
**FINANCIAL SECTOR REFORM (HAYNE ROYAL COMMISSION RESPONSE –
PROTECTING CONSUMERS (2020 MEASURES)) BILL 2020**

EXPOSURE DRAFT EXPLANATORY MATERIALS

Table of contents

Glossary.....	1	
Chapter 1	Implementing Recommendations 1.6 and 2.7 of the Financial Services Royal Commission: Reference Checking and Information Sharing.....	3
Chapter 2	Implementing Recommendations 1.6, 2.8 and 7.2 of the Financial Services Royal Commission	19
Chapter 3	Implementing Recommendations 1.6 and 2.9 and of the Financial Services Royal Commission Investigating and Remediating Misconduct	57

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ABA	Australian Banking Association
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Bill	Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020
Corporations Act	<i>Corporations Act 2001</i>
Credit Act	<i>National Consumer Credit Protection Act 2009</i>
Credit Transitional Act	<i>National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009</i>
Criminal Code	<i>Criminal Code Act 1995</i>
Financial Services Royal Commission	Royal Commission into Misconduct into Banking, Superannuation and Financial Services Industry
the Guide	The Attorney-General’s Department’s <i>A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers</i> , September 2011 edition
National Credit Code	National Credit Code at Schedule 1 of the <i>National Consumer Credit Protection Act 2009</i>
protocol	Reference Checking and Information Sharing Protocol
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>

Chapter 1

Implementing Recommendations 1.6 and 2.7 of the Financial Services Royal Commission: Reference Checking and Information Sharing

Outline of chapter

1.1 Schedule [1.6 and 2.7] to the Bill implements recommendations 1.6 and 2.7 of the Financial Services Royal Commission, which called for Australian financial services licensees and Australian credit licensees to be required, as a condition of their licence, to comply with a reference checking and information sharing protocol in relation to financial advisors and mortgage brokers.

Context of amendments

1.2 A person who carries on a financial services business must hold an Australian financial services licence (section 911A of the Corporations Act). An Australian financial services licensee is subject to general obligations under section 912A of the Corporations Act, including the obligation to take reasonable steps to ensure that its representatives comply with the financial services laws (paragraph 912A(1)(ca) of the Corporations Act).

1.3 Similarly, a person must not engage in a credit activity if they do not hold an Australian credit licence authorising them to engage in the credit activity (section 29 of the Credit Act). An Australian credit licensee is subject to general conduct obligations under section 47 of the Credit Act, including the obligation to comply with the credit legislation (paragraph 47(1)(e) of the Credit Act).

1.4 In support of these obligations, ASIC's Regulatory Guide 104 Licensing: Meeting the general obligations and Regulatory Guide 205 Credit Licensing: General conduct obligations set out measures for monitoring and supervising representatives. Under the Regulatory Guides, ASIC expects Australian financial services licensees and Australian credit licensees to have undertaken appropriate background checks before appointing new representatives. These checks could include, for example, referee reports, searches of ASIC's register of banned and disqualified persons and police checks.

1.5 Despite these requirements, the Financial Services Royal Commission found that Australian financial services licensees are not doing enough to communicate between themselves about the backgrounds of prospective employees. Particularly, the Financial Services Royal Commission found that:

- the reference checking and information sharing protocol administered by the ABA is limited to signatories and not consistently applied;
- Australian financial services licensees frequently fail to respond adequately to requests for references regarding their previous employees; and
- Australian financial services licensees do not always take the information they receive seriously enough.

1.6 As a result of these deficiencies, the Financial Services Royal Commission found that financial advisers facing disciplinary action from their employer can shop around for another Australian financial services licensee to employ them.

1.7 To address these findings, the Financial Services Royal Commission recommended (recommendation 2.7) that Australian financial services licensees should be required to give effect to reference checking and information sharing protocols for financial advisers, to the same effect now provided by the Australian Banking Association in its ‘Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol’. The intention of the protocol is to promote better information sharing about the performance history of financial advisers – focusing on compliance, risk management and advice quality.

1.8 The Financial Services Royal Commission also recommended (recommendation 1.6) that the requirement to give effect to reference checking and information sharing protocols should be extended to Australian credit licensees in respect of mortgage brokers.

Summary of new law

1.9 Schedule [1.6 and 2.7] to the Bill implements recommendation 2.7 of the Financial Services Royal Commission (and, in part, recommendation 1.6) by:

- requiring an Australian financial services licensee and an Australian credit licensee, as an obligation under their licence, to comply with a reference checking and information sharing protocol to be made by ASIC in the form of

legislative instruments under the Corporations Act and the Credit Act; and

- creating a civil penalty for non-compliance with the obligation.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Obligation to undertake reference checking and information sharing	
Australian financial services licensees and Australian credit licensees are subject to a specific obligation to undertake reference checking and information sharing regarding a former, current or prospective employee.	An Australian financial services licensee is subject to general obligations under section 912A of the Corporations Act, including the obligation to take reasonable steps to ensure that its representatives comply with the financial services laws. An Australian credit licensee is subject to general obligations under section 47 of the Credit Act, including the obligation to comply with the credit legislation.
Legislative instrument setting out obligations	
ASIC may make legislative instruments under the Corporations Act and the Credit Act setting out the detail of the reference checking and information sharing obligation.	No equivalent.
Civil penalty for failure to undertake reference checking and information sharing	
Australian financial services licensees and Australian credit licensees who fail to undertake reference checking and information sharing regarding a prospective employee are subject to a civil penalty.	No equivalent.
Defence of qualified privilege against defamation and breach of confidence	

<i>New law</i>	<i>Current law</i>
Australian financial services licensees and Australian credit licensees have a defence of qualified privilege against a defamation action or a breach of confidence action resulting from information shared as part of the obligation.	No equivalent.

Detailed explanation of new law

Amendments to the Corporations Act

1.10 The amendments to the Corporations Act impose the new reference checking and information sharing obligation in section 912A of the Corporations Act.

1.11 Legislative references in this part of this Chapter are to the Corporations Act, unless otherwise specified.

The obligation to check references and share information

1.12 The amendments impose a specific obligation on an Australian financial services licensee to comply with a reference checking and information sharing requirement. [Schedule [1.6 and 2.7], item 3, paragraph 912A(1)(cc) of the Corporations Act]

1.13 Australian financial services licensees are required to conduct reference checking and information sharing in relation to individuals to whom the protocol applies – either by requesting information about the individual or providing information about the individual, as the case may be. A licensee must comply with the obligation in relation to:

- a licensee who is an individual—for example, a current or former licensee who is seeking to work for another licensee; and
- a former, current or prospective representative of a licensee—for example, a financial adviser who currently works for a licensee and is seeking employment with another licensee.

1.14 Requiring all licensees to comply with the protocol will ensure that there is consistent practice throughout the industry, and that employment information will be available about all financial advisers and mortgage brokers.

1.15 In some circumstances, under the obligation a person must provide information to a licensee about themselves. For example, where a person is a licensee in their own right and seeks to become a representative of an employing licensee, the obligation would operate to require the employing licensee to request information from the prospective representative regarding their work as a licensee.

Reference Checking and Information Sharing Protocol

1.16 While the obligation to comply with reference checking and information sharing requirement is contained in the Corporations Act, the particular obligations will be included in a legislative instrument - the Reference Checking and Information Sharing Protocol (the protocol). The protocol is to be made by ASIC and is subject to disallowance and sunseting under the *Legislation Act 2003*. [*Schedule [1.6 and 2.7], item 5, subsection 912A(3A) of the Corporations Act*]

1.17 It is appropriate to delegate the particular requirements of the obligation to a disallowable instrument because it will contain detail that is machinery and technical in nature. This detail may include, for example:

- information that should be sought and provided when checking a reference and sharing information;
- information that need not be sought and provided when checking a reference and sharing information;
- steps a licensee should take to contact referees;
- methods by which information is to be requested and provided;
- the appointment of key contact persons within an Australian financial services licensee organisation; and
- particular record-keeping requirements.

1.18 The delegation of particular requirements to the protocol allows ASIC to ensure the integrity of the scheme. It is important that the protocol can be made and amended quickly so as to accommodate rapidly changing industry practices.

1.19 In order for information to be provided between Australian financial services licensees and other Australian financial services licensees, the amendments provide that ASIC may determine in the protocol arrangements for:

- information about a financial services licensee who is an individual being shared by the licensee with another financial services licensee; and

- information about an individual who is a former, current or prospective representative of a financial services licensee being shared by that licensee with another financial services licensee.

[Schedule [1.6 and 2.7], item 5, paragraph 912A(3A)(a) of the Corporations Act]

1.20 Likewise, in order for information to be provided between Australian financial services licensees and Australian credit licensees, the amendments provide that ASIC may determine in the protocol arrangements for:

- information about a financial services licensee who is an individual being shared by the licensee with an Australian credit licensee; and
- information about an individual who is a former, current or prospective representative of a financial services licensee being shared by that licensee with an Australian credit licensee.

[Schedule [1.6 and 2.7], item 5, paragraph 912A(3A)(b) of the Corporations Act]

1.21 The protocol applies to an individual described in paragraph 912A(3A)(a) (see paragraph 1.19 of this Chapter) if there are reasonable grounds to suspect that, if the individual is successful in obtaining the job they have sought, the individual will provide personal advice to retail clients about relevant financial products. For the purposes of the amendments, relevant financial products are defined in section 910A of the Corporations Act. *[Schedule [1.6 and 2.7], item 5, subsection 912A(3C) of the Corporations Act]*

1.22 Likewise, the protocol applies to an individual described in paragraph 912A(3A)(b) (see paragraph 1.20 of this Chapter) if there are reasonable grounds to suspect that, if they are successful in obtaining the job they have sought, the individual will:

- provide credit assistance in relation to credit contracts secured by mortgages over residential property; and
- be a mortgage broker or a director, employee or agent of a mortgage broker.

[Schedule [1.6 and 2.7], item 5, subsection 912A(3D) of the Corporations Act]

1.23 The ‘reasonable grounds to suspect’ threshold relies on the common law meaning of the term and is not defined by legislation for the purposes of this section. There is a reasonable ground to suspect where there is a positive suspicion about the truth or existence of the circumstance. In determining whether the grounds are reasonable, a person may take into account the facts and circumstances of the situation.

1.24 The references to mortgage broker in subsection 912A(3D) have the same meaning as proposed to be inserted by section 15B of the Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019. The application of the protocol is explained further at paragraph 1.49. [*Schedule [1.6 and 2.7], item 5, subsection 912A(3E) of the Corporations Act*]

Record keeping

1.25 In order for ASIC to monitor compliance with the information sharing and reference checking obligation, the amendments provide that ASIC may determine record keeping requirements in the protocol. [*Schedule [1.6 and 2.7], item 5, paragraph 912A(3A)(c) of the Corporations Act*]

1.26 The protocol may include matters relating to the keeping and retaining records of information shared, and the circumstances under which the information is shared. Under the protocol ASIC may determine requirements including, for example:

- information that should be sought and provided when checking a reference and sharing information;
- information that need not be sought and provided when checking a reference and sharing information;
- steps a licensee should take to contact referees;
- how long records of compliance must be kept for; and
- how records of compliance should be stored.

Consequences for failing to check references and share information

1.27 A civil penalty applies to a licensee's failure to comply with the protocol. This is consistent with the treatment of other contraventions of the general obligations imposed on an Australian financial services licensee—for example, the obligation to do all things necessary to ensure that the financial services covered by the licensee are provided efficiently, honestly and fairly, and the obligation to ensure that representatives of the licensee are adequately trained. [*Schedule [1.6 and 2.7], item 9, subsection 912A(5A) of the Corporations Act*]

1.28 If a court is satisfied that an Australian financial services licensee has contravened the obligation to comply with the protocol, the court must make a declaration of contravention. Once a declaration has been made, ASIC can seek a pecuniary penalty order under which a Court would order the licensee to pay a penalty to the Commonwealth (see sections 1317E and 1317G of the Corporations Act).

1.29 A failure to comply with the protocol may result in a customer being exposed to a representative who has a history of poor conduct,

resulting in the customer having a heightened risk of receiving poor quality advice or another form of unsuitable service. For this reason, it is appropriate that a civil penalty may be imposed in relation to the failure to serve as a deterrent and punishment.

Privacy

1.30 The protocol must not require personal information be shared other than with the consent of the individual to whom the information relates. [*Schedule [1.6 and 2.7], item 5, paragraph 912A(3B)(a) of the Corporations Act*]

1.31 The giving of consent by the prospective appointee means that the disclosure of information by the current or former employer and the use of the information by the prospective employer does not breach the Australian Privacy Principles contained in the *Privacy Act 1988* (provided that the use and disclosure is consistent with the terms of the consent given by the prospective employee). Accordingly, the amendments provide that the protocol must not require or permit personal information (within the meaning of the *Privacy Act 1988*) to be shared, other than with the consent of the individual to whom the information relates.

1.32 The giving of consent for reference checking and information sharing formalises a practice that is standard across a wide range of industries and professions.

1.33 The protocol must not require information to be provided in relation to conduct that occurred more than five years before the information is shared. This reflects the period of time for which employee records would be expected to be retained and therefore does not impose unreasonable record keeping obligations on licensees. It also takes into account the Commonwealth policy about spent convictions not being required to be disclosed. However, the protocol may provide that, if a person is able to do so, the person may voluntarily provide relevant information that relates to conduct that occurred more than five years ago. [*Schedule [1.6 and 2.7], item 5, paragraph 912A(3B)(b) of the Corporations Act*]

Defence against defamation and breach of confidence actions

1.34 It is essential to the operation of the reference checking and information sharing obligation that licensees share information honestly and frankly. For this reason, the defence of qualified privilege applies to a person who gives information about a representative in the course of complying with their obligation under the protocol. [*Schedule [1.6 and 2.7], item 5, subsection 912A(3F) of the Corporations Act*]

1.35 The defence of qualified privilege will apply to an Australian financial services licensee where they provide information about an

individual who is currently or was formerly a representative of the licensee (see section 89 of the Corporations Act).

1.36 The qualified privilege defence in relation to compliance with the protocol is consistent with the defence in similar circumstances under the Corporations Act—namely, in relation to information given to ASIC, for the conduct of market licensees and CS facility licensees, and for information given to market licensees and CS facility licensees (see Division 1 of Part 7.12 of the Corporations Act).

1.37 In addition to a licensee’s qualified privilege when acting in compliance with the obligation to provide a reference about a current, former or prospective representative, licensees are also not liable for any action based on breach of confidence in relation to that conduct. This provides a protection to the licensee where confidential information is divulged in the course of satisfying the obligation to share information. However, in order to balance the interests of a current or former employee with respect to their confidential information, the protocol may specify that certain information does not need to be shared to comply with the protocol. [*Schedule [1.6 and 2.7], item 5, subsection 912A(3G) of the Corporations Act*]

Amendments to the Credit Act

1.38 The amendments to the Credit Act impose the new reference checking and information sharing obligation in section 47 of the Credit Act. The amendments to the Credit Act impose the protocol on Australian credit licensees in relation to mortgage brokers in generally the same manner as the amendments to the Corporations Act impose the obligation on Australian financial services licensees.

1.39 Legislative references in this part of this Chapter are to the Credit Act, unless otherwise specified.

The obligation to check references and share information

1.40 The amendments impose an obligation on an Australian credit licensee to comply with a reference checking and information sharing requirement in respect of mortgage brokers. [*Schedule [1.6 and 2.7], item 13, paragraph 47(1)(ea) of the Credit Act*]

1.41 Australian credit licensees are required to conduct reference checking and information sharing in relation to individuals to whom the protocol applies – either by requesting information about the individual or providing information about the individual, as the case may be. A licensee must comply with the obligation in relation to:

- a licensee who is an individual—for example, a current or former licensee who is seeking to work for another licensee; and
- a former, current or prospective representative of a licensee—for example, a mortgage broker who currently works for a licensee and is seeking employment with another licensee.

1.42 Requiring all licensees to comply with the protocol will ensure that there is consistent practice throughout the industry, and that employment information will be available about all financial advisers and mortgage brokers.

1.43 In some circumstances, under the obligation a person must provide information to a licensee about themselves. For example, where a person is a licensee in their own right and seeks to become a mortgage broker employed by a licensee, the obligation would operate to require the employing licensee to request information from the prospective representative regarding their work as a licensee.

Reference Checking and Information Sharing Protocol

1.44 While the obligation to comply with reference checking and information sharing requirements is contained in the Credit Act, the particular obligations will be included in a legislative instrument - the Reference Checking and Information Sharing Protocol (the protocol). The protocol is to be made by ASIC and is subject to disallowance and sunseting under the *Legislation Act 2003*. [*Schedule [1.6 and 2.7], item 14, subsection 47(3A) of the Credit Act*]

1.45 It is appropriate to delegate the particular requirements of the obligation to a disallowable instrument because it will contain detail that is machinery and technical in nature. This detail may include, for example:

- information that should be sought and provided when checking a reference and sharing information;
- information that need not be sought and provided when checking a reference and sharing information;
- steps a licensee should take to contact referees;
- methods by which information is to be requested and provided;
- the appointment of key contact persons within an Australian financial services licensee organisation; and
- particular record-keeping requirements.

1.46 The delegation of particular requirements to the protocol allows ASIC to ensure the integrity of the scheme. It is important that the protocol can be made and amended quickly so as to accommodate rapidly changing industry practices. In order for information to be provided between different Australian credit licensees, the amendments provide that ASIC may determine in the protocol arrangements for:

- information about an Australian credit licensee who is an individual being shared by the licensee with another Australian credit licensee; and
- information about an individual who is a former, current or prospective representative of an Australian credit licensee being shared by that licensee with another Australian credit licensee.

[Schedule [1.6 and 2.7], item 14, paragraph 47(3A)(a) of the Credit Act]

1.47 Likewise, in order for information to be provided between Australian credit licensees and Australian financial services licensees, the amendments provide that ASIC may determine in the protocol arrangements for:

- information about an Australian credit licensee who is an individual being shared by the licensee with an Australian financial services licensee; and
- information about an individual who is a former, current or prospective representative of an Australian credit licensee being shared by that licensee with an Australian financial services licensee.

[Schedule [1.6 and 2.7], item 14, paragraph 47(3A)(b) of the Credit Act]

1.48 The protocol applies to an individual described in paragraph 1.46 if there are reasonable grounds to suspect that, if they are successful in obtaining the job they have sought, the individual will:

- provide credit assistance in relation to credit contracts secured by mortgages over residential property; and
- be a mortgage broker or a director, employee or agent of a mortgage broker.

[Schedule [1.6 and 2.7], item 14, subsection 47(3C) of the Credit Act]

1.49 The references to mortgage broker, credit assistance and credit contracts in subsection 47(3C) have the same meaning as they have in the Credit Act. A person undertaking mortgage broking for the purposes of these amendments has a broader meaning than that contained in section 15B of the Credit Act as these amendments extend to employees, directors and agents of a mortgage broker (provided that their job involves or will

involve the provision of credit assistance in relation to credit contracts secured by mortgages over residential property). For these individuals, the carrying on of a business is not required. The protocol applies to a broader cohort of people in this way to ensure that the reference checking and information sharing framework operates in relation to all relevant people undertaking mortgage broking activity. For simplicity, this Chapter of the explanatory memorandum refers to this cohort as mortgage brokers.

1.50 Likewise, the protocol applies to an individual described in paragraph 1.47 if there are reasonable grounds to suspect that, if they are successful in obtaining the job they have sought, the individual will provide personal advice to retail clients about relevant financial products. For the purposes of the amendments, relevant financial products are defined in section 910A of the Corporations Act. [*Schedule [1.6 and 2.7], item 14, subsections 47(3D) and (3E) of the Credit Act*]

1.51 The ‘reasonable grounds to suspect’ threshold relies on the common law meaning of the term and is not defined by legislation for the purposes of this section. There is a reasonable ground to suspect where there is a positive suspicion about the truth or existence of the circumstance. In determining whether the grounds are reasonable, a person may take into account the facts and circumstances of the situation.

Record keeping

1.52 In order for ASIC to monitor compliance with the information sharing and reference checking obligation, the amendments provide that ASIC may determine record keeping requirements in the protocol. [*Schedule [1.6 and 2.7], item 14, paragraph 47(3A)(c) of the Credit Act*]

1.53 The protocol may include matters relating to the keeping and retaining records of information shared, and the circumstances under which the information is shared. Under the protocol ASIC may determine requirements including, for example:

- information that should be sought and provided when checking a reference and sharing information;
- information that need not be sought and provided when checking a reference and sharing information;
- steps a licensee should take to contact referees;
- how long records of compliance must be kept for; and
- how records of compliance should be stored.

Consequences for failing to check references and share information

1.54 A civil penalty applies to a contravention of the obligation to comply with the protocol. [*Schedule [1.6 and 2.7], item 15, subsection 47(4) of the Credit Act*]

1.55 The imposition of a civil penalty is consistent with the treatment of other contraventions of the general obligations imposed on an Australian credit licensee, for example:

- the obligation to do all things necessary to ensure that the credit activities authorised by the Australian credit licensee are provided efficiently, honestly and fairly; and
- the obligation to ensure that representatives of the Australian credit licensee are adequately trained, and are competent, to engage in the credit activities authorised by the licence.

1.56 If a court is satisfied that an Australian credit licensee has contravened the obligation to comply with the protocol, the court must make a declaration of contravention. Once a declaration has been made, ASIC can seek a pecuniary penalty order (see sections 166 and 167 of the Credit Act).

1.57 A failure to comply with the protocol may result in a representative of an Australian credit licensee operating as a mortgage broker who has a history of poor conduct, exposing customers to a heightened risk of receiving poor quality advice or another form of inappropriate service. For this reason, it is appropriate that a civil penalty may be imposed in relation to the failure to serve as a deterrent and punishment.

Privacy

1.58 The protocol must not require personal information be shared other than with the consent of the individual to whom the information relates. [*Schedule [1.6 and 2.7], item 14, paragraph 47(3B)(a) of the Credit Act*]

1.59 The giving of consent by the prospective appointee means that the disclosure of information by the current or former employer and the use of the information by the prospective employer does not breach the Australian Privacy Principles contained in the *Privacy Act 1988* (provided that the use and disclosure is consistent with the terms of the consent given by the prospective employee). Accordingly, the amendments provide that the protocol must not require or permit personal information (within the meaning of the *Privacy Act 1988*) to be shared, other than with the consent of the individual to whom the information relates

1.60 The giving of consent for reference checking and information sharing formalises a practice that is standard across a wide range of industries and professions.

1.61 The protocol must not require information shared in relation to conduct that occurred more than five years before the information is shared. This reflects the period of time for which employee records would be expected to be retained. This reflects the period of time for which employee records would be expected to be retained and therefore does not impose unreasonable record keeping obligations on licensees. It also takes into account the Commonwealth policy about spent convictions not being required to be disclosed. However, the protocol may provide that, if a person is able to do so, the person may provide information that relates to conduct that occurred more than five years ago. [*Schedule [1.6 and 2.7], item 14, paragraph 47(3B)(b) of the Credit Act*]

Defence against defamation and breach of confidence actions

1.62 It is essential to the operation of the reference checking and information sharing obligation that licensees share information honestly and frankly. For this reason, the defence of qualified privilege applies to a person who gives information about a representative in the course of complying with their obligation under the protocol. [*Schedule [1.6 and 2.7], item 14, subsection 47(3F) of the Credit Act*]

1.63 The defence of qualified privilege will apply to an Australian credit licensee where they provide information about an individual who is currently or was formerly a representative of the licensee (see section 16 of the Credit Act).

1.64 The qualified privilege defence in relation to compliance with the protocol is consistent with the defence in similar circumstances under the Credit Act—namely, in relation to certain information shared between licensees and ASIC (see sections 73 and 243 of the Credit Act).

1.65 In addition to a licensee’s qualified privilege when acting in compliance with the obligation to provide a reference about a current, former or prospective representative, licensees are also not liable for any action based on breach of confidence in relation to that conduct. This provides a protection to the licensee where confidential information is divulged in the course of satisfying the obligation to share information. However, in order to balance the interests of a current or former employee with respect to their confidential information, the protocol may specify that certain information does not need to be shared to comply with the protocol. [*Schedule [1.6 and 2.7], item 14, subsection 47(3G) of the Credit Act*]

Interaction of the amendments

1.66 As described in this Chapter, the reference checking and information sharing obligation applies both to Australian financial services licensees and Australian credit licensees. This is intended to enable any past misconduct by a person to be ascertained and shared between the financial advice and mortgage broking industries, particularly to identify where the person seeks to move from one industry to the other.

1.67 Example 1.1 below demonstrates how the reference checking and information sharing regime would prevent a person being appointed to a position in one industry where they have engaged in misconduct in the other.

Example 1.1: Reference checking identifying prior breach

Vincent worked as a financial adviser with Company Alpha, an Australian financial services licensee. Vincent stole money from a client and Company Alpha terminated his employment.

One year later, Vincent applies for a position as a financial adviser with Company Bravo, another Australian financial services licensee. Company Bravo undertakes its obligation to check references and contacts Company Alpha (with Vincent's consent). Company Alpha satisfies its obligation to share information with another Australian financial services licensee and informs Company Bravo that Vincent was terminated for stealing money from a client. Company Bravo declines to offer Vincent a position.

After two years, Vincent realises that, owing to his misconduct, it will be difficult for him to find further employment as a financial adviser. He decides to seek work as a mortgage broker and applies for a position with Company Charlie, an Australian credit licensee. Because Vincent had previously worked as a representative of an Australian financial services licensee, Company Charlie undertakes its obligation to check references and contacts Company Alpha (with Vincent's consent). Company Alpha undertakes its obligation to share information with an Australian credit licensee and informs Company Charlie of Vincent's conduct. Company Charlie declines to offer Vincent a position.

Consequential amendments

Amendments to the Corporations Act

1.68 The amendments insert in the Corporations Act a definition of Reference Checking and Information Sharing Protocol to mean the protocol determined by ASIC, and described at paragraph 1.16. The amendments also insert new subheadings in section 912A of the

Corporations Act to add clarity. *[Schedule [1.6 and 2.7], items 1, 2, 4, 6, 7, 8 and 10, sections 910A and 912A of the Corporations Act]*

Amendments to the Credit Act

1.69 The amendments insert a definition in the Credit Act of Reference Checking and Information Sharing Protocol to mean the protocol determined by ASIC, and described at paragraph 1.44. *[Schedule [1.6 and 2.7], item 12, subsection 5(1) of the Credit Act]*

Application and transitional provisions

1.70 The amendments commence on 1 July 2020. *[Clause 2].*

Amendments to the Corporations Act

1.71 The amendments apply from 1 April 2021. Accordingly, the obligation to undertake reference checking about a potential representative of an Australian financial services licensee applies to a representative appointed on and after 1 April 2021. Likewise, the obligation to share information about representatives applies to a request for information made on and after 1 April 2021. *[Schedule [1.6 and 2.7], item 11, section 1669 of the Corporations Act]*

Amendments to the Credit Transitional Act

The obligation to undertake reference checking about a prospective mortgage broker applies in relation to a mortgage broker appointed on and after 1 April 2021. Likewise, the obligation to share information about representatives applies to a request for information made on and after 1 April 2021. *[Schedule [1.6 and 2.7], item 16, clause 1 of Schedule 15 to the Credit Transitional Act]*

Chapter 2

Implementing Recommendations 1.6, 2.8 and 7.2 of the Financial Services Royal Commission

Outline of chapter

2.1 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill implements recommendation 7.2 of the Financial Services Royal Commission, which called for the implementation of the ASIC Enforcement Review Taskforce recommendations to amend:

- the Corporations Act to clarify and strengthen the breach reporting regime for Australian financial services licensees; and
- the Credit Act to introduce a comparable breach reporting regime for Australian credit licensees.

2.2 It also implements recommendations 2.8 and 1.6 of the Financial Services Royal Commission by introducing requirements on financial services licensees and credit licensees to report serious compliance concerns about financial advisers and mortgage brokers respectively.

Context of amendments

2.3 Breach reporting plays an important role in ASIC's oversight of the financial services industry. Information provided by a financial services licensee through breach reporting allows ASIC to detect significant non-compliant behaviours early and take action where appropriate. It also allows ASIC to identify and address emerging trends of non-compliance.

2.4 Section 912D of the Corporations Act sets out the existing breach reporting regime for financial services licensees. It requires financial services licensees to notify ASIC in writing of any significant breach or likely breach of certain obligations. The report must be lodged with ASIC as soon as practicable, and in any event within 10 business days of the licensee becoming aware of the breach or likely breach.

2.5 Both ASIC and industry have raised concerns about the existing breach reporting regime. The concerns relate primarily to the test for when a breach or likely breach is significant and therefore reportable, as this

requires a licensee to make a subjective assessment. This subjectivity means that breach reporting is largely inconsistent amongst licensees in terms of timeliness and the matters reported.

2.6 Currently there is no breach reporting obligation for credit licensees that is equivalent to the reporting obligation that financial services licensees are subject to under section 912D of the Corporations Act.

2.7 Instead, credit licensees are required to lodge annual compliance certificates with ASIC. These certificates give ASIC broad oversight over whether the credit licensee is complying with its general conduct obligations. However, the information in these certificates is high level and generalised, and there is no obligation to provide ASIC with information about breaches in a timely way.

ASIC Enforcement Review Taskforce Report

2.8 In light of these concerns, the ASIC Enforcement Review Taskforce considered the effectiveness of the breach reporting regime.

2.9 The ASIC Enforcement Review Taskforce made nine recommendations to address the issues identified with the existing breach reporting regime. In particular, the recommendations sought to resolve the ambiguity as to when a breach or likely breach is significant and reportable, whether a licensee is required to report significant breaches or likely breaches by its representatives, the timeframe for reporting to ASIC and the content of the breach report.

2.10 The ASIC Enforcement Review Taskforce also recommended that a comparable breach reporting regime for credit licensees be introduced.

The Financial Services Royal Commission

2.11 Recommendation 7.2 of the Financial Services Royal Commission states that the recommendations of the ASIC Enforcement Review Taskforce about breach reporting of contraventions by financial services and credit licensees should be implemented.

2.12 Recommendation 2.8 states that all financial services licensees should be required to report serious compliance concerns about financial advisers to ASIC on a quarterly basis. Commissioner Hayne identified serious compliance concerns as concerns that a financial adviser may have engaged in:

- dishonest, illegal, deceptive and/or fraudulent misconduct;
- any misconduct that, if proven, would be likely to result in instant dismissal or immediate termination;
- deliberate non-compliance with financial services laws; or

- gross incompetence or gross negligence.

2.13 Recommendation 1.6 of the Financial Services Royal Commission states, in part, that credit licensees should be bound by reporting obligations in respect of mortgage brokers similar to those in recommendation 2.8 for financial advisers.

2.14 In its response to the Financial Services Royal Commission, the Government agreed to implement these recommendations. In particular, the Government agreed to implement recommendation 2.8 as part of strengthening the breach reporting requirements.

2.15 Minor amendments are also being made to the breach reporting regime in the SIS Act as part of the implementation of recommendations 3.8, 6.3, 6.4 and 6.5 to partially align it with these amendments.

Summary of new law

2.16 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill amends the Corporations Act to clarify and strengthen the breach reporting regime for financial services licensees. The key features of the amendments are:

- expanding the situations that need to be reported to ASIC, including:
 - investigations about whether a specified breach or likely breach has occurred or will occur, and outcomes of those investigations;
 - conduct constituting gross negligence or serious fraud (to the extent this conduct was not previously considered a breach of the financial services law); and
 - where there are reasonable grounds to suspect that a reportable situation has arisen in relation to a financial adviser operating under another licence;
- financial services licensees must report to ASIC within 30 calendar days after the licensee reasonably knows that there are reasonable grounds to believe a reportable situation has arisen, although outcomes of investigations will need to be reported within 10 calendar days;
- reports need to be lodged in the prescribed form; and
- ASIC must publish data in relation to reports received from financial services licensees.

2.17 Financial services licensees will have to report to ASIC about serious compliance concerns, which are reflected in the reportable situations, in relation to individual financial advisers operating under

another licence. A copy of these reports will need to be provided to the licensee responsible for the financial adviser at the time the concern arose. Such reports are due within 30 calendar days.

2.18 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill amends the Credit Act to introduce a comparable breach and serious compliance concerns reporting regime for credit licensees.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Corporations Act amendments</i>	
Financial services licensees will need to report significant breaches and likely breaches, and investigations into whether there has been a significant breach.	Licensees are not required to report investigations into whether there has been a significant breach.
Licensees need to report reportable situations about other financial advisers to ASIC and the relevant licensee responsible for the financial adviser.	No equivalent.
The test for when a breach or likely breach is significant will include objectively determinable criteria. These criteria are in addition to the existing subjective significance test.	The test for when a breach or likely breach is significant requires licensees to make an assessment based on the listed criteria.
Licensees must report matters to ASIC within 30 calendar days after the licensee reasonably knows the matter has arisen. Outcomes of investigations need to be reported within 10 calendar days.	Licensees must report to ASIC within 10 business days after becoming aware of the breach or likely breach.
Reports must be lodged in the form prescribed or approved by ASIC.	Reports are not required to be lodged in the form prescribed or approved.
ASIC must publish data on breaches.	No equivalent.
<i>Credit Act amendments</i>	
Credit licensees will be subject to a breach reporting regime that is comparable to the new regime for financial services licensees.	No equivalent. Annual compliance certificate contains some information.
Credit licensees need to report serious compliance concerns about	No equivalent.

mortgage brokers to ASIC and the relevant licensee.	
ASIC must publish data on breaches.	No equivalent.

Detailed explanation of new law

Amendments to the Corporations Act

2.19 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill repeals section 912D of the Corporations Act and replaces the provision with re-written provisions.

Matters that may need to be reported to ASIC

2.20 The amendments in Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill refer to matters that may need to be reported to ASIC as ‘reportable situations’. The reportable situations are set out in new section 912D and can be broadly separated into two categories: reportable situations relating to core obligations (core reportable situations) and additional reportable situations. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsections 912D(1) and (2) of the Corporations Act*]

Core reportable situations

2.21 A core reportable situation will arise where:

- the financial services licensee or its representative has breached or is likely to breach a core obligation; or
- the financial services licensee has commenced an investigation into whether the licensee or its representative has breached a core obligation; and

in either case, the breach or likely breach is significant.

[*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912D(1) of the Corporations Act*]

2.22 Investigations into whether the licensee or its representative has breached a core obligation that is significant is a reportable situation. This addresses the issue of long delays between the process of a financial services licensee starting an investigation and lodging a breach report with ASIC in the existing breach reporting regime.

2.23 A financial services licensee is also considered to have commenced an investigation if it outsources the investigation, or if another related entity (such as a parent company) commences the investigation.

What are the core obligations?

2.24 The core obligations largely reflect the existing obligations in the Corporations Act that, if contravened, need to be reported to ASIC.

2.25 The core obligations are:

- the general conduct obligations on licensees under section 912A (other than the obligation under paragraph 912A(1)(c)) and the requirement to have compensation arrangements for retail clients under section 912B;
- the obligation to comply with certain financial services laws under paragraph 912A(1)(c); and
- for a responsible entity of a registered scheme—the obligations under sections 601FC, 601FD or 601FE.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912D(3) of the Corporations Act]

2.26 Section 601FC of the Corporations Act sets out specific conduct obligations for a responsible entity of a registered scheme that largely reflects the fiduciary duties owed by the entity to members of the scheme. Sections 601FD and 601FE set out similar obligations for officers and employees of the responsible entity. As a responsible entity must hold a financial services licence, the specific core obligations relating to responsible entities are in addition to the other core obligations.

What does ‘likely to breach’ mean?

2.27 A financial services licensee is ‘likely to breach’ a core obligation if, and only if, the person is no longer able to comply with the obligation. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912D(4) of the Corporations Act]*

Example 2.1

Paragraph 912A(1)(d) generally requires a financial services licensee to have available adequate resources to provide the financial services covered by the licence and to carry out supervisory arrangements.

Licensee A becomes aware that on a future date, its overdraft facility will be closed and it will no longer be able to comply with its base level financial requirements. Licensee A is aware that it does not have other means of meeting the financial requirements at this time, which is required under paragraph 912A(1)(d).

Licensee A is therefore likely to breach its financial requirements obligations.

When is a breach or likely breach ‘significant’?

2.28 Breaches and likely breaches of core obligations, and investigations of such, only need to be reported if the breach or likely breach is significant.

2.29 There are now two separate components to the significance test.

2.30 A breach or likely breach of a core obligation is *taken* to be significant if any of the following circumstances apply:

- the breach is punishable on conviction by a penalty that may include imprisonment for a maximum period of:
 - if the offence involves dishonesty—3 months or more; or
 - in any case—12 months or more; or
- the breach constitutes a contravention of a civil penalty provision; or
- the breach results or is likely to result in loss or damage to clients, or in the case of a managed investment scheme, members of the scheme; or
- any other circumstances prescribed by the regulations exist.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912D(5) of the Corporations Act]

2.31 A regulation making power is included to prescribe circumstances in which a breach or likely breach of a core obligation is taken to be significant. This allows the Government to respond quickly and effectively to emerging trends of non-compliance in the financial services sector to ensure the breach reporting regime is fit for purpose and achieves the intended policy outcome. Any regulations made would be subject to disallowance and parliamentary scrutiny.

2.32 If none of the circumstances in subsection 912D(5) apply, the financial services licensee must make an assessment under subsection 912D(6) to determine whether a breach or likely breach of a core obligation is significant. This significance test is based on the existing significance test, and requires a licensee to have regard to the following matters:

- the number or frequency of similar previous breaches;
- the impact of the breach or likely breach on the licensee’s ability to provide financial services covered by the licence;
- the extent to which the breach or likely breach indicates that the licensee’s arrangements to ensure compliance with those obligations are inadequate; and
- any other matters prescribed by regulations.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912D(6) of the Corporations Act]

2.33 This new formulation of the significance test gives effect to recommendation 1 of the ASIC Enforcement Review Taskforce Report and aims to provide an additional set of objectively determinable criteria for licensees. This will provide greater certainty for industry, resulting in more consistent reporting, improved regulatory oversight and better outcomes for consumers.

Additional reportable situations

2.34 Additional reportable situations are not linked to the core obligations or the significance test. These reportable situations arise in relation to a financial services licensee if:

- in the course of providing a financial service, the financial services licensee or its representative has engaged in conduct constituting gross negligence; or
- the financial services licensee or its representative has committed serious fraud.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912D(2) of the Corporations Act]

2.35 Serious fraud is defined in section 9 of the Corporations Act and means an offence involving fraud or dishonesty against an Australian law or any other law that is punishable by imprisonment for life or for a period, or maximum period, of at least three months.

2.36 Conduct that constitutes gross negligence or serious fraud must be reported to ASIC because of the potentially considerable detriment that could be caused to consumers as a result of that conduct.

2.37 These additional reportable situations give effect to the serious compliance concerns identified by Commissioner Hayne in relation to recommendation 2.8 of the Financial Services Royal Commission that are not already covered by the core reportable situations.

2.38 A regulation making power is also included to prescribe circumstances in which an additional reportable situation arises. This allows the Government to respond effectively to emerging trends of non-compliance in the financial services sector, particularly if those trends of non-compliance are unrelated to the core obligations. Any regulations made would be subject to disallowance and parliamentary scrutiny.

Self-reporting obligations to ASIC

2.39 Section 912DAB sets out the obligation for a financial services licensee to report to ASIC about its own reportable situations, including reportable situations arising from the conduct of its representatives.

2.40 A financial services licensee is required to report to ASIC if there are reasonable grounds to *believe* that a reportable situation has arisen in relation to the licensee (including in relation to its representatives). [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(1) of the Corporations Act*]

2.41 In practice, this means there will be an obligation to lodge a report with ASIC if a licensee has commenced an investigation into whether the licensee has breached a core obligation (as this is a reportable situation), and an obligation to report if at the end of the investigation, the licensee concludes that there has been a breach of a core obligation that is significant (as this is another reportable situation). The same obligations arise if the licensee has reported a likely breach of a core obligation, and that likely breach eventuates into a breach of a core obligation that is significant. This is because each of these events is a different reportable situation.

2.42 Additionally, a financial services licensee is required to report to ASIC if the licensee has commenced an investigation into whether the licensee or its representative has breached a core obligation and the investigation discloses no reasonable grounds to believe that the licensee or its representative has breached the core obligation. This ensures ASIC has oversight over the progress of an investigation process. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(2) of the Corporations Act*]

Timing for reporting

2.43 A report must be lodged within 30 calendar days after the licensee first reasonably knows that there are reasonable grounds to believe the reportable situation has arisen. This timeframe has been extended to give licensees more time to investigate and determine whether a breach or likely breach that is significant has occurred or will occur before reporting the breach or likely breach. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(4) of the Corporations Act 2001*]

2.44 A person reasonably knows of a circumstance if:

- the person is aware that the circumstance exists or will exist in the ordinary course of events; or
- the person is aware of a substantial risk that the circumstance exists or will exist, and having regard to the circumstances known to the person, it is unjustifiable to take the risk.

[*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, section 912DAA of the Corporations Act*]

2.45 The concept of ‘reasonably knows’ is based on the definitions of ‘knowledge’ and ‘recklessness’ in the Criminal Code. It is intended to capture circumstances where, on the facts available, the licensee either has knowledge that a reportable situation has arisen, or may not have actual

knowledge but ought to have knowledge that a reportable situation has arisen.

2.46 However, the licensee must report the outcome of an investigation within 10 calendar days after the licensee first reasonably knows the outcome of the investigation. This shorter timeframe is appropriate because at this stage of the process, the licensee is not required to make any further inquiries. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(5) of the Corporations Act*]

2.47 As a practical matter, if a licensee commences and concludes an investigation within 30 calendar days, the licensee may report the commencement of an investigation at the same time the outcome of the investigation is reported in order to meet the timing requirements.

2.48 These proposed changes give effect to recommendation 4 of the ASIC Enforcement Review Taskforce Report.

Example 2.2

A representative of Licensee A has been providing customers with misleading fee disclosure statements, causing these customers to suffer financial loss. On 1 March 2022, senior staff at Licensee A are provided with a detailed report on this matter. The senior staff do not proceed to investigate the matter or take any other action.

Based on the facts available, Licensee A is aware of a substantial risk that there are reasonable grounds to believe a reportable situation has arisen, and having regard to the circumstances known to Licensee A, it is unjustifiable to take that risk.

Licensee A therefore reasonably knows that there are reasonable grounds to believe that it has breached a core obligation (that is, the obligation to comply with the financial services law) that is significant (as it results in loss or damage to a client).

Licensee A is obliged to lodge a report with ASIC about this reportable situation before 1 April 2022, which is 30 calendar days after Licensee A first reasonably knows that there are reasonable grounds to believe the reportable situation has arisen.

Example 2.3

On 1 August 2021, a customer complains to Licensee B that its representative did not provide the customer with a Financial Services Guide. However, the customer complaint lacks sufficient detail for Licensee B to reasonably know that there are reasonable grounds to believe it has breached a core obligation that is significant.

On 3 August 2021, Licensee B commences an investigation into the conduct of the representative. This is now a reportable situation as it is an investigation into whether the licensee has breached a core obligation (that is, the obligation to comply with the financial services

law), and the breach is significant (as it would constitute a contravention of a civil penalty provision).

Licensee B has 30 calendar days after 3 August 2021 to lodge a report with ASIC, as on 3 August 2021, Licensee B reasonably knows that there are reasonable grounds to believe that a reportable situation has arisen. Licensee B therefore needs to report to ASIC in relation to the commencement of the investigation before 3 September 2021.

On 1 September 2021, Licensee B concludes that the financial adviser has failed to comply with the financial services law. Licensee B must report that outcome to ASIC before 12 September 2021.

Licensee B reports that the investigation has commenced and the outcome of that investigation to ASIC on 2 September 2021, satisfying the timing requirements.

Example 2.4

On 1 November 2021, Licensee C commences an investigation into the conduct of one of its financial advisers. Licensee C is required to report that reportable situation to ASIC before 2 December 2021.

On 10 November 2021, Licensee C concludes that the financial adviser has failed to comply with the financial services law. Licensee C is required to report that outcome to ASIC before 21 November 2021.

Licensee C reports that the investigation has commenced and the outcome of that investigation to ASIC on 20 November 2021, satisfying the timing requirements.

How is a reportable situation reported to ASIC?

2.49 The report must be lodged by the financial services licensee in the form prescribed by ASIC. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(3) of the Corporations Act*]

2.50 The use of a prescribed form will enhance the efficiency and usefulness of the breach reporting process, as the reports will include the information and supporting documents required by ASIC to assess whether further action should be taken.

2.51 It is expected that the prescribed form will require financial services licensees to include at a minimum: information about the date the reportable situation occurred, a description of the reportable situation, whether and how the reportable situation has been rectified by the licensee, and the steps that have been or will be taken by the licensee to ensure future compliance.

2.52 This gives effect to recommendation 5 of the ASIC Enforcement Review Taskforce Report.

Where reports are received by APRA

2.53 A report that a financial services licensee is required to lodge in relation to its own reportable situations is taken to have been lodged with ASIC if:

- the licensee is also regulated by APRA; and
- the report is given to APRA containing all of the information that is required in a report in relation to the reportable situation.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(6) of the Corporations Act]

2.54 A financial services licensee may need to consider the form prescribed by ASIC to ensure that it gives APRA a report containing all the information that is required in a report about the reportable situation.

2.55 The licensee will also need to ensure it complies with the timing requirements set out in subsections 912DAB(4) and (5) when giving the report to APRA. This is because subsection 912DAB(6) does not operate as a general exemption from the requirement to report, but operates such that a report is taken to have been lodged with ASIC even though it has been physically lodged with APRA.

2.56 A general exemption from the requirement to report is set out in subsection 912DAB(7). This exemption applies if the licensee is also regulated by APRA and the auditor or actuary of the licensee has given APRA a written report about the reportable situation within 10 business days after the licensee reasonably knows that there are reasonable grounds to believe that the reportable situation has arisen. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAB(7) of the Corporations Act]*

2.57 These provisions recognise that there may be overlaps between the matters that need to be reported under the Corporations Act and under other legislation, such as the SIS Act. These provisions reduce the compliance burden on licensees that are dual-regulated, as these licensees will only need to report the matter to one regulator to satisfy their reporting obligations.

Consequences of failing to satisfy self-reporting obligations

2.58 Failure to lodge a report in accordance with the self-reporting obligations is an offence with a maximum penalty of 2 years imprisonment. It is an offence if:

- a licensee does not lodge a report with ASIC in the required timeframe if it has reasonable grounds to believe that a reportable situation has arisen in relation to the licensee;
- a licensee does not lodge a report with ASIC in the required timeframe if it has commenced an investigation into whether

the licensee has breached a core obligation and the investigation discloses no reasonable grounds to believe that the licensee has breached the core obligation; or

- a report that is required to be lodged with ASIC is not lodged in writing in the prescribed form.

[Schedule [1.6, 2.8, 2.9 and 7.2], items 5, 10 and 11, subsections 912DAB(1) and (2), and Schedule 3 to the Corporations Act]

2.59 As a fault element is not specified for a circumstance (in this case, the circumstance that there are reasonable grounds to believe that a reportable situation has arisen), the fault elements for the physical element of the offence are knowledge or recklessness, as provided for by the Criminal Code. Applying default fault elements is consistent with Part 2.2.4 of the Guide.

2.60 The maximum penalty of 2 years imprisonment reflects the seriousness of the offence, and aims to deter and punish the behaviour as appropriate while ensuring the effectiveness of the breach reporting regime. Maximum penalties also provide a court with guidance on how to punish criminal behaviour. The maximum penalty is generally reserved only for the most egregious cases.

2.61 Failure to lodge a report as required by either subsection 91DAB(1) or (2) is also a civil penalty provision. *[Schedule [1.6, 2.8, 2.9 and 7.2], items 5, 7 and 8, subsections 912DAB(8) and 1317E(3) of the Corporations Act]*

2.62 The standard maximum financial penalty for a contravention of a civil penalty provision under the Corporations Act is:

- for individuals, the greater of:
 - 5,000 penalty units; or
 - if the court can determine—the benefit derived or detriment avoided because of the contravention, multiplied by three;
- for bodies corporate, the greater of the following:
 - 50,000 penalty units;
 - if the court can determine—the benefit derived or detriment avoided by the body corporate because of the contravention, multiplied by three;
 - 10 per cent of the annual turnover of the body corporate, but to a maximum monetary value of 2.5 million penalty units.

2.63 The offence provisions will also be subject to an infringement notice. It is expected that regulations will be made for this purpose. The

use of an infringement notice is appropriate as it is expected that there will be a high volume of contraventions of the reporting provisions. The Guide highlights failing to comply with reporting obligations as an example of a case where infringement notices are generally used.

2.64 Further, it is expected that the severity of contraventions – defined by the nature and scale of the reportable situation which has not been reported as required – will range from minor to severe. It is consistent with the Guide that infringement notices are available for more minor offences.

2.65 Minor offences may be caused by poor internal processes. Where this is the case, the use of infringement notices may lead to a faster rectification of processes, as firms are put on notice by ASIC sooner.

2.66 These enforcement options give ASIC sufficient flexibility to pursue the most appropriate action in each case, depending on its assessment of the severity and nature of the reportable situation. These options are also consistent with the existing consequences for failures relating to breach reports.

2.67 This gives effect to recommendations 6 and 7 of the ASIC Enforcement Review Taskforce Report.

Reporting on other financial services licensees to ASIC

2.68 A financial services licensee (the reporting licensee) will also be required to lodge a report with ASIC if the licensee has reasonable grounds to *suspect* that a reportable situation has arisen about an individual who:

- provides personal advice to retail clients about relevant financial products; and
- is operating under another financial services licence.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(1) of the Corporations Act]

2.69 Relevant financial products are defined in section 910A of the Corporations Act as financial products other than basic banking products, general insurance products, consumer credit insurance, or a combination of any of those products.

2.70 This obligation targets misconduct by, and serious compliance concerns about, individual financial advisers who provide personal advice to retail clients about more complex financial products.

2.71 There is a lower threshold for reporting on other financial services licensees (that is, reasonable grounds to suspect as opposed to reasonable grounds to believe). The rationale for this lower threshold is as a practical matter, it may be difficult for a financial services licensee to be

able to come to a belief that a reportable situation has arisen in relation to another licensee as the reporting licensee will not have access to all of the relevant information needed to develop such a belief.

2.72 In practice, a reporting licensee will likely develop reasonable grounds to suspect that a reportable situation has arisen in relation to another financial adviser through a relationship of proximity between the two entities. For example, this may occur because of business dealings between the two entities or through mutual customers.

2.73 A reporting licensee who gives information to ASIC as required by this reporting obligation generally has the benefit of qualified privilege under section 1100A of the Corporations Act. This means the reporting licensee has qualified privilege in proceedings for defamation, or is not liable to an action for defamation if the reporting licensee had no malice when making the report to ASIC. A licensee who lodges a false report under this section for an improper motive, for example to undermine a competitor, will not have the benefit of qualified privilege in an action for defamation.

2.74 This reporting obligation only applies in relation to other financial services licensees. If a licensee has reasonable grounds to suspect that a reportable situation has arisen in relation to its own financial advisers, it is expected the licensee will commence an investigation and report that matter under section 912DAB.

Timing for reporting a breach

2.75 The report must be lodged with ASIC within 30 calendar days after the reporting licensee first reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen in relation to another licensee. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(3) of the Corporations Act*]

2.76 This is consistent with the general timing rules for self-reporting of matters to ASIC.

How is a reportable situation reported to ASIC?

2.77 The report must be lodged by the reporting licensee in the form prescribed by ASIC. This ensures the report includes the information and supporting documents required by ASIC to assess whether further action should be taken. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(2) of the Corporations Act*]

Informing the other financial services licensee

2.78 The reporting licensee will also need to provide a copy of the report lodged with ASIC to the licensee who is the subject of that report. In some cases, this will require the reporting licensee to provide a copy of the report directly to the financial adviser if the adviser operates under their own financial services licence, or to a financial services licensee who

is no longer involved with the financial adviser (for example, a previous employer). [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(7) of the Corporations Act*]

2.79 Upon receiving a copy of the report, the licensee who is the subject of that report may need to commence an investigation and report that matter to ASIC under section 912DAB.

2.80 The copy of the report needs to be provided to the other licensee within 30 calendar days after the reporting licensee first reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen. This is the same timeframe for reporting the matter to ASIC. As a matter of practice, reporting licensees will likely provide the copy to the other licensee at the same time the report is lodged with ASIC, or shortly after.

2.81 This obligation supports the new requirement to be imposed on licensees to take steps to remediate an affected client when they detect misconduct – either arising from their own behaviour or that of a representative under their licence (see recommendation 2.9 of the Financial Services Royal Commission). The new obligation will require licensees to inform a client who is potentially affected by the detected misconduct, and to investigate the nature and full extent of the detected misconduct. As part of this investigation, licensees will be required to determine the quantum of any loss or damage to the client caused by the misconduct. Once the investigation complete, the licensee is required to inform the affected client of the nature and full extent of the misconduct and remediate the client’s loss.

Example 2.5

Licensee C is a financial product issuer. Rachel was authorised to provide financial advice under Licensee D’s licence and provided personal advice to retail clients about Licensee C’s products from 1 January 2021 to 1 May 2022. After finalising an audit for the financial year 2021-22 on 1 September 2022, Licensee C reasonably knows that there are reasonable grounds to suspect that a reportable situation has arisen in relation to Licensee D, as Rachel, acting under Licensee D’s licence provided poor personal advice that amounted to gross negligence.

Licensee C is required to lodge a report with ASIC within 30 calendar days after 1 September 2022. Licensee C is also required to provide a copy of that report to Licensee D within 30 calendar days after 1 September 2022 even though Rachel no longer works under Licensee D’s licence.

Example 2.6

Liz is authorised to provide financial product advice under both Licensee E’s licence and Licensee F’s licence. Following a customer

complaint about Liz's conduct, Licensee F has reasonable grounds to suspect that a reportable situation has arisen about Licensee E, as Liz, acting within authority in relation to Licensee E, has not been complying with the best interests obligations when providing personal advice to retail clients.

Licensee F is required to lodge a report with ASIC within 30 calendar days after developing that suspicion, and is also required to provide a copy of that report to Licensee E in the same timeframe.

Licensee F also commences an investigation into whether Liz, while acting within the authority of Licensee F, has failed to comply with the financial services law. Licensee F concludes that if there has been a breach of the obligation to comply with the financial services law, that breach would be significant because the breach constitutes a contravention of a civil penalty provision. Licensee F is required to report the commencement of the investigation to ASIC within 30 calendar days as this is a reportable situation. Licensee F is also required to report the outcome of the investigation to ASIC within 10 calendar days.

Where reports are received by APRA

2.82 A report that a reporting licensee is required to lodge about another licensee is taken to have been lodged with ASIC if:

- the reporting licensee is also regulated by APRA; and
- the report is given to APRA containing all of the information that is required in a report about the reportable situation.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(4) of the Corporations Act]

2.83 A reporting licensee may need to consider the form prescribed by ASIC for the purposes of lodging reports about other financial services licensees to ensure that it gives APRA a report containing all the information that is required in a report about the reportable situation. The reporting licensee will also need to ensure it gives the report to APRA within 30 calendar days after it reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen.

2.84 A general exemption from the requirement to report about another financial services licensee applies if:

- the reporting licensee is also regulated by APRA; and
- the auditor or actuary of the reporting licensee has given APRA a written report about the reportable situation within 10 business days after the licensee reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(5) of the Corporations Act]

2.85 These provisions aim to reduce the compliance burden on licensees that are regulated by both ASIC and APRA.

No need to report if reasonable grounds to believe ASIC is aware

2.86 A financial services licensee is not required to lodge a report with ASIC about another financial services licensee if the first licensee has reasonable grounds to *believe* that ASIC is aware of:

- the existence of the reportable situation; and
- all of the information that would otherwise be required in a report about the reportable situation.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAC(6) of the Corporations Act]

2.87 This is a high threshold that is primarily intended to reduce instances of reporting matters to ASIC that are publicly well known about an individual financial adviser of another financial services licensee where the first licensee has no additional information to report.

2.88 This exemption only applies to reporting on other financial services licensees. It does not apply in relation to reporting on a licensee's own matters.

Consequences of failing to satisfy reporting obligations in relation to another financial services licensee

2.89 Failure to lodge a report in accordance with these obligations is an offence with a maximum penalty of 2 years imprisonment. Subject to the exemptions above, it is an offence if:

- a licensee does not lodge a report with ASIC within 30 calendar days after developing reasonable grounds to suspect that a reportable situation has arisen about another licensee;
- a report that is required to be lodged with ASIC is not lodged in writing in the prescribed form; or
- a reporting licensee does not provide a copy of the report to the other licensee within 30 calendar days after developing reasonable grounds to suspect that a reportable situation has arisen about the other licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], items 5 and 11, subsections 912DAC(1) and (7), and Schedule 3 to the Corporations Act]

2.90 The fault elements for the physical element of the offences are knowledge or recklessness, as provided for by the Criminal Code.

2.91 The maximum penalty of 2 years reflects the seriousness of the offence, and aims to deter and punish the behaviour as appropriate. It is

also in line with community expectations about misconduct by financial advisers. Maximum penalties provide a court with guidance on how to punish criminal behaviour. The maximum penalty is generally reserved only for the most egregious cases.

2.92 Failure to lodge provide a report as required by either subsection 912DAC(1) or (7) is also a civil penalty provision, which is subject to the standard maximum financial penalties for a contravention of a civil penalty provision under the Corporations Act. [*Schedule [1.6, 2.8, 2.9 and 7.2], items 5 and 8, subsections 912DAC(8) and 1317E(3) of the Corporations Act*]

2.93 The offence provisions will also be subject to the infringement notice regime. It is expected that regulations will be made for this purpose. The use of an infringement notice is appropriate as it is expected that there will be a high volume of contraventions of the reporting provisions. The Guide highlights failing to comply with reporting obligations as an example of a case where infringement notices are generally used.

2.94 Further, it is expected that the severity of contraventions – defined by the nature and scale of the reportable situation which has not been reported as required – will range from minor to severe. It is consistent with the Guide that infringement notices are available for more minor offences.

2.95 Minor offences may be caused by poor internal processes. Where this is the case, the use of infringement notices may lead to a faster rectification of processes, as firms are put on notice by ASIC sooner.

2.96 These enforcement options give ASIC sufficient flexibility to pursue the most appropriate action in each case, depending on the severity and nature of the reportable situation. These options are also consistent with the existing consequences for failures relating to breach reports.

Participants in a licensed market or a licensed CS facility

2.97 A financial services licensee must give written notice to ASIC as soon as practicable if the licensee becomes a participant in a licensed market or a licensed CS facility, or ceases to be such a participant. [*Schedule [1.6, 2.8, 2.9 and 7.2], items 5, 10 and 11, subsections 912DAD(1) and (3) to the Corporations Act*]

2.98 The notice must set out when the event happened, identify the market or facility, and be in the prescribed form. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAD(2) of the Corporations Act*]

2.99 Failure to comply with this requirement is an offence with a maximum penalty of 1 year imprisonment. It is also a civil penalty provision. [*Schedule [1.6, 2.8, 2.9 and 7.2], items 5, 7 and 8, subsections 912DAD(1) and (4), and 1317E(3) of the Corporations Act*]

2.100 This provision rewrites existing subsection 912D(2) of the Corporations Act.

ASIC publication of breach reporting data

2.101 ASIC will be required to publish information about reports lodged under section 912DAB of the Corporations Act during the financial year about significant breaches and likely breaches of core obligations. This includes reports lodged with APRA by dual regulated licensees or their auditors and actuaries. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, paragraphs 912DAE(1)(a) and (b) of the Corporations Act]*

2.102 ASIC’s publication must contain information about the licensees that have lodged reports about their own significant breaches and likely breaches of core obligations. This means the publication will contain licensee-level data. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, paragraph 912DAE(1)(c) of the Corporations Act]*

2.103 Subject to any legislative requirements, ASIC has discretion as to the contents and form of the publication. It is expected that the publication may include the following kinds of information:

- the name of the licensee;
- volume of reported breaches;
- breakdown of breach reports by corporate group; and
- the number of breaches compared to the size, activity or volume of business associated with an entity.

2.104 ASIC’s publication will not include information about reports regarding investigations into whether a significant breach of a core obligation has occurred, or reports made about other financial services licensees.

2.105 ASIC will be required to publish this information on its website within four months after the end of each financial year, starting on the financial year ending on 30 June 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, paragraphs 912DE(2)(a) and (b) of the Corporations Act]*

2.106 The information published must include any information prescribed by the regulations, which may include personal information under the *Privacy Act 1988* about a financial services licensee who is an individual. It is expected that the regulation making power will be exercised to allow ASIC to publish the names of financial services licensees where the licence is held in the name of an individual, as this would constitute personal information. This will allow ASIC to publish breach report data at the licensee-level consistently and ensures licensees who hold a licence in the name of an individual are not excluded from

publication. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, paragraph 912DAE(2)(c) of the Corporations Act]*

2.107 Regulations may also be made to prescribe circumstances in which information need not be included in ASIC's publication. It is expected the regulation making power will be exercised to allow ASIC to avoid publishing information that could prejudice an investigation or court proceeding. This regulation making power provides an appropriate balance to the broad requirement on ASIC to publish breach report data at the licensee-level. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAE(3) of the Corporations Act]*

2.108 The information must also be organised in accordance with the regulations, if any. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, paragraph 912DAE(2)(d) of the Corporations Act]*

2.109 Regulations made for the purposes of these provisions would be subject to disallowance and parliamentary scrutiny.

2.110 ASIC may also correct any error in, or omission from, a report published under this section. This reflects the intention of Australian Privacy Principles 10 and 13, which are set out in Schedule 1 to the *Privacy Act 1988*. The correction may be initiated by an affected entity or by ASIC. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 5, subsection 912DAE(4) of the Corporations Act]*

2.111 This supplements ASIC's existing reporting framework to enhance accountability and provide an incentive for improved behaviour. It will also assist industry and consumers to identify areas where significant numbers of breaches are occurring, and allow licensees to target their efforts to improve their compliance outcomes in those areas.

2.112 This give effect to recommendation 10 of the ASIC Enforcement Review Taskforce Report.

Amendments to the Credit Act

2.113 The amendments made to the Credit Act largely replicate the rewritten provisions in the Corporations Act, with some modifications to reflect the differences between the credit and financial services industries and its participants. These amendments give effect to recommendation 2 of the ASIC Enforcement Review Taskforce Report.

Matters that may need to be reported to ASIC

2.114 Matters that may need to be reported to ASIC are referred to as reportable situations. The reportable situations are set out in section 50A of the Credit Act and can be broadly separated into two categories: reportable situations relating to core obligations (core reportable situations) and additional reportable situations. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsections 50A(1) and (2) of the Credit Act]*

Core reportable situations

2.115 A core reportable situation will arise where:

- the credit licensee or its representative has breached or is likely to breach a core obligation; or
- the credit licensee has commenced an investigation into whether the licensee or its representative has breached a core obligation; and

in either case, the breach or likely breach is significant.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(1) of the Credit Act]

2.116 A credit licensee is also considered to have commenced an investigation if it outsources the handling of the investigation, or if another related entity (such as a parent company) commences the investigation.

What are the core obligations?

2.117 The core obligations largely replicate the core obligations in the Corporations Act to the extent it is relevant in the Credit Act context. The core obligations are:

- the general conduct obligations on credit licensees under section 47 of the Credit Act, other than the obligation under paragraph 47(1)(d) of the Credit Act; and
- the obligation to comply with certain credit legislation under paragraph 47(1)(d) of the Credit Act.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(3) of the Credit Act]

What does 'likely to breach' mean?

2.118 A credit licensee is likely to breach a core obligation if, and only if, the person is no longer able to comply with the obligation. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(4) of the Credit Act]*

Example 2.7

Licensee G becomes aware that it will not be able to lodge its annual compliance certificate within the required timeframe as it has a poor record keeping system and is unable to find the information needed to complete the certificate. ASIC has advised that it is unable to consider Licensee G's application for an extension of time to lodge the certificate before it is due.

Licensee G is therefore likely to breach its obligation to comply with the credit legislation.

When is a breach or likely breach ‘significant’?

2.119 Breaches or likely breaches of core obligations, or investigations of such breaches only need to be reported if the breach or likely breach is significant.

2.120 The test for when a breach or likely breach is significant has two components.

2.121 A breach or likely breach of a core obligation is *taken* to be significant if any of the following circumstances apply:

- the breach is punishable on conviction by a penalty that may include imprisonment for a maximum period of:
 - if the offence involves dishonesty—3 months or more; or
 - in any case—12 months or more; or
- the breach constitutes a contravention of a civil penalty provision; or
- the breach results in or is likely to result in loss or damage to a credit activity client of the licensee; or
- any other circumstances prescribed by the regulations exist.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(5) of the Credit Act]

2.122 A ‘credit activity client’ of a licensee has a broad definition that takes into account the numerous credit activities regulated under the Credit Act. A credit activity client of a licensee therefore includes a consumer who:

- is a party to a credit contract, or will be a party to a proposed credit contract;
- is a person to whom the licensee or its representative provides a credit service;
- is a party to a consumer lease, or will be a party to a proposed consumer lease;
- is a mortgagor under a mortgage, or will be a mortgagor under a proposed mortgage;
- is the guarantor under a guarantee or will be the guarantor under a proposed guarantee; or
- is a person in relation to whom the licensee or its representative engaged in a prescribed activity under table item 6 of subsection (6)(1) of the Credit Act.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(7) of the Credit Act]

2.123 A regulation making power is included to prescribe circumstances in which a breach or likely breach of a core obligation is taken to be significant. This allows the Government to respond quickly and effectively to emerging trends of non-compliance in the credit sector to ensure the breach reporting regime is fit for purpose and achieves the intended policy outcome. Any regulations made would be subject to disallowance and parliamentary scrutiny.

2.124 If none of the circumstances in subsection 50A(5) of the Credit Act apply, the credit licensee will be required to make an assessment under subsection 50A(6) of the Credit Act to determine whether a breach or likely breach or a core obligation is significant. This requires the credit licensee to have regard to the following:

- the number or frequency of similar previous breaches;
- the impact of the breach or likely breach on the licensee’s ability to engage in credit activities covered by the licence;
- the extent to which the breach or likely breach indicates that the licensee’s arrangements to ensure compliance with those obligations are inadequate; and
- any other matters prescribed by regulations.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(6) of the Credit Act]

2.125 The formulation of the significance test mirrors the test in the Corporations Act. By having an additional set of objectively determinable criteria, it is intended to clearly set out the Government’s expectation for when a breach or likely breach of a core obligation is significant and therefore reportable to ASIC. This will provide greater certainty for credit licensees, resulting in consistent reporting, improved regulatory oversight and better outcomes for credit activity clients.

Additional reportable situations

2.126 Additional reportable situations are not linked to the core obligations or the significance test. Additional reportable situations arise for a credit licensee if:

- in the course of engaging in a credit activity, the licensee or its representative has engaged in conduct constituting gross negligence; or
- the credit licensee or its representative has committed serious fraud.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50A(2) of the Credit Act]

2.127 Serious fraud is defined in section 5 of the Credit Act and means an offence involving fraud or dishonesty against an Australian law or any

other law that is punishable by imprisonment for life or for a period, or maximum period, of at least three months.

2.128 Conduct that constitutes gross negligence or serious fraud must be reported to ASIC because of the potentially considerable detriment that could be caused to a credit activity client as a result of that conduct.

2.129 These additional reportable situations give effect to the concerns identified by Commissioner Hayne in relation to recommendation 1.6 of the Financial Services Royal Commission to the extent it relates to recommendation 2.8. That is, serious compliance concerns about mortgage brokers.

2.130 A regulation making power is also included to prescribe circumstances in which an additional reportable situation arises. This allows the Government to respond effectively to emerging trends of non-compliance in the credit sector, particularly if those trends of non-compliance are not directly linked to the core obligations. Any regulations made would be subject to disallowance and parliamentary scrutiny.

Self-reporting obligations to ASIC

2.131 Section 50C sets out the obligation for a credit licensee to report to ASIC about its own reportable situations, including reportable situations arising from the conduct of its representatives.

2.132 A credit licensee is required to report to ASIC if there are reasonable grounds to *believe* that a reportable situation has arisen about the licensee (including about its representatives). [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(1) of the Credit Act*]

2.133 There will be an obligation to lodge a report with ASIC if a licensee has commenced an investigation into whether it has breached a core obligation (as this is a reportable situation) and an obligation to report if at the end of the investigation, the licensee concludes that there has been a breach of a core obligation that is significant (as this is another reportable situation). The same obligations arise if the licensee has reported a likely significant breach of a core obligation, and that likely breach eventuates into a significant breach of a core obligation. This is because each of these events is a different reportable situation.

2.134 Additionally, a credit licensee is required to report to ASIC if the licensee has commenced an investigation into whether the licensee or its representative has breached a core obligation and the investigation discloses no reasonable grounds to believe that the licensee or its representative has breached the core obligation. This ensures ASIC has oversight over the progress of an investigation process. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(2) of the Credit Act*]

Timing for reporting

2.135 A report must be lodged within 30 calendar days after the credit licensee first reasonably knows there are reasonable grounds to believe the reportable situation has arisen. This timeframe gives licensees sufficient time to investigate and determine whether a breach or likely breach that is significant has occurred or will occur before reporting that matter to ASIC. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(5) of the Credit Act]*

2.136 A person reasonably knows of a circumstance if:

- the person is aware that the circumstance exists or will exist in the ordinary course of events; or
- the person is aware of a substantial risk that the circumstance exists or will exist, and having regard to the circumstances known to the person, it is unjustifiable to take the risk.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, section 50B of the Credit Act]

2.137 The concept of ‘reasonably knows’ is based on the definition of ‘knowledge’ and ‘recklessness’ in the Criminal Code. It is intended to capture circumstances where, on the facts available, the credit licensee either has knowledge that a reportable situation has arisen, or may not have actual knowledge but ought to have knowledge that a reportable situation has arisen.

2.138 However, the credit licensee must report the outcome of an investigation within 10 calendar days after the licensee first reasonably knows the outcome of the investigation. This shorter timeframe is appropriate because at this stage of the process, the licensee is not required to make any further enquiries. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(6) of the Credit Act]*

2.139 As a practical matter, if a credit licensee commences and concludes an investigation within 30 calendar days, the licensee may report the commencement of an investigation at the same time the outcome of the investigation is reported in order to meet the timing requirements.

Example 2.8

On 1 February 2022, Licensee H commences an investigation into whether one of its representatives has failed to provide a credit guide to a consumer in relation to a credit contract while providing credit assistance to that consumer.

This is a reportable situation as it is an investigation into whether the licensee or its representative has breached a core obligation (that is, a breach of obligation to comply with the credit legislation), and the breach is significant (as the breach constitutes a contravention of a civil penalty provision).

Licensee H must report the commencement of the investigation to ASIC before 4 March 2022 (30 calendar days after it reasonably knows there are reasonable grounds to believe that the reputable situation has arisen).

On 4 February 2022, Licensee H concludes that it has breached a core obligation that is significant. Licensee H must report this outcome to ASIC before 15 February 2022. Licensee H subsequently reports that the investigation has commenced, and the outcome of that investigation to ASIC on 14 February 2022, satisfying the timing requirements.

How is a reportable situation reported to ASIC?

2.140 The report must be lodged by the credit licensee in the form approved by ASIC. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(4) of the Credit Act*]

2.141 The use of an approved form will enhance the efficiency and usefulness of the breach reporting regime because the reports will include the information and supporting documents required by ASIC to assess whether further action should be taken.

2.142 It is expected that the approved form will require licensees to include at a minimum: information about the date the reportable situation arose, a description of the reportable situation, whether and how the reportable situation has been rectified, and the steps that have been or will be taken by the licensee to ensure future compliance.

Where reports are received by APRA

2.143 A report that a credit licensee is required to lodge in relation to its own reportable situations is taken to have been lodged with ASIC if:

- the licensee is also regulated by APRA; and
- the report is given to APRA containing all of the information that is required in a report in relation to the reportable situation.

[*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(7) of the Credit Act*]

2.144 A credit licensee may need to consider the form approved by ASIC to ensure that it gives APRA a report containing all the information that is required about the reportable situation.

2.145 The licensee will also need to ensure it complies with the timing requirements set out in subsections 50C(5) and (6) of the Credit Act when giving the report to APRA. This is because subsection 50C(7) of the Credit Act does not operate as a general exemption from the requirement to report, but operates such that a report is taken to have been lodged with ASIC even though it has been physically lodged with APRA.

2.146 A general exemption from the requirement to report is set out in subsection 50C(8) of the Credit Act. This exemption applies if the credit licensee is also regulated by APRA and the auditor or actuary of the licensee has given APRA a written report about the reportable situation within 10 business days after the licensee reasonably knows that there are reasonable grounds to believe that the reportable situation has arisen. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(8) of the Credit Act]*

2.147 These provisions recognise that there may be overlaps between the matters that need to be reported under the Credit Act and under other legislation. These provisions reduce the compliance burden on licensees that are dual-regulated, as these licensees will only need to report the matter to one regulator to satisfy their reporting obligations.

Consequences of failing to satisfy self-reporting obligations

2.148 Failure to lodge a report in accordance with the self-reporting obligations is an offence with a maximum penalty of 2 years imprisonment. It is therefore an offence if:

- a licensee does not lodge a report with ASIC in the required timeframe if it has reasonable grounds to believe that a reportable situation has arisen about the licensee;
- a licensee does not lodge a report with ASIC in the required timeframe if it has commenced an investigation into whether the licensee has breached a core obligation and the investigation discloses no reasonable grounds to believe that the licensee has breached the core obligation; or
- a report that is required to be lodged with ASIC is not lodged in writing in the approved form.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(3) of the Credit Act]

2.149 As a fault element is not specified in relation to a circumstance (in this case, the circumstance that there are reasonable grounds to believe that a reportable situation has arisen), the fault elements for the physical element of the offence are knowledge or recklessness, as provided for by the Criminal Code. Applying default fault elements is consistent with Part 2.2.4 of the Guide.

2.150 The maximum penalty of 2 years imprisonment reflects the seriousness of the offence, and aims to deter and punish the behaviour as appropriate while ensuring the effectiveness of the breach reporting regime. Maximum penalties also provide a court with guidance on how to punish criminal behaviour. The maximum penalty is generally reserved only for the most egregious cases.

2.151 Failure to lodge a report as required by either subsection 50C(1) or (2) of the Credit Act is also a civil penalty provision. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsections 50C(1) and (2) of the Credit Act*]

2.152 The specified financial penalty for the contravention of these civil penalty provisions is 5,000 penalty units. However, the maximum penalty applicable in light of section 167B of the Credit Act is:

- for individuals, the greater of:
 - 5,000 penalty units; or
 - if the court can determine—the benefit derived or detriment avoided because of the contravention, multiplied by three;
- for bodies corporate, the greater of the following:
 - 5,000 penalty units multiplied by ten (50,000 penalty units);
 - if the court can determine—the benefit derived or detriment avoided by the body corporate because of the contravention, multiplied by three;
 - 10 per cent of the annual turnover of the body corporate, but to a maximum monetary value of 2.5 million penalty units.

2.153 The offence provisions will also be subject to an infringement notice. It is expected that regulations will be made for this purpose. The use of an infringement notice is appropriate as it is expected that there will be a high volume of contraventions of the reporting provisions. The Guide supports employing infringement notices in these circumstances.

2.154 Further, it is expected that the severity of contraventions – defined by the nature and scale of the reportable situation which has not been reported as required - will range from minor to severe. It is consistent with the Guide that infringement notices are available for more minor offences.

2.155 Minor offences may be caused by poor internal processes. Where this is the case, the use of infringement notices may lead to a faster rectification of these processes, as firms are put on notice by ASIC sooner.

2.156 Notably, the Guide highlights failing to comply with reporting obligations as an example of a case where infringement notices are generally used.

2.157 These enforcement options give ASIC sufficient flexibility to pursue the most appropriate action in each case, depending on the severity and nature of the reportable situation. These options are also consistent

with the existing consequences for failures relating to breach reports in the Corporations Act.

Reporting on other credit licensees to ASIC

2.158 A credit licensee (the reporting licensee) will also be required to lodge a report with ASIC if the licensee has reasonable grounds to *suspect* that a reportable situation has arisen about an individual who:

- is a mortgage broker; and
- is operating under another credit licence.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(1) of the Credit Act]

2.159 A mortgage broker is defined in section 15B of item 4 of Schedule 3 to the Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019 as a licensee or credit representative of a licensee that:

- carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property;
- does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts; and
- in carrying on that business, provides credit assistance in relation to credit contracts offered by more than one credit provider.

2.160 This reporting obligation therefore targets misconduct by and serious compliance concerns about individual mortgage brokers. It also recognises that in the industry, other parties such as lenders and aggregators are often well positioned to identify this misconduct.

2.161 There is a lower threshold for reporting on other credit licensees (that is, reasonable grounds to suspect as opposed to reasonable grounds to believe). The rationale for this lower threshold is because it may be difficult for a credit licensee to come to a belief that a reportable situation has arisen about another licensee as the reporting licensee may not have access to the relevant information needed to develop such a belief.

2.162 In practice, a credit licensee will likely develop reasonable grounds to suspect that a reportable situation has arisen about another mortgage broker through the proximity between the two entities. For example, this may occur because of business dealings between the two entities or through mutual customers.

2.163 A credit licensee who gives information to ASIC as required by this reporting obligation generally has the benefit of qualified privilege

under section 243 of the Credit Act. This means the reporting licensee has qualified privilege in proceedings for defamation, or is not liable to an action for defamation if the reporting licensee had no malice when making the report to ASIC. A credit licensee who lodges a false report under this section for an improper motive, for example to undermine a competitor, will not have the benefit of qualified privilege in an action for defamation.

2.164 This reporting obligation only applies to other credit licensees. If a credit licensee has reasonable grounds to suspect that a reportable situation has arisen about a mortgage broker operating under its licence, it is expected the credit licensee will commence an investigation and report that matter under section 50C of the Credit Act.

Timing for reporting a breach

2.165 The report must be lodged with ASIC within 30 calendar days after the reporting licensee first reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen about another credit licensee. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50C(3) of the Credit Act*]

2.166 This is consistent with the general timing rules for self-reporting of matters to ASIC.

How is a reportable situation reported to ASIC?

2.167 The report must be lodged by the reporting licensee in the form approved by ASIC. This ensures the report will include the information and supporting documents required by ASIC to assess whether further action should be taken. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(2) of the Credit Act*]

Informing the other credit licensee

2.168 The reporting licensee will also need to provide a copy of the report lodged with ASIC to the credit licensee who is the subject of that report. In some cases, this will require the reporting licensee to provide a copy of the report directly to the mortgage broker if the broker holds their own credit licence and is operating under that licence, or to a licensee who is no longer involved with the mortgage broker (for example, a previous employer). [*Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(7) of the Credit Act*]

2.169 Upon receiving a copy of the report lodged with ASIC, a licensee who is the subject of that report may need to commence an investigation into that matter and report to ASIC under section 50C of the Credit Act.

2.170 The copy of the report needs to be provided to the other credit licensee within 30 days after the reporting licensee first reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen. This is the same timeframe for reporting the matter to ASIC.

As a matter of practice, reporting licensees will likely provide the copy to the other licensee at the same time as the report is lodged with ASIC, or shortly after.

2.171 This obligation supports the new requirement to be imposed on licensees to take steps to remediate an affected client when they detect misconduct arising either from their own behaviour or that of a representative under their licence (see recommendation 2.9 of the Financial Services Royal Commission).

Where reports are received by APRA

2.172 A report that a reporting licensee is required to lodge about another credit licensee is taken to have been lodged with ASIC if:

- the licensee is also regulated by APRA; and
- the report is given to APRA and it contains all of the information that is required about the reportable situation.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(4) of the Credit Act]

2.173 A reporting licensee may need to consider the form approved by ASIC for the purposes of lodging reports about other credit licensees to ensure that it gives APRA a report containing all the information that is required about the reportable situation. The reporting licensee will also need to ensure it gives the report to APRA within 30 calendar days after it reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen.

2.174 A general exemption from the requirement to report about another credit licensee applies if:

- the reporting licensee is also regulated by APRA; and
- the auditor or actuary of the reporting licensee has given APRA a written report about the reportable situation within 10 business days after the licensee reasonably knows that there are reasonable grounds to suspect that the reportable situation has arisen.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(5) of the Credit Act]

2.175 These provisions aim to reduce the compliance burden on licensees that are regulated by both ASIC and APRA.

No need to report if reasonable grounds to believe ASIC is aware

2.176 A credit licensee is not required to lodge a report with ASIC about another licensee if the first licensee has reasonable grounds to believe that ASIC is aware of:

- the existence of the reportable situation; and

- all of the information that would otherwise be required in a report about the reportable situation.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(6) of the Credit Act]

2.177 This is a high threshold that is primarily intended to reduce instances of reporting matters to ASIC that are publicly well known about an individual mortgage broker where the credit licensee has no additional information to report.

2.178 This exemption only applies in relation to reporting on other credit licensees. It does not apply in relation to reporting on the licensee's own matters.

Consequences of failing to satisfy reporting obligations about another credit licensee

2.179 Failure to lodge a report in accordance with these obligations is an offence with a maximum penalty of 2 years imprisonment. Subject to the exemptions above, it is an offence if:

- a licensee does not lodge a report with ASIC within 30 calendar days after developing reasonable grounds to suspect that a reportable situation has arisen in relation to another credit licensee;
- a report that is required to be lodged with ASIC is not lodged in writing in the approved form; or
- a reporting licensee does not provide a copy of the report to the other licensee within 30 calendar days after developing reasonable grounds to suspect that a reportable situation has arisen about the other licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50D(8) of the Credit Act]

2.180 The fault elements for the physical element of the offences are knowledge or recklessness, as provided for by the Criminal Code. Applying default fault elements is consistent with Part 2.2.4 of the Guide.

2.181 The maximum penalty of 2 years reflects the seriousness of the offence, and aims to deter and punish the behaviour as appropriate. It is also in line with community expectations relating to misconduct by mortgage brokers. Maximum penalties provide a court with guidance on how to punish criminal behaviour. The maximum penalty is generally reserved only for the most egregious cases.

2.182 Failure to provide a report as required by either subsection 50D(1) or (7) of the Credit Act is also a civil penalty provision. The specified financial penalty for the contravention of these civil penalty provisions is 5,000 penalty units. However, the maximum pecuniary penalty applicable is:

- for individuals, the greater of:
 - 5,000 penalty units; or
 - if the court can determine—the benefit derived or detriment avoided because of the contravention, multiplied by three;
- for bodies corporate, the greater of the following:
 - 5,000 penalty units multiplied by ten (50,000 penalty units);
 - if the court can determine—the benefit derived or detriment avoided by the body corporate because of the contravention, multiplied by three;
 - 10 per cent of the annual turnover of the body corporate, but to a maximum monetary value of 2.5 million penalty units.

2.183 The offence provisions will also be subject to the infringement notice regime. It is expected that regulations will be made for this purpose. The use of an infringement notice is appropriate as it is expected that there will be a high volume of contraventions of the reporting provisions. The Guide supports employing infringement notices in these circumstances.

2.184 Further, it is expected that the severity of contraventions – defined by the nature and scale of the reportable situation which has not been reported as required – will range from minor to severe. It is consistent with the Guide that infringement notices are available for more minor offences.

2.185 Minor offences may be caused by poor internal processes. Where this is the case, the use of infringement notices may lead to a faster rectification of processes, as firms are put on notice by ASIC sooner.

2.186 Notably, the Guide highlights failing to comply with reporting obligations as an example of a case where infringement notices are generally used.

2.187 These enforcement options give ASIC sufficient flexibility to pursue the most appropriate action in each case, depending on the severity and nature of the reportable situation. These options are also consistent with the existing consequences for failures relating to breach reports in the Corporations Act.

ASIC publication of breach reporting data

2.188 ASIC will be required to publish information about reports lodged under section 50C of the Credit Act during the financial year about

significant breaches and likely breaches of core obligations. This includes reports lodged with APRA by dual regulated licensees or their auditors and actuaries. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, paragraphs 50E(1)(a) and (b) of the Credit Act]*

2.189 The publication must also contain information about credit licensees who have lodged reports about their own significant breaches and likely breaches of core obligations. This means the publication will contain licensee-level data. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, paragraph 50E(1)(c) of the Credit Act]*

2.190 Subject to any legislative requirements, ASIC has discretion as to the contents and form of the publication. It is expected that the publication may include the following kinds of information:

- the name of the credit licensee;
- volume of reported breaches;
- breakdown of breach reports by corporate group; and
- number of breaches compared to the size, activity or volume of business associated with an entity.

2.191 ASIC's publication will not include information about reports regarding investigations into whether a significant breach of a core obligation has occurred, or reports made about other financial services licensees.

2.192 ASIC will be required to publish this information on its website within four months after the end of each financial year, starting on the financial year ending on 30 June 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, paragraph 50E(2)(a) and (b) of the Credit Act]*

2.193 The information published by ASIC must include any information prescribed by the regulations, which may include personal information under the *Privacy Act 1988* about a credit licensee who is an individual. It is expected that the regulation making power will be exercised to allow ASIC to publish the names of credit licensees where the licence is held in the name of an individual, as this would be personal information. This will allow ASIC to publish breach report data at the licensee-level consistently and ensures licensees who hold a licence in the name of an individual are not excluded from the publication. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, paragraph 50E(2)(c) of the Credit Act]*

2.194 Regulations may also be made to prescribe circumstances in which information need not be included in ASIC's publication. It is expected the regulation making power will be exercised to allow ASIC to avoid publishing information that could prejudice an ASIC investigation or court proceedings. This regulation making power provides an appropriate balance to the broad requirement on ASIC to publish breach

report data at the licensee-level. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50E(3) of the Credit Act]*

2.195 The information must also be organised in accordance with the regulations, if any. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, paragraph 50E(2)(d) of the Credit Act]*

2.196 Regulations made for the purposes of these provisions would be subject to disallowance and parliamentary scrutiny.

2.197 ASIC may also correct any error in, or omission from, a report published under this section. This reflects the intention of Australian Privacy Principles 10 and 13, which are set out in Schedule 1 to the *Privacy Act 1988*. The correction may be initiated by an affected entity or by ASIC. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 15, subsection 50E(4) of the Credit Act]*

2.198 This supplements ASIC’s existing reporting framework to enhance accountability and provide an incentive for improved behaviour. It will also assist industry and consumers to identify areas where significant numbers of breaches or likely breaches are occurring, and allow licensees to target their efforts to improve their compliance outcomes in those areas.

Consequential amendments

Amendments to the Corporations Act

2.199 The new core obligation relating to a responsible entity of a registered scheme in new paragraph 912D(3)(e) of the Corporations Act brings into the breach reporting regime the existing requirement in paragraph 601FC(1)(l) of the Corporations Act. Paragraph 601FC(1)(l) of the Corporations Act is therefore repealed to avoid duplication. This streamlines the reporting requirements for responsible entities of a managed investment scheme. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 1, paragraph 601FC(1)(l) of the Corporations Act]*

2.200 The definitions in section 910A of the Corporations Act are updated to signpost the new definitions in these amendments, including the definition of ‘core obligation’, ‘reasonably knows’ and ‘reportable situation’. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 2, section 910A of the Corporations Act]*

2.201 The civil penalty and offence provisions for existing section 912D of the Corporations Act have also been repealed and subsequently replaced as the breach reporting provisions have been rewritten. *[Schedule [1.6, 2.8, 2.9 and 7.2], items 7 and 10, subsection 1317E(3) and Schedule 3 to the Corporations Act]*

2.202 Additional headings have also been introduced in Division 3 of Part 7.6 of the Corporations Act to add clarity. *[Schedule [1.6, 2.8, 2.9 and 7.2], items 3, 4 and 6, Subdivisions A, B and D of Division 3 of Part 7.6 of the Corporations Act]*

Amendments to the Credit Act

2.203 The definitions in subsection 5(1) of the Credit Act are updated to signpost the new definitions in these amendments, including the definition of ‘core obligation’ and ‘reportable situation’. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 12, subsection 5(1) of the Credit Act]*

2.204 Additional headings have also been introduced in Division 5 of Part 2-2 of the Credit Act to add clarity. *[Schedule [1.6, 2.8, 2.9 and 7.2], items 13, 14 and 16, Subdivisions A, B and D of Division 5 of Part 2-2 of the Credit Act]*

Application and transitional provisions

Amendments to the Corporations Act

2.205 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill commences on 1 July 2020. *[Clause 2]*

2.206 The new reporting obligations in sections 912DAB and 912DAC of the Corporations Act apply to all reportable situations arising on or after 1 April 2021. This period is designed to give industry and ASIC time to prepare their systems for the change. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 9, sections 1670 and 1670B of the Corporations Act]*

2.207 The obligation to give notice to ASIC in section 912DAD applies if a financial services licensee becomes or ceases to be a participant in a licensed market or a licensed CS facility on or after 1 April 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 9, sections 1670 and 1670C of the Corporations Act]*

2.208 Although paragraph 601FC(1)(l) and section 912D of the Corporations Act are repealed on 1 July 2020, these provisions continue to apply in relation to breaches or likely breaches that occur before 1 April 2021, even if the licensee becomes aware of the breach or likely breach after that date. This ensures there is no gap between the existing reporting obligations and the new reporting obligations introduced by Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 9, sections 1670 and 1670A of the Corporations Act]*

2.209 Reportable situations arising before 1 April 2021 therefore do not need to be reported to ASIC under the new reporting obligations. However, these reportable situations will need to be reported to ASIC if either existing paragraph 601FC(1)(l) or section 912D of the Corporations Act applies.

2.210 If a financial services licensee is uncertain about whether a breach, likely breach or reportable situation arose before or after 1 April 2021, the licensee should consider reporting the matter in the prescribed form under the new reporting obligations in 912DAB or 912DAC. Uncertainty may arise for example where there has been a course of continuous misconduct before and after 1 April 2021. This approach will generally be sufficient as the new reporting obligations are broader in scope and will require the licensee to provide more information compared with the existing reporting obligations.

2.211 ASIC will be required to publish information under section 912DAE of the Corporations Act starting on the financial year ending on 30 June 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 9, section 1670D of the Corporations Act]*

Amendments to the Credit Transitional Act

2.212 The new reporting obligations in the Credit Act apply to all reportable situations arising on or after 1 April 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 17, clauses 1 and 2 of Schedule 16 to the Credit Transitional Act]*

2.213 ASIC will be required to publish information under section 50E of the Credit Act starting on the financial year ending on 30 June 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 17, clause 3 of Schedule 16 to the Credit Transitional Act]*

Chapter 3

Implementing Recommendations 1.6 and 2.9 and of the Financial Services Royal Commission Investigating and Remediating Misconduct

Outline of chapter

3.1 In addition to the measures described in Chapter 2, Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill implements recommendations 1.6 and 2.9 of the Financial Services Royal Commission, which called for Australian financial services licensees and Australian credit licensees to be required, as a condition of their licence, to make whatever inquiries are reasonably necessary to determine the nature and full extent of the misconduct. Licensees are required to investigate potential and actual misconduct engaged in by financial advisers and mortgage brokers, and to inform and remediate affected clients.

Context of amendments

3.2 A person who carries on a financial services business must hold an Australian financial services licence (section 911A of the Corporations Act). A financial services licensee is subject to general obligations under section 912A of the Corporations Act, including the obligation to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly (paragraph 912A(1)(a) of the Corporations Act).

3.3 A financial services licensee must have in place adequate arrangements for compensating retail clients for loss or damage suffered because of breaches of the Corporations Act by the licensee or its representatives (section 912B of the Corporations Act).

3.4 Similarly, a person must not engage in a credit activity if the person does not hold an Australian credit licence authorising the person to engage in the credit activity (section 29 of the Credit Act). An Australian credit licensee is subject to general conduct obligations under section 47 of the Credit Act, including the obligation do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly (paragraph 47(1)(a) of the Credit Act).

3.5 A credit licensee must also have in place adequate arrangements for compensating consumers for loss or damage suffered because of breaches of the Credit Act by the licensee or its representatives (section 48 of the Credit Act).

3.6 ASIC’s Regulatory Guide 256 Client review and remediation conducted by advice licensees provide guidance in support of these obligations. Regulatory Guide 256 sets out guidance on client review and remediation that seeks to remediate clients who have suffered loss or detriment as a result of misconduct or other compliance failure by a financial services licensee or representative. Regulatory Guide 256 provides that the aim of review and remediation is for the licensee to proactively identify clients who have potentially been affected by the misconduct or other compliance failure, and to remediate those clients for any loss or detriment suffered.

3.7 Despite these requirements imposed on financial services licensees, the Financial Services Royal Commission found that when an Australian financial services licensee detects that an adviser has engaged in misconduct (whether by giving inappropriate advice or otherwise), entities do not always consider what steps they should take to see whether the adviser may have acted inappropriately in respect of matters other than those that are the immediate focus of attention. The Commission found that the result is that the damage done by an adviser may not come to light until long after the event, which works to the detriment of both the affected clients and the entity.

3.8 To address these findings, the Financial Services Royal Commission recommended (at recommendation 2.9) that a financial services licensee should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise):

- make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser’s misconduct; and
- where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

3.9 The Financial Services Royal Commission also recommended (at recommendation 1.6) that credit licensees should take the same steps in response to detecting misconduct of a mortgage broker as those referred to in recommendation 2.9 for financial advisers.

Summary of new law

3.10 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill implements recommendations 1.6 and 2.9 of the Financial Services Royal Commission, which called for Australian financial services licensees and credit licensees to be required, as a condition of their licence, to investigate potential and actual misconduct engaged in by financial advisers and mortgage brokers, and to inform and remediate affected clients.

3.11 The obligation on Australian financial services licensees and credit licensees to investigate and remediate contains two limbs:

- firstly, when a licensee detects misconduct, the licensee is required to:
 - within 30 days, inform potentially affected clients of misconduct; and
 - investigate the nature and full extent of any misconduct (including the loss or damage the affected client or consumer suffered or will suffer) within a reasonable amount of time; and
- secondly, once an investigation is complete, the licensee is required to:
 - within 10 days, inform the affected client of the nature and full extent of the misconduct; and
 - within 30 days, remediate the client’s or consumer’s loss.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Obligation to notify, investigate and provide a remedy for misconduct	
In addition to the current law, Australian financial services licensees and Australian credit licensees are subject to a specific obligation to notify clients of suspected misconduct, conduct investigations into suspected misconduct, and remediate affected clients.	An Australian financial services licensee is subject to general obligations under section 912A of the Corporations Act. This includes the obligation to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly.

<i>New law</i>	<i>Current law</i>
	<p>A financial services licensee is required under section 912B of the Corporations Act to have adequate compensation arrangements for loss or damage suffered by retail clients as a result of breaches of Australian financial services licence obligations.</p> <p>An Australian credit licensee is subject to general obligations under section 47 of the Credit Act. This includes the obligation to do all things necessary to ensure that the credit activities covered by the licence are provided efficiently, honestly and fairly.</p> <p>A credit licensee is required under section 48 of the Credit Act to have adequate compensation arrangements for loss or damage suffered by consumers as a result of breaches of Australian credit licence obligations.</p>
Penalties for failure to notify, investigate and provide a remedy for identified misconduct	
<p>In addition to the current law, Australian financial services licensees and Australian credit licences who fail to comply with the obligation to notify, investigate and remediate misconduct are subject to civil penalties and criminal penalties.</p>	<p>Australian financial services licensees and Australian credit licensees are subject to civil penalties for breach of their licensing obligations.</p>
Obligation to maintain records	
<p>Australian financial services licensees and Australian credit licensees are required to maintain records to demonstrate compliance with the requirement to notify, investigate and remediate misconduct.</p>	<p>No current equivalent.</p>

Detailed explanation of new law

Amendments to the Corporations Act

3.12 The amendments to the Corporations Act impose the new obligation to notify affected clients, and investigate and remediate misconduct under sections 912EA and 912EB of the Corporations Act.

3.13 Legislative references in this part of this Chapter are to the Corporations Act, unless otherwise specified.

Notifying clients affected by certain reportable situations

Obligation to notify affected clients regarding misconduct

3.14 Under the obligation to notify misconduct, an Australian financial services licensee must take reasonable steps to notify a person (the affected client) if all of the following are satisfied:

- the licensee or a representative of the licensee provides or has provided personal advice to the affected client as a retail client in relation to a relevant financial product;
- there are reasonable grounds for the licensee to believe that a reportable situation has arisen, and either:
 - that reportable situation amounts to a significant breach of a core obligation; or
 - that reportable situation amounts to gross negligence, serious fraud and other circumstances prescribed by the regulations; and
- there are reasonable grounds for the licensee to suspect that both:
 - the person has suffered or will suffer loss or damage as a result of the reportable situation; and
 - the person has a legally enforceable right to recover the loss or damage from the licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EA(1) of the Corporations Act]

3.15 The person that must be notified is the affected client. Notifying the client allows the client to consider their rights and the ways they can mitigate potential loss or damage arising from the reportable situation.

3.16 The circumstances where a licensee detects misconduct that has potentially resulted in loss or damage for a client are provided at paragraphs 912EA(1)(a), (b) and (c).

3.17 Firstly, there must be a person who receives or has received personal advice from the licensee or a representative of the licensee as a retail client in relation to a relevant financial product. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EA(1)(a) of the Corporations Act]*

3.18 Personal advice is defined in subsection 766(3) of the Corporations Act. Generally, personal advice is financial product advice that is given or directed to a person where:

- the advice has considered one or more of the person’s objectives, or
- a reasonable person might expect the provider to have considered one or more of those matters.

3.19 A representative of a licensee is defined in section 910A of the Corporations Act. This includes an authorised representative of the licensee, an employee or director of the licensee, an employee or director of a related body corporate of the licensee, or any other person acting on behalf of the licensee.

3.20 A retail client is defined in sections 761G and 761GA of the Corporations Act. Generally, a retail client includes persons where a financial product or service is provided to that individual or small business as a retail client.

3.21 Secondly, there must be reasonable grounds for the licensee to believe that:

- a reportable situation that amounts to a significant breach of a core obligation has arisen, or
- a reportable situation that amounts to gross negligence or serious fraud has arisen.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EA(1)(b) of the Corporations Act]

3.22 A licensee has reasonable grounds to believe in a circumstance when the licensee has grounds to believe in that circumstance and those grounds are reasonable. This threshold relies on the common law meaning of term ‘reasonable grounds to believe’ and is not defined by legislation for the purposes of this section. The requirement of reasonable grounds to believe in a circumstance requires positive belief in the truth or existence of the circumstance. This is a higher threshold than that of reasonable grounds to suspect a circumstance. In determining whether the grounds are reasonable, a person may take into account the facts and circumstances of the situation.

3.23 The core obligations of a licensee are defined at the breach reporting obligations under section 912D. These core obligations are

discussed at paragraphs 2.24 and 2.25 2.26 of this explanatory memorandum.

3.24 What constitutes a significant breach will depend on the circumstances of the case. This is discussed at paragraphs 2.28 to 2.33 of this explanatory memorandum.

3.25 A reportable situation as mentioned in subsection 912D(2) includes gross negligence, serious fraud, and any other circumstances prescribed by the regulations. This is discussed at paragraphs 2.34 to 2.38 of this explanatory memorandum. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subparagraph 912EA(1)(b)(ii) of the Corporations Act]*

3.26 Thirdly, there must be reasonable grounds for the licensee to suspect that the client who has suffered or will suffer loss or damage as a result of the reportable situation also has a legally enforceable right against the licensee to recover the loss or damage. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EA(1)(c) of the Corporations Act]*

3.27 A licensee has reasonable grounds to suspect a circumstance where there are grounds to suspect that circumstance and those grounds are reasonable. This threshold relies on the common law meaning of the term ‘reasonable grounds to suspect’ and is not defined by legislation for the purposes of this section. The term ‘suspect’ requires a positive suspicion whether or not there is evidence as to the truth or existence of the circumstance. In determining whether the grounds are reasonable, a person may take into account the facts and circumstances of the situation.

3.28 However, this threshold is lower than that of reasonable grounds to believe in a circumstance. Reasonable grounds to believe require that there are facts that would induce a reasonable person to believe in the truth or existence of the circumstance.

3.29 A person’s legally enforceable right to recover loss or damage as mentioned in subparagraph 912EA(1)(c)(ii) is made with reference to the loss or damage the affected client suffered or will suffer as a result of the reportable situation under subparagraph 912EA(1)(c)(i). Therefore, the relevant legally enforceable right against the licensee is the right to recover loss or damage they suffered or will suffer as a result of the reportable situation. In this sense, it does not require that an affected client already has an enforceable judgment against the licensee, but rather, a right to seek recovery of the loss or damage. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subparagraph 912EA(1)(c)(ii) of the Corporations Act]*

3.30 The requirements under paragraph 912EA(1)(c), along with the requirement under paragraph 912EA(1)(a) establish the adviser-client relationship between the licensee and the person, who is an affected client. The loss or damage an affected client suffered or will suffer does not need

to be the result of the personal advice, but rather, as a result of the reportable situation.

Example 3.1: Reasonable grounds to suspect that a person has a legally enforceable right to recover loss or damage

Zebra Services Corporation is an Australian financial services licensee. Zebra Services Corporation has reasonable grounds to believe that one of their employees, Hayes, who is an adviser, has committed serious fraud.

Zebra Services Corporation has a list of Hayes' clients as at the time of the fraud he is believed to have committed. Based on the circumstances of the fraud, Zebra Services Corporation has reasonable grounds to suspect that five of Hayes' clients are affected clients as a result of the reportable situation as they may have a claim against Zebra Services Corporation for the loss or damage suffered as a result of fraud. Zebra Services Corporation must notify these five affected clients under section 912EA of the Corporations Act. (Additionally, Zebra Services Corporation must investigate and remediate the reportable situation under section 912EB of the Corporations Act).

3.31 An affected client may have a legally enforceable right to recover loss or damage against the licensee in relation to the reportable situation where there is a potential claim that if pursued by the affected client, may be enforced as a judgment by the court against the licensee. Accordingly, this requires an affected person to have standing to seek loss or damage resulting from the reportable situation and can include circumstances where a court has the discretion to make an order for loss or damage. For example, a client may have a legally enforceable right to recover loss or damage against the licensee for negligence, breach of contract, or a compensation order under section 1317HA of the Corporations Act.

3.32 An affected client would not have a legally enforceable right where, for example, the underlying cause of action has been extinguished or barred as not enforceable by expiry of the relevant limitation period.

3.33 Similarly, there may be circumstances where a reportable situation would not result in a client with a legally enforceable right against the licensee for loss or damage as a result of that reportable situation. This may occur where, for example, there is no cause of action available to the client for loss or damage as a result of the reportable situation, or where there is no loss or damage.

Example 3.2: No loss or damage as a result of the reportable situation

Mallard Corporation is an Australian financial services licensee. Mallard Corporation has reasonable grounds to believe that it has significantly breached its obligation to ensure that its representatives are adequately trained to provide financial services under

paragraph 912A(1)(f). In this case, there were two staff members out of a team of nine who continued to avoid mandatory training, and Mallard Corporation did not enforce the obligation.

Further, Mallard Corporation, through its representatives has provided personal advice to retail clients in relation to relevant financial products.

While there are clients who have received relevant advice from Mallard Corporation and Mallard Corporation was at fault for not enforcing mandatory training, the two staff members who were not adequately trained to provide financial services never provided advice to a retail client of Mallard Corporation.

Accordingly, Mallard Corporation would have no reasonable grounds to suspect that there is a person (who is an affected client) with a legally enforceable right to recover loss or damage as a result of the reportable situation. Therefore, Mallard Corporation does not have an obligation to notify clients under section 912EA of the Corporations Act.

3.34 It is relevant for the licensee to consider a claim that may be enforceable against them as this consideration will assist the licensee's obligation under section 912EB to investigate and remediate the reportable situation.

3.35 There may be circumstances where a client has suffered loss or damage as a result of negligent advice which caused them to invest in a particular product and that investment yielded a lower return than they would have received if they invested in a different product with proper advice. However, a client may not suffer loss or damage in all circumstances where they have invested in a product that yielded a lower return than they would have in a different product. For example, where a client knowingly accepted a level of investment risk suited to their circumstances with the objective of obtaining higher returns, the lack of gain or the crystallisation of a loss may not be considered a relevant loss or damage. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EA(1)(c)(i) of the Corporations Act*]

Form and timing of notice

3.36 A notice to an affected client of a reportable situation must be provided in writing and should contain sufficient information to give the affected client an understanding of the nature of the reportable situation and the basis for the suspicion that the client may have suffered or will suffer loss or damage. It may be appropriate for a licensee to provide the date of the reportable situation, a description of the reportable situation, the consequences of the reportable situation and how a client may be affected. Where there is a form approved by ASIC for the purposes of the notice, a licensee must notify the affected client in the approved form.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraphs 912EA(2)(a) and (b) of the Corporations Act]

3.37 The notice must be given to the affected client within 30 days after the licensee first reasonably knows that the misconduct they detect has potentially resulted in, or will result in, loss or damage which the client has a legally enforceable right to recover. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EA(1) and paragraph 912EA(2)(c) of the Corporations Act]*

3.38 The term ‘reasonably knows’ is defined in section 912DAA of the Corporations Act. This is discussed at paragraphs 2.44 and 2.45 of this explanatory memorandum.

3.39 Generally, a licensee reasonably knows of a circumstance if:

- the person is aware that the circumstance exists or will exist in the ordinary course of events; or
- the person is aware of a substantial risk that the circumstance exists or will exist, and having regard to the circumstances known to the person, it is unjustifiable to take the risk.

Consequences of failing to notify affected clients

3.40 A licensee who contravenes the obligation to notify an affected client of misconduct is liable for a civil penalty (see section 1317E of the Corporations Act). *[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EA(3) of the Corporations Act, and item 8, the table under subsection 1317E(3) of the Corporations Act]*

3.41 A licensee who contravenes the obligation to take reasonable steps to notify affected clients of misconduct under subsection 912EA(1) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 11, table under Schedule 3 of the Corporations Act]*

Investigating and remediating certain reportable situations

Obligation to investigate misconduct

3.42 A financial services licensee must conduct an investigation into the misconduct if all of the following are satisfied:

- the licensee or a representative of the licensee provides or has provided personal advice to the affected client as a retail client in relation to a relevant financial product;
- there are reasonable grounds for the licensee to believe that a reportable situation has arisen, and either:
 - that reportable situation amounts to a breach of a core obligation; or

- that reportable situation amounts to gross negligence, serious fraud and other circumstances prescribed by the regulations; and
- there are reasonable grounds for the licensee to suspect that both:
 - the person has suffered loss or damage as a result of the reportable situation; and
 - the person has a legally enforceable right to recover the loss or damage from the licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(1) of the Corporations Act]

3.43 The circumstances where a licensee detects misconduct that has potentially resulted in, or will result in loss or damage for a client is provided at paragraphs 912EB(1)(a), (b) and (c) in the obligation to notify affected clients of misconduct. Accordingly, the threshold for the obligations under subsection 912EA(1) (to notify affected clients of misconduct) and subsection 912EB(1) (to investigate and remediate misconduct) are the same.

3.44 The elements of each requirement are discussed at paragraphs 3.17 and 3.35 of this explanatory memorandum (regarding subsection 912EA(1), the obligation to notify affected clients of misconduct).

3.45 The obligation to investigate and remediate misconduct is intended to restore trust in the Australian financial services sector by encouraging licensees to proactively investigate misconduct and remediate clients.

3.46 The obligation to investigate and remediate misconduct, does not, on its own, create a new cause of action for affected clients in relation to the reportable situation. Along with general law actions, statutes may create a right for a person to seek a compensation order against the licensee for loss or damage (for example, sections 104II and 1317HA). The availability of a compensation order to a person may form the basis on which a client may have a legally enforceable right to recover loss or damage from a licensee.

Timing and duration of the investigation

3.47 The licensee must commence the investigation within 30 days after the licensee reasonably knows of the matters mentioned in paragraphs 912EB(1)(a), (b) and (c). Similar to the obligation to notify affected clients under subsection 912EA(1), in general terms, this is when the licensee first reasonably knows that the misconduct they detect has potentially resulted in, or will result in loss or damage for a client.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(2) of the Corporations Act]

3.48 The term ‘reasonably knows’ is defined in section 912DAA of the Corporations Act. This is discussed at paragraphs 3.38 and 3.39 of this explanatory memorandum.

3.49 The licensee must complete the investigation as soon as reasonably practicable after it is commenced. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(4) of the Corporations Act*]

3.50 During the investigation, as affected clients and ASIC have been informed of the misconduct under sections 912EA and 912D respectively, it is imperative that the licensee completes the investigation within a reasonable amount of time. During this time, an affected client may continue to consider their rights and remedies against the licensee and ASIC may also consider commencing compliance and enforcement action.

3.51 Accordingly, the obligation to investigate and remediate misconduct does not extinguish the right of an affected client to bring an action against the licensee. All of the affected client’s rights continue to exist alongside the investigation process.

3.52 The law does not prescribe what a reasonable time for the duration of the investigation is. This provides the licensee with flexibility to accurately and reasonably assess misconduct and the loss or damage caused. The reasonable amount of time for an investigation will depend on the circumstances of the case, including the size of the licensee’s business, the extent of the misconduct and the nature of the loss or damage caused by the licensee to affected clients.

3.53 After the completion of the investigation, the licensee must take reasonable steps to notify the affected client of the outcome of the investigation in writing. The notification should contain sufficient information to give the affected client an understanding of the nature of the conduct identified, any related misconduct, a description of how the conduct affected the client’s interests, and an assessment of the loss or damage that the licensee reasonably believes the affected client is entitled to seek recovery. Where there is a form approved by ASIC for the purposes of the notice, a licensee must notify the affected client in the approved form. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraphs 912EB(5)(a) and (b) of the Corporations Act*]

3.54 The notice must be given to the affected client within 10 days after the completion of the investigation. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EB(5)(c) of the Corporations Act*]

Matters to be considered in the investigation

3.55 In conducting the investigation, the licensee must do all of the following:

- identify the conduct that gave rise to the reportable situation;
- quantify the loss or damage that there are reasonable grounds to believe:
 - the affected client has suffered or will suffer as a result of the reportable situation; and
 - the affected client has a legally enforceable right to recover from the licensee; and
- do anything prescribed by the regulations for the purposes of this paragraph.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(3) of the Corporations Act]

3.56 Firstly, a licensee must identify the conduct that gave rise to the reportable situation. This conduct can include an act or omission, or a series of acts or omissions that gave rise to the reportable situation.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EB(3)(a) of the Corporations Act]

3.57 There may be circumstances where a licensee who identifies the conduct that gave rise to the reportable situation is put on notice and discovers that the same conduct or related conduct gives rise to further reportable situations. When this occurs, the licensee must comply with the obligation to report those further reportable situations under section 912D. In general terms, the obligation to report under section 912D will arise where there are reasonable grounds for the licensee to believe or suspect that a relevant reportable situation has arisen. Accordingly, a licensee must take into account the factual circumstances of the reportable situation and the conduct that led to the reportable situation.

3.58 Further, there may also be circumstances where in identifying the conduct that gave rise to the reportable situation, the licensee may identify more clients that were also affected by the same or similar conduct. Where this occurs, the obligations to notify, investigate and remediate would apply equally to a later identified client as they do to an originally identified client or clients. Where misconduct has occurred in relation to a client, there is an expectation that the advice given to clients in similar circumstances be investigated by the licensee in order to detect any wider misconduct.

3.59 The conduct that gave rise to the reportable situation may or may not be the same conduct for which the affected client would have a legally enforceable right against the licensee for loss or damage.

3.60 Secondly, in the course of the investigation, a licensee must quantify the loss or damage that there are reasonable grounds to believe that:

- the affected client has suffered or will suffer, and
- the client has a legally enforceable right to recover.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EB(3)(b) of the Corporations Act]

3.61 In order to quantify the loss or a client suffers or will suffer, a licensee may consider that it is appropriate to contact the affected client and discuss the conduct that gave rise to the reportable situation, as well as the reportable situation that resulted or will result in the client’s loss. It is also prudent for licensees to keep affected clients informed of the progress of the investigation as affected clients can continue to consider their rights and remedies against the licensee.

3.62 The term ‘reasonable grounds to believe’ is not defined in legislation for the purposes of this provision. Instead, the threshold relies on its common law meaning. This is discussed at paragraph 3.223.11 of this explanatory memorandum.

3.63 The amendments do not prescribe how a licensee must determine the quantum of the loss or damage an affected client suffers or will suffer. However in determining the loss or damage arising from the reportable situation, a licensee must have regard to legal principles in determining loss or damage.

3.64 Typically, a licensee will need to:

- identify each affected client;
- determine the nature of the legally enforceable right available to the affected clients;
- evaluate the type of remedies available to and appropriate for the affected client based on the misconduct; and
- determine the amount of the payment.

3.65 While section 912EB imposes an obligation on licensees to investigate and remediate misconduct, it does not, on its own, create a new cause of action for an affected client against a licensee regarding misconduct. When investigating and determining loss or damage to affected clients, a licensee should have reference to any underlying liabilities they may have to that client based on causes of action available to the client in relation to the reportable situation.

3.66 The types of legally enforceable rights to recover loss or damage will depend on the circumstances of the case. For example, an affected client may have a legally enforceable right against the licensee to recover loss or damage as a result of the reportable situation where the underlying claim rests on negligence, breach of fiduciary duty or a compensation order (for example, under section 1317HA of the Corporations Act).

3.67 Thirdly, in conducting the investigation, the licensee must do anything else prescribed by the regulations. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, paragraph 912EB(3)(c) of the Corporations Act*]

3.68 The approach to include additional requirements in the regulations is intended to ensure effective compliance and the integrity of the provision. This will allow an evaluation of industry practices to ensure that licensees continue to comply with the policy intent of the provision and actively investigate misconduct.

Obligation to compensate the affected client for loss or damage

3.69 A licensee must take reasonable steps to pay the affected client within 30 days once an investigation under subsection 912EB(1) is complete, and where there are reasonable grounds to believe that:

- the affected client has suffered or will suffer loss or damage; and
- the client has a legally enforceable right to recover loss or damage from the licensee.

[*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(6) of the Corporations Act*]

3.70 Nothing in section 912EB precludes the licensee from providing a remedy to an affected client outside of the obligation to investigate and remediate misconduct.

3.71 The obligation to investigate and remediate misconduct provides a framework for remediation and is intended to ensure that licensees actively provide a remedy to affected clients where a reportable situation has resulted in loss or damage in relation to which the affected client would have an enforceable right to recover, without requiring the affected client to engage in a court process.

3.72 The term ‘reasonable grounds to believe’ is not defined in legislation for the purposes of this provision. Instead, the threshold relies on its common law meaning. This is discussed at paragraph 3.22 of this explanatory memorandum.

3.73 A licensee should consider the facts and circumstances of the case to determine whether they have reasonable grounds to believe that the affected client has:

- suffered or will suffer loss or damage; and
- a legally enforceable right to recover that loss or damage.

3.74 In determining the amount of loss or damage the licensee has reasonable grounds to believe that the affected client has suffered, the licensee may consider it appropriate to take into account the factual circumstances, including matters such as:

- the fair value of the services provided;
- equitable bars to relief where appropriate; and
- the type and amount of remedy a court would typically award.

3.75 The types of remedies that are available to and appropriate for the affected client will depend on the circumstances of the case. Accordingly, it is important for the licensee to identify the basis of the enforceable claim that would be available to a client throughout the investigation.

3.76 As the payment from the licensee is provided on the basis of the loss or damage an affected client suffered or will suffer as a result of the reportable situation, it is not the intention to require licensees to include amounts for damages that do not reflect the loss or damage, such as profit gained by the licensee as a result of the reportable situation, aggravated damages or punitive damages.

3.77 A licensee may also consider other relevant forms of remedies that would complement the affected client. The amendments do not limit the types and combinations of different remedies which a licensee may additionally provide to an affected client having regard to the loss or damage the affected client suffered or will suffer.

3.78 There may be circumstances where non-monetary remediation would be appropriate to accompany monetary payment. Depending on the circumstances of each case, some possible non-monetary remediation may include the rescission of a contract, and the setting aside of a portion or a whole amount of debt owed to the licensee by the affected client.

3.79 At the completion of the investigation, there may be circumstances where the results of an investigation demonstrate that there is no liability for a licensee to remediate as the licensee does not have reasonable grounds to believe that a client suffered or will suffer loss or damage to which they have a legally enforceable right to recover. Accordingly, the quantum of loss or damage in these situations is nil. These may include circumstances where at the end of the investigation:

- the licensee finds that there were no clients affected by the reportable situation; or
- the client does not have a cause of action, or does not have a legally enforceable right against the licensee in relation to the reportable situation; or
- the client suffered no loss or damage as a result of the reportable situation.

Example 3.3: Licensee has no liability to client

Sable Corporation is an Australian financial services licensee. Sable Corporation has notified ASIC under section 912D that it has reasonable grounds to believe that there was a significant breach of a core obligation.

Sable Corporation has reasonable grounds to believe that it did not maintain the competence to provide financial services (under paragraph 912A(1)(e)) for 3 months. With respect to this, Sable Corporation has already notified five clients that could potentially be affected.

Sable Corporation investigated the nature and full extent of the misconduct and the outcome of the investigation demonstrates that no client had suffered any loss or damage with respect to the misconduct. The loss or damage suffered by the clients in this case is determined to be nil. Sable Corporation communicates the outcome of the investigation to the five potentially affected clients.

The right of affected client to pursue legally enforceable rights

3.80 For the avoidance of doubt, nothing in this section affects any legally enforceable rights of the affected client to recover loss or damage that the affected client suffers, or will suffer, as a result of a reportable situation. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(8) of the Corporations Act*]

3.81 The amendments are intended to ensure that licensees investigate and remediate misconduct proactively. The provisions rely on the existing rights of the affected client and do not alter those rights. Accordingly, an affected client's rights are not extinguished by the operation of this section.

3.82 However, a court may take into account the remedy provided by a licensee in relation to a reportable situation. For example, where a licensee has provided a partial remedy to the affected client, the court may take this fact into account to alter its award of damages if an action is brought successfully by the affected client in relation to the same facts. This provision ensures that a client is not enriched unjustly in the same case. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(9) of the Corporations Act*]

Re-triggering of licensee obligations

3.83 There may be circumstances where during the course of an investigation, or after the investigation, licensee obligations are triggered or re-triggered.

3.84 At any time, including during an investigation, a licensee may have reasonable grounds to believe or suspect that further reportable situations have arisen in accordance with section 912D. Where

appropriate, this will also trigger obligations under sections 912EA to notify affected clients and 912EB to investigate misconduct and remediate affected clients.

Example 3.4: Investigation reveals further notifications to ASIC and clients

Tiger Services is an Australian financial services licensee. During Tiger Services' investigation of misconduct in relation to its adviser, Nav, it finds further reasonable grounds to suspect that another adviser working in the same team, Suma, was grossly negligent.

Accordingly, the obligation on Tiger Services to notify ASIC in relation to misconduct on the part of Suma under section 912D is triggered. Tiger Services has reasonable grounds to suspect gross negligence on the part of Suma which could potentially affect three of Tiger Services' clients. Therefore, alongside the investigation into Nav, Tiger Services is also required to notify, investigate and remediate clients affected by Suma's misconduct under sections 912EA and 912EB of the Corporations Act.

Obligation to keep records of compliance

3.85 A licensee must keep records sufficient to enable the licensee's compliance with Subdivision C, the obligations to notify, investigate and remediate clients affected by misconduct, to be readily ascertained.
[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EC(1) of the Corporations Act]

3.86 The regulations may specify records the licensee must keep.
[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EC(2) of the Corporations Act]

3.87 Prescribing record keeping requirements in regulations will allow the requirements to be refined and updated more efficiently and in response to changing industry practices. This is aimed at improving compliance with the record keeping requirements and thereby improving the integrity of the financial services sector.

Consequences of failing to investigate and remediate misconduct

Civil penalties

3.88 A licensee who contravenes any of the following is liable for a civil penalty:

- Subsection 912EB(1) – the obligation to investigate certain reportable situations;
- Subsection 912EB(5) – the obligation to notify the outcome of the investigation within 10 days; or
- Subsection 912EB(6) – the obligation to remediate the affected client within 30 days.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 6, subsection 912EB(7) of the Corporations Act, and item 8, table under subsection 1317E(3) of the Corporations Act]

Criminal penalties

3.89 A licensee who contravenes the obligation to investigate misconduct under subsection 912EB(1) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 11, table under Schedule 3 to the Corporations Act]*

3.90 A licensee who contravenes the obligation to take reasonable steps to notify affected clients of the outcome of the investigation under subsection 912EB(5) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 11, table under Schedule 3 to the Corporations Act]*

3.91 A licensee who contravenes the obligation to take reasonable steps to compensate clients affected by misconduct under subsection 912EB(6) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 11, table under Schedule 3 to the Corporations Act]*

3.92 A licensee who contravenes the obligation to keep records to demonstrate compliance with Subdivision C (the obligations to notify, investigate and remediate misconduct) commits an offence and is liable for 5 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 11, table under Schedule 3 to the Corporations Act]*

Amendments to the Credit Act

3.93 The amendments to the Credit Act impose the new obligation on Australian credit licensees to notify affected clients, and investigate and remediate misconduct under sections 51A and 51B of the Credit Act.

3.94 Legislative references in this part of this Chapter are to the Credit Act, unless otherwise specified.

Notifying consumers affected by certain reportable situations

Obligation to notify an affected consumer regarding misconduct

3.95 Under the obligation to notify misconduct, an Australian credit licensee must take reasonable steps to notify a consumer (the affected consumer) if all of the following are satisfied:

- the licensee, or a representative of the licensee, provides or has provided credit assistance to the affected consumer in relation to a credit contract secured by a mortgage over residential property;
- the licensee, or the representative of the licensee, is a mortgage broker;

- there are reasonable grounds for the licensee to believe that a reportable situation has arisen, and either:
 - that reportable situation amounts to a significant breach of a core obligation; or
 - that reportable situation amounts to gross negligence, serious fraud and other circumstances prescribed by the regulations; and
- there are reasonable grounds for the licensee to suspect that both:
 - the consumer has suffered or will suffer loss or damage as a result of the reportable situation; and
 - the consumer has a legally enforceable right to recover the loss or damage from the licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51A(1) of the Credit Act]

3.96 The consumer that must be notified is the affected consumer. Notifying the consumer allows the consumer to consider their rights and the ways they can mitigate potential loss or damage arising from the reportable situation.

3.97 The circumstances where a licensee detects misconduct that has potentially resulted in loss or damage for a consumer are provided for at paragraphs 51A(1)(a), (b) and (c).

3.98 Firstly, there must be a consumer who receives or has received credit assistance in relation to a credit contract secured by a mortgage over residential property. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51A(1)(a) of the Credit Act]*

3.99 Generally, this obligation requires credit licensees (who are mortgage brokers) to notify affected consumers when they detect misconduct in circumstances where a mortgage broker has provided credit assistance. The term ‘credit assistance’ is defined at section 8 of the Credit Act. The term ‘credit contract’ is defined at section 4 of the National Credit Code and generally refers to a contract under which credit is or may be provided.

3.100 A representative of a licensee is defined in section 5 of the Credit Act. This includes an employee or director of the licensee, an employee or director of a related body corporate of the licensee, a credit representative of the licensee, or any other person acting on behalf of the licensee.

3.101 Secondly, the licensee or the representative of the licensee who provides or has provided that credit assistance must be a mortgage broker. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51A(1)(b) of the Credit Act]*

3.102 The term ‘mortgage broker’ is defined at item 4 of Schedule 3 to the Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019. The Bill would amend the Credit Act to include section 15B which provides that a licensee or a credit representative of a licensee is a mortgage broker if:

- they carry on a business of providing credit assistance in relation to credit contracts secured by mortgage over residential property;
- the licensee does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts; and
- in carrying on the business, the licensee provides credit assistance in relation to credit contracts offered by more than one credit provider.

3.103 Generally, this describes mortgage brokers who provide credit assistance over mortgage contracts offered by more than one credit provider. Accordingly, a credit licensee or representative who deals only with mortgage contracts offered by one credit provider is not considered a mortgage broker.

3.104 Thirdly, there must be reasonable grounds for the licensee to believe that:

- a reportable situation that amounts to a significant breach of a core obligation has arisen, or
- a reportable situation that amounts to gross negligence or serious fraud has arisen.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51A(1)(c) of the Credit Act]

3.105 A licensee has reasonable grounds to believe in a circumstance when the licensee has grounds to believe in that circumstance and those grounds are reasonable. This threshold relies on the general law meaning of term ‘reasonable grounds to believe’ and is not defined by legislation for the purposes of this section. The requirement of reasonable grounds to believe in a circumstance requires positive belief in the truth or existence of the circumstance. This is a higher threshold than that of reasonable grounds to suspect a circumstance. In determining whether the grounds are reasonable, a person may take into account the facts and circumstances of the situation.

3.106 The core obligations of a licensee are defined at the breach reporting obligations under section 50A. These core obligations are discussed at paragraph 2.117 of this explanatory memorandum.

3.107 What constitutes a significant breach will depend on the circumstances of the case. This is discussed at paragraphs 2.119 to 2.125 of this explanatory memorandum.

3.108 A reportable situation as mentioned in subsection 50A(2) includes gross negligence, serious fraud, and any other circumstances prescribed by the regulations. This is discussed at paragraphs 2.126 to 2.130 of this explanatory memorandum. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subparagraph 51A(1)(c)(ii) of the Credit Act*]

3.109 Fourthly, there must be reasonable grounds for the licensee to suspect that the consumer who has suffered or will suffer loss or damage as a result of the reportable situation also has a legally enforceable right against the licensee for the loss or damage. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51A(1)(d) of the Credit Act*]

3.110 A licensee has reasonable grounds to suspect a circumstance where there are grounds to suspect that circumstance and those grounds are reasonable. This threshold relies on the common law meaning of the term ‘reasonable grounds to suspect’ and is not defined by legislation for the purposes of this section. The term ‘suspect’ requires a positive suspicion whether or not there is evidence as to the truth or existence of the circumstance. In determining whether the grounds are reasonable, a person may take into account the facts and circumstances of the situation.

3.111 However, this threshold is lower than that of reasonable grounds to believe in a circumstance. Reasonable grounds to believe require that there are facts that would induce a reasonable person to believe in the truth or existence of the circumstance.

3.112 A person’s legally enforceable right to recover loss or damage as mentioned in subparagraph 51A(1)(d)(ii) is made with reference to the loss or damage the affected consumer suffered or will suffer as a result of the reportable situation under subparagraph 51A(1)(c)(i). Therefore, the relevant legally enforceable right against the licensee is the right to recover loss or damage the affected consumer suffered or will suffer as a result of the reportable situation. In this sense, the threshold does not require that an affected consumer already has an enforceable judgment against the licensee, but rather, a right to seek recovery of the loss or damage. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subparagraph 51A(1)(d)(ii) of the Credit Act*]

3.113 The requirements under paragraph 51A(1)(d), along with the requirements under paragraphs 51A(1)(a) and (b) establish the mortgage broker-consumer relationship between the licensee and the person, who is an affected consumer. The loss or damage an affected consumer suffered or will suffer does not need to be the result of the mortgage credit assistance, but rather, as a result of the reportable situation.

Example 3.5: Reasonable grounds to suspect that a consumer has a legally enforceable right to recover loss or damage

Zebu Home Loans is an Australian credit licensee who is a mortgage broker. Zebu Home Loans has reasonable grounds to believe that one of their employees, Hal, who is an employee mortgage broker, has committed serious fraud.

Zebu Home Loans has a list of consumers served by Hal as at the time of the fraud he is believed to have committed. Based on the circumstances of the fraud, Zebu Home Loans has reasonable grounds to suspect that five of Hal's clients are affected consumers as a result of the reportable situation as they may have a claim against Zebu Home Loans for the loss or damage suffered as a result of fraud. Zebu Home Loans must notify these five affected consumers under section 51A of the Credit Act. (Additionally, Zebu Home Loans must investigate and remediate the reportable situation under section 51B of the Credit Act).

3.114 An affected consumer may have a legally enforceable right to recover loss or damage against the licensee in relation to the reportable situation where there is a potential claim that if pursued by the affected consumer, may be enforced as a judgment by the court against the licensee. Accordingly, this requires an affected person to have standing to seek loss or damage resulting from the reportable situation and can include circumstances where a court has the discretion to make an order for loss or damage. For example, a consumer may have a legally enforceable right to recover loss or damage against the licensee for negligence, breach of contract, or a compensation order under section 178 of the Credit Act.

3.115 A consumer would not have a legally enforceable right where, for example, the underlying cause of action has been extinguished or barred as not enforceable by expiry of the relevant limitation period.

3.116 There may be circumstances where a reportable situation would not result in a consumer with a legally enforceable right against the licensee for loss or damage as a result of that reportable situation. This may occur where, for example, there is no cause of action available to the consumer for loss or damage as a result of the reportable situation, or where there is no loss or damage.

Example 3.6: No loss or damage as a result of the reportable situation

Marmoset Corporation is an Australian credit licensee who is a mortgage broker. Marmoset Corporation has reasonable grounds to believe that it has significantly breached its obligation to ensure that its representatives are adequately trained to engage in credit services under 47(1)(g). In this case, there were two staff members out of a team of nine who continued to avoid mandatory training, and Marmoset Corporation did not enforce the obligation.

Further, Marmoset Corporation, through its employee mortgage brokers has provided credit assistance over mortgages to consumers.

While there are consumers who have received relevant assistance from Marmoset Corporation and Marmoset Corporation was at fault for not enforcing mandatory training, the two staff members who were not adequately trained never provided credit assistance to a consumer of Marmoset Corporation.

Accordingly, Marmoset Corporation would have no reasonable grounds to suspect that there is a consumer (who is an affected consumer) with a legally enforceable right to recover loss or damage as a result of the reportable situation. Therefore, Marmoset Corporation does not have an obligation to notify consumers under section 51A of the Credit Act.

3.117 It is relevant for the licensee to consider a claim that may be enforceable against them as this consideration will assist the licensee's obligation under section 51B to investigate and remediate the reportable situation.

Form and timing of notice

3.118 A notice to an affected consumer of a reportable situation must be provided in writing and should contain sufficient information to give the affected consumer an understanding of the nature of the reportable situation and the basis for the suspicion that the consumer may have suffered or will suffer loss or damage. It may be appropriate for a licensee to provide the date of the reportable situation, a description of the reportable situation, the consequences of the reportable situation and how a consumer may be affected. Where there is a form approved by ASIC for the purposes of the notice, a licensee must notify the affected consumer in the approved form. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraphs 51A(2)(a) and (b) of the Credit Act*]

3.119 The notice must be given to the affected consumer within 30 days after the licensee first reasonably knows that the misconduct they detect has potentially resulted in, or will result in, loss or damage which the consumer has a legally enforceable right to recover. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51A(2)(c) of the Credit Act*]

3.120 The term 'reasonably knows' is defined in section 50B of the Credit Act. This is discussed at paragraphs 2.136 and 2.137 of this explanatory memorandum.

3.121 Generally, a licensee reasonably knows of a circumstance if:

- the person is aware that the circumstance exists or will exist in the ordinary course of events; or

- the person is aware of a substantial risk that the circumstance exists or will exist, and having regard to the circumstances known to the person, it is unjustifiable to take the risk.

Consequences of failing to notify affected consumers

3.122 A licensee who contravenes the obligation to take reasonable steps to notify affected consumers of misconduct is subject to civil penalties. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51A(1) of the Credit Act]*

3.123 A licensee who contravenes the obligation to take reasonable steps to notify affected consumers of misconduct under subsection 51A(1) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51A(3) of the Credit Act]*

Investigating and remediating certain reportable situations

Obligation to investigate misconduct

3.124 An Australian credit licensee must conduct an investigation of misconduct if all of the following are satisfied:

- the licensee or a representative of the licensee provides or has provided credit assistance to the affected consumer in relation to a credit contract secured by a mortgage over residential property;
- the licensee, or the representative of the licensee is a mortgage broker;
- there are reasonable grounds for the licensee to believe that a reportable situation has arisen, and either:
 - that reportable situation amounts to a significant breach of a core obligation; or
 - that reportable situation amounts to gross negligence, serious fraud and other circumstances prescribed by the regulations;
- there are reasonable grounds for the licensee to suspect that both:
 - the consumer has suffered loss or damage as a result of the reportable situation; and
 - the consumer has a legally enforceable right to recover the loss or damage from the licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(1) of the Credit Act]

3.125 The circumstances where a licensee detects misconduct that has potentially resulted in, or will result in loss or damage for a consumer is

provided at paragraphs 51A(1)(a), (b) and (c) in the obligation to notify affected consumers of misconduct. Accordingly, the threshold for the obligations under subsection 51A(1) (to notify affected consumers of misconduct) and 51B(1) (to investigate misconduct) are the same.

3.126 The elements of each requirement are discussed at paragraphs 3.98 and 3.117 of this explanatory memorandum (regarding subsection 51A(1), the obligation to notify affected consumers of misconduct).

3.127 The obligation to investigate and remediate misconduct is intended to restore trust in the mortgage broking sector by encouraging licensees to proactively investigate misconduct and remediate consumers.

3.128 The obligation to investigate and remediate misconduct, does not, on its own, create a new cause of action for affected consumers in relation to the reportable situation. Along with general law actions, statutes may create a right for a person to see a compensation order against the licensee for loss or damage (for example, section 178 of the Credit Act). The availability of a compensation order to a person may form the basis on which a consumer may have a legally enforceable right to recover loss or damage from a licensee.

Timing and duration of the investigation

3.129 The licensee must commence the investigation within 30 days after the licensee reasonably knows of the matters mentioned in paragraphs 51B(1)(a), (b) and (c). Similar to the obligation to notify affected consumers under subsection 51A(1), in general terms, this is when the licensee first reasonably knows that the misconduct they detect has potentially resulted in, or will result in, loss or damage for a consumer. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(2) of the Corporations Act*]

3.130 The term ‘reasonably knows’ is defined in section 50B of the Credit Act. This is further discussed at paragraphs 3.120 and 3.121 of this explanatory memorandum.

3.131 The licensee must complete the investigation as soon as reasonably practicable after it is commenced. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(4) of the Credit Act*]

3.132 During the investigation, as affected consumers and ASIC have been informed of the misconduct under sections 51A and 50A respectively, it is imperative that the licensee completes the investigation within a reasonable amount of time. During this time, an affected consumer may continue to consider their rights and remedies against the licensee and ASIC may also consider commencing compliance and enforcement action.

3.133 Accordingly, the obligation to investigate and remediate misconduct does not extinguish the right of an affected consumer to bring an action against the licensee. All of the affected consumer's rights continue to exist alongside the investigation process.

3.134 The law does not prescribe what a reasonable time for the duration of the investigation is. This provides the licensee with flexibility to accurately and reasonably assess misconduct and the loss or damage caused. The reasonable amount of time for an investigation will depend on the circumstances of the case, including the size of the licensee's business, the extent of the misconduct and the nature of the loss or damage caused by the licensee to affected consumers.

3.135 After the completion of the investigation, the licensee must take reasonable steps to notify the affected consumer of the outcome of the investigation in writing. The notification should contain sufficient information to give the affected consumer an understanding of the nature of the conduct identified, a description of how the conduct affected the consumer's interests, and an assessment of the loss or damage for which the licensee reasonably believes the affected consumer is entitled to seek recovery. Where there is a form approved by ASIC for the purposes of the notice, a licensee must notify the affected consumer in the approved form. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraphs 51B(5)(a) and (b) of the Credit Act]*

3.136 The notice must be given to the affected consumer within 10 days after the completion of the investigation. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51B(5)(c) of the Credit Act]*

Matters to be considered in the investigation

3.137 In conducting the investigation, the licensee must do all of the following:

- identify the conduct that gave rise to the reportable situation;
- quantify the loss or damage that there are reasonable grounds to believe:
 - the affected consumer has suffered or will suffer as a result of the reportable situation; and
 - the affected consumer has a legally enforceable right to recover from the licensee; and
- do anything prescribed by the regulations for the purposes of this paragraph.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(3) of the Credit Act]

3.138 Firstly, a licensee must identify the conduct that gave rise to the reportable situation. This conduct can include an act or omission, or a

series of acts or omissions that gave rise to the reportable situation.
[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51B(3)(a) of the Credit Act]

3.139 There may be circumstances where a licensee who identifies the conduct that gave rise to the reportable situation is put on notice and discovers that the same conduct or related conduct gives rise to further reportable situations. When this occurs, the licensee must comply with the obligation to report those further reportable situations under section 50A. In general terms, the obligation to report under section 50A will arise where there are reasonable grounds for the licensee to believe or suspect that a relevant reportable situation has arisen. Accordingly, a licensee must take into account the factual circumstances of the reportable situation and the conduct that led to the reportable situation.

3.140 Further, there may also be circumstances where in identifying the conduct that gave rise to the reportable situation, the licensee may identify more consumers that were also affected by the same or similar conduct. Where this occurs, the obligations to notify, investigate and remediate apply equally to a later identified consumer or consumers as they do to an originally identified consumer. Where misconduct has occurred in relation to a consumer, there is an expectation that the advice given to consumers in similar circumstances is investigated by the licensee in order to detect any wider misconduct.

3.141 The conduct that gave rise to the reportable situation may or may not be the same conduct for which the affected consumer would have a legally enforceable right against the licensee for loss or damage.

3.142 Secondly, in the course of the investigation, a licensee must quantify the loss or damage that there are reasonable grounds to believe that:

- the affected consumer has suffered or will suffer, and
- the consumer has a legally enforceable right to recover.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51B(3)(b) of the Credit Act]

3.143 In order to quantify the loss or damage a consumer suffers or will suffer, a licensee may consider that it is appropriate to contact the affected consumer and discuss the conduct that gave rise to the reportable situation, as well as the reportable situation that resulted or will result in the consumer's loss. It is also prudent for licensees to keep affected consumers informed of the progress of the investigation as affected consumers can continue to consider their rights and remedies against the licensee.

3.144 The term 'reasonable grounds to believe' is not defined in legislation for the purposes of this provision. Instead, the threshold relies

on its common law meaning. This is discussed at paragraph 3.105 of this explanatory memorandum.

3.145 The amendments do not prescribe how a licensee must determine the quantum of the loss or damage the affected consumer suffers or will suffer. However in determining the loss or damage arising from the reportable situation, a licensee must have regard to legal principles in determining loss or damage.

3.146 Typically, a licensee will need to:

- identify each affected consumer;
- determine the nature of the legally enforceable right available to the affected consumers;
- evaluate the type of remedies that are available to and are appropriate for the affected consumer based on the misconduct; and
- determine the amount of the payment.

3.147 While section 51B imposes an obligation on licensees to investigate and remediate misconduct, it does not, on its own, create a new cause of action for an affected consumer against a licensee regarding misconduct. When investigating and determining loss or damage to affected consumer, a licensee should have reference to any underlying liabilities they may have to that consumer based on causes of action available to the consumer in relation to the reportable situation.

3.148 The types of legally enforceable right to recover loss or damage will depend on the circumstances of the case. For example, an affected consumer may have a legally enforceable right against the licensee to recover loss or damage as a result of the reportable situation where the underlying claim rests on negligence, breach of fiduciary duty or a compensation order (for example, under section 178 of the Credit Act)..

3.149 Thirdly, in conducting the investigation, the licensee must do anything else prescribed by the regulations. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, paragraph 51B(3)(c) of the Credit Act*]

3.150 The approach to include additional requirements in the regulations is intended to ensure effective compliance and the integrity of the provision. This will allow an evaluation of industry practices and ensure that licensees continue to comply with the policy intention of the provision and actively investigate misconduct.

Obligation to compensate the affected consumer for loss or damage

3.151 A licensee must take reasonable steps to pay the affected consumer within 30 days after an investigation under subsection 51B(1) is completed and where there are reasonable grounds to believe that:

- the affected consumer has suffered or will suffer loss or damage, and
- the consumer has a legally enforceable right to recover loss or damage from the licensee.

[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 50(6) of the Credit Act]

3.152 Nothing in section 51B precludes the licensee from providing a remedy to an affected consumer outside of the obligation to investigate and remediate misconduct.

3.153 The obligation to investigate and remediate misconduct provides a framework for remediation and is intended to ensure that licensees actively provide a remedy to affected consumers where a reportable situation has resulted in loss or damage in relation to which the affected consumer would have an enforceable claim, without requiring the affected consumer to engage in a court process.

3.154 The term ‘reasonable grounds to believe’ is not defined in legislation for the purposes of this provision. Instead, the threshold relies on its common law meaning. This is discussed at paragraph 3.105 of this explanatory memorandum.

3.155 A licensee should consider the facts and circumstances of the case to determine whether they have reasonable grounds to believe that the affected consumer has:

- suffered or will suffer loss or damage; and
- a legally enforceable right to recover that loss or damage.

3.156 In determining the amount of loss or damage the licensee has reasonable grounds to believe that the affected consumer has suffered, the licensee may consider it appropriate to take into account the factual circumstances, including matters such as:

- the fair value of the services provided;
- equitable bars to relief where appropriate; and
- the type and amount of remedy a court would typically award.

3.157 The types of remedies that are available to and appropriate for the affected consumer will depend on the circumstances of the case. Accordingly, it is important for the licensee to identify the basis of the enforceable claim that would be available to a consumer throughout the investigation.

3.158 As the payment from the licensee is provided on the basis of the loss or damage the affected consumer suffered or will suffer as a result of the reportable situation, it is not the intention to require licensees to

include amounts for damages that do not reflect loss or damage, such as profit gained by the licensee as a result of the reportable situation, aggravated damages or punitive damages.

3.159 A licensee may also consider other relevant forms of remedies that would complement the affected consumer. The amendments do not limit the types and combinations of different remedies which a licensee may additionally provide to an affected consumer having regard to the loss or damage the affected consumer suffered or will suffer.

3.160 There may be circumstances where non-monetary remediation would be appropriate to accompany monetary payment. Depending on the circumstances of each case, some possible non-monetary remediation may include the rescission of a contract, and the setting aside of a portion or a whole amount of debt owed to the licensee by the affected consumer.

3.161 At the completion of the investigation, there may be circumstances where the results of an investigation demonstrate that there is no liability for a licensee to remediate as the licensee does not have reasonable grounds to believe that a consumer suffered or will suffer loss or damage in relation to which they have a legally enforceable right to recover. Accordingly, the quantum of loss or damage in these situations is nil. These may include circumstances where at the end of the investigation:

- there was no consumer affected by the reportable situation; or
- the consumer does not have a cause of action, or does not have a legally enforceable right against the licensee in relation to the reportable situation; or
- the consumer suffered no loss or damage as a result of the reportable situation.

Example 3.7: Licensee has no liability to consumer

Salamander Corporation is an Australian credit licensee who is a mortgage broker. Salamander Corporation has notified ASIC under section 50A that it has reasonable grounds to believe that there was a significant breach of a core obligation.

Salamander Corporation has reasonable grounds to believe that it did not maintain the competence to provide credit services (under paragraph 47(1)(f)) for 3 months. With respect to this, Salamander Corporation has already notified five consumers that could potentially be affected.

Salamander Corporation investigated the nature and full extent of the misconduct and the outcome of the investigation demonstrates that no consumers suffered any loss or damage with respect to the misconduct. The loss or damage suffered by the consumers in this case is

determined to be nil. Salamander Corporation communicates the outcome of the investigation to the five potentially affected consumers.

The right of an affected consumer to pursue legally enforceable rights

3.162 For the avoidance of doubt, nothing in this section affects any legally enforceable rights of the affected consumer to pursue loss or damage that the affected consumer suffers, or will suffer, as a result of a reportable situation. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(8) of the Credit Act*]

3.163 The amendments are intended to ensure that licensees investigate and remediate misconduct proactively. The provisions rely on the existing rights of the affected consumer and do not alter those rights. Accordingly, an affected consumer’s rights are not extinguished by the operation of this section.

3.164 However, a court may take into account the remedy provided by a licensee in relation to a reportable situation. For example, where a licensee has provided a partial remedy to the affected consumer, the court may take this fact into account to alter its award of damages if an action is brought successfully by the affected consumer in relation to the same facts. This provision ensures that the consumer is not enriched unjustly in the same case. [*Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(9) of the Credit Act*]

Re-triggering of licensee obligations

3.165 There may be circumstances where during the course of an investigation, or after the investigation, licensee obligations are triggered or re-triggered.

3.166 At any time, including during an investigation, a licensee may have reasonable grounds to believe or suspect that further reportable situations have arisen in accordance with section 50A. Where appropriate, this will also trigger obligations under sections 51A to notify affected consumers and 51B to investigate misconduct and remediate affected consumers.

Example 3.8: Investigation reveals further notifications to ASIC

Tapir Services is an Australian credit licensee that is a mortgage broker. During Tapir Services’ investigation of misconduct in relation to its adviser, Nomos, it finds further reasonable grounds to suspect that another mortgage broker working in the same team, Sutte, was grossly negligent.

Accordingly, the obligation on Tapir Services to notify ASIC in relation to misconduct on the part of Sutte under section 50A is triggered. Because Tapir Services has reasonable grounds to suspect gross negligence on the part of Sutte which could potentially affect three of Tapir Services’ consumers. Therefore, alongside the

investigation into Nomos, Tapir Services is also required to notify, investigate and remediate consumers affected by Sutte's misconduct under sections 51A and 51B of the Credit Act.

Obligation to keep records of compliance

3.167 A licensee must keep records sufficient to enable the licensee's compliance with Subdivision C, the obligations to notify, investigate and remediate consumers affected by misconduct, to be readily ascertained. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51C(1) of the Credit Act]*

3.168 The regulations may specify records the licensee must keep. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51C(2) of the Credit Act]*

3.169 Prescribing record keeping requirements in regulations will allow the requirements to be refined and updated more efficiently and in response to changing industry practices. This is aimed at improving compliance with the record keeping requirements and thereby improving the integrity of the mortgage broking sector.

Consequences of failing to investigate and remediate misconduct

Civil penalties

3.170 A licensee who contravenes the obligation to investigate misconduct is liable for a civil penalty. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(1) of the Credit Act]*

3.171 A licensee who contravenes the obligation to take reasonable steps to notify affected consumers of the outcome of the investigation is liable for a civil penalty. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(5) of the Credit Act]*

3.172 A licensee who contravenes the obligation to take reasonable steps to remediate affected consumers is liable for a civil penalty. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(6) of the Credit Act]*

Criminal penalties

3.173 A licensee who contravenes the obligation to investigate misconduct under subsection 51B(1) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(7) of the Credit Act]*

3.174 A licensee who contravenes the obligation to take reasonable steps to notify affected consumers of the outcome of the investigation under subsection 51B(5) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(7) of the Credit Act]*

3.175 A licensee who contravenes the obligation to take reasonable steps to compensate consumers affected by misconduct under subsection

51B(6) commits an offence and is liable for 2 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51B(7) of the Credit Act]*

3.176 A licensee who contravenes the obligation to keep records to demonstrate compliance with Subdivision C (the obligations to notify, and investigate and remediate misconduct) commits an offence and is liable for 5 years imprisonment. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 16, subsection 51C(3) of the Credit Act]*

Application and transitional provisions

3.177 Schedule [1.6, 2.8, 2.9 and 7.2] to the Bill commences on 1 July 2020. *[Clause 2]*.

3.178 The obligation to investigate and remediate misconduct applies from 1 April 2021.

Amendments to the Corporations Act

3.179 The amendments apply from 1 April 2021. Accordingly, the obligation for an Australian financial services licensee to notify affected clients, and investigate and remediate misconduct applies to reportable situations arising on and after 1 April 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 9, section 1670E of the Corporations Act]*

Amendments to the Credit Act

3.180 The amendments apply from 1 April 2021. Accordingly, the obligation for an Australian credit licensee to notify affected consumers, and investigate and remediate misconduct applies to reportable situations arising on and after 1 April 2021. *[Schedule [1.6, 2.8, 2.9 and 7.2], item 17, section 4 of Schedule 16 to the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009]*