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By Electronic Mail

ASIC Enforcement Review
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SUBMISSION ON ASIC ENFORCEMENT REVIEW – POSITION AND CONSULTATION PAPER 1: SELF-REPORTING OF CONTRAVENTIONS BY FINANCIAL SERVICES AND CREDIT LICENSEES ("CONSULTATION PAPER")

Moody's Investors Service (MIS) wishes to thank the ASIC Enforcement Review Taskforce (Taskforce) for the opportunity to comment on the Consultation Paper.

MIS recognises the importance of the self-reporting framework to enable the early detection by ASIC of non-compliant behavior, which contributes to the effective regulation of the financial sector. We also appreciate the Taskforce's efforts to enhance the existing regime and make it more effective. However, we have two primary concerns regarding the preliminary positions set out in the Consultation Paper.

First, the proposed objective 'reasonable person standard' should accommodate the variety of financial services currently regulated under the Australian financial services (AFS) licensing regime. Second, the proposed broadening of the 10-day reporting timeline to cover suspected or potential breaches is likely to result in premature and inaccurate reporting. We believe this aspect of the proposed regime could unintentionally undermine ASIC's objective to discern genuine incidence of misconduct in the sector.

In attached Annex I, we discuss these concerns in more detail and respond to the specific questions posed in relation to preliminary positions 1 and 3 in the Consultation Paper. We hope that you will find the information contained in our responses useful, and we would be pleased to discuss our comments in more detail with you at your convenience.

Yours sincerely

/s/ Natalie Wells

Country Manager

Encl.

ANNEX

Position 1: 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

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?

MIS considers a "reasonable person standard" could be an appropriate trigger if its intent, whilst ensuring the significance of breaches is determined objectively, still accommodates the different circumstances of AFS licensees.

The AFS licensing regime covers a number of financial services that are distinguished (amongst other ways) on the basis of whether they serve retail or wholesale clients, and provides these two groups of clients with different levels of regulatory protections. Amending the significance test should thus recognise that a reasonable person needs to determine significant breaches differently according to which category of clients they deal with; for example, a reasonable person in a financial advisory business serving retail investors as opposed to an institutional provider that only serves large corporate customers. We note the Consultation Paper references examples of financial loss to consumers[1] and the Review of the Four Major Banks: First Report (Coleman Report) also cites the failure to protect consumer interests.[2] Whilst MIS recognises these are important considerations that may be addressed by breach reporting reforms, not all AFS licensees deal with retail clients or is responsible for dealing with client monies. If adopted, the standard should be applied in a manner that reflects this distinction and accommodates all types of AFS licensees.

Furthermore, we note that the "reasonable person standard" has been used in a variety of different situations,[3] and its application can vary accordingly. If a reasonable person standard is introduced, we would encourage the Taskforce to suggest legislative guidance to assist the industry on how that objective standard should be applied and who that "reasonable person" is in likely or anticipated scenarios.

In our view, the "reasonable person" concept should be applied in the context of what that person would do in the position of a person responsible for compliance in an AFS licensee, rather than, for example, what a typical retail investor would expect an AFS licensee to do, when determining the significance of a breach or likely breach. This is consistent with the position in ASIC Regulatory

[1] Discussed in Section 4 "The subjectivity of the significance test" of the Consultation Paper.

[2] Discussed in Section 3 of the Coleman Report regarding the gap between executives and consumer interests.

[3] These situations include in an investor context (e.g. for insider trading in determining whether information is materially price sensitive to a reasonable person), as well as in the context of a company officer (e.g. director's duty to prevent insolvent trading based on a reasonable person's awareness in a like position in the company's circumstances).

Guide 78 (RG 78) that awareness of a breach is when a person responsible for compliance in the licensee becomes aware.[4]

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

MIS agrees that introducing an objective standard via a 'reasonable person' into the significance test could potentially assist AFS licensees in clarifying when the reporting obligation is triggered. However, as noted, financial services businesses widely differ in terms of their "nature, scale and complexity"[5], and an objective test under the law to determine when a breach is significant may still result in a variety of reporting outcomes when it is applied in practice.

Position 3: Breach to be reported within 10 business days from the time the obligation to report arises

3.1 Would the threshold for the obligation to report outlined above be appropriate?

No. The proposed threshold[6] is too low. Imposing an obligation to report on the basis of suspected or potential breaches would, in some instances, result in licensees over-reporting incidents because they do not have an adequate opportunity to investigate or adequately consider the alleged non-compliance. In turn, ASIC will likely face a substantial increase of "false-positive" reporting on the basis of preliminary and inaccurate information. Such a result would be at odds with the Taskforce's objective to improve certainty in the reporting process. Instead, we would encourage the Taskforce to adopt an approach that focuses on when the AFS licensee has had adequate opportunity and a reasonable amount of time to consider and investigate the alleged non-compliance.

Further, we note that under the current self-reporting requirements, ASIC has set out its expectations under RG 78 as to when a breach or likely breach must be reported, namely that licensees should not wait until after certain events have occurred before sending the breach report to ASIC.[7] For example, licensees should not wait until it has completed all possible avenues of investigation to satisfy themselves the significance of the breach. To the extent the issues related to timely reporting have been identified, we would encourage the Taskforce consider whether licensees are taking an overly liberal interpretation to the obligations and an appropriate remedy already exists within the existing framework, rather than by amending the law and introducing a new reporting threshold.

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[4] See paragraph RG78.28.

[5] See paragraph RG78.12 of RG78.

[6] The proposed reporting threshold in paragraph 47 of the Consultation Paper, "when the AFS licensee becomes aware or has reason to suspect that a breach has occurred, may have occurred or may occur".

[7] See paragraph RG78.29.

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?

No. Whilst the intent to broaden the reporting threshold is to improve certainty and reduce subjectivity in the assessment of the obligation, MIS considers that basing it on having "information that reasonably suggests" would not allow the AFS licensee to undertake a reasonable level of enquiry to substantiate the significance of a breach or likely breach. As discussed above in Question 3.1, this will likely result in an increase of "false-positive" reporting; it would be difficult to make an assessment of significance merely based on information that reasonably suggests, when the licensee needs to take into regard the various factors listed under section 912D(1)(b) of the Corporations Act.[8]

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?

No, the ten business day reporting period is not an appropriate limit when applied to the proposed threshold. A limited reporting period will exacerbate the detriment introduced by the proposed threshold. As noted above in response to Question 3.1, the proposed threshold will increase the likelihood that AFS licensees will submit preliminary, incomplete, and/or inaccurate information.

3.4 Would the adoption of such a regime have a cost impact, either positive or negative, for business?

A regime that could result in an increased number of false-positive reports of breach is likely to have a negative cost impact for business. The proposed reporting regime, once implemented, could also cause detriment to ASIC as it might lose focus on significant breaches while dealing with a high volume of false-positive situations that fall under the proposed reasonable test.

[8] The factors that determine whether a breach (or likely breach) is significant are outlined in Table 2 of RG 78 and set out under paragraph 10 of the Consultation Paper.