

16 May 2017

ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ASICenforcementreview@treasury.gov.au

Dear Sir/Madam

SUBMISSION ON SELF REPORTING OF CONTRAVENTIONS BY FINANCIAL SERVICES AND CREDIT LICENSEES

This submission has been prepared by the Superannuation Committee of the Law Council's Legal Practice Section (**the Committee**).¹ The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee makes submissions and provides comments on the legal aspects of the majority of all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

Introduction

The Committee is pleased to have the opportunity to respond to the Australian Securities & Investment Commission (**ASIC**) Enforcement Review Position and Consultation Paper 1 entitled 'Self-reporting of contraventions by financial services and credit licensees' (11 April 2017). The Committee is guided by its objectives identified above and has only made comments below where the Committee has identified issues within its remit.

APRA breach reporting

The Committee acknowledges that paragraph 4 of the Taskforce's paper notes that

[t]he 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.

The Committee would like to emphasise that for such entities, changes to ASIC breach reporting should not be made without considering the existing regime for Australian Prudential Regulation Authority (**APRA**) reporting. The timing of any changes must be co-ordinated between the two regimes, or a transitional administrative solution developed by

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APRA to ensure that there is no ambiguity or difficulty in practice for compliance with the breach reporting regimes by these dual-regulated entities.

Positions 1 – 3: When is a report required and when does time start to run?

This section of the Committee's submission deals with the breach reporting obligation in s 912D of the Corporations Act and the proposed changes to that obligation.

In summary, on balance, the Committee does not object to the introduction of an objective element to the significance test and agrees with the imposition of an obligation to report significant breaches or significant misconduct by an employee in certain circumstances. However, the Superannuation Committee does not consider that the time limit for reporting significant breaches should be shorter than 10 business days nor extend to situations where a licensee has information that 'reasonably suggests' a breach has occurred.

Clarifying the significance test to ensure that it is determined objectively

The Committee notes that the current 'significance' test in s 912D (1) (b) is a cumulative test. As such, simply because a breach does not impact the licensee's ability to provide financial services does **not** mean that a breach is not significant where other factors for significance are present. In the Committee's experience, most licensees would deem a breach to be significant if at least two of the factors listed in s 912D (1) (b) are manifest.

That said, the Committee agrees that a one off incident that has not caused loss or potential loss and that has been detected through the licensee's own compliance arrangements would likely not be considered significant. The question to be asked is the benefit to the regulator of being notified of such breaches, since (except in cases involving significant misconduct by a representative – see below) it seems unlikely that the regulator would seek to intervene in such instances.

In this regard, it would seem that the only 'subjective' factor under s 912D (1) (b) is the impact of a breach on the licensee's ability to provide financial services, because this factor would tend to be more readily met in the case of smaller licensees and less readily met in the case of larger licensees. In the Committee's experience, the other factors tend to be applied objectively.

However, to clarify that the significance test is objective, the Committee would not object to the insertion of a requirement to report breaches that a 'reasonable person' would regard as significant, since this would reinforce an objective consideration of the significance factors. Additional regulatory guidance from the regulator could then provide examples.

Extend breach reporting obligation to include significant breaches or significant misconduct by an employee

The Committee can appreciate why the regulator would seek to be apprised of significant breaches or significant misconduct by a representative of the licensee, particularly in cases that would enable a banning order to be made. In our experience, these events are often reported to the regulator currently on a good governance basis. However, a formal notification obligation could clarify when reporting is required and assist in preventing so-called 'bad apple' financial advisers leaving the employment of one licensee only to continue poor conduct under the employ of another licensee.

If such an obligation were to be imposed, the Committee considers that the reporting obligation should be separate to significant breach reporting relating to the licensee and that the reporting criteria should be confined to circumstances that suggest serious

misconduct of the type that could result in a banning order against the individual. This would be important so that:

- the good faith and confidence between an employer and its employees is not impacted by an obligation to report behaviour that the licensee is able to rectify through its own disciplinary processes,
- a licensee's risk culture whereby employees are encouraged to 'speak up' is not counteracted by a fear of 'dobbing in' a colleague with potentially serious consequences for the individual; and
- licensees are not inadvertently encouraged to make a scapegoat of an individual employee where breaches occur due to the licensee's own systemic or cultural issues.

It is also important to recognise that the 'guilt' of an individual is not up to a licensee or even the regulator to determine. Rather, it is a matter for proper judicial process. Any reporting obligation to ASIC in respect of an individual employee therefore needs to serve purely as an indicator of a potential regulatory 'hotspot', rather than as an indictment of the individual employee concerned.

Delays in reporting

For the most part the Committee considers that the requirement to report breaches with 10 business days of becoming aware of the breach is appropriate. This timeframe allows licensees a period within which

1. to assess whether an incident is in fact a breach of financial services law; and
2. if so, to assess whether it is significant.

It is often necessary to gather more information in order to make the second assessment in particular. Most licensees require incidents to be immediately reported to the compliance officer and it is from the date of the compliance officer becoming aware of the breach that is taken as the commencement of the 10 business day period.

In the Committee's view it would impose an undue burden if licensees were required to report simply where there is information to reasonably suggest a breach. If that were the case, suspected breaches may need to be reported at stage 1, before the significance test has been applied. If it were then to transpire that the breach is not significant, the licensee would have unnecessarily completed a breach report resulting in a waste of resources for both the licensee and ASIC.

Rather than change the timeframe, the Committee submits that the regulator's expectations for when the 10 day period commences should be more firmly communicated.

Positions 4 – 7: Sanctions for failure to report

The following section of our submission deals with the topic of sanctions for a failure to report.

In summary, the Committee submits that a failure to report should not be an offence, the obligation to report should be a civil penalty provision, an infringement notice regime should not be introduced and the proposals to 'encourage a co-operative approach' are unlikely to make any real difference.

A failure to report should not be an offence

A failure to report is currently an offence and the Taskforce suggests that the associated penalties should be increased.

The Committee submits that a failure to report should not be an offence in the first place. Basic principles of justice require that a contravention of the law should not be an offence unless it is tolerably clear when a person will or will not contravene the law. The Committee submits that, as s 912D currently stands, it is not tolerably clear, in many cases, whether a licensee will contravene the section if the matter is not reported. The Committee further submits that, if position 3 is adopted and implemented, the question of whether a licensee will contravene the section will become even less clear. In the Committee's opinion, there is a very significant tension between, on the one hand, the Taskforce's identification of uncertainties attending the existing breach reporting obligation coupled with the additional uncertainties that implementing position 3 would introduce and, on the other hand, the Taskforce's suggestion that a failure to report should not only remain an offence but that the penalties should be increased.

The Taskforce speculates that the current level of penalties (which, as mentioned, it considers to be low) stems from an 'unwillingness by the legislature to truly criminalise conduct that is inherently reliant upon judgment calls'. If the Taskforce's speculation is correct, then the Committee shares the legislature's concern. However, the Committee would go further – the concern provides grounds not just for not increasing the penalties but also for decriminalising conduct that should not have been criminalised in the first place.

The Committee recognises that the obligation to report a significant breach is a core duty of an Australian Financial Services (AFS) licensee. However, the obligations set out in s 912A are also core duties of an AFS licensee and a contravention of s 912A is not an offence. It is not clear to the Committee why a contravention of s 912D should be an offence when a contravention of s 912A is not.

The obligation to report should be a civil penalty provision

The Taskforce suggests that the obligation to report should be a civil penalty provision. The Committee agrees.

A civil penalty regime aims to find a middle ground between making a contravention an offence, on the one hand, and limiting a contravention to having purely civil consequences, on the other. The civil penalty regime is a tried and tested regime in the context of director's duties. A body of law has emerged, reflecting an appropriate balance between the rights of the person who is alleged to have committed the contravention and the interests of other parties and the public generally in the matter.

The Committee acknowledges that s 912A is not a civil penalty provision. The Committee does not express any view on whether it should be. The Committee's recommendation is limited to s 912D and it complements the Committee's view that a contravention of s 912D should not be an offence.

An infringement notice regime should not be introduced

As a general proposition, the Superannuation Committee does not favour infringement notice regimes. They give the regulator the power to impose a fine when they suspect the regulated entity has breached the law and an incentive for the regulated entity to pay despite having not in fact breached the law.

The Committee's general predisposition against infringement notice regimes extends to the Taskforce's suggestion that such a regime should be introduced in respect of the reporting obligation. If the Taskforce's suggestion was adopted, ASIC could ask a licensee to pay a fine because they did not report what ASIC thinks might have been a suspicion that there may have been a breach and, it is very possible that, in that case, the licensee will pay a fine for failing to report something that may not have been reportable and where there was in fact no breach.

The proposals to 'encourage a co-operative approach' are unlikely to make any real difference

The Committee considers that the Taskforce's proposals to encourage a co-operative approach are unlikely to make any real difference because they do not materially add to the options available to ASIC today. A licensee is likely to find little comfort in the Taskforce's suggestion:

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.

Position 8: Breach reporting content and electronic delivery

The Taskforce's preliminary position 8 concerns the question whether the content of reports made under s 912D should be prescribed, and also whether those reports should be delivered electronically.

Prescribed content

The Superannuation Committee considers that it will be workable to have prescribed content requirements, but only provided that:

- The report is still able to be completed and lodged by a licensee and accepted as a valid report by ASIC notwithstanding that certain sections are inapplicable or irrelevant to the licensee or the breach. In other words, mandatory content which requires an answer to a question or a box to be ticked in order to progress to the next stage of the report can tend towards inflexibility without concomitant benefit. That is, it should be acknowledged that one prescribed form with mandatory content requirements would be almost impossible to develop so as to cater for every type of AFS licensee's circumstances and business and for every possible type of reportable breach. Therefore, the report should have sufficient flexibility so that 'Not applicable' for a short answer section or an 'Other' for a tick-box section should be built in. There should also be a facility for a free-form answer section so that any details or nuances not able to be appropriately captured by the set form can be added in by the licensee.
- Consideration should be given not only to consultation on the content of the report (whether based on the existing ASIC Form FS80), but also having a non-mandatory trial or pilot period whereby certain large licensees would be encouraged to complete the new form (perhaps on an 'if not, why not' basis) and provide feedback as to its design.

Also, the Committee notes the proposal in paragraph 75.3 of the Taskforce's paper which indicates the form may require the inclusion of information and supporting documents. The Committee suggests that there be sufficient flexibility allowed for later or separate

lodgement of such information and documents. That is, the Committee considers that regulatory outcomes may be compromised if the form cannot be lodged without the documents. It may be more important for the breach itself to be reported on the prescribed form in a certain basic format and at a certain required level of detail, but the supporting material to follow later as it can take licensees some time to compile complete information depending on the type of breach.

Specifically addressing the questions raised in the Taskforce's paper in relation to Position 8, the Committee responds as follows:

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

There is no need as such, but if ASIC takes the view that its regulatory functions would be better served by prescribing the form, then the Committee considers that would be workable for licensees subject to the comments already made above regarding flexibility.

Question 5.2 *What impact would this have on AFS licensees?*

The impact of a prescribed form would self-evidently be less flexibility for licensees because they will no longer be able to submit 'free form' reports which can be tailored to their circumstances and the circumstances of the particular breach. However, so long as the prescribed form builds in sufficient flexibility as outlined above, then this negative impact on licensees can probably be mitigated.

Electronic delivery

The Committee considers that it will be feasible to require the reports to be delivered electronically.

Position 10: Qualified Privilege

The Taskforce's preliminary position 10 concerns the question whether qualified privilege should continue to apply to licensees reporting under s 912D (having regard to the existing regime under s 1100A of the Act).

The Committee considers that there appears to be no reason why any enhancements to the existing mandatory reporting regime set out in the Taskforce's paper should cause a change to the existing qualified privilege regime (under s 1100A and the definition of 'qualified privilege' in s 89 of the Act). That is not to say that the existing qualified privilege regime is necessarily perfect and without need for review or reform; rather, the Committee can see no reason to change the current interaction between what must be reported under s 912D and the limited protections currently available.

Also, it must be noted that the qualified privilege regime relies on the concept of information which must be reported to ASIC. So any changes which may result in discretionary elements to the reporting should be considered against the limitations of s 1100A.

Accordingly, the Committee agrees with paragraph 98 of the Taskforce's paper that if any changes are made, s 1100A should be reviewed to ensure that licensees are protected from third party liability when making reports in good faith pursuant to the requirements of the breach reporting regime.

Position 12: Annual reporting of breach report data

The Taskforce's preliminary position 12 concerns the question whether ASIC should annually publish breach report data for licensees. Although the Superannuation Committee understands the benefits of transparency, it is concerned that such a measure will cause tension for licensees in deciding whether to report. That is, even with the insertion of a 'reasonable person' test into the significance assessment, there will still be an element of judgment involved and therefore publication of breaches could have a perverse effect on the decision to report borderline cases. However, if ASIC investigates a reported breach and then takes the matter further, the Committee considers that there would then be scope for ASIC to make the licensee's breaches public.

Specifically addressing the questions raised in the Taskforce's paper in relation to Position 12, the Committee respond as follows:

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

Naming of a licensee in an ASIC annual report covering breach reporting would inevitably have the effect of causing licensees to be overly cautious in making the decision whether to report a breach which could lead to under-reporting, as noted above.

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

If (contrary to the Committee's view) the reporting of breaches at a licensee level does proceed, the Committee considers that the most appropriate threshold would be the question whether ASIC action has been taken in relation to the breach. That is, naming the licensee in ASIC's annual report should occur only if the breach report leads to any regulatory action on ASIC's part. In this way, if a licensee reports a very minor matter which is technically caught by the reporting regime but ASIC is not concerned with in the end, then there will not be any naming in the ASIC annual report. This approach may reduce any tendencies toward under-reporting by licensees.

Question 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?*

No. The Committee considers that there would not be any particular utility achieved, either generally or in the administration of laws affecting licensees, if the ASIC annual report were to include the name of the relevant operational unit within the licensee's organisation. This is because those names can sometimes be opaque and inherently and frequently changeable particular within a large licensee's organisation. The corporate entity name of the licensee and the general topic or brief descriptor of the breach should be sufficient (e.g., 'insurance', 'financial advice', 'unit pricing').

Contact

The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:

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- Ms Lisa Butler Beatty, Deputy Chair, Superannuation Committee on (T) 0477 753 941 or at (E) BeattyLi@cba.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jonathan Smithers', written over a horizontal line that extends across the page.

Jonathan Smithers
Chief Executive Officer