Financial Services Reform Act – The Regulator's Experience So Far

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Given the Conference theme, I should, of course, start with some disclosure. My first disclosure: I've been a banking lawyer for three days. My second disclosure is that I think calling me an industry expert is a bit of an over-statement. Anyone who's even been a casual reader of chapter 7 would be able to tell you that it covers a vast number of areas and today's discussions really only deal with about a fifth of what's in chapter 7.

We haven't dealt with market misconduct or the role of the Minister in granting Australian Financial Markets Licences and Clearing and Settlement Facility Licences. The distribution of power between Treasury, the Minister, the Reserve Bank and the regulators on those subjects is, itself, a very interesting subject.

So, today, I'm just going to confine my remarks to these very good papers. Already we can see that a lot of work needs to be done to implement FSR and the regulator has been very busy and, just listening to Susan, I was getting exhausted thinking about all the work that's been done at Westpac.

For my part, I'm going to focus on three things. I have some general remarks to make about the regime as a whole, and, in particular, focusing on, well, how do we assess the performance of the regulator or how the regulator is going and what questions should we be asking ourselves to be able to answer that issue sensibly.

Second, I will be spending a little bit of time on self reporting. I think that is a big sleeper in the regime and of obvious fundamental significance to compliance. And, finally, we've been spending a lot of time this morning looking at the Australian Financial Services Licence and talking about enforcement and what the powers of the regulator are. I will just have a few remarks highlighting some changes in the law which, in my view, place an even greater onus on the licensee than is the case under the present regime, shifting even further the regulatory heat, if you like, away from authorised representatives to the licensee.

Now, just my general remarks first. We've heard a lot today about the complexity of the regime and its impenetrability and many of you, of course, will remember last Christmas when we were treated to a succession of regulations for a consultation with Treasury and, for some light relief, I went to

This whole area which covers about 300 or 400 years of Italian law was all about the idea of regulating excess and consumption and the conspicuous consumption of wealth; and the Italians really worked at it. Apparently, over 300 statutes were passed in 40 cities over the period and it was quite a remarkable exercise, right up to the 18th century. The reason I got this book it was written by a friend of mine, and she was examining the idea, well, did it work? That was the issue. A lot of people went to a lot of trouble to figure out whether it worked and what I found interesting about her conclusions was that - there is a debate raging, even today, about whether all that legislation with all those officials trying to enforce it over all that period really made any difference.

Just before I leave the topic, you would be interested to learn the sorts of things that were being regulated. What clothes servants could wear, excessive mourning at funerals, weddings, feasts, gifts, Christenings, men's clothes and the degree of prescription, I have to say with great respect to the architects of the current regime, leave the current regime looking incredibly prescriptive. Let me just give you some examples.

We all know the current regime is meant to simplify and streamline regulation. Chapter 7 replaces chapter 7 and 8 and many of you would know that the old chapters 7 and 8 created, according to my counting, approximately 92 offences. The new and improved chapter 7 creates 235 offences. Many of them are strict liability offences and, it seems to me, that this excessive use of the criminal justice system to criminalise very minor breaches is something that we need to re-visit and it is something that Susan raised as well.

Now, what sorts of prescription are we talking about? In one of Susan's overheads, she referred to giving a product disclosure statement and the humble subject of giving a document to a consumer is a subject of no less than two sections in the FSRA. Susan kindly drew our attention to one of them, 1015C, How a Product Disclosure Statement Should Be Given, but there is a whole other section, section 940C, How Documents, Information and Statements Are To Be Given and that is three pages of legislation dealing with how to give someone a Financial Services Guide and a Supplementary Financial Services Guide. Apparently, it was all too difficult to come up with a single set of rules for all those documents to be given.

The Criminal Code. Susan mentioned the Criminal Code. It is true that the Criminal Code introduces the concept of corporate culture and I certainly agree with Susan's remarks about the significance of that concept for compliance and its penetration in Australian thinking. But as with so much with this regime, the devil is in the detail. One cannot talk about this regime without having to wade through a whole lot of provisions. So let's go to the Criminal Code.

The corporate culture provisions in part 2.5 of the Criminal Code which is where they are to be found actually don't apply to chapter 7 at all. Section 769A of the Act expressly excludes that part of the Criminal Code dealing with corporate culture, but, curiously, it does apply to the balance of the

Corporations Act. Secondly, the corporate culture provisions only apply to criminal matters so although it is entirely true to say that there is a developing doctrine in Australia of placing reliance on cultures of compliance or lack of them in dealing with some kinds of breaches, the corporate culture provisions only apply to criminal matters and certainly not in the civil liability area.

Sean mentioned the Financial Services Advisory Committee. Now, along with the new regime, we have a proliferation of committees and some of them have been re-badged. We now have a Corporations and Markets Advisory Committee rather than a CASAC and, as Sean reminded us this morning, we have a Parliamentary Joint Committee on Corporations and Financial Services. One of the key issues facing the Financial Services Advisory Committee is, is this working.

And I suppose one of the key things I want to leave you with this morning is we really don't have a model for determining whether this regime is going to work or not. Now, we've heard a lot about consumer protection and the role of consumers and, of course, this session is focusing on the regulator, but, in my view, there are, in fact, four key stakeholders at least. There is the consumers, there's industry, there's the Government and Treasury, and there is ASIC itself.
But how will we know, five years from now, that all this extra disclosure is going to work and all the prescription is going to work. I suppose one indication might be a dropping off of complaints. If ASIC doesn't prosecute anybody after three years, does that mean that compliance standards have gone up? If fewer people lose their money over the next five years, does that mean the regime has worked? If we have more heads on sticks, does that mean that ASIC is doing its job and there's lots of enforcement going on?

From the consumer point of view, I've often heard it said that consumers are concerned about the bewildering array of products. Three or four years from now, will there be a consolidation of the number and availability of products so the consumers can be less confused?

And what about consumer education? It is true that that consumers have a lot of rights under this legislation but I think we have a long way to go before they understand what those rights are. Will it be an indicator of success when the current torrent of regulations and consequential amendments to the legislation starts to ebb. Will that be a sign of success? We finally got it right. We don't need to amend those regulations any more and, indeed, we can even purchase a printed version of them. The version I've got here is chapter 7 and it's already six months old. I just can't bear to carry anything else around with me. So that would be a big step forward to be able to have a consolidated set of material.

So the question of benchmarking in my view is really of fundamental importance. We simply cannot have, as we have in Australia and in many countries, a lot of law reform wafting through the system without any real model for determining whether it works or not.

Let me just leave you with this thought on this point. Many of you will remember, of course, that President Clinton in March 1995 had this to say to all of the regulatory agencies in the United States:

> *I direct you to eliminate all internal personnel performance measures based on process, for example, number of visits made, and punishment, number of violations found, amount of fines levied.*

Just think about that. The regulators are being asked in the States to start thinking about, well, how do we look for ways of measuring results, performance, impact without relying on the tired old approach of six people were prosecuted last year, 50 were banned last year. What inferences do we draw from that?

I promised you something on self-reporting. Now, if I was head of compliance anywhere, I'd be really worried about self-reporting because, under the old regime, the way it worked was you had to self-report breach of a licence condition and that left you some room to move because, if there were departures from particular standards or requirements, that didn't necessarily mean there had been a breach of a condition of your licence. Well, that is certainly the view of many people.

Under the new regime, under section 912D - and I hope you do forgive me for referring to sections of the legislation because it is the only way that I can ever remember any of it is to keep going back to it. So if you go to 912D, what does it have to say? Well, once you've been licensed, you have to self-report within three days a breach of any financial services law and a breach of any obligation under 912A or B. Now, that's a very big subject. That is a breach of any of your licence conditions which include complying with a financial services law. Now, like so much in this legislation, that's been helpfully defined, and the financial services law covers about half the page and I won't take you through all of it but I would point out that it includes "any other Commonwealth, State or Territory legislation that covers conduct relating to the provision of financial services", whether or not it also covers other conduct, "but only insofar as it covers conduct relating to the provision of financial services". That, I have to say, is a mercifully short piece of drafting, but I think you get the message that self-reporting under this regime is on a much broader canvas and, in my mind, that raises several questions.

The first is, there is no materiality thresholds so it is any breach, not significant breaches or material breaches or breaches that affect the interests of consumers. Secondly, I often wonder, well, how is this going to be implemented within an organisation? How is senior management going to send a message to staff to say, "Well, it's okay to tell us, it's okay to confess. If you've breached, tell us, and you'll be all right because we want to create this culture," which Susan has very comprehensively dealt with this morning. So senior management is trying to encourage self-reporting within the organisation.

Now, what is ASIC doing? Now, ASIC has been doing a terrific job with FSR. It has had a huge challenge absorbing, as we have had to do, a whole range of regulations and new legislation and some enormous tasks in administering it and I think it is fair to say that industry has found us doing so with great

success. But on this subject, on the sensitive subject of enforcement, I do think there is a need for ASIC to be a lot more transparent and plain about what its attitude will be to 912D because the range of issues that can be self-reported is very broad and it does seem to me that if the regulator wishes to encourage compliance, that this sensitive issue has to be dealt with in a way about which there can be little or no ambiguity.

Finally, licensees. I said I'd have something to say about licensees. Now, from what I can work out, licensees get a pretty tough rap under this legislation. Under the current regime, if you are an authorised representative, you can be banned for not discharging your duties efficiently, honestly and fairly. Now, from what I can work out, the ASICs power to ban is now found in 920A and it's worth looking at because 920A seems to be saying that only the licence holder can be banned on that basis now. If you are a natural person who is an authorised representative, you can only now be banned if you become insolvent, you've been convicted of fraud or ASIC has a reason to believe that you won't comply with the Financial Services Law or you haven't complied with the Financial Services Law. But that very important provision of being taken out for now behaving efficiently, honestly and fairly has been removed, and, it seems to me, consistent with the broader theme in chapter 7, there are other sections that are numbingly difficult to read, but you can take my word for it, 1022B for example, where there are strong textual implications and indications that, when authorised reps err for civil liability purposes, for example, it's the licensee who bears the brunt of that.

Now, I think there has been a lot of restraint in the way in which we have been discussing these provisions. They are quite impenetrable. Just on the humble subject of who is civilly liable for not giving you a PDS, you will have to start with sections beginning around 917C to F and then read with the provisions which specifically deal with the civil liability consequences. So it seems to me, one of the big issues of this regime is being able to get away from the general, and, when you start drilling down into the particular, the issues for compliance and for lawyers are very complex and, as Susan has pointed out, very costly to deal with.

I am going to stop there because otherwise there won't be any time for questions. Thank you.