Law Council
OF AUSTRALIA

Business Law Section

4 September 2024

Ms Kate Metz
Senior Executive Leader, Regulatory Reform and Implementation
Australian Securities and Investments Commission
GPO Box 9827
Sydney NSW 2000

By email: rri.consultation@asic.gov.au

Dear Ms Metz

Consultation Statement 10 *Proposed extension of breach reporting and record-keeping legislative instruments* (CS 10)

1. This submission is made by the Financial Services Committee of the Business Law Section of the Law Council of Australia (the **Committee**) and relates to CS 10, which the Australian Securities and Investments Commission (**ASIC**) released for consultation on 7 August 2024.

2. The Committee thanks ASIC for the opportunity to provide feedback on CS 10.

Background

3. In CS 10 ASIC has stated its intention to remake each of the following legislative instruments for a further five-year period:

   (a) *ASIC Corporations and Credit (Breach Reporting—Reportable Situations) Instrument 2021/716* (**Instrument 2021/716**);

   (b) ASIC Credit (Breach Reporting—Prescribed Commonwealth Legislation) Instrument 2021/801 (**Instrument 2021/801)**; and

   (c) ASIC Class Order [CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice* (**Class Order 14/923**),

   collectively, the **Instruments**.

4. Each Instrument is due to expire in October 2024.

5. ASIC has expressed the view that each Instrument is "operating efficiently and effectively" and continues "to form a necessary and useful part of the legislative framework".

Submissions

6. The Committee agrees with ASIC that each respective Instrument plays an important role in the legislative framework, and that the legislative modifications made by each respective Instrument should therefore remain in force.

7. The Committee also supports the proposal to combine Instruments 2021/716 and 2021/801 into a single legislative instrument, provided that this does not unnecessarily increase complexity.

8. However, the Committee has some concerns about:

   (a) the process—both the lack of detail in the ASIC consultation and the failure of Parliament to amend the substantive law; and

   (b) in a broader context, the operation of the breach reporting regime under Part 7.6 of the *Corporations Act 2001* (Cth) (the **Corporations Act**), which the Committee believes is currently producing sub-optimal outcomes for both financial services licensees and for ASIC,

   as outlined in further detail below.

Concerns about the process

9. In respect of the consultation process adopted by ASIC, the Committee is concerned that ASIC has not:

   (a) provided any reasons or explanation for its view that the Instruments are "operating effectively and efficiently and continue to form a necessary and useful part of the legislative framework"; or

   (b) provided any draft legislative instruments and accompanying explanatory statements.

10. The Committee also notes that, at least in the case of Instrument 2021/716 and Instrument 2021/801, at the time the Instruments were made, ASIC's modifications of the law were only intended to be *temporary*, with the expectation that Parliament would make corresponding amendments to the substantive law. In particular:

    (a) paragraph 11 of the Explanatory Statement for Instrument 2021/716 stated that the Instrument would apply:

        "for a period of 3 years, as an interim measure. This period will provide Parliament with the necessary time to consider legislative amendments to the relevant regulation power in paragraph 912D(4)(b) of the Corporations Act … and for Government to make appropriate regulations"; and

    (b) paragraph 10 of the Explanatory Statement for Instrument 2021/201, similarly stated:

        "The instrument provides relief for a period of three years. This period will provide Parliament with the necessary time to consider the relevant legislative amendments and regulations."

11. CS 10 has not addressed the fact that these Instruments were meant to be temporary in nature, with the intention that Parliament would amend the substantive law (which would then render the Instruments superfluous).

12. The Committee notes the observations made in the Final Report of the Australian Law Reform Commission Inquiry into Corporations and Financial Services Laws, titled "Confronting Complexity: Reforming Corporations and Financial Services Legislation", which was tabled in Parliament on 18 January 2024 (the **ALRC Report**) about the current challenges in navigability and transparency of Australia's corporations and financial services laws, due to the reliance on modifications under regulations and ASIC legislative instruments.

13. The Committee submits that the modifications to the substantive law that are made by the Instruments ought instead to be dealt with under the Treasury Laws Improvement Program for the stewardship and ongoing maintenance of Treasury portfolio laws.

14. Further, members of the Committee have expressed the view that Instrument 2021/716 only serves to add to the complexity in determining the legal question of whether or not a "reportable situation" has arisen.

15. The Committee would ideally like to see the replacement of Instrument 2021/716 simplify the law so that financial services licensees and their professional advisers do not need to look in so many different places to determine whether there has been a "reportable situation".

Concerns about the breach reporting regime

16. While it is not formally within the scope of CS 10, the Committee wishes to express widely held financial services and credit industry concerns that the breach reporting regime is not operating in a fair, efficient or effective manner.

17. While the Committee acknowledges that some genuine effort has been made to simplify and streamline some aspects of the operation of the regime (including proactive measures taken by ASIC), financial services and credit licensees are nonetheless continuing to expend considerable time, effort and resources to assess and report on a significant volume of matters which are technically reportable, but would not ordinarily be considered material from a consumer protection perspective, meaning that the likelihood of regulatory concern or ASIC enforcement action is negligible.

18. The Committee submits that the breach reporting regime is in need of a significant overhaul to ensure that resources are appropriately directed, both by licensees and by ASIC, to focus on promptly, fairly and appropriately responding to those matters which are serious, systemic and causing (or capable of causing) material consumer harm.

19. As a starting point, the Committee has identified some modifications to the current law that could be made relatively easily (potentially through the replacement of Instrument 2021/716 as an interim measure pending Parliament formally amending the legislation) to address what the Committee considers to be an unreasonable burden imposed on financial services licensees.

20. These are set out in the **Annexure** and focus on the managed funds sector.

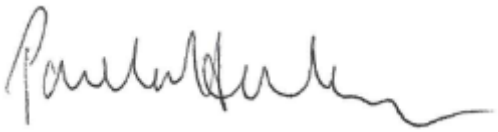
Conclusion and further contact

21. Please contact co-chair of the Committee Pip Bell (committeechairfsc@gmail.com) to discuss the Committee's concerns and potential avenues through which the Committee and ASIC might work together, involving liaison with Treasury and broader stakeholders where appropriate, to:

    (a) reduce the complexity and improve the navigability and transparency of the corporations and financial services legislative framework, as recommended by the ALRC Report; and

    (b) embrace a constructive and consensus-led approach to develop measures to improve the effectiveness of the breach reporting regime for the benefit of ASIC and its regulated population.

Yours sincerely



[redacted]
Chair
Business Law Section

Annexure—Specific examples of breach reporting areas considered ripe for reform

1. This Annexure sets out some matters which the Committee submits should not be treated as "reportable situations" under the breach reporting regime. While they are focused on the experience of Committee members who advise financial services licensees in the managed funds sector, these are intended to be illustrative examples, and the Committee believes that other industry sectors are currently facing similarly frustrating situations.

2. The Committee believes that it is reasonable to assume that *thousands* of the reportable situations reported to ASIC each year relate to circumstances that would *not* have been reportable under section 912D of the Corporations Act as it was drafted prior to October 2021 (when the current breach reporting regime commenced).

3. Set out below are some specific examples of situations which would currently be reportable, yet, in the Committee's view, would not objectively in and of themselves be considered worthy of ASIC's scrutiny because they do not give rise to materially adverse consequences for consumers:

    (a) misleading or deceptive conduct due to a factual error in an annual member statement or investor update that would not be capable of affecting any member's investment decision - see the discussion in paragraphs 4 to 6 below;

    (b) a quarterly obligation under a registered managed investment scheme compliance plan not being met by its due date in one quarter - see the discussion in paragraphs 7 to 12 below; and

    (c) a report required under a registered scheme constitution being delivered one day after its due date - see the discussion in paragraphs 13 to 16 below.

    Misleading or deceptive conduct

4. Currently, paragraph 7 of Instrument 2021/716 gives relief from breach reporting for misleading conduct in respect of:

    (a) what would otherwise be a single reportable situation;

    (b) involving only one (or joint) holders of a product; and

    (c) causing no loss or damage.

5. The Committee submits that:

    (a) it would be reasonable for ASIC to soften its stance on at least the first two of the above criteria without undermining the purpose and integrity of the breach reporting regime; and

    (b) for the third criterion, it would be appropriate to impose a minimum monetary threshold for loss or damage before the loss or damage gives rise to a reportable situation.

6. In the examples above, non-material breaches are likely in practice to sometimes involve a group of persons rather than just one individual, such as the issue of a document that contains a non-material error that may be misleading because it is incorrect. Even if the document is sent to 50 or more people, it should not need to be reported to ASIC in circumstances where:

   (a) there is no resulting loss; and

   (b) the error is unlikely to affect any member investment decision.

   The Committee submits that the appropriate response for a licensee in that situation is to promptly correct the error in a subsequent document or update.

   Breaches of registered scheme compliance plans

7. A compliance plan is a process document which sets out in granular detail the process for the responsible entity (**RE**) of a registered managed investment scheme to check that all requirements applicable to the operation of the scheme under the Corporations Act and the scheme's constitution are complied with.

8. In its current form, the Corporations Act requires all breaches of the compliance plan of a registered managed investment scheme to be reported to ASIC, regardless of the level of materiality. This is because:

   (a) the RE's duty to comply with the compliance plan is set out in paragraph 601FC(1)(h) of the Corporations Act;

   (b) the whole of subsection 601FC(1) is a civil penalty provision (see section 1317E);

   (c) paragraph 912D(4)(b) provides that a breach of a core obligation (which includes Chapter 5C) that is a civil penalty provision is a deemed significant breach and therefore a reportable situation, unless the civil penalty provision is excluded by regulations; and

   (d) to date, no regulations which exclude paragraph 601FC(1)(h) have been made.

9. The Committee notes that subsection 912D(6) of the Corporations Act, which came into effect on 23 February 2022 and allows regulations to exclude contraventions of specified provisions or specified matters, could now be used to exempt a breach of paragraph 601FC(1)(h) from being a reportable situation, without simultaneously preventing breaches of other RE duty provisions of subsection 601FC(1) from being reportable situations. The Committee submits that it would be appropriate for the regulations (or ASIC, in the interim) to do this for the following reasons.

10. By way of example, if a compliance plan requires the RE's compliance officer to review a report from the scheme's unit registry service provider every quarter, the compliance officer is unexpectedly on leave for personal reasons when the report arrives, and neglects to review it on time on that single occasion, such failure would constitute a breach of the compliance plan (and therefore a reportable situation under the current law), even though it would not be likely to have a materially adverse impact on the proper operation of the scheme or the protection of members' interests.

11. This lack of materiality in the current test governing whether a compliance plan breach is reportable has resulted in ASIC receiving a significant number of reports of breaches of the trivial nature described above, which makes it more difficult for ASIC to discern, among the flood of information received, which compliance plan breaches are material to consumer protection. For REs, it creates administrative work, and often requires them to incur legal costs because of lack of clarity as to what amounts to a breach of a compliance plan, without any corresponding regulatory or consumer benefit.

12. The Committee submits that it would be more appropriate for subsection 912D(5) of the Corporations Act to be used to assess whether or not a breach of paragraph 601FC(1)(h) gives rise to a reportable situation.

Breaches of provisions of registered scheme constitutions

13. Similarly, paragraph 601FC(1)(m) of the Corporations Act, which requires the responsible entity of a registered scheme to "carry out or comply with any … duty, not inconsistent with this Act, that is conferred on the responsible entity by the scheme's constitution", is a civil penalty provision.

14. This means that any breach of paragraph 601FC(1)(m) will give rise of a reportable situation, even though it may be trivial in nature.

15. For example, if a registered scheme's constitution requires the RE to give a report to members within 90 days and it is given within 91 days rather than 90 days (e.g., where the due date coincides with a public holiday in the place where the report is generated), the matter will give rise to a reportable situation and therefore must be reported to ASIC. The Committee considers that a materially adverse impact on consumer protection is unlikely to be a consequence of this short delay.

16. The Committee therefore submits that it would be more appropriate for subsection 912D(5) of the Corporations Act to be used to assess whether or not a breach of paragraph 601FC(1)(m) gives rise to a reportable situation.