

ENFORCEMENT – A NEW ENVIRONMENT

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Welcome to the first of a regular series of K&L Gates Legal Insights addressing the new enforcement environment in financial services.

The Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (RC) identified widespread misconduct on the part of market participants from several significant sectors of the industry. Compounding the impact on retail investors of such misconduct was the lack of rigour displayed by the primary regulators in terms of identifying misconduct and in dealing with misconduct once it had been identified. One of the most significant (and long lasting impacts) is sure to be the shift in the enforcement profile of the two lead regulators, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).

This uplift in enforcement is taking place in the context of a number of other regulatory changes that the Federal Government have committed to introduce following the RC. In this regard the Federal Government has published a detailed roadmap of regulatory changes with the Treasurer indicating that 90% of the RC recommendations will be implemented by mid next year.

WHAT THE RC RECOMMENDED

Several of the RC recommendations concerned proposed changes to the financial services enforcement environment including the following:

- the introduction of enforceable provisions for industry codes
- requiring Australian Financial Services licence holders to take reasonable steps to co-operate with the Australian Financial Complaints Authority in its resolution of particular disputes
- co-regulation of superannuation between ASIC and APRA under the "twin peaks" model for financial regulation, whereby:
 - ASIC should be given the power to enforce all provisions under the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) that are, or will become, civil penalty provisions
 - APRA should retain its current functions, including responsibility for licensing and supervision of registrable superannuation entity (RSE) licensees, and
 - ASIC and APRA should jointly administer the Banking Executive Accountability Regime.

In addition to these recommendations on enforcement, the RC referred to ASIC and APRA a number of matters which it considered the regulators needed to examine, and published a number of case studies which contained observations from the RC on the existence of potential breaches of financial services laws.

HOW APRA AND ASIC ARE RESPONDING

The conduct of the RC and the publication of the RC Final Report has already led to a significant increase in the number and scope of enforcement actions initiated by the regulators.

- As at the end of June 2019 ASIC had 17 criminal and 29 civil financial services related matters in the Courts and in the 12 months to June 2019 the number of enforcement investigations increased by 20% across the board.
- ASIC has confirmed that at the core of its enforcement activity is a focus on deterrence public denunciation and punishment.
- APRA has already made use of its new power to issue directions to trustees under the SIS Act in relation to two entities, and has initiated proceedings against five IOOF Holdings Limited executives. This is significant as APRA had not commenced any court proceedings relating to superannuation in the last 10 years.

The Commonwealth Government has also boosted funding for ASIC and APRA in the 2019-20 Budget. ASIC will be provided with more than \$400 million in additional funding to support ASIC's expanded role as the primary regulator for superannuation, and its regulation of the financial services industry following the Royal Commission. APRA's \$150 million in additional funding will enable the regulator to boost its supervision intensity, as well as focus on underperforming superannuation funds and members outcomes.

HOW TO INTERACT WITH ASIC AND APRA

ASIC announced in recent months that their attitude to enforcement has moved from "how can this be resolved by agreement" to "why not litigate". The corresponding announced posture from APRA has been going from litigation as a "last resort" to "constructively tough".

When it comes to enforcement initiatives, both regulators have given indications of their expectations of financial services participants on co-operation as follows:

- APRA expects financial services participants to deal with APRA in an open, co-operative and constructive way.
- ASIC has "high expectations" of financial services participants. Participants are expected to co-operate with ASIC in its supervisory activities and take on ASIC's targeted feedback on non-compliance, financial and non-financial risks.

In the context of the more litigious attitudes at ASIC and APRA, financial services participants need to think carefully about how they should respond to investigations or enforcement activity and to what extent they should assist and co-operate with the regulators as the investigation process matures and possibly as the enforcement process gets underway.

CONCLUSION

It is our view that this new posture from ASIC and APRA is a long term environmental change for the financial services industry. Industry participants will need to revisit their risk management mechanisms and in particular to review the manner in which regulatory and enforcement risks are identified and addressed.

In the following Legal Insights in the series, we will talk about some of these new enforcement risks and will explore ways in which financial services participants can better identify, assess and manage the risks on an ongoing basis. Where relevant, we will also look to other jurisdictions where a similar enforcement environment exists to see what mechanisms have been adopted in those jurisdictions to deal with these more significant regulatory and enforcement risks.

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