

# Re: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

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## Written Submissions of the Australian Prudential Regulation Authority (APRA)

### Round 2: Financial Advice

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#### Introduction

1. Pursuant to an application made by APRA on 6 April 2018, APRA was granted leave to appear at the Royal Commission hearings commencing on 16 April 2018 (**Round 2**).
2. The focus of Round 2 has been on the conduct of financial services entities that provide financial advice to consumers, including the treatment of consumers, compliance with the law and community standards and expectations, and the sufficiency of the current legal and regulatory structure, by reference to specific case studies.
3. APRA does not specifically supervise the activities of financial services entities in so far as they are engaged, directly or indirectly, in the provision of financial advice. However, questions were raised during the course of evidence as to the utilisation by ASIC of enforceable undertakings as an enforcement strategy, including the public perception of outcomes being negotiated rather than powers to bring enforcement proceedings, such as civil penalty proceedings, being exercised (T1923.15).
4. APRA has a number of supervisory and enforcement tools at its disposal, including the power to accept enforceable undertakings in connection with matters in relation to which APRA has a power or function under relevant legislation.<sup>1</sup> As such, APRA has views on the use of enforceable undertakings as a regulatory tool, which may be of assistance to the Commissioner's considerations.

#### APRA's role as prudential regulator

5. APRA's purpose, powers and responsibilities are established under the *Australian Prudential Regulation Authority Act 1998* (APRA Act), supported by specific industry Acts.
6. APRA's mandate, set out in subsection 8(1) of the APRA Act, provides that APRA exists to

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<sup>1</sup> Banking Act 1959 Cth s18A(1), Superannuation Industry (Supervision) Act 1993 Cth s262A(1), Insurance Act 1973 Cth s126(1), Life Insurance Act Cth s133A(1)

regulate bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards. Subsection 8(2) of the APRA Act requires APRA in doing so to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, to promote financial system stability in Australia.<sup>2</sup>

### **Supervisory role**

7. Supervision is a core element of APRA's role as prudential regulator. APRA's approach to supervision is fundamentally focussed on pre-emptive, risk based supervision wherever possible, rather than ex-post enforcement, and involves regular engagement with institutions. APRA's supervisors use a range of tools in their supervision of institutions, including prudential reviews on-site with the entity, formal interactions with Board and senior management, financial analysis and thematic reviews. Successful implementation of APRA's framework for prudential supervision requires extensive collaboration and consultation, with regulated entities, financial sector regulators and other stakeholders. APRA positions itself to identify emerging prudential issues at an early stage and seeks to have them addressed by the entity. Where issues of potential concern are identified, APRA will work with its regulated entities, so that preventative or corrective action is taken before a situation deteriorates.
8. APRA will undertake strengthened supervision, and ultimately enforcement action, if it forms the view that the relevant entity is not addressing identified issues in a sufficiently effective or timely manner.

### **Approach to enforcement**

9. APRA is empowered to take enforcement action and will do so when necessary to fulfil its objectives. Enforcement activities are an important component of APRA's framework for prudential supervision. However given APRA's outcomes focus as a prudential regulator, formal enforcement actions will be less frequently used than by other regulators, whose mandates may necessitate a greater enforcement focus.
10. When APRA identifies a failure to comply with prudential requirements, it will carefully consider how to respond. The objective of any formal intervention, and ultimately, enforcement action by APRA, should be consistent with, and complement, APRA's overall mission and prudential objectives. Having an array of enforcement tools available means that APRA has the ability to react appropriately and effectively, utilising the most appropriate mix of persuasive, remedial, protective, and deterrent sanctions having regard to the given circumstance.

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<sup>2</sup> Additional considerations are imposed by the specific legislation for example Pursuant to s12 of the Banking Act 1959 s12(1) : "It is the duty of APRA to exercise its powers and functions under this Division for the protection of the depositors of the several ADIs and for the promotion of financial system stability in Australia."

## **Enforceable undertakings**

11. An enforceable undertaking is a written undertaking to do or refrain from doing something for an agreed period of time, given by an entity or a person to the regulator in connection with a matter over which the regulator has a statutory function. The enforceable undertaking may also include a penalty for failure to comply with its terms.
12. Enforceable undertakings are one option within the suite of options available to APRA for dealing with any particular case. As a regulatory tool, enforceable undertakings may be seen to operate as an 'intermediate' method of enforcement, within a responsive hierarchy of sanctions, that can range from supervisory measures (such as letters setting out required actions) and administrative sanctions, through to prosecution.
13. An enforceable undertaking can be a very effective enforcement tool in appropriate circumstances. Enforceable undertakings can be utilised to secure quick and effective remedies for contraventions of regulatory provisions without the need for court proceedings. One of the main advantages is that the promises made in an enforceable undertaking can go beyond mere compliance and the payment of financial penalties. They can be tailored to address the level of non-compliance by the regulated entity (or individual), and provide the flexibility to have the entity commit to a range of remedies which are not specifically provided for under the relevant legislation.
14. For example, and typically, an enforceable undertaking will include detail of the specified steps that a regulated entity will take to rectify prudential or compliance failures. An undertaking can be specifically designed to inculcate long term organisational cultural change. In this way, as a tool, enforceable undertakings can provide the opportunity to design constructive, permanent solutions to regulatory compliance issues.
15. Enforceable undertakings also allow for APRA to incorporate a rehabilitation-based approach, consistent with its prudential mandate. For example APRA may accept an undertaking that excludes an individual from acting in the industry until they have completed, to APRA's satisfaction, a specific, APRA-approved course of industry training.
16. The nature of an enforceable undertaking is reflective of APRA's supervisory approach. Its flexibility means that where an issue of concern has been identified, a fit for purpose solution can be designed to ensure that preventative or corrective action is taken, thereby minimising the threat to the regulated institution or its beneficiaries (that is its depositors, policyholders or superannuation fund members). Enforceable undertakings are outcomes orientated. They require regulated entities to focus on actions orientated to addressing the risks identified, with a view to delivering sustainable outcomes.
17. APRA will only consider accepting an enforceable undertaking from a regulated entity (or

associated individual) where APRA considers that to do so will achieve a more expeditious, certain and cost-effective resolution of APRA's prudential concerns than other actions available. There may be circumstances where the seriousness of the matter does not suit use of an enforceable undertaking: this will be a material consideration for APRA, together with our view on the strength of the deterrence message needed.

18. The acceptance of an enforceable undertaking is not regarded by APRA as a final outcome, but rather, a means to achieve a regulatory outcome considered by APRA to be appropriate in the circumstances.
19. Monitoring enforceable undertakings is therefore central to the credibility of undertakings as an enforcement option. An enforceable undertaking given by an entity will typically include a reporting obligation, for example an undertaking to engage an independent third party to review and report to APRA in respect of compliance with the undertaking by an agreed date, and in some cases on an ongoing basis.
20. APRA will only agree to accept an enforceable undertaking if APRA has a high degree of confidence that the entity will deliver on its promises, and that the promises will achieve the desired prudential outcome. APRA publishes on its website the enforceable undertakings it has entered into with an entity or an individual so that the public may know the reasons why the enforceable undertaking was entered into and its terms. The enforceable undertaking will detail APRA's concerns and contain the entity or individual's acknowledgment of those concerns, the steps which will be taken to appropriately address them, and how APRA will monitor compliance with the undertaking. The publication of undertakings also has both an educational and a deterrence effect to industry participants.
21. Under the empowering legislation, APRA may enforce an enforceable undertaking by obtaining Federal Court orders against the person or entity, in the event of non-compliance.<sup>3</sup>
22. APRA regards the ability to make use of enforceable undertakings as an important tool within its suite of formal and informal supervisory and enforcement tools, for pursuing its mandate as a prudential regulator.
23. Tools that allow for a flexible and timely approach and the ability to craft fit for purpose responses to identified risks or concerns, with an outcomes focus, are important to, and consistent with the achievement of APRA's prudential mission. A recent example of such a response is APRA's inquiry and Report on the conduct of CBA. In the case of the CBA Report APRA has utilised an enforceable undertaking as one component of its response. In that case, in the event the

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<sup>3</sup> Banking Act 1959 Cth s18A(4), Superannuation Industry (Supervision) Act 1993 Cth s262A(4), Insurance Act 1973 Cth s126(4), Life Insurance Act Cth s133A(4)

enforceable undertaking is not complied with, APRA has indicated it may consider taking actions using legislative powers such as the Bank Executive Accountability Regime.

24. APRA believes that the use of enforceable undertakings has been, and will continue to be in suitable circumstances, an appropriate means to deal with issues with regulated entities and individuals.
25. As such, APRA would be concerned that to characterise the use of enforceable undertakings as a conceptually weak or sub-optimal response would be to potentially undermine their utility, thereby depriving APRA of an important enforcement tool.
26. APRA recognises that an enforceable undertaking will not be appropriate in all circumstances. Every offer of an enforceable undertaking needs to be assessed on its merits. The matters outlined above are all matters which APRA takes into account when considering whether to accept an enforceable undertaking.

**Further assistance**

27. Insofar as APRA may be able to provide any further assistance to the Commission in respect of the matters addressed in these Submissions or otherwise, APRA would be very willing to do so.

Australian Prudential Regulation Authority

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James Watson