

20 November 2017

ASIC Enforcement Review  
Financial System Division  
The Treasury  
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## **In Word and PDF formats**

Dear Colleagues

### **ASIC Enforcement Review: Position and Consultation Paper 8 (Paper) - ASIC's Directions Powers**

The Financial Services Council (**FSC**) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than \$2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Thank you for the opportunity to provide a submission on the Paper. At the outset and by way of general observation, we acknowledge the intent of this and other proposals and the need for regulators to have a reasonable 'toolbox' to assist in necessary enforcement. We do note however that we have concerns as with the rationale for the proposed changes and the suggested modifications to the enforcement regime. In addition, it is not clear to us how the proposal is intended to interrelate with the proposed product intervention power (**PIP**) regime. We note that we previously have made extensive observations on the PIP regime. To the extent to which it is relevant we confirm our submissions in that regard.

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We have addressed these and other issues in more detail in our submission.

We have made our comments in the extremely limited time available for us to respond to the Paper. For these reasons, we believe this is an area which merits further consultation and consideration.

For convenience, we will adopt the Positions and Questions outlined in the Paper in our response.

**Position 1: ASIC should have the power to direct financial services or credit licensees in the conduct of their business where necessary to address or prevent compliance failures**

**QUESTIONS**

- 1. Should ASIC be able to give a direction to a financial services or credit licensee requiring them to take or refrain from taking specified action in the conduct of their business where necessary to address or prevent compliance failures?**
- 2. Should the directions ASIC can make be prescribed in the legislation (with an ability to extend the list by regulation)? If so, is the above list appropriate?**
- 3. Alternatively, should a directions power be drafted broadly to allow for a wider variety of directions?**

***Our general observations***

1. We do not agree with this position as a matter of first **principles**. We note that the Paper provides three practical justifications for change. In our respectful submission, none of these are overly compelling. Thus, it seems to us that the Paper proceeds, with respect, on incorrect principles.
2. First, the Paper contends that *the resources and procedural requirements necessary to impose additional conditions, or to suspend or cancel a license can result in delay between concerns arising and ASIC achieving a protective outcome* (see, eg, paragraph 4 of the Executive Summary). However, it is likely that the most significant factor in such a delay is the requirement to afford procedural fairness (natural justice) to license holders. The requirements of procedural fairness are acknowledged in the paper (paragraph 8, section 3.1). We see no reason why these rules would not apply in the context of a directions power-albeit that there may be specific considerations. For example, we would have thought in the majority of instances in order to properly exercise such a power, the licensee would need to be given at least some notice of the intention to make such a direction and the reasoning behind this proposed exercise and thus give the licensee an opportunity to respond as might be required. These steps are valuable safeguards which protect the legitimate business interests of licensees. However, procedural fairness is not inflexible. If there is a genuine need for ASIC to act

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quickly, the standard of "reasonableness" will be what is "reasonable in the circumstances". The outcome then is that natural justice potentially would cause delay in the exercise of a directions power. The intention may be to purport to oust the jurisdiction of the courts, or any other body, to review the exercise of ASIC powers (cf: *Anisminic Ltd V Foreign Compensation Commission [1969] 2 AC 147*). If that is the case, we would expect that to be clearly expressed and we would not support any proposal which prevents any form of review of decisions.

3. Second, the Paper states that *applying to a court for an injunction involves significant time, resources and costs in investigating and preparing a case to the required standard to commence court proceedings* (see, eg, paragraph 5 of the Executive Summary). We accept that this **may** be the case in respect of final injunctive relief. However, we do not accept that contention if it is being asserted as a justification for the directions power that the judicial process is too slow and burdensome. Like other litigants, ASIC may apply for *ex parte* relief if the matter is truly urgent on the giving of the usual undertaking as to damages. Moreover, ASIC has in aid of the exercise of its powers inquisitorial avenues and compulsory information gathering and the benefit of a range of statutory provisions to assist it to expeditiously and effectively call in aid the interlocutory and urgent powers of the courts (see for example Sections 1323 and 1324 of the *Corporations Act 2001 (Act)* and Section 23 of the *Federal Court of Australia Act 1976 (Cth)*) on an interlocutory basis. ASIC indeed has relied on these powers on a number of occasions. In any event, to the extent that the requirement to gather evidence is a cause of delay, it must be a justifiable cause. Given the significance of the impact that license changes can have on a business, it is quite appropriate that the regulator have a rational and demonstrable basis for making them.
4. Third, the Paper notes that enforceable undertakings (**EUs**) are effective only as an alternative to the exercise of other powers (see, eg, paragraph 6 of the Executive Summary). We agree. However, this is not to the point. The fact that enforceable undertakings operate only as alternatives to compulsory outcomes has no bearing on what the range of those outcomes should be.
5. The underlying premise of the Paper appears to be that there are matters that licensees should be required to do that are not set out in the complex and extensive legislation that applies to the provision of financial services and credit activity. The intention thus appears to be to provide ASIC the power to fill these perceived gaps. Such a power however, correctly analysed is likely to be either:

(a) A legislative or rule-making power, in which case it should be exercised by Parliament or by ASIC in accordance with its specific legislative powers (such as Class Order powers); or

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- (b) A judicial power, in which case it should be exercised by a Chapter III Constitution court.

6. It is not clear to us whether the Paper is contemplating an approach somewhere between these two points. We are not sure if what is contemplated perhaps is a regime somewhat comparable to the powers exercisable by the Takeovers Panel, held to be valid by the High Court in *Attorney-General (Cth) v Alinta Ltd [2008] HCA 2*. If so, then that is inconsistent with the practical justifications advanced in the Paper for the proposed changes. Although panel proceedings are quick, experience has shown that they are not necessarily any quicker than direct administrative action or judicial intervention. More importantly, an important aspect of the reasoning in the *Alinta case* was that the Panel comprised subject matter specialists making decisions based on considerations and interests that are not apt for judicial decision-making. That cannot be said of the issues in question here. How licensees should conduct their businesses and treat their customers are already the subject of extensive legislation and judicial consideration. They are legal rules well suited to legal process.

7. In this regard we also make the general observation that it is difficult to assess the potential scope and implications of the proposed directions power while there is still uncertainty in the following areas:

- (a) We are yet to see what is being proposed as a final matter on the deterrence and penalty regime front;
- (b) As mentioned previously we are yet to see the details of the PIP proposals, which may replicate these proposed powers to a greater or lesser extent.

8. We would urge that the consideration of a general direction power be considered holistically in the context of any other proposed changes currently being considered.

***Our specific observations***

9. We also have objections to the proposals on the basis of the **existing specific provisions** of the law. In summary, the powers are unnecessary as ASIC can achieve the same outcomes using its current suite of enforcement tools.

10. In particular, if the matter is urgent and consumers need to be protected, it is open to ASIC to seek an interim injunction under s1324 of the Act. ASIC should seek an urgent injunction and be put to proof before an independent decision-maker (ie the court) of an arguable case and that the balance of convenience justifies the making of such orders. Matters of such significance should be reserved to the court.

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11. The fact that ASIC must gather evidence to support its concerns before a Court is a necessary restraint on the exercise of executive power. It is appropriate that a regulator have sufficient evidence to be satisfied that a breach has occurred or will occur before it exercises such significant powers.
12. Seeking an interim injunction does not necessarily require significant resources and costs. An interim injunction should be able to be sought in a matter of days (or hours), if there are real concerns about significant consumer detriment. Other regulators, which have less wide-ranging powers, e.g. ACCC, are very experienced in seeking interim injunctions to prevent consumer detriment occurring in the short term.
13. There is a risk that if such a the proposed direction power were conferred on ASIC and that power were to be misused (or overused) by an arbitrary and less than diligent approach to regulation, significant damage could be done to financial services providers for no other reason than it may be difficult for ASIC to prove its case.
14. If, contrary to our submissions, ASIC were to be granted a directions power, we suggest that at the very least, the following safeguards should be incorporated in the relevant legislation:-
  - (a) A direction should only apply for a limited timeframe of 21 days (which would align with the markets infrastructure directions power);
  - (b) Use of the direction power should be a last resort, when use of ASIC's other powers would be ineffective in the circumstances. ASIC should be required to have clear reasons why this is the case.
15. If a directions power is granted to ASIC, the list of directions that ASIC can make should be set out in the Act and not extended by rules or regulations.
16. We do not agree with the alternative proposal-in order for industry to be aware of what regulation they could be subject to, a clear outline of the possible directions should be provided.

**Position 2: The directions power should be triggered where a licensee has, is or will contravene financial services or credit licensing requirements (including relevant laws)**

**QUESTIONS**

- 4. Should the directions power be triggered if ASIC has reason to believe that a licensee:**
  - a. has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes, or would constitute a contravention of a law relevant to the provision of services by the licensee?**

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***b. has refused or failed, is or is proposing to refuse or fail to do an act or thing that the legislation requires a financial services or credit licensee to do?***

17. In our submission, ***reason to believe*** is too low a threshold. It is disproportionate for a regulator to have power to make directions that can significantly impact the ability of a licensee to continue carrying on its business on the basis of ASIC only having *a reason to believe*. We note that direction powers of regulators in other jurisdictions which may be exercised without a public hearing, for example New Zealand and the United Kingdom, are generally only invoked if the regulator is satisfied that a breach has or is likely to occur. The test in RG 98 that ASIC has *reason to believe* is only for future likely breaches, not for past activity. In our view, this approach should be revised to standard of ASIC having a "reasonable basis to satisfy itself" (or at a minimum a "reasonable basis to believe") that the conduct or failure to act has occurred – this a clearer objective test.

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

18. Yes we agree with this approach-ASIC's objectives under the ASIC Act should be a further requirement for the exercise of the directions power to ensure that there is broader benefit to the use of the power and as a further limitation on the arbitrary use of an executive power (i.e. on top of the objective "reasonable basis" test above). ASIC has a clearly defined mandate, so any actions they take should be restricted to their objectives

19. Public interest needs to be balanced with the potential damage done to the holder of an AFSL licensee if ASIC's determination is unfounded. Requiring ASIC to justify its position before enforcing such directions is a better regulatory outcome.

20. Alternatively, in the absence of a broad public interest consideration or objective requirement, some limitation ought to be incorporated to appropriately set and introduce a materiality threshold for the application of any powers of directions. Notwithstanding our comments more broadly on the directions powers should these powers be made available they should only be utilised to address issues of material nature.

**Position 3: ASIC should be able to apply to a court to enforce the direction and take administrative action if an AFS or credit licensee does not comply with a direction**

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**QUESTIONS**

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

21. This is appropriate provided that the licensee is entitled to challenge the validity of the direction by way of a response to written notice or in review hearings.

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

22. No-this should be subject to the usual rules of court. Otherwise, there is a prospect of double jeopardy and penalties.

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

**a. criminal offence?**

**b. civil penalty provision?**

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

23. These are orders that relate to a licensee's obligations and therefore any breach of these should be subject to administrative or civil penalty action but not criminal proceedings. The penalty for failing to comply with the direction should not exceed the remedies for the primary breach available under the relevant legislation.

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

24. As a matter of fairness and consistent with our previous comments, ASIC should be required to provide a statement to the financial services provider at least 5 business days in advance of giving a direction setting out ASIC's intention to make a direction, reasons and should provide a reasonable period of time for the licensee to respond.

25. This would enable the financial services provider the opportunity to address the concerns with ASIC or seek its own injunction on the basis of ASIC's having failed to provide a proper foundation for its *reason to believe*.

**10. Alternatively, should ASIC be required to offer the affected licensee an opportunity to appear, or be represented at a hearing and to make submissions on the matter before**

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***making a direction? If so, should ASIC also be able to make an interim direction without providing a hearing and be required to provide a hearing within a certain time frame?***

26. Yes, in our view, ASIC should be required to offer the affected licensee an opportunity to appear, make submissions, and be represented at a hearing.

ASIC should not be able to make an interim direction without providing a hearing. If the matter requires an urgent response to prevent consumer detriment, ASIC can seek an interim injunction which will leave the "balance of convenience" consideration to the courts.

27. If contrary to our submissions, ASIC is given the power to make an interim direction without providing a hearing, safeguards for the licensee should be put in place, such as:

(a) ASIC should not be able to make an interim direction without a hearing if the direction is likely to have a significant impact on the Licensee's ability to carry on its business.

(b) While this is expressed as an alternative, our view is that ASIC should be required to provide both written notice and to the opportunity for the licensee to appear at a hearing.

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Should you have any questions, please contact the writer on 02-9299 3022.

**Yours Faithfully**



**Paul Callaghan**

**General Counsel**