7 June 2021

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By email: BR.submissions@asic.gov.au

Dear Ms De Mel

**Consultation Paper 340 - Breach reporting and related obligations**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment to ASIC on the proposals for guidance set out in *CP 340 Breach reporting and related obligations* that support the breach reporting rules clarified by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020, the Draft RG 78 and the related Draft Information Sheet.

The reforms impact AFMA members with financial services and credit licences and will expand the scope of their reporting obligations. While AFMA supports a strong breach reporting framework to promote transparency, accountability and improved conduct in the financial services industry, it is important that the regime is clear, reasonable and practical to enable licensees to deliver on their obligations in an efficient manner.

AFMA holds concerns that the proposed reforms will considerably add to the complexity of licensees' obligations and will impose substantial additional compliance costs on them. We highlight these concerns in our comments and responses to consultative questions.

**Incorporation of the ASIC Market Integrity Rules and Derivative Transaction Rules as *core obligations.***

We restate our concerns from AFMA's submission to Treasury on the draft amendments to Breach Reporting Regulations that the new breach reporting requirements capture the ASIC market integrity rules in the list of 'core obligations', so that all breaches of the rules will be automatically taken to be significant under the deemed significance test of the new s912D(4) of the Corporations Act 2001 (the Act).

AFMA notes additional costs and pressures on ASIC's resources as ASIC acknowledges that the new regime will mean a significant increase in the volume of reports received by it. Similarly, the inclusion of the Market Integrity Rules (MIRs) will create a substantial additional regulatory burden for market participants as even minor breaches of the MIRs such as trivial trading or regulatory data errors, minor trust account discrepancies or trivial contraventions of disclosure obligations, similar to the ones proposed to be exempted will be required to be reported to ASIC as significant matters.

A similar problem arises with breaches of the *Derivatives Transaction Rules (DTRs)*. Section 901E of Chapter 7 of the Act is a civil penalty provision with the obligation to comply with Derivatives Transaction Rules and a breach of this provision will also be automatically deemed significant under the new s912D(4). AFMA notes there is a risk that participants would be forced to file administrative breaches of the DTRs that can include day to day incomplete reporting, incorrect mapping and errors resulting from timing and inadequacies in system administration.

The reporting for DTRs and the associated administrative errors will involve reporting for the regulatory purposes and not the actual transaction that may or may not be client facing. These administrative errors, similar to the administrative errors associated with the delivery of PDS and FSG disclosures would not meet the intended materiality threshold of a 'deemed significant' breach. Consequently, there would be a considerable burden on reporting entities; particularly Phase 3B entities that seek to rely on single-sided reporting. These entities will have to consider and possibly completely reconfigure their current reporting systems to capture and report breaches 'deemed significant' under the proposed new regime.

All reporting entities face significant impacts relating to offshore reporting teams that include time zone differences and capabilities to report administrative errors that would otherwise be detected through internal compliance and operational assurance checks including audit.

Depending on the outcome of the Treasury consultation, AFMA suggests ASIC consider using its powers to carve out these MIRs and DTRs from being automatically deemed significant under the new regime.

**Determining significance**

It is AFMA's view that ASIC should consider further clarifying the 'deemed significant' obligations by providing a comprehensive and clear list of the obligations which would be considered significant, as well as a list of those obligations that fall outside of the breach reporting obligations and are insignificant.

As previously mentioned, the scope of civil penalty provisions potentially caught by s912D(4) is expansive and clear guidance on what does not get deemed as significant would assist in addressing ambiguities; especially where the civil penalties relate to simple administrative errors rather than actual material breaches. AFMA's license holding members are undertaking major systemic capacity-building to reflect the broad range of

offences currently in scope which entails significant design and cost implications. This is particularly onerous for global license holders that have centralised offshore processing teams.

AFMA also notes that the examples provided in the draft RG predominately focus on incidents in the retail services space and little guidance is provided on the assessment of deemed significance test for the types of incidents that occur in the institutional/ wholesale space. We suggest ASIC engage with licensees providing wholesale services to understand the functional aspects of these services, for example the inclusion of DTRs in the 'deemed significance' test as noted above, to ensure the regulatory objectives are appropriately met and obligations do not create unintended outcomes.

**Transition and commencement**

AFMA notes that given the large-scale changes to processing systems required by the new regime, licensees should be allowed a reasonable transition period following the finalisation of RG 78. This period should be arrived at upon consultation with the industry; especially given the differences in scale and complexities of entities caught by this new reporting regime.

We further note that it would be beneficial for ASIC and the licensees if the usability of the reporting portal could be improved by further development and testing with licensees. This would ensure an efficient experience for the industry and reduce costly technical glitches including system outages due to high volume usage at peak hours.

## Responses to consultative questions

### *ASIC Proposal B1*

| **B1Q1.** *Do you agree with our proposed approach? If not, why not?* |
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AFMA agrees that consistent guidance should be provided, and ASIC should especially ensure that it is accurate and does not lead to ambiguity around how licensees comply with their obligations under this regime and more broadly.

We note there is limited guidance around breaches or likely breaches of "efficiently, honestly and fairly" obligations in s912A(1)(a) of the Act. Given past statements made by ASIC that this obligation can be triggered by inadequate controls and compliance monitoring by licensees, licensees would benefit from further guidance in the form of examples to illustrate other reportable situations that are triggered by a contravention of s912A(1)(a); capturing case studies that include both retail and wholesale scenarios.

| **B1Q2.** *Are there differences in the structure or operation of credit licensees that require specific guidance on how the breach reporting obligation applies?* |
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AFMA notes that RG 78.121(a)(vii) references retail clients in relation to credit licensees. The credit legislation does not make the distinction between retail and wholesale clients and a credit licence applies to 'consumers' who may or may not be individuals. Several of our members provide financial services to wholesale clients and credit to both individuals and non-individuals.

We suggest that further information on whether ASIC intends to apply a retail test in this case should be provided. AFMA cautions against conflating the retail and wholesale client tests in the guidance to avoid adding ambiguity.

AFMA also seeks clarity in relation to credit licensees who engage in the purchase of portfolios from originating institutions, comprising of distressed consumer debts now subject to formal Debt Agreements as governed by the Bankruptcy Act. We suggest for the RG to provide clarification on which entity is responsible for reporting breaches that occurred prior to the assignment of debt but detected post assignment of the portfolio.

### *ASIC Proposal B2*

| **B2Q1:** *Are there any specific issues, incidents, challenges or areas of concern you think we should include as examples, case studies or scenarios? If so, please provide details and explain why they should be included.* |
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AFMA notes that further examples of 'likely breaches' will be beneficial to assist licensees with their assessment of situations that may be "grey areas" and help promote consistent reporting across licensees. We find it important to recognise the issues and challenges faced by markets-related business and large firms that may outsource certain functions both within Australia and offshore. We support case studies being provided for the following:

- Markets related breaches involving wholesale client(s)

- How the breach reporting regime interacts with the MIRs, for example, in regard to reconciliation errors that will need to be doubly reported under the MIRs as well as under the Act as a reportable situation.
- DTRs reporting, for example, in regard to incorrect mapping especially where there are offshore operational teams and the Australian entity is either not impacted by the error or responsible for the error. ASIC's expectations for Phase 3B entities that rely on singe-side reporting would be beneficial in this regard
- IT or systems issues that are fairly common amongst firms that rely on electronic infrastructure which is often supported by offshore teams. These issues may or may not lead to breaches of regulatory requirements and/or have impacts on clients.

It is likely that issues involving global or outsourced processes and systems affecting Australia becomes reportable due to the time taken to investigate and priorities at a global level, resulting in unnecessary reporting.

AFMA supports clarity about the treatment of markets related breaches as they are an important segment of the financial services industry, with several licensees who are market participants and many other licensees who use their services. Many participants (or licensees within their corporate group) may also be APRA-regulated making it critical that the intended interaction between the regimes is clear for requirements that are related to the Banking Act 1959.

***ASIC Proposal B3***

| **B3Q1:** *Should we include further guidance to help AFS licensees understand how the existing breach reporting obligation under s912D of the Corporations Act (as in force before 1 October 2021 applies? If so, please provide details.* |
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AFMA notes that guidance would be beneficial in scenarios where there is an investigation into whether a breach of a core obligation has occurred, that started before September 2021 (for example, 1 April 2021) and goes on for more than 30 days (i.e. still being investigated after 1 October 2021). In this case, clarity is needed if the investigation will be required to be reported on 1 October 2021, or would the reportable situation be seen to arise on 1 October (giving 30 days from then to report)? This does not appear to be clarified by the new s1671A.

***ASIC Proposal B4***

| **B4Q1:** *Do you agree with our proposed approach? If not, why not?* |
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AFMA supports ASIC providing practical and effective guidance to licensees that considers the various challenges faced by licensees by addressing ambiguous points and supporting efficient reporting obligations that do not place undue or duplicative obligations on the industry.

**B4Q2:** *Should we include further guidance on what constitutes a 'core obligation'? If so, please provide details.*

AFMA notes its previous comments that s798H and s901E covered items should not be considered significant for the reasons below:

- If minor and/or technical breaches of the MIRs or DTRs are captured as reportable situations by automatically being deemed significant, it would create large regulatory burdens for both ASIC and market participants.
- Generally, breaches of the MIRs are dealt with by ASIC through administrative infringement notices.
- Most DTRs breaches are administrative errors in the reporting that is designed for regulatory purposes only (not client facing reporting) that would typically be captured and rectified by internal assurance checks.

If Treasury and ASIC were to go ahead with capturing MIRs and DTRs as significant, we note that while the lists provided in the Appendix to RG 78 are useful, ASIC should make it clear that in effect almost every obligation applying to financial services and credit licensees is a core obligation.

**B4Q3:** *Should we include further guidance on how to determine whether a breach or likely breach of a core obligation is 'significant'? If so, please provide details.*

In addition to clarity sought on issues outlined above, AFMA seeks further information on the components of the 'deemed significance test' at s912D(4)(a) and (b). For example:

- AFMA seeks clarity on whether a conviction is necessary before reporting an offence that is punishable on conviction by a penalty that may include imprisonment for ≥3 months if the offence involves dishonesty, or ≥ 12 months in any other cases. Licensees will face major challenges with the practical applications of how to monitor representative offenses.
- A list of criminal and civil penalty provisions similar to the list of core obligations in the Appendix to RG 78 would assist licensees to apply the test efficiently and consistently.

AFMA also considers that a markets related example involving wholesale clients is needed in Table 2 for the reasons outlined in the response to question B2Q1 above.

<u>Breaches by representatives – RG 78.26</u>

AFMA notes that the new s912D requires a licensee to report its breaches and the breaches of its representative. AFMA considers that the definition of 'representative' ins 910A is broad and includes an employee or director of a related body corporate.

This definition generally captures staff working for the licensee that may have been employed by another group services entity. AFMA notes it may risk an unintended consequence of capturing a scenario which requires a licensee to report a breach by staff of a subsidiary licensee because that staff is employed by a related body corporate of the reporting licensee. This would cause significant reporting duplications and inefficiency.

<u>Determining significance – RG 78.42 – 45</u>

AFMA notes that guidance such as visual timelines for reporting will be useful in instances where information is not readily available; there is a lengthy investigation; or when a notified breach is not significant, but additional information is identified which changes the outcome.

**B4Q4:** *Should we include further guidance on reporting an 'investigation' to ASIC? If so, what should be clarified? Please provide examples of scenarios (where relevant).*

Investigation commencement

AFMA notes that the draft RG states from the Explanatory Memorandum (EM) for the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020,* that "Merely entering a suspected compliance issue into a risk management system is unlikely to amount to a searching inquiry to ascertain facts, although this will depend on the circumstances in each case."

AFMA notes that an investigation can commence for several reasons such as (i) complaint (ii) whistleblowing (iii) Regulatory request (including inquiries from Market operators) (iv) Internal audit (v) Compliance reviews (vi) queries or comments from clients. It appears that in practice the legislation only requires that the scope of the investigation includes a core obligation, as whether an issue is significant will not always be known from the outset (and would be difficult to rule out). We note that s912D1(c) will create an obligation to make a report once the investigation exceeds 30 days. AFMA suggests ASIC could clarify whether it is necessary to establish whether an investigation into a suspected core breach is also required to be significant, particularly where "deemed significance" does not apply.

In the case of deemed significance, it appears that under the legislation any investigation (for any of the above reasons) that exceeds 30 days that involves a core obligation that is deemed significant would require notification.

This could capture situations where there is an allegation concerning historical behavior which results in additional time needed to collect and review the original records. AFMA seeks clarity whether in this scenario, where deemed significance would be met, but no conclusions could be drawn, would a report still be required to be lodged? AFMA notes there may be a scope for ASIC to provide AFSL holders discretion to only make a report when there are sufficient facts to suggest the possibility that there has been a significant breach.

AFMA notes that there is ambiguity around what actions and activities will mark the commencement of an investigation for the purposes of the regime. Clarification and examples of what is meant by 'investigation' are needed in RG 78 to assist licensees in complying with s912D(1)(c). We seek to understand whether a distinction is drawn between fact gathering or clarifying facts as against launching a formal investigation into the matter.

Whistle-blower disclosures

- AFMA notes the draft regulatory guidance does not account for instances where whistle-blowers make disclosures, alleging a reportable situation under s912D(c).

For example, would s912D(c) be triggered when a whistle-blower disclosure alleges a reportable situation, and the investigation is over 30 days old, despite no material evidence being identified during the investigation to support the allegation?

- AFMA also notes that whistle-blower reports of misconduct are subject to obligations imposed on a licensee under Part 9.4AAA of the Act. Where a whistle-blower makes a report that may involve significant breaches of core obligations, and the confidential claims are investigated, a reportable situation may arise after the 30-day period. This may be common in whistle-blower reports due to the volume of confidential disclosures and typically, the lack of evidence to support allegations made.
- AFMA supports that it may be helpful for ASIC to note intersection of reporting to ASIC under s912D and obligations for whistle-blower protections. We suggest ASIC to consider the feasibility of excluding whistle-blower reports from obligations to investigate within 30 days due to circumstances stated above that are different from other typical breaches of core obligations.

Investigations by related entities

- AFMA notes that RG 78.49(c) could be interpreted as suggesting that where a related entity conducts any investigation, the licensee itself will be considered to have conducted the investigation.
    - It is likely that issues involving global or outsourced processes and systems affecting Australia become reportable even if they do not result in a breach for the Australian business, resulting in unnecessary reporting (see also response to questions under ASIC Proposal B5). Alternatively, an investigation might be initiated by an offshore related entity, and the licensee is unaware of the investigation until some time later.
    - To address this concern, we suggest ASIC state that where a related entity investigates on behalf of the licensee at its instigation, only then will the licensee be taken to conduct the investigation.

**B4Q5:** *Should we include further guidance on what constitutes 'material loss or damage'? If so, what are the challenges licensees face in determining whether loss or damage is material? Please provide examples of how you consider questions of material loss or damage.*

<u>Material loss or damage - RG 78.38</u>

AFMA seeks further guidance to assist licensees in determining -

- When might loss or damage be immaterial at an individual customer level?
- When might loss or damage be material in aggregate, where otherwise it would be immaterial at a per-customer level?

**B4Q6:** *Should we include further guidance on reportable situations involving serious fraud or gross negligence? If so, what are the challenges licensees face in identifying when serious fraud or gross negligence has occurred?*

AFMA strongly supports removing the term 'gross negligence' and substituting it with more precise language that describes the kind of conduct intended to be captured; as it is not a defined legal term. We also support that the criteria of 'commits serious fraud' be limited to 'in the course of providing a financial service' etc. (as with gross negligence). AFMA suggests examples or case studies of serious fraud or gross negligence would assist licensees in identifying whether either of them has occurred. We particularly support markets-related examples.

Additional reportable situations

The EM states at paragraph 11.54 that there is 'some overlap' between the requirement to report 'additional reportable situations' and the requirement to report breaches and likely breaches of 'core obligations'. The EM also states that while investigations about additional reportable situations are not expressly required to be reported to ASIC, they may still need to be reported if they amount to a core obligation reportable situation. AFMA suggests that ASIC provide examples to illustrate the interaction and overlap between additional reportable situations and other reporting obligations, which will help relieve ambiguity.

***ASIC Proposal B5***

| **B5Q1:** *Should we include further guidance to help licensees understand when to report to ASIC? If so, please provide details, including what guidance would be helpful and why.* |
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AFMA notes our response to **B4Q3** and supports the provision of a visual flow chart/timeline of an instance with different scenarios in which reportable situation/s are triggered. This could be similar to example 8 in draft RG 78 where a significant breach is found and another scenario where an investigation takes place, but no significant breach is found.

| **B5Q2:** *Should we include further guidance on what may amount to 'knowledge', 'recklessness' and 'reasonable grounds'? If so, please explain what specific guidance would be helpful and why.* |
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AFMA notes that 'knowledge', 'recklessness' and 'reasonable grounds' are central to the requirement that licensees report 'reportable situations' within 30 days. However, we draw ASIC's attention to critical challenges faced by large companies or groups that have overseas operations or headquarters, for example, IT teams employed by a foreign related body corporate. In these scenarios, the time when local staff know about a 'reportable situation' may differ to when staff of related bodies corporate know. These raises concerns over who 'first knows'.

To effectively address these uncertainties, AFMA suggests ASIC further consult with the industry to understand these challenges and arrive at a suitable mechanism to determine reporting obligations. For example, ASIC's view as to whether it would consider that the investigation began when the offshore team first knew of the issue or when the Australian team knew can be better determined upon understanding the practical issues and challenges of global entities.

Requisite knowledge

AFMA seeks to understand whether ASIC expects licensees to assign a designated breach reporting officer and the effect this will have on ‘investigations’ unders 912D(1)(c). We seek clarity around if a licensee does assign a designated breach reporting officer and the officer does not have the requisite knowledge in a particular circumstance, would ASIC be inclined to find that another employee (e.g. senior member of the Compliance or Legal function) has ‘knowledge’ within the scope of their ‘apparent authority’ within the meaning of s769B? AFMA suggests that further clarification on how ASIC conceptualises this ‘apparent authority’ to work from a practical standpoint would be useful.

***ASIC Proposal B6***

| **B6Q1:** *Do you have any feedback about the types of information we propose must be included in the prescribed form? If so, please provide details, and identify any issues.* |
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AFMA supports that the ASIC portal should be designed that allows a licensee to provide the information that it has access to at the time of reporting – with acknowledgement that a licensee may not have all the information at that time. As such, we suggest that ASIC should consider the feasibility of making most fields optional rather than mandatory where there is a case to be made that not all information is reasonably attainable at the time of reporting.

Further, we seek to understand the following aspects of the portal:

- What does ASIC consider to be the ‘rectification’ of the matter? We note that in the portal the terms ‘remediation’ and ‘rectification’ are used interchangeably as equivalents. Clarity on whether ASIC intends rectification to occur when the remediation concludes would be beneficial.
- Within the portal, ASIC asks “are you aware of any action or proposed action by the other regulatory body in relation to the breach?”. AFMA seeks to understand whether it is intended for the term ‘action’ to mean enforcement action or litigation action, or would it mean action in a broader sense (i.e. a request for information).

***ASIC Proposal B7***

| **B7Q3:** *Are there any challenges that you would face in applying our guidance to your specific circumstances (i.e. the nature, scale or type of your business)? If so, please provide details.* |
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As noted above, AFMA supports consideration of the complexities within large firms with global models in contrast to simpler entities that only operate domestically. We support more guidance and examples determined in consultation with the industry that are relevant to markets businesses, wholesale clients and IT-related issues. AFMA also seeks to remove the ambiguity around expectations regarding investigations that take place offshore and the ‘knowledge’ triggers for reporting obligations.

***ASIC Proposal C1:***

***C1Q3:*** *Should we include further or more specific guidance on the circumstances in which licensees must: (a) notify affected clients of a breach of the law; (b) investigate the full extent of that breach; or (c) remediate affected clients? If so, what other information would be helpful in determining how these obligations apply?*

In addition to our comments about 'remediation' and 'rectification' for B6Q1 above, AFMA considers that ASIC should make clear its expectations regarding remediation of clients that are wholesale clients (for financial services) and non-individuals (for credit activities). We note that the new 'notify, investigate, remediate' obligations apply to mortgage brokers and financial advisers who provide advice to retail clients.

AFMA also seeks to understand what remediation actions ASIC expects licensees to take, particularly where no financial or non-financial loss is caused to wholesale clients.

***ASIC Proposal C2***

**C2Q2:** *Do you agree with our proposed approach? If not, why not?*

AFMA agrees with ASIC's proposed approach. We note that initial notification is required to be provided before an investigation has been completed, and in some cases before the breach has been confirmed. For this purpose, we suggest ASIC consider replacing the term "breach" by "reportable situation" in these instances.

We trust our comments are of assistance and we look forward to an ongoing engagement with ASIC over the breach reporting regime.

Please contact Nikita Dhanraj either on [redacted] or by email on [redacted] if further clarification or elaboration is desired.

Yours sincerely

[redacted]

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