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## WHITE PAPER

September 2019

### Australian Financial Services Subject to Perfect Storm of Enforcement

Recent strategies and initiatives announced by Australia's corporate and prudential regulators and the Australian government's release in August 2019 of its *Financial Services Royal Commission Implementation Roadmap* provide a very clear signal—a new wave of regulatory proceedings is gathering against financial services institutions, their directors and other officers, and will hit Australian boardrooms before the year's end.

The government's *Roadmap* outlines an ambitious agenda over the next several years, including the introduction of significant legislative reform, to give effect to all 76 recommendations in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The *Roadmap* also details a further 18 commitments on the part of the government which have been developed in response to the observations of Commissioner Hayne in the Final Report.

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- Set clear objectives for the Australian Securities and Investments Commission (“ASIC”) and the Australian Prudential Regulation Authority (“APRA”), with provision for the government to issue updated Statements of Expectations to continually refine the regulators’ mandates;
- Increase the accountability of regulators by the establishment of a financial regulator oversight authority, which will independently assess the regulators’ effectiveness in delivering on their mandates;
- Arm regulators with substantially expanded powers and greater funding;
- Increase the accountability of financial firms, their senior executives and boards; and
- Strengthen consumer protections and improve remediation and redress mechanisms.

The financial services sector is the current focus, but it is likely that the regulatory mindset-shift will extend well beyond this sector in the months and years to come.

## THE PERFECT STORM

The political and public pressure from the Royal Commission has triggered four major developments resulting in the “perfect storm” for regulatory proceedings:

- ASIC's greater willingness to litigate
- Increased penalties
- Increased regulator resourcing
- Greater access to information for regulators

## ASIC'S OFFICE OF ENFORCEMENT AND “WHY NOT LITIGATE?”

Having been chastised by Commissioner Hayne for having an ineffective enforcement culture and being susceptible to capture by those whom they are bound to regulate, ASIC is moving at speed to institute a number of court proceedings. ASIC has established an Office of Enforcement, and the regulatory mindset has changed from that of consensual compliance to a “why not litigate?” approach, whereby ASIC considers first why it would not be in the public interest to litigate. ASIC's aim is to approach suspected contraventions of the law by asking itself why it would not be in the public interest to bring court proceedings, based on the view that litigation is of clear public benefit because it achieves deterrence, public denunciation and punishment of wrongdoing. Only if the public benefits from litigation are outweighed, will another approach be adopted. This does not mean litigation in every instance, but it does mean that there will be a significant uptick in regulatory litigation. This change in enforcement approach is also coupled with a greater preparedness on the part of the regulator to utilise the media to highlight its enforcement activities. ASIC's changing approach and willingness to pursue litigation is evidenced by the sharp decline in the number of enforceable undertakings accepted by ASIC since the Royal Commission. Since 1 January 2019, ASIC has entered into only one enforceable undertaking (compared with the 20 enforceable undertakings accepted in 2018).

ASIC's increased focus on enforcement is also demonstrated by ASIC's *Corporate Plan 2019-23* released in August 2019, which lists as the regulator's first priority “[h]igh-deterrence enforcement action.” The *Corporate Plan* sets out actions for 2019-20 and identifies the focus of enforcement as follows:

*Focusing on cases with high deterrence value and that involve the most serious misconduct, including cases that:*

- *involve the exploitation of vulnerable consumers;*
- *involve large institutions;*

- allow us to use ASIC's new powers and remedies to achieve better outcomes; and
- will hold individuals accountable for poor governance or conduct that results in harm.

## INCREASED PENALTIES

The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 (Cth) increases maximum prison penalties for the most serious offences to 15 years. It significantly increases civil penalties for companies, now to be capped at \$525 million, with maximum civil penalties for individuals increasing to \$1.05 million. Alternatively, if the court can evaluate the benefit derived from, or detriment avoided by, the contravention, it is empowered to impose a penalty of up to three times that number.

As part of the same reforms, there are an additional 60 provisions that ASIC will be able to enforce by way of civil penalty proceedings. Significantly, this includes making the obligation to *"to do all things necessary to ensure the financial services covered by the licence are provided efficiently, honestly and fairly"* a civil penalty provision.

## INCREASED RESOURCES FOR REGULATORS

Regulator resourcing has also increased. In March 2019, the federal treasurer announced additional funding over four years for ASIC, \$404 million, and for APRA, \$151.7 million. This funding will enable both regulators to expand their investigation and enforcement teams with a view to increasing enforcement and supervision activity.

However, more significant than the increased funding from government is the move to ASIC being industry funded. In 2017, the Australian Parliament passed legislation that adopted a cost recovery model that required market participants to reimburse the regulatory cost of ASIC's activities, including education, surveillance and enforcement. Prior to July 2017, when the regulator took some form of enforcement action, the cost was borne by the taxpayer. Since July 2017, under the

cost recovery model, enforcement costs are included in the regulatory costs charged to industry. ASIC's ability to charge back enforcement costs may have far-reaching effects as it encourages ASIC to incur the costs of top-shelf litigation practitioners from private practice. If ASIC loses a case and has to pay costs to its opponent, then those costs may be charged back to industry.

## GREATER ACCESS TO INFORMATION

Key to effective enforcement is being able to prove the facts that establish a contravention of the law. Access to information is a necessity. ASIC has always had strong coercive investigatory powers, including being able to require individuals to answer questions, even if self-incriminatory, and to produce documents. It also could call on the search warrant powers in *the Crimes Act 1914* (Cth) with the help of the Australian Federal Police. However, the government has committed to giving ASIC its own search warrant powers and access to telecommunications intercepts. Added to this, AFSL holders must lodge breach reports with ASIC, and a failure to do so will expose the entity to a civil penalty. As Commissioner Hayne stated in the Final Report: *"ASIC will approach litigation knowing that the first document to be tendered in evidence will show what the entity has said it has done or may have done in contravention of the law"*. The banking and financial services sector is required by law to confess and, in doing so, help prove the regulator's case.

The combination of new civil penalty provisions, increased penalties and greater access to information has led to ASIC noting that it is now possible *"to properly punish corporate wrongdoing in Australia"*. When a preparedness to pursue criminal prosecutions and civil penalty actions is added, enforcement is far more likely than in the past.

## PREPARING FOR THE STORM

Having seen the combination of factors that make regulatory litigation more likely, the financial services sector, and individual directors and officers in particular, must consider what to expect and how to respond.

- **Expect the upcoming litigation to target individuals**, not just companies—and to reach beyond boards and further down the executive ranks than has been seen before.
- **Expect new approaches and more aggressive litigation strategies** in regulatory proceedings:
  - (i) Not just breaches of officers' duties, but allegations of misleading conduct by individuals (both civil and criminal).
  - (ii) Not just communications to customers and shareholders, but communications to boards and regulators.
  - (iii) Use of the *ASIC Act 2001* (Cth), the *Competition and Consumer Act 2010* (Cth) and the *Superannuation Industry (Supervision) Act 1993* (Cth), not just the *Corporations Act 2001* (Cth).
- **Individuals targeted by regulatory proceedings** should prepare on the basis that their interests may not be closely aligned with those of the company:
  - (i) Individuals should obtain their own independent advice in respect of their interests, separate to the company, and they should get support early on.
  - (ii) Individual officers and executives in the regulators' crosshairs should obtain independent advice as to whether they should be represented by the company's counsel.
  - (iii) Early steps taken (or not taken) by individuals or the company in regulatory proceedings can significantly affect the position of individuals in litigation.
- **Formal legal processes are often there to protect individual's rights**, it is entirely proper to invoke those procedures, and in the current environment, it is critical that individuals obtain independent advice in that regard.
- **It is important to understand the information gathering powers** that ASIC, APRA and the Australian Federal Police have—before they come knocking.
- **Individuals should clarify their indemnity and information access rights** with the company and relevant insurers, as well as take steps to understand who has privilege in any legal advice they have relied on to date.

## LAWYER CONTACTS

For further information, please contact your principal Firm representative or the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at [www.jonesday.com/contactus/](http://www.jonesday.com/contactus/).

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