FSR GPS Podcast Series
Episode 7 – What to expect when ASIC joins the FAR enforcement beat

Michael Vrisakis	Hi everyone. I'm Michael Vrisakis, a partner in the Herbert Smith Freehills Financial Services Team. Welcome to our podcast series called the FSR GPS. This series focuses on topical and emerging issues in financial services regulation which we think are the most strategic and important issues for our clients. Feel free to suggest topics you would like us to cover in the future but for now, we hope you enjoy today's episode.
Andrew Eastwood	Hello, I'm Andrew Eastwood, a partner in the Disputes group at HSF with a focus on contentious regulatory issues, especially in the financial service sector.
Edward Einfeld	Hi, I'm Ed Einfeld, and I'm a part of HSF's Disputes practice, with a focus on FSR investigations, and board and executive accountability.
James Samartzis	And hi, I'm James Samartzis, and I specialise in contentious disputes and regulatory implementation also within the financial services sector.
Andrew Eastwood	So the focus of today's podcast is about what ASIC will bring to the table as a co-regulator of the Financial Accountability Regime, or FAR as we'll call it during this podcast, and what we expect to be an increasing role for internal legal teams in seeking to insulate financial institutions, and their directors and senior executives, from serious enforcement risk. So what I expect we'll cover in this discussion, it will include the different approaches that ASIC and APRA take to enforcement, the investigative toolkit that ASIC brings to the table; the major pain points for entities and individuals that could result from ASIC's involvement; and some practical takeaways to think about. Finally, some reflections on what we have seen in similar overseas regimes. So Ed, do you want to kick things off?
Edward Einfeld	Yeah, sure. So the first thing to note here is that regulators working closely together is not a new thing. In fact it really is an expectation of modern financial services regulation and enforcement. However, we are in somewhat new and interesting territory here with the recent passage of the

FAR legislation, which is going to govern director and senior executive conduct across all APRA-regulated entities. It's going to mean a significant change in the way in which entities have come to expect the BEAR to be regulated.

In the past week or so, ASIC and APRA have released guidance on how they will perform their functions and exercise their powers under the FAR. The Joint Administration Agreement, they call it, sets out the high level principles that those regulators will adopt when exercising their respective powers.

Of particular interest to me is that prior to the commencement of an investigation, APRA and ASIC will identify the objectives of the investigation and establish the role of each regulator, including establishing an investigative lead. For entities that are used to dealing with APRA, you're going to want to have regard to ASIC's enforcement priorities here so that you can be alert to potential points where an investigation into FAR could seed from what might start off as enquiries into compliance with prudential standards, for example.

In our experience of dealing with ASIC in regulatory investigations and court enforcement, ASIC has a focus on holding individuals and entities to account, with a focus in particular on deterrence and punishment. APRA, on the other hand, tends to walk softly and carry a big stick, focusing more on supervision and prudential stability.

James Samartzis

Yes, I'd agree with that, Ed, and it sort of really reflects the different roles that ASIC and APRA have in the financial regulatory framework and also just within the broader community.

It's probably best drawn out in APRA and ASIC's public statements on enforcement approach. So, for example, taking APRA in its own words it identifies itself as a "forward-looking regulator" that seeks to identify prudential risks proactively and then take action to prevent harm before it occurs. And so much of its work is achieved through using what we called "non-formal approaches" and working cooperatively with entities to identify and rectify problems before they in fact threaten the ability of an entity to meet its financial promises or impact its prudential standing. Compare that to ASIC's enforcement approach which in its own words is to investigate and take enforcement action to detect, disrupt and respond to unlawful conduct and in doing so, seek to prevent and deter actual and future misconduct. Also to seek to improve standards and behaviours within the regulated

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population. And there's also that third added sort of bow to ASIC's enforcement approach which is to reduce the risk of harm to Australian consumers and investors more generally.

Andrew Eastwood

Yeah. I mean that's a pretty stark difference, when you put it like that, James. I mean, my experience in recent times is that APRA has become more sort of active in the investigations and enforcement area. But it is clear enough that ASIC brings a lot of experience in that kind of area and will likely look to use FAR as part of its pursuing of its enforcement priorities.

So, Ed, why do you think this approach is particularly relevant to the FAR?

Edward Einfeld

Well, for one, it brings into scope the range of tools that ASIC has that can be used to enforce the regime, and many of these are specifically contemplated in the legislation.

As you've said, ASIC is a sort of veteran in running enforcement activities that compel the production of documents, written responses to questions, compelling individuals to attend oral examinations, and even executing search warrants. Under the FAR legislation, ASIC will now be empowered to issue directions to accountable entities to re-allocate responsibilities, for example. It can also disqualify directors and senior executives and take the multitude of steps that I've just mentioned to ensure compliance with the legislation. Also, accountable entities will face civil penalties for breaches of their obligations and individuals too can face civil penalties if they're found to have knowingly or recklessly contributed to a breach of the FAR.

Andrew Eastwood

Yes, Ed. And, of course, most institutions will be familiar with these tools. But it seems to me that there are two key points to make here about why we think these regulatory tools will be especially acute under the FAR. The first is the sensitive nature of the issues that the FAR deals with, specifically the conduct and responsibilities of accountable persons. And the second flows from that first point, which is the potential reputational consequences of ASIC investigatory or enforcement action.

Edward Einfeld

Yeah, the potential reputational consequences is one I've been thinking about too. Andrew, what would you say are some of the other key challenges that clients are going to have to grapple with?

Andrew Eastwood

I think there are many. But, look, if we want to drill down to the most prominent challenges, I think there are probably three main ones.

So one, understanding the breach reporting requirements and protecting your fact-find and investigation processes.

Two, dealing with conflicts of interest that may arise between accountable persons and the accountable entity.

And then three, the approach to engagement with the regulators, which I think will be a really important piece to the puzzle.

Edward Einfeld

Yeah, I agree with those.

On the first point, I've been looking at the new reporting obligations under the FAR legislation. Accountable entities are already required to report many potential or actual breaches to ASIC under ASIC's breach reporting regime. And this includes reporting investigations into possible breaches if the investigation into that possible breach takes longer than 30 days. While the FAR reporting requirements deal with slightly different considerations, it is inevitable I think that many FAR investigations will derive from incidents and matters that have been previously reported to ASIC under the breach reporting regime.

So with that in mind, it will be important to consider how accountable entities breach reporting processes interact with the processes that entities will need to establish, to consider and determine potential breaches of the FAR by either the accountable entity or the accountable individuals.

James Samartzis

And that's really where I think the point about protecting your fact-find and investigation processes sort of really kicks in so that it becomes a bit more central.

So the first step is to ensure that there's a clear understanding of what information, if any, is intended to be privileged. And this means thinking about, you know, who is tasked with running these processes, also the role of the legal teams in those processes. And under the BEAR, which a lot of, you know, entities will be familiar with, there's been arguably a less prominent need for legal involvement in the implementation and operation of the regime. We've seen other functions like Risk and Compliance take a more central role in running those processes. But with ASIC now coming on the beat and the FAR locked in, companies, I think, will need to start considering whether there's a greater role for legal teams to be involved,

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what that role in fact is, how it's documented and whether certain advice given as part of the process will be privileged.

I think the other point on this to bear in mind is ensuring there's clear separation between the various stages of an entity's process. So using as an example, the fact-find process and then the assessment of reasonable grounds process. Otherwise, you know, what entities may find is that they're triggering reporting obligations and requirements earlier than they might have expected.

Andrew Eastwood

Yeah, thanks, James. On the second point I mentioned about dealing with conflicts of interest, because both accountable entities and accountable persons have obligations under the FAR, there'll often be an overlap and potential conflicts between the subject matter that regulators are investigating, the obligations of the company and the obligations of the executives responsible. So I think Institutions will need to be sensitive to this at an earlier stage than they might have previously been. So, for example, they may need to consider the use of independent counsel or accountable persons to ensure they're provided with a fair opportunity to understand the risks that they face during an ASIC investigation. Now of course, the involvement of additional lawyers will generate some practical challenges and potential delays as new lawyers get up to speed.

James Samartzis

And, Andrew, to loop back and come back to your third point that you raised earlier about the approach to engagement with the regulators, the point sort of touching on earlier about the different focus of the regulators I think comes into play here. So I think most teams that have been dealing with APRA on the BEAR will know broadly what to expect from the regulator and they will have built relationships with the regulator. That approach won't be the same as dealing with ASIC. And, in particular, if an entity is sort of on ASIC's radar, it's going to need to be doing a lot more analysis around its potential breaches, while simultaneously meeting APRA's expectations around the impact of that relevant conduct on the management of its prudential risk.

One way in which ASIC's behaviour might be moderated by the FAR is through the recognition in the Joint Administration Statement that Ed mentioned earlier, for the purposes of ongoing compliance with the FAR, the regulators will inform industry about better practice examples and thematic

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review findings to strengthen accountability frameworks and draw the industry's attention to areas that require further focus.

Andrew Eastwood

Yeah, that's interesting, James. And it's important to keep in mind that financial services institutions should not only be trying to prevent and avoid enforcement activity, but also be in a position to mitigate risk and potential penalties if enforcement activity is taken. And for that reason, it's important to remain proactive and take onboard guidance issued by the regulators and undertake regular peer comparison and benchmarking.

James Samartzis

And particularly important when there are several new obligations that have been introduced into the FAR legislation that I think ASIC will approach differently to how APRA may have approached those obligations. In particular, I'm thinking of the obligation to take reasonable steps to prevent matters from arising that would or would be likely to result in a material contravention of financial services laws.

There's a risk here that this could create a new kind of stepping stone liability where ASIC relies on one contravention to establish another, something that we see commonly in cases that ASIC brings for breaches of directors' duties.

And just another point to make here is it's near certain that ASIC will seek to test the scope of these provisions where it can find a case that is consistent with its enforcement priorities that we touched on some of those priorities earlier, and particularly relevant I think where the regulators have again sort of decided against releasing more specific and detailed guidance on the outer remit and scope of some of these new provisions, including the reasonable steps provision.

Andrew Eastwood

Yeah, I agree with that.

Well before we wrap it up, one interesting feature of the FAR is that it really moves the dial from the overarching purpose of the BEAR, which was to ensure that prudential risk and reputation was monitored, to having a much sharper conduct focus. And that brings the regime in line, or at least closer to similar overseas regimes such as the Senior Manager's Conduct Regime in the UK.

The UK regime is more mature than what we've had in Australia and in the BEAR and now the FAR, and it's useful to briefly share some of the key enforcement themes that our international colleagues have been seeing.

So, Ed, did you want to quickly run through the key ones?

Edward Einfeld

Yeah, of course. So the areas that HSF have seen come to the fore, in enforcement action in the UK, there are probably about four of them:

- One is the lack of awareness of the relevant rules and requirements.
- The second is failing to take steps in response to a continued breach.
- The third relates to non-financial misconduct.
- And the fourth is where failures of the company might be attributable to the relevant individual's failures. So, for example, failing to implement proper structures and controls and failure to allocate adequate resources.

So just earlier this year there was the first enforcement action under the UK SMCR against an individual, in which the regulator found the senior manager responsible for the planned migration of an IT system and that manager did not take reasonable steps to comply with the relevant regulatory standards.

One of the interesting aspects of that case is how it related to IT activities being performed at a group level and the manager there was required to supervise the activities of those higher up the chain, at least from the perspective of the company structure.

So we've seen issues like this arise with banks headquartered overseas but with branches in Australia, where the expectation is, and the obligation really is, to ensure that the Australian operations are not being impacted by insufficient processes occurring in other jurisdictions, even where that is in effect looking up the chain, requiring people in Australia to go further up the chain.

So I mentioned earlier that the entities need to be aware of the moment when an inquiry into prudential compliance, for example, might seed into a FAR investigation, and it's this type of circumstance that I was thinking of.

Andrew Eastwood Thanks Ed, that's really interesting.

Well, we hope you've all found the podcast interesting and useful – we'll share it around via our usual social media platforms, so please feel free to share it with anyone who you think would find it beneficial and of course, feel free to reach out with any follow-up questions or your own views on where this might lead. We'd love to hear from you.

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