



Law Council
OF AUSTRALIA

3 March 2020

Manager
Financial Services Reform Taskforce
Treasury
Langton Cres
PARKES ACT 2600

By email: FSRCconsultations@treasury.gov.au

Dear Sir/Madam

Implementation of ASIC Enforcement Review Taskforce – Directions Powers

1. The Law Council of Australia (**Law Council**) welcomes the opportunity to make a submission to Treasury in relation to the Financial Services Royal Commission Recommendation 7.2, which proposes to expand the powers of the Australian Securities and Investments Commission (**ASIC**) to issue directions.
2. The Law Council is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.
3. This submission has been prepared by the Corporations Committee of the Law Council's Business Law Section (**Corporations Committee**), the Australian Consumer Law Committee (**ACL**) of the Law Council's Legal Practice Section and the Superannuation Committee of the Law Council's Legal Practice Section (**Superannuation Committee**). The views of each contributor have been provided separately to ensure clarity of message.

Input from the Corporations Committee of the Law Council's Business Law Section

4. The Corporations Committee notes that the proposal, if implemented, would give ASIC expanded powers to issue directions to the holder of an Australian Financial Services Licence (**AFSL**) or credit licence. The Corporations Committee considers the scope of the proposed directions power to be very broad, albeit consistent with recommendations made by the ASIC Enforcement Review Taskforce in its report in December 2017.¹
5. The Corporations Committee considers the proposed threshold that ASIC must meet before making a direction is low: ASIC must have 'reason to suspect' that a financial

¹ Australian Government, *ASIC Enforcement Review Taskforce Report* (December 2017), <<https://treasury.gov.au/review/asic-enforcement-review/r2018-282438>>.

services licensee has engaged, is engaging, or will engage in conduct that constitutes a contravention of a financial services law.²

6. If that threshold is met, ASIC may direct the licensee to engage in specified conduct in order to address or prevent the contravention, or a similar or related contravention. There is no other limit on the nature of the conduct that ASIC may direct a licensee to take. The Corporations Committee submits that such unlimited power is unwarranted and should not be vested in a regulator without appropriate limits, especially if the power can be exercised on mere suspicion of a contravention. Further, ASIC's suspicion which enlivens the power is not expressly required to be based on reasonable grounds.
7. The Exposure Draft contains a list of examples of directions that may be given, which serve to highlight the concerns of the Corporations Committee. These include a direction to:
 - not accept new clients;
 - not transfer a specified asset to another person;
 - conduct a review or audit of the activities or records of an authorised representative of the licensee; and
 - identify persons who have suffered loss or damage as a result of the contravention and establish and implement a specified program to compensate those persons, and providing compensation to those persons without the need for them to take any action (such as making claims).
8. ASIC may not make a direction unless it first allows the licensee to appear and make submissions at a private hearing conducted by ASIC. However, the Corporations Committee notes that ASIC may make an interim direction without a hearing if it considers that a delay would be prejudicial to the public interest. Such interim direction should be subject to strict time limits and amenable to urgent review by the courts.
9. The Corporations Committee is concerned that notwithstanding that the proposed directions power was recommended by the ASIC Enforcement Review Taskforce, it would give ASIC unlimited powers to force AFSL and Credit Licence holders to act to their detriment without any proof of wrongdoing by the licensee. ASIC does not, in accordance with the current drafting, need to set out the grounds for issuing the direction. The threshold that must be met before a direction can be given, 'reason to suspect a contravention', is the same low threshold that currently applies in order for ASIC to do no more than to commence an investigation. The Corporations Committee submits that it should not be the basis for forcing a licensee to take irrevocable action, and which would also amount to a civil penalty if the direction is not complied with.
10. The examples given in the Exposure Draft indicate a level of power to be vested in ASIC that until now has been reserved to the courts and administrative tribunals where appropriate checks, balances and reviews can be considered objectively. The Corporations Committee does not consider it appropriate to vest such wide-sweeping

² Exposure Draft: Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020, 918F.

powers in a regulator, whose role it is to administer the law and prosecute contraventions, not to enforce it by its own orders.

11. To take an example in the Exposure Draft, the Corporations Committee notes that it is not necessary for the protection of consumers for ASIC to be able to direct the payment of compensation to customers on the mere suspicion of a contravention, without any claim being required to be made. The courts and the availability of class actions are effective to protect consumers. The use of a directions power in this example is an irrevocable act that cannot be reversed if ASIC fails to prove that a contravention occurred or fails to establish that the customer was entitled to compensation.
12. It would be inappropriate to allow such broad and unrestrained powers with the potential to affect the commercial activities of licensees to be unlocked on the basis of a mere subjective suspicion formed by ASIC. The Corporations Committee strongly suggests that the drafting should be revisited to:
 - (a) impose a stricter objective threshold which triggers ASIC's directions power. For instance, ASIC's decision to make a direction should be based on reasonable grounds if it believes that there is a contravention or likely contravention;
 - (b) impose an obligation on ASIC to consider a mandatory list of matters before issuing a direction – such matters to include, for example, the necessity of the direction and the financial impact on the licensee;
 - (c) impose a requirement that ASIC's direction must be proportionate to the contravention or likely contravention; and
 - (d) impose a requirement that ASIC should state the grounds for its decision to issue a direction.
13. The Corporations Committee is also concerned that this proposal will subvert the proper governance of licensees. Licensees will be excused from any consequential contravention of licence conditions when they comply with a direction, but will directors be relieved of their duties when they conduct their business in accordance with ASIC's directions? Will ASIC be responsible for compensating third parties when they suffer loss as a consequence of ASIC's intervention, or will third parties have no recourse for that loss?
14. Further, whether an avenue is available for a licensee to challenge ASIC's direction is unclear. While the Explanatory Memorandum to the Bill suggest that licensees can apply to the Administrative Appeals Tribunal (**AAT**) for an independent merits review, it is not certain whether the set of circumstances which ASIC relies for its "reason to suspect" is reviewable. The AAT may only consider whether the decision to issue the direction was correct or preferable assuming the suspicion is held. The Corporations Committee therefore recommends that the drafting in the legislation be amended to clarify this.
15. The Corporations Committee urges Treasury to reconsider the proposal, which it perceives as a gross over-reach in nature. If it is to proceed, the Corporations Committee submits that it should be subject to limits. For example, it would be less objectionable if the power was limited to directing a person to cease doing something, or not to deal with an asset, where ASIC suspects a contravention on reasonable

grounds, provided that ASIC is required to publish its reasons to the person. The Corporations Committee submits that the power should not extend to matters that cause permanent detriment, such as directing a person to pay money, transfer assets, assume liabilities, terminate employment, or terminate a contract. These types of consequences should only apply if a contravention is established. Further, any interim directions should also be subject to a requirement that ASIC publish its reasons to the parties concerned and be amenable to urgent review by the court. In doing so, the onus of proof should not be on the person to disprove ASIC's subjective suspicion but rather the onus should be on ASIC to justify its direction.

Input from the Australian Consumer Law Committee of the Law Council's Legal Practice Section

16. The ACLC is supportive of the notion of ASIC being provided with an appropriate power to direct financial services and credit licensees in order to address or prevent risks to consumers.
17. The ACLC notes that the proposed trigger for the directions power is limited to those circumstances where ASIC has 'reason to suspect' that a licensee will or is engaging in contravening conduct: section 918(1) and section 78B(1).
18. Finally, the ACLC recommends amending the Exposure Draft to provide for the creation of a compensation scheme, and *cy près* powers in establishing such a compensation scheme in line with recommendations from the Australian Law Reform Commission in its final report titled '*Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders*'.³

Input from the Superannuation Committee of the Law Council's Legal Practice Section

19. The Superannuation Committee notes that it will be difficult to predict how ASIC practice will develop in this area. However, if there is inappropriate over-reach, industry recourse may be to the 'super regulator' who will periodically review ASIC and APRA to ensure powers of this nature are exercised appropriately and not capriciously or inconsistently.
20. The Superannuation Committee also expresses its concern that the proposed publication of adverse directions prior to any wrongdoing being admitted or proven may be contrary to the best interests of fund members, and disproportionate to the risks and issues involved.
21. In addition, the Superannuation Committee submits that given that the threshold of 'reason to suspect a contravention' is quite low, it is suggested that it would be reasonable for there to be a clearer requirement that any ASIC direction be reasonably connected to preventing or remedying the suspected contraventions. The Superannuation Committee makes this submission because at present the only suggestion of such a connection is that proposed subsection 918(3) provides that ASIC may make a direction 'in order to' address or prevent the contraventions.
22. Paragraph 1.20 of the Explanatory Memorandum states that the direction 'must' be directed toward addressing or preventing the suspected contravention. The Superannuation Committee suggests that this could be made clearer in the Exposure Draft (for example, by words like 'ASIC may direct the licensee in writing to engage in

³ Australian Law Reform Commission, *Integrity, Fairness and Efficiency—An Inquiry into Class Action Proceedings and Third-Party Litigation Funders* (ALRC Report 134), (December 2018).

conduct specified in the direction that ASIC [reasonably] considers will, or is likely to'). That is, ASIC must have a reasonable basis to consider that there is a connection between the direction and the outcome. ASIC's internal processes would require that consideration to be documented and it could therefore be objectively scrutinised. While this might be the intended position in any event under the current drafting, the Superannuation Committee submits that an amendment would make it clearer. Further, the Superannuation Committee notes that this test should be compared with the new product intervention power which requires ASIC to be 'satisfied' of likely harm.

23. Finally, the Superannuation Committee notes that paragraph 1.24 of the Explanatory Memorandum provides that ASIC will not have the power to direct a licensee to compensate anyone. The Superannuation Committee is of the view that this conclusion is not clear from the Exposure Draft. Even though proposed paragraph 918(5)(f) only refers to a program to compensate persons who have been identified as having suffered loss or damage, this is only part of an inclusive list of possible directions, and subsection 918(5) is expressed not to limit the directions power in subsections 918(3) and (4).

The Law Council would welcome the opportunity to discuss this submission further with Treasury. In the first instance, please contact [REDACTED]
[REDACTED]

Yours faithfully

Margery Nicoll
Acting Chief Executive Officer