14 July 2020

Mr Ashley George
Banking and Access to Finance Unit
Financial System Division
The Treasury, Langton Crescent, Parkes ACT 2600
Langton Crescent
PARKES ACT 2600

By email: Ashley.George@TREASURY.GOV.AU

Dear Ashley

Breach Reporting Draft Amendments – July 2020

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the proposed draft Breach Reporting legislative provisions dated 2 July 2020.

1. General Policy Concern

Although outside the scope of this targeted consultation on the revised drafting of the proposed breach reporting requirements, AFMA wishes to restate for the record that the requirement to report investigations was not contemplated by ASIC's Enforcement Review Taskforce, which endorsed an objective test requiring the early reporting of potential breaches in many situations. AFMA believes that the proposed reporting of investigations lies outside the scope of implementation of the Royal Commission recommendations and is not the result of carefully considered and rigorous policy development, and that inadequate review and debate was given to the Taskforce recommendations. At a policy principles level, we maintain a steadfast objection to this aspect of the proposed legislation.

2. Commencement and transitional compliance

The commencement of the new provisions is a matter of considerable concern to AFMA members. The original legislative commencement date was expected for 1 July 2020, and the new regime was expected to apply to all reportable situations arising on or after 1 April 2021. However, based on the Government announcement of 8 May 2020 confirming deferrals to Royal Commission commitments, we kindly ask for public clarity on the official commencement date and transitional compliance for the new breach reporting regime.

3. Reportable situations

In response to the proposal under s 912D(1)(d), this proposed section seems to require a licensee to report the outcome of an investigation that extends beyond 30 days, despite there being no reportable situation. This requirement will, in effect, require licensees to report most, if not all, investigations to be reported to ASIC. If the initial review is to determine whether or not there is a breach /or not related to the core obligation, is the investigation reportable under the 30 days rule? If this is the case, this proposal appears to depart from, and extend beyond, the recommendations made in the Hayne Royal Commission and even the Enforcement Review Taskforce.

If the review is not reportable, it would be logical that there is no requirement to report the result of the investigation. Otherwise, this would significantly increase the volume of reportable events. As a result, unintended consequences may arise, such as operational constraints and undue administrative burden for both the licensee and ASIC with no public benefit.

Members indicate that the meaning of 'investigation' and from when a 30 day period runs lack clarity and guidance, which at the very least should be provided in the Explanatory Memorandum.

4. Drafting issues

4.1. Offence only exists after Court decision

912D (4) states that the following are taken to be significant breaches of the core obligations:

> *(a) 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;*

This would only be known when a court has determined that an offence was committed.

Similarly, paragraph (c) requires reporting when there is misleading or deceptive conduct in relation to a financial product or a financial service. Would the reporting then take place after a court has made a decision? Otherwise, it is unclear how an AFSL could determine there was misleading and deceptive conduct, as these are complex cases which depend on extensive regulatory investigations and the preparation of a brief to satisfy the DPP before proceeding to court. An AFSL could not know there was such conduct until proven.

4.2. Material loss

Paragraph 912D(4)(d) refers to 'material loss'. The term 'material' is very much a subjective term. Something that is immaterial to one person may be said to be material to another. It will very much depend on whose viewpoint this is decided upon. Accordingly, guidance should be provided on this term.

5. Deemed significance

The deemed significance of breaches described in s912D(4)(b) continues to be considered an area of serious concern, given the consequences of misjudging matters which have an element of subjectivity in them.

The revised wording in section 912D(4)(b) provides that a breach of a core obligation is taken to be significant if the breach is a contravention of a civil penalty provision under any law, other than a civil penalty provision prescribed by the regulation. A core obligation is defined in s912D(3) as an obligation under s912A or s912B, excluding part of the obligations under s912A(1)(c). This is very wide, as it is all encompassing with the only mechanism for filtering by means of regulation expressly excluding a civil penalty provision. This type of all inclusionary drafting has proved to be a serious design fault in many of the financial provisions of the Corporations Act and has led to much legal uncertainty and needless interpretative debate with ASIC, when the law should be written in a clear and certain manner.

Royal Commissioner Hayne rightly critiqued the financial services legislation for its lack of clarity and certainty and indicated the need to address this problem. He should be heeded in this regard. The better way to draft the law is to allow for express inclusion of civil penalty provisions by regulation for an obligation to arise. Such a process ensures that a proper regulatory impact assessment is undertaken before legal liability is created and achieves a much greater degree of clarity and certainty in the law. Only civil penalty provisions with substantial penalties attached to them should be considered significant.

Paragraph 912D(4)(b) would substantially increase the reporting compliance burden for financial firms, because without a reporting threshold, almost any financial services law related incident could fall under the scope of the subsections. The interaction with s912A(1)(a) is a strong factor in this regard. Section 912A(5A) sets out s912A(1)(a), (aa), (ca), (d), (e), (f), (g), (h) or(j) as civil penalty subsections, hence, a contravention of any of these subsections is deemed a significant breach. In this form, any minor breach of matters would be reportable under the new reporting regime regardless of whether the customer impact is small or large. In practice, the present wording of s912D(4)(b) has the effect of forcing AFSLs to report all financial services law related incidents regardless of genuine significance.

6. Use of Terms

6.1. Gross negligence

Subsection 912D(2)(a) uses the term ‘gross negligence’, which has long been a problematic expression. The recent decision of Tottle J in the Supreme Court of Western Australia in *GR Engineering Services Ltd v Investment Ltd* [2019] WASC 439 discusses the uncertainty surrounding the expression gross negligence where used as a carve out from a no liability clause.

Tottle J usefully identified the principal Australian case law on the subject. The expression 'gross negligence' is problematic and characterising particular conduct presents difficulties for legal counsel, never mind compliance staff. Finding its source in tort law, gross negligence is not a separate tort and does not have a precise meaning at common law. Tottle J noted that the Australian courts, in considering the common law meaning of "gross negligence" in the context of exclusion and indemnity clauses, followed the approach of Mance J in *Red Sea Tankers Ltd v Papachristidis* [1997] 2 Lloyd's Rep 547 in which his Lordship said:

> *'Gross' negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. But, as a matter of ordinary language and general impression, the concept of gross negligence seems to me to be capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or an indifference to an obvious risk.*

Mance J takes us down the road towards recklessness, which as noted below is also troubling and confusing. The difference between negligence and gross negligence is one of degree and not of kind. The concept is more fundamental than failure to exercise proper care but that additional dimension can only be determined by context. Ultimately, the question of whether conduct constitutes gross negligence will turn upon the impression of a court. This makes it highly unclear in a statutory context and makes it difficult for AFSLs to determine where the boundaries are. Greater clarity is required on what is intended by Parliament.

6.2. Reckless

AFMA considers the application of the criminal law 'reckless' fault element to be inappropriate in the context of s912DAB(3). This would seem to suggest criminal liability for Responsible Managers, Directors and Senior Management where s912DAB is a civil penalty provision. While applicable to injury and death, the concept is hard to reconcile with the obligations in s912DAB.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

David Love
General Counsel & International Adviser