> Subsequently, ASIC made further submissions about other licensing related reforms to the Financial System Inquiry (FSI).<sup>18</sup>
10. The FSI final report acknowledged ASIC's submissions and recommended that ASIC be provided with stronger regulatory tools.<sup>19</sup> The Government's response stated that it would develop legislative amendments to strengthen ASIC's enforcement tools in relation to the financial services and credit licensing regimes. These included enabling ASIC to:
  - 10.1. approve changes of licensee control;
  - 10.2. consider a broader range of factors in determining whether an applicant satisfies the 'fit and proper' test to be granted a licence; and
  - 10.3. impose conditions on firms to address concerns about internal systems relating to serious or systemic conduct (including external reviews).<sup>20</sup>

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17 See paragraph 2.16 of the Explanatory Statement to the Corporations Amendment (Future of Financial Advice) Bill 2011.

18 ASIC's submissions included providing greater clarity and discretion to refuse a licence and requiring reassessment of a licence on any change in control.

19 See Recommendation 29 of the Final Report of the Financial System Inquiry, Dec 2014.

20 Improving Australia's financial system - Government response to the Financial System Inquiry, Oct 2015 at page 24.

## 2. CONTROLLERS OF LICENSEES

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1. Control of an AFS or credit licensee means:<sup>21</sup>
  - 1.1. if the licensee is a body corporate:
  - 1.2. having the capacity to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the body corporate financial services licensee; or
  - 1.3. directly or indirectly holding more than one half of the issued share capital of the body corporate financial services licensee (not including any part of the issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital); or
  - 1.4. the capacity to control the composition of the financial services licensee's board or governing body; or
  - 1.5. the capacity to determine the outcome of decisions about the licensee's financial and operating policies (which includes the practical influence the person can exert (rather than the rights it can enforce) and any practice or pattern of behaviour affecting the financial services licensee's financial or operating policies is to be taken into account (whether or not it involves a breach of an agreement or a breach of trust)).
2. Notwithstanding the legal separation between the controller and the licensee, the controller or controllers are the directing mind and will of the licensee given they have the capacity to determine the outcome of decisions about the licensee's financial and operating policy and any practice or behaviour of the licensee. The controller also has the ability to influence the conduct and delivery of the licensee's financial services.<sup>22</sup>
3. In a number of international jurisdictions the influence that controllers and shareholders have on regulated entities is recognised through requirements to obtain regulator approval before acquiring or increasing control. For example:
  - 3.1. in the United Kingdom individuals and companies must seek prior approval from the Financial Conduct Authority to acquire or increase control in a regulated firm;
  - 3.2. a person must be approved by the Securities and Futures Commission in Hong Kong before becoming a substantial shareholder in a licensed entity;
  - 3.3. a person must obtain prior approval from the Monetary Authority of Singapore before entering into a shareholding arrangement in the holder of a capital markets licence.<sup>23</sup>

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<sup>21</sup> Corporations Regulation 7.6.04(2)(b) and the National Consumer Credit Protection Regulation 9(11).

<sup>22</sup> Corporations Regulation 7.6.04(2)(b) as discussed at para 11 above.

<sup>23</sup> See Annexure A.

## 2.1 ASSESSMENT OF CONTROLLERS OF LICENCE APPLICANTS

4. There is no express requirement for ASIC to assess whether a controller is of good fame or character, or is fit and proper to be a controller of an applicant seeking a licence, or on a change in controllers of a licensee (discussed further below). As set out above, when assessing a licence application ASIC must consider and be satisfied that:
  - 4.1. the responsible officers (directors or secretaries who perform duties in connection with holding the licence) of AFS licence applicants are of good fame and character; and
  - 4.2. the directors, secretaries and senior managers of credit licence applicants are fit and proper to engage in credit activities.<sup>24</sup>
5. There is no express requirement for ASIC to assess whether a controller is of good fame or character, or is fit and proper to be a controller of an applicant seeking a licence, or on a change in controllers of a licensee (discussed further below). As a result, there is no obligation for an applicant to make specific disclosure about the past history, conduct or character of controllers of an applicant and ASIC receives no up-front information about these matters.
6. Despite this, ASIC does require new applicants to identify any controller on its application form. ASIC then undertakes a search of its database to ascertain if it has any information regarding the character or any prior conduct known to ASIC about those individuals. If so, this conduct is taken into account in determining whether ASIC believes the applicant will be able to comply with its obligations as a licensee. The onus is on ASIC to show the causal connection.

## 2.2 CHANGE OF A LICENSEE'S CONTROLLER

7. Licensees are required by a statutory licence condition to notify ASIC within 10 business days of the licensee becoming aware of a change in control.<sup>25</sup> This is the only express obligation relating to controllers of a licensee. When complying with the notification obligation licensees are not required to provide information about, nor is there a requirement on ASIC to assess, the prior history or conduct of the new controllers or the implications for the ongoing conduct of the licensee's business.<sup>26</sup>

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<sup>24</sup> Corporations Act s.913A(3) and definition of responsible officer in s9, and Credit Act s.37(2)(h).

<sup>25</sup> Corporations Regulation 7.6.04(1)(i) and the National Consumer Credit Protection Regulation 9(10).

<sup>26</sup> Note that ASIC currently has imposed conditions that may trigger the need for a licensee to have to make an application to ASIC (e.g. a change in key person-responsible manager is a change to a condition of the licence which requires the licensee to seek a licence variation, which provides ASIC with a mechanism to assess whether the licensee remains competent).

8. A new controller has the ability to change the licensee's directors, senior managers, responsible managers and financial, technological and human resources and the licensee's policies and procedures. The business of the licensee and/or the manner in which it is conducted may materially change. This can give rise to the following:
  - 8.1. new controllers may take over an applicant that ASIC may not otherwise regard as suitable or fit and proper to control a licence had ASIC had the opportunity to review related information about the controllers before the transfer occurred. This may be problematic where the bona fides of the new controllers are questionable;
  - 8.2. a new controller can very quickly make irrelevant any or all of the factors that ASIC was required to have regard to when it assessed and granted the licence (although it remains the licensee's responsibility to ensure that it complies with its licence obligations);
  - 8.3. a licensee who changes control may no longer be fit to hold the licence, or may no longer be competent because the processes, technology and/or human resources change.
9. If after being notified of a change in control ASIC has concerns about the new controllers, ASIC must undertake a surveillance or investigation and seek relevant information or documents (for example, pursuant to a notice issued under s912C of the Corporations Act for information and/or for documents under s30 of the ASIC Act). The action available to ASIC is to seek to have the licence suspended or cancelled on the basis, amongst other things, that the licensee has not complied with its obligations under s912A of the Corporations Act or ASIC has reason to believe that it is likely to contravene those obligations.<sup>27</sup> This can be time and resource intensive.<sup>28</sup>
10. Until ASIC establishes a basis for taking action, holds a hearing and makes a decision with respect to the licence the licensee continues to provide financial services. Licensees also often continue conducting business during the period of any subsequent review by the Administrative Appeals Tribunal (AAT). In serious cases, financial consumers may be disadvantaged and/or lose money due to the provision of financial services under new controllers, who may not be competent or compliant.

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<sup>27</sup> Corporations Act ss. 915C(1)(a) and (aa).

<sup>28</sup> For example, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-293mr-asic-cancels-retail-derivative-issuers-licence/>

### **CASE STUDY 1**

An application was lodged by a body corporate subsidiary of an existing well-resourced licensee that held multiple licences within different entities in the corporate group. The application submitted that the competence and resources of the corporate group would be utilised by the subsidiary. ASIC relied on this representation in granting the subsidiary a licence in September 2015.

A week after granting the AFS licence ASIC discovered that the licensee had been sold to new controllers prior to the grant of the licence. Aside from certain minor contractual arrangements to provide 'hand-over' support for a limited period of time, the entire basis on which ASIC assessed the application (that is, having the full support and resources of the corporate group) would become irrelevant.

### CASE STUDY 1 (CONTINUED)

ASIC considered that it had been misled about material matters in the licence application and cancelled the licence in February 2016. The licensee applied to the AAT for a review of the decision, stay and confidentiality orders. In August 2016, the AAT rejected the application for a stay and confidentiality orders. The applicant then withdrew its application seeking a review of ASIC's decision to cancel the licence. As a result there was 11 months between the time ASIC became aware of significant concerns arising from a change in control and the time ASIC could publicly update its AFS licence register to indicate that the licence had been cancelled.

### CASE STUDY 2

Control of a licensee passed to an unrelated third party. At the same time the key person responsible manager resigned. ASIC had imposed a key person-responsible manager condition because the licensee was reliant on the knowledge and experience of that person to have the competence to provide the relevant financial services.

Within 10 business days of the change of controller, ASIC was notified of the change of control, and the licensee lodged a licence variation application to replace the key person with a new responsible manager. ASIC assessed the newly nominated key person and concluded that they were not competent (i.e. did not meet the organisational competence requirements in ASIC Regulatory Guide 105). The licensee then sought to recruit another key person. During this time the licensee continued to provide its authorised services.

11. ASIC considers that this has resulted in an undesirable situation where the licence becomes a commodity, independent of the value of the business operations.

### CASE STUDY 3

A new controller was prepared to pay \$150,000 for a newly incorporated body conditional on that body corporate being granted a licence with authorisations the new controller wished to possess. The new controller could have applied for its own licence at a significantly lower cost, but in doing so would have to subject its directors and responsible managers to ASIC assessment.

12. Another problem is that there are no penalties for failing to comply with the requirement to notify ASIC of a change in control. A failure by a licensee to notify of a change in control is a breach of a licence condition. However, it may be difficult for ASIC to suspend or cancel a licence merely for a failure to notify of a change in control.
13. In addition, a notification made well after the date the change of control takes effect may still comply with the licence obligation as the 10 day time frame is triggered by the licensee becoming aware of the change. A review by ASIC of a sample of 162 notifications of change of control (48% of a total of 328) between October 2015 and May 2017, indicated that:
  - 13.1. 34% (56 out of 162) notified ASIC more than 10 days after the change of control occurred;

- 13.2. 13% (21 out of 162) notified ASIC more than 50 days after the change of control occurred;
  - 13.3. 4% (7 out of 162) notified ASIC more than 100 days after the change of control occurred.
14. Establishing whether any of these notifications involved situations where the licensee became aware of the change earlier, but did not lodge a notification until more than 10 days after becoming so aware can be resource intensive and, in some, cases may be difficult.

#### **CASE STUDY 4**

In a recent surveillance<sup>29</sup> of 55 licensees in the Australian retail OTC derivative industry, ASIC found that over 60% had gone through some material change of control but 85% of those had failed to notify ASIC. Many of these licensees were smaller foreign-owned or foreign-controlled businesses who demonstrated either a lack of awareness or understanding of their Australian regulatory obligations, or reluctance to invest resources in meeting compliance obligations for their Australian businesses. It also became evident in that surveillance that many of these AFS licensees were outsourcing key aspects of their financial service to third parties. Often these third parties were related to the AFS licensees and based overseas. At times, these parties were subject to little or no regulatory oversight in the jurisdiction in which they operated.

### **POSITION 1: ASIC SHOULD BE ABLE TO REFUSE A LICENCE APPLICATION (OR, FOR EXISTING LICENSEES, TAKE LICENSING ACTION) IF IT IS NOT SATISFIED CONTROLLERS ARE FIT AND PROPER**

15. The Taskforce adopts as its preliminary position that ASIC should be able to refuse a licence application if it is not satisfied that the controllers of the applicant are fit and proper and to take licensing action if it is no longer satisfied of this, including on a change of control. To achieve this it will be necessary to:
- 15.1. enable ASIC to refuse to grant a licence (after offering a hearing) if it is not satisfied that the controllers of the applicant are fit and proper to control an AFS or credit licensee;
  - 15.2. following a change in control require licensees to provide ASIC with information to enable ASIC to assess whether the new controllers are fit and proper to control the licensee and confirmation that the licensee continues to be competent to provide the relevant services and comply with its licence obligations; and
  - 15.3. enable ASIC to suspend or cancel a licence if it is no longer satisfied that the controllers of a licensee are fit and proper to control an AFS or credit licensee.

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<sup>29</sup> ASIC Report 482 Compliance Review of Retail OTC derivatives sector at paragraph 35-36. <http://download.asic.gov.au/media/3899926/rep482-published-20-june-2016.pdf>.



## ASIC should be satisfied that controllers of licence applicants are fit and proper

16. The Taskforce considers that ASIC should be able to refuse to grant a licence (after offering a hearing) if it is not satisfied that the controllers of the applicant are fit and proper to control an AFS or credit licensee. The legislation could:
  - 16.1. expressly require ASIC to assess whether the controllers of a licence applicant are fit and proper persons to control an AFS or credit licensee;<sup>30</sup> and
  - 16.2. enable ASIC to refuse to grant the licence applied for if it is not satisfied of the fitness and propriety of the applicant's controllers.<sup>31</sup>
17. The Taskforce considers that the requirement for ASIC to assess the fitness and propriety of controllers should not require the applicant to establish that its controllers are fit and proper. Rather, the assessment that applies to responsible officers (for AFS licence applicants) and directors and senior managers (for credit licence applicants) should apply to controllers. That is, before granting a licence ASIC would have to assess and have no reason to believe that a controller is not a fit and proper person to control a licensee.
18. The licence applicant would need to provide ASIC with sufficient information about its controllers, including relating to their prior conduct, to enable ASIC to properly make this assessment.
19. Given the definition of 'control' set out in paragraph 1 above, the concept of who is a controller goes beyond merely the holding company of the licensee as the definition of control includes consideration of:
  - 19.1. the practical influence a person can exert; and
  - 19.2. any practice or behaviour affecting the licensee's operating policies.
20. Therefore in assessing controllers, ASIC would look to assessing the suitability of the individual or groups of individuals acting together who actually exercise control of a licensee.
21. After offering a hearing, ASIC could refuse to grant the licence applied for if it was not satisfied that the controllers of the applicant were fit and proper to control a licensee.<sup>32</sup>

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30 If the other positions in this paper are adopted the test for assessing individuals in AFS licence applications will consider whether the person is 'fit and proper' to hold the relevant position within the licensee, as for credit licence applications, rather than the test of 'good fame and character' that currently applies.

31 Corporations Act s. 913B(1) and (5).

32 Corporations Act s. 913B(1) and (5).

## Licensees to provide ASIC with information about new controllers

22. The Taskforce considers that following a change in control licensees should provide ASIC with information to enable ASIC to assess whether the new controllers are fit and proper to control the licensee and the licensee continues to be competent to provide the relevant services and comply with its licence obligations. This information could include the following:
  - 22.1. notification of the new controllers and the date control passed;<sup>33</sup>
  - 22.2. sufficient information about the controllers (eg police check, bankruptcy check, references, statement of personal information declaration) to enable ASIC to assess whether the proposed new controllers are fit and proper to control the licensee;<sup>34</sup> and
  - 22.3. a confirmation that the licensee remains competent and continues to have the financial, technological and human resources to provide the financial services covered by the licence and comply with its licence obligations under the new controller.
23. This information should be provided at the time the change of control is notified to ASIC.<sup>35</sup> This would ensure that ASIC receives timely information about the new controllers rather than requiring ASIC to identify whether there is a cause for concern on the basis of minimal or no information and then expend resources to identify and compel production of relevant information from the licensee after the event.
24. As stated above, the Government's response to the final report of the FSI stated that it would develop legislative amendments to strengthen ASIC's enforcement tools in relation to the financial services and credit licensing regimes, including enabling ASIC to 'approve changes of licensee control'. It is the Taskforce's preliminary position, that it is not necessary or desirable to achieve this by requiring new prospective controllers to seek ASIC approval prior to taking control or licensees to seek approval before a change of control takes place.
25. The Taskforce acknowledges regulator pre-approval is required in a number of jurisdictions as set out in paragraph 3 above<sup>36</sup> and that there may be benefits to such a requirement, which would be limited to an assessment of whether the controller was fit and proper rather than a full re-assessment of the licensee's competence or capacity. Case studies 1 and 2 above demonstrate the potential risk to financial consumers posed by the time it can take for ASIC administrative action to be finalised while a licensee continues to operate.

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33 The current notification is contained in Form FS20.

34 For an example of the information required see *Regulatory Guide 2: AFS Licensing Kit: Part 2 - Preparing your AFS licence application* paragraphs 2.283 - 2.302 and RG 204 paragraphs 204.273 - 204.279.

35 If the positions in this paper are adopted this will be within 10 business days of the change of control taking effect.

36 For more information see Annexure A.

26. If changes in control do not require pre-approval by ASIC, but ASIC becomes concerned that the new controller is not fit and proper, it is necessary for ASIC to take action to suspend or cancel the licence, which may not become effective until after a hearing has been afforded to the licensee and any subsequent review by the AAT. In addition, new controllers face uncertainty having paid valuable consideration to acquire a licence only to find out that ASIC has concerns about whether they are fit and proper.
27. Against this, while there is potential for significant changes to occur within a licensee upon a change of control that may affect the operations, policies, procedures and competency of the licensee, licensees continue to be subject to the general obligations imposed on AFS licensees by s912A of the Corporations Act and credit licensees by s47 of the Credit Act. The expectation of the Taskforce is that the majority of licensees will ensure that they continue to do this.
28. Requiring all licensees or controllers to seek pre-approval from ASIC before a change of control can occur will impose a new administrative process on all licensees that will increase the regulatory burden. This has the potential to result in increased costs for business resulting from the need to comply with a new process, increased complexity of transactions and delays associated with the new process.
29. In addition, introducing a requirement for pre-approval by ASIC will have significant resourcing implications for ASIC.

### **ASIC to take licensing action if it is no longer satisfied controllers are fit and proper**

30. If after a change of licensee control ASIC has concerns about the licensee's competence or ability to comply with its obligations it could take action to suspend or cancel the licence.<sup>37</sup> The Taskforce considers that in addition, ASIC should be given an express power to take action to suspend or cancel an AFS or credit licence if it is no longer satisfied that the controllers of the licensee are fit and proper to control the licensee. The licensee would be offered the opportunity to attend or be represented at a private hearing and make submissions before any decision is made.
31. As set out in paragraphs 4 to 5 and 7 to 8 above, currently ASIC may suspend or cancel a licence if it is no longer satisfied:
  - 31.1. in the case of AFS licensees, that there is no reason to believe that individuals assessed as part of the licence application are not of good fame or character; and
  - 31.2. in the case of credit licensees, that there is no reason to believe that individuals assessed as part of the licence application are not fit and proper to engage in credit activities.
32. If ASIC is required to assess whether the controllers of a licence applicant are fit and proper persons to control an AFS or credit licensee, it should similarly be given the ability to suspend or cancel a licence if it is no longer satisfied of this. In this way, ASIC will be provided with a basis for ongoing consideration of the fitness and propriety of controllers of licensees, including following a change in control.

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<sup>37</sup> Corporations Act s. 915C.

## QUESTIONS

1. Should ASIC be able to refuse a licence application if it is not satisfied that applicant's controllers are fit and proper to control a licensee?
2. What would be the impact of this position on licence applicants?
3. When notifying ASIC of a change of control should licensees be required to provide ASIC with sufficient information to enable ASIC to assess whether:
  - a. The proposed new controllers are fit and proper to control a licensee? and/or
  - b. The licensee remains competent to provide the financial services covered by the licence and able to comply with its obligations under the new controller?
4. Should ASIC be able to take action to suspend or cancel an AFS or credit licence (after offering a private hearing) if it is no longer satisfied that the controllers of the licensee are fit and proper to control the licensee?
5. Should a change of control require pre-approval by ASIC?

## **POSITION 2: INTRODUCE A STATUTORY OBLIGATION TO NOTIFY CHANGE OF CONTROL WITHIN 10 DAYS OF CONTROL PASSING AND IMPOSE PENALTIES FOR FAILURE TO NOTIFY**

33. The Taskforce adopts, as a preliminary position, that a statutory obligation requiring licensees to notify ASIC of changes of control within 10 business days of the change of control taking effect and penalties for failure to notify should be introduced. This would replace the existing statutory licence condition that requires notification within 10 business days of the licensee becoming aware of the change. Given the impact that a change of licensee control can have it is important that ASIC is provided with timely notifications about changes of controllers of licensees.
34. Requiring notification to ASIC within 10 business days of the change of control taking effect will provide certainty as to when the 10 day time frame commences. In addition, licensees will be required to have in place systems and procedures to ensure that they can comply with the notification requirement within the 10 day time frame. If Position 1 is adopted this will include provision of the information outlined in paragraph 22 above.
35. Imposing penalties will deter deliberate non-compliance with the notification obligation and enable ASIC to take specific action to respond to a failure to notify. Currently, the only available response is to take action to suspend or cancel the licensee's licence, which may not be appropriate or proportionate in all circumstances. A licensee's failure to notify of a change of control may be deliberate or result from a failure in processes or procedures. In either case, the conduct may not impact on the licensee's ability to provide the financial services authorised by the licence. Suspending or cancelling the licence may not always be warranted or desirable given the impact on the licensee's clients. However, it may still be appropriate for ASIC to take some form of action to deter further contraventions of the obligation by the licensee or others in the industry. ASIC should retain the ability to take licensing action for a breach of the obligation to notify of a change in control where the circumstances warrant such action.

## QUESTIONS

6. Would it be appropriate for the requirement to notify ASIC of licensee changes in control to be a statutory obligation rather than a statutory licence condition?
7. Would it be appropriate for the obligation to require notification within 10 business days of the change of control taking effect?
8. Would it be appropriate to introduce penalties for failure to notify ASIC of a change in licensee control?
9. If so, what penalties should apply? Should the penalty be criminal, civil penalty or both?

## 3. LICENCE APPLICATIONS

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### 3.1 ASSESSMENT REQUIREMENTS

1. The Corporations Act provides for different assessment powers and thresholds for assessment of AFS licence applications than those that apply to credit applications. Those differences include the following, which are described further in Table 1 below:
  - 1.1. The assessment of persons involved with the applicant extends to responsible officers for AFS licence applications and directors, secretaries and senior managers for credit licence applications;
  - 1.2. Individuals are assessed against a good fame or character test in AFS licence applications and a fit and proper test in credit licence applications.<sup>38</sup> A fit and proper test is adopted in a number of international jurisdictions as set out in Annexures A and B;
  - 1.3. If ASIC considers that the responsible officers of a body corporate, partners of a partnership or trustees of a trust are not of good fame and character it must also assess whether the applicant's ability to provide the financial services covered by the licence would nevertheless not be significantly impaired.<sup>39</sup> However, where ASIC has reason to believe that relevant individuals are not fit and proper to engage in credit activities there is no requirement to also consider whether the applicant's ability to engage in credit activities would nevertheless not be impaired;
  - 1.4. ASIC can require an audit report from credit licence applicants but not AFS licence applicants;
  - 1.5. Failure to provide additional information requested by ASIC results in a deemed withdrawal of credit licence applications but not AFS licence applications.
2. These differences are largely the result of enhancements being adopted in the implementation of the credit licence regime after having regard to the administration of the AFS licensing regime, which had been in existence for eight years when the credit licence regime was designed and implemented. ASIC's experience of administering the credit licence regime since 2010 is that these enhancements make that regime more robust than the AFS licensing regime.

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<sup>38</sup> The good fame or character test is limited to assessment of AFS licence applications under Chapter 7.6 of the Corporations Act. It is also used in relation to bannings under sections 920A and 920B of the Corporations Act. The Credit Act and the auditor and liquidator registration requirements in the Corporations Act use the 'fit and proper' test. See sections 1280 (auditors) and s1282 (liquidators) of the Corporations Act.

<sup>39</sup> Corporations Act s.913B(3)(a) and (b).

**CASE STUDY 5**

In *George and Australian Securities and Investments Commission* [2014] AATA 167, the relevant misconduct included dishonest conduct in relation to deposit guarantee applications and falsification of documents provided by Mr George to support the applications.

An assessment of the misconduct under the 'fit and proper person' test resulted in the AAT concluding that, as a result of the dishonest nature of the conduct in the relevant credit applications and the falsification of supporting documents, Mr George was not a fit and proper person (at p86).

However, an assessment of the same misconduct under the 'good fame or character' test led the AAT to conclude that Mr George was of good fame and character. Mr George's genuine remorse and numerous character witnesses lead the AAT to conclude that the misconduct, "whilst dishonest, was out of character; [and] it did not justify a finding that there is reason to believe he is not of good fame or character" (at p80).

In contrast, *Frugtniet v Australian Securities and Investments Commission* [2016] FCA 995 was an appeal against an AAT decision to uphold permanent banning orders against Mr Frugtniet. It was submitted that the AAT had taken into consideration matters which were not relevant to the operation of the Credit Act, particularly with regard to a number of non-disclosures.

The court held that "there is no question that a person's conduct and character in non-credit activities might bear upon that person's fitness and propriety to carry out credit activities, in the sense that it is probative of likely future conduct" (at p92).

The court also stated that "it is quite plain that the legislature intended [to]... confer broad scope to ASIC in its consideration of whether a person is a fit and proper person to carry out credit activities". (at p34).

### **POSITION 3: ALIGN THE ASSESSMENT REQUIREMENTS FOR AFS LICENCE APPLICATIONS WITH THE ENHANCED CREDIT LICENCE ASSESSMENT REQUIREMENTS**

3. The Taskforce adopts, as a preliminary position, that there should be uniformity in the assessment requirements for AFS and credit licence applications. The Taskforce considers that there are no policy reasons for treating them differently and that licence applicants in similar circumstances should be subject to the same assessment criteria and requirements. To the extent practicable, the requirements should be universal for both types of licence applicants.
4. To achieve this the AFS licence assessment criteria in the Corporations Act should be updated and made consistent with the equivalent and enhanced provisions adopted in the Credit Act in 2010. This will require amendments to the Corporations Act as follows:

**Table 1**

<b>Corporations Act – AFS licence applications</b>	<b>Credit Act – Credit licence applications</b>	<b>Proposed amendments to s913B of the Corporations Act</b>
<p>1. ASIC looks at the:</p> <ul style="list-style-type: none"> <li>• natural person applicant;</li> <li>• responsible officers of a body corporate applicant;</li> <li>• natural person partners of partnership applicants; and</li> <li>• natural person trustees of trust applicants.<sup>40</sup></li> </ul>	<p>ASIC looks at the:</p> <ul style="list-style-type: none"> <li>• natural person applicant;</li> <li>• directors, secretaries and senior managers of a body corporate applicant;</li> <li>• natural person partners of partnership applicants; and</li> <li>• natural person trustees of trust applicants.<sup>41</sup></li> </ul>	<p>Amend subsection 913B(3)(a)(i) from “responsible officer” to “director or secretary and senior manager” of body corporate applicants.</p>
<p>2. ASIC has regard to whether the above persons are of “good fame or character”.<sup>42</sup></p>	<p>ASIC has regard to whether the above persons are “fit and proper” to engage in credit activities.<sup>43</sup></p>	<p>Change the test of “good fame or character” to the “fit and proper” test.</p>
<b>If Position 1 is adopted the above will be extended to ‘controllers’ for AFS and credit licence applications.</b>		
<p>3. Where ASIC has reason to believe that individuals associated with the AFS licence applicant are not of good fame and character it must also consider whether the applicant’s ability to provide financial services will nevertheless not be significantly impaired.<sup>44</sup></p>	<p>No requirement to consider whether the applicant’s ability to engage in credit activities would nevertheless not be significantly impaired after forming a reasonable belief that individuals are not fit and proper to engage in credit activities.</p>	<p>Remove the requirement to consider whether an AFS licence applicant’s ability to provide financial services would nevertheless not be significantly impaired after forming a reasonable belief that individuals are not of good fame and character (or fit and proper if the test is amended).</p>
<p>4. ASIC has no express power to request an audit report. There is a ‘catch-all’ power to request any additional information in relation to matters that can be taken into account in deciding whether to grant the licence.<sup>45</sup></p>	<p>ASIC can expressly request an audit report as well as any additional information in relation to any matters that ASIC may have regard to in deciding whether to grant the licence.<sup>46</sup></p>	<p>Include an express power for ASIC to require an audit report as well as any additional information in relation to any matters that ASIC may have regard to in deciding whether to grant the licence.</p>
<p>5. No deemed withdrawal mechanism for failure to comply with ASIC’s request for additional information.</p>	<p>Deemed withdrawal where the applicant does not lodge the additional information requested by ASIC, including an audit report.<sup>47</sup></p>	<p>Include a deemed withdrawal where there is a failure to provide additional information requested by ASIC.</p>

40 Corporations Act ss.913B(2) and (3).

41 Credit Act ss.37(1)(g) and (h).

42 Corporations Act ss.913B(2) and (3).

43 Credit Act s.37(1)(c).

44 Corporations Act ss.913B(3)(a) and (b).

45 Corporations Act s.913B(1)(ca).

46 Credit Act s.37(4).

47 Credit Act s.38(5).



**QUESTIONS**

10. Should the assessment requirements for AFS and credit licence applications be uniform? Or are there factors relevant to each sector that justify differences?
11. If so, should the Corporations Act be amended to reflect the provisions of the Credit Act with respect to licence applications? In particular should:
  - a. directors, secretaries and senior managers, rather than only responsible officers be assessed for AFS licence applications?
  - b. individuals be assessed against a 'fit and proper' rather than a test of 'good fame or character' for AFS licence applications?
  - c. the requirement to consider whether an AFS licence applicant's ability to provide financial services would nevertheless not be significantly impaired after forming a reasonable belief that individuals are not of good fame and character (or fit and proper) be removed?
  - d. ASIC be able to require an audit report from AFS licence applicants?
  - e. a failure to provide additional information requested by ASIC result in a deemed withdrawal of an AFS licence application?
12. What will be the impact on AFS licence applicants?

**3.2 DORMANT LICENCES**

5. Section 915B(1)(a) of the Corporations Act enables ASIC to immediately suspend or cancel an AFS licence where a licensee ceases to carry on a financial services business. ASIC can also immediately suspend or cancel a licence where a credit licensee *has not commenced*, or has ceased to carry on a credit business under s54(1)(b) of the Credit Act (emphasis added).
6. The lack of a power to suspend or cancel an AFS licence if a licensee fails to commence carrying on the business of providing financial services provides entities with an opportunity to 'warehouse' a licence. This can have the effect of commoditising the licence by making it attractive for holders to obtain and subsequently sell the licensee. This also impacts on ASIC's resources, which are expended to assess an application for which there may be no present intention to commence operations.
7. While the Credit Act enables ASIC to immediately suspend or cancel a credit licence if the licensee does not commence operations (as well as if it has ceased carrying on the business), there is a lack of certainty as to when it may be expected that a licensee should have commenced to conduct a business. Greater certainty would benefit licensees and ASIC.

**POSITION 4: ASIC TO BE EMPOWERED TO CANCEL OR SUSPEND A LICENCE IF THE LICENSEE FAILS TO COMMENCE BUSINESS WITHIN SIX MONTHS**

8. The Taskforce adopts, as a preliminary position, that ASIC should be able to immediately cancel or suspend an AFS licence and credit licence if the licensee:
  - 8.1. has not commenced to engage in a financial services or credit business within six months of being granted a licence to do so; and

- 8.2. has ceased to carry on a financial services or credit business.
9. Licensees should be given the ability to seek an extension of time from ASIC where a licensee is unable to commence its business within the six month time frame. The extension should be sought before the expiry of the initial six month period.
10. This will address the issue of 'warehousing' AFS licences as discussed above and provide certainty for AFS and credit licensees as to when ASIC's power to suspend or cancel a licence for failure to commence engaging in business will arise.

#### QUESTIONS

13. Should ASIC be able to immediately suspend or cancel an AFS or credit licence if the licensee fails to commence engaging in a financial services or credit business within six months of being granted a licence?
14. If so, should licensees be given an opportunity to seek an extension of time?
15. Is six months an appropriate initial time frame?

### 3.3. FALSE AND MISLEADING APPLICATIONS

11. It is not uncommon for ASIC to identify through a licence assessment process that an applicant has provided ASIC with false or misleading information. For example, ASIC has received applications that include the provision of false bank documents purporting to be issued by a major bank; false education and qualification certificates; false declarations relating to a person's past involvement in failed companies or their bankruptcy status (including prior and current bankruptcies and false business references).

#### False or misleading credit licence applications

12. Section 225 of the Credit Act sets out a number of civil penalty provisions and offences relating to the lodgement of documents with ASIC that apply to credit licence applications, including:
  - 12.1. making or authorising the making of a statement in a document where the person knows or is reckless as to whether the statement is false or materially misleading, omits a matter or thing that makes the statement materially misleading or is based on information that is false or materially misleading;<sup>48</sup>
  - 12.2. omitting or authorising the omission of a matter from a document where the person knows or is reckless as to whether, without that matter, the document is false or materially misleading;<sup>49</sup>
  - 12.3. a requirement that a person take reasonable steps to ensure that they do not do the things described above.<sup>50</sup>

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48 Credit Act ss.225(2)(a) and (3).

49 Credit Act ss.225(2)(b) and (4).

50 Credit Act ss.225(5) and (6).

13. A person who is reckless as to the matters described in paragraphs 12.1 and 12.2 is liable to a civil penalty, while a person who has actual knowledge may have committed a criminal offence or be liable to a civil penalty. A failure to comply with the requirement to take reasonable steps may give rise to a civil penalty or criminal offence of strict liability with a maximum penalty of 5 penalty units. Liability for civil penalty breaches of s225 of the Credit Act may give rise to a penalty of up to 2,000 penalty units.

### False or misleading AFS licence applications

14. Section 1308 of the Corporations Act sets out a number of offences relating to false or misleading statements made to ASIC, including:
- 14.1. in a document required by the Corporations Act or lodged or submitted to ASIC:
  - 14.2. making or authorising the making of a statement that to the person's knowledge is false or misleading in a material particular;
  - 14.3. omitting or authorising the omission of any matter or thing which to the person's knowledge makes the document materially misleading; or
  - 14.4. making or authorising the making of a statement that is based on information that the person knows is false or misleading in a material particular or omits a matter or thing that renders the information misleading in a material respect;<sup>51</sup>
  - 14.5. failing to take reasonable steps to ensure that a person does not do the things described in paragraph 14.1 above;<sup>52</sup>
  - 14.6. in connection with an application for an AFS licence:
  - 14.7. making a statement that is false or misleading knowing it to be so; or
  - 14.8. omitting to state any matter or thing knowing that the omission will render the application false or misleading.<sup>53</sup>
15. A person who engages in conduct described in paragraph 14.1 is liable to a criminal penalty of 200 penalty units, imprisonment for 5 years or both. However, making false or misleading statements in AFS licence applications (as described in paragraph 14.6) is a strict liability offence of 5 penalty units for an individual and 25 for a company.<sup>54</sup>

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<sup>51</sup> Corporations Act s.1308(2) and (3).

<sup>52</sup> Corporations Act s.1308(4).

<sup>53</sup> Corporations Act s.1308(8). This offence also applies to statements made in applications for Australian CS facility and market licences.

<sup>54</sup> Section 1308(8) dealing with statements made in connection with AFS licence applications falls under the general penalty provided for in s1311 of the Corporations Act.

## Specific licence provision v general document provision

16. As set out in paragraph 14.6 above s1308(8) of the Corporations Act specifically covers statements made in respect of AFS licence applications and provides for a lesser penalty of 5 penalty units. This suggests that the specific power should be used in respect of licence applications rather than the general powers also set out in s1308 of the Corporations Act. As a result there is a significantly lower penalty for making a false statement in an AFS licence application than for making a false statement in a credit licence application or any other document required to be lodged with ASIC.
17. This approach is in contrast with s225 of the Credit Act which makes no distinction between licence applications, licence variation applications and other documents lodged with ASIC. The Explanatory Memorandum to the Credit Act used the following licensing example to illustrate the effect of s225, indicating that there is no distinction drawn by the legislature between a licence application and other documents lodged with ASIC in a Credit Act context:

*“Brigitte's Home Loans Pty Ltd's application for a licence to engage in credit activities recklessly fails to disclose details of a director who will perform duties in relation to those credit activities if the registration is granted. Without inclusion of this information, the application is false in a material particular or materially misleading. ASIC may therefore seek a civil penalty from the court against Brigitte's Home Loans Pty Ltd of up to \$1.1 million. In addition, ASIC may reject the application for a licence.”<sup>55</sup>*

18. In addition, the differences between the Credit Act provision and Corporations Act provision identify the following problems with ASIC's ability to take action when false or misleading statements are made in AFS licence applications:

**Recklessness** - False statements in AFS licence applications are not subject to the prohibition on reckless statements. Section 225(2) of the Credit Act provides that a person must not make a statement that a person knows 'or is reckless as to whether' a statement is false or misleading or contains a material omission. Section 1308 of the Corporations Act covers a person knowingly making a false statement but does not address whether the person is reckless as to whether a statement is false or misleading or contains a material omission;

**Reasonable steps to verify information** - The Corporations Act (s1308(4)) and the Credit Act (s225(5)) impose a requirement that a person making a statement or authorising the making of a statement take reasonable steps to ensure that a document submitted to ASIC does not contain a false or misleading statement or a material omission which renders a document materially misleading. However, it is not clear whether s1308(4) applies to statements made in a licence application for the purposes of 1308(8);

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55 Explanatory Memorandum to the National Consumer Credit Protection Bill, 2009 at para 5.1.

**Authorising a statement** - Sections 1308(2) of the Corporations Act and s225(2) of the Credit Act extend the prohibition on false or misleading statements and material omissions to persons who authorise the making of the statement. However, s1308(8) makes no reference to a person authorising a statement that is false or misleading or contains a material omission and only refers to the person making the statement. This leaves open the risk that a director authorising a false statement in a licence application but not personally making a statement to ASIC is not subject to the prohibition in s1308(8);

- 18.1. There are low specific criminal penalties for issues arising from AFS licence applications as opposed to other documents lodged with ASIC under the Corporations Act and the Credit Act;<sup>56</sup>
- 18.2. False statements in AFS licence applications are not civil penalty provisions and do not attract the penalty of 2000 penalty units that apply to false statements made in credit licence applications.

## **POSITION 5: ALIGN CONSEQUENCES FOR MAKING FALSE OR MISLEADING STATEMENTS IN DOCUMENTS PROVIDED TO ASIC IN THE AFS AND CREDIT CONTEXTS**

19. The Taskforce adopts, as a preliminary position, that the consequences for making false or misleading statements in documents provided to ASIC in the AFS and credit contexts should be the same. This should apply with respect to statements made in licence applications, licence variation applications and any other document lodged with ASIC. The AFS and credit licensing regimes impose similar standards of conduct on those wishing to offer licensed services and similar consequences for breaching those obligations. The process for applying for an AFS and credit licence are also similar. If Position 5 in this paper is adopted the assessment criteria will be aligned. Accordingly, the consequences for misleading ASIC should also be aligned between the Corporations Act and Credit Act.
20. This will require amendments to the Corporations Act to address the issues identified in paragraphs 16 and 18 above so that there is no specific provision that applies with respect to false or misleading statements made in AFS licence applications and/or to ensure that:
  - 20.1. recklessness as to whether a statement is false or misleading or contains a material omission is prohibited;
  - 20.2. a person making a statement or authorising the making of a statement is required to take reasonable steps to ensure that a document submitted to ASIC does not contain a false or misleading statement or a material omission which renders a document materially misleading;
  - 20.3. authorising a statement in an AFS licence application that is false or misleading or contains a material omission is prohibited.

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<sup>56</sup> Section 1308(8) dealing with statements made in connection with AFS licence applications falls under the general penalty provided in s1311 of the Corporations Act. This is a strict liability offence of only 5 penalty units for an individual and 25 for a company.

21. In addition, the Taskforce considers that the penalties for misleading ASIC in AFS licence applications should be consistent with the penalties that apply for misleading ASIC in any other circumstance and are aligned with those that currently apply with respect to false or misleading statements in the Credit Act. To achieve this it will be necessary to increase the applicable criminal penalty and introduce similar civil penalty consequences to those that apply in section 225 of the Credit Act (as described in paragraph 13 above).

#### QUESTIONS

16. Should the consequences for making false or misleading statements in documents provided to ASIC in the AFS and credit contexts be aligned?
17. Should the same penalties, including a combination of criminal and civil penalties, apply?

### **POSITION 6: MAKING A MATERIALLY FALSE OR MISLEADING STATEMENT IN A LICENCE APPLICATION SHOULD BE A SPECIFIC BASIS FOR REFUSING TO GRANT THE LICENCE**

22. The Taskforce adopts, as a preliminary position, that the making of a materially false or misleading statement in an AFS or credit licence application should be a specific ground for ASIC to refuse to grant a licence.
23. Currently, there is no express power to refuse a licence application if an application is false or misleading in a material particular. ASIC must rely on the general test<sup>57</sup> and the false or misleading statement would provide a basis for ASIC to have reason to believe that the applicant is likely to contravene its licence obligations. Licence applicants may seek to argue that the relevant conduct was inadvertent, not serious or that the circumstances leading to the making of the statement have been remediated and therefore the conduct does not impact on the applicant's ability to comply with its licence obligations.

#### CASE STUDY 6

An applicant applies for an AFS licence with an authorisation to provide advice in relation to OTC derivatives to retail clients. The application submits that the applicant's nominated responsible manager has experience in providing this type of advice based on their past employment.

A review of the authorisations of the nominated responsible manager's past employers indicates that those licensees were not authorised to advise retail clients on OTC derivatives. When questioned, the applicant withdrew the nomination of the responsible manager for that authorisation and hired another responsible manager with the relevant experience. Given that the application is now in order, ASIC is unable to refuse to grant the licence.

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<sup>57</sup> Corporations Act s.913B(1)(b) and Credit Act s.37(1)(b).

24. Expressly including a power for ASIC to refuse an application if the information relating to the application (by statement or omission) or documents accompany the application, are false or misleading in a material particular, in effect creates a presumption that a licence applicant who engages in conduct of this kind cannot satisfy a reasonable belief that they will comply with their licence obligations. The Taskforce considers that this may be appropriate given that an application for an AFS or credit licence is the applicant's first engagement with ASIC and step as a prospective licensee who is seeking to be given the right to provide licensed services.
25. This proposal would mean that once ASIC is satisfied that the information or document was false or misleading in a material particular it may refuse to grant the licence, after offering the applicant an opportunity to attend a hearing and make submissions.

#### QUESTION

18. Should ASIC be able to refuse to grant an AFS or credit licence if the application or documents accompanying the licence application are false or materially misleading?

## 4. UPDATING LICENCE APPLICATIONS

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1. An AFS and credit licence application or a request to vary an existing licence may take months to finalise. During this period the applicant's circumstances may change. Those changes may relate to significant matters on which the licensee has relied to satisfy ASIC that it can meet the requirements to be granted a licence, including changes in the applicant's financial position, changes of directors or managers, changes in control or entering into negotiations to change control or business plan changes. A further relevant example may be the termination of contractual arrangements with a key third party on which the applicant relies in order to provide its financial services efficiently, honestly and fairly.<sup>58</sup>
2. The Corporations Act and the Credit Act do not specify that licence applicants or applicants seeking a licence variation are required to take steps to update or maintain the accuracy of statements made in an application during the period of assessment by ASIC.<sup>59</sup> This can lead to situations in which the applicant fails to update significant matters on which the applicant has relied to satisfy ASIC that it can meet the requirements to be granted a licence.

### CASE STUDY 7

ASIC sought additional information about the potential sale of the body corporate applicant. The applicant asserted that this was not a relevant consideration in ASIC's assessment under s913B of the Corporations Act.

### CASE STUDY 8

A key person-responsible manager of an applicant gave notice of their intention to resign prior to the grant of a licence, but with effect shortly after the grant of the licence. The applicant did not notify ASIC of a change in key person-responsible manager until after the licence was granted.

3. Although it is not a view that ASIC accepts, ASIC has experienced applicants attempting to argue that there is no requirement to update or correct a statement that was accurate when it was made. The obligation not to mislead depends on the applicant's state of mind at the time the application is made, rather than an obligation to correct any statements that subsequently become misleading due to a change in circumstances.

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<sup>58</sup> See s135(3) of the Hong Kong Securities and Futures Ordinance referred to in para 97 above.

<sup>59</sup> This may be contrasted with the ongoing notification obligations for a number of matters specified in Corporations Regulation 7.6.04 (e.g. the licensee's financial position, changes to particulars entered on a register, a change of control of the licensee) and the Credit Act Regulation 9.



**CASE STUDY 9**

A body corporate applicant failed to disclose to ASIC that it had become aware that its controllers (who were directors and responsible managers of the applicant) had signed an agreement to dispose of control of the applicant. The application submitted that the applicant would rely on the competence of the current directors and the financial, technical and human resources of the corporate group controlled by the existing controllers.

The applicant argued that when it applied for the licence, there was no intention to dispose of the applicant. ASIC had no information about the new controllers or the personnel that it would engage to comply with its obligations, and had to undertake a fact find in order to form a view about whether there was a reason to believe that the applicant, under the new controllers, was likely to or not contravene its licence obligations.

**POSITION 7: INTRODUCE AN EXPRESS OBLIGATION REQUIRING APPLICANTS TO CONFIRM THAT THERE HAVE BEEN NO MATERIAL CHANGES TO INFORMATION GIVEN IN THE APPLICATION BEFORE THE LICENCE IS GRANTED**

4. The Taskforce adopts, as a preliminary position, that applicants seeking an AFS or credit licence or to vary an existing licence should have an express obligation to confirm, before the licence or variation is granted, that there have been no material changes in the applicant's circumstances that would render statements or information in the application to be false or materially misleading. The confirmation could be provided at the end of the assessment period after the applicant has been provided with a draft of the licence that ASIC proposes to grant. The granting of the licence would be subject to provision of the applicant's confirmation as to the currency and accuracy of the information in the application (and any other matters required by ASIC in the relevant circumstances).
5. This will ensure that ASIC's decision to grant a licence or licence variation is based on up to date material information about the circumstances of the applicant, particularly with respect to the arrangements on which the applicant relies to satisfy ASIC that it can comply with its obligations as a licensee.

**QUESTION**

19. Should applicants seeking an AFS or credit licence or to vary an existing licence have an express obligation to confirm, before the licence is granted, that there have been no material changes in the applicant's circumstances that would render statements or information in the application false or materially misleading?
20. Alternatively, should applicants be required to notify ASIC of material changes in the applicant's circumstances on an ongoing basis between the time of lodging an application for a licence or licence variation and ASIC making a decision with respect to the application?

# ANNEXURE A – APPROACHES TO CONTROLLERS IN OTHER JURISDICTIONS

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## UNITED KINGDOM – FINANCIAL CONDUCT AUTHORITY (FCA)

1. Individuals and companies that wish to acquire or increase control in a firm regulated by the FCA must seek prior approval to do so (s178 of the Financial Services and Markets Act 2000 (FS&M Act)). There is also a statutory obligation to notify the FCA of proposed or actual changes in control.
2. A firm must also notify the appropriate regulator immediately upon becoming aware of any of the following matters in respect of one or more of its controllers:
  - 2.1. If a controller or entity subject to their control has been the subject of legal action or investigation that questions integrity;
  - 2.2. If there is a significant deterioration in the financial position of a controller;
  - 2.3. If a corporate controller undergoes a substantial change or series of changes in its governing body.
3. The FS&M Act provides that a person acquires or increases control over a UK authorised person ('A') in circumstances where the acquirer 'holds 10% or more of the shares in A', or controller of an authorised person, and 'is able to exercise significant influence' over either A or the controller by virtue of that shareholding or of voting power in either A or the parent entity.<sup>60</sup>
4. A relevant individual or organisation must lodge a statutory notice of control in writing, and including 'such information and be accompanied by such documents as the Authority may reasonably require'.<sup>61</sup> In lodging a notice, the relevant person / entity must provide supporting documents, including, but not limited to, post-transition structure charts, CV's for relevant individual controllers / directors / members, proof and source of funding, accounts for corporate controllers, a comprehensive business plan, negative disclosure supporting documents (for example, insolvency) (see s182 of the FS&M Act).
5. Within three months, the FCA must determine whether 'to approve of the person... to which the notice relates' or 'serve a warning notice' (see s183 of the FS&M Act). A warning notice is imposed in circumstances where approval will only be granted 'subject to such conditions as the Authority considers appropriate'.<sup>62</sup> If the FCA is not satisfied that such conditions have been complied with, it has the power to lodge a notice of objection to the change in control (see s187 and 188 of the FS&M Act).
6. It is a criminal offence to acquire, increase or cease control without notifying the FCA first, and to fail to obtain prior approval in those circumstances (see s191F of the FS&M Act).

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<sup>60</sup> *Financial Services and Markets Act 2000* s 179, 180.

<sup>61</sup> *Financial Services and Markets Act 2000* s182.

<sup>62</sup> *Financial Services and Markets Act 2000* s185.

## HONG KONG – SECURITIES AND FUTURES COMMISSION (SFC)

7. Section 131(1) of the Securities and Futures Ordinance (SFO) provides that a person shall not become and continue to be a substantial shareholder of a corporation licensed under s116 without first being approved by the SFC under s132(1).
8. If a person becomes a substantial shareholder without the SFC's prior approval then:
  - 8.1. if the person became a substantial shareholder by transfer, issue, or right to be issued with, shares, unless and until the SFC provides approval, the voting rights conferred by the shares are not exercisable (s131(4)); and
  - 8.2. the SFC may direct the licensee corporation to prevent the involvement of the person in the management of the business, deem void any votes cast by the person and their associates at meetings, and to take such steps as the SFC may specify (s s133(1)).
9. The SFO uses a fit and proper test which it applies to a range of persons<sup>63</sup> including substantial shareholders of a licensed corporation (s120(3), 126(2) and 132(2) of the SFO).

## SINGAPORE – MONETARY AUTHORITY OF SINGAPORE (MAS)

10. Section 97A of the Securities and Futures Act (Chapter 289) (S&F Act) provides that: "No person shall enter into any [shareholding] arrangement in the holder of a capital markets services licence... unless they have obtained the prior approval of the Authority."
11. The Authority must be satisfied that: the applicant is a fit and proper person to have effective control of the licence holder, the licence holder would continue to conduct its business prudently and competently with the provisions of the Act, and the applicant satisfies any other criteria that may be prescribed. In addition, the Securities and Futures (Licensing and Conduct of Business) Regulations, it appears that the holder of a capital markets services licence shall ensure that its substantial shareholders or equivalent persons are fit and proper persons (Regulation 14A).
12. Any approval granted by the Authority may include any condition the Authority determines, including restrictions on the exercise of voting power or disposal or acquisition of shares or voting power.
13. Section 99AB of the S&F Act provides that a transferor may transfer the whole or any part of its business to a transferee if:
  - 13.1. The Authority has consented to the transfer;
  - 13.2. The transfer involves the whole or any part of the business of the transferor that is the usual business of a holder of a licence; and
  - 13.3. The Court has approved the transfer.

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<sup>63</sup> Persons include licensed representatives, responsible officers and substantial shareholders of a licensed corporation.

14. And s99AC of the S&F Act provides that the transferor may only apply to the Court for approval after it has obtained the consent of the Authority under ss99AB(1)(a).
15. Section 97B provides that the Authority may serve a written notice of objection on any such person if it satisfied that the person has failed to comply with any prescribed conditions, is not or has ceased to be a fit and proper person, has ceased to satisfy other criteria, has provided false or misleading information etc.
16. Any person served such a notice must take the necessary steps to cease to be shareholder or controller, or comply with any other requirements specified by the Authority.
17. Failure to comply with such a notice is guilty of an offence and will be liable on conviction to a maximum fine of \$150,000 or to imprisonment up to 3 years or both.

### **CANADA (ONTARIO) – ONTARIO SECURITIES COMMISSION**

18. A change to one or more of a licensee's directors, officers, partners of a partnership or a principal broker requires notification to the OSC within 5 days of the change occurring. If no notification by the 5 day deadline pecuniary penalties apply.

## ANNEXURE B – APPROACHES TO DISCLOSURE IN LICENCE APPLICATIONS IN OTHER JURISDICTIONS

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### UNITED KINGDOM – FINANCIAL CONDUCT AUTHORITY

1. The Financial Services and Markets Act 2000 (FS&M Act) adopts the term “fit and proper” person test (s41 of the FS&M Act, section 5 of Schedule 6 to the FS&M Act) which has regard to subject to the "fit and proper" person test, which considers honesty (and openness regarding self-disclosures), integrity and reputation, competence and capability and financial soundness.
2. An approved person is an individual approved by the FCA under s59 of the FS&M Act to perform controlled functions for a licensee.<sup>64</sup> The FCA will only approve a person to engage in controlled activities on behalf of a licensee if it is satisfied that one of the following conditions are met:
  - 2.1. Authorisation would enable the person responsible to exercise a significant influence on the conduct of the licensee's affairs in relation to the regulated activity;
  - 2.2. The individual deals with the customers of the licensee 'in a manner substantially connected with the carrying on of the regulated activity'; and
  - 2.3. The individual will be dealing with the property of customers of the licensee 'in a manner substantially connected with the carrying on of the regulated activity'.<sup>65</sup>
3. A firm can be an approved person if they are a corporation that acts either as director or partner within the governance structure of a firm.
4. It does not have to be an officer of the company, but the number of approved persons depends on the number of 'controlled activities' the licensee wishes to engage in.
5. The FCA can:
  - 5.1. “At any time after receiving an application and before determining it, the Authority may require the applicant to provide it with such further information as it reasonably considers necessary to enable it to determine the application.” (s51(4) of the FS&M Act);
  - 5.2. “[make] different directions, and different requirements imposed, in relation to different applications or categories of application (s51(5) of the FS&M Act); and
  - 5.3. “[t]he Authority may require an applicant to provide information.... in such form, or to verify it in such a way, as the Authority may direct” (s51(6) of the FS&M Act).

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<sup>64</sup> *Financial Services and Markets Act 2000* s64(13).

<sup>65</sup> *Financial Services and Markets Act 2000* s59(5),(6) and (7).

## HONG KONG – SECURITIES AND FUTURES COMMISSION

6. The Securities and Futures Ordinance (SFO) uses the term 'fit and proper'.
7. The fit and proper test applies to licensed representatives, responsible officers and substantial shareholders of a licensed corporation (s120(3), 126(2) and 132(2) of SFO).
8. The Fit and Proper Guidelines and the core matters to which the SFC will have regard include an individual's financial status or solvency, educational or other qualifications or experience regarding the nature of the functions to be performed, ability to carry on the regulated activity **competently, honestly and fairly** and reputation, character, reliability and financial integrity (see para 3.1 of the Fit and Proper Guidelines).
9. The Fit and Proper Guidelines apply to a number of persons including the following: an individual who applies for a licence under Part V of the SFO, a licensed representative who applies for approval or is approved under Part V of the SFO, a corporation which applies for a licence or is licensed under Part V of the SFO (see paragraph 2.1 of the Fit and Proper Guidelines).
10. The Fit and proper test must be applied to individual applicants, corporate applicants and any of its officers or if a financial institution, its directors, chief executive, managers and executive officers (see para 3.2 of the Fit and Proper Guidelines).
11. Section 128(1) of the SFO provides that "A person who applies for a licence or registration shall provide the SFC with such information as the SFC may reasonably require enabling it to consider the application". Section 128(3) goes on to provide the SFC with the power to make rules for information to be provided by an applicant for the purposes of assessment.
12. Also, s135(3) of the SFO provides: "where a person has provided any information to the Commission under any provision of this Part and a change in the information occurs, then in such circumstances as are prescribed under s397 for the purposes of this subsection, the person shall, within 7 business days of the change, give notice in writing of the change containing a full description of it". Cap 571S-Securities and Futures (Licensing and Registration)(Information) Rules provides in relation to Licensed Corporations, that (amongst other matters), the entity is required to notify the Commission within 7 days of:
  - 12.1. significant changes in the nature of the business carried on or to be carried on and types of services provided or to be provided by the licensed corporation;
  - 12.2. significant changes in the business plan of the licensed corporation covering internal controls, organizational structure, contingency plans and related matters; and
  - 12.3. changes in the capital and shareholding structure of the licensed corporation and the basic information in respect of any person in accordance with whose directions or instructions the licensed corporation is, or its directors are, accustomed or obliged to act.

## NEW ZEALAND – FINANCIAL MARKETS AUTHORITY

13. Section 396 – A licence must be issued where the FMA is satisfied that:
  - 13.1. Any relevant eligibility criteria prescribed by the regulations has been satisfied;
  - 13.2. The applicant's directors, senior managers, and proposed directors and senior managers are fit and proper persons to hold their respective positions and otherwise satisfy the requirements that are prescribed by the regulations for licences for that service;
  - 13.3. The applicant is capable of effectively performing that service; and
  - 13.4. There is no reason to believe that the applicant is likely to contravene the market services licensee obligations.

## SINGAPORE – MONETARY AUTHORITY OF SINGAPORE (MAS)

14. Securities and Futures (Licensing and Conduct of Business) Regulations, Regulation 14A requires that the holder of a capital markets services licence shall ensure that:
  - 14.1. It is a fit and proper person to carry on business for which it is licensed;
  - 14.2. Its representatives are fit and proper persons;
  - 14.3. Its CEO, directors or equivalent persons are fit and proper persons for office; and
  - 14.4. Its substantial shareholders or equivalent persons are fit and proper persons.
15. The fit and proper test for an applicant entity is very broad (effectively assesses all individuals connected with an applicant that would engage in licensed activities or have a position of control).
16. The MAS Guidelines on Fit & Proper Persons includes, but is not limited to the following considerations: competent, honest, to have integrity and to be of sound financial standing (see para 2 and 8 of the MAS Guidelines on Fit & Proper Person).
17. Paragraph 6 of the MAS Guidelines on Fit & Proper Persons defines "relevant person" as:
  - 17.1. **In relation to a bank:** 'a substantial shareholder, a director, a CEO or deputy CEO, a CFO, Head of Treasury, or any other officer by whatever name described, who has responsibilities or functions similar to any of the persons' previously identified.
  - 17.2. **In relation to a licensee:** 'a substantial shareholder or equivalent person of a licensee, a licensee, an appointed or provisional representative or a licensee, a CEO, director or equivalent person or holder of a licensee, and exempt financial institution or its representatives, a person for which an application for authorisation has been made to MAS.'

18. Where the relevant person is an institution, the institution must according to paragraph 10 of the Guidelines on Fit & Proper Persons, have in place appropriate recruitment policies, adequate internal control systems and procedures to ensure that its employees and representatives that engage in regulated activity meet the fit and proper test.
19. MAS may require an applicant to furnish it with such information or documents as the Authority considers necessary in relation to the application (s84(2) of the Securities and Futures Act (Chapter 289)).
20. In addition, MAS has the express power, subject to the regulations, to refuse an application if "any information or document that is furnished by the applicant to the Authority is false or misleading" (see s86(4)(aa) of the Securities and Futures Act (Chapter 289)).



## ANNEXURE C – ASIC ENFORCEMENT REVIEW TASKFORCE

### TERMS OF REFERENCE

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The Taskforce will review the enforcement regime of the Australian Securities and Investments Commission (ASIC), to assess the suitability of the existing regulatory tools available to it to perform its functions adequately.

The review will include an examination of legislation dealing with corporations, financial services, credit and insurance as to:

- The adequacy of civil and criminal penalties for serious contraventions relating to the financial system (including corporate fraud);
- The need for alternative enforcement mechanisms, including the use of infringement notices in relation to less serious contraventions, and the possibility of utilising peer disciplinary review panels (akin to the existing Markets Disciplinary Panel) in relation to financial services and credit businesses generally;
- The adequacy of existing penalties for serious contraventions, including disgorgement of profits;
- The adequacy of enforcement related financial services and credit licensing powers;
- The adequacy of ASIC's power to ban offenders from occupying company offices following the commission of, or involvement in, serious contraventions where appropriate;
- The adequacy of ASIC's information gathering powers and whether there is a need to amend legislation to enable ASIC to utilise the fruits of telephone interception warrants or to grant the equivalent of Federal Crimes Act search warrant powers under ASIC's enabling legislation for market misconduct or other serious offences;
- The adequacy of ASIC's powers in respect of licensing of financial services and credit providers, including the threshold for granting or refusing to grant a licence, the circumstances in which ASIC may vary, suspend, or cancel licenses; and its coercive powers (including whether there is a need for ASIC to have a power to direct licensees to take, or refrain from taking, particular action);
- The adequacy of the frameworks for notifying ASIC of breaches of law, including the triggers for the obligation to notify; the time in which notification is required to be made; and whether the obligation to notify breaches should be expanded to a general obligation (currently confined under the Corporations Act to auditors, liquidators, and licensees, and noting that obligations to report offences exist under other Federal or State statutes); and
- Any other matters, which arise during the course of the Taskforce's review of the above, which appear necessary to address any deficiencies in ASIC's regulatory toolset.

Upon completion of the Review, the Taskforce will identify any gaps in ASIC's powers and make recommendations to the Government which it considers necessary to strengthen any of ASIC's regulatory tools and as to the policy options available that:

- address gaps or deficiencies identified in a way that allows more effective enforcement of the regulatory regime;
- foster consumer confidence in the financial system and enhance ASIC's ability to prevent harm effectively;
- do not impose undue regulatory burden on business, and promote engagement and cooperation between ASIC and its regulated population;
- promote a competitive and stable financial system that contributes to Australia's productivity growth; and
- relate to other matters that fall within this Terms of Reference.

Further information on the ASIC Enforcement Review taskforce is available at our website: <http://www.treasury.gov.au/ConsultationsandReviews/Reviews/2016/ASIC-Enforcement-Review>.