Australian Banking Association

From: Jerome Davidson
Sent: Tuesday, 14 July 2020 6:28 PM
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Subject: RE: Breach reporting - targeted consultation [SEC=OFFICIAL]

Ashley

Thanks for the opportunity to provide comments on the proposed amendments to the exposure draft legislation on breach reporting. Our comments are set out below.

Investigations and reporting periods

We appreciate the attempt Treasury has made to address the issues we raised in our submission. However, in our view the draft still does not achieve the intended effect of the ASIC Enforcement Review recommendations in relation to the reporting of breaches and investigations, and requires some adjustments in other respects if it is to prove effective in improving the breach reporting regime.

If this regime is to be effectively implemented by licensees, it is important that the obligations around reporting are readily ascertainable. On the proposed drafting, there is uncertainty - particularly in establishing the point at which an investigation is taken to commence. There is also uncertainty around potential overlap of the reporting obligations relating to various reportable situations.

In order to determine its obligations regarding the reporting of investigations, a licensee needs to establish when it first knew that there were reasonable grounds to believe (912DAB(3)) that it had investigated a breach for more than 30 days (912D(1)(c)). This requires the licensee to know with confidence when it is taken to have commenced an investigation, but the draft is silent on this. This is an issue of some complexity and we would be open to commenting on any further adjustments that may be proposed to address this.

Separately, it should be made clear that, where a licensee is investigating a reportable situation, no parallel obligation arises under 912D(1)(a) or (b) prior to the licensee concluding that investigation.

Finally, it should be clarified beyond doubt that any obligation to report is extinguished on the licensee reasonably drawing a conclusion, prior to the expiry of the reporting period, that there are no reasonable grounds to believe that a reportable situation exists in relation to the matter investigated.

Use of 'recklessness' as a reporting trigger

We note the inclusion of the words 'or is reckless with respect to' in 912DAB(3) and 50A(3)(c) of the NCCP Act. This language does not assist licensees and complicates the drafting. We understand the intention is to apply the fault element of 'recklessness' as set out in the Criminal Code. However, we think this could be achieved by setting this out in a separate subparagraph.

Deemed significance

Breaches of civil penalty provisions should not be universally deemed significant. Rather, the Bill should contain a power to make regulations, or for ASIC to make an instrument (or both), prescribing any civil penalty provisions the breach of which is to be deemed significant.

The deemed significance of breaches of civil penalty provisions will result in a large increase in the volume, and a reduction in the quality of, breaches being reported to ASIC.

We note that the revised draft contains a power for regulations to exclude specific civil penalty provisions from this deeming regime. However, in the absence of any indications as to what provisions, if any, will be excluded, our original concerns remain regarding the effect of this provision.

Financial services laws now provide a very broad range of matters that are civil penalty provisions. This includes provisions that are very general in scope. Examples of this include the 'general conduct obligations' in the Corporations Act and National Consumer Credit Protection Act (NCCP Act). The scope of conduct that could potentially be caught by these provisions is very broad. If they were not expressly excluded from the deemed significance provisions, this could effectively undermine any attempt to refine the quality of breaches reported to ASIC by the inclusion of things like materiality thresholds, or, potentially, the exclusion of more targeted civil penalty provisions.

We suggest that, rather than address this issue by providing an exclusion power, the appropriate solution would be to provide that civil penalty provisions, the breach of which will be deemed significant, can be prescribed by regulation or by ASIC. In our view, ASIC should also have this power as it is best placed to determine whether the deemed significance of breaches of civil penalty provisions will assist or hinder its operations.

For similar reasons as outlined above, breaches of misleading and deceptive conduct provisions such as those in section 12DA of the ASIC Act should not be deemed significant and so be reportable without regard to their significance. The ASIC ERT did not recommend that these provisions be expressly deemed significant. Breaches of such provisions can be constituted by a broad range of conduct ranging from high to low in significance. It is appropriate that such breaches be subject to the significance test.

Finally, we note that the ASIC ERT recommendation was for breaches of *financial services* civil penalty provisions to be deemed significant. The proposal to deem breaches significant where they also breach *any* civil penalty provision is not consistent with this recommendation and introduces additional difficulty and complexity for licensees to implement.

Material loss

We note and endorse the addition of a materiality threshold for the deeming of significance in relation to loss or damage to customers. However, the addition of the term 'material' offers little by way of guidance. We reiterate the point made in our submission on the original exposure draft legislation – that breaches of core obligations should be deemed significant where they result in material financial loss to clients having regard to the amount invested and the circumstances of the client/s in question – as recommended by the ASIC Enforcement Review.

We note that, at the appropriate time, Regulatory Guidance from ASIC is likely to be necessary to help inform the question of materiality of loss.

It may help to provide clarity around this if the bill provided for regulations, or ASIC instrument, to set materiality thresholds. This would allow the Government or ASIC to calibrate the volume of reporting going to ASIC. This could be particularly helpful when licensees are trying to assess the materiality of breaches affecting small numbers of clients with a view to resolving the question quickly and making timely reports where the breach is judged to be significant.

Gross negligence

We note that no change to or explanation of the term 'gross negligence' is proposed. We reiterate the point made in our original submission that it will be difficult for licensees to determine whether 'gross negligence' or 'serious fraud' has been committed. Such questions are usually determined by the courts according to settled legal principles or criminal statutes with the benefit of a trial. The term 'gross negligence' should be replaced with more precise language that describes the kind of conduct intended to be caught by the legislation.

Reportable situations in relation to other financial services licensees

As noted in our original submission, the obligation to report breaches by other financial services licensees should be subjective and apply where a licensee '*has* reasonable grounds', rather than '*there are* reasonable grounds to believe that a breach has occurred'.

The obligation to report suspected reportable situations relating to other licensees could lead to cross-reporting of entities within a corporate group where there is more than one licensee within the group. In our view, and reiterating a point we made in our original submissions, the regime should include an exemption from reporting under s.912DAC where members of the same corporate group would be required to report on one another (i.e. a single report from the licensee engaging in the breach should be sufficient).

It is noted that the above refers to the amendments to the Corporations Act. For the avoidance of doubt, these comments also apply to the proposed changes to the NCCP Act.

Qualified privilege

We note that the draft includes provision for qualified privilege to apply to reports made under section 912DAC. However, this defence would not apply to actions based on grounds other than defamation. For example, an action based on negligence or breach of a statutory misleading or deceptive conduct provision is conceivable. A broader defence or immunity provision could address this.

Reportable situations under NCCP Act - Definition of core obligation

Under s50A(3)(c), the definition of core obligation is wide enough to also capture any other Commonwealth legislation that applies to conduct relating to credit activities, for example, under the Privacy Act. The equivalent provision in the proposed amendments to the Corporations Act (s912D(3)(c)) limits the scope to obligations that are "specified in regulations made for the purposes of this paragraph". This is missing from the proposed s50A(3)(c), and it is unclear whether the difference / broader scope is intended.

Review of the regime

Given the significant impact of this regime, we recommend a review of its operation within its first two years of implementation. This will also provide clarity on whether ASIC is receiving quality, timely access to information about breaches, or whether further changes are required to improve the regime's operation.

Transitional arrangements

We assume that, following the Government's announcement of a six-month delay to these measures, that the transitional date will now be 1 October 2021. We'd appreciate your confirmation of this.

For clarity, the legislation should outline that the new regime will apply to breaches where knowledge of the breach occurred after commencement of the legislation and investigations that begin after the commencement of the new reporting regime as well. This will eliminate any operational confusion over which regime will apply to which breaches.

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Subject: Breach reporting - targeted consultation [SEC=OFFICIAL]

OFFICIAL

Good morning Jerome,

Thank you for the discussion regarding the *Strengthening Breach Reporting* exposure draft legislation, your submission in response and next steps.

As discussed, please see attached proposed amendments to the draft legislation, which reflect Treasury's current thinking following stakeholder consultation. Some of the changes reflected in these draft provisions remain subject to Government decisions, and we are looking to test the approach in these provisions with you.

In particular, we'd be interested to receive feedback on the extent to which the following changes will affect your compliance with the breach reporting regime:

- the changes which have been made to the 'significance test';
- the change to only require investigations that have been ongoing for more than 30 days to be reported to ASIC; and
- the simplifications to the obligation to report (in sections 912DAB and 50C).

We have included some select other provisions for context. While our focus is on the above issues, we're happy to receive feedback on other provisions that we've included in this pack.

To the extent that sharing of these proposed amendments within your organisation or to members is necessary to inform views and responses to the amendments, we are comfortable for them to be shared on an as needs basis. However, it should be made clear that these amendments represent Treasury's thinking and are not a settled position of the Government and should be treated as such.

We require any feedback you would like to provide on the proposed amendments by COB Thursday the 9th of July.

Should you wish to discuss anything in this draft, please don't hesitate to contact me.

Kind regards,

Ashley

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