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By email

Dear Ms De Mel

Consultation Paper 340 – Breach reporting and related obligations

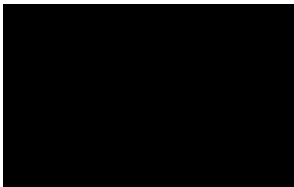
We refer to the above consultation paper (**CP 340**) and the draft revised Regulatory Guide 78 included in that paper (**Draft RG 78**).

We enclose our written submission to the Australian Securities and Investments Commission (**ASIC**) in connection with CP 340 and Draft RG 78. We are grateful for the opportunity to comment on CP 340 and Draft RG 78.

In making this submission we seek to focus on the three areas of **knowledge**, **“deemed significant” obligations**, and **investigations**. These are areas that we expect to be key for licensees in complying with the breach reporting regime and where licensees and their advisers would particularly benefit from ASIC guidance.

Our submission is informed by our work with financial services and credit licensees in the context of the existing regime and in preparing for the new regime. Our proposals therefore reflect our perspectives and those of licensees that have experience within the existing regime and are currently tackling the issues that arise in establishing processes for compliance with the new regime.

Yours sincerely



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Introduction

Australia's regime for the reporting of significant breaches by financial services licensees is a core component of Australia's financial services regulatory structure.¹ It has taken various forms since its introduction and has recently been the subject of significant law reform reviews² and a detailed report by ASIC into licensees' practices.³ The breach reporting obligation has also become a civil penalty provision in recent years.⁴

The new regime to be introduced from 1 October 2021 by amendments to the Corporations Act 2001 (Cth) (**Corporations Act**) and National Consumer Credit Protection Act 2009 (Cth) (**National Credit Act**) brings significant changes to the regime and extends the regime to credit licensees for the first time.

Our submission focuses on three key areas that we anticipate will arise frequently for licensees in complying with the regime and where licensees and their advisers would particularly benefit from ASIC guidance. Our submission in each of those areas may be summarised as follows:

- **Knowledge:** Understanding when a licensee "knows that, or is reckless with respect to whether, there are reasonable grounds to believe [a] reportable situation has arisen" will be pivotal for licensees as they establish and implement their processes to comply with the new regime. For accuracy, and to avoid uncertainty for licensees in this important area, we submit that:
 - Draft RG 78 does not accurately capture the effect of sections 769B(3) of the Corporations Act and 324(3) of the National Credit Act (which set out a circumstance in which the state of mind of an individual within a corporation will be attributed to the corporation); and
 - paragraphs RG 78.73, RG78.74 and RG78.77 should be amended to correct this.
- **"Deemed significant" obligations:** Sections 912D(4) of the Corporations Act and 50A(4) of the National Credit Act mean that a single breach of any one of hundreds of legislative provisions is reportable, regardless of whether it would otherwise be characterised as "significant". This is a significant change and presents risks of non-compliance and/or inconsistency across licensees, contrary to the purpose stated at [11.37] in the Explanatory Memorandum.⁵ We propose that ASIC publish and maintain a list of "deemed significant" provisions, as an important measure to promote compliance with the regime and put licensees on a more equal footing in seeking to achieve such compliance.
- **Investigations:** Understanding when an "investigation" (within the meaning of sections 912D(1) of the Corporations Act and 50A(1) of the National Credit Act) begins will be pivotal for licensees as they establish and implement their processes to comply with the new requirements to report investigations that run for more than 30 days. Aspects of the guidance in Draft RG 78 create uncertainty in this area, as they suggest that various preliminary or other steps may be regarded by ASIC as investigations for the purpose of those sections. We submit that too broad an interpretation of "investigations" might actually impede licensees' ability to conduct and track investigations and report them to ASIC in keeping with the objectives of the new regime. We propose amendments to Draft RG 78 in this regard, including further examples of steps that would not have the status of (relevant) investigations.

¹ As noted in, for example, the Explanatory Memorandum to the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 (Cth) (**Explanatory Memorandum**) at [11.3]; and ASIC's Report 594 ("Review of selected financial services groups' compliance with the breach reporting obligation") dated September 2018 (**Report 594**) at [2].

² See, for example, the ASIC Enforcement Review Taskforce Report dated December 2017 at Chapter 1.

³ Report 594.

⁴ With effect from 13 March 2019.

⁵ "The purpose of the deemed significance test is to provide greater certainty for industry and to ensure significant breaches are reported to ASIC in a timely manner."



Section 1: Knowledge

Context

Section 912DAA(3) of the Corporations Act states that a financial services licensee must lodge a report with ASIC in relation to a reportable situation within 30 days after the licensee first knows that, or is reckless with respect to whether, there are reasonable grounds to believe the reportable situation has arisen. Section 50B(4) is the equivalent under the National Credit Act.

Section 769B(3) of the Corporations Act relevantly states:

"If, in a proceeding under this Chapter in respect of conduct engaged in by a body corporate, it is necessary to establish the state of mind of the body, it is sufficient to show that a director, employee or agent of the body, being a director, employee or agent by whom the conduct was engaged in within the scope of the person's actual or apparent authority, had that state of mind."

Section 324(3) is the equivalent under the National Credit Act.

Paragraphs RG 78.73 to RG 78.81 of Draft RG 78 address the question "When does the licensee first know that a reportable situation has arisen?" These paragraphs include the following statement at RG 78.77:

"Where an employee (or agent) may not have been granted actual authority within their employment by the licensee to make a decision to lodge a breach report, s769B of the Corporations Act or s324 of the National Credit Act can still apply. The employee can be shown to possess knowledge that there are reasonable grounds to believe a reportable situation has arisen, provided that they acquire this knowledge within the scope of their apparent authority within their employment.

Note: The Explanatory Memorandum, at paragraph 11.81 states: 'In accordance with section 769B(3) of the Corporations Act, for a licensee that is a body corporate, the state of mind of a director, employee or agent of the licensee (or certain other persons) will be attributed to the licensee where that person was engaged in the relevant conduct within the scope of their actual or apparent authority.'

In the current RG 78, notwithstanding that section 769B(3) has existed in the above form since before that guide was first published in 2008, ASIC does not refer to section 769B(3), and states (at RG 78.28):

"The reporting period starts on the day you became aware of a breach (or likely breach) that you consider could be significant. We will administer this requirement as meaning that you become aware of a breach (or likely breach) when a person responsible for compliance becomes aware of the breach. We expect your internal systems to make sure that the relevant people are aware of breaches in a timely and efficient manner."

Issues

For the following summary reasons, we submit that paragraph RG 78.77 of Draft RG 78 does not accurately capture the effect of section 769B(3) of the Corporations Act and paragraph 11.81 of the Explanatory Memorandum.

- 1 Paragraph RG 78.77 of Draft RG 78 in effect states that any employee or agent can be shown to possess knowledge, attributable to the licensee, that there are reasonable grounds to believe a reportable situation has arisen, provided that they acquired this knowledge within the scope of their apparent authority within their employment.
 - 2 In our view, that is not the effect of section 769B(3), nor is it consistent with paragraph 11.81 of the Explanatory Memorandum.
 - 3 That interpretation appears to ignore the requirement in section 769B(3) that the person who holds the relevant state of mind is also the person "by whom the conduct was engaged in". The same requirement is evident in paragraph 11.81 of the Explanatory
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Memorandum, by its inclusion of the words "...where that person was engaged in the relevant conduct".

- 4 The "conduct" (or "the relevant conduct") in proceedings for breach of section 912DAA(3) would be an alleged failure to lodge a breach report within the 30-day period. To the extent that such conduct can be done by a natural person, it can only be the natural person or persons within the licensee who is/are responsible for compliance with the breach reporting obligation.
- 5 Section 769B(3) cannot, therefore, have the effect of attributing the state or mind of any employee or agent to the body corporate, as long as that person "acquired this knowledge within the scope of their apparent authority within their employment". We suggest that it can only attribute to the body corporate the state of mind of the person or persons within the body corporate who is/are responsible for compliance with the breach reporting obligation (being the person/s "by whom the conduct [of failing to lodge the report within 30 days] was engaged in").
- 6 This understanding of the effect of section 769B(3) is consistent with the guidance in current paragraph RG 78.28 that ASIC will treat the licensee as becoming aware of a breach (or likely breach) when a person responsible for compliance becomes aware of the breach.

The same analysis applies, mutatis mutandis, when considering sections 50B(4) and 324(3) of the National Credit Act.

The above is a very important issue, as there will typically be a number of persons involved in the process of considering whether a breach has occurred or is likely to occur. The question of when a licensee first knows that, or is reckless with respect to whether, there are reasonable grounds to believe a reportable situation has arisen is a critical one.

In addition, we note that there appears to be a typographical error in paragraph RG 78.73 of Draft RG 78 such that it is an incomplete sentence.

Proposed solutions

We propose a slight amendment to RG 78.73 to the following effect, to address the apparent typographical error:

~~"The issue arises. In considering~~ when the licensee first knows or is reckless to whether there are reasonable grounds to believe a reportable situation has arisen ~~and, a question arises of~~ whose knowledge is attributable to the licensee for the purposes of s912DAA(3) of the Corporations Act or s50B(4) of the National Credit Act."

We propose amendments to RG 78.74 to 78.77 as follows:

"RG 78.74 ~~If a licensee delegates the decision whether to lodge a breach report to a particular person or committee as part of its breach reporting process, in~~ determining ~~who within when~~ the licensee 'first knows' (or is reckless as to whether) ~~whether~~ there are reasonable grounds to believe a reportable situation has arisen, the licensee must consider s769B of the Corporations Act or s324 of the National Credit Act.

RG 78.75 Section 769B(3) of the Corporations Act states:

If, in a proceeding under this Chapter in respect of conduct engaged in by a body corporate, it is necessary to establish the state of mind of the body, it is sufficient to show that a director, employee or agent of the body, being a director, employee or agent by whom the conduct was engaged in within the scope of the person's actual or apparent authority, had that state of mind. For this purpose, a person acting as mentioned in paragraph (1)(b) is taken to be an agent of the body corporate concerned.



RG 78.76 Section 324(3) of the National Credit Act states:

If, for the purposes of this Act (other than the National Credit Code), it is necessary to establish the state of mind of the body corporate in relation to particular conduct, it is enough to show:

- (a) that the conduct was engaged in by a person referred to in paragraph (1)(a) or (b); and
- (b) that the person had that state of mind.

RG 78.77 Where an employee (or agent) ~~may not have~~ has been granted actual or apparent authority within their employment by the licensee to make a decision to lodge a breach report, s769B of the Corporations Act or s324 of the National Credit Act ~~can still apply. The employee can be shown to possess~~ will mean that the licensee has knowledge that there are reasonable grounds to believe a reportable situation has arisen, ~~provided that they if that employee (or agent) has that knowledge~~ acquire this knowledge within the scope of their apparent authority within their employment.

Note: The Explanatory Memorandum, at paragraph 11.81 states: 'In accordance with section 769B(3) of the Corporations Act, for a licensee that is a body corporate, the state of mind of a director, employee or agent of the licensee (or certain other persons) will be attributed to the licensee where that person was engaged in the relevant conduct within the scope of their actual or apparent authority.'

Section 2: "Deemed significant" obligations

Context Section 912D(4) of the Corporations Act states that, for the purposes of section 912D, a breach of a core obligation is taken to be significant if (among other things):

- (a) the breach is constituted by the commission of an offence under any law and the commission of the offence is punishable on conviction by a penalty that may include imprisonment for a maximum period of:
 - (i) if the offence involves dishonesty – 3 months or more; or
 - (ii) in any other case – 12 months or more(relevant offences); or
- (b) the breach is constituted by the contravention of a civil penalty provision under any law, other than a civil penalty provision prescribed by the regulations for the purposes of this paragraph.

Section 50A(4) is the equivalent provision under the National Credit Act.

Unlike under the current regime, no assessment of "significance" is needed for such breaches, beyond assessing whether they contravene a civil penalty provision (that is not excluded by the regulations), or they constitute a relevant offence. Understanding which core obligations are civil penalty provisions and relevant offences will therefore be key to licensees' ability to comply with the new regime.

The number of core obligations that are civil penalty provisions or relevant offences is extensive. By way of example:



- 1 Chapter 7 of the Corporations Act (financial services and markets) alone contains more than 90 civil penalty provisions and more than 200 relevant offences.⁶
- 2 Chapters 5C, 5D, 6, 6A, 6B, 6C, 6D, 8A and 9 of the Corporations Act together contain more than 20 civil penalty provisions and at least 60 relevant offences.⁶
- 3 “Deemed significance” also applies to any civil penalty provisions or relevant offences in an extensive list of other legislation (being “core obligations”), including:
(for Australian financial services licensees)
 - the Australian National Registry of Emissions Units Act 2011 (Cth);
 - the Banking Act 1959 (Cth);
 - the Carbon Credits (Carbon Farming Initiative) Act 2011 (Cth);
 - the Clean Energy Act 2011 (Cth);
 - the Financial Sector (Collection of Data) Act 2001 (Cth);
 - the Financial Sector (Shareholding) Act 1998 (Cth);
 - the Financial Sector (Transfers of Business) Act 1999 (Cth);
 - the Insurance Acquisitions and Takeovers Act 1991 (Cth);
 - the Insurance Act 1973 (Cth);
 - the Insurance Contracts Act 1984 (Cth);
 - the Life Insurance Act 1995 (Cth);
 - the Retirement Savings Accounts Act 1997 (Cth);
 - the Superannuation Industry (Supervision) Act 1993 (Cth);
 - the Superannuation (Resolution of Complaints) Act 1993 (Cth); and
 - in relation to traditional trustee company services provided by a licensed trustee company – any other Commonwealth, State or Territory legislation that covers conduct relating to the provision of financial services;⁷ and
(for Australian credit licensees)
 - the National Credit Act;
 - the National Consumer Credit Protection (Transitional and Consequential Provisions) Act 2009 (Cth) and instruments made under that Act;
 - any other Commonwealth legislation that covers conduct relating to credit activities (whether or not it also covers other conduct), but only insofar as it covers conduct relating to credit activities.⁸

To our knowledge, only a small fraction of these are currently contemplated to be excluded from “deemed significance” by regulation.⁹

Issue As a result of the provisions summarised above:

⁶ Corporations Act section 1317E and Schedule 3.

⁷ Corporations Act section 912D(3) (definition of “core obligation”), read with section 912A(1)(c) and the definition of “financial services law” in section 761A.

⁸ National Credit Act section 50A(3) (definition of “core obligation”), read with section 47(1)(d) and the definition of “credit legislation” in section 5.

⁹ Exposure Draft regulations published for consultation in March 2021: https://treasury.gov.au/sites/default/files/2021-03/155284-exposure_draft.pdf



- (a) many more breaches will be reportable than under the current regime; and
- (b) identifying what is reportable will require licensees to test each potential breach against an extensive list of “deemed significance” provisions.

This risks:

- 1 overwhelming licensees with factual matters to assess and impeding their ability to report matters to ASIC in a timely manner in accordance with the regime;
- 2 overwhelming ASIC with reports about minor, inadvertent or technical breaches which would not otherwise be significant, as acknowledged in paragraph 11.29 of the Explanatory Memorandum;
- 3 an inequitable system where licensees who do not have compliance systems and resources to obtain a good understanding of the “deemed significance” provisions (e.g. through legal advice or dedicated breach-reporting teams) are under-reporting to ASIC when compared with licensees that do have such systems and resources.

Such outcomes are contrary to the purpose of the regime, and of the deemed significance test as stated in the Explanatory Memorandum (namely “to provide greater certainty for industry and to ensure significant breaches are reported to ASIC in a timely manner”).¹⁰

Proposed solution

We propose that ASIC make available to all licensees a list of “deemed significance” provisions. We note that Draft RG 78 includes a summary of core obligations in its appendix, but does not include an equivalent summary or list of “deemed significance” provisions.

We also propose that ASIC maintain that list by updating it at appropriate regular intervals.

Whilst acknowledging that such a list would be lengthy, we consider that making it available would promote certainty and consistency and place licensees on a more equal footing in endeavouring to comply with the regime. We also consider that it may be more practicable than, for example, seeking to add more examples of breaches that may not be significant to RG 78 (Table 5) in circumstances where breaches of that type are inherently limited due to the deemed significance provisions.

We also propose that the sentence referring to specific provisions of the Corporations Act and ASIC Act in example 2(a) in Draft RG 78 be deleted, so as not to suggest that an assessment of likelihood of “material loss or damage” is needed where the provision breached is a “deemed significance” provision (as with the provisions specified in that sentence).

Section 3: Investigations

Context

“Reportable situations” under the Corporations Act and National Credit Act include where:

- 1 the licensee or a representative of the licensee conducts an investigation into whether there is a [significant breach or likely significant breach of a core obligation] and the investigation continues for more than 30 days; or
- 2 an investigation of that type discloses that there is no [significant breach or likely significant breach of a core obligation].¹¹

Issues

Paragraph RG 78.51 in Draft RG 78 states:

¹⁰ Explanatory Memorandum at [11.37].

¹¹ Corporations Act s 912D(1); National Credit Act section 50A(1).



“The time at which an investigation commences is a matter of fact and is not a matter for subjective determination by the licensee.

For example, after receiving a complaint from a client, if the licensee begins to look into the matter or take steps towards ascertaining whether a significant breach has occurred, this would generally be considered to be when the investigation has commenced for the purposes of s912D(1)(c) of the Corporations Act or s50A(1)(c) of the National Credit Act.

Note: See Explanatory Memorandum, paragraph 11.47.”

In our view the first sentence does not assist licensees in circumstances where licensees need to form a view on when each investigation started in order to ensure they report the investigation to ASIC after it has run for 30 days.

In addition, the words “...if the licensee begins to look into the matter” are uncertain as they suggest that merely “looking into” a customer complaint is an “investigation” within the meaning of sections 912D(1)(c) and 50A(1)(c), notwithstanding that those sections expressly require it to be an investigation into whether there is a significant breach or likely significant breach of a core obligation – that is, an investigation into whether any applicable laws have been breached. Merely “looking into” a customer complaint, without more, does not have the character of such an investigation.

Draft RG 78 gives two examples of “investigations” that are said to meet the description in s912D(1)(c) and 50A(1)(c), but (apart from a brief mention of a routine audit in example 5(a)) gives no examples of inquiries that do not meet that description (for example, inquiries that are purely factual, inquiries that are ‘business as usual’ rather than for the purpose of assessing whether a significant breach has occurred, etc - see further examples below).

If too broad an approach to “investigations” is taken, it might capture an overwhelming number of scenarios and thereby impede licensees’ ability to track investigations and track when they have run for more than 30 days so as to report them to ASIC. This would be contrary to the objectives of the new regime.

**Proposed
solution**

We propose that ASIC:

- 1 Delete paragraph RG 78.51 of Draft RG 78. If ASIC is not minded to delete it, we propose that ASIC move it into paragraph RG 78.49, given its content is taken directly from the Explanatory Memorandum (as with the other content in RG 78.49).
- 2 Add into RG 78 some examples of steps that may arguably meet the plain English definition of “investigation” but are not (or are not yet) “investigations” of the type referred to in RG 78.46 (that is, investigations into whether a significant breach or likely significant breach of a core obligation has occurred). This might include, for example:
 - factual inquiries in respect of a customer complaint;
 - factual inquiries in respect of an issue that has been entered into an incidents register (or for the purpose of entering that issue into the incidents register);
 - factual inquiries in respect of a suspected compliance issue before it has moved into the phase of further investigation for the purpose of determining whether it is a significant breach of a core obligation; and
 - audits, “business as usual” inquiries, and other investigations for purposes other than assessing whether there is (or will be) a significant breach of a core obligation.

In considering these proposals it is important to bear in mind that (as stated in RG 78.57 of Draft RG 78) not all circumstances will require an investigation before reporting to ASIC and, in some cases, a reportable situation will be clear to a licensee without an investigation.
