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The Treasury
Langton Crescent
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Dear James

Reforms to strengthen penalties for corporate and financial sector misconduct – Draft Legislation

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Exposure Draft of the Treasury Laws Amendment (ASIC Enforcement) Bill 2018 (the **Bill**).

The Bill implements recommendations from Chapter 7 of the ASIC Enforcement Review Taskforce Final Report, and we support the swift implementation of those recommendations. We particularly support the proposed increases to maximum criminal and civil penalties across a number of provisions, the expansion in provisions subject to penalties, and the power to obtain disgorgement remedies (referred to as a relinquishment order in the Bill) if there has been a contravention of a civil penalty provision.

This submission provides comments and recommendations in relation to the following:

- The importance of extending civil penalties to the general obligations of licensees;
- The need for the general prohibition on misleading and deceptive conduct as well as the prohibition on unfair contract terms to be offence provisions and subject to a civil penalty;
- The need to provide additional guidance to the courts to impose higher penalties that meet community expectations; and
- The appropriateness of funds obtained through a relinquishment order being returned to customers.

General obligations of licensees

Consumer Action strongly supports the extension of the civil penalty regime to the general licensee obligations in the *Corporations Act 2001* (Cth) (the **Corporations Act**)[i] and the *National Consumer Credit Protection Act 2009* (Cth) (the **NCCP Act**).[ii] These provisions require licensees to do all things necessary to ensure services are provided efficiently, honestly and fairly, and to have in place adequate arrangements to deal with conflicts of interest, among other obligations.

The Interim Report from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Interim Report**) described the former duty as "overarching and fundamental" obligation[iii]. We agree. While historically this duty to ensure services are provided efficiently, honestly and fairly has been considered as a licence condition, it is clear that the prospect of licence suspension or cancellation has not operated as sufficient discipline to ensure providers treat customers fairly and honestly. The lack of a realistic

sanction for breach of this duty has meant that the obligation has little meaning, particularly for large licensees like banks, insurers and superannuation funds. The ability for the regulator to seek a civil penalty for breach of this provision would provide a greater incentive for licensees to treat customers well having regard to basic principles of fairness and honesty.

Licensees should not have difficulty in identifying the content of this duty, and we consider that there are a range of circumstances which may indicate a breach of the duty. This may include where a licensee has not responded effectively to a systemic issue identified by an external dispute resolution scheme, or an industry code monitoring body.

Relatedly, the Interim Report noted that breaches of industry codes did not amount to a breach of the law, and that "the enforcement of these norms (in codes) should not be left to borrowers (or customers)".[iv] The Interim Report asked whether industry codes relating to the provision of financial services be recognised and applied by legislation like Part IVB of the *Competition and Consumer Act 2010* (Cth)[v].

For as long as industry codes are largely authored by industry participants themselves, we do not support them being given the force of law in this way. This would, in effect, result in the industry writing the law, which is inappropriate. However, systemic breaches of industry codes could be taken into consideration by the regulator in determining whether the general obligation to provide services efficiently, honestly and fairly has been breached. We recommend that either amendments are enacted to this effect or for this to be included in any regulatory guide relating to general conduct obligations. This would respond to the concern of the Royal Commission that codes have meaningful sanctions.

We also consider that a civil penalty should be available where a licensee fails to have in place adequate arrangements for dealing with conflicts of interests. This issue was also raised in the context of the Royal Commission, with the Interim Report suggesting a conclusion that lenders which paid value-based upfront and trail commissions to intermediaries did not have adequate arrangements for dealing with conflicts of interests that arise.[vi] In short, borrowers were disadvantaged by the conflict between the intermediary's interest in maximising income and the borrower's interest in minimising their costs or only purchasing a suitable loan. Again, the lack of realistic consequence from failing to abide by this duty contributed to certain lenders' failure to comply and the development of a deleterious sales culture in the banking and finance sector.

Recommendation:

- That the Bill or regulatory guidance clarify that systemic breaches of industry codes, and the way in which these are responded to by licensees, inform whether there has been a breach of the obligation to provide services efficiently, honestly and fairly.

Misleading and deceptive conduct and unfair contract terms

While the ASIC Enforcement Review Taskforce did not recommend that section 12DA of the *Australian Securities & Investments Commission Act 2001* (Cth) (**ASIC Act**) become a civil penalty provision, we consider this to be a significant gap. While section 12DB does attach civil penalties to various forms of misleading representations, there remains conduct that falls within the purview of the former and not the latter.

Such conduct might include misleading omissions. For a long time, courts have acknowledged that where there is a reasonable expectation of disclosure, then misleading omissions may fall foul of section 12DA.[vii] While a finding of such conduct may allow a regulator to seek some court orders, such as injunctions or declarations, or issue infringement orders, ASIC will be unable to seek pecuniary penalties for a breach of section 12DA alone. This can severely limit the regulator's ability to deter potential misconduct.

The benefits from attaching financial penalties to the prohibition on misleading and deceptive conduct would far outweigh any perceived risk that courts would bring a more cautious judicial approach to the interpretation of the prohibition.[viii] We do not consider this to be a realistic concern. First, courts are bound by precedent and the existing case law relating to the prohibition on misleading and deceptive conduct is extensive. Second, should the concern be more related to the level of penalty that might be attached to contraventions of the prohibition generally, we consider that if our recommendations below relating to the setting of penalties are adopted, then that risk would be substantially lowered.

Consumer Action also endorses the calls from the Australian Competition & Consumer Commission (**ACCC**) to make the prohibition on unfair contract terms an offence provision and subject to civil penalties.[ix] While a court can declare that an unfair term is void, there is no penalty associated with including an unfair contract term in a contract, and the regulators cannot issue infringement notices. The Royal Commission considered the implementation of the extension of unfair contract terms to small businesses, noting that when the law came into effect, a number of the banks' standard form contracts still contained unfair contract terms. We consider that a key problem contributing to this was the fact that, despite existing law, it is not illegal to include an unfair contract term in a standard form contract.

Recommendation:

- That the prohibitions on misleading and deceptive conduct and unfair contract terms be offence and civil penalty provisions.

The level of penalties

Consumer Action strongly supports the proposed increases to maximum criminal and civil penalties for corporations, including for contravention of consumer protection provisions in the ASIC Act and the NCCP Act as well as the director duties in the Corporations Act. Setting maximum civil penalties at the greater of 50,000 penalty units (currently $10.5 million) or three times the value of benefits obtained or losses avoided, or 10% of annual turnover in the 12 months preceding the contravening conduct, more closely aligns the level of penalties with those under the *Competition & Consumer Act 2010* (Cth), as well as community expectations. We also warmly welcome the extension of the civil penalty framework to the *Insurance Contracts Act 1984* (Cth).

However, we are not convinced there is a strong policy justification for introducing a maximum limit on civil penalties of 1 million penalty units (currently $210 million). Setting a maximum does not recognise that there are very large differences in sizes of banks, insurers and superannuation funds, and that a penalty in excess of this amount may be appropriate in the context of very large corporations.

Further, we remain concerned that the courts may not seek to impose high penalties. First, while we welcome the inclusion of the 'three times the value of benefits obtained or losses avoided' limb, we consider that it many cases this will be difficult to determine. For example, if the contravention involves misleading advertising, is it correct to attribute revenue from sales of all products that is contemporaneous with that advertising to 'benefits obtained'? This difficulty may lead the court to instead rely on the maximum penalty unit or annual turnover limbs.

Second, we note that Australian courts have adopted techniques and principles from criminal law in the setting of penalties, and that this can lead to the setting of lower penalties. For example, courts commonly adopt "instinctive synthesis" of various factors in the setting of penalties.[x] Such an approach appears to eschew rational thought for mystery, relying on judicial knowledge and expertise in reaching the appropriate penalty

rather than reflecting community standards and expectations or the seriousness of the conduct. A particular concern with this approach is that it is rarely considered appropriate for a court to commence with the maximum penalty and proceed by making a proportional deduction from that maximum.[xi] This may limit the effectiveness of law reform that increases maximum penalties alone.

The "instinctive synthesis" approach might be contrasted with a more structured approach that imposes an expected level of penalty in response to a particular type or course of conduct. While in a different context (competition law), the OECD has found that Australian courts have tended to impose civil penalties consistently lower compared to countries that use more structured approaches to the setting of penalties.[xii] A structured approach may also deal with concerns about the potential for courts to take a cautious approach to the setting of penalties. For example, a structured approach might allow for a higher penalty to be imposed where there is deception (i.e. involving deliberate dishonesty or knowledge), rather than conduct that has a misleading effect.

Other principles adopted by Australian courts when applying penalties include the 'totality principle' and the 'parity principle'. It is our observation that these principles can also operate to limit the imposition of high penalties. For example, the totality principle 'is designed to ensure that overall an appropriate sentence or penalty is appropriate and that the sum of the penalties imposed for several contraventions does not result in the total of the penalties exceeding what is proper having regard to the totality of the contravening conduct involved'.[xiii] This approach may serve to reduce the penalty imposed by a court. The parity principle requires that, other things being equal, persons committing the same contravention should receive the same punishment. Particularly in a transition period, this principle may also serve to limit higher penalties—despite the increase to the maximum penalty, courts may consider it inappropriate to impose a much larger penalty for similar conduct, particularly where it was recently awarded. This was a concern noted by OECD in its report on competition law penalties:

> "… the current amount of pecuniary penalties [may be] a consequence of initial decisions based on the statutory regime in place before 2007, which set a maximum penalty amount that did not take into account the size of the infringing companies' conduct – and which adopted relatively low pecuniary penalties by international standards.
>
> Subsequent judgments, even those that were adopted after the law was reformed to allow for larger penalties to be imposed, merely followed precedent when imposing pecuniary penalties which were low by international standards, in accordance with the principle that similar conduct should be treated similarly."[xiv]

Finally, we note that many civil penalties sought by ASIC are the result of agreed submissions with the opposing party, after it has admitted the relevant misconduct. While the court retains an important role in the setting the penalty when agreed submissions are made, the question for the court in these circumstances is generally more limited—that is, it is whether the Court is satisfied that the submitted agreed penalty is appropriate.[xv] An appropriate penalty may be one that falls within a "permissible range".

We consider there is a willingness and/or incentive for regulators to recommend an agreed penalty that is pragmatic and perhaps lower than otherwise, given doing so may offset the expense of contested litigation. While this may be an appropriate and efficient way for the regulator to approach its use of limited resources, the outcome may be one whereby the court imposes a lower penalty than would otherwise be appropriate.

Given the concerns listed above, we strongly recommend that this legislation include further guidance for the court that would encourage a higher level of penalties in appropriate cases. We note the provisions of the Bill,

with respect to the introduction of civil penalties in the Insurance Contracts Act, which require the court take into account certain matters when setting a civil penalty, including:[xvi]

- The nature of the contravention;
- The nature and extent of losses or damages as a result of the contravention;
- The circumstances in which the contravention took place; and
- Whether a court has found the person has engaged in similar conduct in the past.

We consider that this list could be added to, with consequent amendments to the Corporations Act and NCCP Act. We recommend an additional factor for the court to consider that has the effect of encouraging the court to set penalties at a level sufficient to ensure deterrence and meet community expectations. Separately, we encourage the Government to initiate a review to consider whether the adoption of a more structured approach to the setting of civil penalties would be more appropriate in the modern context.

Recommendation:

- That ASIC-administered legislation be amended so that the court must consider the following factors in the setting of civil penalties: that the penalty is sufficient to ensure deterrence and meet community expectations.
- That the Government establish an independent review, involving experts from legal, regulatory and the community backgrounds, to consider whether a more structured approach to the setting of civil penalties would be more appropriate in the modern context.

Relinquishment orders

Consumer Action strongly supports the Bill's amendments to enable courts to make a relinquishment order if there has been a contravention of a civil penalty provision. A relinquishment order would enable 'disgorgement' of financial benefits that arise from misconduct and is a vehicle for preventing unjust enrichment. We consider that such orders can offer significant deterrence by reducing the likelihood that wrongdoers can consider penalties to be merely a business cost. Financial service providers treating breaches of legislation, and the consequences of breaches, as a cost of doing business was a concern identified in the Interim Report.[xvii]

Consumer Action suggests, however, that the court be given the power to award these amounts directly to consumers in appropriate circumstances, not just to the Commonwealth. We note that the Bill as drafted provides that an amount owing under a relinquishment order will be a debt payable to ASIC on behalf of the Commonwealth.[xviii]

We consider that in many, if not most, cases these funds will be more akin to restitution or refunds for consumers rather than a pecuniary penalty. Given the focus is on returning ill-gotten gains, the effect of disgorgement isn't punitive like a pecuniary penalty. As such, it is appropriate for the court to at least have a discretion to return these amounts to consumers, or for the benefit of consumers, in appropriate cases.

Even where the particular consumers affected cannot be identified, we urge that a mechanism be established for funds obtained through relinquishment orders be applied for the benefit of consumers. An example might be the Victorian Consumer Law Fund, which is established by virtue of the ACL application legislation in that state.[xix] Pecuniary penalties and various other amounts, including non-party consumer redress, can be paid into this Fund. Grants can be subsequently paid out of the fund for the purposes of improving consumer wellbeing, consumer protection or fair trading.

Similarly, the Queensland Government maintains a Consumer Credit Fund (established under the *Consumer Credit (Queensland) Act 1994* [repealed] and continued under the *Credit (Commonwealth Powers) Act 2010*. The fund can make payments in respect of consumer policy research, consumer education, consumer surveys and other consumer-related initiatives.

We consider that ASIC-administered legislation should be amended allow for the establishment of a similar fund, and for relinquishment orders to be directed into the fund. This would have additional benefits by enhancing consumer research and advocacy, thereby consumer protection more broadly. As an alternative, funds obtained through relinquishment could be directed to appropriate trusts, such as the recently established independent Consumer Advocacy Trust, an initiative of the Financial Rights Legal Centre. The Consumer Advocacy Trust is intended to fund applications from not-for-profit organisations 'seeking to undertake independent consumer research, policy analysis, casework and/or systemic advocacy (and related consumer education, where appropriate)', among other things consistent with the objectives of the Trust'.

Recommendation

- That the court be given the power to award amounts paid pursuant to relinquishment orders to consumers in appropriate circumstances.

Please contact Katherine Temple on 03 9670 5088 or at katherine@consumeraction.org.au if you would like to discuss this submission further.

Yours Sincerely,
CONSUMER ACTION LAW CENTRE

Gerard Brody
Chief Executive Officer

[i] Section 912A, Corporations Act.
[ii] Section 47, NCCP Act.
[iii] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Interim Report*, September 2018, volume 1, page 21.
[iv] As above, page 292.
[v] As above, page 293.
[vi] As above, volume 2, pages 28-28.
[vii] See *Demagogue Pty Ltd v Ramensky* (1992) 39 FCR 31 at 32.
[viii] CAANZ, *Review of the Australian Consumer Law—Final Report*, page 93.
[ix] See, ACCC, *Submission to Inquiry into the operation and effectiveness of the Franchising Code of Conduct*, recommendation 3, available at: https://www.accc.gov.au/system/files/ACCC%20Submission%20to%20the%20Franchising%20Code%20of%20Conduct%20Inquiry%20-%2011%20May%202018....pdf.
[x] See, eg, *Singtel Optus Pty Ltd v ACCC* [2012] FCAFC 20; (2012) 287 ALR 249; *ACCC v Telstra Corporation Ltd* [2010] FCA 790; (2010) 188 FCR 238; *ACCC v TPG Internet Pty Ltd* (No 2) [2012] FCA 629; *Commonwealth v Director, Fair Work Building Industry Inspectorate* [2015] HCA 46. These are not cases relating to financial services, but apply the substantially same civil penalty framework.
[xi] *Markarian v The Queen* [2005] HCA 25; applied in *ACCC v Spreets Pty Ltd* [2015] FCA 382 (Collier J)
[xii] OECD, *Pecuniary Penalties for Competition Law in Australia*, 2018, available at. http://www.oecd.org/daf/competition/Australia-Pecuniary-Penalties-OECD-Report-2018.pdf
[xiii] *McDonald v The Queen* [1994] FCA 956.
[xiv] OECD, above.
[xv] *Commonwealth v Director, Fair Work Building Industry Inspectorate* [2015] HCA 46
[xvi] Schedule 4, item 4, subsection 75B(5) ICA
[xvii] Vol 1, p 228
[xviii] Schedule 1, item 103, subsections 1317GAF(4) and 1317GAF(5) of the Corporations Act; Schedule 2, item 17, subsections 12GCA(4) and 12GCA(5) of the ASIC Act; Schedule 3, item 10, subsections 180B(4) and 180B(5) of the NCCP Act.
[xix] *Australian Consumer Law & Fair Trading Act 2012* (Vic), division 5.