

# ALLEN & OVERY

## The Expanding Enforcement Armoury of Australia's Financial Regulators



As the fallout from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) continues, key Australian regulators are increasingly focused on more robust enforcement as a primary tool to address misconduct by financial services institutions. At the same time, their ability to do so effectively is being substantially augmented by the introduction of a range of new enforcement powers that have been proposed for the Australian Securities and Investments Commission (**ASIC**) and the Australian Prudential Regulation Authority (**APRA**). Amongst those new powers, the implementation of the Banking Executive Accountability Regime (**BEAR**) also marks a clear shift in the historic role of APRA as a supervision-led agency to one with far greater potential to use the courts to enforce standards of behaviour in the banking sector. Meanwhile, the Australian Competition and Consumer Commission (**ACCC**) and the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) are increasingly using their substantial existing powers to intensify their focus on financial institutions.

In a post-Royal Commission world, these changes signal a 'new normal' in the financial regulatory landscape in Australia. The financial sector would do well to take heed of this shift in regulatory approach and fire-power and respond pro-actively.

### A Need for Greater Enforcement

With the September release of its interim report, the Royal Commission gave us a glimpse into key structural failings at Australia's biggest banks, superannuation providers and insurers. The interim report also highlighted the importance of adequate enforcement by regulators of financial and prudential misconduct, and their shortcomings. In particular, the Commissioner criticised the lack of enforcement proceedings brought by both ASIC and APRA. The Commissioner reported that '[t]he conduct regulator, ASIC rarely went to court to seek public denunciation of and punishment for misconduct<sup>1</sup> while '[t]he prudential regulator, APRA, never went to court. Much more often than not, when misconduct was revealed, little happened beyond apology from the entity, a drawn-out remediation program and protracted negotiation with ASIC of a media release, an infringement notice, or an enforceable undertaking that acknowledged no more than that ASIC had reasonable 'concerns' about the entity's conduct'.<sup>2</sup> Such comments have underscored the need for greater regulator pro-activity and prosecution of misconduct.

The suggestions in the Royal Commission's interim report found further support in the report from the current Senate Economics References Committee (**Committee**) inquiry into the regulatory framework for the protection of consumers, including small

businesses, in the banking, insurance and financial services sector (including Managed Investment Schemes). The Committee commended the Royal Commission's work and, although it did not make any policy recommendations, noted the "need for serious reform to the entire financial services system"<sup>3</sup>.

### ASIC

Against the backdrop of the Royal Commission's observations on enforcement, ASIC is due to receive a significant boost to its regulatory powers. ASIC regulates Australian companies, financial markets, and financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. ASIC has a range of enforcement powers and can seek to initiate a civil action, brief the Commonwealth Director of Public Prosecutions (**CDPP**) to consider whether to lay criminal charges, or conduct its own administrative hearing. The remedies that it has available range from infringement notices to court actions seeking the enforcement of penalties and (in conjunction with the CDPP) imprisonment. It has now also placed supervisors inside Australian financial institutions, as part of an onsite supervisory program for which ASIC recently received an AUD8 million funding grant from the Australian Federal Government.<sup>4</sup>

While ASIC's current powers, in theory, are substantial, its

1 Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report (2018) vol 1, xix.

2 Commonwealth, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report (2018) vol 1, 296.

3 Senate Economics References Committee, Report on Regulatory Framework for the Protection of Consumers in the Banking, Insurance and Financial Services Sector (15 November 2018)

4 The funds were provided to implement the new supervisory approach to Australia's five largest financial institutions (the big four banks and AMP); O'Dwyer, Kelly, 'Tumbull Government Expands ASIC's Armoury' (Joint media release with The Hon Scott Morrison MP, 7 August 2018) Treasurer < <http://kmo.ministers.treasury.gov.au/media-release/092-2018/> >.

effectiveness as an enforcer has been called into question. ASIC is expected to receive more extensive enforcement powers, which are pending approval by Parliament. The *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) 2018 Bill (Corporate Penalties Bill)*, which was subject to public consultation in September and October 2018, proposes to, among other things, double maximum imprisonment penalties and significantly increase financial penalties for a number of white collar criminal offences. The *Corporate Penalties Bill* intends to:

- update and increase the penalties for certain criminal offences in ASIC-administered legislation and introduce criminal offences that sit alongside strict and absolute liability offences;
- significantly increase the financial penalties for civil contraventions and introduce ‘relinquishment’ orders, allowing the disgorgement of improperly obtained benefits in civil penalty proceedings;
- harmonise, modernise and expand the civil penalty and infringement notice regimes of ASIC;
- allow ASIC to ban individuals from performing any role in a financial services entity where they are found to be unfit, improper, or incompetent;
- grant ASIC the power to refuse, revoke or cancel financial services and credit licences where the licensee is not fit and proper; and
- introduce a new test to determine dishonesty, applicable to all offences under the Corporations Act.<sup>5</sup>

The Government also announced new penalties of up to ten years imprisonment and heftier fines (up to the larger of AUD9.45m and three times the benefit gained or loss avoided, or 10% of annual turnover for corporations) for breaches of the Corporations Act.

The appointment of Victorian silk, Daniel Crennan QC as ASIC’s Deputy Chairman is expected to accelerate the use of ASIC’s proposed new enforcement powers. Crennan has expressed a clear appetite to drive a more aggressive enforcement agenda. Speaking at the Parliamentary Joint Committee, Crennan noted ASIC’s shift to an ‘enforcement focus and a litigation focus’<sup>6</sup> and he expects to hand over around 25 extra criminal briefs to the CDPP over the next two years.<sup>7</sup> Crennan will also lead a ‘Review of ASIC’s Enforcement Policies, Processes and Decision-Making Procedures’,<sup>8</sup> due to report its findings to ASIC by 10 January 2019, looking at a number of areas including how ASIC’s enforcement policies will respond to new powers and penalties, proposed under the *Corporate Penalties Bill*.

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## APRA and BEAR

One of the key initiatives to increase accountability in the banking sector is through the Banking Executive Accountability Regime (BEAR). BEAR compliance has been required by the largest ADIs from 1 July 2018, with medium sized and smaller ADIs having another year to implement the regime. BEAR will require authorised deposit-taking institutions (ADIs) and their subsidiaries to, amongst other things, meet a number of new accountability obligations, restrict the variable remuneration of certain executives and be subject to a greater range of penalties under APRA’s increased powers. Taking inspiration from the UK Senior Managers Regime, BEAR will require ADIs to register their ‘accountable persons’, and act with honesty, integrity and due skill, care and diligence. Individuals within management positions will also become personally accountable for compliance at the ADI. BEAR will require ADIs to notify APRA of any conduct which falls short of the required conduct, and to defer a portion of executives’ remuneration to make it conditional on the achievement of compliance objectives.

Importantly, BEAR gives APRA enhanced powers to remove and disqualify senior executives and directors. This includes the ability to disqualify directors and senior managers from being ‘accountable persons’ without the need to apply to the Federal Court. Although there are no civil penalties under BEAR for individuals, breaches of the accountability obligations by ADIs include civil penalties of up to AUD210m. These additional powers also signal the first time that senior banking executives have their remuneration overseen and linked to the culture at the bank.

In November 2018, APRA announced a review of its enforcement strategy and powers, including its powers to hold individuals and entities to account under the BEAR regime.<sup>9</sup> The review, for which results are expected in March 2019, will examine APRA’s approach to enforcement actions and whistleblowers, its cooperation with other regulatory agencies and whether the current and proposed legislative framework is adequate to support its enforcement strategy. APRA’s leadership ranks have also been recently bolstered by the appointment of a second deputy chairman, John Lonsdale, a former senior Treasury official. APRA chairman Wayne Byres recently stated to a Senate Estimate Committee that ‘with the benefit of John’s fresh perspective, we are re-examining how our enforcement philosophy, our governance structures for enforcement decisions, and our resourcing for enforcement activity can be improved’.<sup>10</sup> Byres went on to say that the review ‘will take account of not only the lessons from the royal commission, but also the need for new processes and structures to be developed for the BEAR’ while expressly noting ‘the potential for greater use of enforcement powers to achieve general deterrence across the industry’.<sup>11</sup>

With discussions about the extension of BEAR more broadly to other financial services providers, it seems likely that APRA will become a much more powerful and aggressive regulator than we have previously seen.

5 The Department of Treasury, Reforms to strengthen penalties for corporate and financial sector misconduct – Draft Legislation (consultation period 26 September 2018 – 17 October 2018) Government of Australia < <https://treasury.gov.au/consultation/c2018-t328482/> >. Explanatory Memorandum, Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) 2018 Bill (Cth), 8 < [https://www.aph.gov.au/Parliamentary\\_Business/Bills\\_Legislation/Bills\\_Search\\_Results/Result?bld=r6213](https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r6213) >.

6 Evidence to the Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 19 October 2018 (David Crennan QC, Deputy Chairman of ASIC).

7 Evidence to the Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, Canberra, 19 October 2018 (David Crennan QC, Deputy Chairman of ASIC).

8 Australian Securities and Investment Commission, Review of ASIC’s Enforcement Policies, Processes and Decision-Making Procedures (17 October 2018), Terms of Reference < <https://download.asic.gov.au/media/4910547/terms-of-reference-review-of-asic-s-enforcement-policies-processes-and-decision-making-procedures.pdf> >.

9 APRA, APRA announces Terms of Reference for Enforcement Strategy Review, 12 November 2018, < <https://www.apra.gov.au/media-centre/media-releases/apra-announces-terms-reference-enforcement-strategy-review> >.

10 Evidence to the Senate Economics Legislation Committee, Parliament of Australia, Canberra, 25 October 2018 (Wayne Byres, Chairman of APRA).

11 Evidence to the Senate Economics Legislation Committee, Parliament of Australia, Canberra, 25 October 2018 (Wayne Byres, Chairman of APRA).

## AUSTRAC

AUSTRAC rose to prominence with a civil penalty of AUD700m against a financial institution for breaches of money-laundering and terror financing laws. The fine was the largest penalty in Australian corporate history for violations of anti-money laundering laws, including failures to report suspicious deposits, transfers and accounts at the bank. AUSTRAC has also recently announced its annual compliance report which requires self-assessment of compliance with anti-money laundering obligations by financial institutions and reporting entities, such as remittance dealers, digital currency exchanges, bullion dealers and entities that provide gaming or gambling services.<sup>12</sup> We expect to see AUSTRAC become even more active in the years to come, and increasingly rely on its civil penalty powers.

## ACCC

In parallel with the Royal Commission, the ACCC has also been focusing on misconduct in the financial sector, bringing unprecedented enforcement proceedings earlier this year against a number of major banks involving a AUD3 billion stock issue. Three banks have been charged with criminal cartel offences by the ACCC, with criminal charges also laid against senior executives from those banks.<sup>13</sup> The matter is before the court, with proceedings currently adjourned until 5 February 2019.

The ACCC's role is to enforce the *Competition and Consumer Act 2010* (**Competition and Consumer Act**), promoting competition, fair trading and regulating national infrastructure for the benefit of consumers. This year, one of the ACCC's enforcement and compliance priorities was competition issues in the financial services sector. We expect the ACCC to continue closely monitoring anti-competitive conduct by banks, and to bring more proceedings including where misconduct has been revealed by the Royal Commission.<sup>14</sup>

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## Conclusion

By shining a light on misconduct across the financial sector, the Royal Commission has already proven, and is likely to continue to be, a significant catalyst for change in Australia's financial sector, both in terms of the pace and degree of that change. The next few years will see regulators increasingly cooperating and sharing information with each other and it is only a matter of time before we see multiple regulators going after the same entities for similar conduct, particularly where such conduct falls within the purview of BEAR and the Corporations Act. With regulators due to gain new and stronger powers, financial services organisations would do well to take a pro-active stance, and prepare for increased regulatory scrutiny and enforcement now. This might include:

- reviewing that their systems and controls are in line with recommendations made in the interim Royal Commission report and recommendations made by APRA in their recent prudential inquiry;
- updating systems to safeguard against breaches, and escalating anomalies quickly to an 'independent' department for review;
- linking management and board salaries to compliance with financial laws and regulations;
- installing compliance experts within the business and legal departments;
- changing corporate culture to focus on client outcomes; and
- updating remuneration policies to de-incentivise misconduct.

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<sup>12</sup> AUSTRAC, Compliance Report 2018, < <http://www.austrac.gov.au/businesses/obligations-and-compliance/amictf-compliance-reports> >. The AUSTRAC Compliance Report 2018 will be made available on 2 January 2019 through the AUSTRAC Online portal.

<sup>13</sup> Australian Competition & Consumer Commission, Criminal Cartel Charges Laid Against ANZ, Citigroup and Deutsche Bank (5 June 2018) 3 [18] < <https://www.accc.gov.au/media-release/criminal-cartel-charges-laid-against-anz-citigroup-and-deutsche-bank> >.

<sup>14</sup> Australian Competition & Consumer Commission, Compliance & Enforcement Policy & Priorities (undated) < <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities#2018-priorities> >.