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Knowingly Concerned: Economic Distress and Being a Party to the Contraventions of Others

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Global economies continue to experience distress and uncertainty. Businesses, including those in financial services, are all faced with the same or similar challenges, including:

- Negotiating inflationary pressures
- Managing supply chain risks
- Overcoming contract or project completion risks
- Labour market challenges
- The tension between the interventionist monetary policies of central banks and the more casual fiscal policies of governments more focused on the political landscape

Those challenges exist across all global markets, and Australia is no different. Here, as in the rest of the world, the pressures on balance sheets and in boardrooms will likely increase if, as anticipated, the economic landscape continues to deteriorate before stabilising. In that context, it is likely that financial market regulators will closely monitor the conduct of financial service providers to determine whether, for example, they have acted outside the terms of their financial products, or in any other ways that contravene financial market laws.

If the regulators uncover evidence of wrongdoing, which, in some cases, might arise from self-reporting, it is likely they will take enforcement action.[1] Their preparedness to take recourse will likely increase if economic trading conditions continue to worsen and consumers (both retail and wholesale) are exposed to adverse market risks.

Australian financial services licences (AFSLs) are governed by various instruments not limited to the Corporations Act (Cth) 2001 and the ASIC Act (Cth) 2001. Those laws apply strict requirements for the governance of AFSLs, including by imposing an obligation to ensure that:

- Financial services are provided efficiently, honestly and fairly[2]
- In trade or commerce, at the time of accepting payments or other consideration for the provision of financial services, there are no reasonable grounds for believing that the person will not be able to supply the financial services[3]
- A financial services provider is not knowingly concerned in the contraventions of related or unrelated third parties (not limited to authorised representatives) involved in the provision of financial services or management of financial products[4]

Being Knowingly Concerned and the Deterrent Value of Penalties

One can become knowingly concerned in the contravention of a third party without necessarily having actual knowledge of a contravention having been committed. Actual knowledge, whether by the identification of contravening conduct or the receipt of complaints, serves to potentially compound the contraventions. There is no need to establish that a party knew that the conduct in which they are said to have been knowingly concerned had a particular legal character or that the party knew that the conduct of the other engaged a particular sequence of integers of a statutory provision rendering the other's conduct contravening conduct.[5]

In many instances, financial products and services are now largely administered by automated systems. The regulators (and the courts) will take those systems, their designs and potential limitations into account in assessing contraventions and the imposition of civil penalties. However, the extent of any system limitations, poor functionality or design, or a lack of proper human oversight, will not likely lead to any discount when it comes to civil (or criminal) penalties. If anything, a failure to proactively identify and overcome those limitations will likely lead a court to conclude that the financial services were not provided efficiently, honestly or fairly.

1 See, for example, *ASIC v. AMP Financial Planning Proprietary Ltd* [2022] FCA 115 (AMP).

2 s 912A, Corporations Act (Cth) 2001.

3 s 12DI(3), ASIC Act (Cth) 2001.

4 s 12 GBA(1)(e), ASIC Act (Cth) 2001, as in force and applied in AMP.

5 See, *Australian Securities and Investments Commission v Westpac Banking Corporation* (2022) 159 ACSR 381, [49].

Similarly, self-reporting, cooperating with the regulators, developing and implementing remediation schemes efficiently, and incorporating system or protocol changes all help to mitigate risks, but they will not eliminate exposures to civil or pecuniary penalties for AFSL holders or their affiliates. In assessing whether or not to impose such penalties, the court is required to assess the deterrent value of penalties in the market beyond the contravening of those in question at any given time. In assessing the deterrent value, the court considers:

- The nature and extent of the contravening conduct
- The amount of loss or damage caused
- The circumstances in which the conduct took place
- The size of the contravening company
- The degree of power it has, as evidenced by its market share and ease of entry into the market
- The deliberateness of the contravention and the period over which it extended
- Whether the contravention arose out of the conduct of senior management or at a lower level
- Whether the company has a corporate culture conducive to compliance with the laws, as evidenced by educational programs and disciplinary or other corrective measures in response to an acknowledged contravention
- Whether the company has shown a disposition to cooperate with the authorities responsible for the enforcement of the laws in relation to the contravention

Future Risks

The economic uncertainty will continue to put the spotlight on financial service providers, particularly in relation to their dealings with unsophisticated consumers or small businesses. The fallout from the banking Royal Commission may largely be over, but it is likely that some of the concerns raised by that inquiry will continue to resurface, particularly as consumers and businesses alike contend with obvious (and increasing) financial challenges. In that context, AFSL holders must periodically assess whether their services are being provided efficiently, honestly and fairly, and take immediate corrective action where any deficiencies are identified.

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