

*University of
Sydney*

*Compliance:
Financial Services
Industry
(LAWS 6264)*

***Financial Services Industry:
Core Compliance Issues***

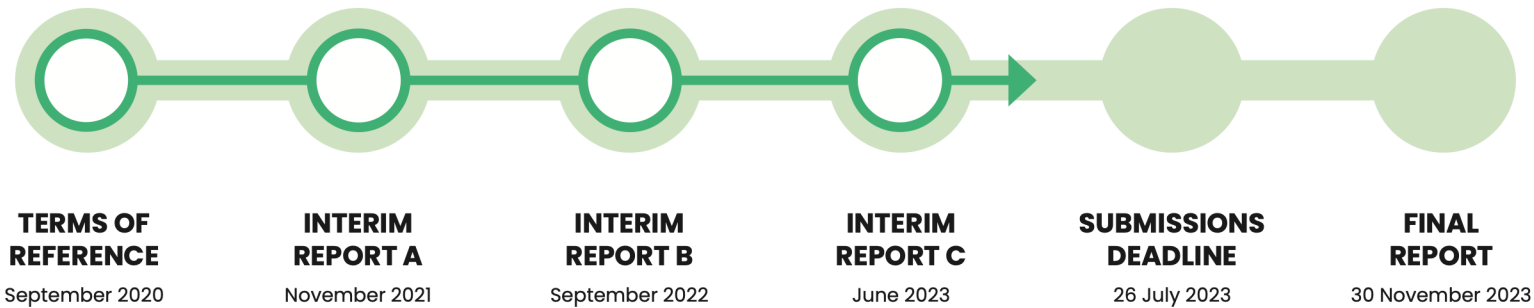
Dominique Hogan-Doran SC
5 Wentworth Chambers

5 August 2023



ISSUES OF SIGNIFICANCE

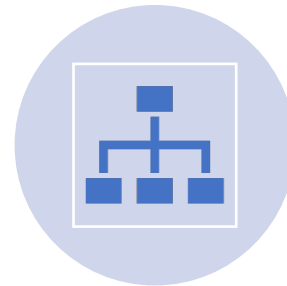
Australian Law Reform Commission Inquiry



Australian Law Reform Commission Inquiry



The [first interim report](#) focussed on the appropriate use of definitions in corporations and financial services legislation



The [second interim report](#) focussed on regulatory design and the hierarchy of primary law provisions, regulations, class orders, and standards



The [third interim report](#) focussed on potential reframing or restructuring of Chapter 7 of the Corporations Act



The consolidated final report is due by 30 November 2023.

Context

8. On 11 September 2020, the ALRC received Terms of Reference which asked the ALRC to consider whether the *Corporations Act* and the *Corporations Regulations* could be simplified and rationalised, particularly in relation to:
 - A. the use of definitions in corporations and financial services legislation;
 - B. the coherence of the regulatory design and hierarchy of laws, covering primary law provisions, regulations, class orders, and standards; and
 - C. how the provisions contained in Chapter 7 of the *Corporations Act* and the *Corporations Regulations* could be reframed or restructured.
9. Significantly, the Terms of Reference do not require the ALRC to consider whether the substantive law by which corporations and financial services are regulated requires reform. Rather, the focus of the Inquiry is simplifying the existing regulatory framework within existing policy settings.
10. The Inquiry is set against the background of the Australian Government's response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ('the Financial Services Royal Commission') and, in particular, the Government's acceptance of the Commission's call for simplification of the law so that its intent is met.⁴ In its Final Report, the Financial Services Royal Commission emphasised that the existing legislative framework for corporations and financial services regulation is unnecessarily complex, fails to communicate fundamental norms, and hinders compliance.⁵
11. The Terms of Reference for this Inquiry are therefore underpinned by a focus on simplification — designing legislation that can be more easily navigated and understood, and may therefore more effectively and efficiently achieve its policy objectives.

Figure 3.1: Financial services regulatory ecosystem map

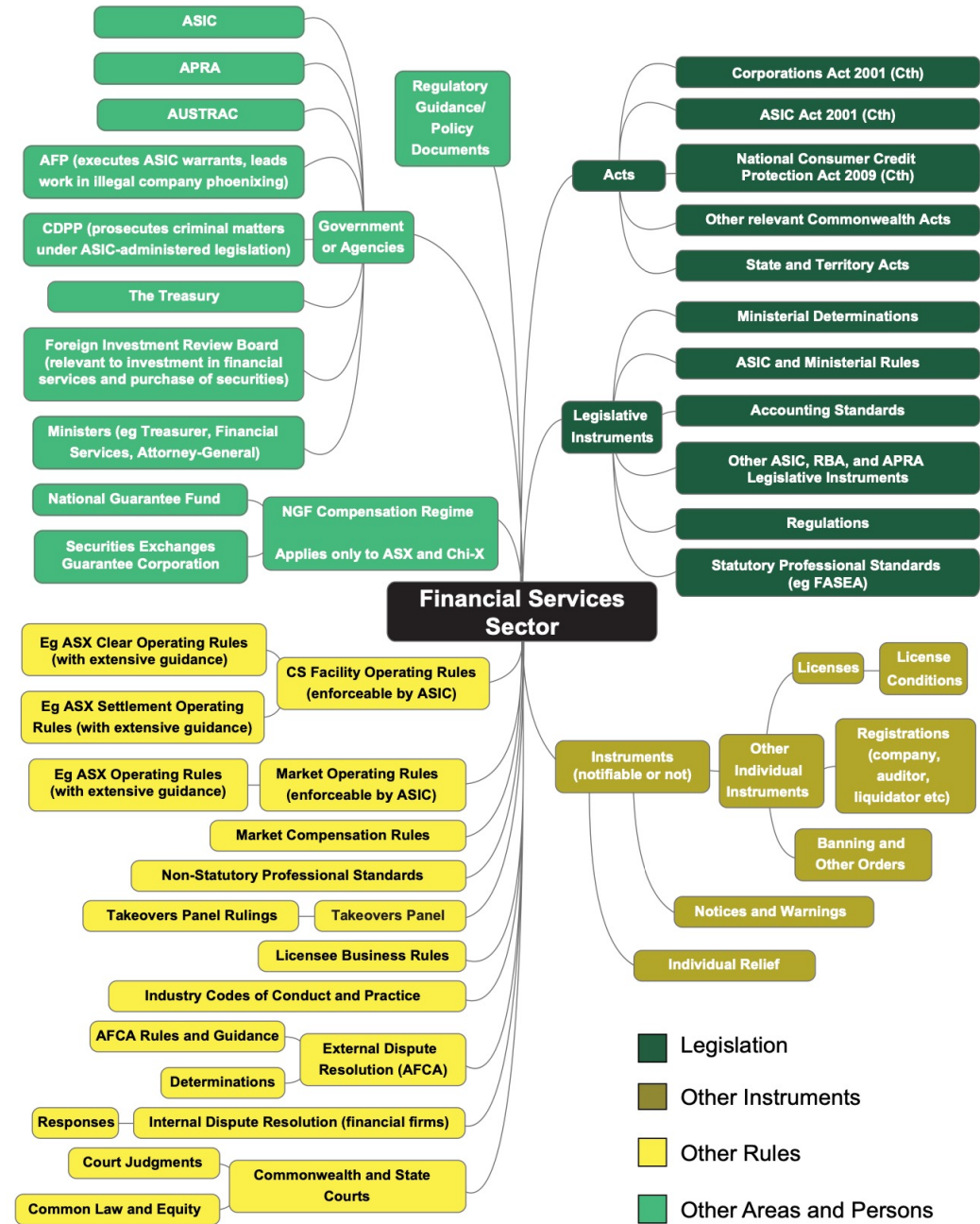


Figure 1.1: Interim Report C and work undertaken to date

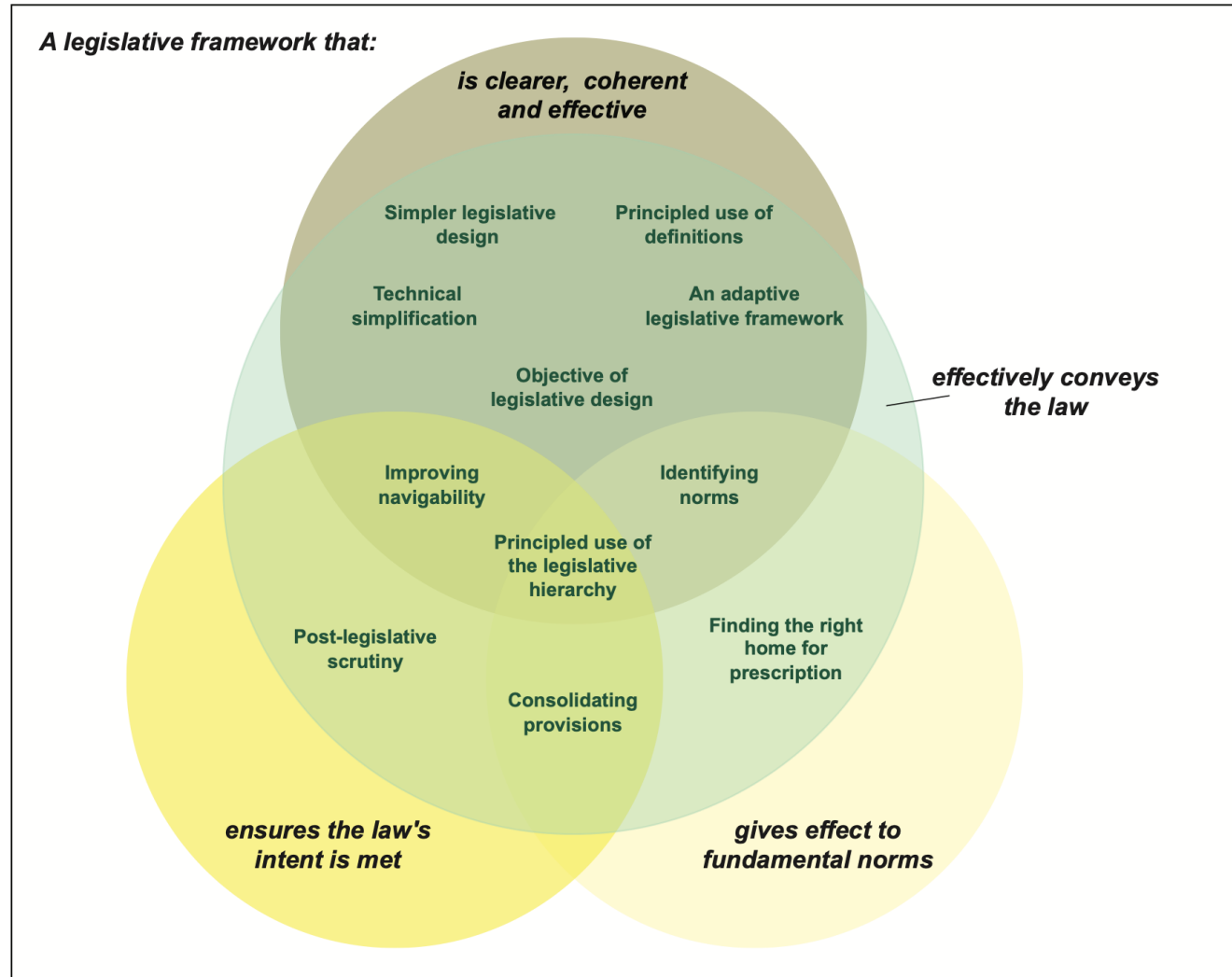


Figure 2.1: Taxonomy

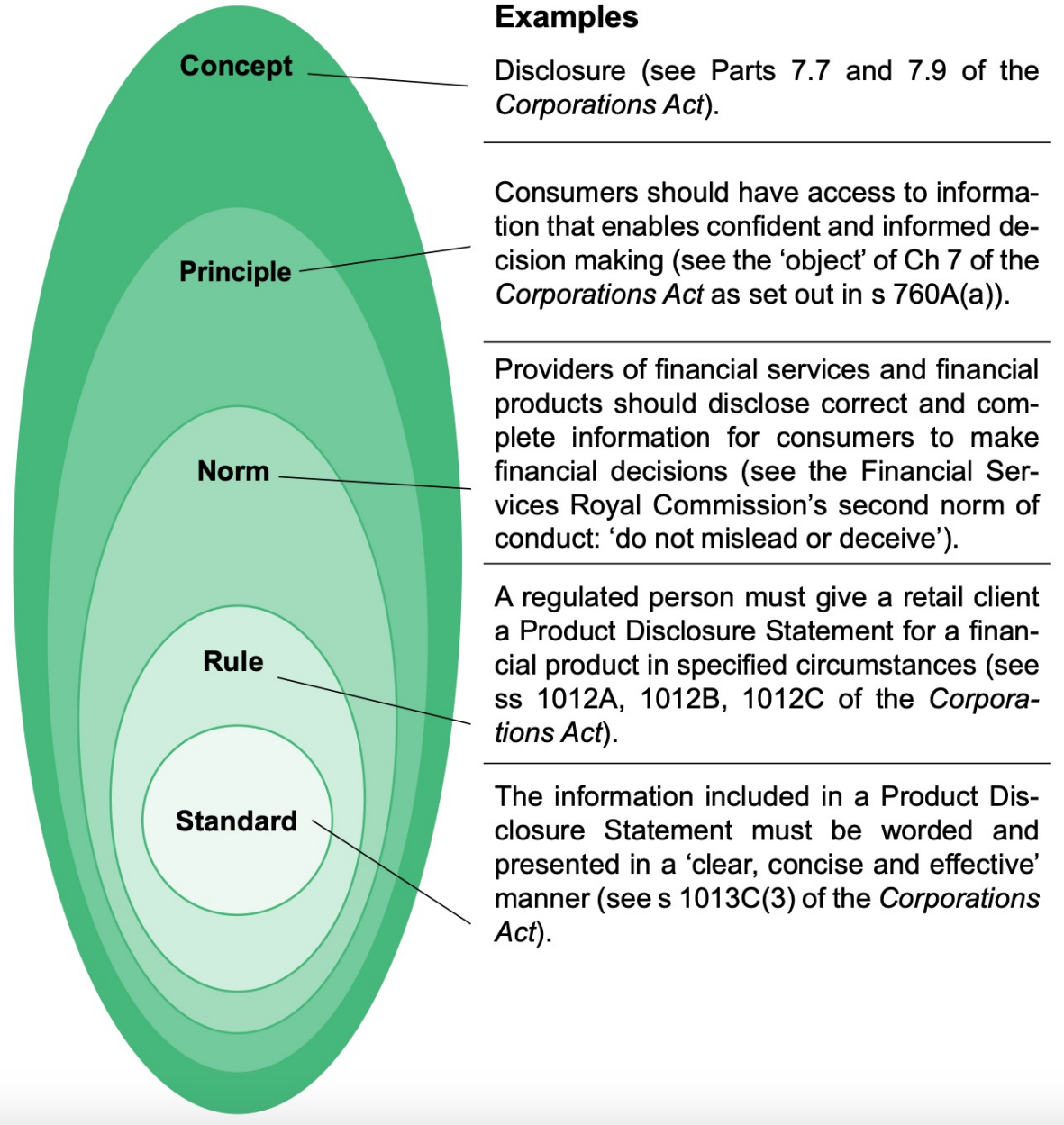
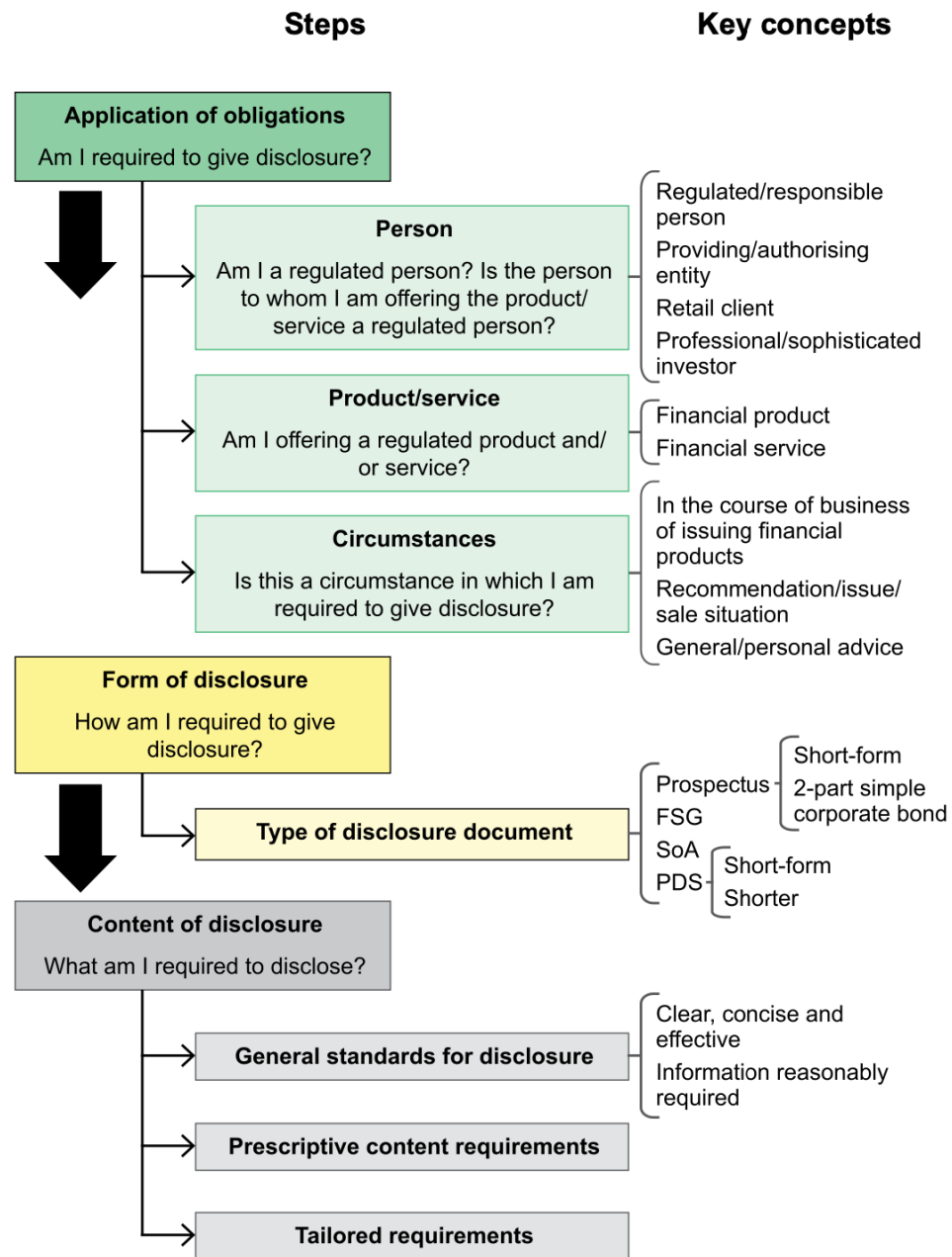


Figure 9.1: Steps for determining scope and content of disclosure obligations





FINANCIAL PRODUCT



FINANCIAL PRODUCT



makes a financial investment



manages financial risk



makes non-cash payments



specific inclusions & exclusions



FINANCIAL PRODUCT



makes a financial investment



manages financial risk



makes non-cash payments



specific inclusions & exclusions



money



benefit



interest



derivative



person



security



excluded security



margin lending facility



Figure 11.1: Comparison of the regulation of financial product advice and other financial services

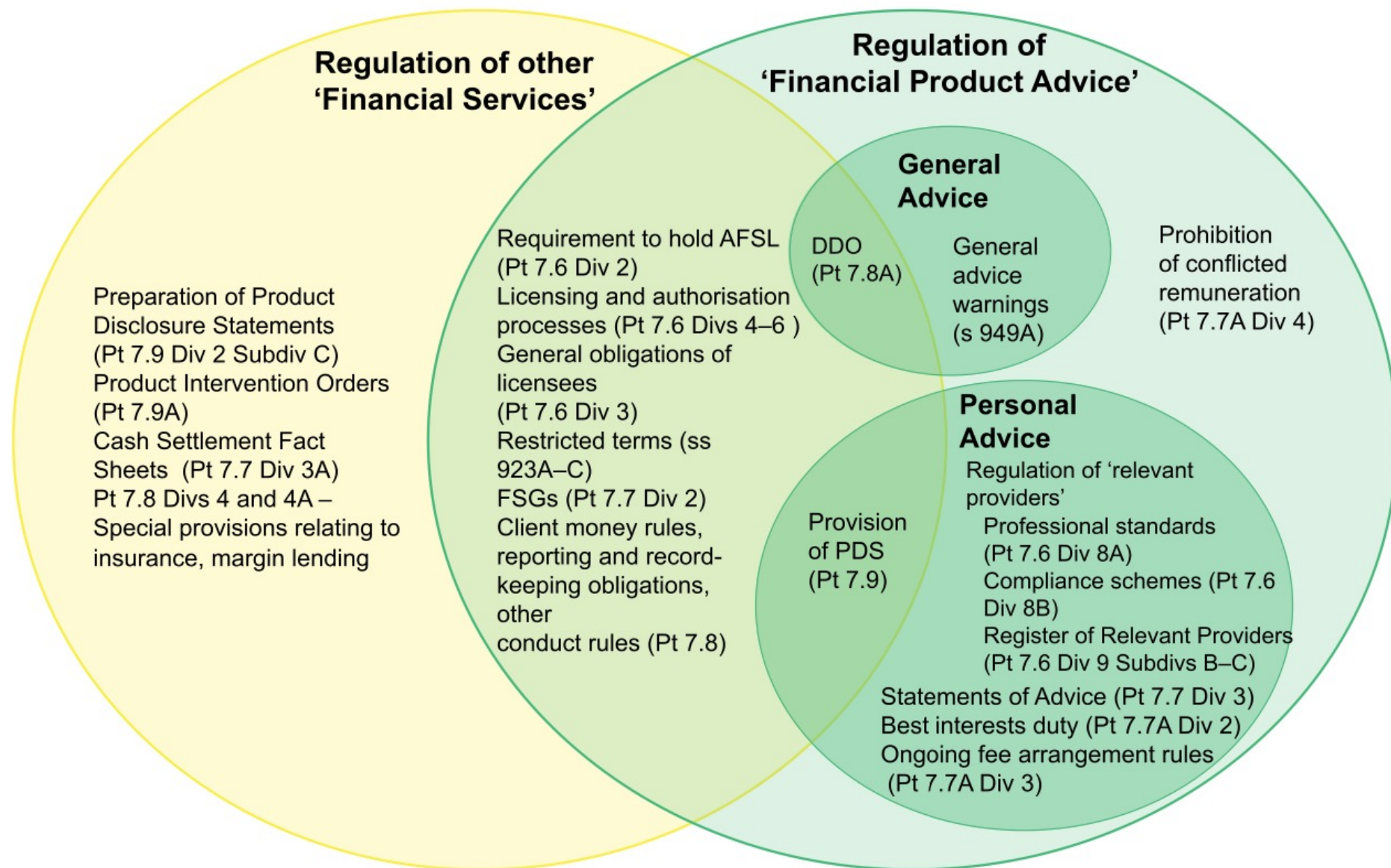


Figure 12.1: Current model for the 'retail client' definition

Product/service Circumstances in which product/service will not be provided to a person as a retail client

1. What type of product is being provided? To which type of product does the service being provided relate?

General insurance product	<p>Product type other than one prescribed by s 761G(5)(b)</p> <p>Provided to a person other than an individual and not for use in connection with a small business</p>
Superannuation product or RSA product	<p>Provision of interest in a pooled superannuation trust by trustee to the trustee of a super fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme that has net assets of at least \$10m</p>
Other	<p>Financial service (other than provision of a financial product) is provided to a person who is: the trustee of a super fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme that has net assets of at least \$10m; or an RSA provider</p>



2. What kind of service is being provided?

Traditional trustee company service	<p>Provided to a person who is a professional investor</p> <p>Provided for use in connection with a business that is not a small business</p>
Superannuation trustee service	<p>Financial service (other than provision of a financial product) is provided to a person who is: the trustee of a super fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme that has net assets of at least \$10m; or an RSA provider</p>
Other	<p>Value/price of product exceeds prescribed thresholds</p> <p>Provided for use in connection with a business that is not a small business</p> <p>Provided to a person who obtains a certificate from a qualified accountant that demonstrates they meet the net assets or gross income thresholds</p> <p>Provided to a person who is a professional investor</p> <p>Provided to a person who is a sophisticated investor</p>

Figure 4.1: The existing structure of financial advice provisions

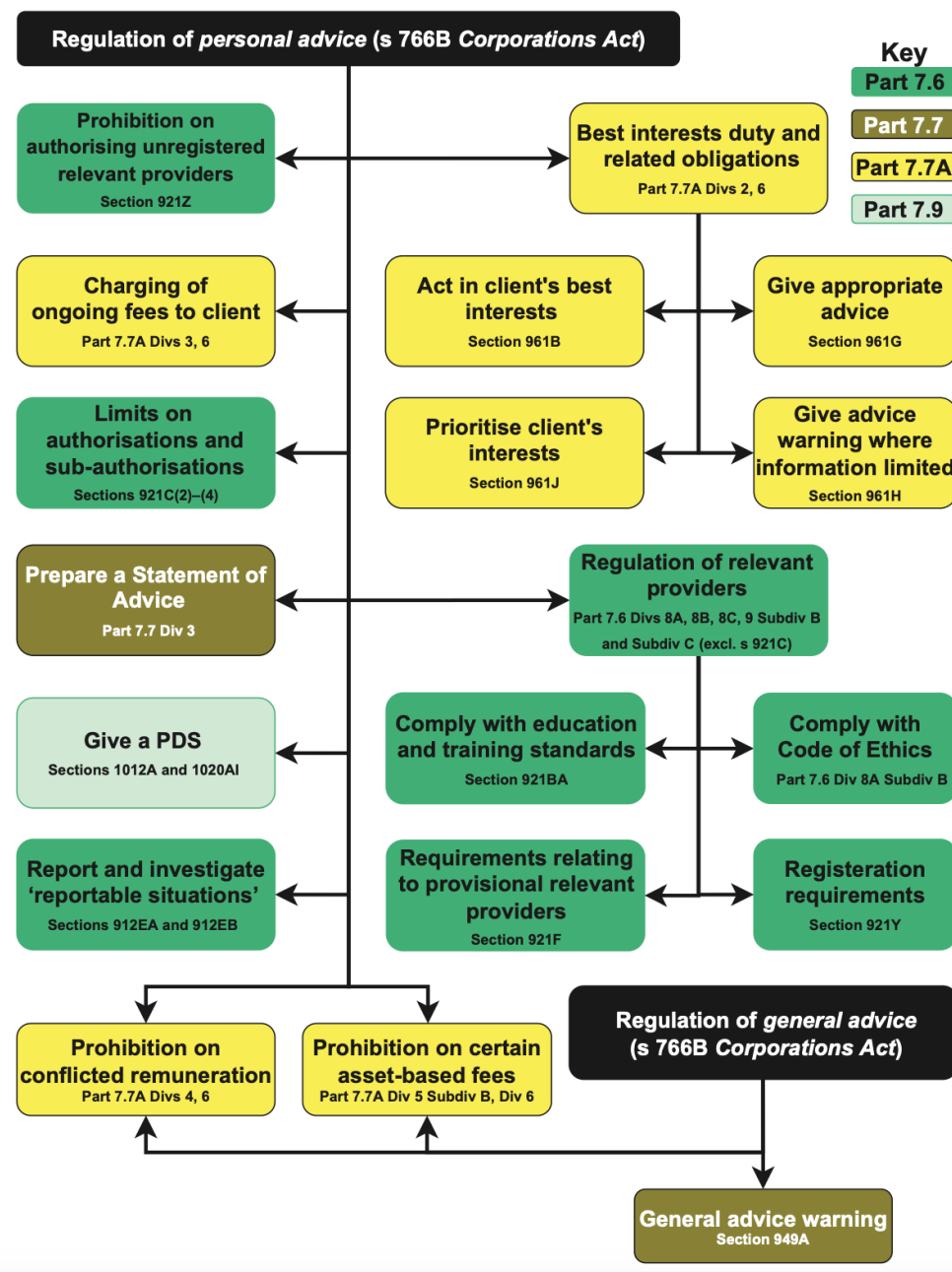


Figure 11.2: Summary overview of advice-related exclusions and exemptions

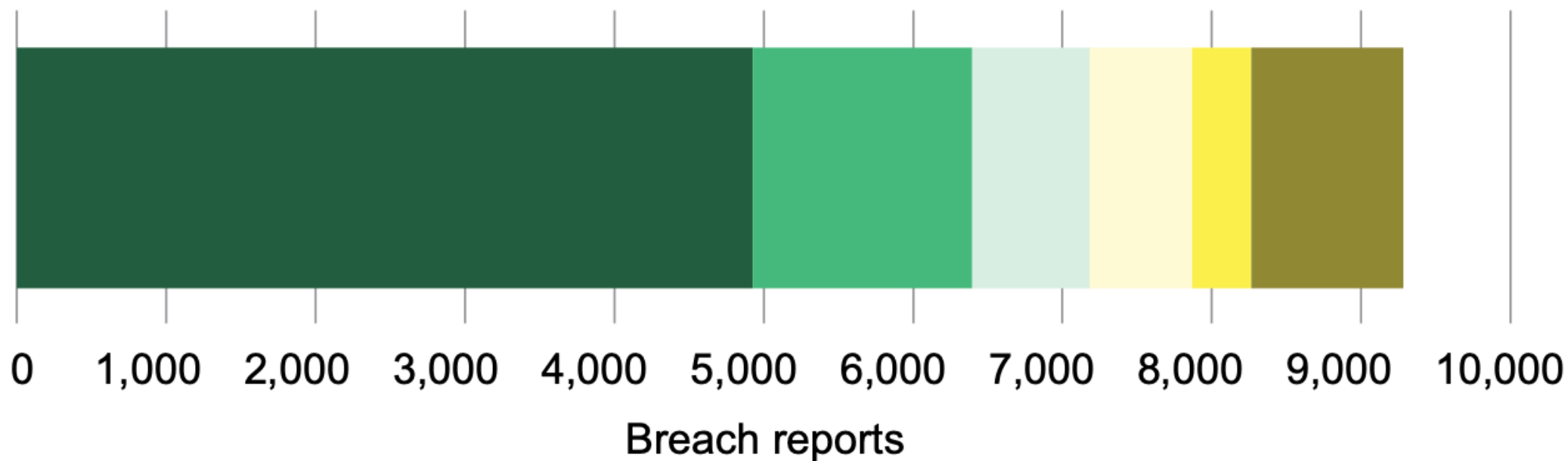
Sources of exemptions/exclusions	Examples of advice-related exclusions/exemptions
<p>I am providing financial product advice</p> <p>Unless... Excluded by s 766B</p>	<ul style="list-style-type: none"> Exempt documents Advice by lawyers, registered tax or BAS agents Info about costs/rate of return Advice as part of claims handling and settling service
<p>I am providing a financial service</p> <p>Unless... Excluded by regulations made under s 766A(2)</p>	<ul style="list-style-type: none"> Necessary advice in course of exempt service (eg tax advice) Advice re: voting rights for securities or interests in MIS General advice re: school banking product Advice re: allocation of funds for investment among different products
<p>I must hold an AFS licence to carry on my business</p> <p>Unless... Exempted by regs made under s 911A(2)(k)</p> <p>Exempted by ASIC instrument made under ss 911A(2)(l), 926A</p>	<ul style="list-style-type: none"> General advice in newspaper etc whose sole purpose is not financial product advice General advice re: offer under employee share/incentive scheme Advice re: medical indemnity insurance Advice by money management service provider re: basic deposit product Advice by financial counselling agencies in certain circumstances Advice re: mortgage offset account Advice by an 'eligible company' re: issue of member shares
<p>I must comply with AFS licensee obligations</p> <p>Unless... Exempted under the Act</p> <p>Exempted by regs made under ss 926B, 941C(8), 951C, 992C</p> <p>Exempted by ASIC instrument made under ss 926A, 951B, 992B</p>	<ul style="list-style-type: none"> Advice in a retirement estimate statement that meets certain conditions (exemption from Pt 7.7 Divs 2, 3, 4) Advice provided through financial calculator (exemption from Pt 7.7 Divs 2, 3, 4) Small investment advice (exemption from obligation to provide SoA) General advice in the form of advertising if conditions are met (exemption from obligation to provide FSG; general advice warning) General insurance product advice (exception from requirement to prove steps in s 961B(2)(d)–(g))

Exemption under the Corporations Act

Authority for exemption by Corporations Regulations

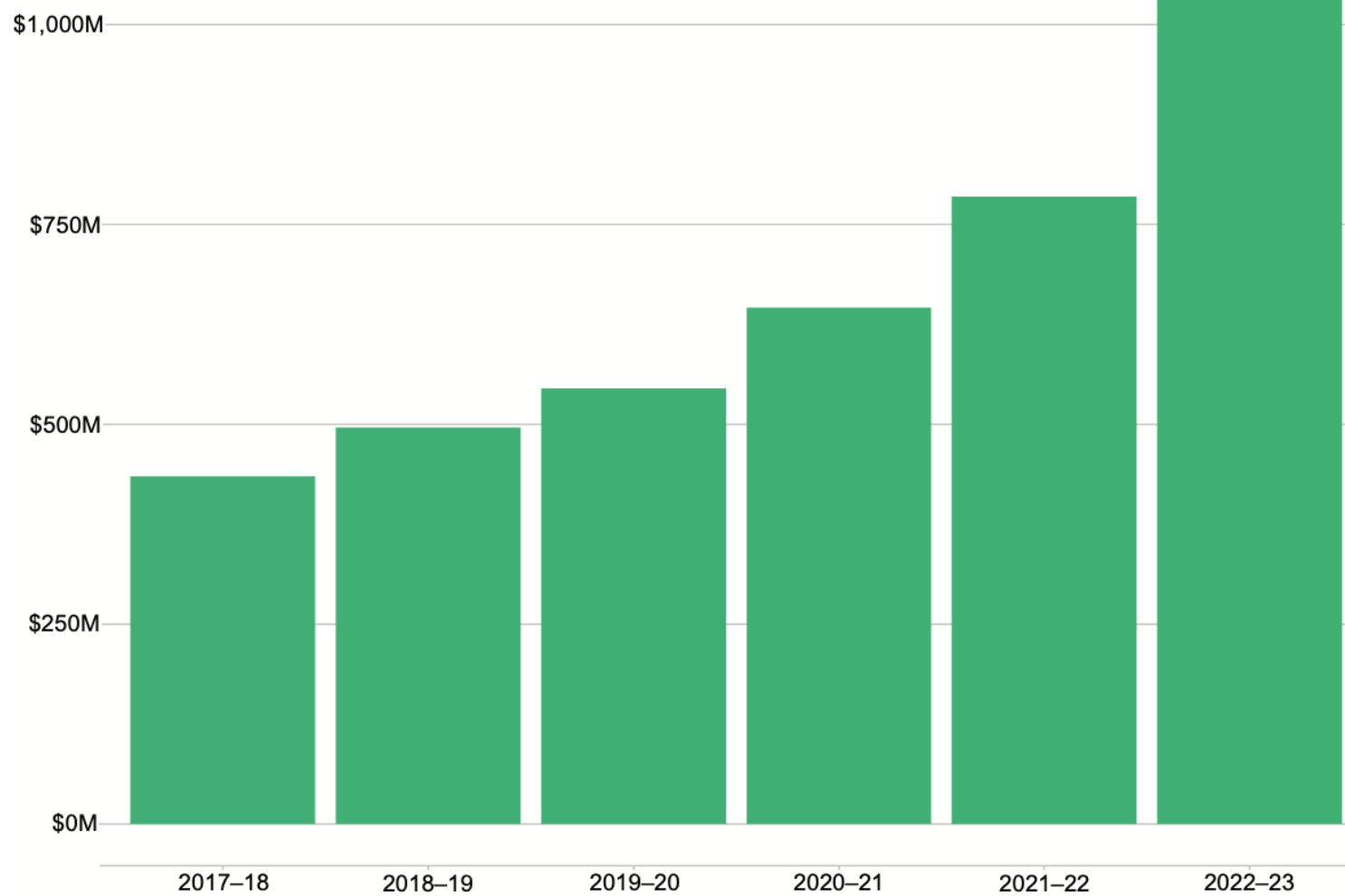
Authority for exemption by ASIC legislative instrument

Figure 3.20: Breach reports relating to financial services and retail investors



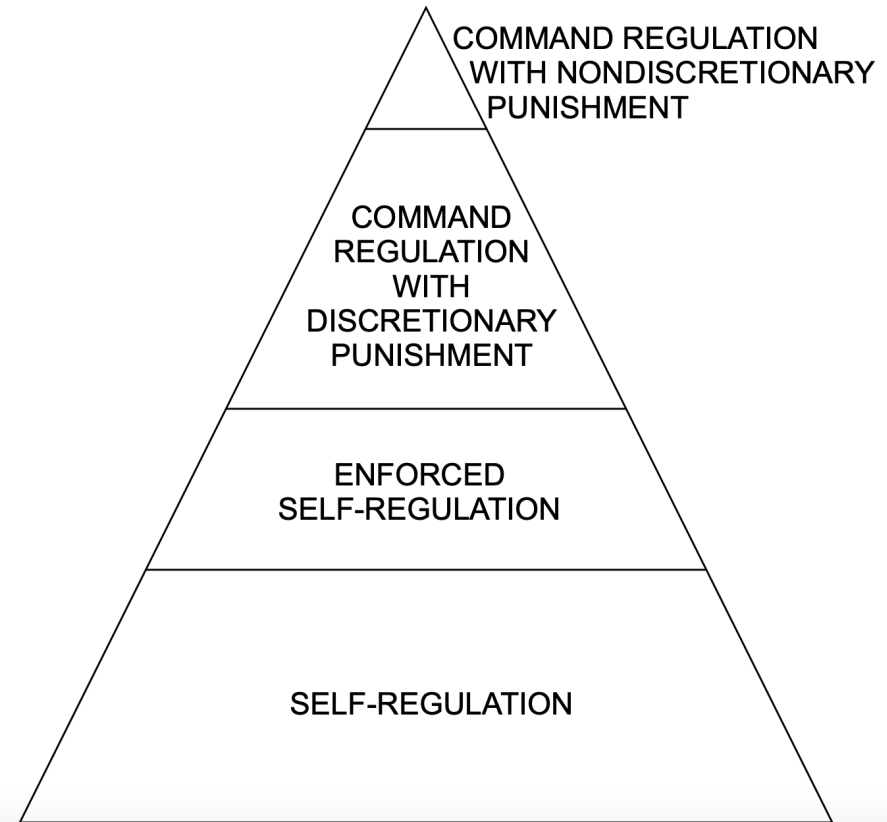
- AFS Licensee conduct
- Credit Licensee conduct
- Disclosure
- Errors related to fees and charges
- Misleading or deceptive conduct
- Other

Figure 7.1: Total regulatory compliance spend — Macquarie Group Limited¹³

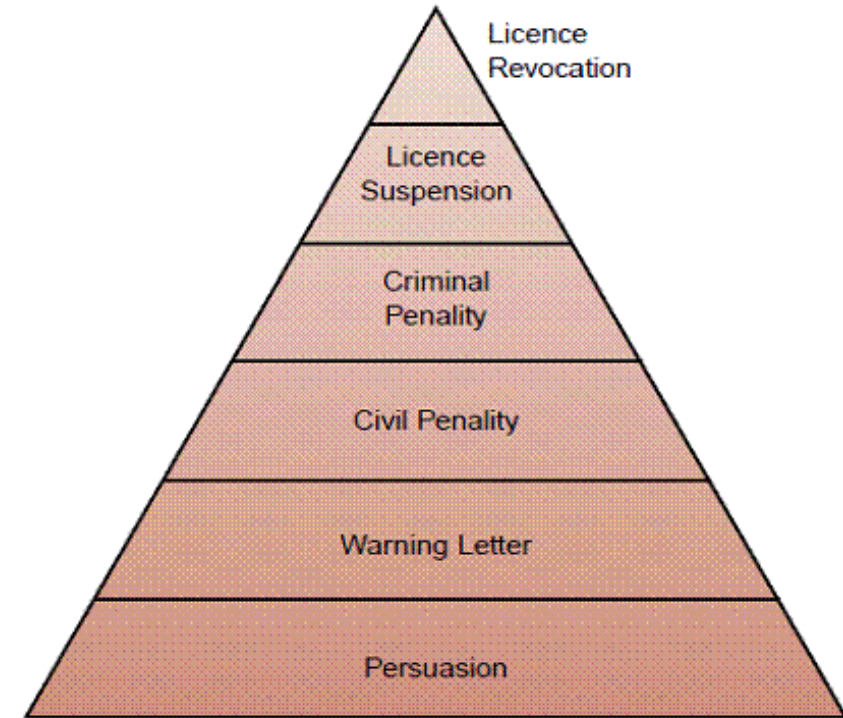


Theories of Regulatory Compliance

I Ayres, & J Braithwaite,
*Responsive regulation:
Transcending the deregulation
debate* (Oxford University Press,
New York, 1992)

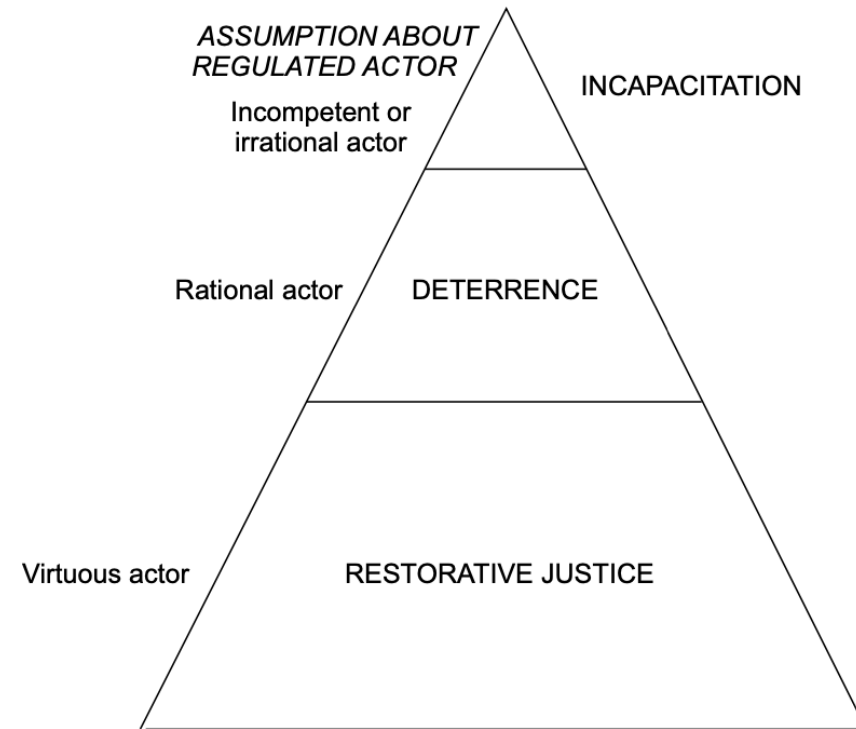


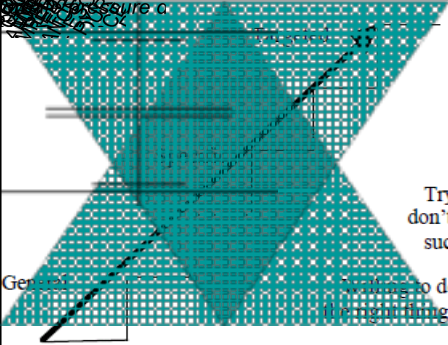
The Ayres and Braithwaite Enforcement Pyramid has been foundation 'compliance model' for most regulatory agencies.



Source: Ayres and Braithwaite (1992).

Responsive regulation's enforcement pyramid, showing assumptions made by regulator about regulated entity

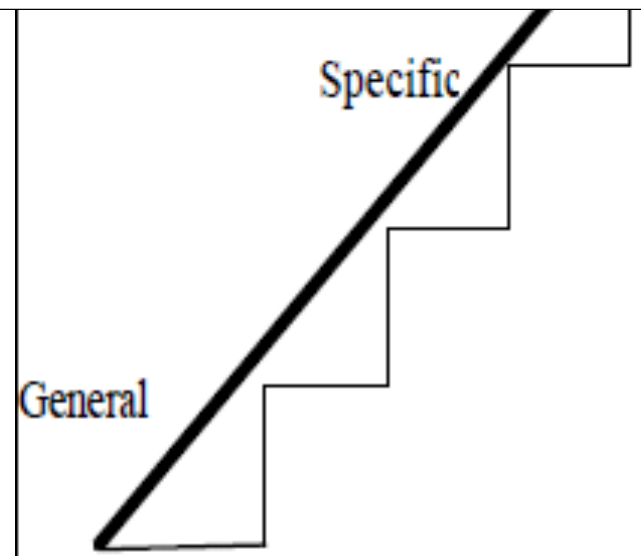
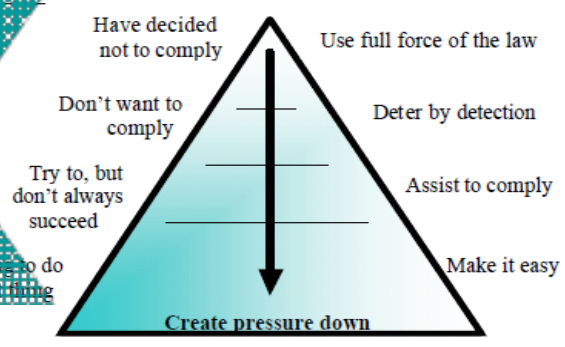




Leverage

Attitude to Compliance

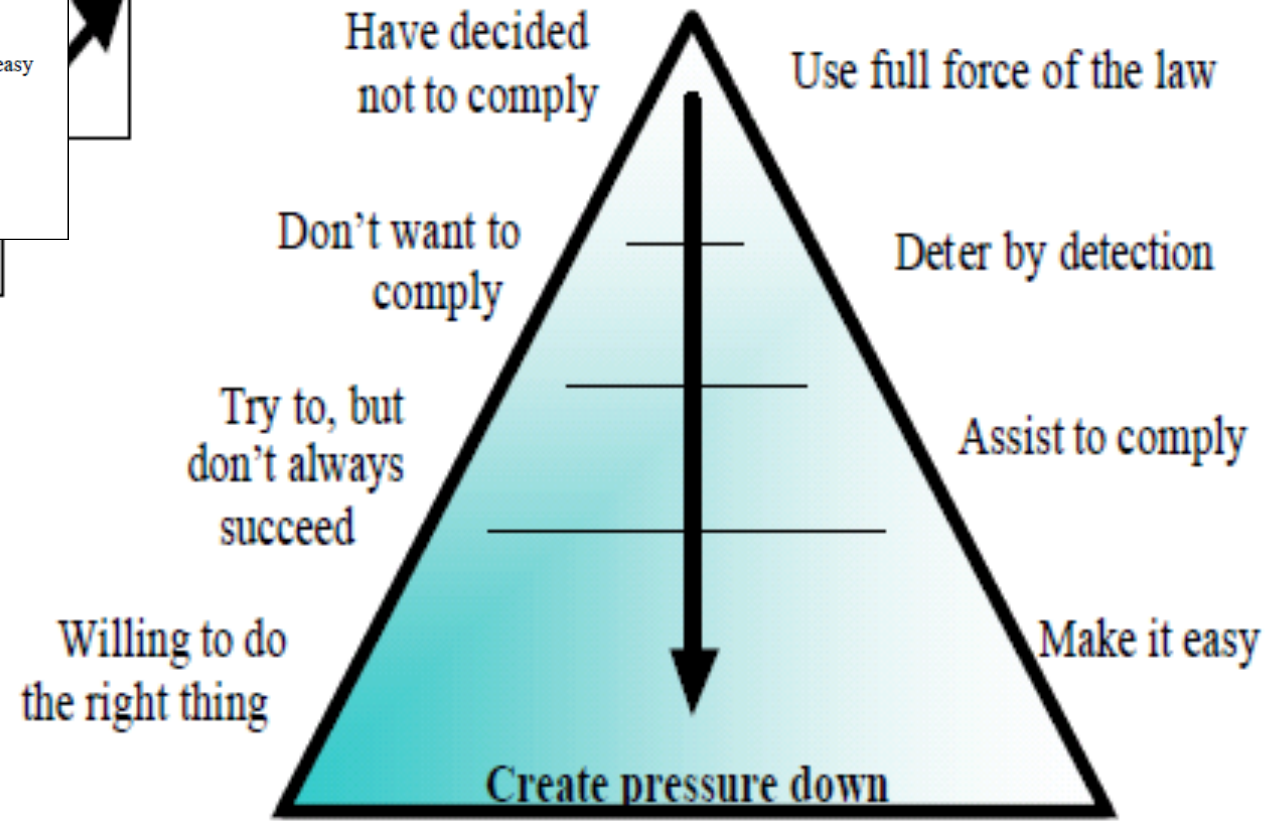
Compliance Strategy

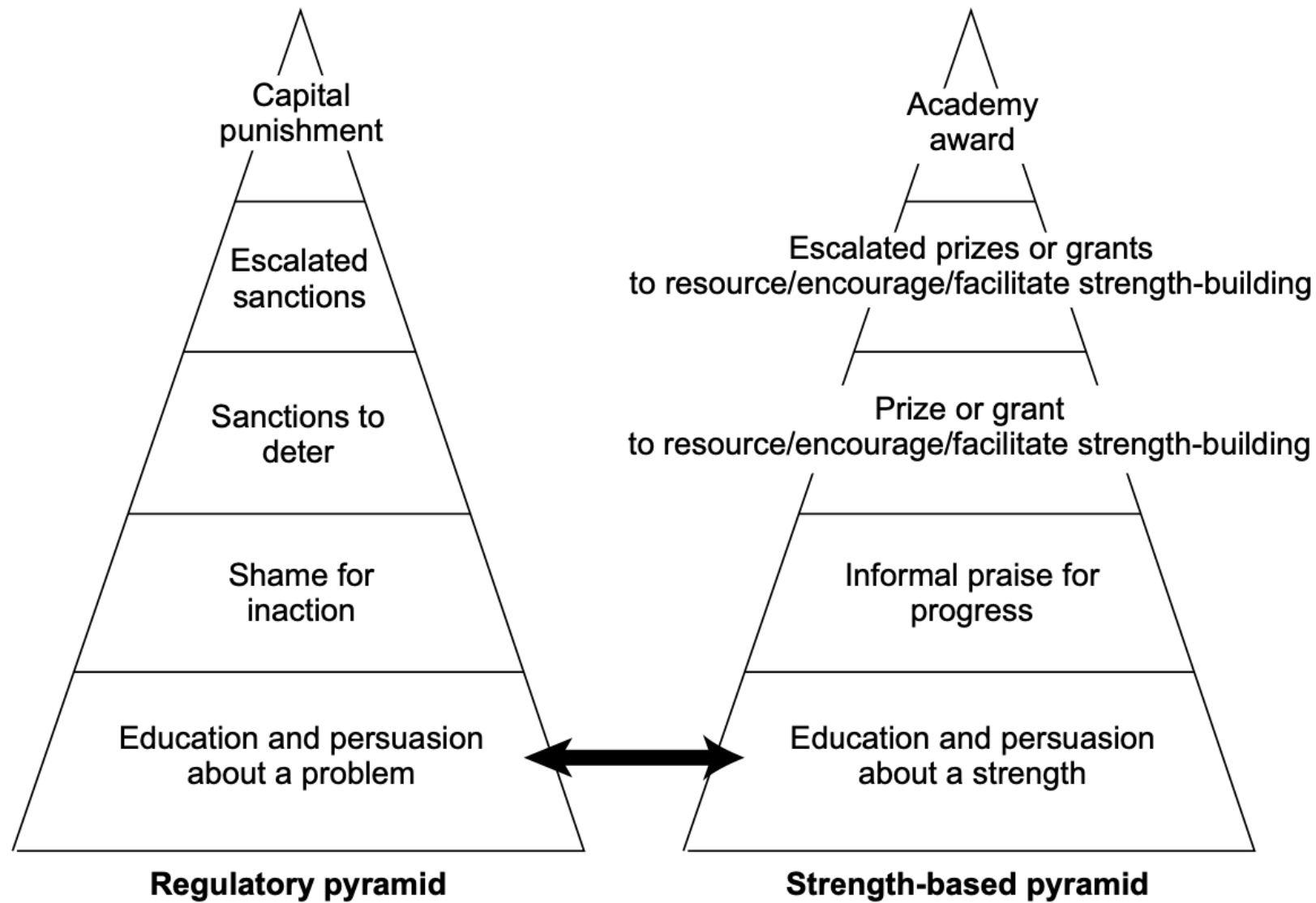


Leverage

Attitude to Compliance

Compliance Strategy

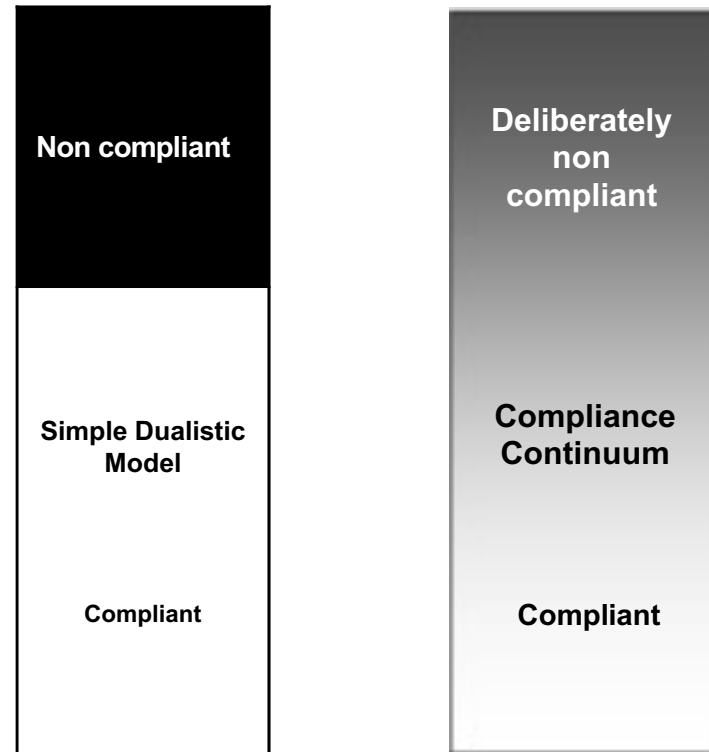




Simple dualistic or
binary compliance model
(strict liability)

v

Linear compliance
continuum – introducing
shades of grey



Licensing of Financial Service Providers

Liability limited pursuant to a scheme approved under professional standards legislation

General licence obligations

- [s 912A\(1\)\(a\)](#): efficiently, honestly and fairly
- s 912A(1)(b): comply with the conditions on the licence
- s 912A(1)(c): comply with the financial services laws
- s 912A(1)(ca): take reasonable steps to ensure that representatives comply with the financial services laws
- s 912A(1)(e): civil penalty provision if contravene para (1)(a), (aa), (ca), (cc), (d), (e), (f), (g), (h) or (j) from 13 March 2019: *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) [sch 1, s 76](#)
 - [s 761A](#): “financial services laws”: a provision of Chapter 7 of Corporations Act or provision of Division 2 of Part 2 of ASIC Act
 - [s 766H\(1\)](#): “meaning of provides a superannuation trustee service”: if person *operates* a ‘registrable superannuation entity’



s 912A(1)(a): “efficiently, honestly and fairly”

In *ASIC v Westpac (Omnibus)* [2022] FCA 515 [60], Beach J quoted his observations in *ASIC v AGM (No 3)* (2020) 275 FCR 57; [2020] FCA 208

- read as a **compendious indication** requiring licensee to go about duties efficiently having regard to dictates of honesty and fairness, honestly having regard to dictates of efficiency and fairness, and fairly having regard to dictates of efficiency and honesty.
- **connote a requirement of competence in providing advice and in complying with relevant statutory obligations.** Also connote an element not just of even handedness in dealing with clients but a less readily defined concept of sound ethical values and judgment in matters relevant to a client’s affairs. ... boundaries and content of the phrase or its various elements are incapable of clear or exhaustive definition.
- word “**efficient**” refers to person who performs duties efficiently, meaning person is **adequate in performance, produces the desired effect, is capable, competent and adequate.** Inefficiency may be established by demonstrating that the performance of a licensee’s functions falls short of the **reasonable standard of performance** by a dealer that the public is **entitled to expect.**
- **not necessary to establish dishonesty in the criminal sense.** The word “honestly” may comprehend conduct which is not criminal but which is morally wrong in a commercial sense

s 912A(1)(a): “*efficiently, honestly and fairly*”

[62] ... A finding of contravention is determined by reference to objective circumstances. Accordingly, **a contravention may be made out even though it is not shown that the contravener engaged in an intentional wrong.**

- the word “honestly” when used in conjunction with the word “fairly” tends to give the flavour of a person who not only is not dishonest, but also a person who is **ethically sound**.
- These observations are **consistent with the express object of Ch 7** of the Corporations Act set out in [s 760A](#)... [t]he statutory standard itself is the source of the obligation.

Should “fairly” only be viewed from the perspective of an investor, borrower or other person interacting with the licensee? No. **Fairness is to be judged having regard to the interests of both parties.**



Compliance Systems

Liability limited pursuant to a scheme approved under professional standards legislation

Three Lines of Defence Model

*Australian Securities and Investments Commission v Westpac Banking Corporation (No 2) [\[2018\] FCA 751](#)
(the Bank Bill Swap Rate case)*

[330] During most of the relevant period, Westpac had a “**Risk Governance Framework**” in place that established “three lines of defence”; the relevant Risk Governance Framework documents applying were dated 30 April 2010, 28 April 2011 and 5 March 2012. **Professor Stulz stated that such an approach was common in large financial institutions.** It was introduced at Westpac early in 2010.

The “Three Lines of Defence” Model

[331] The first line of defence consisted of having **each business unit identify, assess, and manage the risks it was exposed to in light of its pre-existing risk limits and policies**. Each division was responsible for ensuring it had sufficient resources to effectively monitor its risk and ensure it complied with firm-wide and business-specific risk limits and policies.

[332] The second line of defence was to have **established risk management policies and frameworks for monitoring risk at the business level**, operating in an independent fashion. In turn, it contained three layers ...

[333] The third line of defence contained **internal and external auditors and advisors**, who provided an **independent assessment** of Westpac’s risk management framework, policies, procedures, and controls.

Second Line of Defence

(a) The **first layer** contained **executive risk committees** comprised of both risk and business representatives, whose ultimate goal was to optimise the risk-reward relation for each relevant risk factor. They **provided advice** on the development of divisional risk appetite statements, risk management frameworks, limits, and policies, and **monitored the levels of risk** of the businesses **to guarantee** that they were **aligned with existing risk appetite limits and policies**. At Westpac these committees included the Operational Risk & Compliance Committee (**OPCO**), CREDCO, MARCO and ALCO. As already described, ALCO was responsible for overseeing Westpac's funding and liquidity risk.

Second Line of Defence

(b) The **second layer** consisted of a “**Group Risk**” function, **independent** of the business side of the bank and reporting directly to Westpac’s Chief Risk Officer (**CRO**). The CRO reported to the CEO and had direct access to the chairs of the Board and of the BRMC. At Westpac, key responsibilities of Group Risk were centred around the development and maintenance of (1) group-wide risk management frameworks, policies, models, and procedures, and (2) group-wide risk estimates and risk capital models. Group Risk was also responsible for monitoring the quality of the risk management information provided to senior executives and Board members.

Second Line of Defence

(c) The **third layer** consisted of the **specific risk units** of each business division, which were independent of the business and reported directly to the CRO. They were responsible for developing the relevant risk management policies, procedures, monitoring and reporting systems, and controls at the business division level, in line with Westpac's general Risk Appetite Statement (**RAS**), divisional RASs and the wider risk management framework.

Three Lines of Defence: caution!

[2500] ... there appeared to be general agreement between the experts that **what was written down in Westpac's policies was sufficient so far as it went**. But Professor O'Brien **cautioned**, in my view appropriately, against the **proceduralism** which reliance only upon written documents can engender. And Professor Stulz did not disagree that **Westpac's three lines of defence could be applied "in poor ways and in good ways"**.

ASIC v Westpac (Omnibus) [\[2022\] FCA 515](#)

- Long running investigations into Westpac Group including various subsidiaries.
- 6 matters filed and heard together based on agreed statements of facts and penalties.
- Numerous breaches of ss 912A, 962P, 963K and 1041H *Corporations Act 2001* (Cth) and ss 12CB, 12DA, 12DB, 12DI and 12DM *ASIC Act 2001* (Cth) admitted.
- Widespread compliance failures across multiple businesses, including Westpac's banking, superannuation, wealth management & insurance
- 'Profound failure' by Westpac over many years and across many areas of its business to implement 'appropriate' systems & processes to ensure its customers were 'treated fairly'.
- Systems and compliance failures were a 'common feature' and the misconduct by Westpac was considered 'serious'.
- \$80 million in remediation paid.
- \$113 million in penalties negotiated across 6 matters.

[ASIC Release](#)

Mandated non-exhaustive considerations

- (a) the nature and extent of the contravention
- (b) the nature and extent of any loss or damage suffered because of the contravention
- (c) the circumstances in which the contravention took place
- (d) whether the person has previously been found by a court to have engaged in any similar conduct and
- (e) from 13 March 2019 under s 1317G of the Corporations Act and s 12GBB of the ASIC Act, in case of a contravention by trustee of a registrable superannuation entity, the impact that the penalty under consideration would have on the beneficiaries of the entity.

'French factors' and others

- (a) extent to which contravention was result of deliberate or reckless conduct by corporation, as opposed to negligence or carelessness;
- (b) number of contraventions, the length of period over which contraventions occurred, and whether contraventions comprised isolated conduct or were systematic;
- (c) seniority of officers responsible for contravention;
- (d) size and financial position of the contravening group of which corporation forms part (taking into account capacity to pay) and degree of power it has, as evidenced by its market share;
- (e) existence within the corporation at the time of the contravention or contraventions of compliance systems, including provisions for and evidence of education and internal enforcement of such systems; the notion of an existing culture of compliance is an amorphous concept which transcends simply putting in place expensive systems, or having persons whose titles include terms such as governance and compliance;
- (f) remedial and disciplinary steps taken after the contravention and directed to putting in place a compliance system or improving existing systems and disciplining officers responsible for the contravention; where a compliance program seeks to ensure an understanding by executives of the requirements of the Act and of their obligations under it, and where a corporation has committed itself to future expenditure upon such a program, that may provide reason to reduce the penalty

-
- (g) whether directors of corporation were aware of relevant facts and, if not, what processes were in place at time or put in place after contravention to ensure their awareness of such facts in the future;
 - (h) any change in composition of board or senior managers since contravention;
 - (i) degree of corporation's cooperation with regulator, including any admission of an actual or attempted contravention;
 - (j) impact or consequences of contravention on the market or innocent third parties;
 - (k) extent of any profit or benefit derived as a result of contravention;
 - (l) whether company has disgorged any profit or benefit received as a result of contravention, or made reparation; and
 - (m) whether corporation has been found to have engaged in similar conduct in the past.

[123]. A voluntary remediation program that is effective and provides adequate financial compensation to persons affected by contravention and ameliorates loss or damage otherwise suffered by consumers is a mitigating circumstance

Other recent judgments

- *Australian Securities and Investments Commission v Select AFSL Pty Ltd (No 2)* [\[2022\] FCA 786](#) (liability stage)
- *Australian Securities and Investments Commission v Select AFSL Pty Ltd (No 3)* [\[2023\] FCA 723](#) (penalty stage)
- *Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd* [\[2022\] FCA 1105](#)
- *Australian Securities and Investments Commission v RI Advice Group Pty Ltd* [\[2022\] FCA 496](#)
- *Australian Securities and Investments Commission v TAL Life Limited (No 2)* [\[2021\] FCA 193](#)

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