Stockbrokers
And Financial Advisers
Association Limited

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ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
CANBERRA ACT 2600

By email: ASICenforcementreview@treasury.gov.au

ASIC ENFORCEMENT REVIEW – POSITION AND CONSULTATION PAPER 1 – BREACH REPORTING
SUBMISSION FROM STOCKBROKERS AND FINANCIAL ADVISERS ASSOCIATION

We refer to the Position and Consultation Paper 1 – *Self-Reporting of contraventions by financial services and credit licensees* ("the Consultation Paper") issued by the ASIC Enforcement Review Task Force.

The Stockbrokers and Financial Advisers Association ("SAFAA") appreciates the opportunity to provide the comments set out below on the subject of breach reporting and on the specific Positions set out in the Consultation Paper.

PRELIMINARY COMMENTS

SAFAA members acknowledge the importance of the breach reporting regime to the efficient supervision of the financial services sector by ASIC, and to the maintenance of market integrity. Members have advised that they take their breach reporting obligations, not only under the AFSL regime but also under the Market Integrity Rules and the AUSTRAC legislation as well, very seriously. We understand the reasons why

ASIC and Treasury attach the importance which they do to those obligations, and the reasons why it was considered timely to undertake a review of them.

As a general comment, to the extent that there may be a perception that there is widespread or significant non-compliance with the obligations to self-report contraventions, or to report within the specified time, we would challenge that perception. It is certainly different to the perception and experience that our members have communicated.

Furthermore, our members are strongly of the view that forming a conclusion that a breach has occurred, or whether a breach is significant, is frequently not as easy and straightforward as it may sound. If there is a perception that this uncertainty is being used as a cover in order to delay reporting, then this has certainly not been the experience of our members. Rather, there are genuine steps that need to be taken in order to form a proper as opposed to a speculative decision in most situations.

Our members have also made the observation that, if there has been a strong pattern of non-compliance, then this should be reflected in ASIC enforcement action. However, we struggle to think of many, or any, prosecutions for failure to self-report that have been reported by ASIC in recent years.

Considering all of the investigations that have been undertaken by ASIC, and all of the resources now devoted to the monitoring of market activity, then if there have been breaches uncovered by ASIC that the licensees involved had been aware of, and had not reported to ASIC as required, then enforcement action should have been taken in relation to those failures to report.

As a general observation, SAFAA has some reservations that some of the Positions being put forward in the Consultation may generate just as much uncertainty as currently exists, which is likely to lead to over-reporting. The end result may not necessarily be any better than is currently the situation under the provisions as they now stand.

SPECIFIC POSITIONS IN CONSULTATION PAPER

Position 1 – Retain "significance test" but introduce reasonable person component

Questions

1.1 Would a requirement to report breaches that a reasonable person would regard as significant be an appropriate trigger for the breach reporting obligation?

1.2 Would such a test reduce ambiguity around the triggering of the obligation to report?

SAFAA members strongly support the Position reached by the Review Panel that the significance test must be retained. Any other conclusion would have created an administrative and resource problem for ASIC through the over-reporting of cases of minor importance.

SAFAA appreciates the shortcomings that arise from the subjectivity inherent in the current wording of the self-reporting requirement. They identify with paragraphs 18- 24 in the Consultation Paper. Members have often struggled with the assessment of "significance", precisely because, as the Paper identifies, what is significant in the context of one firm's business may not be significant in another's. In our view, there is not much wrong with this. Significance really does depend on all of the facts and circumstances.

We can understand the motivation for a more objective element to be introduced. Our members have indicated that they can live with the proposed change, although we caution that it may not necessarily result in any more certainty to the obligation. In our view, a substantial ambiguity would still remain.

For example, it is difficult in our view to assess who "a reasonable person" is for the purposes of this obligation, or to then come to a decision as to what that reasonable person would regard as significant. Is a reasonable person the ordinary person in the street, who may not have ever turned their mind to obtaining a financial service or product? Or is it to be a reasonable compliance professional?

We note the example given in paragraph 26 of the reference to a "reasonable person" in the context of the test or material price sensitive information, as a justification for such tests being effective in other areas of law. It is open to argue that the test of material price sensitive information is fraught with the same difficulties and uncertainties, only that they do not appear to have ever been articulated in any legal proceedings.

For example, is price sensitivity to be determined by reference to a reasonable person who commonly buys securities generally? Or securities of that particular type, because what a person who invests in speculative small cap stocks would regard as material is likely to be very different to what a person who invests in ASX 200 stocks would regard as material.

For these reasons, in our view, the injection of a "reasonable person" element to the test of what is significant is not likely to lead to any more certainty from the point of view of the person whose task it is to make the decision whether the breach requires reporting.

If the obligation is to be re-drafted to include the objective standard, then it needs to be made as certain as possible. In addition, clear and better guidance from ASIC is essential. Otherwise, the result will be that firms, and potentially individuals, could face liability under an uncertain obligation for which they are judged in hindsight (and increased liability, if the other proposals for increased criminal and civil penalties discussed elsewhere in the Consultation Paper are adopted).

Position 2 – Obligation to report should expressly include significant breaches or other significant misconduct by an employee or representative

Question

2.1 What would be the implications of this extension of the obligation of licensee's to report?

The scope of what is being proposed in Position 2 is somewhat unclear, hence it is not possible to comment on the precise implications of introducing such a requirement without some more detail. Much will depend on what types of breaches, or what types of misconduct, by an employee or representative, would come under the reporting umbrella.

It is probably the case that significant breaches or misconduct by employees or representatives relevant to the provision of financial services is already being reported due to a combination of:

- Breaches by employees or representatives will in many cases generate a breach by the licensee, due to the licensee being liable for their acts (section 917B). Hence licensees will already be self-reporting their breach occasioned by their employee, and providing details of the employees or representatives concerned;

- ASIC MIR requirements, applicable to licensees who are Market Participants, which include the obligation to report breaches by any person in connection with market manipulation and insider trading.
- The requirements under AUSTRAC legislation to report suspicious transactions, including a breach of any Commonwealth law or any tax offences.

In addition, in relation to retail financial advisers, the professional standards regime which has come into force will require all retail advisers to be a member of a Code Monitoring body which will have obligations to report to ASIC matters which it has found in the course of code monitoring, complaint handling and other activities enforcing professional and ethical standards.

It is therefore not clear to us what universe of breaches or misconduct remains that would not already be covered by one or more of the above reporting regimes, and whether that is significant enough to warrant introducing a new piece of legislation.

Subject to the above comments, SAFAA members would not have any objection if the breach reporting obligation is extended to breaches by employees or representatives.

Position 3 – Breach to be reported within 10 business days of obligation arising

Questions

3.1 Would the threshold for the obligation to report outlined above be appropriate?
3.2 Should the threshold extend to broader circumstances such as where a licensee "has information that reasonably suggests" a breach has or may have occurred, as in the United Kingdom?
3.3 Is 10 business days from the time the obligation to report arises an appropriate limit? Or should the period be shorter or longer than 10 days?
3.4 Would the adoption of such a regime have a cost impact, either positive or negative, for business?

If the reporting obligation is to be redrafted to an objective standard, then SAFAA members consider that they could live with the proposed 10 day reporting deadline. Their view was definitely that it should not be any shorter.

In particular, if the obligation is being triggered by the licensee receiving information, such as from one of the sources referred to in paragraph 50 of the Consultation Paper, the licensee will have a range of other matters to consider at the same time, including any immediate steps to prevent or remedy the breach and steps to uncover the extent of any breach. Allowing a period of not less than 10 days in which to deal with all relevant matters would be necessary.

It is not entirely clear from the discussion relating to Position 3 how the 10 day time limit interacts with the "significance" criterion. It may not at all be clear at the time of receipt of the information whether the breach is "significant", either according to the elusive "reasonable person" standard or in the licensee's own judgment. SAFAA does not support the 10 day time limit starting as soon as information is received, if the information is not at that point such that the particular licensee should reasonably have determined that the breach was significant.

There are many reasons why it may take longer than 10 days for a licensee to form a view as to whether information received discloses a significant breach. For example, one should not underestimate the amount of time that a licensee with a large national network of advisers, or a large national office structure, would require, acting with all due speed and diligence, to gather the necessary information in order to determine whether a small breach in respect of one adviser, or one client, was not replicated by other advisers or across many clients, elevating what may have been thought of potentially as a minor matter into a significant matter.

On the other hand, a smaller firm which might not face as big a logistical task in investigating the extent of a breach, would be less likely to be able to justify taking as long to determine whether the breach was significant.

Position 4 – Increase penalties for failure to report
Position 5 – Introduce a civil penalty regime
Position 6 – Introduce an infringement notice regime

Questions

4.1 What is the appropriate consequence for a failure to report breaches to ASIC?
4.2 Should a failure to report be a criminal offence? Are the current maximum prison term and monetary penalty sufficient deterrents?
4.3 Should a civil penalty regime be introduced?
4.4 Should an infringement notice regime be introduced?
4.5 Should the self-reporting regime include incentives such as that outlined above? What will be effective to achieve this? What will be the practical implications for ASIC and licensees?

SAFAA members do not object to a reasonable monetary fine as the penalty for failure to comply with the self-reporting obligation.

Members also do not object in principle for a civil penalty option to be included in the mix of remedies.

SAFAA does object in principle to increases in penalties for failure to report where there is a clear need for this. However, in order to justify an increases in penalties, it should be mandatory for Government to show that there is a failure or inadequacy in the existing penalty regime such that the existing level of penalties do not serve as an adequate deterrent. As we mention in our Preliminary Comments, SAFAA does not accept that there is any evidence of widespread non-compliance with the existing self-reporting obligations. As mentioned, if there is a perception that licensees are not reporting matters that they ought to be, then we do not agree with such a perception.

In addition, in view of our analysis that the new "objectivized" standard that is proposed will create a significant level of ongoing uncertainty and ambiguity for licensees as regards compliance, then we would argue that it would be very unfair at the same time to make any increases in the penalties for failure to comply with those requirements.

This uncertainty is also a reason for not introducing an "infringement notice" regime to apply to these obligations. Infringement notices should be reserved for obligations which are clear in their interpretation, more straightforward, and where facts are evident, not for requirements that can be a matter of contention.

It is conceivable that, after some experience with re-drafted obligations, and if ASIC were to issue clear and comprehensive guidance, then at a future point there may no longer be any significant lack of clarity. In that event, then there may be grounds to support an infringement notice regime, or if a pattern of non-compliance emerges during that time, an increase in the level of penalties.

In our submission, changes to penalties as put forward in Position 4, other than perhaps the civil penalty addition, should be deferred for consideration until after any redrafted reporting obligations have been in operation for a few years and their impact assessed in a future review.

Position 8 – Prescribe required content of reports and require electronic delivery

Questions

5.1 Is there a need to prescribe the form in which AFS licensees report breaches to ASIC?
5.2 What impact would this have on AFS licensees?

SAFAA has no objection to the specification of a prescribed form for breach reports or that electronic lodgment be required.

We note that Market Participants are already electronically connected through the MECS portal, and leveraging that framework should offer some efficiencies.

There should however be sufficient flexibility to permit a report to be received that may because of the particular circumstances be hard to fit into a standardized reporting template, for whatever reason.

In addition, consideration should be given to the means of electronic reporting for licensees that may be small firms, and who may not be connected to a facility such as the MECS portal. A simple reporting mechanism operating through the ASIC website should be available to any licensees who fit into that category.

Position 9 – Introduce equivalent self-reporting regime for credit licensees

Questions

6.1 Should the self-reporting regime for credit licensees and AFS licensees be aligned?
6.2 What will be the impact on industry?

SAFAA does not express any particular views on the regulation of the credit industry, other than to say that as a matter of principle, SAFAA supports regulation being product neutral. Equivalent obligations should apply across the spectrum of financial services licensees there is a good reason not to do so.

Position 10 – Ensure qualified privilege continues to apply to licensees reporting under section 921D

SAFAA views the existence of qualified privilege as fundamental to the operation of any self-reporting regime, and must be preserved.

SAFAA has also consistently argued in support of a reporting regime to prevent the movement of "bad apples" across industry, and the existence of qualified privilege for bona fide reporting of such matters is something which should be introduced either as part of this review or as a separate matter.

Position 12 – Require annual publication by ASIC of breach report data

Questions

8.1 What would be the implications for licensees of a requirement for ASIC to report breach data at the licensee level?
8.2 Should ASIC reporting on breaches at a licensee level be subject to a threshold? If so, what should that threshold be?
8.3 Should annual reports by ASIC on breaches include, in addition to the name of the licensee, the name of the relevant operational unit within the licensee's organisation? Or any other information?

SAFAA supports the publication of breach reporting date on an annual basis in order to provide useful information to licensees to help manage risk, including reviewing resources, identifying areas of risk or practices and products that should be the subject of close attention, and the like.

We do not support the "naming and shaming" of individuals, and are supportive of the conclusions reached by the Task Force on this matter. This is not necessary for an effective breach reporting regime.

This is not to say that individuals and entities against whom criminal, civil or disciplinary orders have been made, including under the proposed Professional Standards regime, ought not be publicized, which they clearly should, however that is not something that should form part of the breach reporting regime.

We question whether there is any need for ASIC to report breach reporting data at the licensee level. Our members do not see any value in comparing their performance against others. The wide variety of business models as between entities make any such comparisons largely meaningless. We also do not see any value in ASIC reporting the name of the relevant operation unit at a licensee as part of ASIC's periodic reporting.

CONCLUSION

The Stockbrokers and Financial Advisers Association appreciates the opportunity to provide the above comments in respect of the Consultation Paper. We would be happy to discuss any issues arising these comments, or to provide any further material that may assist. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au.

Yours sincerely,

Andrew Green
Chief Executive