9 April 2021

Regulatory Powers and Accountability Unit
Financial System Division
Treasury
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By email: Breach.Reporting@TREASURY.GOV.AU

Dear Treasury Team

Draft Amendments to Breach Reporting Regulations

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the draft Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Regulations 2021: breach reporting (Draft Regulations) that support the breach reporting rules in Schedule 11 of the Financial Sector Reform Act 2020. AFMA members with financial services licences participating on the exchange markets are affected by changes relating to market integrity rules being incorporated as 'core obligations'. Our comments focus on these changes based on feedback from our members.

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

AFMA is concerned that the new breach reporting requirements capture the ASIC market integrity rules in the list of 'core obligations', in that all breaches of the rules will be automatically taken to be significant under the *deemed significance test* of the new section 912D(4) of the *Corporations Act 2001* (the Act).

The new section 912D(3) which lists the 'core obligations' states under 912D(3)(b) that section 912A(1)(c) (the general licence obligation to comply with financial services laws) is a *core obligation* in that the financial services law relates to the specified paragraphs of the definition in section 761A[1].

Section 761A defines 'financial services law' to include "a provision of this Chapter" (Chapter 7 of the Act). One of the provisions in Chapter 7 is section 798H[2] -the obligation for participants of licensed markets to comply with the Market Integrity Rules (MIRs).

[1] Corporations Act 2001 - http://www5.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s761a.html
[2] Corporations Act 2001 - http://www5.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s798h.html

Section 798H(1) is a civil penalty provision and a breach of that section, through a breach of the Market Integrity Rules, is automatically deemed to be significant under the new section 912D(4).

The Draft Regulations carve out certain civil penalty provisions that will not be deemed significant for the purposes of section 912D(4) of the Act. However, this provision only makes exceptions for certain contraventions of disclosure obligations involving FSGs, PDSs and credit disclosures.

The inclusion of the MIRs will create a substantial additional regulatory burden for market participants as even minor breaches of the MIRs such as 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.

It is AFMA's view that the rationale in the Explanatory Memorandum for excepting the disclosure obligations applies equally to many high volume, low impact breaches of the MIRs which are often identified and resolved promptly.

In summary, AFMA considers that section 798H covered items should not be considered significant for two reasons:

- If minor and/or technical breaches of the MIRs 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.

Breaches of the Derivative Transaction Rules

A similar problem arises in our view with breaches of the Derivatives Transaction Rules. 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 automatically be deemed to be significant under the new section 912D(4). AFMA notes there is a risk that participants would be forced to file administrative breaches of the Derivatives Transaction Rules (DTRs) due to their deemed significance when they would not otherwise be considered as significant under the existing significance test.

Suggested solution

AFMA suggests that for a MIR or DTR breach to be reportable it must meet the significance test. This means removing it from the 'core obligations'. The 'deemed significance' test in addition to existing significance assessment factors under the current requirements (which are to be maintained in the second significance test), provides a satisfactory basis for the breach reporting regime to pick up serious breaches. Accordingly, material breaches of the MIRs and the DTRs could still be captured by other arms of the significance tests and reported to ASIC, including the second significance test under the new section 912D(5). The approach we suggest strikes an appropriate cost benefit balance consistent with the policy objectives of the new legislation.

In addition, AFMA repeats its previous request that greater clarity on the scope of 'deemed significance' test would be useful as relates to other areas of law captured by the broad reference to it in section 761A.

Please contact Nikita Dhanraj either on 02 9776 7994 or by email on ndhanraj@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

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