



Breach reporting reforms

Commencing 1 October 2021

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Overview

- Comparison of old and new breach reporting requirements
- Special provisions for financial advisers and mortgage brokers
- Compliance action steps

About us



- Dwyer Harris is a law firm specialising in financial services sector.
- We advise on regulatory compliance, commercial agreements, corporate law, dispute resolution.
- Based in Sydney but working with clients around Australia.
- Our website is www.dwyerharris.com



Background

- Australian Financial Services Licensees have obligations to report significant breaches of the financial services laws.
- Australian Credit Licensees do not have equivalent obligations (but do have to provide an annual compliance certificate).
- ASIC Enforcement Review Taskforce (December 2017) considered the breach reporting regime and made 9 recommendations for change – including extension of breach reporting to credit licensees.
- Financial Services Royal Commission recommends:
 - Adopting recommendations of ASIC Enforcement Review Taskforce.
 - Licensees to report serious compliance concerns about financial advisers and mortgage brokers.



Legislation and regulations

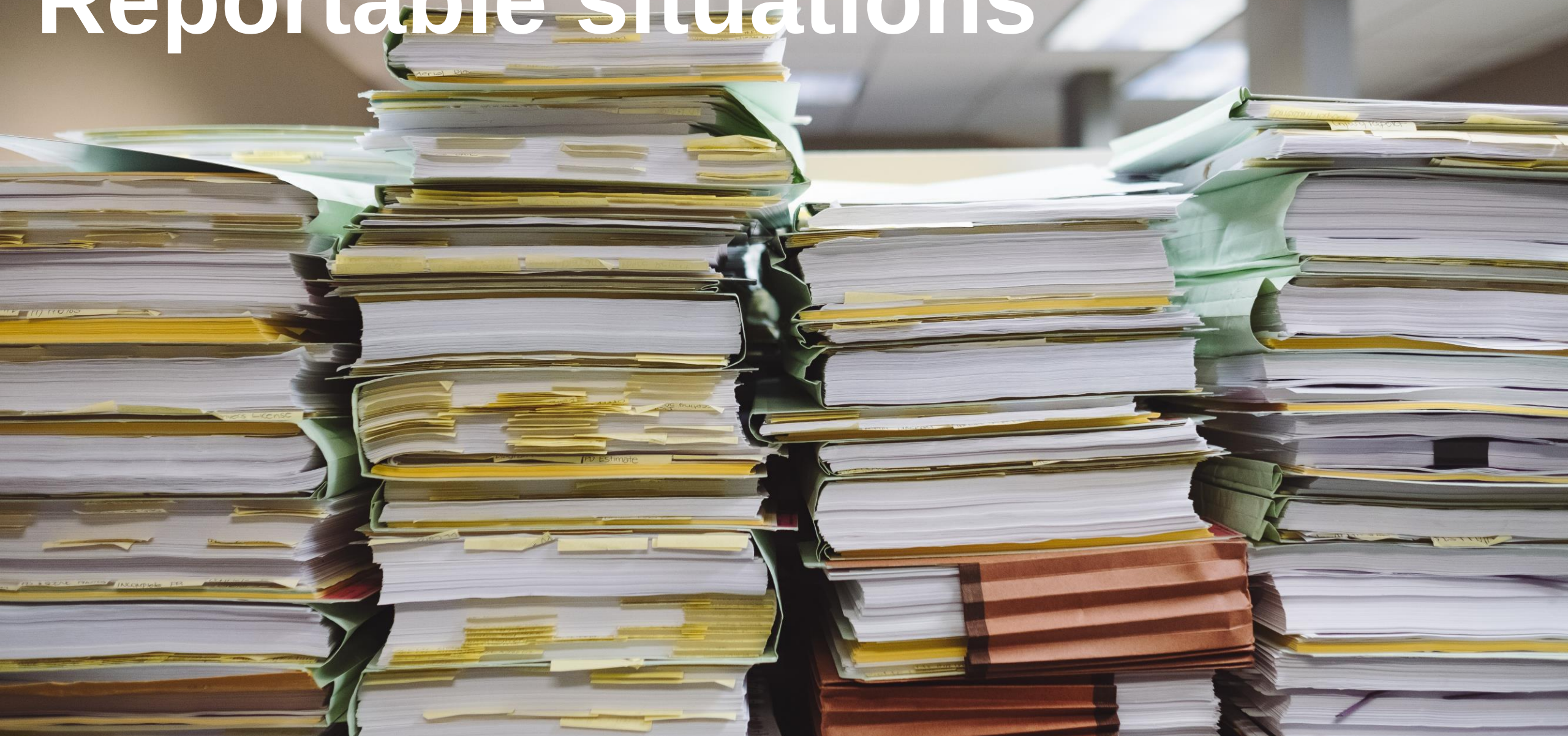
- *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth).
- Amends the *Corporations Act 2001* (Cth) (in relation to AFSLs) and the *National Consumer Credit Protection Act 2009* (Cth) (in relation to ACLs).
- Commencement date 1 October 2021.
- *Financial Sector Reform (Hayne Royal Commission Response - Breach Reporting and Remediation) Regulations 2021* (Cth).
- *ASIC Corporations and Credit (Breach Reporting—Reportable Situations) Instrument 2021/716* (Cth).



Guidance

- ASIC Regulatory Guide RG 78 *Breach reporting* (RG 78).
- Draft revised RG 78 released for comment in April 2021.
- ASIC statement on enforcement 12 August 2021: *“We ... recognise there will be a period of transition as industry finalises implementation of additional compliance measures, and ASIC will take a reasonable approach in the early stages of these reforms provided industry participants are using their best efforts to comply.”*

Reportable situations



What is reportable?

OLD	NEW
<p>If a financial services licensee has committed a significant breach of certain key obligations under the financial services laws, or is no longer able to comply and is therefore likely to commit a breach of those obligations</p>	<p>If there are reasonable grounds to believe that a reportable situation has arisen in relation to a financial services licensee or a credit licensee</p>



What is a “reportable situation”?

1. The licensee or a representative has breached a **core obligation** and the breach is **significant**.
2. The licensee or a representative is no longer able to comply with a **core obligation** and the breach, if it occurs, will be **significant**.

3. The licensee or a representative conducts an investigation into one of the above kinds of reportable situation and the investigation continues for more than 30 days.
4. Such an investigation discloses that there is no reportable situation of the kind mentioned in the first 2 points above.

5. In the course of providing a financial service (for a financial services licensee) or engaging in credit activity (for a credit licensee), the licensee or a representative has engaged in conduct constituting **gross negligence**.
6. The licensee or a representative has committed a **serious fraud**.

7. As prescribed by the regulations.



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What are the “core obligations”?

- In the case of financial services licensees, the core obligations are the general obligations of licensees under sections 912A and 912B of the *Corporations Act*.
- In the case of credit licensees, the core obligations are the equivalent obligations of credit licensees found in section 47 of the *National Consumer Credit Protection Act*.



When is a breach significant?

- Two tests –
 - Test 1 – “deemed significant”
 - Test 2 – similar to the existing test
- ASIC says you should apply test 1 first



When is a breach significant? Test 1

OLD	NEW
Not applicable	<p>Deemed significance test</p> <p>A breach of a core obligation is deemed to be significant if:</p> <ul style="list-style-type: none">• it involves the commission of an offence punishable by a penalty of 12 months or more (or three months or more if the offence involves dishonesty), or contravention of a civil penalty• it involves contravention of certain provisions of the <i>Corporations Act</i> or <i>ASIC Act</i> concerning misleading or deceptive conduct in relation to financial products or services• in the case of a credit licensee, it involves the breach of a key requirement under the National Credit Code (except as prescribed by the regulations)• the breach results or is likely to result in material loss or damage to a client• as prescribed by the regulations



Exemptions granted – offence and civil penalty provisions

- *Financial Sector Reform (Hayne Royal Commission Response - Breach Reporting and Remediation) Regulations 2021 (Cth).*
 - Exempt a number of requirements that would otherwise be reportable – e.g. failure to provide a PDS.
 - Such a breach may still be significant and reportable under the breach reporting regime if one of the other circumstances in the deemed significance test apply, or if the breach is otherwise significant
- *ASIC Corporations and Credit (Breach Reporting - Reportable Situations) Instrument 2021/716 (Cth).*
 - Mandatory IDR provisions in RG 271 – would be reportable situations – this instrument exempts them.



Material loss or damage

- Not defined
- Explanatory Memorandum for the legislation says:
 - these terms have their ordinary meaning
 - includes financial and non-financial loss
 - could be material for an individual or material if it affects a number of people
- RG 78 has examples (see Table 2)

When is a breach significant? Test 2

OLD	NEW
<ul style="list-style-type: none"> the number or frequency of similar previous breaches 	<ul style="list-style-type: none"> the number or frequency of similar breaches
<ul style="list-style-type: none"> the impact of the breach or likely breach on the licensee's ability to provide the financial services covered by the licence 	<ul style="list-style-type: none"> the impact of the breach on the licensee's ability to provide financial services covered by the licence (in the case of financial services licensee) or to engage in credit activities covered by the licence (in the case of a credit licensee)
<ul style="list-style-type: none"> the extent to which the breach or likely breach indicates that the licensee's arrangements to ensure compliance with those obligations is inadequate 	<ul style="list-style-type: none"> the extent to which the breach indicates that the licensee's arrangements to ensure compliance with those obligations are inadequate
<ul style="list-style-type: none"> the actual or potential financial loss to clients, or the licensee itself, arising from the breach or likely breach 	<ul style="list-style-type: none"> any matters prescribed by the regulations



Factors to consider

- RG 78
 - Table 2 – Discusses the factors
 - Table 3 – Examples of breaches that may be significant
 - Table 4 – Examples of breaches that may not be significant



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When an investigation has to be reported

- “Investigation” is not defined
- Information gathering may be sufficient to amount to an investigation – communicating with staff or customers, or seeking advice
- Doesn’t matter if it is not described as an “investigation”
- Can be an external investigation
- No required timeframe for completing an investigation but ASIC expects timely and no unreasonable delay (this has been an issue in the past)



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5. **In the course of providing a financial service (for a financial services licensee) or engaging in credit activity (for a credit licensee), the licensee or a representative has engaged in conduct constituting gross negligence.**
6. **The licensee or a representative has committed a serious fraud.**

7. As prescribed by the regulations.



Gross negligence and serious fraud

- Not defined
- Nothing in the draft ASIC guidance
- Courts will apply their interpretation based on precedent
- “Gross” negligence is more than ordinary negligence (?)
- Fraud is dishonestly obtaining a benefit, or causing a loss, by deception or other means
- “Serious” fraud is more than ordinary fraud (?)



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Prescribed by the regulations

- None currently
- The regulations do prescribe some provisions which are not deemed to be significant



When does a breach have to be reported?

OLD

As soon as **practicable** and in any case within **10 business days** after the licensee becomes aware of the breach or likely breach.

NEW

Within **30 calendar days** after the licensee first **knows**, or is **reckless with respect to whether there are reasonable grounds to believe**, the reportable situation has arisen.



When does the licensee “know”?

Section 769B(3) of the Corporations Act:

“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.”

Reckless about reasonable grounds to believe

Explanatory Memorandum states:

“A licensee knows of reasonable grounds to believe a reportable situation has arisen if the licensee knows of facts and/or evidence sufficient to induce in a reasonable person a belief that a reportable situation has arisen. The term ‘reckless’ is intended to capture circumstances where the licensee does not know that there are reasonable grounds to believe a reportable situation has arisen, but:

- is aware of a substantial risk that there are reasonable grounds to believe a reportable situation has arisen; and
- having regard to the circumstances known to the licensee, it is unjustifiable to take the risk that there are reasonable grounds to believe a reportable situation has arisen.”



Example of recklessness

Example 7 from RG 78

A licensee's Executive Committee issues a directive to its business units. The directive informs these areas not to escalate any matters to the Legal and Compliance areas (such as incidents and potential breaches of the law) over the next six months, so that Legal and Compliance can deal with a significant backlog of work.

A scheduled software review of a new underwriting software finds a technical error. A draft report is prepared, identifying significant overcharging of some clients. It also finds that the full extent and impact of the error (including total number of clients affected and amount of overcharging per client) is unclear. The draft report is reviewed by the Head of Retail Underwriting business unit. Because of the directive, they do not escalate the report (or its findings) to the Legal or Compliance areas, and no investigative action is taken.



Don't wait

ASIC in RG 78.80 says:

... you should not wait until after the following events to lodge your report:

- the reportable situation has been considered by your board of directors;
- the reportable situation has been considered by your internal or external legal advisers;
- you have rectified (when appropriate), or you have taken steps to rectify, the breach (or likely breach) of a core obligation or additional reportable situation; or
- in the case of a likely breach, the breach has in fact occurred.



Reporting to APRA not ASIC

OLD	NEW
<p>A report is taken to be lodged with ASIC if the licensee is regulated by APRA and the report is received by APRA in accordance with any agreement between APRA and ASIC under which APRA is to act as ASIC's agent for such reports.</p> <p>The ASIC breach reporting obligation does not apply in the situation where the licensee is a body regulated by APRA and the auditor or actuary of the licensee gives APRA a written report about the breach before, or within 10 business days after, the licensee becomes aware of the breach.</p>	<p>The exceptions for when reports have been given to APRA are broadly the same, but the new law does not refer to an agreement between APRA and ASIC and simply requires that the licensee has given a report to APRA which contains all of the information that the licensee would otherwise have been required to give to ASIC.</p>



What does a breach report have to include?

OLD	NEW
<p>RG 78. The breach report should include:</p> <ul style="list-style-type: none">• the date of the breach or likely breach• a description of the breach• why the breach is significant• how the breach was identified• how long the breach lasted• information about authorised representatives involved• how the breach was rectified• details of any remediation to compensate clients that have suffered a loss• any steps taken or to be taken to ensure future compliance with the obligation	<p>(See Table 8 in RG 78). A prescribed form on the ASIC Regulatory Portal which includes:</p> <ul style="list-style-type: none">• the date the reportable situation occurred• nature of the reportable situation• description of the reportable situation• why the breach is significant (if relevant)• how the reportable situation was identified• how long the breach lasted• information about representatives• whether and how the reportable situation has been rectified• whether and when affected clients have been compensated – remediation• whether and how the reportable situation has been rectified by the licensee• the steps that have been taken or will be taken by the licensee to ensure future compliance

Record keeping and ASIC publication

OLD	NEW
<p>No obligation on a licensee to keep records specifically in relation to its compliance with breach reporting obligations</p>	<p>Licensees must keep records sufficient to enable their compliance with the breach reporting requirements to be readily ascertained.</p> <p>The regulations may specify records that a licensee is required to keep.</p>
<p>ASIC presently has no statutory obligation to publish details of breaches reported to ASIC</p>	<p>ASIC to publish information for each financial year about breach reports lodged with ASIC or APRA during the financial year.</p> <ul style="list-style-type: none">• This applies to reports about breaches and likely breaches of core obligations.• ASIC is also required to publish information about the entities who lodged the reports.• ASIC's publication must be made within four months after the end of the financial year and included on its website.



Transitional provisions

- New regime applies to reportable situations that arise on or after 1 October 2021.
- For AFS licensees, the previous breach reporting regime applies if:
 - the obligation is breached or is likely to be breached before 1 October 2021; and
 - before 1 October 2021, the licensee knows of the breach or likely breach.

Failure to report

- The maximum **civil penalty** for not reporting a reportable situation:
 - *for an individual* - the greater of 5,000 penalty units*, and three times the benefit derived and detriment avoided; and
 - *for a body corporate* - the greatest of 50,000 penalty units, three times the benefit derived and detriment avoided, and 10% of the annual turnover for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene (capped at 2.5 million penalty units).
- The maximum **criminal penalties** are:
 - fine of 240 penalty units for an individual or 2,400 penalty units for a body corporate;
 - two years' imprisonment; or
 - both
- *Penalty unit is currently \$222

A man and a woman are in an office setting, looking at a large calendar board. The man is standing and pointing at a calendar, while the woman is sitting at a desk and looking at a document. The calendar board displays several months from 2016, including August, September, October, and December. The office has desks with computers, a pen holder, and stacks of papers. The overall scene is brightly lit, suggesting a professional and collaborative environment.

Special provisions for financial advisers and mortgage brokers



Special provisions for financial advisers and mortgage brokers

- Reportable situations about other licensees
- Initial reporting to customers
- Mandatory investigation of issue
- Notice to customers after mandatory investigation
- Compensation



Reportable situations about other licensees

- A licensee must report to ASIC if it has reasonable grounds to believe that a reportable situation (other than a reportable situation involving an investigation) has arisen in relation to an **individual** who:
 - provides **personal advice** to retail clients about relevant financial products or is a **mortgage broker**; and
 - is any of the following:
 - another AFS or credit licensee;
 - an employee of another AFS or credit licensee (or a related body corporate of another licensee), acting within the scope of the employee's employment;
 - a director of another AFS or credit licensee (or a related body corporate of another licensee), acting within the scope of the director's duties as director; or
 - a representative of another AFS or credit licensee, acting within the scope of the representative's authority given by the licensee.
- AFS licensees must report re personal advice and credit licensees must report re mortgage brokers



When and how to report

- The reporting period is within 30 days after the reporting licensee first knows of, or is reckless with respect to, the conditions for reporting being met.
- The reporting licensee must also give a copy of the report to the licensee being reported on. The licensee has qualified privilege here and is not liable for any action based on breach of confidence in relation to the conduct.
- A report is not required if there are reasonable grounds to believe that ASIC is already aware of the reportable situation, including all the information required in a report for the reportable situation.



Who is a mortgage broker?

- A credit licensee or credit representative
- Carries on a business of providing credit assistance in relation to credit contracts secured by mortgages over residential property
- Licensee or representative does not perform the obligations, or exercise the rights, of a credit provider in relation to the majority of those credit contracts
- In carrying on the business, provides credit assistance in relation to credit contracts offered by more than one credit provider



Special provisions for financial advisers and mortgage brokers

- The following provisions:
 - Apply to a **financial services licensee** if the licensee (or a representative of the licensee) provides or has provided **personal advice** to the affected customer as a retail client in relation to a relevant financial product.
 - Apply to a **credit licensee** if the credit licensee (or a representative of the licensee) has provided **credit assistance** to the affected customer in relation to a **credit contract secured by a mortgage over residential property**, and the licensee or representative is a **mortgage broker**.



Initial reporting to customers

The licensee must take reasonable steps to notify affected customers of a reportable situation if:

- there are reasonable grounds to believe that the reportable situation is a significant breach of a core obligation, or gross negligence or serious fraud;
- there are reasonable grounds to suspect that the affected client has suffered or will suffer loss or damage as a result of the reportable situation; and
- there are reasonable grounds to suspect that the affected client has a legally enforceable right to recover the loss or damage from the licensee.



Initial reporting to customers

- The notice to customers must be given in writing within 30 days.
- The notice to customers must be in a form approved by ASIC.
- A licensee has qualified privilege in relation to a notice given to a customer. This means that the licensee is protected if there is an action against the licensee for defamation regarding the contents of the notice.
- The licensee will also not be liable for any action based on breach of confidence in relation to the giving of notice.



Mandatory investigation of issue

- The licensee must conduct an investigation in those cases where the licensee is also required to notify the affected customer. The investigation must begin within the same 30 day period for notifying customers.
- In conducting the investigation, the licensee is required to identify the conduct that gave rise to the reportable situation and to quantify the loss or damage to the affected customer. The loss or damage that must be quantified is loss or damage that there are reasonable grounds to believe the affected customer has suffered or will suffer as a result of the reportable situation and that the affected customer has a legally enforceable right to recover from the licensee.
- There is no hard deadline for completion of the investigation, but it must be completed as soon as reasonably practicable after commencement.



Notice to customers after mandatory investigation

- On the completion of a mandatory investigation, there is a further obligation to notify the affected customers.
- The licensee must take reasonable steps to give them notice of the outcome of investigation. This must occur within 10 days after the investigation is completed and be given in writing.
- If ASIC has approved the form of notice, it must be in that approved form, and include content required by the form and accompanied by any material required by the form.
- The licensee has qualified privilege in relation to the notice and is not liable for any action based on breach of confidence in relation to that conduct.



Compensation

- The licensee must take reasonable steps to pay the customer an amount equal to their loss or damage. This obligation arises when:
 - the investigation is a mandatory investigation;
 - the investigation is completed; and
 - there are reasonable grounds to believe that the affected customer has suffered or will suffer loss or damage as a result of the reportable situation and that the affected customer has a legally enforceable right to recover from the licensee.
- These obligations do not affect any legally enforceable right that an affected customer may have to recover loss or damage, but a court may take into account any compensation paid by the licensee under this obligation when determining the amount of any compensation to be paid for loss or damage.

A blue-tinted photograph of a modern staircase. The staircase features a glass railing with a metal handrail and a set of stairs. The text "Compliance action steps" is overlaid in white, bold, sans-serif font across the center of the image.

Compliance action steps



Complying with breach reporting

- Under your general obligations as an AFS or credit licensee you must maintain adequate risk management systems and have available adequate resources (including financial, technological and human resources) to ensure compliance.
- ASIC considers that failure to report a significant breach (or likely breach) is likely, in itself, to be a significant breach of your obligation to comply with the financial services laws or credit legislation.
- ASIC also says that unreasonable delays may be an indicator that you do not have adequate compliance processes, systems and resources in place and may suggest a breach of your obligations.

Breach reporting process

ASIC says you should have a clear, well-understood and documented process for:

- identifying and recording incidents (e.g. suspected or possible reportable situations);
- assessing and determining whether an identified incident is a reportable situation, including timely and appropriately resourced investigations as required;
- reporting to ASIC all incidents identified as reportable situations within 30 calendar days in the form prescribed;
- when appropriate, rectifying loss or damage as required; and
- ensuring that arrangements are in place to prevent the recurrence of the breach (or likely breach).



Breach register

- ASIC says that:
 - You will need a breach register to ensure that you have adequate arrangements in place to comply with your obligation to identify and report all reportable situations
 - Your breach register should contain the information in the prescribed reportable situation form (as summarised in Table 8 of RG 78).



Risk management

ASIC says you should:

- prioritise and support the ability to meet breach reporting obligations including clear end-to-end senior accountability of breach reporting processes and procedures
- provide an environment where:
 - staff can raise concerns about risks, including incidents (and are vigilant about these);
 - investigations, rectification and remediation are prioritised - and overseen and championed by senior management; and
 - transparent communication about breaches and incidents promotes identification, rectification and reporting.



Legal professional privilege

- Using legal counsel to investigate potentially reportable breaches may provide legal professional privilege over the information collected and reported

Other legal support

- Assessment template to determine whether a breach is reportable
- Incident/breach reporting checklist and timeline
- Template for reporting
- Gap analysis re existing incident breach reporting processes as against new process
- Training
- Breach assessment
- Audit of process/procedure after a period of operation under the new regime.



Breach reporting reforms

Commencing 1 October 2021

Patrick Dwyer
Dwyer Harris

26 August 2021

