



3 March 2023

Senator Andrew Bragg
Chair, Senate Economics Reference Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Senator Bragg

Inquiry—Australian Securities and Investments Commission investigation and enforcement

1. The Financial Services Committee of the Business Law Section (**BLS**) of the Law Council of Australia (the **FS Committee**) and the Small and Medium Enterprise Committee (the **SME Committee**) are pleased to provide this submission to the Senate Economics Reference Committee in response to its Inquiry into the capacity and capability of the Australian Securities and Investments Commission (**ASIC**) to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct (the **Inquiry**).
2. Each Committee welcomes the opportunity to comment on ASIC's investigation and enforcement capacity and capability, and thanks the Senate Economics Reference Committee for granting a short extension to allow this submission to be prepared.
3. The matters on which the FS Committee wishes to comment are set out below under headings that correspond to the Inquiry's Terms of Reference. The SME Committee's feedback is set out at the end of this letter.

a. The potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action and the balance in policy settings that deliver an efficient market but also effectively deter poor behaviour

Competition schemes and effective markets

4. The proposed introduction of the Compensation Scheme of Last Resort (the **Compensation Scheme**) through the *Financial Services Compensation Scheme of Last Resort Levy Bill 2022* (Cth) and the *Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022* (Cth) is designed to provide financial compensation for eligible consumers where the Australian Financial Complaints Authority (**AFCA**) has determined that compensation should be payable, and that compensation has not been paid. This is likely to occur in circumstances where the

offending financial firm has ceased trading or become insolvent. The Compensation Scheme will draw on funds contributed through an industry levy, and so the costs of failing to comply with an AFCA determination will be borne by other participants in the market, rather than the offending financial firm or its (former) directors or officers. In this regard, the FS Committee submits that the Compensation Scheme will not deter poor behaviour, because the persons responsible for the offending conduct will not bear the cost of compensation.

5. The FS Committee understands that the Compensation Scheme has been broadly welcomed by consumer groups on the basis that it provides an avenue for compensation that eligible consumers would not otherwise get. However, the FS Committee understands that the financial services industry has opposed the Compensation Scheme on the basis that it adds a compliance burden and penalises 'good' financial firms by making them fund compensation for the actions of 'bad' financial firms. The FS Committee is sympathetic to both perspectives, noting that a failure by 'bad' financial firms to compensate their consumers is an obvious area of market failure which government has a role to address.
6. The FS Committee submits that ASIC and government more broadly could use their existing regulatory resources to reduce the risk of compensation failure and deter poor behaviour by:
 - (a) increasing minimum capital requirements so that licensees are more likely to have sufficient resources at hand to meet compensation requirements and less likely to become insolvent; and
 - (b) ensuring that sufficient insurances are in place.

Efficient dispute resolution

7. The FS Committee would welcome ASIC increasing its use of non-litigious dispute resolution outcomes, as the FS Committee is of the view that these represent a more tailored and efficient dispute resolution method for responding to actual or suspected breach of the laws that ASIC oversees. The FS Committee believes that, unlike litigation, the use of court enforceable undertakings gives ASIC the ability to shape and monitor aspects of firms' behaviour and serves as a more tailored and facilitative enforcement process than the blunt and very costly instrument of litigation. The FS Committee also notes that, in litigious matters, it can sometimes take several years between the time when the offending conduct occurs and the final court outcome.
8. The FS Committee submits that, where possible, ASIC should consider the opportunities to make use of non-litigious options such as court enforceable undertakings, while recognising that litigation has a role to play in pursuing serious and egregious cases of non-compliance.

b. The balance in policy settings that deliver an efficient market but also effectively deter poor behaviour

9. The FS Committee makes no comment.

c. Whether ASIC is meeting the expectations of government, business and the community with respect to regulatory action and enforcement

10. The FS Committee acknowledges that there has been recent media commentary that reflects on ASIC's regulatory and enforcement action, particularly in respect of preventing misconduct that affects vulnerable consumers.
11. The FS Committee acknowledges that ASIC's resources are scarce and finite. This means that ASIC has to make strategic choices about who it will take action against and what form that action will take. The FS Committee considers that ASIC has clearly and publicly articulated that addressing misconduct which is harmful to vulnerable consumers is a key priority.

d. The range and use of various regulatory tools and their effectiveness in contributing to good market outcomes

12. The FS Committee notes that academic work strongly suggests that it is appropriate for regulators to use a wide range of regulatory tools so that a proportionate regulatory response can be adopted for particular issues.¹ ASIC has a range of regulatory tools from which it is able to draw in response to an actual or suspected breach of the laws it oversees. Depending on the particular breach and circumstances, these include:
 - (a) the ability to compel a person or entity to provide documentation;
 - (b) the ability to compel a person to participate in an examination by ASIC;
 - (c) educative action that is designed to facilitate awareness;
 - (d) administrative action such as banning orders, stop orders, suspension or cancellation of licences;
 - (e) infringement notices in relation to breaches of legislation covering matters such as consumer credit, consumer protection, market integrity, continuous disclosure and reporting of derivative transactions;
 - (f) enforceable undertakings between an entity and ASIC where the entity commits to undertake certain behaviour or remedial action;
 - (g) litigation—civil penalties (which include fines); and
 - (h) litigation—criminal penalties (which include fines and terms of imprisonment).
13. ASIC's approach to regulatory enforcement has been the subject of commentary and discussion, particularly during and after the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the **Royal Commission**) where Commissioner Hayne described ASIC as having a 'deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of, and punishment for, wrongdoing'. Commissioner Hayne indicated that ASIC's starting point when considering enforcement measures should be 'why not litigate?'. The FS Committee understands that ASIC formerly adopted 'why not litigate' as the guiding principle for determining the regulatory response to be taken arising out of an actual

¹ See Ian Ayres & John Braithwaite, *Responsive Regulation* (Oxford University Press, 1992), Professor Malcom Sparrow, *The Regulatory Craft* (Brookings Institution Press, 2000), and Robert Baldwin & Julia Black, 'Really Responsive Regulation' (2008) 71(1) *The Modern Law Review* 59-94.

or suspected breach of the laws it oversees, and that ASIC has since moved away from this approach to some extent.

14. The FS Committee believes that ASIC's existing regulatory tools are appropriate to meet its statutory objectives set out in the *Australian Securities and Investments Commission Act 2001* (Cth) (the **ASIC Act**). In recent years, legislative changes have delivered ASIC with more powerful and tailored regulatory tools to prevent misconduct and reduce harm. For example, the introduction of Director Identification Numbers will provide ASIC with a more granular view of the persons and entities involved in the running of companies so that it can better address suspected phoenix activity. In a financial services context, the Design and Distribution Obligations in Part 7.8A of the *Corporations Act 2001* (Cth) (the **Corporations Act**) and associated enforcement mechanisms are intended to allow ASIC to more easily identify financial products that carry a risk of detriment to consumers.
15. The reportable situations regime now found in sections 912D, 912DAA and 912DAB of the Corporations Act (which commenced in October 2021 and has expanded the scope of breaches that are deemed reportable compared to the former breach reporting regime) presents ASIC with almost real-time data on the state of compliance with the financial services laws by Australian financial services and Australian credit licensees, because reporting is required within 30 days of the licensee becoming aware of a "reportable situation". The FS Committee is concerned that the effectiveness of the reportable situations regime is undermined by the wide variety of incidents that are deemed reportable. For example, there is no materiality threshold that applies to incidents of misleading and deceptive conduct before the reporting obligation arises.
16. The wide scope of reportable situations has resulted in some 8,000 reports being made to ASIC between 1 October 2021 and 30 June 2022, with ASIC noting that a smaller proportion of licensees have reported than expected. This indicates that ASIC expects that reporting volumes will only increase over time. It is unclear to the FS Committee whether ASIC has the systems or processes to adequately triage and review the voluminous reports that it expects to receive, which raises questions about how and whether ASIC will be able to investigate and enforce suspected breaches in an efficient and effective manner, with a focus on breaches that cause or could cause significant consumer harm.

e. The offences from which penalties can be considered and the nature of liability in these offences

17. The Committee has previously expressed concern regarding the proliferation of civil penalty offences which can carry hefty maximum penalties.
18. Subject to some limited exceptions, breach of a civil penalty offence is a reportable situation under the breach reporting regime, even if the commission of that offence is minor and isolated. The FS Committee believes that this is resulting in ASIC having an unnecessarily large volume of reported breaches to review, which can be counterproductive to enabling ASIC to efficiently respond to cases of serious misconduct.

f. The resourcing allocated to ensure investigations and enforcement action progresses in a timely manner

19. The FS Committee does not have sufficient information to comment on whether ASIC has sufficient resources to meet its statutory objectives set out in the ASIC Act.
20. The FS Committee has observed that ASIC is increasingly being called upon to play an active role in the prevention of consumer harm arising from financial products or services that are poorly designed or marketed, as well as the prevention of financial scams. In this regard, the FS Committee is of the view that ASIC does not appear to have adequate physical and technical resources to identify consumer harm or scams when they are in their early stages, and before harm has become widespread.
21. The FS Committee understands that ASIC, in part, relies on intelligence provided by consumers directly through its complaints and scam reporting portals. The wide scope of reports made to ASIC requires analysis to determine if there are grounds for ASIC to investigate or take action. Given the volume of reports it receives, the FS Committee believes that ASIC will only be in a position to investigate and commence enforcement action if it has sophisticated data collection and analysis tools and resources.
22. The FS Committee notes that ASIC has not made the same level of investment in information technology tools to assist with triaging and identifying trends in its data compared with private sector financial institutions such as the major banks. The FS Committee submits that the fast-moving nature of scams and predatory operators means that ASIC needs appropriate information technology tools to filter the information it receives from the public and identify priority areas. While the FS Committee acknowledges that ASIC will not be able to adequately address all instances of consumer harm and scams, the FS Committee believes that more sophisticated systems would assist ASIC to respond to these incidents in a more timely and effective manner.

g. Opportunities to reduce duplicative regulation

23. As part of the former Government's response to the Royal Commission, the Australian Law Reform Commission (the **ALRC**) is currently conducting a Review of the Legislative Framework for Corporations and Financial Services Regulation, with the third interim report due in August, and the final report due in November of this year. The Terms of Reference of this review include addressing the complexity that arises from the lack of consistency in definitions and key terms across the Corporations Act, and the breadth of material that covers financial services (such as legislation, regulations, class orders, and regulatory guides). The FS Committee, as part of the BLS, has previously indicated that it is highly supportive of measures to simplify and streamline the Corporations Act appropriately, particularly Chapter 7, to improve regulatory coherence and certainty for users of the legislative framework. In addition, the BLS has previously suggested the establishment of a new body, the Corporations Rules Committee, to promote simplicity and to provide a nimble and effective method of maintaining flexible and up to date rules. These and other measures are further discussed in the BLS's response to the ALRC's Interim Report B, published in December 2022.
24. In addition to those efforts, the FS Committee submits that the United Kingdom's Financial Services Regulatory Initiatives Forum provides a model for Australian regulatory agencies to consider adopting to minimise regulatory duplication and

complexity. The Financial Services Regulatory Initiatives Forum is made up of key regulatory agencies including the Bank of England, the Financial Conduct Authority (the UK's financial services conduct regulator), the Prudential Regulation Authority, the Payment Systems Regulator, the Competition and Markets Authority, the Information Commissioner's Office, The Pensions Regulator and the Financial Reporting Council.

25. The Financial Services Regulatory Initiatives Forum publishes a twice-yearly grid setting out the regulatory pipeline across those agencies for regulatory initiatives for expected regulatory initiatives in the following 24 months. The FS Committee submits that using such a model allows regulatory agencies to identify potential or likely duplication, and also assists industry participants in understanding and meeting compliance requirements. The FS Committee therefore recommends that a similar process be introduced in Australia.

SME Committee response

26. The SME Committee wishes to comment briefly on a number of small business issues which are relevant to the Inquiry. The SME Committee's comments focus on ASIC's use of infringement notices in relation to small business.
27. Whilst the SME Committee understands the various benefits associated with the use of infringement notices, it is concerned that the use of such powers could be used to target small businesses in disproportionate manner. This is of concern as small businesses have less capacity than large businesses to contest ASIC allegations in court. For example, the SME Committee notes research which has shown that continuous disclosure infringement notices have been used frequently by ASIC against small companies.²
28. The SME Committee is also concerned about limited ASIC guidance as to if and when ASIC will seek to issue an infringement notice to a small business, and whether the notices will only be used for less serious contraventions. The SME Committee further notes concerns expressed by the ALRC that infringement notices were being issued for more serious contraventions:

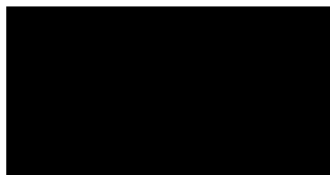
ASIC has made relatively frequent use of the infringement notice powers in relation to alleged contraventions of significant (ie non-minor) provisions. ASIC has used infringement notices for breaches of continuous disclosure obligations 37 times since their introduction, issuing approximately 3 per year on average. The number of infringement notices issued to a party at one time ranged from 1 to 3. The penalty amounts have ranged from \$33,000 to \$300,000 (by way of three notices in relation to 3 contraventions). ASIC has issued infringement notices under the ASIC Act for breaches of consumer protection provisions, 64 times since their introduction, issuing approximately 13 per year on average. The penalty amounts have ranged from \$2,040 to \$42,000. The number of infringement notices issued to a party at one time ranged from 1 to 4. Under the National Credit Act, ASIC has issued infringement notices, approximately 38 per year. The penalty

² Aakash Desai and Ian M Ramsay, 'The Use of Infringement Notices by ASIC for Alleged Continuous Disclosure Contraventions: Trends and Analysis' (2011) 39 *Australian Business Law Review* 260, 267; and Ian Ramsay, 'Enforcement of Continuous Disclosure Laws by the Australian Securities and Investments Commission' (2015) 33 *Company and Securities Law Journal* 196, 202.

amounts have ranged from \$5,500 to \$1.35M in total. The number of infringement notices issued to a party at one time ranged from 1 to 58.³

29. While the SME Committee has observed that ASIC's use of infringement notices has declined in recent times, due to the relatively short-lived "Why not litigate?" policy, the SME Committee considers that it is likely that ASIC's use of infringement notices will increase again in the near future.
30. In the SME Committee's view, given the disparity of financial resources between ASIC and small businesses, it will often be the case that a small business will decide not to contest an infringement notice in relation to a serious matter because of the cost associated with doing so.
31. The SME Committee also wishes to express its concerns about the associated adverse publicity when ASIC issues an infringement notice. As noted by Rees, the attendant publication may be more punitive than the infringement notice itself.⁴ This is particularly the case for small businesses, which often are not able to continue trading in the face of the loss of custom that arises from negative publicity following ASIC issuing an infringement notice.
32. The SME Committee's final concern relates to the inconsistencies between the penalties which apply to infringement notice provisions—for example, between the *National Consumer Credit Protection Act 2009* (Cth) and ASIC Act infringements, on the one hand, and the market integrity rule and continuous disclosure infringements on the other. The inconsistencies do not appear explicable by reference to the seriousness of the infringement. Such inconsistencies create considerable confusion and uncertainty for small business, who generally cannot afford to retain more sophisticated and experienced legal advisors to advise them about responding to an infringement notice.
33. If the Senate Economics Reference Committee has any questions or would like to further discuss with any matters raised in this submission with the FS Committee or the SME Committee, please do not hesitate to contact [REDACTED], Chair of the FS Committee [REDACTED] or [REDACTED], Chair of the SME Committee [REDACTED], as appropriate.

Yours faithfully



Philip Argy
Chairman
Business Law Section

³ ASIC Enforcement Review Taskforce Report – Treasury, 2017, p 81 (footnotes omitted)

⁴ Anne Rees, 'Infringement Notices and Federal Regulation: Wolves in Sheep's Clothing?' (2014) 42 *Australian Business Law Review* 276.