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ASIC Enforcement Review
Financial System Division
The Treasury
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PARKES ACT 2600

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NIBA Submission in response to the ASIC Enforcement Review Position and Consultation Paper 1 Self-reporting of contraventions by financial services and credit licensees 11 April 2017 (the Review)

The National Insurance Brokers Association of Australia (**NIBA**) appreciates the opportunity to make this submission in response to the Review.

NIBA represents over 300 insurance broking firms across Australia, the majority of which are small to medium businesses. Insurance broking firms provide traditional insurance broking and risk management advice in the areas of property and liability insurance, and in many cases broking firms also provide advice in relation to life risk insurance (as opposed to life investment products).

EXECUTIVE SUMMARY

NIBA supports a robust and clear breach reporting regime that operates appropriately for the reasonable benefit of all relevant stakeholders.

NIBA strongly agrees with paragraph 56 on page 21 of the Review that "Having a self-reporting system that encourages licensees to notify ASIC early of issues and a co-operative approach is more likely to yield quicker, more durable outcomes for consumers and the industry generally."

The following summarises NIBA's comments on the proposals relevant to its members. More detailed responses are contained later in this submission.

Position 1: The 'significance test' in section 912D of the *Corporations Act 2001* (Cth) should be retained but clarified to ensure that the significance of breaches is determined objectively

NIBA agrees that a properly drafted objective standard is likely to be preferable but raises concerns with a number of the matters raised and proposed. With ambiguity comes confusion and resulting litigation and waste of industry and regulator resources. See below for details.

Position 2: The obligation for licensees to report should expressly include significant breaches or other significant misconduct by an employee or representative

NIBA agrees that such an obligation is appropriate but raises concerns with a number of the matters raised and proposed. Similar concerns to Position 1 arise regarding ambiguity. See below for details.

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

NIBA has a number of concerns with this proposal and much will depend on how the above breach reporting obligations are drafted based on Positions 1 and 2 as to whether it is workable or not. See below for details.

Position 4: Increase penalties for failure to report as and when required

As above.

Position 5: Introduce a civil penalty in addition to the criminal offence for failure to report as and when required

As above.

Position 6: Introduce an infringement notice regime for failure to report breaches as and when required

As above.

Position 7: Encourage a co-operative approach where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity

NIBA supports a cooperative approach and agrees with the comment "ASIC's resources are finite. If it needs to conduct a detailed investigation and ultimately

pursue to finality legal action to secure greater compliance and deterrence this is inefficient and has the potential to substantially delay consumer redress in contrast to the speed with which licensees may be able to provide this with the right incentives" (Review, para 56, page 31).

The proposals do not appear to provide industry with sufficient confidence that the above would be the end result. Ultimately the end result of the proposals is that what ASIC will and won't do is left to its discretion. We have concerns in this regard. See below for details.

Position 8: Prescribe the required content of reports under section 912D and require them to be delivered electronically

NIBA supports this proposal subject to the agreed content being appropriate.

Position 10: Ensure qualified privilege continues to apply to licensees reporting under section 912D

NIBA supports this proposal.

Position 12: Require annual publication by ASIC, of breach report data for licensees

NIBA supports the view taken in the report that any reforms should not require the early publication of breach reports made to ASIC, including names of individuals concerned either directly or indirectly with the breach, as well as information on whether action, such as dismissal, was taken against senior executives concerned.

There were significant practical concerns with such a proposal.

NIBA supports the proposal regarding annual publication of useful information by ASIC regarding breaches but is concerned that the information, if not appropriately qualified, may mislead the public. This is a challenge industry constantly faces in its advertising and ASIC needs to be subject to a similar standard.

SUBMISSION

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

NIBA supports the position that the current "significance" test for the obligation to report should be retained.

The proposal that the *Corporations Act 2001* (**the Act**) should be amended to provide that significance is to be determined by reference to an objective standard, i.e. "matters that a *reasonable person* would regard as significant having regard to the existing factors set out in subsection 912D(1)(b) of the Act" (Review, para 25, page 12), or words such as, needs to be considered carefully.

The risk is that a lack of clarity can have the effect of creating confusion and resulting in argument between licensees and ASIC (as has been the case), and/or requiring licensees to unnecessarily over notify contrary to intent. Unnecessary confusion leads to litigation and waste of industry and regulator resources.

Before choosing the words to be used, Government and/or ASIC should identify how they believe the test should be practically applied, i.e. the basis on which they expect a licensee to make a decision or be tested on this decision.

The statement in paragraph 26 that "This would not introduce any concepts unknown to Australian law. For example, the continuous disclosure provisions of the Act require information to be disclosed where "a reasonable person would expect, if it were generally available, to have a material effect on the price or value of its securities" (s 674), is not overly helpful.

The application of the test differs greatly depending on the relevant context it is used in. There are less issues of concern where the *cause* being determined and the *effect* being measured are relatively simple. In continuous disclosure the information and effect on price and value are relatively simple. In the context of a breach of Chapter 7 of the Corporations Act they can be very complex.

Setting out the basic principles to be applied in making such a decision based on this referenced law will identify if it is as clear as is thought and any issues that need to be resolved in advance rather than after the fact.

The comments in paragraph 29 on page 13 of the Review are unclear to NIBA:

> "Any overarching obligation in the Australian context could be supplemented by additional regulatory guidance from ASIC that may specify certain types of breaches that it considers **should always be reported**…[our bold]"

Paragraph 29 goes on to provide examples, including:

- Breaches or suspected breaches of Part 7.7A of the Act (including, among other things, best interest obligations and conflicted remuneration provisions);

- Matters that could result in the suspension, demotion, termination or resignation of an AFS licensee's representative or employee or in relation to which there has been a referral to a law enforcement agency;

- Breaches or suspected breaches of the Future of Financial Advice (FOFA) provisions in Part 7.7A of Chapter 7 of the Act in relation to which an AFS licensee is liable for its representatives' actions;

- Matters that may involve dishonesty, as defined in section 130.3 of the Commonwealth Criminal Code;

- Breaches or suspected breaches of a provision of a financial services law referred to in section 912D of the Act which carries a penalty of imprisonment of five years or more; and/or

- Breaches or suspected breaches of a financial services civil penalty provision in Chapter 7 of the Act."

It is not clear from the above whether the proposal is that:

- any such breach is automatically deemed significant or not and must be reported; or

- such breaches will still be subject to a materiality threshold test per the comment in paragraph 28.

The former would be concerning to NIBA given the number of matters that could give rise to the listed breaches which on any reasonable view may not be significant – e.g. a one off breach of a Part 7.7A requirement or failure to meet the ongoing disclosure of material changes and significant events requirement.

We assume this is not the intent as this would lead to the same issues that gave rise to the original inclusion of the significance test, i.e. "Such a requirement put a large regulatory burden on licensees, as well as an administrative burden on ASIC in

having to deal with an influx of minor and insignificant reports" (Review, Executive Summary, para II, page 5).

NIBA supports the proposal that any guidance "should also provide examples that take into account differing businesses, products and/or distribution channels" (Review, para 30, page 14).

This proposal needs to be clarified and if automatic notification is to be required, clear justification should be given on each requirement to be included up front and not after the fact.

NIBA also requests ASIC consider the operation of section 990K of the Corporations Act as part of finalising its review. Section 990K has no requirements of either "is likely" or "is significant" like section 912D(1). It also has no factors like section 912D(1)(b). Thirdly, it refers to "may" in section 990K(2)(a) and (b).

However, section 990K has concepts of "adversely" and "unduly" in sections 990K(2)(a) and (c) respectively.

In other words, the thresholds differ between sections 912D and 990K.

Section 990K requires auditors to report. NIBA believes the public policy of ASIC receiving information from auditors will be achieved if the thresholds line up with the revised section 912D. In particular, it does not seem useful for ASIC to receive reports on minor or technical matters.

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?

See comment above on the need for Government and/or ASIC to be clear (in advance) on what rules would be applied under such a test in order to avoid a poor result (i.e. confusion and argument or over reporting). Unnecessary confusion leads to litigation and waste of industry and regulator resources. Industry specific guidance could then be provided in the context of such rules.

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

If the above is not properly addressed in advance, NIBA is concerned it will increase ambiguity. With ambiguity comes confusion and resulting litigation and waste of industry and regulator resources.

Position 2: The obligation for licensees to report should expressly include significant breaches or other significant misconduct by an employee or representative

NIBA supports the preliminary position that the self-reporting obligation should be extended to require AFS licensees to report matters relating to the conduct of employees and representatives.

NIBA agrees that the aim should be to ensure that ASIC is notified of misconduct or other serious regulatory issues by representatives at the earliest opportunity so that ASIC can, where necessary, investigate and take timely action to remove individuals from the industry in order to protect consumers.

In paragraph 38 on page 16, the Review states that:

> "38. Matters referred to in section 920A of the Act that might be appropriate for AFS licensees to report to ASIC include where the AFS licensee has reason to believe or suspect that an employee or authorised representative:
>
> 38.1 has become an insolvent under administration; or
>
> 38.2 has engaged in fraudulent conduct; or
>
> 38.3 is not of good fame and character; or
>
> 38.4 is not adequately trained or is not competent to provide a financial service or financial services" (Review, para 38, page 16).

A materiality test should be applied, otherwise one failure in following a procedure, no matter how immaterial (e.g. 38.4 above), could trigger the obligation. If a materiality test is not to be applied, it should be clearly identified.

To avoid unnecessary dispute, NIBA believes guidance should be provided in advance on what tests the Government and/or ASIC want to apply in determining what would constitute a "reason to believe or suspect".

It appears from the proposal that the belief will be that of the actual AFSL holder, and an objective reasonable person test is not to apply.

Question

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

See comments above.

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

Whether this proposal is appropriate depends on the final position taken and clarity of the reporting triggers.

The Review proposes to make the 10 business day timeframe commence from when the AFS licensee "*becomes aware or has reason to suspect that a breach has occurred, may have occurred or may occur"* (Review, para 47, page 19) rather than when the licensee determines that the relevant breach *has* occurred and *is* significant.

NIBA assumes that the reference to "breach" is only intended to be one that *also* meets the significance test. This is unclear.

Again, it is crucial to understand in advance what rules the Government and ASIC would seek to apply in forming a view regarding the key concepts to be used, e.g. "reason to suspect" to avoid unnecessary dispute and confusion. A failure to do so can impact on qualified privilege.

Is it to be the subjective AFSL holder or objective reasonable person etc.? A good example of where issues can arise in this respect if not properly addressed, is in section 21(1) of the *Insurance Contracts Act 1984* (Cth) where a "reasonable person in the circumstances" test applies. This was subject to contrary judicial decisions and subsequent legislative amendments to seek to fix the issues.

Some guidance is provided in paragraph 50 of the Report on circumstances which trigger "deemed awareness". It is proposed that an AFSL holder will be deemed to be aware of the "facts and circumstances that established the breach, suspected breach or potential breach" where they have received that information from any of the following:

- a government agency;
- its auditor;
- an industry Ombudsman, or other body to which the licensee must belong under its external dispute resolution scheme obligations; and/or
- a current or former representative or employee who has provided it to a director, secretary, or senior manager of the licensee or a person authorised by the licensee to receive whistle-blower type disclosures.

It is not obvious to NIBA how this concept would operate practically. For example:

- Does the proposal mean that the AFSL holder must assume what they are told by such entities to be correct, despite being of a contrary view?

- Does it apply to the conclusion of such an entity as to a breach or just facts and circumstances notified?

- How is this assumption intended to impact on the consideration of the materiality of the breach, which is a necessary part of determining when to report?

Ultimately a breach or suspected breach may be identified but a view on the significance of the breach still needs to be formed. Inevitably, it will remain necessary for the AFSL holder to undertake appropriate investigations in this regard.

Questions

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

See comments above.

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?

See comments above.

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?

Whether it is appropriate will depend on the agreed triggers. See comments above.

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

This will depend on the agreed triggers. If unclear it is likely to have a significant cost impact on industry. The more restrictive the definition the higher the cost given the increased likelihood that internal and external resources would need to be devoted to investigating the breach.

Position 4: Increase penalties for failure to report as and when required

NIBA supports appropriate and fair increases to promote good behaviour, but only where the provisions giving rise to a breach are clearly drafted. We have noted our concerns in this regard above already.

NIBA strongly supports the view in paragraph 57 of the Report that a "balance must be struck between co-operation and ASIC's mandate to take appropriate and proportionate action in relation to identified breaches of the law."

What is not obvious to NIBA from the Report is where industry can have comfort that ASIC will take appropriate and proportionate action in relation to identified breaches of the law.

Where ASIC and an AFSL holder cannot agree on an approach, ultimately the major penalty is a new stick in ASIC's arsenal. There is recent evidence of ASIC acting in a manner that has caused much industry concern about its appropriateness.

ASIC released REP 498 Life insurance claims: An industry review as a result of a review which examined 15 life insurers (*no general insurers*) covering more than 90% of the market.

The six-month review analysed data from the three-year period from 1 January 2013 to 31 December 2015 on the four major life insurance policy types – term life cover, total and permanent disablement (TPD), trauma, and income protection.

ASIC concluded that the "review did not find evidence of cross-industry misconduct across the life insurance sector in relation to life insurance claims payments and procedures…and… 90% of claims are paid in the first instance" (para 18, REP 498).

Despite this, ASIC made a number of significant recommendations for change. The one of most concern is the recommendation to Government to strengthen the legal framework covering claims handling.

ASIC stated that "Currently 'handling insurance claims' is explicitly exempted from the conduct provisions of the Corporations legislation. ASIC is recommending that this exemption be removed by the Government and that more significant penalties for misconduct in relation to insurance claims handling are also included in the review of ASIC's penalty powers" (para 48, REP 498).

This recommendation is not limited to life insurance.

In the life insurance context, it is concerning how such a significant recommendation can be made where ASIC concludes 90% of claims are paid in the first instance.

It is more concerning that it is thought appropriate to publicly make such a recommendation that affects all of the insurance industry, where there was no evidence of cross-industry misconduct in relation to life insurance, and where no recent review of claims handling in the general insurance industry has been conducted.

For example, applying these recommendations broadly to the whole insurance sector ignores ASIC's 2011 review (REP 245 Review of general insurance claims handling and internal dispute resolution procedures) which made no such finding in relation to general insurance claims handling procedures, and the high-level findings of ASIC's review were generally positive.

Any recommendations for change by ASIC should be supported by clear and unambiguous evidence of detriment to consumers or failure by the industry to meet the requirements of the Financial Services Laws.

Position 5: Introduce a civil penalty in addition to the criminal offence for failure to report as and when required

NIBA repeats its comments above.

Giving ASIC greater flexibility to choose a lesser penalty is supported.

However, the reality is that where a high and low penalty option is available, if ASIC wants a certain result (not matter how significant the breach) the threat of a higher penalty can be used by it as way to get what it wants.

Thought needs to be given as to how rules can be built into the legislation that give industry sufficient comfort that ASIC will not improperly use its powers, whilst at the same time not unduly fettering a proper exercise of these powers.

The Report states in paragraph 59 that:

"The introduction of a civil penalty may result in ASIC taking enforcement action in relation to breach reporting obligations **more often**, particularly because it could seek a civil penalty for any breach of section 912D of the Act when it takes civil penalty proceedings relating to the subject matter of the breach itself" [our bold].

This seems at odds with the Report comments in paragraph 56 and elsewhere regarding a "co-operative approach" which "is more likely to yield quicker, more durable outcomes for consumers and the industry generally".

NIBA does not agree, without reasonable restrictions being applied to ASIC, that the addition of a civil penalty option may increase the willingness of licensees to report to ASIC.

Position 6: Introduce an infringement notice regime for failure to report breaches as and when required

NIBA supports ASIC being empowered to issue infringement notices to AFS licensees for simple or minor contraventions that do not involve a deliberate failure to report.

It is proposed that ASIC could do so if there are "reasonable grounds to believe that a person has contravened a relevant provision" (Review, para 62, page 22). To avoid unnecessary and costly disputes for industry and ASIC, the triggers for breach reporting must be made as clear as possible. NIBA has expressed its concerns in this regard above. Any public reporting of infringement notices by ASIC would make this more important to get right.

NIBA supports the proposal that if an infringement notice is issued and complied with, no further regulatory action may be taken against the recipient for the breach, the recipient is not taken to have admitted guilt or liability in relation to the alleged contravention or to have contravened the relevant provision.

It is reasonable that if the infringement notice is issued and not complied with, ASIC may take enforcement action in relation to the underlying contravention.

Position 7: Encourage a co-operative approach where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity

NIBA supports provisions that encourage a collaborative approach between the regulated and regulator and encourage licensees to report events and information to the regulator at the earliest opportunity, even where proper investigation of the circumstances may take some time and resources of the licensee.

A formal provision expressly allowing ASIC to decide not to take action in respect of licensees when they self-report and certain additional requirements are satisfied is also supported.

The proposed option "to provide that ASIC may decide to take no administrative or civil action against the licensee if the licensee cooperates with ASIC and addresses the matter to ASIC's satisfaction" (Review, para 68, page 23) would be improved if there was specified criteria ASIC could be tested against in this regard to ensure consistency and fairness of approach.

If not, there seems little point in having the provision as ASIC currently makes such decisions. The only value would be if it makes it easier for ASIC to do so if it wants to.

NIBA also supports the proposals that:

- an uplift or discount in the penalty for an underlying breach of the law could be provided for, depending on whether the AFS licensee has reported the breach within the statutory timeframe; and

- the fact that a licensee self–reported the matter to ASIC could be identified as a circumstance to be taken into account when considering whether a licensee should be granted relief from liability in civil or civil penalty proceedings under sections 1318 and 1317S of the *Corporations Act 2001*.

Questions

4.1 What is the appropriate consequence for a failure to report breaches to ASIC?

This will depend on the final triggers for a breach. See NIBA's comments above.

4.2 Should a failure to report be a criminal offence? Are the current maximum prison term and monetary penalty sufficient deterrents?

See comments above.

4*.3 Should a civil penalty regime be introduced?*

See comments above.

4.4 Should an infringement notice regime be introduced?

See comments above.

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?

See comments above.

Position 8: Prescribe the required content of reports under section 912D and require them to be delivered electronically

NIBA supports this proposal subject to the agreed content being appropriate.

Questions

5.1 Is there a need to prescribe the form in which AFS licensees report breaches to ASIC?

NIBA has no issue with this proposal if it reduces the regulatory cost that will be imposed on industry via the ASIC funding legislation. See comments above.

5.2 What impact would this have on AFS licensees?

This will depend on the content in most cases.

Position 10: Qualified privilege

NIBA supports the review of section 1100A of the Corporations Act to continue the protection of qualified privilege if the proposed reforms to breach reporting were to proceed. This is particularly critical if entities are expected to report suspected breaches. We note our concern above that a lack of clarity regarding notification obligations can affect this protection.

Position 12: Require annual publication by ASIC, of breach report data for licensees

NIBA supports the decision not to incorporate in the proposals the calls for the early publication of breach reports made to ASIC, including the names of individuals concerned either directly or indirectly with the breach, as well as information on whether action, such as dismissal, was taken against senior executives concerned. There were many practical concerns that arose in relation to the proposal.

NIBA supports the annual publishing of breach report data at a firm or licensee level, provided it is done in a fair and appropriate manner and not in a way that would prejudice any type of AFSL holder (e.g based on business size). Where appropriate proper qualifications must be built into the reporting to manage such risks.

NIBA agrees that reporting should be confined to significant breaches, and should be at the licensee level. Whether it should be extended to identifying the operational area of a licensee's organisation in which the breach occurred warrants further consideration.

Questions

8.1 What would be the implications for licensees of a requirement for ASIC to report breach data at the licensee level?

See comments above.

8.2 Should ASIC reporting on breaches at a licensee level be subject to a threshold? If so, what should that threshold be?

It is unclear to NIBA how any kind of threshold could practically work.

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?

This is worth further consideration. If the breach notification provisions are clearly and appropriately drafted this is less likely to be of concern. The main issue is to ensure misleading impressions are not conveyed in such reporting.

Please do not hesitate to contact me if you would like to discuss any aspect of this submission.

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