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31 March 2015

Senior Adviser  
Financial System and Services Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600

Dear Sir/Madam

**Financial System Inquiry Final Report**

We are lawyers practising in the area of financial services regulation.

This letter sets out our submission on recommendation 22 of the Financial System Inquiry.

Recommendation 22 is in these terms:

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is a risk of significant consumer detriment.

We begin with a summary of our submission before providing further details in support of it.

**1 Summary of submission**

- 1.1 We have enormous respect for the work that has been done by the Financial System Inquiry. However, we consider recommendation 22 to be flawed. We say this primarily because the recommendation assumes that ASIC does not have the power to intervene in the design and distribution of financial products when, as a matter of fact, it does. Indeed, its existing powers are extensive and they have been used many times to support very significant interventions.
- 1.2 We submit that Treasury should seek the opinion of the Commonwealth Solicitor-General on the question of the true extent of ASIC's existing product intervention powers. The question is ultimately a legal question and, in our submission, it should not be left to the competing claims of ASIC and industry participants.
- 1.3 The proposal to confer such a power on ASIC is also troubling given the criticisms that can be made of the nature and quality of financial services regulation in Australia. We addressed this matter in our second-round submission to the Inquiry (copy enclosed). If, as we contend, financial services regulation is both sprawling and generally of poor quality, the correct policy response to that problem would not seem to be to give ASIC additional powers to effectively write the law. Such a response would only make it even harder for the regulated population to comply.

**2 Further discussion**

- 2.1 The difficulty with recommendation 22 is the Inquiry's point of departure.
- 2.2 Under the heading 'Problem the recommendation seeks to address' on page 207 of the final report, this statement is made: 'Currently, ASIC can only take action to rectify consumer detriment after a breach or suspected breach of the law by a firm'. The report also says: 'Further, ASIC can only take

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enforcement action against conduct causing consumer detriment on a firm-by-firm basis, even where the problem is industry-wide'.

- 2.3 Neither of these statements is correct.
- 2.4 Financial services and financial products are regulated primarily by Chapter 7 of the Corporations Act 2001. ASIC is empowered to exempt one or more people from, and to modify the application of, the key Parts of Chapter 7: see sections 926A, 951B, 992B and 1020F. These powers are extraordinary powers. ASIC exercises them regularly as a basis for intervening in the design and distribution of financial products.
- 2.5 The origins and breadth of ASIC's powers have been carefully analysed by Professor Stephen Bottomley, Dean of the ANU Law School, in 'The Notional Legislator: The Australian Securities and Investments Commission's Role as a Law-Maker', *Federal Law Review* (2011) 39 (copy enclosed). Professor Bottomley describes the resulting position as 'the executive agency that is charged with administering the corporations legislation [having] the power to re-write aspects of that legislation. It can, in effect, do the work of Parliament' (at 2).
- 2.6 The Federal Court has said 'there is no statutory foundation for stating that the power ... should be used "sparingly": *Otter Gold Mines Limited v ASC* (1997) 15 ACLC 1,732 at 1,738. The High Court has noted 'the difficulty of pointing to any basis upon which [the power's] operation could be confined': *ASIC v DB Management Pty Limited* (1999) 199 CLR 321 at 333. ASIC appears to share the courts' views as to the breadth of its powers. Financial services lawyers are well familiar with class orders which effectively enact wholly new provisions of the Corporations Act. Two examples will suffice for now.
- 2.7 Suppose you are an Australian financial services (**AFS**) licensee and you would like to offer an 'investor-directed portfolio service' (**IDPS**). You will first need to ensure your AFS licence authorises you to do so. If it does, you will, consequently, be subject to section 912AD of the Corporations Act. That section was not introduced by Parliament, nor even by a Minister by making a regulation. Instead, it was introduced by ASIC in 2013 when it made Class Order 13/763 Investor directed portfolio services.
- 2.8 Through 45 subsections, section 912AD regulates virtually every aspect of the design and distribution of an IDPS. There is even a separate provision, section 912ADA, also introduced by ASIC, concerning IDPS dispute resolution. These provisions are not the handiwork of a regulator that has a narrow view of its existing product intervention powers.
- 2.9 ASIC's powers were also used in an extraordinary fashion in September 2008 to regulate short-selling. ASIC made four class orders concerning short-selling over a period of just over four days. The cumulative effect of the class orders was that 'two new sections of the Corporations Act had come into effect, regulating a major form of market activity, and those sections had then been subject to several amendments, all without any parliamentary involvement' (Bottomley, at 4). The obvious response is that September 2008 was an extraordinary time requiring extraordinary action. But that response does not undermine the point we are making about the breadth of ASIC's powers – if anything, it reinforces it.
- 2.10 In addition to the exemption and modification powers discussed above, ASIC also has other powers it can use to intervene in financial services and financial products in the absence of any breach of the law. These include the power to impose additional conditions on an AFS licensee under section 914A of the Corporations Act. Clearly, the section requires ASIC to follow certain (not-very-demanding) processes before taking this action, particularly where the AFS licensee is also regulated by APRA. However, the power remains very broad all the same.

- 2.11 Much was made, in the various submissions to the Inquiry, of the position in the United Kingdom and, in particular, the Financial Conduct Authority's (**FCA**) 'new' temporary product intervention powers. Again, much of what was said seems to misunderstand the situation.
- 2.12 True, the FCA now has a specific power to make temporary product intervention rules, where it considers it 'necessary or expedient' not to go through public consultation. However, its predecessor, the Financial Services Authority, had long had the power to make product intervention rules (whether permanent or temporary), although the test for avoiding public consultation was somewhat more demanding – previously, the associated delay had to be 'prejudicial to the interests of consumers'. The simple point is that referring to the FCA's 'new' powers, without also referring to the previous position, tends to overstate the extent of the change that has happened there.
- 2.13 An objection that may be raised to our submission is this: if ASIC's existing product intervention powers are so wide and extraordinary, what does it matter if ASIC is given a further, circumscribed power? There are two responses to that objection. The first is that neither ASIC's submissions to the Inquiry nor the Inquiry's reports (interim and final) recognise that ASIC's existing powers are wide and extraordinary. The second response is that no-one (leaving aside Professor Bottomley) has examined the appropriateness of ASIC's existing powers. If neither the scope nor the appropriateness of those existing powers has been considered as part of the Inquiry's processes, how can recommendation 22 be adopted?
- 2.14 It is for these reasons that we submit that, before any decision on recommendation 22 is made, the Solicitor-General should be asked to provide an opinion to the Government on the true extent of ASIC's existing product intervention powers.

If you have any questions about any aspect of this submission, please contact any one of us, using the details provided below.

Yours faithfully



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