Australian Banking Association

14 April 2021

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Langton Crescent, Parkes ACT

By email: Breach.Reporting@TREASURY.GOV.AU

Dear Ms Reeve,

Breach Reporting Regulations

We note Treasury's call for submissions on the draft regulation amendments and explanatory materials for changes to regulations that support the breach reporting rules in Schedule 11 of the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Hayne Response Act).

Key Points

- We note that the breach reporting reforms contained in the Hayne Response Act strengthen the regime generally by adding the obligation to report breach investigations that go beyond 30 days, and by deeming breaches to be significant in circumstances including where there is material loss to customers.
- While we generally support the reforms, we note that a key objective of an effective breach reporting regime should be to ensure that ASIC is advised of *material* breaches of important provisions of financial services and credit legislation, and that its intelligence is not diluted by breach reports that lack significance.
- The report of the ASIC Enforcement Review Taskforce (ASICERT), which forms the genesis of the new breach reporting regime, recognised the importance of materiality by specifically recommending retention of the significance test for reporting.
    - While it is appropriate that breaches of some provisions be deemed significant (and we note the ASICERT recommended this), the deeming of breaches of *all* civil penalty provisions to be significant has the potential to undermine the ASICERT recommendation on retention of the significance the potential.
    - While potential exposure to significant penalties is relevant to significance, the indiscriminate deeming of all civil penalty provisions to be in scope overlooks the fact that exposure to these penalties only generally occurs only after a materiality threshold is met.[1]
- The Hayne Response Act recognised the need to refine the scope of the deemed significance of civil penalty provision breaches. Accordingly, it specifically provides for the scope of this deeming provision to be limited by regulation.
    - *Breaches of any provisions that are excluded by this regulation will nevertheless be reportable if the breach is significant for another reason – such as where it causes material loss to customers*.

[1] See for example, Corporations Act, section 1317G(1)(c)(i)

- To ensure consistency with the overall objectives of the ASICERT, and to make the breach reporting reforms effective and workable, the regulations should provide that:
    - Categories of civil penalty provisions the contravention of which could span a broad spectrum from insignificant at one end, to very serious at the other, are subject to the (new) significance test, and are not deemed significant for this reason only.
    - Categories of civil penalty provisions that fall outside the general civil penalty regimes in relevant Acts and attract much lesser maximum penalties are subject to the (new) significance test, and are not deemed significant for this reason only.
- Specific provisions that we propose for inclusion in regulation 7.6.02A(2) are set out in the **Schedule** to this submission.

Impact of deeming civil penalty provisions significant

In our submission to Treasury on the regime in February 2020, we suggested that breaches of civil penalty provisions should not be deemed significant per se (but should be reportable if they are significant when assessed against the statutory test, or otherwise deemed significant). The 'deemed significance' approach, if applied indiscriminately to civil penalty provisions, will result in many minor and technical errors being reported.

Our member banks have advised that it is difficult to quantify the extent to which reporting of otherwise insignificant breaches could increase in light of this provision. However, all agree that the increase will be very substantial, and some have indicated that very high multiples of current reporting levels can be expected.

The result may be a reduction rather than an improvement in the ability of banks and regulators to focus on the incidents that really matter - i.e. those causing material customer harm or loss, or those that reflect egregious misconduct by licensees.

Why deem civil penalty provisions significant?

The ASICERT, the recommendations of which formed the genesis of the reforms to the breach reporting regime contained in the Hayne Response Act, specifically recommended that the significance test be retained.[2] Prior to its final report, the ASICERT issued a consultation paper specific to breach reporting in which it traced the history of the significance test:

> "Breaches of obligations set out in the *Corporations Act 2001* come within a broad spectrum of severity – spanning relatively minor contraventions such as a one off failure to supply a customer with a relevant form, at one end, to serious offences such as fraud at the other. Originally, AFS licensees were required to report all breaches to ASIC, regardless of severity. Such a requirement put a large regulatory burden on licensees, as well as an administrative burden on ASIC in having to deal with an influx of minor and insignificant reports. In that context, in 2003 a 'significance' test was introduced to provide a threshold for matters that were required to be reported to ASIC."

The ASICERT had some concerns about the significance test but these centred on its subjective nature. This was addressed by the review's recommendations that the test be retained, but that it be applied objectively.

The ASICERT did recommend that some provisions be deemed to be significant, including breaches of financial services civil penalty provisions. However, it is clear that the intention behind deeming certain provisions to be significant was to ensure that *serious* matters are reported to ASIC. This is evident from the review's rationale for retaining the significance test.

In our view, if the ASICERT's recommendation on deemed significance of civil penalty provisions is read in an open-ended, indiscriminate way, this would undermine its general recommendation and stated intent in retaining the significance test. This is because the range of contraventions of financial

[2] Recommendation 1

services laws potentially subject to civil penalties is now extraordinarily broad. For example, many of the general licensee obligations in the *Corporations Act 2001* (Corporations Act) and *National Consumer Protection Act 2009* (Credit Act) are, since the implementation of the ASICERT recommendations on penalties, civil penalty provisions. This includes the obligation to do all things necessary to ensure that the financial services or credit activities covered by the relevant licence are provided efficiently, honestly and fairly, as well as a range of other provisions that relate to transactional or procedural matters, and where in many cases there is unlikely to be material harm to customers in the event of a breach.

Deeming all contraventions of this kind to be significant is likely to result in ASIC receiving a very large number reports of *insignificant* contraventions, diluting the quality of its intelligence and essentially undermining the intent behind the ASICERT recommendation to preserve the significance test.

The question might be asked as to why the ASICERT made these apparently conflicting recommendations. It seems likely that what motivated the ASICERT to recommend that breaches of civil penalty provisions be deemed significant was the fact that these breaches are potentially subject to large pecuniary penalties, reflecting their potential seriousness. However, a point arguably overlooked by the ASICERT is that civil penalty provisions, before they can be subject to the pecuniary penalties outlined in the Corporations Act, *are subjected to a materiality threshold*. That is, pecuniary penalties only become applicable where, for example, a contravention "materially prejudices the interests of acquirers or disposers of the relevant financial products" or is "serious".[3]

Similarly, under the Credit Act, a court must take into account a range of factors in determining the appropriate amount of a pecuniary penalty associated with a contravention of a civil penalty provision.[4] These factors include the nature and extent of the contravention and loss or damage suffered because of the contravention. This reflects the fact that contraventions of civil penalty provisions can range drastically in seriousness. The large penalties associated with contraventions of civil penalty provisions are maximums, rather than automatically applicable amounts.[5]

In addition, while there is a general pecuniary penalty regime in the Corporations Act, which provides for very significant penalties[6], there are other provisions in the Act and financial service laws generally that, while caught by the definition of civil penalty provision under the Act, provide for maximum penalties of much lesser amounts than the general regime and so should not be considered significant *per se*, on the basis of potential penalty exposure. These lesser penalties reflect the relatively lower likelihood of customer harm in the event of breach.

Provisions that should be subjected to a significance test

Broadly speaking, we think that the intent of the ASICERT can be achieved if:

- Categories of civil penalty provision the contravention of which could span a broad spectrum for insignificant at one end, to very serious at the other, should be subject to the (new) significance test, and should not be deemed significant.
- Categories of civil penalty provision that fall outside the general civil penalty regimes in relevant Acts and attract much lesser maximum penalties should not be deemed significant by reason only of their status as civil penalty provisions.

In essence, we think that this approach is consistent with the rationale for prescribing civil penalty provisions as set out in the Explanatory Statement to the regulations:

- a breach of these provisions may be minor, technical or inadvertent in nature;
- given the frequency with which these provisions can require particular conduct (such as providing disclosure documents), it is possible minor, technical or inadvertent breaches (that

[3] Section 1317G(1)(c)(i)
[4] Credit Act, section 167(3)
[5] Credit Act, s 167A.
[6] See section 1317G

would not otherwise be significant) would result in a large regulatory burden if they were deemed automatically significant; and

- more material breaches of these provisions would be captured by the other limbs of the deemed significant test in subsection 912D(4) or by the test in subsection 912D(5) of the Corporations Act.

We expand on this approach, with reference to specific provisions and categories of provisions below. We set out a full list of specific provisions that we propose for inclusion in regulation 7.6.02A(2) in the Schedule.

We note again that breaches of these provisions would remain reportable if they were significant for a reason other than their status as civil penalty provisions alone.

General licensing obligations

Contraventions of section 912A(5A) of the Corporations Act and section 47(4) of the Credit Act should not be deemed to be significant

As noted above, the general licensee obligations listed in section 912A(1) of the Corporations Act and section 47(1) of the Credit Act are very broad and cover an enormous scope of both provisions and contravening behaviour.

Under the Corporations Act, contraventions of subparagraphs 912A(1)(a), (aa), (ca), (d), (e), (f), (g), (h) or (j) are effectively subject to the civil penalty regime because they will be contraventions of subsection 912(5A). Similarly, under the Credit Act, by virtue of section 47(4), subparagraphs 47(1)(a), (b), (e), (f), (g), (h) or (i) to (m) are civil penalty provisions.

Above we have highlighted the obligation to do all things necessary to ensure that the financial services or credit activities covered by the relevant licence are provided efficiently, honestly and fairly, as a prime example of a provision that should be subject to the significance test.[7] In our view, the same can be said for the other subparagraphs referred to in subsection 912(5A) of the Corporations Act and section 47(4) of the Credit Act.

For example, subparagraph 912(1)(g) of the Corporations Act is included in 912(5A). This subsection contains the obligation to have, when providing financial services to retail clients a dispute resolution system that complies with ASIC requirements (including those set out in RG 271), to comply with the rules of that IDR scheme, and to give ASIC certain information. Essentially, this brings in a very large number of requirements including many of low-level significance. Yet all contraventions of these requirements will be reportable if contraventions of section 912(5A) are not excluded from the deeming regime. These same considerations apply in relation to credit activities under section 47(1)(h) of the Credit Act, which is included in section 74(4) of that Act. Further, banks will be required to provide IDR data to ASIC under its new reporting regime. AFCA also has the ability to investigate systemic issues and refer bank conduct to ASIC.

Market Integrity Rules

The Corporations Act provides that breach of the Market Integrity rules is a civil penalty provision.[8] In our submission, such breaches are often low impact and do not represent any pattern that would cause concern.

For example, the following types of trading errors would constitute breaches of Market Integrity Rule 3.3.1 on the basis the transaction was not “in accordance with the instructions of the Client” or “entered into on the instructions of the Client”:

[7] Corporations Act, section 912A(1)(a); Credit Act, section 47(1)(a)
[8] Subsection 798H(1)

For example, trading errors such as wrong account / quantity / price / stock / direction would constitute breaches of Market Integrity Rule 3.3.1 on the basis the transaction was not “in accordance with the instructions of the Client” or “entered into on the instructions of the Client”

These could represent hundreds of breaches per calendar year across various market participants.

If there is a broader issue of compliance with market integrity rules, this would be assessed for significance under other tests in section 912D (such as 912D(4)(d) or 912D(5)).

Disclosure obligations

We note that the draft regulations include the following provisions:

Corporations Act	Credit Act
• subsection 941A(3) - Obligation on financial services licensee to give a Financial Services Guide if financial service provided to person as a retail client; • subsection 941B(4) - Obligation on authorised representative to give a Financial Services Guide if financial service provided to person as a retail client; • subsection 1012A(5) - Obligation to give Product Disclosure Statement—personal advice recommending particular financial product; • subsection 1012B(6) - Obligation to give Product Disclosure Statement—situations related to issue of financial products; • subsection 1012C(11) - Obligation to give Product Disclosure Statement—offers related to sale of financial products; • subsection 1021E(8) - Preparer of defective disclosure document or statement giving the document or statement (whether or not known to be defective).	• subsection 52(2) - Failure to cite the licensee’s Australian credit licence number in a document of a kind prescribed by the regulations • subsection 113(1) - Failure to give a consumer the licensee’s credit guide before providing credit assistance to the consumer in relation to a credit contract • subsection 126(1) - Failure to give a consumer the licensee’s credit guide before entering a credit contract with the consumer • subsection 127(1) - Failure to give a debtor the licensee’s credit guide after the licensee is assigned any rights or obligations of a credit provider under the credit contract • subsection 136(1) - Failure to give a consumer the licensee’s credit guide before providing credit assistance to the consumer in relation to a consumer lease • subsection 149(1) - Failure to give a consumer the license’s credit guide before entering a consumer lease with the consumer • subsection 150(1) - Failure to give a lessee the licensee’s credit guide after the licensee is assigned any rights or obligations of a lessor under the consumer lease • subsection 158(1) - Failure to give the credit representative’s credit guide • subsection 160(1) - Failure to give a debtor the licensee’s or credit representative’s credit guide after the licensee or credit representative becomes authorised to collect repayments by the debtor on behalf of the credit provider • subsection 160(2) - Failure to give a lessee the licensee’s or credit representative’s credit guide after the licensee or credit representative becomes authorised to collect payments by the lessee on behalf of the lessor

We agree that these provisions should be excluded from the deeming regime. We believe excluding these provisions is consistent with the Exposure Draft Explanatory Statement. In particular:

- A breach of these provisions may be minor, technical or inadvertent in nature;
- Given the frequency with which these documents must be provided, it is possible minor, technical or inadvertent breaches (that would not otherwise be significant) would result in a large regulatory burden if they were deemed automatically significant; and
- More material breaches of these provisions would be captured by the other limbs of the deemed significant test in subsection 912D(4) or by the test in subsection 912D(5) of the Corporations Act.

We note, however, that the list in the draft regulations overlooks many similar provisions. We include these in the Schedule. In our submission, all provisions of this kind should be treated consistently and excluded from the deeming provision.

Non-critical timing requirements

Some substantive provisions may involve important obligations but have specific timing requirements which render them open to breach in minor ways. For example, section 71 of the Credit Act imposes an obligation on licensees to notify ASIC when they authorise credit representatives. The requirement must be fulfilled within 15 business days of the authorisation. While this is an important obligation, in our submission an instance where notification was made on the 16th business day would not in substance constitute a significant breach.

Low-level civil penalty provisions

As noted above, there are some civil penalty provisions that fall outside the general regime in section 1317G of the Corporations Act and attract much lesser maximum penalties. These provisions should not be deemed significant by reason only of their status as civil penalty provisions.

Enforceable code provisions

For example, the new enforceable codes regime under the Corporations Act and Credit Act provides for maximum penalties of 300 penalty units[9] for a breach of an enforceable code provision (ordinarily) or up to 1000 penalty units[10] for a breaches of 'mandatory codes of conduct'. As indicated in the Explanatory Memorandum to the Financial Sector Reform (Hayne Royal Commission Response) Bill, it seems it was the intention that these be subject to the significance test:

> "1.101 In addition to the obligations to comply with enforceable code provisions under the voluntary codes of conduct regime, if a holder of an Australian financial services licence or an Australian credit licence knows or is reckless as to whether there are reasonable grounds to believe that it has breached, or will breach an enforceable code provision, and that breach is or will be significant, they must report that breach to ASIC."

This seems appropriate, having regard to the fact that the maximum penalties for breaches of these provisions are of a different order to the general civil penalty regime under the Act.

We note, in addition, that deeming every breach of enforceable code provisions to be 'significant' is likely to substantially increase the volume of breaches reported to ASIC. The Banking Code Compliance Committee (BCCC) Report *Banks' compliance with the Banking Code of Practice July to December 2019* (August 2020) is indicative, reporting 20,863 breaches for the 6 month period to December 2019.

[9] Corporations Act, Section 1101AC; Credit Act, section 238D.
[10] Section 1101AE(3); Credit Act, section 238F(3).

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Other legislation

The new breach reporting regime, like the old one, incorporates breaches of provisions of other legislation insofar as it relates to financial services. For the Corporations Act, sections 912D(3)(c), the definition of financial services laws in 761A(d), and paragraph 7.06.02A of the Corporations Regulations, have the effect that breaches of provisions of the following come within scope of the breach reporting obligations in so far as they cover conduct relating to the provision of financial services:

Australian National Registry of Emissions Units Act 2011	Insurance Acquisitions and Takeovers Act 1991
Banking Act 1959	Insurance Act 1973
Carbon Credits (Carbon Farming Initiative) Act 2011	Insurance Contracts Act 1984
Clean Energy Act 2011	Life Insurance Act 1995
Financial Sector (Collection of Data) Act 2001	Retirement Savings Accounts Act 1997
Financial Sector (Shareholdings) Act 1998	Superannuation Industry (Supervision) Act 1993
Financial Sector (Transfers of Business) Act 1999	Superannuation (Resolution of Complaints) Act 1993.

For the Credit Act, currently the obligation applies in an open-ended fashion to Commonwealth legislation in so far as it covers conduct relating to credit activities.[11]

If the deeming of civil penalty provisions was applied to core obligations arising under the above legislation, licensees would need to trace through each Act, regardless of the seriousness of any potential breach, to discover whether any civil penalty provision could have been breached.

In our view, core obligations arising from the inclusions of provisions of other legislation because of sections 912D(3)(c) of the Corporations Act or section 50A(3)(c) of the Credit Act should be excluded from the deeming provision.

We would be pleased to discuss any of the above matters further if this would be of assistance.

Yours sincerely

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[11] Credit Act section 50A(3)(c) and definition of 'credit legislation' in section 5.

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Schedule

Provisions proposed for inclusion in regulation 7.6.02A(2)

Legislation	Provision
Corporations Act	798H(1) - Complying with market integrity rules
	912A(5A) – General obligations
	941A(3) - Obligation on financial services licensee to give a Financial Services Guide if financial service provided to person as a retail client
	941B(4) - Obligation on authorised representative to give a Financial Services Guide if financial service provided to person as a retail client
	946A(4) - Obligation to give client a Statement of Advice
	948C(2) - Obligation to give client a Cash Settlement Fact Sheet
	952E(9) - Giving a defective disclosure document or statement (whether or not known to be defective)
	952H(3) - Failure by a licensee to ensure authorised representative gives disclosure document or statement as required
	962G(1) - Failure of fee recipient to give a Fee Disclosure Document
	962S(1) - Fee recipient must give fee disclosure statement
	962V(3) - Failure by a fee recipient to give written notice of cessation of consent to account provider
	981C - Regulations may deal with various matters relating to accounts maintained for the purposes of section 981B
	1012A(5) - Obligation to give Product Disclosure Statement—personal advice recommending particular financial product
	1012B(6) - Obligation to give Product Disclosure Statement—situations related to issue of financial products
	1012C(11) - Obligation to give Product Disclosure Statement—offers related to sale of financial products
	1021E(8) - Preparer of defective disclosure document or statement giving the document or statement (whether or not known to be defective)
	1021G(3) - Failure by a licensee to ensure authorised representative give etc. disclosure documents or statements as required
	1101AC - Obligation to comply with enforceable code provisions
	1101AE(3) - Mandatory codes of conduct
	Any civil penalty provision for breach of a core obligation that comes within subsection 912D(3)(c)
Credit Act	47(4) - General conduct obligations of licensees
	52(2) - Failure to cite the licensee's Australian credit licence number in a document of a kind prescribed by the regulations
	71(1), (2), & (4) - Obligation to notify ASIC etc. about credit representatives

	113(1) - Failure to give a consumer the licensee's credit guide before providing credit assistance to the consumer in relation to a credit contract
	114(1) - A licensee must not provide credit assistance to a consumer in relation to a credit contract unless the licensee has given the consumer a quote etc
	120(1) - Providing the consumer with the preliminary assessment
	121(1) – Obligation to give the consumer a credit proposal disclosure document in accordance with subsection
	126(1) - Credit guide of credit providers
	127(1) - Credit guide of credit providers who are assignees
	132(1)&(2) - Giving the consumer the assessment
	133AC - Credit provider's website to provide capacity to generate Key Facts Sheet
	133AD - Credit provider to provide Key Facts Sheet in other situations
	133AE - What if more information is needed from the consumer?
	133BC - Application form for credit card contract to include up-to-date Key Facts Sheet
	133BD - Credit provider not to enter into credit card contract unless Key Facts Sheet has been provided etc.
	133BH - Credit provider to notify consumer of use of credit card in excess of credit limit
	136(1) - Failure to give a consumer the licensee's credit guide before providing credit assistance to the consumer in relation to a consumer lease
	149(1) - Failure to give a consumer the license's credit guide before entering a consumer lease with the consumer
	150(1) - Failure to give a lessee the licensee's credit guide after the licensee is assigned any rights or obligations of a lessor under the consumer lease
	158(1) - Failure to give the credit representative's credit guide
	160(1) - Failure to give a debtor the licensee's or credit representative's credit guide after the licensee or credit representative becomes authorised to collect repayments by the debtor on behalf of the credit provider
	160(2) - Failure to give a lessee the licensee's or credit representative's credit guide after the licensee or credit representative becomes authorised to collect payments by the lessee on behalf of the lessor
	Any civil penalty provision for breach of a core obligation that comes within subsection 50A(3)(c)
National Credit Code – Key requirements	17(3),(4),(5),(6),(8)(a)&(b),(9),(11),(15)(a)&(b),(15A) - Matters that must be in contract document
	34(6) - Information to be contained in statements of account
	35 - Opening balance must not exceed closing balance of previous statement
	72(4) - Notice of decision on changing credit contract
	87 - One-off notice to be given the first time a direct debit default occurs
ASIC Act	12DL - Unsolicited credit cards and debit cards