

Senator Mark Bishop
Chair
Senate Economic References Committee
Parliament House
Canberra ACT 2600
Via email: economics.sen@aph.gov.au

21 March 2014

Dear Senator Bishop,

Senate Economics References Committee - Response to question on notice

1. We refer to the email dated 28 February 2014 from Morana Kavgic requesting a response to a question on notice, arising out of the hearing of the Senate Economic References Committee on 20 February 2014. This response is provided on behalf of the Corporations Committee of the Business Law Section of the Law Council of Australia ('the Corporations Committee').
2. As requested, we set out below the text of the question:

(p. 7)

CHAIR: *Before I go to Senator Bushby, could I ask you to take on notice and raise with your committee the issue that has been quite prominent in these discussions. We would like the Law Council's views on some form of early intervention mechanism where there is more than a fear that a clear and present danger of malfeasance or fraud is occurring and what appropriate response and appropriate protections should ASIC be armed with to prevent these scandals leaving minor areas to turn into major events. Could you relate the thrust of the discussion that the committee has had with your organisation today and perhaps ask it to give us a written submission on notice that addresses those concerns. The committee is going to be meeting for some time yet. Although I have not caucused my colleagues, I suspect all of us would be very interested in your considered response in due course.*

The Corporations Committee's response to the Chair's question

3. The Corporations Committee understands that the Senate Economic References Committee is considering a possible legislative response to perceived limitations on ASIC's ability to act in cases of inappropriate conduct by financial services

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licensees, perhaps by giving ASIC power to intervene when there was a basis for concern about the activities of the licensee.

4. For the purposes of responding the question, the Corporations Committee assumes that the measure would involve giving ASIC the power to stop the activities of the licensee, presumably by suspending the licensee's Australian financial services licence (**AFSL**).¹

ASIC's current powers

5. The Corporations Committee notes that ASIC has the power to suspend an AFSL under section 915C of the Corporations Act. A copy of section 915C is set out in Appendix 1 for ease of reference.
6. Under section 915C, ASIC has the power to suspend an AFSL (subject to giving a prior hearing in accordance with section 915C(4)) in various circumstances, including where:
 - the licensee has failed to comply with its obligations under section 912A
 - ASIC has "reason to believe" that the licensee will not comply with its obligations under section 912A
 - ASIC is no longer satisfied that the licensee or the licensee's representatives are of good fame or character.
7. In addition, section 915B allows ASIC to suspend or cancel a licence immediately in certain circumstances which suggest a need for quick action, including, in the case of an AFSL held by a body corporate, where the body:
 - becomes an externally-administered body corporate
 - is a responsible entity of a registered scheme whose members have suffered, or are likely to suffer, loss or damage because the body has breached the Corporations Act
 - is a trustee company whose clients have suffered, or are likely to suffer, loss or damage because the company has breached the Corporations Act or certain financial services laws.
8. In the view of the Corporations Committee, these powers should be adequate to enable ASIC to respond to inappropriate behaviour by licensees.
9. In relation to ASIC's powers under section 912A, section 912A sets out the general obligations of a licensee. A copy of section 912A is set out for ease of reference in Appendix 2.
10. Among other things, ASIC can act if it has reason to believe that the licensee is will not act "honestly, efficiently and fairly" (reading section 915C together with section

¹ Another possible measure would be extending ASIC's power to ban individuals. The principles applicable to such a measure are in the Committee's submission essentially the same as for the assumed measure in relation to licensees.

912A). This is not, in our submission, a very difficult threshold for ASIC to meet to enable suspension. Certainly, if ASIC had evidence that would justify the view there was a “clear and present danger” (to use the expression used in the question on notice) of a breach of the Corporations Act or other malfeasance, it is likely that it would be empowered to suspend the AFLS in question.

11. We do note that ASIC must have some evidentiary basis for acting under section 915C. A decision by ASIC to take action without some probative material as a basis would be unlawful and reviewable. Further, ASIC is required to give a licensee the opportunity to appear at a hearing.
12. These requirements reflect very basic protections for citizens in relation to action taken by government or its agencies (not just ASIC) – that there must be some basis for an administrative act such as suspending a licence and that natural justice requires a hearing before the removal of a licence that permits a person to earn their livelihood. The Corporations Act currently reflect these widely accepted values, that are reflected to a greater or lesser extent in relation to other forms of occupational regulation.

A more pre-emptive power?

13. Is there a case for granting ASIC a more pre-emptive power to intervene? While such a proposal may appear, on the face of it, to be attractive in order to seek to avoid clients suffering substantial losses, in our submission, any such legislative proposal would need to be considered with great care. It is by no means clear (see above) that ASIC’s current powers are insufficient. Further, the removal of fundamental safeguards that reflect basic rule of law and natural justice principles should only contemplated where this has been shown to be both necessary and justified.
14. First, allowing ASIC to suspend a licence pre-emptively on the basis of a mere suspicion of a breach of section 912A, would likely be inherently unfair, in that it could inflict irreparable damage to a licensee’s livelihood and reputation in circumstances where the suspicion may on inquiry prove to be unfounded. The mere fact of a suspension would be damaging in a manner that would be difficult to reverse if the suspicion ultimately turned out to be wrong. Further, the suspension could adversely affect the clients of the licensee – the very people that measure would be designed to protect – by removing their access to advice.
15. Second, suspending a licence without a hearing, merely on the basis of suspicion places considerable power in the hands of a regulator, power that can, unjustly, cause great harm, despite the best of intentions. As a general principle, it has been long accepted that a licence generally should not be revoked or suspended by a regulator without first giving the citizen the opportunity to respond to the complaint.
16. That said, ASIC could be given a power to immediately suspend an AFSL without having to give any prior opportunity to be heard, but such powers are generally confined to circumstances where there is a clearly demonstrated need for urgent action. That is why the power in section 915B, which does not expressly require a prior hearing (although, depending on the circumstances, procedural fairness may still require one), is only exercisable in limited cases such as where the licensee

has been placed in external administration or has committed serious breaches of relevant laws. An unnecessarily broad power to act without regard to procedural fairness would be offensive to long accepted and fundamentally important rule of law principles.² Moreover, would AFSL holders be prepared to invest in businesses and employ workers if they were at risk of having their licence suspended at the whim of ASIC? Such a power would be both unfair and lead to uncertainty, deterring a far wider range of economic activity than just the intended targets of the measure.

17. If ASIC exercised the power inappropriately and inflicted damage on a licensee, would ASIC be obliged to compensate the licensee, and the licensee's clients? If ASIC had such an obligation it might be hesitant to act, but if ASIC did not have such an obligation it could unfairly and unnecessarily inflict damage on licensees who have done nothing wrong.
18. In our submission, sections 915B and 915C as they currently stand give ASIC adequate power and strike an appropriate balance between the competing interests.
19. The Corporations Committee also notes the existence of section 1101B of the Corporations Act that gives Court the power, on the application of ASIC, to make orders if it appears to the Court that a person, among other things, has contravened a provision of Chapter 7 of the Corporations Act (dealing with financial products, services and licensing) or breached an AFSL. The Court may also make interim orders pending the determination of the application (subsection 1101B(5)), and ASIC is not required to give an undertaking as to damages as a condition to making an interim order (subsection 1101B(6)).
20. These provisions already give the Court, on the application of ASIC, wide powers to intervene. In the view of the Corporations Committee, ASIC should not be given additional powers unless it can be shown that it has exhausted the existing regulatory responses available to it, including ASIC's current powers to apply to the Court for orders under section 1101B. If it was to be asserted that ASIC was not able to use that (or any other) power due to an inability to marshal sufficient evidence to form the basis for an application to the Court (or the exercise of another power), the Corporations Committee would not consider that an appropriate policy response would be to simply empower ASIC to act in the absence of appropriate evidence.
21. However, if the Committee was minded to recommend an expanded power to pre-emptively suspend an AFSL, the following approach could be adopted in order to minimise the potential for unnecessary prejudice.
22. ASIC could be required to obtain approval from the Court before pre-emptively suspending an AFSL without a hearing. This would provide a measure of oversight and external scrutiny and ensure that ASIC has appropriate justification for proceeding in this manner. If this approach were to be adopted, the legislation should set out, in terms no wider than necessary, the very exceptional circumstances in which the exercise of this power would be warranted.

² It might also be offensive to the principle of separation of powers, which requires that a finding of criminal conduct should only be made by a court exercising criminal jurisdiction – see the recent case of *Today FM (Sydney) Pty Ltd v ACMA* [2014] FCAFC 22 (14 March 2014).

23. This might be achieved by amending section 1101B and outlining the circumstances in which AFSL might be pre-emptively suspended by, or with the approval of, an order of the Court under that provision.³

The Corporations Committee's suggested response to the problem

24. However, in our submission, the better response to concerns about the conduct of holders of AFSLs is to raise the general standards of behaviour in the finance industry, and “pre-emptively” prevent the inappropriate behaviour that may be likely to have adverse effects on others.
25. In other words, we submit that, if anything is to be done, further measures should be considered to *prevent* inappropriate behaviour before it happens rather than respond after the event.

* * *

Yours sincerely

John Keeves
Chairman, Business Law Section

³ Any such power would need to be drafted in terms appropriate for a Court exercising jurisdiction under Chapter III of the Commonwealth Constitution.

Appendix 1

915C Suspension or cancellation after offering a hearing

- (1) ASIC may suspend or cancel an Australian financial services licence (subject to complying with subsection (4)) in any of the following cases:
 - (a) the licensee has not complied with their obligations under section 912A;
 - (aa) ASIC has reason to believe that the licensee will not comply with their obligations under section 912A;
 - (b) ASIC is no longer satisfied of the matter in whichever of subsection 913B(2) or (3) applied at the time the licence was granted (about whether the licensee, or the licensee's representatives, are of good fame or character);
 - (c) a banning order or disqualification order under Division 8 is made against the licensee;
 - (d) a banning order or disqualification order under Division 8 is made against a representative of the licensee and ASIC considers that the representative's involvement in the provision of the licensee's financial services will significantly impair the licensee's ability to meet its obligations under this Chapter.
- (2) ASIC may also cancel an Australian financial services licence (subject to complying with subsection (4)) if:
 - (a) the application for the licence was false in a material particular or materially misleading; or
 - (b) there was an omission of a material matter from the application.
- (3) An Australian financial services licence is suspended or cancelled by ASIC giving written notice to the licensee.
- (4) However, ASIC may only suspend or cancel an Australian financial services licence under this section after giving the licensee an opportunity:
 - (a) to appear, or be represented, at a hearing before ASIC that takes place in private; and
 - (b) to make submissions to ASIC on the matter.

Appendix 2

912A General obligations

- (1) A financial services licensee must:
 - (a) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; and
 - (aa) have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative; and
 - (b) comply with the conditions on the licence; and
 - (c) comply with the financial services laws; and
 - (ca) take reasonable steps to ensure that its representatives comply with the financial services laws; and
 - (d) unless the licensee is a body regulated by APRA—have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and
 - (e) maintain the competence to provide those financial services; and
 - (f) ensure that its representatives are adequately trained, and are competent, to provide those financial services; and
 - (g) if those financial services are provided to persons as retail clients—have a dispute resolution system complying with subsection (2); and
 - (h) unless the licensee is a body regulated by APRA—have adequate risk management systems; and
 - (i) comply with any other obligations that are prescribed by regulations made for the purposes of this paragraph.