



# **FINANCIAL SERVICES ROYAL COMMISSION FINAL REPORT**

**Part 3: A new regulatory frontier – ASIC  
enforcement in a post-Royal Commission  
environment**

*8 February 2019*

**CLAYTON UTZ**

The release of the Final Report of the Financial Services Royal Commission will herald a new era in regulatory enforcement of the financial services industry in Australia.

The message from Commissioner Hayne is clear – **ASIC's approach to enforcement must change.**

ASIC has heeded the warnings and industry is likely to face a different ASIC, one that is far more litigious with issues of non-compliance.

Commissioner Hayne's key recommendations relating to the regulators and enforcement are set out at Annexure A.

In this update, we explain what you can expect from ASIC in a new regulatory environment.

## 1 ASIC'S MANDATE

Commissioner Hayne has:

- ▶ endorsed Australia's regulatory twin peaks model, with ASIC as the conduct regulator and APRA as the prudential regulator of the financial services industry; and
- ▶ concluded that the matters presented to the Commission showed ASIC had not focused enough on its core mandate to enforce the law when faced with misconduct and contraventions of the law.

Commissioner Hayne criticises ASIC for falling prey to regulatory capture by seeking agreement and negotiating outcomes with those it regulates, rather than seeking punishment and public denunciations of wrongdoings.

To correct ASIC's course, Commissioner Hayne recommends "the enforcement culture of ASIC... should be the focus of change".

At the heart of this cultural change is Commissioner Hayne's view that answering the question "why not litigate" requires skill and judgment, especially when dealing with systemic issues, and a clear view of the types of outcomes to be considered and sought.

Remediation cannot be the only outcome pursued. The community expects remediation of those affected by breaches of the law and what is required from the conduct regulator is "the exercise of public power for public purposes" to ensure there is "adequate deterrence of misconduct through visible public denunciation and punishment".

ASIC has been asked to consider pushing the boundaries of enforcement by pursuing litigation even if there are uncertain prospects of success.

## 2 RECOMMENDATIONS

Commissioner Hayne has made recommendations:

- ▶ to improve the effectiveness and efficiency of ASIC and APRA (see recommendations 6.1 to 6.14 in Annexure A);
- ▶ to implement, from the ASIC Enforcement Review Taskforce Report of December 2017 (set out in Annexure B), the recommendations that improve the breach reporting regime and extend the regime to Australian credit licensees (**ACL**) (recommendation 7.2); and
- ▶ to move to a regime of quarterly reporting to ASIC of any serious compliance concerns about financial advisers or mortgage brokers (recommendations 1.6 and 2.7 to 2.9).

The Government has agreed to implement **all** of these recommendations and has announced it will expand the Federal Court's jurisdiction to cover criminal corporate misconduct and expedite cases commenced by the regulators.

Commissioner Hayne's recommendations, combined with the changes proposed under the Treasury Laws Amendment (ASIC Enforcement) 2018 Bill to implement other recommendations of the ASIC Taskforce Report, mean there will be significant changes ahead in the regulatory landscape for the industry. These include:

- ▶ imposing greater financial penalties for contraventions of law;
- ▶ introducing new civil penalties for contraventions;
- ▶ providing ASIC with disgorgement remedies in civil proceedings and a directions power to order remediation; and
- ▶ an increased preparedness to seek judicial determination of key legal provisions in key policy areas.

### **3 WHAT TO EXPECT FROM ASIC**

ASIC has openly accepted that its enforcement culture must change.

Changes are already underway. ASIC has recognised the need to change its enforcement priorities and practices so it can be more agile in prosecuting contraventions.

James Shipton was appointed the new ASIC Commissioner, and Karen Chester (former Commissioner of the Productivity Commission) and Daniel Crennan QC were appointed as ASIC's new Deputy Commissioners during 2018.

Mr Shipton gave evidence during the Commission hearing in November 2018 that ASIC has undertaken an internal review of its enforcement policies, processes and decision-making procedures to ensure financial institutions refocus on conduct risk.

The shift in ASIC's enforcement strategy and priorities means that corporate Australia's dealings with ASIC are likely to change.

#### ▶ **"Why not litigate" approach**

The Government has announced additional funding of \$170 million to ASIC and APRA. This will enhance their enforcement capabilities. Funding of the Commonwealth Director of Public Prosecutions will enhance its ability to undertake prosecutions referred from ASIC.

Armed with this additional funding, and ASIC's acceptance of Commissioner Hayne's recommendations on its role, we can expect to see ASIC proactively pursuing litigation as the preferred outcome for breaches of the law.

ASIC's new starting point for dealing with misconduct and potential contraventions of the law is to ask "why not litigate". That means it will need to consider whether judicial determination of the contravention is required.

This has wide implications for dealings with ASIC. For instance, the question of "why not litigate" will be asked every time a significant breach report is lodged (bearing in mind that the breach reporting regime is likely to be extended to ACL holders).

ASIC will implement the traditional regulatory pyramid approach in responding to misconduct requiring the highest level of regulatory response to deal with the most serious breaches of law by larger entities.

#### ▶ **Enforcing the law**

ASIC has been challenged to re-prioritise the visible enforcement of the law. It is expected ASIC will emphasise punishment and deterrence more strongly in its use of regulatory tools and outcomes. This is what the community expects from ASIC.

For contestable matters of judgment (for example, breaches of false or misleading conduct or best interests duty), the appropriate regulatory response will likely require visible public determinations in order to achieve the required level of general deterrence and appropriate punishment.

### ► Pursuing policy

ASIC is likely to view Commissioner Hayne's comments to pursue litigation, even where there are uncertain prospects of success, as further encouragement to pursue policy outcomes where it considers the law requires further clarification, or where the issue raised is systemic.

Commissioner Hayne makes clear that ASIC's obligations under the Model Litigant Rules do not prevent ASIC from commencing proceedings even if it does not meet the test of reasonable prospects of success.

### ► Less negotiation

Where there has been an actual contravention of the law, ASIC may be more likely to seek judicial determination of the consequences of that contravention, rather than accept an alternative negotiated outcome, such as an enforceable undertaking (EU).

Enforcement staff within ASIC will no longer engage with entities about non-enforcement related matters to avoid any risk or further criticism of regulatory capture, with internal management changes.

The establishment of the new oversight body for ASIC and APRA, which will assess the performance of each regulator, provides further incentive for ASIC to ensure it discharges its enforcement obligations and mandate as required.

### ► Remediation not enough

ASIC will not consider the full remediation of any affected customers following a contravention to be a complete enforcement outcome, or sufficient punishment or deterrence of the contravention.

ASIC will be expected to enforce the law, including, if necessary, through the commencement of civil penalty proceedings or seeking disgorgement orders (once the Treasury Laws Amendment (ASIC Enforcement) 2018 Bill is enacted).

### ► Enforceable undertakings with admissions

ASIC may be less likely to accept an EU for serious breaches of the law (where the preferred enforcement outcome may be judicial determination) and may confine its use of enforceable undertakings to administrative matters going forward.

In any case, ASIC is unlikely to accept an EU unless there is an acknowledgment by the entity that it has breached one or more legislative provisions. ASIC will not accept acknowledgement of "concerns held by ASIC".

Such acknowledgements may expose entities to the risk of litigation or class action arising from any admissions in an EU.

### ► Limited use of infringement notices

ASIC will be unlikely to issue infringement notices for large entities or for serious breaches of the law which deal with contestable matters of judgment. The use of infringement notices is likely to be confined to administrative failings by entities.

### ► Breach reporting obligations

ASIC will change its attitude towards significant breach reports. There is an expectation that financial services licensees will notify ASIC of any breaches, or likely breaches, at the earliest opportunity.

As stated above, ASIC will need to ask and answer "why not litigate" each time it receives a breach report. ASIC may, given the emphasis on litigation, also be more likely to pursue action for failure to breach-report.

These expectations will also extend to ACL holders when the Treasury Laws Amendment (ASIC Enforcement) 2018 Bill is enacted and the breach reporting regime is likely to be extended to apply to ACL holders.

► **Expectation of greater and transparent engagement with ASIC**

Authorised deposit-taking institutions (**ADIs**) and Accountable Persons under the Banking Executive and Accountability Regime (**BEAR**) will be obliged to deal with APRA and ASIC in an open, constructive and co-operative way.

ASIC will no doubt expect any individual responsible for communicating or dealing with ASIC to engage with the regulator in a transparent and proactive manner for all types of matters, including during breach reporting, investigations, negotiations and monitoring under the Close and Continuous Monitoring Program.

► **Enforcement of accountability obligations**

As the conduct regulator, ASIC has been given joint responsibility for the administration of the BEAR. ASIC will have responsibility for those parts of the BEAR that concern consumer protection and market conduct.

As the prudential regulator, APRA will have responsibility for overseeing the prudential aspects of the BEAR.

ADIs may need appoint an accountable person with responsibility for product design, delivery, maintenance and, where necessary, remediation.

With ASIC responsible for conduct obligations under the BEAR, it is possible that where it is investigating an entity for misconduct, it may also find and pursue conduct against an individual under the BEAR.

► **Increased focus on improving culture**

ASIC has been focusing on improving the cultural practices of financial institutions as part of its conduct regulation. It can now be expected to increase that focus and enforce, where possible, sound cultural practices.

The new co-operation principles between the regulators mean that any concerns that ASIC holds about an entity's cultural practices may also be referred to APRA to investigate from a prudential perspective.

► **Stronger stance on legal professional privilege claims**

ASIC's emphasis on litigation, together with an expectation of greater transparency, may mean it takes a stronger stance in objecting to claims for legal professional privilege. It remains to be seen how ASIC's new approach will affect the continuing use of voluntary disclosure agreements.

► **The Close and Continuous Monitoring Program giving rise to investigations**

ASIC is expected to use the Close and Continuous Monitoring Program to focus on driving improvements in breach reporting, assessing specific governance issues, identifying differences in appetite for culture and practices (noting that ASIC will now be sharing information with APRA), and identify key influencers or decision-makers within the entity.

► **Reliance on whistleblowers**

With the benefit of recent reforms to improve protections for whistleblowers and the increased public attention following the Commission, there may be more whistleblowers willing to provide information to assist ASIC in its investigations into misconduct.

The Australian Labor Party has announced that, if elected, it will introduce a suite of measures to encourage whistleblowers who expose misconduct, including a whistleblower's rewards scheme where people would receive a percentage of the penalties that eventuate from the misconduct identified by the whistleblower.

► **Internal changes at ASIC**

In addition to the appointments of Mr Crennan QC and Ms Chester, ASIC can be expected to make further changes to its internal management and day-to-day conduct of enforcement actions.

Importantly, Commissioner Hayne recommends a demarcation of ASIC's enforcement function from its other functions.

ASIC (and APRA) will also be required to formulate and apply its own accountability principles similar to BEAR so that its senior staff would be subject to accountability obligations.

Commissioner Hayne observed that the rigour required to produce accountability maps and statements would oblige ASIC to consider its internal arrangements carefully.

## **4 PREPARATION**

ASIC is expected to release an update in the coming weeks outlining the further steps that it will take to strengthen its enforcement and regulatory priorities.

In the meantime, you should:

- ▶ have regard to what ASIC expectations may be in all decisions, starting at the product design phase, the self-reporting of contraventions, and right through to investigations and dealings with ASIC;
- ▶ consider updating your internal governance and compliance policies and processes in light of the recommendations in the Report;
- ▶ ensure that internal practices strive for a culture of engaging or dealing with ASIC in an open, transparent and co-operative way, and consider implementing an engagement model or set of engagement principles with ASIC, reflecting those matters as the guiding principles;
- ▶ bear in mind that ASIC may ultimately compel production of all documents and communications related to misconduct, and may share any documents provided to it with APRA to investigate any prudential-related matter.

# ANNEXURE A – RECOMMENDATIONS FROM ROYAL COMMISSION

## Twin Peaks

**Recommendation 6.1 — Retain twin peaks**  
The "twin peaks" model of financial regulation should be retained.

## ASIC's enforcement practices

**Recommendation 6.2 — ASIC's approach to enforcement**  
ASIC should adopt an approach to enforcement that:

- ▶ takes, as its starting point, the question of whether a court should determine the consequences of a contravention;
- ▶ recognises that infringement notices should principally be used in respect of administrative failings by entities, will rarely be appropriate for provisions that require an evaluative judgment and, beyond purely administrative failings, will rarely be an appropriate enforcement tool where the infringing party is a large corporation;
- ▶ recognises the relevance and importance of general and specific deterrence in deciding whether to accept an enforceable undertaking and the utility in obtaining admissions in enforceable undertakings; and
- ▶ separates, as much as possible, enforcement staff from non-enforcement related contact with regulated entities.

## Superannuation: Conduct regulation

**Recommendation 6.3 — General principles for co-regulation**  
The roles of APRA and ASIC in relation to superannuation should be adjusted to accord with the general principles that:

- ▶ APRA, as the prudential regulator for superannuation, is responsible for establishing and enforcing Prudential Standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by superannuation entities APRA supervises are met within a stable, efficient and competitive financial system; and
- ▶ as the conduct and disclosure regulator, ASIC's role in superannuation primarily concerns the relationship between RSE licensees and individual consumers.

Effect should be given to these principles by taking the steps described in Recommendations 6.4 and 6.5.

**Recommendation 6.4 — ASIC as conduct regulator**  
Without limiting any powers APRA currently has under the SIS Act, ASIC should be given the power to enforce all provisions in the SIS Act that are, or will become, civil penalty provisions or otherwise give rise to a cause of action against an RSE licensee or director for conduct that may harm a consumer. There should be co-regulation by APRA and ASIC of these provisions.

### **Recommendation 6.5 — APRA to retain functions**

APRA should retain its current functions, including responsibility for the licensing and supervision of RSE licensees and the powers and functions that come with it, including any power to issue directions that APRA presently has or is to be given.

### **Recommendation 6.6 — Joint administration of the BEAR**

ASIC and APRA should jointly administer the BEAR. ASIC should be charged with overseeing those parts of Divisions 1, 2 and 3 of Part IIAA of the Banking Act that concern consumer protection and market conduct matters. APRA should be charged with overseeing the prudential aspects of Part IIAA.

## **The BEAR: Co-regulation**

### **Recommendation 6.7 — Statutory amendments**

The obligations in sections 37C and 37CA of the Banking Act should be amended to make clear that an ADI and accountable person must deal with APRA and ASIC (as the case may be) in an open, constructive and co-operative way. Practical amendments should be made to provisions such as sections 37K and 37G(1) so as to facilitate joint administration.

### **Recommendation 6.8 — Extending the BEAR**

Over time, provisions modelled on the BEAR should be extended to all APRA-regulated financial services institutions. APRA and ASIC should jointly administer those new provisions.

### **Recommendation 1.17 — BEAR product responsibility**

After appropriate consultation, APRA should determine for the purposes of section 37BA(2)(b) of the Banking Act, a responsibility, within each ADI subject to the BEAR, for all steps in the design, delivery and maintenance of all products offered to customers by the ADI and any necessary remediation of customers in respect of any of those products.

## **Co-ordination and information-sharing**

### **Recommendation 6.9 — Statutory obligation to co-operate**

The law should be amended to oblige each of APRA and ASIC to:

- ▶ co-operate with the other;
- ▶ share information to the maximum extent practicable; and
- ▶ notify the other whenever it forms the belief that a breach in respect of which the other has enforcement responsibility may have occurred.

### **Recommendation 6.10 — Co-operation memorandum**

ASIC and APRA should prepare and maintain a joint memorandum setting out how they intend to comply with their statutory obligation to co-operate.

The memorandum should be reviewed biennially and each of ASIC and APRA should report each year on the operation of and steps taken under it in its annual report.

## **Governance**

### **Recommendation 6.11 — Formalising meeting procedure**

The ASIC Act should be amended to include provisions substantially similar to those set out in sections 27–32 of the APRA Act — dealing with the times and places of Commissioner meetings, the quorum required, who is to preside, how voting is to occur and the passing of resolutions without meetings.

### **Recommendation 6.12 — Application of the BEAR to regulators**

In a manner agreed with the external oversight body (the establishment of which is the subject of Recommendation 6.14 below) each of APRA and ASIC should internally formulate and apply to its own management accountability principles of the kind established by the BEAR.

### **Recommendation 6.13 — Regular capability reviews**

APRA and ASIC should each be subject to at least quadrennial capability reviews. A capability review should be undertaken for APRA as soon as is reasonably practicable.

## **Oversight**

### **Recommendation 6.14 — A new oversight authority**

A new oversight authority for APRA and ASIC, independent of Government, should be established by legislation to assess the effectiveness of each regulator in discharging its functions and meeting its statutory objects.

The authority should be comprised of three part-time members and staffed by a permanent secretariat.

It should be required to report to the Minister in respect of each regulator at least biennially.

## **ASIC Enforcement Review Taskforce**

### **Recommendation 7.2 — Implementation of recommendations**

The recommendations of the ASIC Enforcement Review Taskforce made in December 2017 that relate to self-reporting of contraventions by financial services and credit licensees should be carried into effect.

## **Reporting serious compliance concerns**

### **Recommendation 2.7 — Reference checking and information sharing**

All AFSL holders should be required, as a condition of their licence, to give effect to reference checking and information-sharing protocols for financial advisers, to the same effect as now provided by the ABA in its "Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol".

**Recommendation 2.8 — Reporting compliance concerns**

All AFSL holders should be required, as a condition of their licence, to report "serious compliance concerns" about individual financial advisers to ASIC on a quarterly basis.

**Recommendation 2.9 — Misconduct by financial advisers**

All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise):

- ▶ make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser's misconduct; and
- ▶ where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

**Recommendation 1.6 — Misconduct by mortgage brokers**

ACL holders should:

- ▶ be bound by information-sharing and reporting obligations in respect of mortgage brokers similar to those referred to in Recommendations 2.7 and 2.8 for financial advisers; and
- ▶ take the same steps in response to detecting misconduct of a mortgage broker as those referred to in Recommendation 2.9 for financial advisers.

## **ANNEXURE B – BREACH REPORTING RECOMMENDATIONS FROM ASIC TASKFORCE REPORT**

### **Recommendation 1**

The "significance test" in section 912D of the Corporations Act 2001 should be retained but clarified to ensure that the significance of breaches is determined objectively.

### **Recommendation 2**

Introduce a self-reporting regime for credit licensees equivalent to the regime for AFS licensees under section 912D of the Corporations Act 2001.

### **Recommendation 3**

The obligation for licensees to report should expressly apply to misconduct by an employee or representative.

### **Recommendation 4**

Significant breaches (and suspected breach investigations that are ongoing) must be reported within 30 days.

### **Recommendation 5**

The required content of breach reports should be prescribed by ASIC and be lodged electronically

### **Recommendation 6**

Criminal penalties should be increased for failure to report as and when required.

### **Recommendation 7**

A civil penalty should be introduced in addition to the criminal offence for failure to report as and when required.

### **Recommendation 8**

Encourage a co-operative approach where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity.

### **Recommendation 9**

Streamline the reporting requirements for responsible entities of managed investment schemes by replacing the requirements in section 601FC(1)(l) of the Corporations Act with an expanded requirement in section 912D.

### **Recommendation 10**

Require annual publication of breach report data for licensees by ASIC.

## GET IN TOUCH

We welcome conversations on Commissioner Hayne's report. If you wish to have your own conversation with us on the report and how it may affect you and your business, please contact us:

[FinancialServicesRC@ClaytonUtz.com](mailto:FinancialServicesRC@ClaytonUtz.com)

You can also keep up with our rolling coverage at our dedicated Financial Services Royal Commission hub <https://www.claytonutz.com/financial-services-royal-commission/hub>.

**Sydney**

Level 15

1 Bligh Street

Sydney NSW 2000

+61 2 9353 4000

**Melbourne**

Level 18

333 Collins Street

Melbourne VIC 3000

+61 3 9286 6000

**Brisbane**

Level 28

Riparian Plaza

71 Eagle Street

Brisbane QLD 4000

+61 7 3292 7000

**Perth**

Level 27

QV.1 Building

250 St Georges Terrace

Perth WA 6000

+61 8 9426 8000

**Canberra**

Level 10

NewActon Nishi

2 Phillip Law Street

Canberra ACT 2601

+61 2 6279 4000

**Darwin**

17–19 Lindsay Street

Darwin NT 0800

+61 8 8943 2555

**Disclaimer**

Clayton Utz communications are intended to provide commentary and general information. They should not be relied upon as legal advice. Formal legal advice should be sought in particular transactions or on matters of interest arising from this communication. Persons listed may not be admitted in all States and Territories.

© Clayton Utz 2019

[www.claytonutz.com](http://www.claytonutz.com)