Law and order… and ASIC

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While banks came under fire during the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the regulatory body may have come under more scrutiny and criticism for failing to enforce current laws.

The Australian Securities and Investments Commission (ASIC) responded in the only way it felt appropriate – enforcing harsher punishment in the way of more litigation.

In October last year, the commission said it would take a "Why not litigate" approach to enforcement to "deter future misconduct and address the community expectation that wrongdoing be punished and denounced through the courts". Then at the beginning of this year the regulator announced that it had created a separate Office of Enforcement away from its regulatory team.

Indicating that ASIC would make more court appearances, it said they would only pursue the litigation route if the breach of law was more likely than not and if it was evident that the pursuit of the matter would be in the public interest.

ASIC's track record of litigation has been hit and miss in the past and earlier this month the watchdog lost a landmark case against Westpac Banking Corporation over the bank's alleged breach of responsible lending laws.

ASIC alleged the bank was "required to have regard to the higher repayments at the end of the interest-only period" but did not.

However, the judge found that a lender "may do what it wants in the assessment process" and that other provisions of the National Credit Protection Act 2009 impose penalties if lenders make unsuitable loans as a result of that process.

ASIC commissioner Sean Hughes responded to the outcome by stating the case was needed for judicial clarification of a cornerstone legal obligation on lenders and referred to the case as a "test case".

"As a regulator, it is our role to test the law and its ambit," he said.

Speaking to Money Management, solicitor director at The Fold Legal, Simon Carrodus, said the commission has taken this route in response to criticism and it was trying to do the right thing.

"They're copping the criticism on the chin and adapting which I think is better than just stubbornly refusing to adapt," Carrodus said. "In many ways they didn't have a choice so they're hiring new people, and taking a new approach."

FEAR OF SELF-REPORTING

While ASIC seems to be doing the right thing, Hall & Wilcox Lawyers partner, Graydon Dowd, said some advisers were feeling isolated from their licensee, especially institutions that looked to shed their advice arm as a result of misconduct.

"What I have seen first-hand are examples where ASIC focused their attention on large corporates in relation to the conduct of the financial advisers who are affiliated or employed by large corporates and this could give tension to the corporate and individual financial advisers. Sometimes the advisers might feel isolated in relation to that," he said.

"I have seen that firsthand and rather than it being advisers scared of losing their AFSL [Australian Financial Services Licence] or having some other penalty imposed, it's more that they won't have the backing of the corporate with whom they have the affiliation with."

Holley Nethercote Commercial and Financial Services Lawyers partner, Paul Derham, said ASIC's litigation approach would lead to a drop in self-reporting due to fear.

"The fear is that if they report a significant breach that has some real problems to it, the licensees are afraid ASIC will now take them to federal court," Derham said.
Derham noted that prior to this regime, the best thing licensees could have done was to self-report the breach and show how they self-remediated and self-regulated.

"However, now it's like you have two different messages. One is to self-report and show you've remediated and fixed the problem but, two, ASIC is now asking 'why not litigate?'," he said.

"I think there will be less self-reporting of significant breaches that will take a long time to fix. I have seen an increase in reluctance to tell ASIC from smaller businesses, especially when they're in self-preservation mode," Derham said.

"We have also seen a lot of regulatory training requests since the 'why not litigate' approach.

"Training for responsible managers and best interest duty are the two main topics and these requests are coming from banks, financial planning dealer groups and even industry funds as they are responding to that message."

WHAT CAN ADVISERS DO?

However, smaller businesses may have some time to get themselves in order as ASIC tackles the larger institutions but it won't be forever.

"ASIC has limited resources and history tells us they generally investigate the bigger end of town first, like the Big Four, Macquarie and AMP. They do this to gather information and develop an enforcement framework," Carrodus said.

"However, we have been pretty quick to disabuse our smaller clients of the notion that smaller licensees are immune from ASIC's new enforcement approach. ASIC will eventually apply its framework to the rest of the market."

Advisers need to get their record keeping right, Carrodus explains, as the big remediation programs that the Big Six have run have been due to lax record keeping.

"One of the biggest problems is record-keeping by advisers and licensees. We've seen cases of inappropriate advice and fees-for-no-service, but in a lot of those cases we don't actually know whether service was provided or if advice was appropriate – because there are no records," he said.

"I've seen cases where an adviser can verbally explain why a recommendation was in the client's best interests, or they remember meeting a client five years ago. However, if there is no record of these events, the adviser is effectively guilty until proven innocent."

"There is no substitute for contemporaneous records. This is the holy grail for ASIC. Advisers should keep detailed file notes, ROAs, and SOAs."

Dowd said advisers needed to check they were complying with obligations, and to ensure that their advice was in accordance with their licensee to ensure they were not contributing to a culture of breach.

CULTURAL EXPERIENCE

For Derham driving the right culture is what is needed.

"To really do something about driving a good culture firms need to look at the behaviour drivers. We're seeing changes by Australian Prudential Regulation Authority (APRA) related organisations with respect to accountability and remuneration," he said.

"Everyone talks about culture and doing the right thing but actually saying 'we have to change the way we incentivise people and actually make a financial decision to change that' is what's going to drive change.

"It is obvious academically but when you're in thick of running a business you try and change the culture by doing everything except change the very incentives that form the basis of the organisation."

WILL ASIC SUCCEED?

Derham, Dowd, and Carrodus agree that it is too early to tell whether this new legal route will be successful but that it was not just the case of the regulator beating its chest.

All three believed it was the most appropriate response the body could make after the criticism it received, and that it would take at least six to 12 months to truly see whether this was the right path.

Derham said while there was no reason to think ASIC's success rate would be any better he noted the watchdog had boosted its budget.

In the regulator's latest enforcement report, ASIC deputy chair, Daniel Crennan, said it looked to recruit litigation lawyers, analysts and investigators, through a funding of $404 million over four years by the Australian Government following the Royal Commission.

"The enforcement division has a new deputy chair and it operates independently of the supervisory teams. It will pursue remedies, including litigation, without fear or favour where in the past ASIC may have looked for a negotiated outcome," Carrodus said.

ASIC ENFORCEMENT OUTCOMES SO FAR IN 2019

ASIC's Office of Enforcement has increased the number of enforcement investigations by 20 per cent between July 2018 and July 2019, increased enforcement investigations involving the Big Six by 51 per cent, and increased wealth management investigations by 216 per cent.

In its latest enforcement report, ASIC deputy chair, Daniel Crennan, said the 'why not litigate?' approach "does not suggest we take every matter to court but allows us to consider relevant factors to ensure we are doing what we should to punish past misconduct and to deter future misconduct".

The report noted that between January to June 2019:

- 10 individuals had been charged in criminal proceedings;
- 70 criminal charges laid;
- Seven custodial sentences (six people imprisoned);
- Six non-custodial sentences;

- 191 individuals charged in prosecutions for strict liability offences;
- 386 criminal charges laid in prosecutions for strict liability offences;
- 103 individuals removed or restricted from providing financial services or credit;
- 29 individuals disqualified or removed from directing companies;
- Five infringement notices issued;
- $370,800 in infringement penalties paid;
- $19.2 million in compensation and remediation for consumers and investors; and
- One court enforceable undertaking.

In terms of financial services outcomes, between 1 January to 30 June 2019 there were 51 financial services-related outcomes. Only seven of these outcomes were negotiated.
Financial services outcomes by misconduct and remedy type during 1 January to 30 June 2019

As at 1 July, 2019 there were 17 criminal and 29 civil financial services-related matters still awaiting outcomes.

Crennan noted that Australian financial services licensees who failed to ensure their financial services that were provided were "efficiently honestly, and fairly," could expect the enforcement team to pursue the harsher civil penalties now available to the regulator.

"These include financial penalties of up to $525 million. When a person engages in dishonest conduct in carrying on a financial services business, they now face imprisonment of up to 15 years," he said.