



# **NATIONAL AUSTRALIA BANK SUBMISSION**

ASIC Enforcement Review: Position and  
Consultation Paper 1

26 May 2017

National Australia Bank (NAB) welcomes the opportunity to respond to the Australian Securities and Investments Commission (ASIC) Enforcement Review Taskforce's Position and Consultation Paper 1 (the Paper) on self-reporting of contraventions by financial services and credit licensees.

NAB is committed to working with the Taskforce in reviewing the breach reporting framework and supporting ASIC as a strong regulator. NAB recognises the value of a robust and timely breach reporting process. We take the view that enhancements can always be made in current processes, and look to continually review and assess for improvement opportunities, including through open dialogue with our regulators.

NAB is also participating in ASIC's Breach Reporting Project which, among other objectives, is seeking to complement contributions to law reform proposals, including updates to guidance, and how ASIC could better use data analytics. NAB anticipates the findings of that project will assist in the further development and implementation of the positions outlined in the Paper.

Our response to each of the positions outlined in the paper is set out below. NAB has also contributed to, and is supportive of, the Australian Bankers' Association (ABA) submission in respect of the Paper.

We look forward to engaging further with the Taskforce and with ASIC on this important topic to discuss how industry and its regulators can promote greater accountability, transparency and trust in the banking sector.

**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.**

NAB supports retaining the current 'significance test' in section 912D of the *Corporations Act 2001* (Cth) (**Corporations Act**), with a clarification to ensure that 'significance' is determined objectively. In NAB's view, a requirement to report breaches that a reasonable person would regard as significant is an appropriate trigger for the breach reporting obligation. Whilst the proposed revision to the significance test will still involve a considerable degree of judgment to be exercised by an Australian financial services licensee (Licensee), it may reduce ambiguity for some Licensees around the triggering of the obligation to report.

Any amending legislation should appropriately set out any deemed attributes of the 'reasonable person' and when that person would consider a breach significant. NAB suggests that the reasonable person be defined as a person in the position of the Licensee.

NAB would welcome the opportunity to be engaged in the consultation process for developing appropriate supporting regulatory guidance. NAB believes that guidance should be principles based. We do not support guidance which dictates the types of breaches that should always be reported; this approach may reduce the breach reporting regime's focus on ensuring that significant matters are reported to ASIC.

**Position 2: the obligation for licensees to report should expressly include significant breaches or other significant misconduct by an employee or representative.**

NAB supports a regulatory approach that enables ASIC to investigate and, where necessary, take timely action against individuals where this will assist to protect customers.

Currently, a breach by an employee representative is considered a breach by the Licensee, but a breach by an Authorised Representative may not give rise to a breach by the Licensee (for example if the Licensee's compliance framework has operated effectively and efficiently). The

introduction of a specific obligation on Licensees to report significant breaches or other significant misconduct by an individual (including employees, representatives, and Authorised Representatives) would reconcile these differences.

Where a significant breach involves an individual, Licensees are required to appropriately assess and verify the information available to them to determine whether misconduct has occurred. This is significant, as there is the potential for third party liability, where an Authorised Representative's livelihood may be adversely impacted by premature reporting of concerns.

In this regard NAB recommends the following:

- Any amending legislation should define 'significant misconduct' and 'significant breach' in the context of their application to an individual whose conduct is assessed for the purpose of section 912D, as the existing criteria for 'significance' are considered as they apply to the Licensee. This would help ensure a consistent and efficient process for reporting significant and material misconduct and may be necessary for Licensees to have the benefit of qualified privilege. Any definition of reportable 'significant misconduct' by an individual must have a relevant connection to the financial services provided under the Licensee's AFSL.
- NAB considers the obligation to report, in respect of individuals, should only be triggered where the conduct amounts to a significant breach in connection with the Licensee's obligations, to avoid a circumstance where the obligation to report is triggered by significant misconduct which bears no relationship to those operations (for example, significant misconduct under the individual's contract of employment).
- To ensure individuals are not adversely affected by premature reports, which are ultimately determined to be unfounded, NAB considers reports in respect of individuals should be limited to objective facts and should not be required to contain the Licensee's subjective assessments or conclusions in respect of those facts.
- Regulatory guidance should be provided to assist Licensees to establish which acts or omissions amount to 'significant misconduct' and 'significant breach'. The challenges of determining materiality for 'significant misconduct' and 'significant breach' may be similar to challenges Licensees have faced with the term 'serious compliance concerns' used in recent ASIC communications.<sup>1</sup> Industry would benefit from additional guidance.
- Procedural fairness dictates that the Licensee ought to properly investigate and, where appropriate, permit the individual to respond to allegations about conduct. Accordingly, the potential for a longer period than the 10 business day requirement, or more flexibility within it, should be considered where reports relate to an individual's conduct under the proposed new obligation. Further, an obligation to report an individual upon 'mere suspicion' appears counter to established principles of due process.
- ASIC must inform Licensees of the outcome of investigations following an individual's 'serious misconduct' being reported to ASIC. If a matter is reported on mere suspicion, or indeed for any reason, and it is determined that adviser is not at fault or ultimately found

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<sup>1</sup> See ASIC, *Report 515: Financial advice: review of how large institutions oversee their advisers* (March 2017), available at: <http://download.asic.gov.au/media/4186280/rep515-published-17-march-2017.pdf>, which notes there were different approaches to defining and interpreting this definition by large institutions. We also note that Licensees who did not participate in ASIC's review may not currently be aware of, or apply, this definition.

not to be in breach of a regulatory requirement, mechanisms will need to be established to ensure ASIC and Licensee records properly reflect this outcome and there is no prejudice to the individual.

In NAB's view, extending the obligation to report significant misconduct or breaches by individuals should not materially increase the reporting obligation for Licensees, provided the reporting obligation is clear and objective, and appropriate guidance is provided in respect of the matters described above.

**Position 3: breach to be reported within 10 business days from the time that the obligation to report arises.**

*Appropriateness of the proposed threshold for reporting (including suspected or potential breaches)*

Position 3 aims to clarify when time starts to run for the 10 business day period in which a breach must be reported. The proposed position includes an objective trigger (where the Licensee has reason to suspect a breach has occurred) and extends the reporting to suspected or potential breaches. NAB supports amendments to section 912D(1B) of the Corporations Act which:

- Provide further clarity as to when the obligation to report is triggered; and
- Retain the threshold requirement that the breach must be 'significant' before any obligation to report arises.

NAB is concerned that the changes proposed in the Paper do not provide the intended clarification. As worded, the proposed change to the threshold for the obligation to report outlined in the Paper appears to contradict Position 1. Position 1 recognises the need for a significance test. However, paragraphs 47 to 51 of the Paper, and questions 3.1 to 3.4, do not make reference to the 'significance test' being applied where there is a suspected or potential breach. It is not clear if this is intended; however, if this is the proposal, NAB does not support this change.

NAB considers that a significance test should apply, consistent with Position 1. In principle, Licensees should have a reasonable opportunity to make a genuine attempt to understand circumstances that may give rise to a breach and determine whether the matter is significant and therefore reportable.

Nonetheless, should the proposed extension include suspected or potential breaches, this will be difficult to apply in practice. In many situations, Licensees could come to a conclusion that a suspected or potential breach is significant or not by applying a different set of assumptions about the suspected breach. The proposed extension would create ambiguity in interpretation, and would not assist Licensees in determining whether a suspected breach is significant and thus reportable.

The phrase 'reason to suspect' is likely to create further uncertainty for Licensees. Australian Courts have held that 'suspicion' is a slight opinion without sufficient evidence.<sup>2</sup> NAB considers many Licensees would face difficulties in determining the level of certainty required, and this would lead to inconsistencies in the assessment of whether or not an obligation to report has been triggered.

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<sup>2</sup> *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266 at 303; see also Andrew Eastwood, "Breach reporting: some difficult issues to consider" (2014) 32 *Company and Securities Law Journal* 251 at 258-9.

Additionally, the likely practical outcome of the proposed requirement to report suspected breaches appears to be contrary to ASIC's regulatory objectives and the legislative intent of section 912D of the Corporations Act, which we note was amended in 2003 for the express purpose of reducing the compliance burden on Licensees and ensuring that ASIC allocated its limited resources to investigating serious breaches. Given the ambiguities created by the proposed changes, the breaches reported could range from hypothetical breaches not supported by evidence to actual breaches that have been determined to be significant. NAB does not believe that this outcome would provide ASIC with clear and valuable sources of intelligence. It is also likely to materially increase the regulatory burden on Licensees.

NAB also notes that the proposed change, as drafted, would create overlapping and inconsistent obligations to report under the *Superannuation Industry (Supervision) Act 1993* (Cth), *Insurance Act 1973* (Cth), *Life Insurance Act 1995* (Cth) and *Banking Act 1959* (Cth).

NAB supports continued regulatory guidance that confirms a Licensee's internal systems must ensure that the relevant people are aware of breaches in a timely and efficient manner and would welcome additional regulatory guidance on best practice governance frameworks for breach reporting by Licensees.

#### ***Extending the threshold to broader circumstances (information that "reasonably suggests")***

As discussed above, extending the threshold to broader circumstances, such as where a Licensee "has information that reasonably suggests" a breach has or may have occurred, is likely to introduce uncertainty for Licensees as to when the obligation to report is triggered.

#### ***Time period for reporting***

NAB considers the 10 business day reporting timeframe under the current regime to be appropriate. If any modified obligation requires a Licensee to report actual or likely significant breaches, rather than all suspected breaches, then the 10 business day reporting timeframe would remain appropriate. However, if the threshold is changed to require reporting of suspected breaches, then this may result in a higher volume of reports; at this time it is not possible to fully determine the operational impact of this proposal on reporting timeframes or compliance and management costs for Licensees.

#### ***The cost of the regime***

The adoption of the proposed amended regime, in particular a change to the threshold for the obligation to report as outlined in the Paper, would increase costs for Licensees.

As noted above, if Position 3 is adopted as proposed, it would likely result in a substantial increase in the volume of reports made to ASIC with a commensurate increase in compliance and management costs for Licensees. It would also likely increase the resources ASIC would need to allocate to administering the regime. These increased costs are unlikely to result in any clear substantive public benefit – to the contrary, NAB considers that extending the obligation to included suspected breaches would result in reports being made in circumstances where suspicions are ultimately determined to be unfounded and no breach has occurred. Further, the proposed amendments are unlikely to improve the quality of the reports made to ASIC.

If the regime is expanded to require Licensees to report suspected breaches, NAB considers Licensees ought to be permitted to specify whether they are reporting an actual, potential or suspected breach at the time the report is made. In addition, a Licensee should have the ability to withdraw a report where it subsequently determined no breach has occurred. This would be

particularly important if there is to be periodic publication of reported breaches and naming of Licensees (see Position 12).

**Position 4: increase penalties for failure to report as and when required.**

NAB acknowledges the importance of ensuring the penalty framework for failure to report, as and when required, is fit for purpose. This can be achieved by ensuring ASIC has the ability to draw on a range of appropriate sanctions. In NAB's view, the existing criminal penalties for a failure to report breaches could be enhanced by the introduction of a civil penalty regime.

NAB takes its breach reporting obligations seriously and believes an increase in the existing potential monetary penalties for a failure to report breaches in a timely fashion may be appropriate to reflect the importance of the obligation and community expectations. However, before NAB can form a view on this proposal it requires detail of the proposed increase in penalties. NAB also notes the potential to increase potential monetary penalties through increases to the value of a penalty unit under the *Crimes Act 1914* (Cth).

Compliance with the breach reporting obligation will still be inherently reliant upon the exercise of judgment by Licensees and, as such, NAB does not support an increase to the current potential term of imprisonment. NAB notes that circumstances where imprisonment would be appropriate are extremely limited, and should be reserved for serious contraventions involving deliberate non-compliance with the obligation.

**Position 5: introduce a civil penalty in addition to the criminal offence for failure to report breaches as and when required.**

NAB supports in principle the introduction of a civil penalty regime which will allow ASIC to take enforcement action where there has been non-compliance that does not warrant criminal penalty action being taken. While NAB supports this proposal in principle, it would need to consider the details of any proposed regime before commenting further.

**Position 6: introduce an infringement notice regime for failure to report breaches as and when required.**

As a means to improve consumer confidence in the industry, NAB supports increasing the range of possible remedies for failure to lodge a breach report, including introduction of a civil penalty regime. However, NAB does not support the introduction of an infringement notice regime given the complexity of the breach reporting regime and the degree of judgment a Licensee is required to exercise when determining whether a breach is significant (despite the proposed amendment to the significance test).

Under the current regulatory framework for breach reporting, significant criminal penalties follow a failure to lodge a breach report. This reflects a clear legislative intention that a failure to comply with reporting obligations is considered a serious contravention of the financial services laws.

Similarly, ASIC has indicated that it takes failure to lodge breach reports where required extremely seriously and considers that such a failure may indicate other cultural or compliance problems.<sup>3</sup> NAB recognises this, and takes its breach reporting obligations very seriously.

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<sup>3</sup> See ASIC Deputy Chair Peter Kell, *Speech to the Risk Management Association of Australia: Why breach reporting is important*, 16 September 2014, available at <http://download.asic.gov.au/media/1901747/speech-to-rma-cro-forum-published-16-september-2014.pdf>.

In contrast, it is generally accepted that the policy behind the availability of infringement notices as a remedy is to provide for the 'expeditious collection of monetary penalties [for] minor offences, such as routine traffic offences'.<sup>4</sup>

The Australian Law Reform Commission has previously recommended, following an inquiry into civil and administrative penalties which:

- In criminal penalty schemes, an infringement notice scheme should apply only to minor offences of strict or absolute liability; and
- In civil penalty schemes, an infringement notice scheme should apply only to minor contraventions in which no proof of a fault element or state of mind is required.<sup>5</sup>

NAB considers that the determination of whether a Licensee has contravened section 912D of the Corporations Act is a matter that should be reserved for the judiciary. Even if ASIC limits the execution of this power to 'simple' or 'minor' contraventions, the mere fact an infringement notice has been issued can give rise to reputational impacts for the Licensee.

**Position 7: encourage a cooperative approach where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity.**

NAB considers a cooperative approach between Licensees and regulators to be an important aspect of Australia's regulatory framework. ASIC's ability to respond flexibly, through negotiated and tailored responses, allows for efficient enforcement outcomes that benefit all market participants. It is important to leverage the existing discretion that ASIC holds to undertake enforcement action.

NAB considers that ASIC already has a level of discretion with respect to taking administrative or civil action. Any specific provisions which permit ASIC to take no administrative or civil action should be carefully considered to ensure that ASIC can continue to respond appropriately in circumstances not contemplated by the legislation.

**Position 8: prescribe the required content of reports under section 912D of the Corporations Act and require them to be delivered electronically.**

NAB supports in principle the proposal in Position 8 to prescribe the required content of breach reports under section 912D of the Corporations Act and require them to be delivered electronically.

NAB believes that best practice design principles should be applied to ensure the reporting process is as simple and fast as possible, while providing flexibility to cater for the range of breaches that may be reported. NAB assumes the prescribed form would be tailored to reflect the breach reporting framework following the implementation of any amendments ultimately made as a result of the Taskforce's review. A reasonable consultation period regarding the prescribed content, as well as a reasonable transitional period before use of the prescribed form is mandated, would be appropriate.

While it is difficult to comment further on this proposal in the abstract, NAB considers that any prescribed form should not require the provision of additional supporting documents, as doing so may create the potential for delays in breach reporting which would be inconsistent with the intent of the proposals. If a Licensee is required to report suspected or potential breaches, in

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<sup>4</sup> *Brian William Mcquade v Marion City Council* (1998) 100 ACrimR 204 at 206.

<sup>5</sup> See *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95), recommendations 12-1 and 12-2.

particular where it has not been possible to conduct a full investigation, the report should reflect that it may not in fact relate to an actual breach (as noted in respect of Position 3 above).

The impact of this proposal on Licensees will largely depend on the prescribed content, usability of the form, the transitional period allowed and the other proposals that are ultimately implemented. NAB would welcome further consultation in relation to this proposal.

**Position 9: introduce a self-reporting regime for credit licensees equivalent to the regime for AFS licensees under section 912D of the Corporations Act.**

NAB supports in principle the proposal in Position 9 to introduce a self-reporting regime for credit licensees. The framework of such a regime could be based on the regime for financial services licensees under section 912D of the Corporations Act; however, it should be subject to further detailed consultation with industry to ensure it is workable and fit for purpose. The introduction of a self-reporting regime would be a substantial increase to the obligations of credit licensees which would require significant changes to their existing compliance frameworks, even for credit licensees whose existing compliance frameworks are sophisticated and robust. NAB notes that a corresponding review of the annual compliance certificate under the *National Consumer Credit Protection Act 2009* (Cth) to ensure no duplication of reporting requirements would be beneficial.

Among other things, the introduction of such a regime would require credit licensees to define and implement changes to their systems, policies, procedures and control frameworks and provide relevant training on the new obligations. Credit licensees may also require a review and changes to commercial relationships (brokers, aggregators, lenders and third party service providers) to establish the regime. An appropriate transitional period will be required for the implementation of any new self-reporting regime as well as clear regulatory guidance (particularly on responsible lending), developed after appropriate public consultation to ensure credit licensees are appropriately equipped to comply.

Finally, we note that NAB's concerns in relation to the proposed changes to the reporting regime for financial services licensees apply equally to credit licensees.

**Position 10: ensure qualified privilege continues to apply to licensees reporting under section 912D of the Corporations Act.**

NAB believes that if changes are made to the self-reporting requirements, relevant legislation must be reviewed and amended, as required, to ensure qualified privilege continues to apply to Licensees providing information to ASIC. Qualified privilege should also be an element of any self-reporting regime for credit licensees.

**Position 11: remove the additional reporting requirements for responsible entities.**

NAB supports reforms that reduce regulatory duplication, and therefore supports the proposal to streamline the self-reporting regime for responsible entities by removing the additional requirement for responsible entities in section 601FC of the Corporations Act.

If this proposal is implemented, an additional requirement would need to be added to the assessment of 'significance' in section 912D of the Corporations Act; namely that where the breach relates to a registered scheme, consideration should be given to the extent the breach has had, or is likely to have, a materially adverse effect on the interests of members of the scheme.



**Position 12: require annual publication by ASIC of breach report data for licensees.**

NAB supports appropriate measures to enhance consumer confidence and ensure industry is transparent and accountable. To that end, NAB supports publication of the existing ASIC reporting framework at a firm or Licensee level. Supplementing the existing ASIC reporting framework with summary reports containing information on the volume, nature and customer impacts of reported breaches would increase transparency and consumer confidence.

As noted in the Paper, ASIC's current annual report includes data on the number of criminal convictions, civil actions, amount of fines or civil penalties imposed and administrative actions such as banning individuals for misconduct.

NAB agrees there must be an appropriate balance between procedural fairness and the need to preserve the integrity of investigative processes. To ensure these principles are upheld, NAB believes that reporting should be subject to the threshold finding of fact that there is a breach which has been determined significant. Breach reports of suspected matters (to the extent included in the regime) should be excluded from annual publication.

NAB notes that individuals subject to banning, criminal conviction or civil penalties are currently published in ASIC's six monthly enforcement reporting. NAB does not believe that additional reporting or naming of individuals is appropriate and should remain restricted to those subject to findings of fact regarding misconduct. NAB also notes the framework being developed by the ABA to expand reference checking and information sharing protocols beyond financial advisors to include other employees.