

## Chapter 8

### Discretionary powers of the Australian Securities and Investments Commission

8.1 The Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) enhances the Australian Securities and Investments Commission's (ASIC's) licensing and banning powers. Currently, ASIC only has the ability to prosecute licensees: the Bill will allow ASIC to prosecute individual financial advisers in breach of their obligations.

8.2 Under the new provisions, ASIC's licensing and banning powers will be extended to:

- refuse or cancel/suspend a licence where ASIC has a reason to believe a person is likely to contravene (rather than will breach) its obligations;
- ban a person (as opposed to an entity) who is not of good fame and character or not adequately trained or competent to provide financial services;
- consider any conviction for an offence involving dishonesty that is punishable by imprisonment for at least three months, in having a reason to believe a person is not of good fame and character for licensing and banning decisions;
- ban a person if it believes they are likely to (rather than will) contravene a financial services law; and
- ban a person who is involved, or is likely to be involved, in a contravention of obligations by another person.<sup>1</sup>

8.3 These provisions are in response to concerns raised by ASIC about its ability to protect investors by restricting or removing industry participants who may cause investor losses. ASIC has encountered difficulty in this process because the licence threshold entry is low and the threshold for cancelling a licence is relatively high.<sup>2</sup>

8.4 Treasury noted the difficulties that ASIC has in taking a proactive approach to protect consumers and that the Bill is intended to address this issue:

It is recognised that while there are important reasons for the current formulation of ASIC's powers (around, for example, natural justice for licensees and their representatives), current evidentiary thresholds make it very difficult for a regulator to be proactive in protecting consumers before an adverse outcome takes place. Under current arrangements, it is relatively

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1 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 20.

2 Australian Securities and Investments Commission, *Submission 28*, p. 6.

easier to be reactive by enforcing the law after it has been breached and after potential adverse outcomes have already taken place.

In light of the above concerns, in the Ripoll Report recommended that the Corporations Act should be amended to provide extended powers for ASIC to ban people from the financial services industry under section 920A (recommendation 6). It also recommended that ASIC be able to deny a licence application or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with its obligations under sections 913B and 915C of the Corporations Act (recommendation 8).<sup>15</sup>

As a result of this recommendation, the Bill clarifies the operation of ASIC's banning power and sets out new tests under which ASIC can exercise its discretion to remove persons from the financial services industry.<sup>3</sup>

### *Adequacy of ASIC's current powers*

8.5 Currently, ASIC can suspend or cancel a license or ban an individual after a hearing when a licensee has failed to meet their obligations, or if ASIC has reason to believe that a licensee will not comply with their obligations in the future. Following a hearing, ASIC can also suspend or cancel a licence when it is no longer satisfied that the licensee is of good fame or character, a banning order is made against the licensee or a key representative of the licensee, or the application was materially false or misleading or omitted a material matter.<sup>4</sup>

8.6 ASIC's position is that the current laws make it difficult to cancel a licence or refuse to grant one. ASIC can only immediately suspend or cancel a license of an entity in limited circumstances; for example, if a licensee has committed serious fraud, is insolvent, ceases to carry on the business, or is incapacitated.<sup>5</sup>

8.7 Further, ASIC argues that it has struggled to prove its case when its decisions have been appealed before the Administrative Appeals Tribunal (AAT) and that this 'makes it difficult to remove licensees who may potentially cause investor losses in advance of an actual breach'.<sup>6</sup>

If we were to express it in general terms, we would say that the challenge that ASIC faces is that the barriers to entry to this industry are, frankly, too low in terms of ASIC's ability to keep out players that we believe are going to create problems, and it is too difficult for us to take out planners who are causing significant problems—the 'bad apples' that the industry is concerned about. To give you a sense of ASIC's test of this issue of whether a person will or will not comply with the relevant law, the AAT has

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3 Treasury, *Submission 22*, p. 8.

4 Australian Securities and Investments Commission, *Submission 28*, pp 7, 8–9.

5 Australian Securities and Investments Commission, *Submission 28*, p. 7.

6 Australian Securities and Investments Commission, *Submission 28*, p. 7.

rejected ASIC's finding that a person will not comply with the relevant law in 10 matters. There have been only two matters where the AAT has accepted ASIC's finding that a person will not comply with the relevant law. So this is not something where we are speaking about a hypothetical.<sup>7</sup>

8.8 In addition, the licensing regime focuses on entities rather than its agents, such as employees or directors. This prohibits ASIC from refusing, restricting or banning an individual from providing financial services.<sup>8</sup> On the whole, ASIC relies on licensees to ensure the competency and integrity of its representatives in the industry.<sup>9</sup> Treasury noted broad concerns about 'the effectiveness of licensees being responsible for the actions of their representatives, with implications for the professionalism of the industry'.<sup>10</sup>

8.9 Moreover, ASIC is concerned that the current licensing regime does not align with general consumer expectations that there are assurances that a licensee will provide a high quality of financial services:

The relatively low threshold for obtaining an AFS licence and the relatively high threshold for removing a licence is not well understood by retail investors. Licensing, therefore, may give retail investors a sense of security which is inconsistent with the settings of the regime. There is a perception amongst some consumers that an AFS licence means that the licensee has been approved by ASIC or that it signifies the high quality of the financial services provided by the licensee, which is not the case.<sup>11</sup>

## Submitters' views

8.10 Broadly speaking, the majority of submitters to the inquiry supported the new discretionary powers granted to ASIC to prosecute individuals,<sup>12</sup> provided there is clarity regarding the circumstances under which the powers can be employed, and there are controls in place around the application of the powers.<sup>13</sup> The Australian Institute of Superannuation Trustees (AIST) stated:

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7 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 January 2012, pp 72–73.

8 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p.18; Australian Securities and Investments Commission, *Submission 28*, pp 3–4.

9 Australian Securities and Investments Commission, *Submission 28*, p. 8.

10 Treasury, *Submission 22*, pp 7-8.

11 Australian Securities and Investments Commission, *Submission 28*, p. 9.

12 Chartered Secretaries Australia Ltd, *Submission 13*, p. 4; Abacus – Australian Mutuals, *Submission 14*, p. 1; Trustee Corporations Association of Australia, *Submission 16*, p. 2; Boutique Financial Planning Principals Group, *Submission 48*, p. 6.

13 Association of Financial Advisers, *Submission 67*, p. 5; Industry Super Network, *Submission 12*, p. 5; Financial Services Council, *Submission 58*, p. 21; Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants, Joint Accounting Bodies, *Committee Hansard*, 24 January 2012, p. 54.

Overall, AIST is supportive of the enhanced licensing and banning powers that are proposed to be given to ASIC. ASIC has raised concerns about its ability to protect investors and we feel that the changes slated to improve the supervision of the financial services industry are critical to creating greater trust within the Australian community toward the sector and moving the financial planning industry further toward a profession.<sup>14</sup>

8.11 A number of submitters, however, argued that the new powers are too broad and called for further clarity on how certain provisions will be applied and interpreted. The Joint Accounting Bodies (JAB), for example, commented:

For us, the issue of giving any regulator such a broad power was not something that we looked at lightly. However we had to look at what is best for the clients and protecting their interest. ASIC has told us that often they have been hamstrung in taking the necessary action because of the existing legislation so giving them these powers would then allow them to take those actions. However we do not want to give ASIC carte blanche and we think that they need to set out in strict terms the circumstances in which they will use those powers and how they will use those powers and how people can then appeal against the use of those powers. Our concern was making sure that if ASIC had this power that there were some rules around it and they did not just have the capacity to take whatever action they wanted.<sup>15</sup>

### ***Review process for ASIC decisions***

8.12 The Australasian Securities Dealers Association Inc. voiced concern that without adequate controls in place, ASIC's powers could be used maliciously:

Whilst we understand that the Government may feel the need to give ASIC such sweeping powers, we are concerned that appropriate check and balances are not in place to prevent malicious pursuit of advisers or licensees under their supervision. Most enforcement agencies throughout the developed world have an internal agency or overseeing body that has the ability to conduct investigations.

Banning orders, enforceable undertaking and disqualifications are handed out by ASIC and in most cases with good reason. We do however see that if such a malicious pursuit did occur under 920(1A)(d) then the tarnished image of the adviser or AFSL would be significant.<sup>16</sup>

8.13 The Financial Services Council called for assurances that ASIC's enhanced powers will be used only if a hearing for licensees and individuals has occurred:

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14 Australian Institute of Superannuation Trustees, *Submission 18*, p. 4.

15 Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants, *Committee Hansard*, 24 January 2012, p. 54.

16 Australasian Securities Dealers Association Inc, *Submission 10*, pp 3–4.

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Given the widening of ASIC's powers, the legislative scheme should ensure that all decisions involving the exercise of those powers should be made after affording affected individuals or licensees an opportunity to appear at a hearing and to make submissions to ASIC, and all decisions should be reviewable by the Administrative Appeals Tribunal and Federal Court.<sup>17</sup>

8.14 The Explanatory Memorandum (EM) does indeed outline that 'existing review rights in relation to ASIC decisions about licensing and banning continue to apply' (including those under the provisions of the Bill) and, as such, are subject to review by the Administrative Appeals Tribunal.<sup>18</sup>

8.15 As a matter of general principle, ASIC must give persons affected by its decisions an opportunity to be heard (either in writing or orally). The Corporations Act and Regulations specifically give a person a statutory right to a hearing in certain circumstances. This includes instances where a decision is made to refuse, vary or revoke a license:<sup>19</sup>

Under s913A of the Corporations Act a person may apply to ASIC for an Australian financial services licence. ASIC must, before refusing to grant a licence, give the affected person an opportunity to have a private hearing.

Under s914A(1) of the Corporations Act ASIC may impose conditions on a financial services licence. If ASIC imposes conditions when the initial licence application is granted the affected person has no statutory right to a hearing (see s914A(3)). If, however, after granting the initial licence, ASIC proposes to vary, revoke or impose additional conditions the affected person does have a statutory right to be heard at a private hearing.<sup>20</sup>

***Further clarity required: 'Reason to believe' and 'likely to contravene'***

8.16 A number of submitters claimed that certain provisions of the Bill carry significant uncertainty for financial advisers, particularly the provision allowing ASIC to ban or refuse a license on the grounds that a person is 'likely to contravene' obligations under the Act.<sup>21</sup>

8.17 The Financial Planning Association of Australia (FPA), for example, expressed concern that the phrases 'reason to believe' and 'is likely to contravene' are too flexible and allow ASIC to take action prior to a breach being committed, with

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17 Financial Services Council, *Submission 58*, p. 21.

18 Explanatory Memorandum, p. 22.

19 Australian Securities and Investments Commission, *Regulatory Guide 8: Hearings practice manual*, March 2002, pp 3, 4.

20 Australian Securities and Investments Commission, *Regulatory Guide 8: Hearings practice manual*, March 2002, p. 24.

21 Stockbrokers Association of Australia, *Submission 8*, p. 10; Joint Accounting Bodies, *Submission 23*, p. 2; National Insurance Brokers Association of Australia, *Submission 59*, p. 8.

minimal obligation on the Commission. The Superannuation Committee of the Law Council of Australia commented:

The Committee is concerned by the breadth of the discretion these powers give to ASIC. There is no standard of proof which must be satisfied by ASIC and no prescription of the matters which go to whether a person is “likely to contravene” their obligations. Given the consequences that can flow from an exercise of ASIC’s powers under new sections 913B(1)(b), 915C(1)(aa), 920A(1)(f) and 920A(1)(h), including the closure of a licensee’s business, the Committee submits that what is required in order for ASIC to form the view that a licensee is “likely to contravene” their obligations should be subject to greater certainty.<sup>22</sup>

### *Requests for a legislated statutory test*

8.18 The FPA recommended that the EM and/or the Regulations should detail an objective test that ASIC would have to meet to show reason to believe that an applicant, licensee or provider is 'likely to contravene' its obligations. The FPA suggested that ASIC should have a range of appropriate actions it can take if it has reason to believe a licensee, representative, applicant or provider is 'likely to contravene' its obligations, such as further investigations, an Enforceable Undertaking or education requirement.<sup>23</sup>

8.19 The Australian Bankers' Association (ABA) was also concerned about the breadth of ASIC's new discretionary powers and application of penalties, particularly in the absence of a reasonable steps defence. ABA agreed that there is a need for regulations to address these concerns.<sup>24</sup> The Joint Accounting Bodies agreed with this view, and recommended that ASIC issue a statement which sets out how they intend to use the proposed powers, particularly in relation to the terms 'believe' and 'likely to contravene':

These are broad terms and therefore have the capacity for misuse. While we believe that ASIC has no intention to misuse such powers, in order to generate confidence in the new system ASIC must set out how it will interpret the law and how it will implement them.<sup>25</sup>

8.20 The Westpac Group also called for objective criteria that ASIC would be required to follow when exercising its new discretionary powers. The Westpac Group suggested the criteria could include items such as:

- the number of previous similar contraventions the individual/licensee holds;

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22 Law Council of Australia, *Submission 55*, p. 3.

23 Financial Planning Association of Australia, *Submission 62*, p. 15.

24 Australian Bankers' Association, *Submission 67*, p. 40.

25 Joint Accounting Bodies, *Submission 23*, pp 4-5; see also Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants, Joint Accounting Bodies, *Committee Hansard*, 24 January 2012, p. 54.

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- the likelihood of a contravention remaining unrectified; and
  - the extent to which the likely contravention indicates the licensee or individual will not comply with their obligations in general.<sup>26</sup>

8.21 At this stage, Treasury has not released a statutory test or any specific criteria ASIC would follow that would equate to ASIC having reason to believe that a person is 'likely to contravene' a financial services law. However, there is some further clarification provided in the EM which outlines the due diligence and evidentiary processes proposed for ASIC:

The statutory test is whether the applicant is likely to contravene the obligations under section 912A. ASIC may take into account any information relevant to this question, such as:

- conduct of the applicant that shows deliberation and planning in wilfully disregarding the law;
- the extent of compliance by the applicant with analogous obligations in another regime; or
- any other conduct of the applicant that may lead ASIC to conclude, on reasonable grounds, that the applicant is not likely to comply.<sup>27</sup>

8.22 The EM highlights that the current legislative standards are too onerous for ASIC to prove that a person is 'likely to contravene' a financial services law, and the new provisions allow ASIC to act appropriately in these circumstances:

In the 10 years since the introduction of the Financial Services Reform Act, interpretation of this provision has tended to a view that ASIC is required to believe, as a matter of certainty, that the person will contravene the obligations in future. Such a standard would be so onerous that it could result, in practice, in ASIC never being able to refuse a licence using this part of the test. This new formulation is designed to ensure that ASIC can more appropriately account for the likelihood or probability of a future contravention.

8.23 The committee acknowledges the concerns of submitters and notes that ASIC has undertaken to provide further regulatory guidance on its amended licensing and banning powers.<sup>28</sup> In addition, it suggests that the committee has itself an important role to monitor the way in which ASIC uses these new powers.

8.24 The committee notes that as part of its ongoing oversight of ASIC, it will closely monitor the exercise of ASIC's new licensing and banning powers as conferred through the Future of Financial Advice legislation.

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26 The Westpac Group, *Submission 64*, p. 11.

27 Explanatory Memorandum, pp 22-23.

28 Australian Securities and Investments Commission, *Supplementary Submission 28*, p. 3; Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 24 January 2012, p. 73.

