



Australian Government

ASIC Enforcement Review

Position and Consultation Paper 1
Self-reporting of contraventions by financial services and
credit licensees
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EXECUTIVE SUMMARY

- I. The self-reporting regime for Australian Financial Services licensees (AFS licensees) has come under scrutiny over the last decade or so in the media and in a series of inquiries into banking or banking and financial services related misconduct. Concurrently, ASIC has publicly outlined concerns with the effectiveness of some aspects of the existing regime. These matters doubtless contributed to the Government's decision to include in the ASIC Enforcement Review Taskforce's Terms of Reference:

"The adequacy of the frameworks for notifying ASIC of breaches of law, including the triggers for the obligation to notify; the time in which notification is required to be made; and whether the obligation to notify breaches should be expanded".
- II. Breaches of obligations set out in the Corporations Act 2001 come within a broad spectrum of severity – spanning relatively minor contraventions such as a one off failure to supply a customer with a relevant form, at one end, to serious offences such as fraud at the other. Originally, AFS licensees were required to report all breaches to ASIC, regardless of severity. Such a requirement put a large regulatory burden on licensees, as well as an administrative burden on ASIC in having to deal with an influx of minor and insignificant reports. In that context, in 2003 a 'significance' test was introduced to provide a threshold for matters that were required to be reported to ASIC.
- III. The introduction of the significance test however, while effective in reducing these regulatory and administrative burdens, has given rise to ambiguity as to whether the threshold for the obligation to report is triggered in any given circumstance. This is in large part because the test has a high degree of subjectivity – it relies on an exercise of judgment by the licensee, having regard to criteria that are also subjective in some respects. For example, in deciding whether a breach is significant, a licensee must consider "the impact of the breach or likely breach on the licensee's ability to provide the financial services covered by the licence"¹ This could mean that, for a large licensee, a breach that was serious and therefore significant by objective standards (by what a reasonable person would think), may not be considered by the licensee to be significant in the context of its overall operations, and that consequently, it has no clear obligation to report it to ASIC.
- IV. By contrast, the United Kingdom for example, makes clear that there is an objective threshold for the obligation to report, requiring that a firm must notify "anything relating to the firm of which that regulator would reasonably expect notice."²
- V. The Taskforce's preliminary view is that the significance test should be retained, but that significance should be determined by reference to an objective standard.
- VI. The Taskforce notes that there have been calls for the early publication of breach reports made to ASIC, including names of individuals concerned either directly or indirectly with the breach, as well as information on whether action, such as dismissal, was taken against senior executives concerned.³

¹ Corporations Act s. 912D(1)(b).

² Principle 11, Principles of good regulation, Financial Conduct Authority.

³ House of Representatives Standing Committee on Economics, *Review of the Four Major Banks*:

First Report November 2016, recommendations 2 and 10.

While the Taskforce supports the push for enhanced transparency and accountability for misconduct in the financial sector, it does not, except to the limited extent outlined below, agree that the existing breach reporting regime is the appropriate vehicle for reforms that address this. In the Taskforce's opinion, the primary purpose of the existing breach reporting regime is to enhance ASIC's intelligence and better enable it to carry out its functions, including investigating reports of wrongdoing and taking appropriate action – administrative, civil or criminal – against individuals or entities guilty of misconduct. In short, it exists to alert ASIC to matters that it may need to investigate. Premature public disclosure of issues and naming of individuals may impede ASIC action by publicising the fact that ASIC is or may be investigating - for example, by resulting in the destruction of evidence before ASIC can fully implement its investigative processes and place people on non-disclosure orders to limit tipping and collusion about evidence.

- VII. The breach reporting regime has not been established as a mechanism for determining guilt or innocence of individuals accused of misconduct, and to use it as such would risk undermining fundamental principles of procedural fairness and due process for individual staff or representatives of licensees who may be named. Even where a licensee reports an actual breach of obligations, further investigations are often necessary after the licensee reports the breach to ASIC to determine, amongst other things, the individuals involved, the extent of their role in the relevant events, the full impact on the licensee and/or consumers. The Taskforce notes, in this regard, that the Coleman report's recommendation that licensees notify ASIC within 5 days of lodging a breach report, of consequences for senior executives concerned in the breach, including whether or not they have been dismissed, does not seem practical. A key goal of the Taskforce is to encourage early reporting of breaches or suspected breaches. A licensee who reports early in good faith is unlikely to be able to make a properly informed decision, in accordance with the principles of procedural fairness, within 5 days.
- VIII. A breach report is not, therefore, of itself an appropriate basis for public attribution of wrongdoing to individuals. This is all the more the case if the Taskforce's position on requiring 'suspected' breaches to be reported is accepted. In this case ASIC gets early awareness of the possibility of a breach but this would hardly be a fair basis on which to name individuals publicly.
- IX. The Taskforce is not aware of any other comparable overseas jurisdiction that uses breach reporting requirements as a basis for public naming of individuals for accountability purposes, and does not consider it appropriate for Australia to be an outlier in this regard.⁴
- X. The Taskforce does, however, see some merit, drawing on recommendation 9 of House of Representatives Standing Committee on Economics, Review of the Four Major Banks: First Report (Coleman Report), in the annual publishing of breach report data at a licensee level. ASIC reports annually on aggregate breach report data (and the amount of breaches reported to ASIC, if reforms outlined in this paper are adopted, is likely to increase substantially). In addition, ASIC includes, in its annual report, data on the number of criminal convictions, civil actions, and amounts of fines or civil penalties imposed, and administrative actions such as banning of individuals, in respect of misconduct in financial services. The existing ASIC reporting framework could be supplemented, however, by firm or licensee level data. This addresses the substance of the concerns of the Coleman Report regarding

⁴ The Taskforce notes that the Financial Industry Regulatory Authority in the United States, an independent, not-for-profit organisation with authorisation from the United States Congress, publishes information about terminations of employment (whether voluntarily resigned, discharged or permitted to resign) after allegations of investment-related breaches, fraud or failing to supervise subordinates in relation to investment-related breaches.

enhancing accountability and providing an incentive for improved behaviour, and provide a more appropriate balance between the need for procedural fairness and the need to preserve the integrity of investigative processes. It would also enable licensees to compare their performance against others, and assist both ASIC and licensees to identify any concerning trends in compliance.

- XI. Another key issue identified in respect of the existing regime for breach reporting is that the penalty for failure to report is potentially inflexible – being limited to a criminal offence, with a relatively modest maximum fine. A criminal sanction is inappropriate for more minor or inadvertent infractions, and conversely, the modest nature of the fine is an insufficient deterrent to be effective in encouraging licensees to self-report offences at the more serious end of the spectrum.
- XII. The Taskforce notes that legislation governing credit licensees does not currently have a regime for breach reporting equivalent to that for financial services licensees. The Taskforce’s preliminary view is that an equivalent regime should be introduced for credit licensees.
- XIII. Having regard to the above and to associated matters, the Taskforce has developed preliminary positions on a set of reforms aimed at enhancing the current regime and making it more effective. These positions are:
- Position 1: The ‘significance test’ in section 912D of the *Corporations Act 2001* (Cth) should be retained but clarified to ensure that the significance of breaches is determined objectively.
 - Position 2: The obligation for licensees to report should expressly include significant breaches or other significant misconduct by an employee or representative.
 - Position 3: Breach to be reported within 10 business days from the time the obligation to report arises.
 - Position 4: Increase penalties for failure to report as and when required.
 - Position 5: Introduce a civil penalty in addition to the criminal offence for failure to report as and when required.
 - Position 6: Introduce an infringement notice regime for failure to report breaches as and when required.
 - Position 7: Encourage a co-operative approach where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity.
 - Position 8: Prescribe the required content of reports under section 912D and require them to be delivered electronically.
 - Position 9: Introduce a self-reporting regime for credit licensees equivalent to the regime for AFS licensees under section 912D of the *Corporations Act*.
 - Position 10: Ensure qualified privilege continues to apply to licensees reporting under section 912D.
 - Position 11: Remove the additional reporting requirement for responsible entities.
 - Position 12: Require annual publication by ASIC, of breach report data for licensees.
- XIV. The Taskforce has prepared these positions on a preliminary basis, and now seeks industry and community feedback prior to reaching its final conclusions and preparing recommendations to Government.

- XV. The background and detailed reasons for the Taskforce’s adoption of the positions set out above are described below.
- XVI. The Taskforce has analysed some comparative regimes in other countries. This analysis is set out in Attachment A.

1. INTRODUCTION

1. Early detection of misconduct, breaches of regulatory requirements or other important matters that should be brought to the regulator’s attention are integral to good regulation of the sector. Timely detection of non-compliance with the regulatory framework enables ASIC to:
 - 1.1. Monitor the extent and severity of non-compliance and commence surveillances and investigations where necessary;
 - 1.2. Take law enforcement and regulatory action where warranted, including administrative action to protect consumers of financial products and services; and
 - 1.3. Identify and respond to emerging risks and trends within the financial services industry.
2. Regulatory supervision is one way to detect non-compliant behaviour but, where there are many individuals and entities subject to the regime, the detection of such behaviour can be significantly enhanced by an effective regime for self-notification. The *Corporations Act 2001* (Cth) (the Act) creates a self-reporting regime for the holders of an Australian financial services licence (AFS licence) requiring them to report certain breaches of their obligations to ASIC⁵.
3. To comply with the mandatory obligation licensees need to put in place systems, policies and procedures to ensure that contraventions are identified and escalated within each licensee’s business.
4. The self-reporting framework established in the Act is harmonised with the framework for self-reporting to the Australian Prudential Regulation Authority by banks, superannuation trustees and insurers.
5. The self-reporting regime has come under scrutiny in the media and in a series of inquiries into banking or banking and financial services related misconduct. Concurrently, ASIC has publicly outlined concerns with the effectiveness of some aspects of the existing regime. These matters doubtless contributed to the Government’s decision to include in the ASIC Enforcement Review Taskforce’s Terms of Reference:

“The adequacy of the frameworks for notifying ASIC of breaches of law, including the triggers for the obligation to notify; the time in which notification is required to be made; and whether the obligation to notify breaches should be expanded.”
6. The Taskforce has conducted preliminary analysis of these issues, with the benefit of ongoing targeted consultation with industry and other stakeholders. This has enabled the Taskforce to develop preliminary positions on a set of reforms aimed at enhancing the current regime and making it more effective. These positions, together with background on the current regime and issues identified, are set out below.

⁵ Corporations Act, s. 912D.

2. CURRENT OBLIGATION TO SELF-REPORT

7. A person who carries on a financial services business in Australia must hold an AFS licence⁶ and, amongst other things, comply with a set of general conduct obligations outlined in the Act.⁷
8. If an AFS licensee contravenes, or is likely to contravene in future, one or more of the relevant obligations, and the contravention or likely contravention is significant, the licensee has an obligation to report the matter to ASIC in writing.⁸
9. The report to ASIC must be made within 10 business days of the licensee "becoming aware of" the contravention or likely contravention.⁹ Failure to comply with this requirement is a criminal offence.¹⁰
10. The Act requires AFS licensees in assessing the significance of a contravention to have regard to¹¹:
 - 10.1. the number or frequency of similar previous breaches;
 - 10.2. the impact of the breach or likely breach on the AFS licensee's ability to provide the financial services covered by the licence;
 - 10.3. the extent to which the breach or likely breach indicates that the AFS licensee's arrangements to ensure compliance with those obligations is inadequate;
 - 10.4. the actual or potential financial loss to clients of the AFS licensee, or the AFS licensee itself, arising from the breach or likely breach; and
 - 10.5. any other matters prescribed by regulations made for the purposes of section 912(1)(b).¹²Licensees may take into account other factors, but they must take account of these.
11. Prior to 2003, AFS licensees were required to report all contraventions as soon as practicable, and in any case within 3 days of becoming aware of a contravention.
12. Following amendments in 2003,¹³ the reporting obligation was modified so that only *significant* breaches or likely breaches needed to be reported.¹⁴ This was done to reduce the compliance burden

⁶ Responsible entities of managed investment schemes must hold an AFS Licence pursuant to section 601FA of the Act and are subject to reporting requirements under both sections 912D and 601FC(1)(l) of the Act.

⁷ Corporations Act, s. 912A and s. 912B. Note there are some obligations set out in sections 912A and 912B of the Act that do not require a significant breach or likely breach to be reported to ASIC: section 912D(1)(a).

⁸ Corporations Act, s. 912D.

⁹Section 912D(1B) of the Act.

¹⁰ Sections 1311 and 1312 and item 264A of Schedule 3 of the Act.

¹¹ Section 912D(1)(b) of the Act.

¹² Nothing has yet been prescribed.

¹³ *Financial Services Reform Amendment Act 2003* (Cth).

¹⁴ See paragraph 6 above.

upon licensees and to enable ASIC to focus its limited resources upon more serious or important breaches.

13. The 2003 amendments also introduced a definition of “likely breach” as follows:

“a financial services licensee is likely to breach an obligation referred toif, and only if, the person is no longer able to comply with the obligation.”¹⁵

3. ISSUES WITH THE EXISTING REGIME

14. A number of concerns with the effectiveness of the existing self-reporting regime have been raised by ASIC and others in the course of a number of inquiries in recent years. Those concerns centre on:
 - 14.1. the subjectivity of the ‘significance’ test leading to inconsistent reporting of matters;
 - 14.2. ambiguity as to when the time for reporting commences and delays in reporting due to the time taken by AFS licensees in assessing whether the circumstances in question give rise to a breach that is significant;
 - 14.3. the obligation to report being confined to breaches of obligations by AFS licensees when the Act now places important obligations on employees and representatives as the providers of financial advice;
 - 14.4. the lack of flexibility in sanctioning failures to report (there is a single, criminal pecuniary penalty that is relatively low).
15. In addition, the *National Consumer Credit Protection Act 2009* (Cth) (National Credit Act) does not currently impose an equivalent reporting obligation on credit licensees. Instead the National Credit Act requires credit licensees to lodge an annual compliance certificate with ASIC.¹⁶
16. These concerns are considered in more detail below.

4. THE SUBJECTIVITY OF THE SIGNIFICANCE TEST

17. The key trigger for the obligation to self-report breaches is the “significance” of the breach. The significance threshold requires AFS licensees to make a qualitative assessment of any breach or likely breach, having regard to, among other things, the factors set out in the Act¹⁷.
18. The significance test transformed the previous objective self-reporting obligation (to report all contraventions irrespective of seriousness) into a subjective one, coupled with some seemingly objective factors to guide licensees in determining whether the obligation has been triggered. Nevertheless, the overall test being set at the level of significance from the perspective of the licensee results in the ultimate standard being strongly subjective. This subjectivity has the result that,

¹⁵ Section 912D(1A) of the Act.

¹⁶ Section 53 of the National Credit Act.

¹⁷ Subsection 912D(1)(b).

although all AFS licensees have an obligation to report, the differing scale, nature and complexity of their respective businesses and balance sheets can mean that larger organisations need to report fewer breaches or less often - depending upon the precise interplay of each of the factors in the particular circumstances.

19. Subjectivity also connotes an element of uncertainty in borderline cases whether a report is necessary (significant) or not. In effect, in the absence of a clear or indisputable breach, licensees need to make judgment calls about whether a breach is significant or not having regard to the factors stipulated in the statute. Licensees may err on the side of not reporting or to only report after the breach has been remedied, if:
 - 19.1. there is no impact of the breach on their ability to provide services,
 - 19.2. it is an isolated incident,
 - 19.3. it does not indicate that their compliance arrangements are inadequate, and there are no losses to clients or licensee businesses or the losses are small or immaterial relative to capitalisation or balance sheet strength.
20. The factors themselves are not necessarily objective either, since these involve judgments as to impact, adequacy of arrangements, and whether there is sufficient information or data to form views as to frequency and loss. In addition, only one factor focuses attention on the impact of the breach on consumers (actual or potential financial loss to clients). This is balanced against the other factors which focus on the breach's significance to the AFS licensee's business. In aggregate, the test, including the statutory factors, therefore can tend to privilege licensee perceptions as to significance (subjective perspectives) over external perceptions of the community as a whole (objective perspectives).
21. The subjectivity of the significance test is highlighted in *Regulatory Guide 78: Breach reporting by AFS licensees (RG78)*, where it states:

“Whether a breach (or likely breach) is significant or not will depend on the individual circumstances of the breach. We consider that the nature, scale and complexity of your financial services business might also affect whether a particular breach is significant or not. You will need to decide whether a breach (or likely breach) is significant and thus reportable. When you are not sure whether a breach (or likely breach) is significant, we encourage you to report the breach” (emphasis added)
22. The subjectivity of the test may be compounded by the fact that:
 - 22.1. while some of the relevant licensee obligations in s.912A are objectively ascertainable, others are phrased in broad and subjective terms; and
 - 22.2. AFS licensees must make their own decisions about the weight to be given to each of the listed factors (and any other factors they consider relevant) in determining whether a breach or likely breach is significant, in the absence of a clear objective standard.

23. The potential inconsistencies brought about by the subjective nature of the significance test are illustrated in the following example:

A small AFS licensee has 10 advisers, one of which misappropriates \$1 million from a single client may consider this significant and as triggering the reporting obligation; whereas a large institution with over 300 advisers may consider that it does not.

A very large financial loss to a single consumer as a result of poor advice may be considered significant to both the consumer and a smaller AFS licensee. However, a larger licensee may regard the matter as not being significant in the context of the scale and diversity of their operation.

24. Another potential problem arises in respect of breaches that may involve detriment to consumers. Financial loss is not the only way in which an event can have an impact on consumers, but this is the only statutory factor which directs licensee attention towards consumers. So, for example, a failure to provide proper disclosure contemporaneously to a large number of clients may not be considered significant enough to report if it does not immediately involve financial loss. Nevertheless, a breach of this nature is something that ASIC may wish to be aware of as it might be indicative of a broader systemic failing within the licensee. ASIC will be concerned to ensure consumers in future are not exposed to losses and the licensee will be concerned to avoid or minimise the risk of private legal or class actions arising from the same failing.

POSITION 1: THE ‘SIGNIFICANCE TEST’ IN SECTION 912D OF THE CORPORATIONS ACT SHOULD BE RETAINED BUT CLARIFIED TO ENSURE THAT THE SIGNIFICANCE OF BREACHES IS DETERMINED OBJECTIVELY

25. The Taskforce adopts as its preliminary position that the current ‘significance’ test for the obligation to report should be retained but the Act should be amended to provide that significance is to be determined by reference to an objective standard. This could be achieved, for example, by providing that AFS licensees are required to notify ASIC of matters that a reasonable person would regard as significant having regard to the existing factors set out in subsection 912D(1)(b) of the Act. The flexibility in the existing factors would be maintained with the ability to prescribe additional factors in the regulations.¹⁸
26. This would not introduce any concepts unknown to Australian law. For example, the continuous disclosure provisions of the Act require information to be disclosed where “a reasonable person would expect, if it were generally available, to have a material effect on the price or value of its securities”¹⁹.
27. A proposal of this kind would adopt to some extent Principle 11 of the FCA Handbook’s Principles for Businesses, which requires a firm to deal in an open and cooperative way with regulators and to disclose to its regulators anything relating to the firm of which the regulator would reasonably expect notice. Principle 11 creates an overarching ‘objective’ test for the operation of the self-reporting regime that is supplemented by specific provisions that make clear that certain types of breaches are deemed to be reportable within varying time frames, depending on the nature of the breach. For example, events that have a serious regulatory impact require immediate notification to the FCA once

¹⁸ Subsection 912D(1)(b)(v).

¹⁹ Sections 674-677.

the firm becomes aware or has information that reasonably suggests that the event has occurred, may have occurred or may occur in the foreseeable future.²⁰

28. At the same time, maintaining a materiality threshold for the matters that are to be self-reported is consistent with the regimes in a number of international jurisdictions. For example:
 - 28.1. the FCA requirement to immediately notify it of breaches of rules, laws or regulations, includes a significant breach of a rule and a significant breach of the Consumer Credit Act²¹. However, the significance threshold does not apply to breaches of the Financial Services and Markets Act 2000 and regulations and orders made under that Act²²;
 - 28.2. different materiality thresholds apply to the requirement to report violations of laws, rules, regulations or standards of conduct to FINRA depending on whether the member itself or an associated person engaged in the violative conduct²³;
 - 28.3. self-reporting requirements to the Hong Kong Securities and Futures Commission include requirements to report (amongst other things) any material breach, infringement of or non-compliance with laws, rules, regulations and codes²⁴.
29. Any overarching obligation in the Australian context could be supplemented by additional regulatory guidance from ASIC that may specify certain types of breaches that it considers should always be reported. For example, such a list might include:
 - 29.1. Breaches or suspected breaches of Part 7.7A of the Act (including, among other things, best interest obligations and conflicted remuneration provisions);
 - 29.2. Matters that could result in the suspension, demotion, termination or resignation of an AFS licensee's representative or employee or in relation to which there has been a referral to a law enforcement agency;
 - 29.3. Breaches or suspected breaches of the Future of Financial Advice (FOFA) provisions in Part 7.7A of Chapter 7 of the Act in relation to which an AFS licensee is liable for its representatives' actions;
 - 29.4. Matters that may involve dishonesty, as defined in section 130.3 of the Commonwealth Criminal Code;
 - 29.5. Breaches or suspected breaches of Division 2 of Part 2 of the ASIC Act;
 - 29.6. Breaches or suspected breaches of Chapter 5C of the Act;

²⁰ See Annexure A paragraphs 110 to 118.

²¹ FCA Handbook SUP 15.3.11R(1)(a) and (aa). Significance is determined having regard to potential financial losses to the firm or customers, frequency of the breach, implications for systems and controls and delays in identifying or rectifying the breach (SUP 15.3.12G).

²² FCA Handbook SUP 15.3.11R(1)(b).

²³ Rule 4530(b). See further Annexure A paragraphs 131 to 133.

²⁴ See Annexure A paragraph 136.

- 29.7. Breaches or suspected breaches of a provision of a financial services law referred to in section 912D of the Act which carries a penalty of imprisonment of five years or more; and/or
- 29.8. Breaches or suspected breaches of a financial services civil penalty provision in Chapter 7 of the Act.
30. The guidance could also provide examples that take into account differing businesses, products and/or distribution channels.

Questions

1.1 Would a requirement to report breaches that a reasonable person would regard as significant be an appropriate trigger for the breach reporting obligation?

1.2 Would such a test reduce ambiguity around the triggering of the obligation to report?

5. OBLIGATION TO REPORT IS SET BY REFERENCE TO BREACHES BY AFS LICENSEES

31. Currently, the reporting obligation applies to breaches by an AFS licensee. However, Chapter 7 of the Act, and in particular Part 7.7A, places important obligations on a representative (or provider of advice), rather than just on the AFS licensee.
32. While AFS licensees are in most circumstances liable for the conduct of employees and authorised representatives,²⁵ and so a breach by the latter may sometimes amount to a breach by the licensee, there may be ambiguity about when a breach by a representative is reportable. The decentralised nature of the authorised representative base in larger licensees may also present difficulties in ensuring timely identification and reporting of breaches. At present licensees need a system and policies to require representatives to report issues to them, a surveillance system, or both, to identify breaches and assess whether the licensees need to report them.
33. If misconduct by an authorised representative is not reported to ASIC early, ASIC will not be able to assess the severity of the conduct and take appropriate action swiftly. For example, in extreme cases, protection of consumers may require prompt action to remove an individual from the industry. This is exemplified by the Commonwealth Financial Planning Limited example outlined in paragraph 41 below and the example below:

Case study

An AFS licensee notified ASIC that an employee had stolen \$1 million in client funds and was about to appear before Court on fraud charges. The AFS licensee had not notified ASIC of the breach at the time it was discovered because it did not consider the breach to be "significant" despite reporting it to the police. The licensee's assessment of significance turned on the fact that the money had been repaid and the lack of loss by any clients.

34. In its guidance ASIC states that, for example, if a representative of an AFS licensee gives inappropriate financial product advice to clients this may constitute a breach of the AFS licensee's obligations to

²⁵ See sections 917B and 917C of the Act.

comply with the relevant financial services laws and to take reasonable steps to ensure that representatives comply with those laws²⁶. Similarly in the case of fraudulent conduct by a representative ASIC considers this may involve a significant breach of a number of relevant obligations.²⁷ Licensees, however, may form different views based on individual assessments of the significance of a breach in particular circumstances.

POSITION 2: THE OBLIGATION FOR LICENSEES TO REPORT SHOULD EXPRESSLY INCLUDE SIGNIFICANT BREACHES OR OTHER SIGNIFICANT MISCONDUCT BY AN EMPLOYEE OR REPRESENTATIVE

35. The Taskforce adopts, as a preliminary position, that the self-reporting obligation should be extended to require AFS licensees to report matters relating to the conduct of employees and representatives. The aim would be to ensure that ASIC is notified of misconduct or other serious regulatory issues by representatives at the earliest opportunity so that ASIC can, where necessary, investigate and take timely action to remove individuals from the industry in order to protect consumers.
36. In addition, AFS licensees reporting to ASIC in these circumstances will have the benefit of qualified privilege so that they are protected from third party liability when making reports in good faith pursuant to the requirements of the regime.
37. Extending the reporting obligation in this way would be consistent with the self-reporting regimes in a number of international jurisdictions that specifically require firms or companies to report misconduct engaged in by employees or representatives. For example:
 - 37.1. the FCA's reporting requirements include immediate notification of specified breaches of rules, laws or regulations by the firm, its directors, officers, employees, approved persons or appointed representatives. Firms must also make notifications about complaints and compensation paid in relation to employees who are retail investment advisers in certain circumstances. In addition, section 64C of the *Financial Services and Markets Act 2000* requires firms to submit information about disciplinary action taken or commenced against staff as a result of a breach of one or more rules of conduct;
 - 37.2. FINRA requires members to report if the member concludes or reasonably should have concluded that an associated person or the member itself has violated any securities, insurance, commodities, financial, investment or investment related laws, rules or regulations, standards of conduct;
 - 37.3. licensed and registered persons in Hong Kong have a duty to self-report any suspected material breach, infringement of or non-compliance with any law, rules, regulations or codes by itself or persons it employs or appoints to conduct business;
 - 37.4. financial institutions in Singapore are required to investigate the facts and circumstances relating to misconduct by representatives and submit a report to Monetary Authority of Singapore.

²⁶ Table 3, example 4, on page 10 of RG78.

²⁷ Table 3, example 6, on page 10 of RG78.

38. The provisions in Part 7.7A of the Act, which impose obligations on representatives as providers of financial advice, fall within the definition of financial services laws. Accordingly, AFS licensees could be required to report significant breaches of the financial services laws by employees and representatives. Additionally the existence, or suspicion of the existence of some of the circumstances that would enable ASIC to make a banning order against a person under section 920A of the Act should trigger the requirement for the licensee to report. This would recognise that there may be a broader range of matters arising from conduct engaged in by individuals that may raise concerns with respect to their ability to provide financial services. Matters referred to in section 920A of the Act that might be appropriate for AFS licensees to report to ASIC include where the AFS licensee has reason to believe or suspect that an employee or authorised representative:
- 38.1. has become an insolvent under administration; or
 - 38.2. has engaged in fraudulent conduct; or
 - 38.3. is not of good fame and character; or
 - 38.4. is not adequately trained or is not competent to provide a financial service or financial services.

Question

2.1 What would be the implications of this extension of the obligation of licensee's to report?

6. DELAYS IN REPORTING AND AMBIGUITY AS TO WHEN THE TIME ALLOWED FOR REPORTING COMMENCES

39. ASIC is concerned that uncertainty regarding the requirement to report within 10 business days after becoming aware of a breach or likely breach may delay reports. The uncertainty arises from the fact that the commencement of the time period for reporting is dependent on subjective factors, namely the point in time at which an AFS licensee becomes aware of the breach, and its significance (the timing for each may differ), and logistical factors such as the internal process and policies for breach reporting. There is also uncertainty whether the 10 business days runs from becoming aware of the breach or from the date upon which the licensee forms the view that it is significant. The latter usually, though not always, may involve an internal investigation and in addition may give rise to a need to obtain legal advice as to significance and whether the reporting obligation is triggered or not.
40. As the existing obligation is to self-report actual breaches or likely breaches in future, as distinct from probable or suspected breaches, licensees may need a relatively high degree of information and well developed understanding of the circumstances giving rise to the breach to satisfy the criteria for reporting. Depending on the circumstances - including where, when and by whom the incident is first identified within a licensee - and the scale, nature and complexity of the business, this can take time.
41. An illustration of this arose in the context of the Senate Standing Committee on Economics' (the Committee) report on the *Performance of the Australian Securities and Investments Commission*.²⁸ In the course of its inquiry the Committee examined dealings by the financial planning arm of the

²⁸ Senate Economics References Committee Report *Performance of the Australian Securities and Investments Commission June 2014*.

Commonwealth Bank of Australia's (**CBA**), Commonwealth Financial Planning Limited (**CFPL**) which in September 2008, suspended financial adviser Don Nguyen, for compliance failures. These "failures" were not reported to ASIC, and CFPL reinstated Mr Nguyen in October 2008. Following disclosures by a whistleblower concerning continuing misconduct of Mr Nguyen, he resigned in July 2009. CBA, as the parent entity of CFPL, subsequently lodged a breach report with ASIC about Mr Nguyen's conduct. When asked why it did not make a breach report to ASIC when Mr Nguyen was first suspended in September 2008, CBA informed the Committee that:

"...the findings from the investigation at the time were 'inconclusive'. While acknowledging 'the decisions made around the investigation of Mr Nguyen in September 2008 and his subsequent return to work were 'the wrong decisions', CBA did not directly concede that it should have made a breach report to ASIC at the time"²⁹

42. The Committee noted that:

"...this was not the only instance, according to ASIC, that disclosed shortcomings in CFPL's breach reporting. ASIC told the Senate inquiry of its concerns over this extending back at least to 2006, and continuing to at least 2014"³⁰

43. A recent ASIC review of how large financial advice licensees dealt with past poor advice and non-compliant advisers³¹ highlighted similar issues, including delayed reports and that a number of reports had not been made at all. The review, amongst other things, required 35 advice licensees solely owned or controlled by large institutions to identify advisers who demonstrated serious compliance concerns (SCC)³² between 1 January 2009 and 30 June 2015 (noting that the FOFA reforms commenced on 1 July 2013). The licensees identified 149 SCC advisers, only 42 of whom had previously been the subjects of self-reports by the licensees to ASIC. Another 34 SCC advisers had been notified to ASIC in some other way, leaving 73 SCC advisers who were not notified to ASIC until the review. ASIC also found that where breach reports had been made, a number were delayed as they were not made until several months after the relevant licensee became aware of the matters giving rise to the SCCs.³³

44. The tendency of licensees to require a high degree of certainty that a contravention has occurred and that it is significant might be an unintended consequence of a desire by licensees to accord procedural fairness to staff and authorised representatives if the initial issue identified indicates misconduct has occurred. Although the Act provides AFS licensees qualified privilege in respect of mandatory reports

²⁹ *ibid.*, p. 120.

³⁰ *ibid.*, p. 13.

³¹ ASIC Report 515 'Financial Advice: Review of how large institutions oversee their advisers', March 2017.

³² That is, they may have engaged in the following:

- (i) dishonest, illegal, deceptive, and/or fraudulent misconduct;
- (ii) any misconduct that, if proven, would be likely to result in the instant dismissal or immediate termination of the adviser;
- (iii) deliberate non-compliance with financial services laws; or
- (iv) gross incompetence or gross negligence.

³³ *Ibid* pages 31-36.

to ASIC, voluntary disclosures are not similarly protected.³⁴ This may create a tension between the regulatory benefit of timely reporting of misconduct to ASIC and the potential consequences for an AFS licensee that reports information before it is satisfied that the obligation to report actually exists and so can be said to be *required* or mandated under the Act. Consequently licensees may perceive there to be a risk that a premature report could expose them to action by an individual named in the report for defamation or for unfair dismissal if they act too quickly, in an attempt to assuage ASIC's concerns, by terminating the relevant employment contract or the authorisation of a representative. The rise of class actions in respect of unsuitable or inappropriate financial services and products may also be a factor influencing the timeliness of self-reports, especially given the reports necessarily entail an admission of breach (because the obligation to report only arises when a contravention has occurred as a matter of fact).

45. In other cases, delay could result because the authority to determine the significance of a breach and whether it should be reported is invested in one staff member of an AFS licensee who, because of internal investigation and reporting processes, may not be asked to consider the matter until long after the relevant event or events have occurred. ASIC has received breach reports from AFS licensees concerning conduct that occurred some years earlier, due to internal investigations taking a long time to conclude on the evidence gathered that the breach was significant.

Case studies

Staff within an AFS licensee identified that some clients were being overcharged compared to the fee set out in the AFS licensee's Financial Services Guide. Staff within the AFS licensee investigated the issue, identified clients who were incorrectly charged and 12 months later engaged an external firm to provide independent advice on systems and controls. That firm advised that there were deficiencies in the controls in place to prevent such occurrences. Nine months later the risk rating of the issue was "upgraded" from low to medium risk. Eight months later the staff member responsible determined that it was reportable and a breach report was lodged with ASIC. Two and half years had passed since the problem was originally identified.

Staff within an AFS licensee became aware that the licensee had failed to provide promised services to customers who had paid for those services almost three years before the conduct was reported to ASIC. The issue was raised with senior management more than 18 months before the AFS licensee submitted its breach report.

46. ASIC has raised concerns that extended processes may have been adopted in some instances to enable the AFS licensee to delay notifying ASIC until after it has taken steps to remedy the issue without ASIC oversight or involvement.³⁵ If true this may be due to the fact that self-reporting may trigger enforcement action by ASIC in respect of the underlying breach and reflect a concern by some licensees about ASIC's focus on enforcement outcomes.³⁶ So delay could be operating in some cases as a means of mitigating or pre-empting enforcement outcomes by seeking to avoid having to negotiate an approach with ASIC while under the spectre of enforcement action. On the other hand, as a

³⁴ Pursuant to section 1100A(1)(a) of the Act, a person has qualified privilege in respect of the giving of information to ASIC that is required to be given under Chapter 7 of the Act, which includes section 912D.

³⁵ RG78.29.

³⁶ A number of stakeholders raised this as a concern in the ASIC Capability Review of December 2015 (report released in April 2016).

purpose of the breach reporting obligation is to encourage licensees to identify and presumably to remedy any breaches quickly, any tendency to privilege remedial action over reporting may be understandable from a commercial and risk-mitigation perspective. However, it limits ASIC's ability to be engaged in the process of fashioning the remedial action and to provide guidance to the licensee in question, or licensees generally if the issue is such that it may be more widespread. Individual licensees are not in the best position to evaluate such trends, but ASIC is by virtue of the reports it receives.

POSITION 3: BREACH TO BE REPORTED WITHIN 10 BUSINESS DAYS FROM THE TIME THE OBLIGATION TO REPORT ARISES

47. The Taskforce adopts, as a preliminary view, that in order to improve certainty and reduce subjectivity in assessing the existence of the obligation to report, the trigger for reporting could be modified so that it is clearly based on an objective assessment of the information available to the AFS licensee. This could be achieved by making the 10 business day timeframe commence from when the AFS licensee becomes aware or has reason to suspect that a breach has occurred, may have occurred or may occur rather than when the licensee determines that the relevant breach *has* occurred and *is* significant.
48. This would be to adopt, to some extent, the reporting requirements to the UK's FCA (outlined in Annexure A), that trigger the requirement to report a breach when the licensee becomes aware, or has information that reasonably suggests, that a reportable breach *has occurred, may have occurred, or may occur in the foreseeable future*. Whether it is necessary to adopt words such as 'has information that reasonably suggests', is a matter on which the Taskforce draws no conclusion at this stage, and invites comment.
49. Similarly member firms in the United States are required to make reports to FINRA when the member has concluded or reasonably should have concluded that an associated person or the member itself has violated a relevant law, rule, regulation or standard of conduct. Reports must be made promptly and not later than 30 calendar days after the member concludes that there has been a violation and that the violation meets specified thresholds for reporting (see Annexure A for further information).
50. An AFS licensee could be deemed to be aware of the facts and circumstances that established the breach, suspected breach or potential breach where the licensee has received that information from any of the following:
 - 50.1. a government agency;
 - 50.2. its auditor;
 - 50.3. an industry Ombudsman, or other body to which the licensee must belong under its external dispute resolution scheme obligations; and/or
 - 50.4. a current or former representative or employee who has provided it to a director, secretary, or senior manager of the licensee or a person authorised by the licensee to receive whistleblower type disclosures.
51. By extending breach reporting to suspected or potential breaches, this reform would ensure that AFS licensees do not have to conduct extensive investigations to determine whether a breach of relevant obligations has in fact occurred before notifying ASIC. They can report compliance concerns and

misconduct at an earlier stage and attract the protection of qualified privilege in section 1100A of the Act, protecting them from third party consequences of reporting the breach.

Questions

3.1 Would the threshold for the obligation to report outlined above be appropriate?

3.2 Should the threshold extend to broader circumstances such as where a licensee “has information that reasonably suggests” a breach has or may have occurred, as in the United Kingdom?

3.3 Is 10 business days from the time the obligation to report arises an appropriate limit? Or should the period be shorter or longer than 10 days?

3.4 Would the adoption of such a regime have a cost impact, either positive or negative, for business?

7. SANCTION FOR FAILURE TO REPORT

52. A failure to comply with the obligation to report is a criminal offence³⁷, with a maximum penalty of 50 penalty units or imprisonment for one year or both in the case of an individual, and a maximum penalty of 250 penalty units in the case of a body corporate³⁸.
53. The fact that there is solely a criminal sanction paradoxically may both encourage a focus by licensees on being certain that there is a breach before they report and discourage a collaborative approach between ASIC and licensees for the reasons already noted. As things stand, the sanction is unlikely to be available in all but the most egregious cases of intentional failure to report where there is clear evidence of intention. In most instances, such evidence is unlikely to be available or it may be ambiguous. Further, prosecutions are likely to be complex as the criminal standard of proof will apply. That ASIC has only ever brought one prosecution for failing to report, suggests the limitation of the current formulation is problematic as there is little utility in having a sanction that is rarely if ever applied, undermining any deterrent effect for non-compliance.
54. The level of the fines is also relatively low compared to other statutory offences which may be a compounding factor. It is unclear why this level was set. This could be reflective of unwillingness by the legislature to truly criminalise conduct that is inherently reliant upon judgment calls (so that good faith attempts to comply are not penalised heavily) or a perception that self-reporting, while desirable, is not an end in itself. Irrespective, given the importance self-reporting now assumes in ASIC’s regulatory approach, and the concerns expressed in recent times about industry compliance generally, particularly in the banking sector, it is appropriate to revisit these considerations to assess whether the sanction may need to be tailored to create more of an inducement to comply, while still reserving the criminal sanction (and perhaps a harsher one) for cases of deliberate non-compliance.

³⁷ Refer to the note to Section 912D(1B) of the Act.

³⁸ See sections 1311(1A), 1312, and item 264A of Schedule 3 of the Act. Currently a penalty unit is \$180, therefore the maximum penalties at present are \$9,000 for individuals and \$45,000 for a body corporate.

POSITION 4: INCREASE PENALTIES FOR FAILURE TO REPORT AS AND WHEN REQUIRED

55. The Taskforce adopts, as a preliminary position, that the monetary and custodial penalties for failure to report breaches in a timely fashion should be increased to reflect the importance of the obligation and community expectations. An increase to the maximum criminal penalty would make the offence an indictable rather than a summary offence, conveying the seriousness of a breach³⁹.
56. Conversely, substantially increasing penalties without adjusting the balance of the provision to create more inducements to encourage compliance may send the wrong message and exacerbate existing concerns about ASIC's enforcement approach and concerns about the potential for disproportionate outcomes. The efficacy of continuing to focus on ASIC delivering enforcement outcomes rather than industry and individual licensees, in particular, accepting responsibility is also an important consideration in this regard. ASIC's resources are finite. If it needs to conduct a detailed investigation and ultimately pursue to finality legal action to secure greater compliance and deterrence this is inefficient and has the potential to substantially delay consumer redress in contrast to the speed with which licensees may be able to provide this with the right incentives. Having a self-reporting system that encourages licensees to notify ASIC early of issues and a co-operative approach is more likely to yield quicker, more durable outcomes for consumers and the industry generally.
57. That said, there remains a case for maintaining at one end of the spectrum of sanctions or inducements to self-report, a serious sanction to deter deliberate non-compliance with the reporting obligation. A balance must be struck between co-operation and ASIC's mandate to take appropriate and proportionate action in relation to identified breaches of the law.

POSITION 5: INTRODUCE A CIVIL PENALTY IN ADDITION TO THE CRIMINAL OFFENCE FOR FAILURE TO REPORT AS AND WHEN REQUIRED

58. The Taskforce adopts the preliminary position that there should be a civil penalty in addition to a criminal penalty for failure to report when required, or at all. This would, give ASIC greater flexibility to choose which avenue to pursue, depending on whether the breach was serious and blatant. This might include where a licensee intentionally fails to report a breach of which it has actual knowledge. Providing a range of enforcement options may become more important if the criminal penalty is increased, as proposed above.
59. The introduction of a civil penalty may result in ASIC taking enforcement action in relation to breach reporting obligations more often, particularly because it could seek a civil penalty for any breach of section 912D of the Act when it takes civil penalty proceedings relating to the subject matter of the breach itself. This may result in ASIC being able to generally deter failures to breach report more effectively. Against this is the fact, however, that civil penalty proceedings can often be complex and take significant time to resolve. Nonetheless, the addition of a civil penalty option may increase the willingness of licensees to report to ASIC. The civil penalty regime, which is an important part of ASIC's regulatory toolkit is to be the subject of a separate review by the taskforce.

³⁹ In certain circumstances an indictable offence may be heard and determined by a court of summary jurisdiction with an adjustment to the maximum penalties the court can impose. See sections 4G, 4J and 4JA of the *Crimes Act 1914*.

POSITION 6: INTRODUCE AN INFRINGEMENT NOTICE REGIME FOR FAILURE TO REPORT BREACHES AS AND WHEN REQUIRED

60. In addition to the above, the Taskforce takes the preliminary view that ASIC should be empowered to issue infringement notices to AFS licensees for simple or minor contraventions that do not involve a deliberate failure to report.
61. This too would introduce greater flexibility for ASIC when responding to failures to breach report. For minor breaches, an infringement notice may be an appropriate measure, and a less costly remedy for ASIC and AFS licensees. Against this, however, is the risk that paradoxically such a regime may encourage non-compliance as the cost of infringement would be relatively low, almost a minor tax on doing business. This criticism has been levelled at other infringement notice regimes, in particular the continuous disclosure regime.
62. There are a number of infringement notice regimes relating to provisions administered by ASIC. ASIC may issue infringement notices for less serious contraventions of the ASIC Act, for breaches of strict liability offences and certain civil penalty provisions of the *National Consumer Credit Protection Act 2009* (Cth) as well as for breaches of the Market Integrity Rules, continuous disclosure provisions, Derivative Transaction Rules and Derivative Trade Repository Rules. ASIC is also able to issue 'penalty notices' for minor prescribed offences. Common characteristics of the various infringement notice regimes are:
 - 62.1. an infringement notice can be issued if there are reasonable grounds to believe that a person has contravened a relevant provision;
 - 62.2. the recipient can apply for an extension of time to comply with or to withdraw the infringement notice;
 - 62.3. if an infringement notice is issued and complied with no further regulatory action may be taken against the recipient for the breach, the recipient is not taken to have admitted guilt or liability in relation to the alleged contravention or to have contravened the relevant provision; and
 - 62.4. if the infringement notice is issued and not complied with, ASIC may take enforcement action in relation to the underlying contravention.
63. There are also differences in the way the various infringement notice schemes operate. The availability of infringement notices as an enforcement remedy will be the subject of a separate review by the taskforce.
64. The availability and breadth of such infringement notice regimes generally and whether they should be extended beyond the current areas of application is also part of a separate review that the Taskforce will be undertaking. The possible extension of an infringement notice regime as a consequence for a failure to self-report under s912D of the Act is considered in this context.

POSITION 7: ENCOURAGE A CO-OPERATIVE APPROACH WHERE LICENSEES REPORT BREACHES, SUSPECTED OR POTENTIAL BREACHES OR EMPLOYEE OR REPRESENTATIVE MISCONDUCT AT THE EARLIEST OPPORTUNITY

65. In addition to the sanctions modifications outlined above, the self-reporting regime could include provisions that encourage a collaborative approach between the regulated and regulator and encourage licensees to report events and information to the regulator at the earliest opportunity, even where proper investigation of the circumstances may take some time and resources of the licensee.
66. This could be achieved by creating a formal provision expressly allowing ASIC to decide not to take action in respect of licensees when they self-report and certain additional requirements are satisfied, particularly if the self-reporting obligation is amended to require suspected or potential breaches of obligations to be reported. If a licensee is self-reporting suspected or potential breaches of obligations it should be given an opportunity to complete its investigations.
67. ASIC currently provides information about its approach to breach reporting and enforcement more generally in regulatory guides and information sheets including RG 78, which deals specifically with breach reporting, Information Sheet 151 ASIC's approach to enforcement and Information Sheet 172 Cooperating with ASIC.
68. An appropriate additional option may be to provide that ASIC may decide to take no administrative or civil action against the licensee if the licensee cooperates with ASIC and addresses the matter to ASIC's satisfaction. Matters that may enable an AFS licensee to show this could include that:
 - 68.1. the report to ASIC sets out a program to address the matter including completion of any further investigations and the manner in which the licensee will rectify or remediate the matter;
 - 68.2. the program includes regular time frames for the provision of additional information to ASIC;
 - 68.3. the program has clear time frames for implementation and completion;
 - 68.4. the program will resolve the matter to the satisfaction of ASIC; and
 - 68.5. the program is implemented to the satisfaction of ASIC.
69. The circumstances giving rise to any decision by ASIC not to take action would need to be sufficiently flexible to enable licensees to address a range of matters with varying degrees of complexity. In some cases the program put forward by the licensee may need to address failures of systems or processes that are apparent when the events in one breach report are read together with previous or subsequent reports.
70. Another related option for reform would be to allow for an uplift or discount in the penalty for an underlying breach of the law, depending on whether the AFS licensee has reported the breach within the statutory timeframe.⁴⁰ In addition, the fact that a licensee self-reported the matter to ASIC could be identified as a circumstance to be taken into account when considering whether a licensee should

⁴⁰ Cooperation and the degree to which a person has shown contrition are matters that would be taken into account on sentencing (amongst other factors) in criminal prosecutions, see section 16A(2) of the Crimes Act 1914 (Cth).

be granted relief from liability in civil or civil penalty proceedings under sections 1318 and 1317S of the Corporations Act.

71. These possible reforms may encourage AFS licensees to report breaches by offering the opportunity to mitigate any potential penalty later imposed.

Questions

- 4.1 What is the appropriate consequence for a failure to report breaches to ASIC?
- 4.2 Should a failure to report be a criminal offence? Are the current maximum prison term and monetary penalty sufficient deterrents?
- 4.3 Should a civil penalty regime be introduced?
- 4.4 Should an infringement notice regime be introduced?
- 4.5 Should the self-reporting regime include incentives such as that outlined above? What will be effective to achieve this? What will be the practical implications for ASIC and licensees?

8. CONTENT OF BREACH REPORTS

72. While there is a requirement to report breaches, there is no prescribed form in which to provide reports. Accordingly, the information contained in reports is determined by the AFS licensee and may not always be sufficient to enable ASIC to properly assess the breach. ASIC has suggested Form FS80 *'Notification by an AFS licensee of a significant breach of a licensee's obligations'* on its website, however, it is not uniformly used and is not compulsory.
73. The varying quality and comprehensiveness of breach reports provided by AFS licensees means that ASIC is often not provided with enough information in order to assess and action a breach. This necessitates further inquiries by ASIC, which in turn increases the length of time taken to consider and deal with the breach report. Further, there is no obligation on AFS licensees to provide relevant supporting documentation with the breach report. ASIC's information gathering powers of course, can address some gaps in information initially provided by licensees, but only if the information is accessible to licensees at the time of issue of the notices. From the perspective of licensees however, it is often difficult to gather quickly all of the information needed to assess and report to ASIC within the 10 business day limit, especially if fraud or deliberate concealment of information by the person responsible for the conduct has occurred.
74. This highlights a key tension between the regulatory or enforcement aims of the regulator and the difficulties for licensees in trying to marshal all necessary information within the statutory timeframe and to form a clear view whether there has in fact been a breach or not and its significance. Although it may appear paradoxical, an approach which allows licensees time to marshal information before reporting could shorten the investigative process from ASIC's perspective and lead to swifter outcomes.

POSITION 8: PRESCRIBE THE REQUIRED CONTENT OF REPORTS UNDER SECTION 912D AND REQUIRE THEM TO BE DELIVERED ELECTRONICALLY

75. In a number of other reporting regimes under the Act, documents are required to be lodged with ASIC in a “prescribed form”. This means that the lodged form must either be in a form prescribed in the regulations or a form approved by ASIC⁴¹. The Taskforce considers that the efficiency and usefulness of the reporting process may be enhanced if a report had to:
- 75.1. be lodged with ASIC electronically in machine readable form to allow for some automated analysis of reports;
 - 75.2. be lodged in a prescribed form; and
 - 75.3. include information and supporting documents required by the form.
76. While specific information should be provided in the prescribed form there should also be sufficient flexibility to allow AFS licensees to supplement the information provided to ensure that ASIC receives all relevant information and contextual background.
77. The requirement for electronic delivery would assist ASIC in processing the larger volume of reports that is likely to result from the changes to the reporting regime referred to above.
78. Further, the increase in reports in combination with electronic lodgement will enable ASIC to more readily identify trends, problem areas or vulnerabilities in the financial services industry. For transparency, ASIC could publish on a periodic basis aggregate self-reporting information received from AFS licensees, identifying types and number of breaches by industry sectors (without identifying individual licensees).

Questions

5.1 Is there a need to prescribe the form in which AFS licensees report breaches to ASIC?

5.2 What impact would this have on AFS licensees?

9. NO EQUIVALENT REGIME FOR CREDIT LICENSEES

79. Currently, the *National Consumer Credit Protection Act 2009* (Cth) (National Credit Act) does not impose an equivalent reporting obligation on credit licensees. It is understood that the main reason for this was to reduce the range of new obligations placed on credit licensees following the introduction of the regime. Instead the National Credit Act introduced a different obligation requiring credit licensees to lodge an annual compliance certificate (Compliance Certificate) with ASIC, discussed further below⁴².

⁴¹ Section 350 of the Act.

⁴² Section 53 of the National Credit Act.

9.1 Credit licensees have an obligation to monitor compliance with general conduct obligations

80. Currently credit licensees are required, by way of general conduct obligations under section 47 of the National Credit Act, to put in place and maintain adequate compliance arrangements and systems to ensure that they comply with the National Credit Act and the conditions of their credit licence. A credit licensee which fails to comply with the law or their licence conditions may not be meeting their general conduct obligations.
81. ASIC's view is that credit licensees are required to have in place adequate measures to monitor compliance, detect breaches and address issues of non-compliance. Regulatory Guide 204 *Applying for and varying a credit licence* (RG204) states that when applying for a credit licence, applicants are required to confirm that they have in place, and will maintain, adequate compliance arrangements and systems, including whether⁴³:
- 81.1. they have a written plan documenting their arrangements and systems;
 - 81.2. the arrangements specify how often compliance with procedures is monitored and reported on; and
 - 81.3. there are people internal to the business responsible for ongoing monitoring and reporting.
82. Regulatory Guide 205 *Credit licensing: general conduct obligations* (RG205) sets out ASIC's expectations regarding how credit licensees will comply with the general conduct obligations under section 47 of the National Credit Act. It states :
- "...in some instances, your monitoring and reporting will be built into your business processes. We also acknowledge that your compliance measures might reflect your business's overall approach to compliance. Whatever the case, you need to be able to show us how you are able to monitor your compliance and appropriately address any compliance breaches."⁴⁴*
83. While the obligations on credit licensees are an important way of influencing licensee conduct, unlike the position with AFS licensees and responsible entities, they are not supported by any self-reporting obligation in respect of breaches. Given the overlap between the credit and financial services regimes (for instance, it is common for financial products to be acquired using some form of credit), and the need for correct and timely advice to be provided to retail consumers under both regimes as to the nature of each product and the risks of being involved with each, there is an argument for imposing a similar obligation upon credit licensees to self-report significant or material breaches in lieu of, or in addition to, the current annual compliance certificate requirement for credit licensees.

9.2 Annual Compliance Certificate

84. Section 53 of the National Credit Act requires credit licensees to lodge a Compliance Certificate with ASIC on an annual basis. The Compliance Certificate enables ASIC, in a rudimentary way, to monitor compliance with the general conduct obligations. When completing the Compliance Certificate, credit

⁴³ RG204.226.

⁴⁴ Paragraph 205.37.

licensees are required to answer a series of questions including whether they have adequate arrangements in place to meet their general compliance obligations.

85. RG205.35 states:

"To comply with this obligation [to lodge a Compliance Certificate], we expect that you will need to keep records of your monitoring and reporting, including records of reports on compliance and non-compliance".

86. The Compliance Certificate regime is not a ready substitute for the self-reporting obligation that AFS licensees are subject to because:

86.1. The information in the certificate is high level, generalised information;

86.2. ASIC is not able by reason of this to test the veracity of credit licensee responses in certificates without undertaking surveillance or issuing notices to obtain additional information;

86.3. Credit licensees are not required to provide details of any negative response to enable ASIC to assess whether a breach has occurred, what it entails, whether it is significant or not, the effects (if any) on consumers or the adequacy of the licensee's remedial action, if any were taken. ASIC will often ask for this information once the Compliance Certificate is lodged;

86.4. The lack of detail may encourage a "tick-box" approach to compliance, rather than focus credit licensees upon identifying systemic risks or issues; and

86.5. There is no obligation to provide to ASIC information about breaches in a timely way as certificates are only required annually.

87. One option for improving the quality of information reported is to align the credit reporting regime with the financial services reporting regime so that both are subject to the same test for self-reporting.

9.3 Other reporting practices in relation to credit licensees

88. ASIC currently receives information about possible significant failures to comply with the National Credit Act from the following sources:

88.1. Self-reporting by a small number of credit licensees voluntarily;

88.2. Competitor reports of misconduct from credit licensees about other credit licensees (particularly in relation to persons providing false information to support applications for credit by their clients); and

88.3. Anonymised (generally) reports of possible systemic problems that are identified as a result of clients or customers activating external dispute resolution schemes (EDR Schemes).

89. More information on each of these sources is set out below.

Self-reporting

90. Although credit licensees are not required to lodge breach reports, ASIC has received a small number of reports from licensees self-reporting compliance breaches. However, self-reporting is inconsistent and not comprehensive.

91. In contrast, ASIC received 1,162 breach reports in the 2015-16 financial year from AFS licensees which dealt with generally more significant issues.

Reports of misconduct

92. ASIC receives competitor reports of misconduct from credit licensees. This kind of reporting however, is also voluntary and inconsistent. Any extension of the breach reporting regime to credit licensees would not require licensees to report this type of conduct to ASIC, as the focus of such a requirement would still be on each licensee's own business and compliance. However, it is possible that this form of voluntary reporting may increase as there would be greater awareness of and sensitivity to breach identification as a by-product of requiring credit licensees to self-report breaches.

EDR Scheme reports

93. Finally, ASIC receives information about compliance breaches from the operators of EDR Schemes. All credit licensees are required to be members of an ASIC approved EDR scheme and operators are required to report systemic breaches to ASIC⁴⁵. Since 1 January 2015, 53 such notifications were made to ASIC. 14 were confirmed as systemic issues, 23 were confirmed as potential systemic issues and 16 were reports of serious misconduct. Of these, six were accepted as referrals for the commencement of regulatory action, eight were accepted as referrals of information to assist existing investigations or surveillance, three were merged with other reports and 36 were marked as "no further action". The reports covered a wide range of organisations, but most commonly involved payday lenders and finance brokers⁴⁶.

POSITION 9: INTRODUCE A SELF-REPORTING REGIME FOR CREDIT LICENSEES EQUIVALENT TO THE REGIME FOR AFS LICENSEES UNDER SECTION 912D OF THE CORPORATIONS ACT

94. The Taskforce adopts the preliminary view that the self-reporting regime under section 912D of the Act should be extended to credit licensees. This will extend the benefits outlined above to the credit industry.
95. ASIC would be informed of compliance issues in a more consistent and timely manner. It will also be provided with information that will enable it to assess the nature of the breach, the adequacy of the credit licensee's response and whether any further regulatory action should be taken against the licensee.
96. As credit licensees are currently expected to identify breaches and to maintain records of non-compliance, reporting compliance breaches to ASIC should not add significantly to the compliance obligations of credit licensees. However, it is also noted that as a higher proportion of credit licensees are sole traders or one person companies, the compliance burden of self-reporting may be relatively higher for credit licensees as compared with AFS licensees.
97. Some of the increased compliance burden could be offset by making Compliance Certificates less onerous to complete (for example, by removing questioning around the adequacy of the licensee's

⁴⁵ This is also the case for AFS licensees.

⁴⁶ Data supplied by ASIC.

compliance arrangements). However, as the Compliance Certificate serves additional purposes, such as providing information upon which a credit licensee's annual fee is calculated, the requirement to lodge a Compliance Certificate should not be removed.

Questions

6.1 Should the self-reporting regime for credit licensees and AFS licensees be aligned?

6.2 What will be the impact on industry?

10. ADDITIONAL ISSUES

POSITION 10: ENSURE QUALIFIED PRIVILEGE CONTINUES TO APPLY TO LICENSEES REPORTING UNDER SECTION 912D

98. If any changes are made to self-reporting content and process requirements, section 1100A of the Act may need to be reviewed to ensure qualified privilege continues to be provided to AFS licensees reporting to ASIC under section 912D. This would ensure licensees are protected from third party liability when making reports in good faith pursuant to the requirements of the regime.

POSITION 11: REMOVE THE ADDITIONAL REPORTING REQUIREMENT FOR RESPONSIBLE ENTITIES

99. Section s601FC(1)(l) of the Act imposes an additional self-reporting obligation on responsible entities of managed investment schemes.⁴⁷ Breaches of the Act that relate to the relevant scheme and have had or are likely to have a materially adverse effect on the interests of members of the scheme must be reported by a responsible entity as soon as practicable after it becomes aware of the breach.
100. The trigger and time frame for reporting are different from those in section 912D of the Act. Generally, a breach that is required to be reported under s601FC(1)(l) would, in most circumstances, also need to be reported under section 912D. However, a breach that must be reported under s912D would not necessarily need to be reported under s601FC(1)(l).
101. This creates additional and unnecessary complexity and regulatory burden. An option that would streamline the self-reporting regime for responsible entities would be to remove the self-reporting obligation in section 601FC(1)(l) so that all breaches by responsible entities are self-reported under section 912D of the Act.
102. If this option was adopted it may be appropriate to incorporate the threshold for reporting in s601FC(1)(l) (material adverse effect on the interests of members/consumers) within the factors for significance in section 912D.

Questions

7.1 Should the self-reporting regime for responsible entities be streamlined?

⁴⁷ This obligation has been in place since the introduction of Chapter 5C of the Act in 1998, and before the imposition of the obligation in section 912D of the Act that applies to all financial services license

7.2 Is it appropriate to remove the separate self-reporting obligation in section 601FC? If so, should the threshold for reporting be incorporated in the factors for assessing significance in section 912D?

POSITION 12: REQUIRE ANNUAL PUBLICATION BY ASIC, OF BREACH REPORT DATA FOR LICENSEES

103. The Taskforce has noted the Coleman Report's recommendation 9 – regarding annual publishing of breach report and other data, including names of those 'guilty of misconduct in the provision of financial services'. For the reasons outlined in the Executive Summary, the Taskforce does not support the public naming of individuals based solely on breach reporting.
104. ASIC includes aggregate breach report data in its annual reports including the amount of breaches reported to ASIC (which, if the reforms outlined in this paper are adopted, is likely to increase substantially). In addition, ASIC's annual reports also contain data on the number of criminal convictions, civil actions, amounts of fines or civil penalties imposed, and administrative actions such as banning of individuals, in respect of misconduct in financial services. In respect of convictions and civil action, as well as bannings, the names of culpable individuals are published by ASIC in one form or another during the relevant year, including in media releases and ASIC's six-monthly enforcement reports⁴⁸. ASIC also reports on its current Wealth Management Project⁴⁹ in its enforcement and annual reports, which includes information about the categories of gatekeeper against whom enforcement action was taken and highlight examples of conduct targeted during the relevant period.
105. The existing ASIC reporting framework could be supplemented, however, by publication of firm or licensee level breach reporting data.⁵⁰ This addresses the substance of the concerns of the Coleman Report regarding enhancing accountability and providing an incentive for improved behaviour, and provides a more appropriate balance between the need for procedural fairness and the need to preserve the integrity of investigative processes. It would also enable licensees to compare their performance against others, and assist both ASIC and licensees to identify any concerning trends in compliance.

⁴⁸ See <http://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-enforcement-outcomes/>

⁴⁹ The ASIC Wealth Management Project was established in October 2014 with the objective of lifting standards in major financial advice providers. Under this project ASIC is undertaking a number of investigations and a range of proactive risk-based surveillances with particular focus on compliance in large financial institutions.

⁵⁰ The Taskforce notes that some jurisdictions have regimes for public reporting of complaints data. For example, in the United Kingdom firms reporting 500 or more complaints are named in Financial Conduct Authority reports, although the UK does not appear to require public reporting of breach data at a firm level. (FCA Handbook DISP 1.10 Complaints reporting rules and DISP 1.10A Complaints data publication rules.) The Consumer Finance Protection Bureau in the United States publishes every complaint made by consumers to the regulator, including narratives from consumers. In Australia, the Office of Fair Trading in NSW publishes consumer complaint data.

106. The Taskforce's initial view is that this reporting should be confined to significant breaches, and should be at the licensee level, but could extend to identifying the operational area of the licensee's organisation in which the breach occurred. This would assist in enabling industry and consumers to identify areas where significant numbers of breaches are occurring and provide licensees with an incentive to improve their compliance outcomes in those areas.
107. This information would probably be most useful in respect of licensees reporting significant numbers of breaches, so could be subject to a threshold based, for example, on the total number of breaches reported by the licensee for the relevant year.

Questions

8.1 What would be the implications for licensees of a requirement for ASIC to report breach data at the licensee level?

8.2 Should ASIC reporting on breaches at a licensee level be subject to a threshold? If so, what should that threshold be?

8.3 Should annual reports by ASIC on breaches include, in addition to the name of the licensee, the name of the relevant operational unit within the licensee's organisation? Or any other information?

ANNEXURE A – SELF-REPORTING REGIMES IN OTHER JURISDICTIONS

Self-reporting in the United Kingdom

108. The United Kingdom's Financial Conduct Authority (**FCA**) supervises and monitors authorised firms' compliance with the FCA's regulatory obligations. The FCA relies on regular notifications and regulatory reporting by firms to fulfil its supervisory role.
109. When considering the regime for notifications to the FCA, it is important to bear in mind that the FCA has significant rule making powers.⁵¹ The FCA Handbook contains the complete record of FCA Legal Instruments. All regulated firms must comply with the rules set out in the Handbook. Civil action can be taken in response to breaches of the rules. The FCA can also take action in response to breaches of the Principles for Businesses.
110. Principle 11 of the Handbook's Principles for Businesses requires a firm to deal in an open and cooperative way with regulators and to disclose to its regulators anything relating to the firm of which the regulator would reasonably expect notice.
111. Chapter 15 of the Handbook deals with notifications that firms must make to the FCA. It provides guidance on matters to be reported in accordance with Principle 11 and in addition sets out specific events or circumstances that require immediate reporting to the FCA or reporting within a specified timeframe.
112. Events or changes in conditions that firms should consider notifying in accordance with Principle 11 include:
 - 112.1.any proposed restructuring, reorganisation or business expansion that could have a significant impact on the firm's risk profile or resources;
 - 112.2.any significant failure in the firm's systems or controls; and
 - 112.3.any action that would result in a material change in the firm's capital adequacy or solvency.⁵²
113. Significance is not defined for the purposes of these notifications, although the overriding requirement of Principle 11 is to notify the FCA of anything relating to the firm of which the regulator would "reasonably expect" notice. The period of notice depends on the event although the FCA expects a firm to discuss the relevant matters at an early stage and before making internal or external commitments.⁵³
114. Events that have a serious regulatory impact require immediate notification to the FCA once the firm becomes aware or has information that reasonably suggests that the event has occurred, may have occurred or may occur in the foreseeable future and include:
 - 114.1.breaches of the FCA/PRA rules or UK/EU laws and regulations;⁵⁴
 - 114.2.civil, criminal or disciplinary proceedings against a firm;⁵⁵

⁵¹ Although note that ASIC does have some rule making powers in relation to license conditions and class orders.

⁵² SUP 15.3.8

⁵³ SUP 15.3.9.

⁵⁴ SUP 15.3.11R.

- 114.3.fraud, errors and other irregularities that are significant events, including suspected misconduct by employees;⁵⁶ and
- 114.4.insolvency, bankruptcy or winding up of a firm.⁵⁷
115. Immediate notification of breaches of rules, laws or regulations includes a requirement to notify of the following:
- 115.1.a significant breach of a rule; or
- 115.2.a significant breach of any requirement imposed by the Consumer Credit Act (CCA) or Act, regulations or orders made under the CCA or the Companies Act;
- 115.3.a breach of any requirement imposed under the *Financial Services & Markets Act 2000* or regulations or order made under that Act,
- by the firm, its directors, officers, employees, approved persons or appointed representatives.
116. Significance is determined having regard to potential financial losses to the firm or customers, frequency of the breach, implications for systems and controls and delays in identifying or rectifying the breach.⁵⁸
117. A firm must make a notification that includes specified information⁵⁹ immediately once it becomes aware or has information that reasonably suggests that any of the matters identified has occurred, may have occurred or may occur in the foreseeable future.
118. While it is the case that only breaches that are significant need to be notified the discretion afforded to firms about making a notification and when to notify is more limited than that provided in the Australian context as a firm must make the notification as soon as it has information that reasonably suggests that a significant breach has or may have occurred or may occur.
119. Authorised firms must also submit a number of periodic reports that may be monthly, quarterly, half yearly or annually. Reporting requirements differ according to the firm's regulated activity group. Relevantly, annual reporting is required about disciplinary action taken against employees, discussed further below.
120. Section 64C of the Financial Services and Markets Act 2000 requires firms to submit information about disciplinary action taken or commenced against staff as a result of a breach of one or more rules of conduct⁶⁰. This requirement came into force as part of the updated Senior Managers & Certification Regime in March 2016. That regime also introduced (amongst other things) new Code of Conduct Rules that provide for:

⁵⁵ SUP 15.3.15R.

⁵⁶ SUP 15.3.17R.

⁵⁷ SUP 15.3.21R.

⁵⁸ SUP 15.3.12G

⁵⁹ SUP 15.3.14G.

⁶⁰ See s64A of the Financial Services and Markets Act 2000 and SUP15.11.1 and SUP15.11.2.

120.1. Individual Conduct Rules that apply to all employees, including individuals in Senior Management Function⁶¹ (SMF) roles (apart from ancillary staff); and

120.2. additional Senior Manager Conduct Rules that apply to individuals in SMF roles.

121. When initially enacted this requirement required annual reporting of known and suspected breaches of rules of conduct by employees. However, this was later modified to a requirement to report disciplinary action taken or commenced.⁶² The FCA stated that this would result in 'streamlined' reporting requirements.⁶³

122. Generally notifications under s64C relating to individuals in SMF roles will need to be made to the FCA within 7 days of becoming aware of relevant information.⁶⁴ Notification of disciplinary action relating to other employees must be made annually in a prescribed form.⁶⁵ The first reporting window was between September and October 2016 for disciplinary action taken or commenced between 7 March and 31 August 2016.

123. When considering whether to make a notification pursuant to section 64C of the Act, a firm should also consider whether a notification should be made under any other notification rules, including, any rules that require a notification to be made to the PRA, Principle 11 and immediate notification of breaches of the FCA/PRA rules or UK/EU laws and regulations.⁶⁶

124. Another specific form of notification relating to employees is a requirement to make notifications about complaints and compensation paid in relation to employees who are retail investment advisers. A firm must notify the FCA in an approved form where:

124.1. It has upheld three complaints relating to the activities of a retail investment adviser within 20 business days of upholding the third complaint; or

124.2. It has upheld a complaint and the redress paid exceeds £50,000 within 20 business days of upholding the complaint.⁶⁷

Self-reporting in the United States

125. The Financial Industry Regulatory Authority (FINRA) is an independent, not-for-profit organisation authorised by United States Congress to protect investors by making sure the broker-dealer industry operates fairly and honestly. FINRA's mission is to ensure investor protection and market integrity. It does this by:

125.1. writing and enforcing rules governing the activities of broker-dealers and brokers;

⁶¹ Senior management functions are specified by the FCA and the Prudential Regulatory Authority.

⁶² Section 64B(5) of the *Financial Services and Markets Act 2000*, which required firms to report known and suspected breaches of rules of conduct, was repealed before it came into force. Significant rule breaches must still be notified in accordance with SUP15.3 discussed above.

⁶³ FCA, Consultation Paper CP16/1 'Consequential changes to the Senior Managers Regime', January 2016 para 1.2.

⁶⁴ SUP 15.11.12 G and 10C.14.18 R.

⁶⁵ SUP 15.11.13 R.

⁶⁶ SUP 15.3.11R.

⁶⁷ SUP 15.12 1 Ongoing alerts for retail adviser complaints

- 125.2. examining firms for compliance with those rules and disciplining those who break the rules;
- 125.3. detecting and preventing wrong doing in United States markets;
- 125.4. educating investors; and
- 125.5. resolving securities disputes.

126. FINRA Rule 4530 requires firms to:

- 126.1. report specified events⁶⁸;
- 126.2. report quarterly statistical and summary information regarding written customer complaints⁶⁹;
- 126.3. file copies of specified criminal actions, civil complaints and arbitration claims⁷⁰.

127. Specified events and customer complaint information must be electronically reported via the Firm Gateway and copies of actions, civil complaints and arbitration claims may be filed by mail, email or online.

128. Rule 4530 sets out in detail the events, circumstances and information that must be reported and the time frames for reporting. Additional guidance is also provided in Regulatory Notices and Frequently Asked Questions⁷¹.

129. The specified events required to be reported include, where the member or an associated person of the member:

- 129.1. has been found by an external body (such as a court, domestic or foreign regulator, self-regulatory, business or professional organisation) to have violated any securities, insurance, commodities, financial or investment related laws, rules, regulations or standards of conduct;
- 129.2. is the subject of a written customer complaint involving allegations of theft, misappropriation or forgery;
- 129.3. is named as a defendant or respondent in any proceeding brought by a regulatory body or self-regulatory organisation alleging violation of the Exchange Act or any other federal, state or foreign statute, rule or regulation relating to securities, insurance or commodities;
- 129.4. is denied registration or membership, or is expelled or otherwise disciplined by any securities, insurance or commodities industry domestic or foreign regulator or self-regulatory organisation;
- 129.5. is indicted, convicted, pleads guilty or pleads no contest to any felony or any misdemeanor that involves a range of specified conduct including the purchase or sale of a security, fraudulent and criminal conduct;
- 129.6. has a role in or is associated with a broker, dealer, investment company or adviser, underwriter or insurance company that was suspended, expelled or had its registration denied or revoked by a domestic or foreign regulator or self-regulatory organisation;

⁶⁸ Rule 4530(a) and (b).

⁶⁹ Rule 4530(d)

⁷⁰ Rule 4530(f).

⁷¹ Regulatory Notice 11-10, Regulatory Notice 11-32 and Rule 4530 Frequently Asked Questions (<http://www.finra.org/industry/faq-rule-4530-frequently-asked-questions>)

129.7.is a defendant or respondent in civil proceedings that is disposed of by judgment, award or settlement exceeding \$15,000 in the case of an associated person and \$25,000 in the case of a member;

129.8.is subject to a statutory disqualification or is involved in financial services activities with a person that is the subject of a statutory disqualification;

129.9.certain disciplinary action taken by the member against an associated person⁷².

130. The trigger for reporting the above events is when the members knows or should have known of the existence of the event. Reports must then be made promptly and not later than 30 calendar days.

131. In addition to the specified events set out in 129.1 above members must report if the member concludes or reasonably should have concluded that an associated person or the member itself has violated any securities, insurance, commodities, financial, investment or investment related laws, rules or regulations, standards of conduct⁷³. However, not every violation is reportable and the following materiality thresholds are applied:

131.1.in the case of a member conduct must be reported if it has widespread or potential widespread impact to the member, customers or the markets or the conduct that arises from a material failure of systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts;

131.2.in the case of associated persons conduct must be reported if it has widespread or potential widespread impact to the member, customers or markets, or there are multiple instances of violative conduct.⁷⁴

132. The reporting requirement is only triggered when the member has concluded or reasonably should have concluded that laws have been violated and the violation meets the threshold for reporting. The member is not required to when it becomes aware of a potential violation or while it is gathering the available facts to determine whether a violation has occurred and the violation meets the reporting threshold.⁷⁵

133. FINRA applies an objective standard when determining whether a violation should have been reported and states as follows:

“FINRA will apply a “reasonable person” standard to determine whether a violation should have been reported. If a reasonable person, considering the available facts, would have concluded that a violation meeting the reporting thresholds occurred, then the matter would be reportable.”⁷⁶

Self-reporting in Hong Kong

134. The Securities and Futures Commission (**SFC**) is the independent statutory body charged with regulating securities and markets in Hong Kong. The SFC typically becomes aware of information suggesting

⁷² Rule 4530(a).

⁷³ Rule 4530(b).

⁷⁴ Rule 4530.01.

⁷⁵ Rule 4530 Frequently Asked Questions see response to question 1.2.

⁷⁶ Ibid.

market misconduct through self-reports made by licensed or registered persons under the 'Code of Conduct for Persons Licensed or Registered with the Securities and Futures Commission' (**HK Code**).

135. The SFC has specific power to publish codes of conduct to give guidance relating to the practices and standards with which intermediaries and their representatives are expected to comply.⁷⁷ Failure to comply with a code does not itself render a person or firm liable to judicial or other proceedings, but the SFC may take this into account when considering whether a licensee is a fit and proper person to remain licensed or registered.⁷⁸ If a licensee is found not to be fit or proper, the SFC can impose one or more sanctions including revocation or suspension of licence and a fine.⁷⁹ Breaching a self-reporting obligation under the HK Code can therefore ultimately lead to disciplinary action.
136. Licensed and registered persons have a duty to self-report any suspected regulatory contraventions to the SFC. There is a requirement to notify the SFC upon the happening of any one or more of the following:⁸⁰
- 136.1.any material breach, infringement of or non-compliance with any law, rules, regulations, and codes administered or issued by the SFC, the rules of any exchange or clearing house and the requirements of any regulatory authority, or where it suspects any such breach, infringement or non-compliance whether by itself or persons it employs or appoints to conduct business;
 - 136.2.the passing of any resolutions, the initiation of any proceedings, or the making of any order which may result in the appointment of a receiver, provisional liquidator, liquidator or administrator or the winding-up, re-organisation, reconstruction, amalgamation, dissolution or bankruptcy of the licensed or registered person or any of its substantial shareholders or the making of any receiving order or arrangement or composition with creditors;
 - 136.3.the bankruptcy of any of its directors;
 - 136.4.the exercise of any disciplinary measure against it by any regulatory or other professional or trade body or the refusal, suspension or revocation of any regulatory licence, consent or approval required in connection with its business;
 - 136.5.any material failure, error or defect in the operation or functioning of its trading, accounting, clearing or settlement systems or equipment;
 - 136.6.any material breach, infringement or non-compliance of market misconduct provisions set out in Part XIII or Part XIV of the Securities and Futures Ordinance that it reasonably suspects may have been committed by its client; and
 - 136.7.any determination or settlement of a complaint in connection with the Financial Dispute Resolution Scheme.

Self-reporting in Singapore

137. The Monetary Authority of Singapore (**MAS**) regulates the financial services sector in Singapore. In 2010, the MAS issued the 'Notice on Reporting of Misconduct of Representatives by Financial Advisers'

⁷⁷ Securities and Futures Ordinance (Cap. 571), section 169(1).

⁷⁸ Securities and Futures Ordinance (Cap. 571), section 169(4).

⁷⁹ Securities and Futures Ordinance (Cap. 571), section 194.

⁸⁰ The HK Code, paragraph 12.5.

(the Notice) which sets out the responsibilities and reporting requirements of financial advisers for the misconduct of their representatives.

138. The MAS has the power to issue written directions, including circulars or notices, to financial advisers generally or in relation to a specific adviser, where it thinks it necessary or expedient in public interest or for the protection of investors.⁸¹ Failure to comply with any requirement under a written direction is an offence liable on conviction to a fine.⁸²
139. The MAS' approach is that financial institutions are primarily responsible for supervising the conduct of their staff. In particular, financial institutions have a duty to ensure that their representatives conduct themselves in accordance with all applicable regulatory requirements.⁸³
140. In the event of misconduct by a representative, the financial institution is required to investigate the facts and circumstances of that misconduct, and submit a report to MAS. A financial adviser is required to report to the MAS upon discovery of any of the following types of misconduct:⁸⁴
 - 140.1. acts involving fraud, dishonesty or other offences of a similar nature;
 - 140.2. acts involving inappropriate advice, misrepresentation or inadequate disclosure of information; and
 - 140.3. failure to satisfy the guidelines on fit and proper criteria.
141. There is also a requirement to report any other type of misconduct resulting in:⁸⁵
 - 141.1. a non-compliance with any regulatory requirement to the provision of any financial advisory service under the Financial Advisers Act; and
 - 141.2. a serious breach of the financial adviser's internal policy or code of conduct which would render the representative liable to demotion, suspension or termination of the representative's employment or arrangement with the financial adviser
142. The financial adviser must submit a Misconduct Report in the appropriate form to the MAS no later than 14 days after the discovery of the misconduct. If there is no Misconduct Report a financial adviser is required to report for the calendar year, the financial adviser must submit to the MAS a declaration to that effect no later than 14 days after 31 December of that calendar year.⁸⁶
143. Where necessary, the financial institution is also expected to take appropriate disciplinary action against a representative found guilty of misconduct. The type of disciplinary action that can be taken includes:⁸⁷
 - 143.1. suspension from providing any financial advisory service;

⁸¹ Financial Advisers Act (Cap. 110), section 58.

⁸² Financial Advisers Act (Cap. 110), section 58(5).

⁸³ Capital Markets Enforcement Monograph, Monetary Authority of Singapore, January 2016, p 14.

⁸⁴ Notice on Reporting of Misconduct of Representatives by Financial Advisers, paragraph 4(a) – (c).

⁸⁵ The Notice, paragraphs 4(d).

⁸⁶ The Notice, paragraphs 6 and 9.

⁸⁷ The Notice, paragraph 13.

143.2. restitution of misappropriated monies;

143.3. fine;

143.4. formal warning;

143.5. demotion; and

143.6. termination of the representative's employment or arrangement with the financial adviser.

144. The receipt of such information allows MAS to assess the need for formal sanctions against the individual involved. It also allows MAS to check that the financial institution implements relevant measures to prevent similar offences from recurring. Indeed, the MAS can take into account any information contained in a report submitted by a financial adviser under the Notice in exercising its powers or performing its functions under the Financial Advisers Act.⁸⁸

Self-reporting in Canada

145. The Financial Consumer Agency of Canada (FCAC) supervises financial institutions' compliance with consumer protection obligations and promotes increased financial literacy.⁸⁹ The Compliance and Enforcement Branch of the FCAC is responsible for supervising:

145.1. Federally Regulated Financial Entity (FRFE) compliance with consumer provisions set out in federal financial institution legislation;

145.2. payment card network operators; and

145.3. adherence by both types of entities to the various industry voluntary codes and public commitments.

146. The FCAC states that it expects FRFEs to forward reportable compliance matters, which include reportable complaints and reportable compliance issues, within specified timeframes.

147. A reportable complaint is a complaint involving a legislative provision, a voluntary code or a public commitment, that has been received by or forwarded to the designated reportable level, or higher, of the financial entity's complaint handling procedure⁹⁰. Reportable complaints are expected to be submitted to the Compliance and Enforcement Branch quarterly using specified reporting forms. Entities must submit a nil complaints form if there are no reportable complaints to report in the quarter.

148. A reportable complaint must be forwarded to FCAC even if:

⁸⁸ The Notice, paragraph 15.

⁸⁹ In addition to the FCAC: provincial and territorial regulators are responsible for securities and markets regulation, market supervision and regulation of financial advice; federal registration of companies is administered by Corporations Canada with provincial agencies registering other companies; and the Canadian Public Accountability Board deals with auditors.

⁹⁰ Federally regulated financial institutions are legally required to have a complaint-handling process in place for dealing with complaints made by consumers. The process must be made available to consumers in various ways and filed with the FCAC, which maintains a publicly accessible database of complaint-handling procedures.

148.1.the consumer has also contacted the FCAC

148.2.the consumer is satisfied with the outcome of the complaint

148.3.the complaint was received at the reportable level or higher but then sent to a lower level of the complaint-handling process for response or resolution

148.4.the complaint was received at a reportable level of the complaint-handling process and was resolved directly

148.5.the FRFE concluded that it had complied with its obligations to consumers.

149. A reportable compliance issue is a compliance deficiency that is a material or systemic issue that would normally be reported to the compliance division of the FRFE or captured in the regulatory compliance management process. This includes any material or systemic compliance deficiency relating to a legislative provision, a voluntary code or a public commitment that is monitored by FCAC.

150. A reportable compliance issue needs to be forwarded to FCAC even though:

150.1.the compliance matter has been addressed by the FRFE;

150.2.consumers were not financially affected;

150.3.an implementation plan for fixing the identified compliance matter is not yet in place.

151. Reportable compliance issues must be reported within 60 days of the compliance issue being identified, reported or received by an entity's compliance group. The FCAC records each reportable compliance issue in its tracking system.

ANNEXURE B – ASIC ENFORCEMENT REVIEW TASKFORCE TERMS OF REFERENCE

The Taskforce will review the enforcement regime of the Australian Securities and Investments Commission (ASIC), to assess the suitability of the existing regulatory tools available to it to perform its functions adequately.

The review will include an examination of legislation dealing with corporations, financial services, credit and insurance as to:

- The adequacy of civil and criminal penalties for serious contraventions relating to the financial system (including corporate fraud);
- The need for alternative enforcement mechanisms, including the use of infringement notices in relation to less serious contraventions, and the possibility of utilising peer disciplinary review panels (akin to the existing Markets Disciplinary Panel) in relation to financial services and credit businesses generally;
- The adequacy of existing penalties for serious contraventions, including disgorgement of profits;
- The adequacy of enforcement related financial services and credit licensing powers;
- The adequacy of ASIC's power to ban offenders from occupying company offices following the commission of, or involvement in, serious contraventions where appropriate;
- The adequacy of ASIC's information gathering powers and whether there is a need to amend legislation to enable ASIC to utilise the fruits of telephone interception warrants or to grant the equivalent of Federal

Crimes Act search warrant powers under ASIC's enabling legislation for market misconduct or other serious offences;

- The adequacy of ASIC's powers in respect of licensing of financial services and credit providers, including the threshold for granting or refusing to grant a license, the circumstances in which ASIC may vary, suspend, or cancel licenses; and its coercive powers (including whether there is a need for ASIC to have a power to direct licensees to take, or refrain from taking, particular action);
- The adequacy of the frameworks for notifying ASIC of breaches of law, including the triggers for the obligation to notify; the time in which notification is required to be made; and whether the obligation to notify breaches should be expanded to a general obligation (currently confined under the Corporations Act to auditors, liquidators, and licensees, and noting that obligations to report offences exist under other Federal or State statutes); and
- Any other matters, which arise during the course of the Taskforce's review of the above, which appear necessary to address any deficiencies in ASIC's regulatory toolset.

Upon completion of the Review, the Taskforce will identify any gaps in ASIC's powers and make recommendations to the Government which it considers necessary to strengthen any of ASIC's regulatory tools and as to the policy options available that:

1. address gaps or deficiencies identified in a way that allows more effective enforcement of the regulatory regime;
2. foster consumer confidence in the financial system and enhance ASIC's ability to prevent harm effectively;
3. do not impose undue regulatory burden on business, and promote engagement and cooperation between ASIC and its regulated population;
4. promote a competitive and stable financial system that contributes to Australia's productivity growth; and
5. relate to other matters that fall within this Terms of Reference.