FSC FINANCIAL SERVICES COUNCIL

Australian Securities and Investment Commission investigation and enforcement - Senate Economics References Committee Inquiry

FSC Submission

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1. About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pools of managed funds in the world.

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2. Introduction and Executive Summary

2.1. Introduction

The FSC welcomes the opportunity to provide this submission to the Senate Economics References Committee (**Committee**) on the inquiry (**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.

We note the Inquiry is to have particular reference to:

a. the potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action;
b. the balance in policy settings that deliver an efficient market but also effectively deter poor behaviour;
c. whether ASIC is meeting the expectations of government, business and the community with respect to regulatory action and enforcement;
d. the range and use of various regulatory tools and their effectiveness in contributing to good market outcomes;
e. the offences from which penalties can be considered and the nature of liability in these offences;
f. the resourcing allocated to ensure investigations and enforcement action progresses in a timely manner;
g. opportunities to reduce duplicative regulation; and
h. any other related matters.

2.2. Executive summary

As an overall comment, the FSC is appreciative of ASIC's increasing efforts to make improvements to its investigation and enforcement action. We recognise and respect the importance of ASIC's investigation and enforcement action in seeking to prevent and address consumer harm and effectively administer the law.

However, we respectfully encourage the Committee to consider the following issues and suggestions which we submit could enhance ASIC's ability to investigate and bring effective enforcement action against serious misconduct to the benefit of consumers.

a. the potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action

The FSC believes that there is potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action. To reduce the impact of such undesirable consequences and resulting harm to consumers, it is necessary to focus on appropriately tailored design features and deliver equitable, efficient implementation of such schemes.

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

The FSC notes that there are a number of policy settings relevant to financial services where the balance could be materially adjusted to enhance the efficiency of the market and more effectively deter poor behaviour, to the benefit of consumers and other stakeholders. We have identified breach reporting, the proposed Financial Accountability Regime, superannuation trustee investment switching and superannuation funds amending trust deeds as four issues to note.

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

The FSC appreciates ASIC's continuing efforts to administer the law and protect consumers. The FSC is respectful of the hard work and good faith efforts of the large number of professionals at ASIC who strive to enforce the law. However, in the FSC's view ASIC can do more to meet the expectations of government, business and the community with respect to regulatory action and enforcement.

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

ASIC can do more to strike a better balance in the way it uses its regulatory tools to be effective and contribute to good market outcomes and protect consumers. A better balance needs to be struck in the use of court enforceable undertakings, civil penalties, reviews of the regulated population and the monitoring of licence conditions.

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

There are arguably too many legislated offences with serious consequences including custodial sentences that inappropriately capture minor misconduct which would not be an appropriate use of resources to prosecute. In our view, an overly expansive list of offences is less likely to be taken seriously as an effective deterrent against serious criminal behaviour.

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

The FSC supports a level of funding for the regulator which enables it to protect consumers by pursuing investigations and enforcement action in a timely manner. However, the current user-pays industry funding model places a significant cost on financial services businesses. If ASIC is provided with an increased level of funding, this should either be via the government acting to appropriate more funds, or diverting funds for further investment from existing funding. The FSC does not think it would be fair or appropriate to require industry to pay more.

g. opportunities to reduce duplicative regulation

The FSC notes that there are a number of opportunities to reduce duplicative regulation affecting the financial services industry and thus provide a clearer, more navigable and ultimately more effective framework for the prevention of consumer harm.

h. any other related matters

The FSC recommends that the Committee consider recommending changes to ASIC's current relationship model to allow stakeholders to contact ASIC's frontline staff as allocated relationship managers. This would facilitate more effective and prompt responses to simple enquiries. In turn, this should enable business to prevent and remediate consumer harm more effectively.

The FSC recommends that the Committee consider recommending ASIC reviews should include a more representative cross-section of the relevant regulated sector to reduce the likelihood of not identifying the risks present in the system that may lead to serious consumer harm.

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3. FSC Comments on Terms of Reference

3.1. potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action

The FSC believes that there is potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action. To reduce the impact of such undesirable consequences and resulting harm to consumers, it is necessary to focus on appropriately tailored design features and deliver equitable, efficient implementation of such schemes.

Dispute Resolution Schemes

The FSC believes that it is important that consumers have access to a free and open external dispute resolution (**EDR**) mechanism. Such a mechanism should provide timely outcomes for consumers and be fair to both parties to the dispute. The FSC believes a fair, transparent, timely and independent dispute resolution mechanism is in the best interest of both consumers and the financial services industry.

However, with respect to Australia's dispute resolution body, the Australian Financial Complaints Authority (**AFCA**), the FSC is concerned that AFCA is not able to consistently meet its obligations in providing a fair, efficient, timely and independent dispute resolution scheme to all parties. Any EDR scheme must ensure it can provide procedural fairness and prevent any perception of bias in favour of the complainant, remain independent and not fulfil the role of a consumer advocate nor act as a policy or law-making body. If it fails to do so, then there is the potential for complainants (and more to the point, plaintiff law firms that represent such complainants) to bring a higher number of often unmeritorious complaints than would otherwise be brought, and for the regulator to be less proactive and vigilant than it otherwise would be in its mission to protect consumers.

AFCA should not compensate consumers for an unsuccessful financial investment where the financial business has acted within the law. Financial investments can and do result in a loss for the investor, and it is not the function of a dispute resolution scheme to make an investor whole simply because the investment did not turn out the way the investor would have liked. To do so would be to potentially encourage investors to take on more risk than they otherwise would, and will add unnecessary costs to the industry.

AFCA should also remain cognisant that its role is to resolve disputes, not to make or administer law or policy. In short, AFCA must not unduly impinge on the role of Parliament or the regulator. The activities of AFCA must not discourage or disincentivise ASIC from fulfilling its duties as regulator because of the way AFCA operates.

For AFCA, this entails a number of principles that the FSC **recommends** be adhered to:

- It should be made clear that AFCA's mandate is not to advocate for or represent consumers but rather to act as an independent and impartial adjudicator.

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- AFCA should more efficiently triage cases that do not fall within its jurisdiction before requiring businesses to expend time and costs in producing documents and submissions or before taking any steps to consider the merits of an individual case.
- AFCA should not make judgments on matters of law or seek to create new policy but rather be limited to dispute resolution only.
- AFCA's jurisdiction should not overlap with other decision making bodies.
- Where AFCA identifies a potential systemic issue, it should be referred to ASIC rather than conduct its own investigation.
- In limited circumstances, AFCA's decisions should be subject to an independent review mechanism which is binding and enforceable.
- AFCA's user charge should be adjusted depending on the merits of a financial firm's case and its conduct.[1]

In addition, the FSC submits that the accountability and oversight mechanisms that apply to AFCA could be strengthened. For example, regulatory bodies, such as ASIC and APRA, are held to high standards of governance and accountability. This oversight includes being subject to the Parliamentary Joint Committee on Corporates and Financial Services; appearing before the Senate Economics Committee; independent reviews of their capability; oversight by the Financial Regulatory Assessment Authority; and public consultation on the level of industry levies and methodology.

The FSC **recommends** that the Committee consider recommending requiring AFCA to be held to a similar level of accountability as both ASIC and APRA. We believe this is important so that both consumers and financial firms can have confidence in the ability of AFCA to operate fairly, efficiently, transparently and on a cost-effective basis.

Compensation Schemes

We note that the proposed compensation scheme of last resort (**CSLR**) is premised on the proposition that those who are well resourced and capitalised (and innocent of a particular wrongdoing) should fund the wrongdoings of those who have been poorly or inadequately financially resourced. Similar to our comments regarding AFCA above, the FSC submits that the CSLR should not be seen as a general pool of funds available to compensate consumers for an unsuccessful financial investment that has simply gone wrong where the relevant

[1] The FSC notes that according to AFCA its recently revised "user charge" is proportionately allocated based on the number, closure point and complexity of the complaints each financial services business closed in the relevant financial year (compared with the same data for other firms in the same period), but it does not differentiate between financial services businesses who have been successful in defending complaints and those that have not been successful. Nor does it cater for the conduct of members during the complaints process. This is unfair. The FSC submits that the user charge should have the flexibility to charge a member more where it is generally less successful when complaints are progressed to a Determination. This would be more equitable than ignoring the result and the merits of the defence mounted by a member. If members know that their costs will be assessed based in part on the result of the case it would better incentivise members to settle cases with less merit rather than continuing to defend them. On the other hand, adopting a flat fee approach for all members reaching a certain stage of the complaints process irrespective of whether or not they are successful is plainly less fair to members who are successful in defending the complaint.

financial business has acted within the law, nor a reason for ASIC to be any the less vigorous or active in its investigation and enforcement role.

Whatever the final parameters of a CSLR, the FSC submits that without greater ASIC oversight and enforcement of existing laws, the CSLR itself will do little to reduce the consumer risk of unpaid AFCA determinations and simply shifts the cost, via levies, to financial services companies that have done nothing wrong. As a general matter, notwithstanding the introduction of the CSLR, we believe that ASIC should continue to strive to be more proactive and effective in enforcing the existing legal framework. See further comments at 3.3 to 3.6 below,

The FSC **recommends** that the Committee consider recommending that government and/or ASIC take the following measures to support the goals of the CSLR:

- introduce minimum capital requirements for Advice Licensees – this can be phased in over a suitable transition period to help streamline any financial impact;
- enhance oversight of Professional Indemnity Insurance (**PI**) – see section below "*Monitoring of license conditions – Professional Indemnity (PI) Insurance*" on page [ ];
- take greater steps to prevent phoenixing - those responsible under the licence should also be prohibited from obtaining another AFSL where unpaid determinations have been paid by the CSLR;
- reduce the administrative costs of the CSLR; and
- align the CSLR cost recovery process with the annual ASIC levy in order to reduce the operational and administrative costs for providers required to fund the CSLR.

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

The FSC notes that there are a number of policy settings relevant to financial services where the balance could be materially adjusted to enhance the efficiency of the market and more effectively deter poor behaviour, to the benefit of consumers and other stakeholders. We set out below some key issues of particular concern.

Breach Reporting

One well-known example of a policy setting that in our view does not strike the right balance between market efficiency and deterrence of serious misconduct is the new reportable situations/breach reporting regime that has been in force since 1 October 2021.

The FSC and other stakeholders have publicly commented on the problems with the breach reporting framework, some of which could be addressed as follows:

- *Reduce the number of minor breaches that must be reported*. The new breach reporting framework has created significant additional costs and resourcing pressures on industry and ASIC due to the substantial increase in the number of incidents that have now become reportable. We note that the breach reporting regulations[2] have already exempted various minor breaches from being reportable to ASIC. The FSC suggests that further exemptions are introduced by way of regulation by Treasury to reduce the regulatory burden, and the FSC also suggests that ASIC be authorised to provide further exemptions by way of legislative instrument where appropriate.
- *Improve ASIC regulatory guidance*. Regulatory Guidance RG 78 provides helpful guidance on applying the breach reporting framework. However, the FSC has pointed out to ASIC a number of areas where improvements could be made. The FSC understands that ASIC is aiming to publish a revised RG 78 in March/April 2023 and we look forward to receipt of this guidance in due course.
- *Improve the ASIC Portal*. Our members consistently tell us that using the ASIC Portal is cumbersome and needs improvement. A number of issues have previously been discussed with ASIC on various occasions. The FSC submits that the ASIC Portal functionality should be materially enhanced by ASIC.

In short, the requirement to report volumes of minor breaches coupled with significant deficiencies with the ASIC Portal and inadequate regulatory guidance are imposing significant inefficiencies and cost on the market, with no identifiable improvement in ASIC's ability to identify emerging trends of non-compliance in industry or deter material wrongdoing.

The FSC **recommends** that the Committee consider recommending that government address these and other problems with the breach reporting framework as soon as practicable to provide a better framework for the protection of consumers.

Proposed Financial Accountability Regime (FAR)

The FSC notes that there is continuing uncertainty as to whether the proposed FAR will include individual civil penalties of up to $1.1 million, as widely discussed in the press[3]. The FSC submits that government should not include individual civil penalties in the final legislation. As previously noted by the FSC, we are concerned that firms will find it more expensive to recruit for senior roles given the increased risk that will apply and this could have a detrimental impact to the Australian industry. The industry may see increased remuneration costs to compensate for risk at multiple levels of the organisation or alternatively a reduced talent pool in relation to second line roles such as IT or Human Resources due to the increased risk associated with financial services businesses. The proposed FAR that was introduced by the previous government[4] already contained a number of provisions regarding penalties (including certain ancillary liability provisions that attaches to individuals), deferred remuneration obligations and

[2] See the Financial Sector Reform (Hayne Royal Commission Response—Breach Reporting and Remediation) Regulations 2021 and the ASIC Corporations and Credit (Breach Reporting—Reportable Situations) Instrument 2021/716
[3] See for example Financial Accountability Regime: Banks force Labor to rethink $1 million executive fines (afr.com)
[4] See Financial Accountability Regime Bill 2022 – Parliament of Australia (aph.gov.au)

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disqualification orders which in our view strike the right balance between deterring misconduct and encouraging financial services businesses to grow and invest in the Australian market.

The FSC **recommends** that the Committee consider recommending that government does not include individual civil penalties in the final FAR legislation.

Superannuation Trustee Investment Switching

The FSC notes that ASIC recently investigated investment switches made by a number of superannuation fund executives in connection with possible charges for insider trading[5]. This reportedly involved a number of high level executives or their family members moving their assets out of unlisted assets on the basis of essentially information price-sensitive information known to them (but not publicly available) before these investments were materially devalued. However, in due course it became clear that the conduct in question did not technically infringe the insider trading laws[6], although did raise serious concerns about how trustees manage conflicts of interest and could constitute breaches of other financial services laws[7].

The FSC submits that this is a gap in the law and sees no policy reason why superannuation funds should not be covered by the insider trading laws or laws which are materially similar and are able to deter and punish such investment switching by superannuation fund executives in future. The gap is particularly large given that assets held by superannuation funds has grown to more than $3 trillion (with Australians generally investing more in super than in the share market, to which insider trading laws have traditionally applied) and constitute for most Australians their biggest pool of assets after their home. Meanwhile, to protect member interests, pending appropriate law reform, conduct such as this should be robustly monitored and investigated by ASIC.

The FSC **recommends** that the Committee consider recommending that government implements law reform to address the issue of investment switching by superannuation trustees on the basis of essentially information price-sensitive information known to them (but not publicly available).

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[5] See ASIC scrutinising 67 super fund employees in insider trading inquiry (afr.com); Super fund trustee snouts in the trough (afr.com)

[6] the FSC understands that insider trading in Australia covers a definition of "financial products" which as relevantly applied in the Australian legislation excludes superannuation products that are not provided by a "public offer entity", thus not capturing superannuation funds that are not open to all members of the public. The FSC does not see any policy reason why such a distinction should be made. Also, "trading" may not cover switching investment options within a fund.

[7] As ASIC explained in its media release "although this switching activity does not generally involve the acquisition or disposal of a new financial product to which the 'insider trading' prohibition attaches, investment switching with the benefit of price-sensitive information that is not available generally is similar to insider trading and may contravene other provisions of the law". See 21-282MR Surveillance of investment switching by super fund executives identifies concerns with trustees' conflicts arrangements | ASIC

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Superannuation Funds Amending Trust Deeds

The FSC refers to the various court applications[8] made by industry superannuation funds in 2021 requesting court permission to amend their trust deeds to levy a fee on members for the purposes of risk reserve funding. Court permission was obtained to enable them to raise funds by way of charging a fee to establish a risk reserve to pay criminal, civil or administrative penalties in the future, and thus mitigating the insolvency risk facing superannuation trustees. Court applications were made to ensure that the funds would be complying with the amendments to Section 56 and 57 of the Superannuation Industry (Supervision) Act 1993 Act (**SIS Act**), noting that these Sections do not permit indemnities in favour of a trustee to meet penalties for trustee wrongdoing but do permit the establishment of a risk reserve to meet penalties for trustee wrongdoing.

The FSC submits that where this enables trustees to raise a risk reserve which can be applied to pay a penalty incurred for a trustee's wrongdoing, this is an unintended consequence of the new law: there does not seem to be a logical policy reason why an indemnity is not permitted to pay for that penalty, but a risk reserve is. As drafted, the law will not deter poor behaviour or protect members if the trustee is able to seek recourse to a risk reserve to effectively pay for the trustee's wrongdoing.

The FSC **recommends** that the Committee consider recommending amendments to the SIS Act to better protect members by addressing the discrepancy caused by the wording in Section 56 and 57 which do not permit indemnities in favour of a trustee to meet penalties imposed for trustee wrongdoing but do permit the establishment of a risk reserve to meet penalties for trustee wrongdoing.

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

The FSC appreciates ASIC's continuing efforts to administer the law and protect consumers. The FSC is respectful of the hard work and good faith efforts of the large number of professionals at ASIC who strive to enforce the law. However, in the FSC's view ASIC can do more to meet the expectations of government, business and the community with respect to regulatory action and enforcement.

Government

In the FSC's view, ASIC can do more to meet the expectations of government. The Royal Commission Report, the Financial Regulator Assessment Authority (**FRAA**) Report on ASIC[9],

[8] Including Re QSuper Board [2021] QSC 276; HEST Australia Ltd [2021] VSC 809; Re Care Super Pty Ltd [2021] VSC 805; Application by LGSS Pty Ltd atf Local Government Super [2021] NSWSC 1613; Application by Maritime Super Pty Ltd atf Maritime Super [2021] NSWSC 1614; Application by Motor Trades Association of Australia Superannuation Fund Pty Ltd atf Spirit Super [2021] NSWSC 1672; Application by United Super Pty Ltd atf Construction and Building Unions Superannuation Fund [2021] NSWSC 1679; Re Care Super Pty Ltd (No 2) [2021] VSC 854; Application by NGS Super Pty Ltd atf NGS Super [2021] NSWSC 1694; and, AustralianSuper v McMillan [2021] SASC 147

[9] See Effectiveness and Capability Reviews of the Australian Securities and Investments Commission | Financial Regulator Assessment Authority (fraa.gov.au)

the records of various parliamentary committees over a number of years and the press all provide insights into areas where ASIC can improve to meet government's expectations.

We refer to the other sections of this submission with respect to the details of ASIC's areas for improvement when it comes to investigation and enforcement, and would merely mention here one notable concern that has been an issue for government, namely that ASIC has strayed into areas of policy more properly left to Parliament. While ASIC is both a regulator (law-enforcer) and law-maker, its law-making role is theoretically confined to making technical rules, or dealing with matters of detail and instruments that should not involve matters of "policy". However, in practice this line has sometimes blurred. For example, arguably, the class orders and subsequent legislative instruments that ASIC made in connection with the Foreign Financial Services Provider (**FFSP**)[10] regime involved significant matters of policy which departed from established guidelines on allocating matters in the legislative hierarchy. ASIC has also imposed positive obligations on the regulated population, which amount to quasi-legislative regimes, through class orders in the areas of custody and investment platforms.

Business

For Australian financial services businesses to serve consumers, thrive and grow Australia's reputation as an increasingly international financial centre it is important that ASIC works efficiently, transparently and effectively when investigating and enforcing the law. As a general matter, many financial services businesses consider ASIC needs to improve on these fronts. While the FSC notes that the scope of the First FRAA Review did not directly concern investigation and enforcement, there are a number of recurrent themes outlined in the public submissions provided to the FRAA which give a sense of the wide ranging concerns identified by business.[11] In particular, the FSC agrees with the FRAA Report recommendations set out on page 3 of the Report which point to a number of themes that have consistently been of concern to our members which in our view should be addressed to reduce consumer harm:

"ASIC requires a substantial uplift in its data and technology capability, which will involve cultural change.

ASIC should have a stronger focus across the organisation on enhancing the quality of its engagement with stakeholders.

ASIC should enhance its ability to measure its own effectiveness and capability and communicate the outcomes of such assessment transparently, both internally and externally.

ASIC should continue to broaden its mix of skill sets to ensure it can meet the current and future needs of the organisation."

[10] See Foreign financial services providers | ASIC.
[11] See Scope of assessment of the Australian Securities and Investments Commission | Financial Regulator Assessment Authority (fraa.gov.au)

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Community

ASIC has historically been slow to identify material wrongdoing that harms consumers and has often been ineffective at preventing it. The failings of ASIC were well documented in the by the Hayne Royal Commission (**Royal Commission**)[12], as well as more recently in the Senate Economics References Committee Report on the Sterling Income Trust[13]. ASIC has not been sufficiently effective in protecting the community. As noted in the Senate Economics Legislation Committee Report examining the proposed FAR and CSLR: "*Recent reports found ASIC investigated less than 1% of misconduct reports received during the 2020-21 Financial Year. The investigation process of ASIC must be examined in detail to determine the causes behind these low rates of investigation*."[14]

We refer the reader to the other sections of this submission which sets out in more detail areas where ASIC has not been meeting expectations of government, business or the community and where they should make further improvements to better protect consumers.

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

ASIC can do more to strike a better balance in the way it uses its regulatory tools to be effective and contribute to good market outcomes and protect consumers. To summarise the approach ASIC has taken in recent years: after a long period of over-reliance on conciliation and enforceable undertakings which was heavily criticised by the Royal Commission, ASIC then embarked on a period of high-profile and costly litigation, the merits of which were not always clear. Following the release of the Royal Commission's final reports, ASIC then briefly adopted a culture of "why not litigate" under former Chairman James Shipton, until this mantra was then abandoned by current Chairman Joe Longo. The FSC considers that there is now a risk that ASIC will go from a strategy of embarking on arguably excessive litigation to a strategy of not initiating appropriately directed litigation that seeks to address serious misconduct. A better balance needs to be struck.

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[12] See Final Report | Royal Commissions, for example at page 413 "the Australian Securities and Investments Commission (ASIC) accepted that its enforcement approach
must change."

[13] See Sterling Income Trust – Parliament of Australia (aph.gov.au) at paragraph 4.3.5 "many stakeholders expressed strong concerns that the losses suffered by tenants and other investors could have been prevented had ASIC taken a more proactive stance on protecting consumers in the financial services industry", at paragraph 4.5.1 "Given that each of the risks outlined above should have been of serious concern, a question arises as to why ASIC did not consider the combined risks to be of sufficient gravity to act sooner", and at paragraph 5.5.2 "Also of note is ASIC's lack of concern regarding the involvement of questionable directors and key personnel."

[14] See paragraph 1.40 at page 42 of the Senate Economics Legislation Committee Report: Financial Accountability Regime Bill 2022 [Provisions] and Financial Sector Reform Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 [Provisions] (aph.gov.au)

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Court enforceable undertakings

With respect to court enforceable undertakings, the FSC supports the recent changed requirement where ASIC will now generally require that an enforceable undertaking contains an admission that the entity contravened specific legislative provisions accept an enforceable undertaking, and that accepting it would be in the public interest (in contrast to previous guidance which required it to be the most effective and appropriate regulatory outcome). This is an improvement from previous practice. We also note that ASIC is willing to accept an enforceable undertaking to deal with remediation and systemic compliance or systems errors. But it remains the case that an enforceable undertaking only remains suitable for certain situations (and should not be an option in cases involving criminal conduct, wilful misconduct or similar).

The FSC submits that litigation (and civil penalty proceedings) should still be an option for those cases that demonstrate material harm to consumers or market integrity, or cases that demonstrate deliberate or reckless misconduct.

Civil penalties

That said, ASIC should not commence civil penalty litigation where reputable financial services businesses have effectively remediated losses suffered by their customers, or properly addressed compliance breaches or inadvertent minor breaches. ASIC should also enable financial services businesses to engage in investigations where appropriate so that different regulatory tools can be assessed in context and with the benefit of input from the business.

The FSC submits that ultimately the range of civil penalties available to ASIC for breach of financial services laws in Australia will only have an effective deterrence value and better protect consumers if ASIC is willing and able to bring timely enforcement proceedings in appropriate circumstances. The penalty amount must be carefully calibrated so that it acts as a deterrent, but not so high as to make financial services business overly risk-averse.

As Professor Hanrahan notes[15], *"in the area of white-collar crime (which typically involves deliberate wrongdoing) studies conclude that increasing the perception in people's minds that they will get caught if they break the law is much more significant than increasing the size of the maximum penalty. In regulation, there is a trade-off in finding optimal deterrence, otherwise the danger is that companies and their directors will become excessively risk-averse*".

The FSC **recommends** that the Committee consider recommending that ASIC seeks to address consumer harm by initiating more timely enforcement proceedings for serious misconduct.

[15] See Professor Pamela Hanrahan "*Could civil penalties deter misconduct of director duties"* Could civil penalties deter misconduct of director duties? (aicd.com.au).

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Reviews of the regulated population

In addition, with respect to all the above, it is suggested that ASIC work in a more coordinated fashion across the organisation and move more quickly to abandon the "siloed" approach in respect of which it has been criticised in recent years. Working across teams in a whole of organisation approach should start well before any enforcement action proper commences. For example, ASIC's approach to the regulation of managed investment schemes (**MIS**) and superannuation sector has often been quite siloed and not aligned between both sectors. Take ASIC's review of responsible entity governance[16] (**RE governance**) which reviewed 10 large responsible entities of managed investment schemes and reviewed specific aspects of RE governance. We understand that the review solely focused on RE business models; such as board composition, performance and governance including compliance committees and service provided oversight. ASIC did not at the same time appear to be examining similar business and governance practices in place by trustees across superannuation. Given that the vast majority of funds under management by Australians is indirectly held we submit that it is prudent for ASIC to undertake such reviews of the MIS and superannuation sectors together.

Internal operational segmentation within ASIC, with separate Superannuation and investment management divisions, should not form the basis for siloed oversight over these two segments given Australian investors expect strong governance and oversight of both sectors.

The FSC **recommends** the Committee consider recommending that ASIC consider jointly reviewing funds management and superannuation sectors together in its reviews.

Monitoring of licence conditions – Professional Indemnity (PI) Insurance

To better prevent consumer harm, the FSC suggests that ASIC can do more to monitor whether financial services businesses actually comply with their licence conditions from time to time.

One well-known area of concern is that of PI. If a regulated provider does not have in place appropriate PI, this may materially impact the institutions' ability to compensate consumers for misconduct. This issue was raised by the ombudsman preceding AFCA, the Financial Ombudsman Service (**FOS**) that identified a key contributor to unpaid determinations arises from a financial services provider having insufficient capital to pay the unpaid determination or a professional indemnity insurance policy which does not respond to claims, and

[16] See ASIC releases findings from review of responsible entity governance | ASIC. In our view, whilst there are legal distinctions for investment held directly through a managed fund or indirectly via superannuation, the key distinction for most Australians is that these are simply two different investment vehicles - providing different entry and exit points for Australians to invest their capital. Consumers expect strong governance and seek positive financial outcomes from their investments irrespective of whether they are invested directly in a managed fund or indirectly through superannuation.

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acknowledged by AFCA in its submission to the Royal Commission's Interim Report[17]. ASIC also noted in its **submission to the Review of the financial system external dispute resolution framework Supplementary Issues Paper** that "*PI insurance is an essential component of the compensation framework and a first line of defence against uncompensated loss". and should continue to be so, noting that "PI insurance must remain the first line of defence so that any scheme is truly a last resort for uncompensated loss*"[18].

Given this, it is concerning that ASIC appears to have done little to ensure licensees have appropriate professional indemnity insurance/adequate compensation arrangements in place. One of the shortcomings with PI is that it is based on a self-assessment model whereby licensees self-determine that the PI is sufficient to meet compensation arrangement requirement[19]. Further, ASIC only collects information about a licensee's PI Insurance policy at the time of license application (other than in the context of a specific surveillance).[20] But the FSC is not aware of any general monitoring or oversight process being undertaken by ASIC to check whether a licensee continues to have adequate compensation arrangements/PI in place other than at time of issuing a licence.

In 2017, in a submission to the EDR Review Supplementary Issuer paper, ASIC proposed strengthening PI oversight for those licensees which rely on PI To meet their AFSL obligations;

"*If a compensation scheme of last resort is introduced, we think that there is merit in considering whether those licensees that rely on PI insurance to meet their licensing obligations should provide ASIC with data about their PI insurance on an annual, ongoing basis."*[21]

The FSC would query why ASIC suggested that bolstering oversight over PI should be linked to the CSLR introduction. In our view, system weaknesses should be addressed irrespective of whether a CSLR is introduced.

Similarly, in July 2022, ASIC released update *Regulatory Guide 126 :Compensation and insurance arrangements for AFS licensee*. The guidance notes that ASIC may ask a licensee to provide a copy of their PI policy or information on compensation arrangements "from time to time".[22] This suggests that since putting forward their proposal to strengthen PI oversight – requiring licensees to provide PI information to ASIC on an annual basis –ASIC has not implemented this requirement, notwithstanding the benefits to consumers that it could provide. The FSC respectfully submits that ASIC has had the opportunity to implement the proposal requiring AFSL providers to give the PI to ASIC on an annual basis, however it has apparently not done so.

[17] http://www.afca.org.au/sites/default/files/2019-12/afcas-submission-response-to-the-royal-commission-interim-report.pdf
[18] See ASIC - Submission to the EDR Review Supplementary Issues Paper (treasury.gov.au)
[19] Financial planners' unpaid FOS penalties exceed $7.6 million - Professional Planner
[20] Paragraph 36 ASIC - Submission to the EDR Review Supplementary Issues Paper (treasury.gov.au)
[21] See Paragraph 32 ASIC - Submission to the EDR Review Supplementary Issues Paper (treasury.gov.au)
[22] See RG 126.56 Regulatory Guide RG 126 Compensation and insurance arrangements for AFS licensees (asic.gov.au)

The FSC **recommends** that the Committee consider recommending that ASIC require licensees that rely on PI to meet licensing and compensation obligations to provide ASIC PI insurance data on an annual basis[23].

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

The FSC notes that following the Royal Commission's report and the findings of the ASIC Enforcement Review Taskforce[24], the penalties framework contained in, among others, the Corporations Act was significantly expanded (notably, there was a material expansion in the civil penalty regime and the introduction of heightened penalties for companies and individuals). Individuals working in the financial services industry now face longer custodial sentences for criminal offences, while companies face higher pecuniary penalties.

The aim of introducing these more severe penalties was to increase the deterrent effect of the law in respect of serious misconduct. However, the fact is that these offences and penalty provisions catch a very broad range of misconduct, including misconduct which may not result in consumer harm and which no ordinary person would consider sufficiently serious to merit a prison sentence.

For example, where an insurance representative at some stage in a communication provides general advice about a financial product or class of product but omits to provide the general advice warning (**GAW**) in breach of s949A(2) of the Corporations Act this constitutes an offence pursuant to s1311 of the Act with a maximum penalty of 2 years imprisonment. But in our view it is hard to conceive of a scenario where a reasonable person would think that the insurance representative should spend 2 years in prison just for this. In addition, under the new breach reporting framework, this type of offence is automatically reportable as a "deemed significant breach" under section 912D(4)(a)(ii) of the Act. But again, we submit that it is likely most people would not consider simply forgetting to provide a GAW in this situation should be considered a significant breach that needs to be reported to ASIC and which ASIC needs to consider and catalogue.

Another example arises in respect of the new criminal offence provisions in the Design and Distribution (**DDO**) legislation. While it is arguable that some of the more serious breaches in the DDO regime – such as failing to make a target market determination – could, depending on the circumstances, potentially justify a criminal sanction, this is more difficult to justify for other provisions. For instance, the requirement in section 994B(9) of the Act, which requires that target market determinations be made available to the public free of charge. A breach of

[23] On a related note, ASIC has also in recent years began a process of substantial data collection, including notably via the new breach reporting regime. This has resulted in excessive volumes of inconsequential data being provided to ASIC ostens bly for the purposes of better regulation. Again, the FSC submits that a better balance needs to be struck with respect to ASIC's approach to data collection so that it is better able to use the limited resources available to it and avoid an undue regulatory burden on industry.

[24] See Taskforce report | Treasury.gov.au

this section is both a criminal offence and a civil penalty provision. It would seem that a business which accidentally and unknowingly fails to upload a TMD to its website due to technical problems or human error would be caught and it is in our view inappropriate that this should lead to criminal sanction.

The FSC **recommends** that the Committee consider recommending that the legislation should be reviewed so that the offence provisions only capture serious misconduct that causes consumer harm. There are arguably too many legislated offences with serious consequences including custodial sentences that inappropriately capture minor misconduct which would not be an appropriate use of resources to prosecute. An overly expansive list of offences is less likely to be taken seriously as an effective deterrent against serious criminal behaviour.

3.6. the resourcing allocated to ensure investigations and enforcement action progresses in a timely manner;

The FSC supports a level of funding for the regulator which enables it to protect consumers by pursuing investigations and enforcement action in a timely manner. However, the current user-pays industry funding model places a significant cost on financial services businesses. If ASIC is provided with an increased level of funding, this should either be via the government acting to appropriate more funds, or diverting funds for further investment from existing funding. The FSC does not think it would be fair or appropriate to require industry to pay more.

We note that ASIC has consistently received funding increases to properly perform its duties, notably after the Royal Commission report was released in 2019, the previous government provided $400 million in additional funding to ASIC over the following four years, which represented a 25% increase on 2017-18 funding. The annual appropriation given to ASIC has risen substantially over the last five years, from $607 million in 2016-17 to $861 million in 2021-22.23[25].

In this regard, the cost burden for industry in funding ASIC's activities is significant. The rising cost of ASIC cost recovery levies should be considered together with the cost of other industry levies. For example, the FSC notes that other industry levies administered by APRA – e.g. the Financial Institutions Supervisory Levies - have also increased, while new proposed legislation such as the Financial Accountability Regime and Compensation Scheme of Last Resort will add to the already significant financial burden.

The FSC **recommends** that the Committee consider recommending that the ASIC industry levy cost burden be reassessed in the context of the total burden on regulated businesses.

[25] See page 41, paragraph 1.38 of the Senate Economics Legislation Committee Report: Financial Accountability Regime Bill 2022 [Provisions] and Financial Sector Reform Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy Bill 2022 [Provisions] and Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 [Provisions] (aph.gov.au).

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ASIC industry funding model should be revisited

The FSC submits that consideration should be given to the question of whether the ASIC IFM should be changed from an ex-post model to an ex-ante model to improve ASIC's investigation and enforcement action.

In this regard, we refer to the recent Treasury Discussion Paper[26], which noted:

"*ASIC is one of the few regulators that recovers regulatory costs via industry levies using an ex-post model – that is, costs are recovered in the financial year after the regulatory costs were incurred. Most other regulators that recover regulatory costs via levies do so on an ex-ante basis – that is, costs are determined and recovered before the costs are expended. This requires regulators to set a budget and determine resource and cost allocations across their regulated population in advance of regulatory activity being undertaken*".

The ex-post model effectively reimburses for costs it incurs in a prior financial year, and hence does not require ASIC to efficiently set a budget and determine resource allocations in advance. This model differs from the model which governs other international peer group regulators, such as the UKFCA and the US SEC. But it is not clear to the FSC why other regulators are able to work with an ex-ante model and ASIC is not and we would respectfully welcome more detail as to what the arguments are for this distinction.

The FSC **recommends** that the Committee consider recommending that government examine the basic characteristics of the ex-post model and consider whether it should be changed to an ex-ante model, which is the model that applies to many other international regulators.

Costs of enforcement activity are not effectively controlled

The amount of the industry levy related to costs of enforcement activity should be better controlled. ASIC should implement effective measures to control third party professional adviser fees of legal counsel and other relevant professionals. For example, professional advisers could be asked to provide fee caps or strictly controlled fee estimates in respect of particular matters. In many other jurisdictions, legal counsel are required to provide fee caps for work done. ASIC could require this as well. ASIC could also consider how it can better control enforcement costs (for example, through more appropriate numbers and levels of staff being allocated to particular workstreams for particular time periods). ASIC could also be required to provide more details regarding the basis on which third party advisor fees are paid.

The FSC **recommends** that the Committee consider recommending that ASIC make material changes to control the internal and third party costs of enforcement activity.

[26] See ASIC Industry Funding Model Review | Treasury.gov.au

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Moral hazard caused by ASIC Industry Funding Model

Relatedly, we note that the basic premise regarding the ASIC IFM requires innocent third parties to pay for the wrongdoings of others. In our view, this is another example of moral hazard that can distort the market. It is in our view an unfair model. It requires businesses that fall within the IFM regulated sector to pay for wrongdoing even if they have no meaningful connection to a business that has engaged in wrongdoing. Meanwhile the IFM does not include any funding from government consolidated revenue, even where it is plain that certain activities of ASIC can and do serve and protect "the public" at large more than they serve and protect the regulated sectors that are required to fund the IFM.

3.7. opportunities to reduce duplicative regulation

The FSC notes that there are a number of opportunities to reduce duplicative regulation affecting the financial services industry and thus provide a clearer, more navigable and ultimately more effective framework for the prevention of consumer harm. Set out below are a few examples for consideration.

Duplication of offence provisions

In respect of the offence and penalty provisions in corporations and financial services legislation, the FSC submits that there are opportunities to consolidate these into a smaller number of provisions covering the same conduct. Consolidation of this nature should reduce duplication. That said, care needs to be taken so that any provisions repealed under any consolidation of provisions cover the "same" conduct and not simply "similar" conduct. In addition, any consolidation should not dilute the operational effectiveness of the provision or result in the purpose of the repealed provision no longer operating as intended in any consolidated form. And consistency would be important in determining the "new" penalty for a consolidated offence (that is to say, where two "similar offences" covering the "same conduct" have different penalties and are then consolidated into a single offence, what process would determine whether the lower penalty is applied or the higher penalty)?

The application of civil penalties to a particular action is not clear

The FSC is concerned that there are multiple avenues for ASIC and other regulators to impose penalties on persons operating in the financial services industry, with different Acts containing similar prohibitions having different penalties, and a lack of clarity on how this can apply. For example, with respect to civil penalties that can be imposed on RSE licensees, these would differ depending on whether action is taken against them for (a) breach of the standard of care in the SIS Act, (b) the efficiently, honestly and fairly obligation in the Corporations Act, or (c) the honesty, integrity and standard of care obligations in the proposed FAR. In respect of FAR, it is also unclear whether ASIC and APRA can each seek civil penalties. This would appear to afford undue opportunities for regulatory arbitrage on the part of regulators.

Misalignments between legislation

A related issue is that of misalignments between legislation. For example, APRA's directions power under the SIS Act permits APRA to give a direction where APRA "has a reason to

believe" the RSE licensee has contravened a provision of the SIS Act. Yet under FAR, APRA may give a direction where it "reasonably believes". The FAR wording imposes an objective test (which is arguably stricter) whereas the SIS Act test is subjective. It is not clear why these tests should be worded differently in respect of these different two different Acts, nor how the APRA proposes to interpret these provisions when the FAR is brought in to force. The two Acts should in due course be aligned, failing which appropriate regulatory guidance should be published to clarify the position.

Design and Distribution Obligations and Internal Dispute Resolution (IDR) requirements overlap

The DDO requires distributors, including investment platforms and financial advisers, to make regular reports to product issuers about any complaints the distributor has received about a product. This requirement applies whether or not the distributor has already made a report to the issuer about the complaint.

With the introduction of IDR requirements, there is a separate requirement for distributors to provide product issuers with details of certain complaints they have received.

As a result, there is now overlapping complaint reporting requirements, each with different approaches. The DDO complaint requirements and the IDR requirements have multiple differences:

- The requirements can cover different types of complaints;
- They can have different requirements for content of reporting;
- They can have different reporting periods; and
- They can have different reporting deadlines.

This is costly, complicated and confusing for both distributors and issuers and seems of little apparent benefit to consumers. Product issuers can easily receive multiple versions of the same complaint and the versions may differ and cause unnecessary work for all parties. This duplication should be rationalised.

ASIC and APRA also overlap

Both ASIC and APRA have a regulatory role in relation to a number of areas that overlap with regards to financial services businesses. For example, with regards to the matter of conflict obligations, ASIC administers the Corporations Act 2001, which provides that trustees must have in place arrangements for the management of conflicts of interests involved in providing a superannuation trustee service. ASIC has published guidance[27] which sets out their approach to compliance with the Corporations Act. Similarly, APRA also administers conflict obligations that apply to superannuation trustees under the SIS Act. APRA has released a

[27] See RG 181 *Licensing: Managing conflicts of interest*

Prudential Standard[28] that deals with conflicts. The FSC submits that this overlap should be reduced.

3.8. any other related matters

Relationship Model

Currently, the process for external stakeholders wishing to address small queries with ASIC is unnecessarily complex. Communication options include sending an email (which can take up to 5 business days to respond), waiting on the general enquiry phone line (which often takes hours to answer), or corresponding on web chat (which can also take hours). Designated ASIC officers for public entities would improve the response time and relational outcomes of interactions with the regulator. This situation could be improved. As a minimum measure a contact centre should be established, however, preference is given to the adoption of a relationship model that allows stakeholders to contact ASIC's frontline staff as allocated relationship managers. ASIC's development of allocated relationship managers for superannuation funds, who are familiar with the businesses they look after, has strong support from our members and should be considered for other major regulated entities.

The FSC **recommends** that the Committee consider recommending changes to ASIC's current relationship model that allows stakeholders to contact ASIC's frontline staff as allocated relationship managers. This would facilitate more effective and prompt responses to simple enquiries. In turn, this should enable business to more effectively prevent and remediate consumer harm.

Reviews of the regulated population are not representative

The FSC submits that ASIC reviews should include a more representative cross-section of its regulated sector/population. Instead, ASIC reviews commonly focus on the largest entities in a sector only, which is unlikely to be representative of the systems and practices implemented within the sector more broadly[29]. Larger entities may have more resources in place to allocate to systems, processes and personal required to carry out requirements, meet their financial services obligations and serve their customers. And by failing to obtain a broader representation of sectoral viewpoints, this may add to the risk of not identifying the risks

[28] See SPS 521 Conflicts of Interest.
[29] See for example the 2022 ASIC responsible entity review which focused on 10 large RE's which represented 39.9% of funds under management in all registered schemes Governance of respons ble entities Slide Pack (asici.gov.au); review of financial advice provided by the 5 biggest vertically integrated institutions 18-019MR ASIC reports on how large financial institutions manage conflicts of interest in financial advice | ASIC; ASIC TPD Insurance Report 969 in 2021 – focused on 9 insurers Report REP 696 TPD insurance: Progress made but gaps remain (asic.gov.au); and ASIC Report 675 Default insurance in superannuation member value for money in 2020 issued notices to 11 super trustees Report REP 675 Default insurance in superannuation: Member value for money (asic.gov.au)

present in the system that may lead to serious consumer harm. The FSC submits that including a more representative sample in ASIC's reviews has the potential to better reflect the breadth of practices, potential shortcomings and risks to consumers in a sector. To the extent that reviews also require providers to address any potential shortcomings or lift practices, this may lift practices across the board not just for larger institutions which often tend to be part of a review. Further, data and information requests are resource intensive and can be cumbersome imposing costs on businesses subject to the data request. Having a cross-section of the industry participate in a review would also help to spread resource requirements across the industry, reducing the risk that larger entities are called on to provide data/information on a repeated basis.

The FSC **recommends** that the Committee consider recommending that ASIC reviews should include a more representative cross-section of the relevant regulated sector to reduce the likelihood of not identifying the risks present in the system that may lead to serious consumer harm.