

Misconduct and reporting

Recommendation	Existing law	Summary of proposed reform
<p>Recommendation 1.6 – Misconduct by mortgage brokers</p> <p>ACL holders should:</p> <ul style="list-style-type: none">• be bound by information-sharing and reporting obligations in respect of mortgage brokers similar to those referred to in Recommendations 2.7 and 2.8 for financial advisers; and• take the same steps in response to detecting misconduct of a mortgage broker as those referred to in Recommendation 2.9 for financial advisers. <p>Recommendation 2.7 – Reference checking and information sharing</p> <p>All AFSL holders should be required, as a condition of their licence, to give effect to reference checking and information-sharing protocols for financial advisers, to the same effect as now provided by the ABA in its “Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol”.</p>	<p>N/A</p>	<p>ASIC may determine a “Reference Checking and Information Sharing Protocol” by legislative instrument, applicable to AFS and credit licensees.</p> <p>For AFS licensees, the Protocol applies to information shared by an AFS licensee with another AFS licensee or a credit licensee about an individual AFS licensee (whom the information is about) or representatives who are reasonably likely to:</p> <ul style="list-style-type: none">• provide personal advice to retail clients if the individual becomes a representative of the AFS licensee to whom information is shared; or• provide credit assistance relating to residential property mortgages and be a mortgage broker or director, employee or agent of a mortgage broker if the individual becomes a representative of the credit licensee. <p>Qualified privilege attaches to information shared under the Protocol.</p> <p>Failure to comply with the Protocol will result in a civil penalty.</p> <p>For credit licensees, new obligations will apply under the National Consumer Credit Protection Act in generally the same manner.</p>

Recommendation

Recommendation 2.8 – Reporting compliance concerns

All AFS licence holders should be required, as a condition of their licence, to report “serious compliance concerns” about individual financial advisers to ASIC on a quarterly basis.

Recommendation 2.9 – Misconduct by financial advisers

All AFSL holders should be required, as a condition of their licence, to take the following steps when they detect that a financial adviser has engaged in misconduct in respect of financial advice given to a retail client (whether by giving inappropriate advice or otherwise):

- make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser’s misconduct; and
- where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

Recommendation 7.2 – Implementation of recommendations

The recommendations of the ASIC Enforcement Review Taskforce made in December 2017 that relate to self-reporting of contraventions by financial services and credit licensees should be carried into effect.

In the ASIC Enforcement Review Taskforce Report, ASIC’s recommendations included, relevantly:

- the “significance test” in section 912D of the Corporations Act should be retained but clarified to ensure that the significance of breaches is determined objectively;
- introduce a self-reporting regime for credit licensees equivalent to the regime for AFS licensees under section 912D of the Corporations Act; and
- the obligation for licensees to report should expressly apply to misconduct by an employee or representative.

The Taskforce Report also recommended that significant breaches (and suspected breach investigations that are ongoing) must be reported within 30 days.

Existing law

In respect of reporting obligations, section 912D of the Corporations Act requires an AFS licensee to notify ASIC of breaches or likely breaches of any of the licensee obligations in sections 912A or 912B, and where those breaches are determined to be significant.

The report must be made within 10 business days of the AFS licensee becoming aware of the contravention or likely contravention.

The considerations which go towards significance are set out in section 912D(1)(b).

Summary of proposed reform

There will be a new obligation for AFS and credit licensees to lodge a report with ASIC where there are reasonable grounds to believe that a “reportable situation” has arisen. Failure to do so will be an offence.

A “reportable situation” is where:

- the licensee or a representative has either breached a “core obligation” or such a breach is likely; or
- the licensee has commenced an investigation into whether it or a representative has breached a core obligation; and
- the breach/likely breach is significant.

A breach is deemed significant if:

- the provision breached is an offence that may involve imprisonment (3 months for dishonesty offences, 12 months for others);
- the provision breached is a civil penalty provision; or
- the breach results, or is likely to result, in loss or damage to clients or members; or
- a circumstance prescribed by regulations exists.

AFS licensees

Other “reportable situations” for AFS licensees include where the licensee or representative engages in gross negligence in the provision of financial services, serious fraud, or any other conduct prescribed by regulations.

“Core obligations” for AFS licensees are those obligations already subject to section 912D, as well as the obligations under sections 601FC, 601FD and 601FE for AFS licensees who are the responsible entities of registered schemes.

The test of “significance” includes the current 912D(1)(b) factors.

A report must be lodged within 30 days after the AFS licensee first reasonably knows that there are reasonable grounds to believe the reportable situation has arisen.

However, if there is an investigation and the investigation discloses that there are either reasonable grounds or no reasonable grounds (as above), then the report must be lodged within 10 days of the AFS licensee reasonably knowing either

outcome of the investigation.

An AFS licensee must also lodge a report in relation to another AFS licensee that is an individual who provides personal advice to retail clients, where there are reasonable grounds to suspect a reportable situation has arisen in relation to the other licensee.

ASIC must publish information about breach reports every financial year, in accordance with the regulations

The AFS licensees must take reasonable steps to notify affected retail clients who are reasonably likely to suffer loss or damage, or have a legally enforceable right to recover the loss or damage from the licensee.

The licensee will have an obligation to investigate a reportable situation in relation to affected clients, including quantifying the loss or damage affected clients have suffered / will suffer. Such an investigation must be completed as soon as reasonably practicable.

The licensee will have an obligation to compensate affected clients where there are reasonable grounds to believe loss will be suffered or was suffered, or the client has a legally enforceable right to recover loss or damage, and must take reasonable steps to compensate clients within 30 days after completion of the investigation.

Failure to investigate, notify the affected client or compensate the client may result in a civil penalty.

Credit licensees

The core obligations for credit licensees/representatives are the obligations under section 47 of the National Consumer Credit Protection Act.

The “significance” factors are transposed from section 912D(1)(b), and are in addition to the deemed significant breaches, discussed above.

The obligations follow those for AFS licensees above.

The obligation to report suspected core obligation breaches of other credit licensees only applies where the other licensee is a mortgage broker, and the obligation to investigate loss/damage to affected consumers and notify affected consumers only applies to credit licensees that are mortgage brokers.

Comments

- Significant changes will be needed to licensee breach reporting and escalation procedures.
- The regime seeks to clarify that a licensee's reporting obligations will extend to breaches of obligations by its representatives (such as directors and employees).
- It is unclear how some key concepts in the new regime will operate in practice. Eg the concept of "reasonably knows" appears circular in context and does not address risks outside the entity's control. In addition, the concept of "gross negligence" is used in the concept of "reportable situation" but is not defined. Noting that the concept of gross negligence is not settled at common law – this will give rise to uncertainty.
- Further, the concept of "likely to breach" arises if the person is no longer able to comply with the obligation. This wording indicates actual rather than likely breach.
- The concept of "significant" is defined to expressly include breaches that result in or are likely to result in loss or damage to client or members. However, there is no materiality threshold imposed here, which substantially broadens the scope of the meaning of "significant." In addition, it is unclear whether this concept will allow the licensee to take into account any remediation that will remedy any loss or damage to clients.
- Interestingly, the amendments with respect to when a breach is taken to be "significant" go beyond the recommendations in the ASIC Enforcement Review Taskforce Report in two respects. The Taskforce recommended that a breach is taken to be "significant" if the breach: (1) results in material loss to clients or (2) is likely to have a materially adverse effect on scheme members (effectively integrating the current test in the Chapter 5C breach reporting regime into Chapter 7 of the Corporations Act). However, the exposure draft adopts a lower threshold by effectively removing these materiality thresholds and deeming significance where the breach results, or is likely to result, in any loss or damage to clients or scheme members.
- The proposed regime also requires ASIC to publish information about breach reports. The proposal is consistent with the ASIC Enforcement Review Taskforce Report recommendation that such reporting should be done at the licensee level. It is important to note that as reiterated in the APRA v Kelaher (IOOF case) in 2019, a breach report is not evidence of an actual contravention of financial services law by the licensee (which is particularly relevant in an increasingly litigious industry).
- In addition, licensees will have an obligation to lodge a report with ASIC where the licensee has reasonable grounds to suspect that there is a breach or likely breach by another licensee in respect of the provision of personal advice. This obligation was not contemplated by the ASIC Enforcement Review Taskforce Report.
- The introduction of a suspicion test here considerably lowers the threshold for lodging an ASIC report, with "suspect" being given its ordinary common law meaning (ie positive suspicion about the truth or existence of the circumstance). The evidentiary requirements for a suspicion are significantly lower when compared to a reasonable belief test (which applies to the remainder of the breach reporting regime).
- Further, where a licensee lodges such a report with ASIC, the licensee must provide the report to the other licensee who is the subject of the report within 30 days. This requirement effectively removes any anonymity the first licensee has in respect of reporting, which can frustrate the effectiveness of the requirement (eg a subsidiary company can be placed in a difficult position in respect of lodging a report with respect to its holding company where it cannot be protected by anonymous reporting).