



3 June 2021

Nicki De Mel
Strategic Policy Adviser, Strategy Group
Australian Securities and Investments Commission

By Email:

BR.submissions@asic.gov.au

Dear Ms Del Mel,

SMSF ASSOCIATION SUBMISSION – CP 340 BREACH REPORTING AND RELATED OBLIGATIONS

The SMSF Association welcomes the opportunity to provide a submission on ASIC's Consultation Paper 340: Breach Reporting.

We refer to recent roundtables and other industry engagement undertaken by ASIC which included discussions on the improvement of ASIC regulatory guides and how to make them more user friendly, understandable and engageable, including the need for more, practical real world case studies and examples.

Despite the engagement and work already undertaken by ASIC, in our view, the outcome of this draft is a very legalistic style of document.

The ASIC website states the purpose of its regulatory guides:

Regulatory guides give guidance to regulated entities by:

- *explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)*
- *explaining how ASIC interprets the law*
- *describing the principles underlying ASIC's approach*
- *giving practical guidance (for example, describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).*

(Source: <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/>)

Overall, we believe there is a need for greater explanation of ASIC's interpretation and application of the law and associated practical guidance including relevant case studies.

In our view, some of the questions posed would have benefited from being included in round table engagements or similar with licensees and the compliance managers, prior to the drafting of this regulatory guide. Perhaps there will an opportunity for further industry engagement once ASIC has reviewed the submissions it has received and prior to the finalisation of RG 78.

Our responses to the prescribed questions in the consultation paper are set out below. Note, no comments or feedback are provided for questions B5Q3, B6, B7 and C1Q3.



B1 We propose to give consistent guidance for AFS licensees and credit licensees on how they can comply with the breach reporting obligation, with examples of how the obligation applies in particular situations.

B1Q1 Do you agree with our proposed approach? If not, why not?

Broadly, draft Regulatory Guide 78 is a reassembly and quotation of the legislation supported with some segments taken from the explanatory memorandum that accompanied the Bill. Limited guidance on ASICs interpretation or guiding principles that will underly any approach taken is included. Overall, practical guidance is limited.

As a result, the draft regulatory guide is very legalistic and at times difficult to follow.

It is acknowledged that there is need to set out the law and how it applies. Clear referencing of the relevant legislative sources is crucial. However, what is missing is ASIC's interpretation and proposed application of the law.

More of these elements are needed along with a greater use of tables, charts, diagrams, and representative case study examples. Where applicable we have provided specific comments in response to the questions following.

B1Q2 Are there differences in the structure or operation of credit licensees that require specific guidance on how the breach reporting obligation applies?

We are not aware of any differences that would require specific guidance to be provided to credit licensees on how breach reporting obligations apply.

B2 We propose to include case studies and scenarios to supplement our general guidance and help illustrate key principles as they might apply to different licensees, industries and business models.

B2Q1 Are there any specific issues, incidents, challenges or areas of concern you think we should include as examples, case studies or scenarios? If so, please provide details and explain why they should be included.

More case studies are needed that consider a broader range of scenarios and types of businesses. Much of the focus was on corporate businesses and did not consider issues that could arise around an adviser who operates in a small business structure. Some businesses are self-licensed whereas others operate as authorised representatives of a larger licensee. Case studies to assist credit licensees were also limited.

Many of the case studies lacked sufficient detail to assist users to interpret, understand and apply the law. Further they did not provide any guidance on ASIC's interpretation and proposed application of the legislation.

Further, specific comments are also included at other relevant sections of this submission.



B3 Draft RG 78 identifies where the existing breach reporting obligation (as in force immediately before 1 October 2021) continues to apply to AFS licensees: see draft RG 78.14–RG 78.18.

B3Q1 Should we include further guidance to help AFS licensees understand how the existing breach reporting obligation under s912D of the Corporations Act (as in force before 1 October 2021 applies? If so, please provide details.

The application date of the Draft RG 78 at RG 78.14 is a critical piece of information and should be given greater prominence.

A statement needs to be included confirming that RG 78 (March 2020) continues to have effect, applying to historical or transitional matters. Reference to the previous version should be hyper-linked to direct those requiring the earlier version to the correct document.

RG 78 (March 2020) should be updated with a clear warning on the cover, noting its currency and application to specific matters. A statement that the guide is still in force with regards to pre 1 October 2021 matters should be included.

We recommend the inclusion of a decision tree or process style flow diagram to guide the user to navigate the different sets of rules and determine whether the new reporting framework or the previous framework applies. This would likely form the basis of an important decision tool for licensees.

It is essential that both the new version and former March 2020 version of RG 78 are clearly identifiable and distinguishable to one another and that their purpose is clear.

B4 We propose to provide high-level guidance to help AFS licensees and credit licensees identify what they must report to ASIC, including guidance on:

- (a) what is a ‘reportable situation’ (see draft RG 78.19–RG 78.25);**
- (b) whether a breach or likely breach of a core obligation is significant (see draft RG 78.26–RG78.45);**
- (c) when an investigation is a reportable situation (see draft RG 78.46–RG 78.57);**
- (d) what are ‘additional reportable situations’ (see draft RG 78.58–RG 78.60); and**
- (e) what are reportable situations about other licensees (see draft RG 78.61–RG 78.67).**

B4Q1 Do you agree with our proposed approach? If not, why not?

Although a high-level approach is proposed, the draft guide provides no guidance or insights into ASIC’s interpretation and proposed application of the law.

The guide merely repeats sections of the law, that often simply reference another section of the law. It provides little value.

A high-level approach can be taken but at the same time there is a need to provide clear commentary, insights, and guidance. This can be achieved through greater use of flow charts, diagrammatic representations, tables, and case study examples.



[B4Q2 Should we include further guidance on what constitutes a ‘core obligation’? If so, please provide details.](#)

The core obligations need to be clearly and expressly set out. The draft guide merely replicates the definition of a core obligation as expressed in s.912D(3) of the Corporations Act. This in turn references other sections of the Corporations Act.

Some further details on core obligations from the legislation are included in the appendix to the draft guide. However, this is not referred to or referenced.

Whilst clear referencing to the legislation is needed, legislative extracts on their own do not provide any further information, interpretation, or context.

Additional commentary from ASIC is needed to assist users in the application and interpretation of the law.

[B4Q3 Should we include further guidance on how to determine whether a breach or likely breach of a core obligation is ‘significant’? If so, please provide details.](#)

The intention of the legislation is for the reporting of significant breaches. However, there is a risk that a high volume of matters will be reported to ASIC as licensees are likely to take a prescriptive and conservative approach. This is largely due to the nature of the guidance proposed and how it can be interpreted. That interpretation is subjective which will drive conservatism on the part of licensees who will seek to avoid penalties for non-compliance.

The number and frequency of breaches are discussed in table 3, page 18. It seeks to address the issue of minor breaches, similar in nature that occur more than once:

“The greater the number or frequency of similar breaches, the more likely the new breach will be significant.”

Broadly we agree with the above statement. However, what is missing is clear context. Does it matter if the similar breaches occurred over 12-months, 6 months or a 3-month period?

Taking into account the applicable time period, how is materiality on the number of events to be determined? At what point, and over what period of time, will a minor breach constitute a reportable event?

Will three similar, minor breaches in a month constitute a reportable event? What if the root cause, had been identified, immediately fixed and any affected clients contacted, and the clients have not suffered a loss?

How is materiality or an applicable threshold determined?

An example is provided in Table 5: Example 4(a). This example considers an ‘isolated instance’ of non-compliance. This is suggestive of a singular event and provides no additional context on what frequency results in a breach.



The example goes on to state that *“if you identify multiple breaches of the same nature, or issues surrounding the contravention that suggest that there are deficiencies in your compliance systems, you may be required to report the breach to ASIC.” [Emphasis added]*

Considering that the nature of the breaches here would be considered in isolation to be minor, what number starts to be indicative of a systemic problem or failure to comply?

How will ASIC assess these types of scenarios? What guidance or decision tools can you provide to licensees to ensure that their processes align with your expectations and comply with the law? What if the cause is identified, immediately rectified and no clients have suffered any loss or detriment?

Without more detailed explanations and examples, there are concerns that there will be excessive reporting of minor matters due to the lack of clarity. Over reporting of minor and trifling matters will cause a drain on ASIC resources. This also raises concerns on the costs to administer and impact that will ultimately have on advisers via the annual levy.

B4Q4 Should we include further guidance on reporting an ‘investigation’ to ASIC? If so, what should be clarified? Please provide examples of scenarios (where relevant).

Information on when an investigation must be commenced (refer to RG78.56 – 57) should appear with its own section header and before “When is an investigation a reportable situation?”

Presently, references are to legislation which in turn further references legislation. More detailed discussion and commentary is need, with explanations in addition to the legislative references provided.

Specific examples are needed on when “you must commence an investigation”.

Clearer representation of when an investigation is a reportable event is needed. A roadmap setting out the requisite steps using a decision tree or flow diagram would add value to the information and commentary provided here.

The combined use of charts and diagrams enhance the engagement with and understanding of technical information and commentary.

B4Q5 Should we include further guidance on what constitutes ‘material loss or damage’? If so, what are the challenges licensees face in determining whether loss or damage is material? Please provide examples of how you consider questions of material loss or damage.

Given the nature of the questions asked, ASIC is seeking to be informed from licensees how they will address the assessment of ‘material loss or damages’ in practice. It may have been prudent to run industry engagement events such as round tables with licensees and their compliance officers, to garner such intelligence prior to the drafting of the proposed regulatory guide.

This form of consultation would have informed ASIC and enabled a more practical guidance document to be issued, taking into account licensees’ interpretations, current practices along with ASIC’s interpretations.



The expectation from users of regulatory guides is that it will inform and provide insights on ASICs interpretation and application of the legislation. We do however acknowledge that the concept of materiality is a subjective one and can be assessed several different ways.

How is materiality to be applied in the case involving an individual client? Does ASIC intend for a loss to be deemed to be material on consideration of:

1. An individual's total personal wealth?
2. Total of the individual's funds under management with an adviser?
3. The areas of advice addressed in the adviser – client relationship?
4. The quantum of loss and the value of that product or investment subject to a loss?

Examining each of the various options above, is the loss deemed material if on assessment, at least one of those metrics results in a materiality threshold being exceeded?

One of the examples provided in Table 2 - example 2(a): "*Material loss or damage to consumer credit insurance clients*" - is suggestive of such a detailed analysis and scenario overview. However, this scenario is also one where multiple clients are affected, and the financial impact is considered in aggregate.

Is an individual's loss material if it is equal to or more than a threshold amount of say 5% or \$100,000, whichever is the greater? Whether in isolation or in aggregate?

The guidance document needs to precisely set out the types of steps that licensees are expected to work through in assessing materiality.

Some examples on 'material loss or damage' are included in the draft guide. However, these do not provide sufficient detail or insights on how a material loss or damages are to be assessed for materiality.

Overall, the examples are not contextual or specific enough to provide the level of guidance needed. They appear to cover corporate style scenarios and do not provide any context on how in a non-corporate environment or on an individual client basis a material loss or damages are assessed.

No guidance is included that considers the assessment of an individual client's scenario. Examples could include where inappropriate financial advice is given, and/or an investment product that is unsuitable to the client is recommended and a loss is suffered because of that advice.

Some fully worked examples are needed:

1. Setting out the scenario and issues at play;
2. Including figures and data relevant to the matter
3. How the licensee assesses whether the losses are material
 - a. Do they take several different approaches to ensure a correct assessment is made?
 - b. What do these look like?
 - c. How and why is the assessment ultimately deemed to be material?



Examples of this nature are not expected to cover every scenario but can provide insight to the procedures and processes that need to be followed, ensuring that each matter is appropriately assessed and considered, taking into account the specific facts and circumstances at play.

Without more specific guidance, the risk for ASIC will be the adoption of conservative policies and processes by licensees, driven by fear due to the uncertainty on how ASIC will assess the same set of facts and circumstances.

B4Q6 Should we include further guidance on reportable situations involving serious fraud or gross negligence? If so, what are the challenges licensees face in identifying when serious fraud or gross negligence has occurred?

This is another question that we think would have benefited from being discussed with licensees in ASIC roundtable engagement prior to the preparation and issue of this draft regulatory guide.

A definition of gross negligence is not included in the legislation. Further, the draft guide does not incorporate clear guidance here on what constitutes gross negligence. This should be clearly defined, illustrating the distinction that needs to be made between negligence and gross negligence. What quantum or degree determines gross negligence? Examples will also be important in providing context and clarity.

It would be beneficial to insert the commentary from the Explanatory Memorandum, paragraphs 11.52, 11.53, 11.163 and 11.164 which also incorporates the legislated definition of serious fraud. This will start to build a better resource for this section.

B4Q7 Should we include further guidance on reportable situations about other licensees? If so, please provide details.

Paragraph RG 78.66 points out that civil penalties can apply where a licensee fails to lodge a report with ASIC or provide a copy to the other licensee. It however goes on to say that if there are *“reasonable grounds to believe that ASIC is aware of the reportable situation and all of the information that is required in a report, you do not need to lodge a report.”*

Although this reporting concession is legislated, it is difficult to see where a licensee will be able to practically satisfy this exemption without sighting a copy of the report lodged with ASIC by the other licensee.

If there are other methods or processes by which a licensee can meet this standard, ASIC should provide further details on how that can be met.

B5 We propose to include guidance in draft RG 78 about the obligation for licensees to report to ASIC within 30 days after they first know that, or are reckless with respect to whether, there are reasonable grounds to believe a reportable situation has arisen: see draft RG 78.68–RG 78.81.

B5Q1 Should we include further guidance to help licensees understand when to report to ASIC? If so, please provide details, including what guidance would be helpful and why.



As stated in previous sections, consider the inclusion of decision trees or flow diagrams to clearly set out the process and applicable pathways in addition to the commentary provided.

B5Q2 Should we include further guidance on what may amount to ‘knowledge’, ‘recklessness’ and ‘reasonable grounds’? If so, please explain what specific guidance would be helpful and why.

A satisfactory explanation of ‘reasonable grounds’ is provided, utilising a partial extract from the explanatory memorandum, and supported by a practical and clearly worked example.

Reference is made to the terms ‘knowledge’ and ‘recklessness’ and to the source location of their definitions in sections 5.3 and 5.4 respectively, of the Schedule to the *Criminal Code Act 1995*. Whilst aspects of these definitions appear partially in the extract taken from the Executive Summary at RG 78.71, it would be beneficial to include these legislated definitions in full in the regulatory guide.

C1 We propose to provide guidance for AFS licensees who are financial advisers and credit licensees who are mortgage brokers. The new obligations require these licensees to notify, investigate and remediate affected clients in certain circumstances. We have set out our proposed guidance in an information sheet: see draft INFO 000 in Attachment 2 to this paper.

C1Q1 Do you agree with our proposed approach? If not, why not?

C1Q2 Should the guidance we provide on the new obligations be provided in the form of a separate information sheet, or be incorporated into RG 256? Please provide details.

The information included in the draft information sheet should be incorporated into an updated RG 256. This is consistent with the objectives of that regulatory guide and the current processes contained therein. The outgoing breach reporting process is contemplated within the current version of RG 256. It is logical to therefore review and update RG 256.

C2 We propose to give high-level guidance to AFS licensees and credit licensees about the types of information we consider should be included in the notices that must be given to affected clients: see in Actions 1 and 3 of draft INFO 000 in Attachment 2 to this paper.

C2Q1 Do you agree with our proposed approach? If not, why not?

C2Q2 Should the form of the notices referred to in Actions 1 and 3 of the information sheet be approved by ASIC? If so, what information, or types of information, should be mandatory, and what should be left to the discretion of the licensee?

There should not be a requirement for ASIC to approve the individual form of notices used. Rather, the ASIC guidance should clearly set out the essential components that must be incorporated as a minimum standard, such as that incorporated into the draft information sheet.



If you have any questions about our submission, please do not hesitate to contact us, and we thank you again for the opportunity to provide this submission.

Yours sincerely,

A handwritten signature in black ink, appearing to be "Peter Burgess".

Peter Burgess
Deputy CEO/Director of Policy and Education
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing SMSF sector which is comprised of over 1.1 million SMSF members who have more than \$700 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.