SUBMISSION TO THE TREASURY

STRENGTHENING BREACH REPORTING

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This is a joint consumer submission from Consumer Credit Legal Service (WA), CHOICE, Consumer Action Law Centre and Financial Rights Legal Centre.

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INTRODUCTION

Landmark inquiries from the ASIC Enforcement Taskforce Review ('the Taskforce'), the Banking Royal Commission and ASIC investigations have all found that Australia's breach reporting system is broken and leads to widespread consumer harm.[1]

It's clear that financial institutions do not take breach reporting seriously. A recent ASIC investigation found that on average it took over five years from when a breach by a financial institution occured before the first remediation payments to customers happened.[2] It's clear that consumer protections and penalties need to be significantly bolstered.

There is a glaring weakness in the current system breach reporting system that allows large businesses to not report breaches that may be significant to consumers but are relatively minor when looking at the overall size of the business. In short, it allows commercial scale to hide consumer harm.

We strongly support proposed reforms to the breach reporting regime. We need an objective significance test, expansion of enforcement options, public data on breach reporting and the expansion of breach reporting requirements to include all Australian Credit Licence (ACL) holders.

However, there are a number of important areas that the Treasury need to strengthen to ensure that breach reporting adequately protects consumers:

- The breach reporting regime needs to be streamlined. From 1 April 2021, all breaches must be subject to the new breach reporting regime.
- The proposed s50D reporting obligations of the *National Consumer Credit Protection Act* 2009 ('the Credit Act') must be expanded to include all credit licensees. This will create a dangerous loophole that will allow other credit licensees to have no obligation to report on the activities of other credit licensees.

This submission also provides comment on the Treasury's proposed reform to create a Reference Checking and Information Sharing Protocol ('the Protocol)**.** This reform codifies Recommendation 2.7 of the Banking Royal Commission. This will be an important protection to prevent the frequent occurrence of 'rolling bad apples' in the financial services industry.

The submission finally comments on the Treasury's proposed obligation for Australian financial services licensees (AFSL) and Australian credit licence holders to be required, as a condition of

[1] ASIC Enforcement Review Taskforce 2017, https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2018, and ASIC Rep 594, Review of selected financial services groups' compliance with the breach reporting obligation

[2] ASIC Rep 594, Review of selected financial services group's compliance with the breach reporting obligation

their licence, to notify, investigate, and remediate misconduct. While we support the reforms, we remain sceptical that only with strong regulatory oversight and enforcement, institutions will be incentivised to conduct fair remediation processes.

These three important reforms will embed greater fairness and transparency in Australia's financial system.

Recommendations

1. That Treasury amend the draft legislation to state that any breach that is discovered after 1 April 2021 is subject to the new breach reporting obligations. This can be achieved by amending s1670A of the *Corporations Act* 2001 and Schedule 16 of *National Consumer Credit Protection Act* 2009

2. ASIC should be required to release all breach reports on a regular basis. If individual reports are not released, ASIC, at a minimum must release breach reporting data including by institution and a breakdown of the types of breaches by category.

3. That Treasury expand the proposed s50D reporting obligations under the *National Consumer Credit Protection Act* 2009 to capture all Australian Credit Licence (ACL) holders.

4. That Treasury expand Reference Checking and Information Sharing Protocol (Protocol) to include all Australian Credit Licensee holders. This can be achieved by amending obligations in s912A(3D) of the *Corporations Act* 2001 and s47(3C) of the *National Consumer Credit Protection Act* 2009 to explicitly capture all credit licensees.

5. That Treasury amend the law to clearly state a failure to provide consent to the Protocol must be grounds for an entity to not hire that individual.

6. That Treasury expand the the Reference Checking and Information Sharing Protocol to ten years.

7. That Treasury amend S51A and S51B of the *National Consumer Credit Protection Act* 2009 to explicitly state that all credit providers are subject to obligations to investigate, notify, and remediate misconduct.

8. That Treasury add a section to the exposure draft s912EB(1)(5)(c) of the *Corporations Act* 2001 and s51A(2)(d) of the *National Consumer Credit Protection Act* 2009 to state that licensees must:
"*clearly inform consumers of their rights to access external dispute resolution"*

1. Breach reporting requirements

A robust breach reporting regime is essential for the transparency and accountability of Australia's financial services sector. The Taskforce made a number of important recommendations that will improve the breach reporting system. It is welcome to see the Government acting on these recommendations.

Objective significance test

We strongly support the proposal for an objective significance test for breach reporting. The current significance test for breach reporting is too subjective. As the Taskforce found:

> "*This subjectivity has the result that, although all AFS licensees have an obligation to report, the differing scale, nature and complexity of their respective businesses and balance sheets can mean that larger organisations need to report fewer breaches or less often*"[3]

That is, a glaring weakness of the current system is that it allows large businesses to not report breaches that may be significant to consumers but are relatively minor when looking at the overall size of the business. In short, it allows commercial scale to hide consumer harm.

Businesses that have done wrong should not be allowed to judge whether their actions should be reported to the regulator. Businesses that have breached laws or regulations have strong incentives to hide that behaviour, especially when fines or infringement notices are likely. We strongly support the proposed introduction of an objective significance test.

Expanding ASIC's enforcement toolbox

We strongly support the proposal for a full range of penalties available for ASIC to prosecute companies who fail to breach report correctly. This codifies Recommendation 6 and 7 of the ASIC Enforcement Taskforce Review. The proposed expansion of enforcement options, including infringement notices, civil and criminal penalties will allow ASIC flexibility and adaptability to prosecute institutions and individuals who break the law.

[3] ASIC Enforcement Review Taskforce 2017, p.4
https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf

As the Taskforce identified, under the existing breach reporting regime, the only sanctions available for ASIC are criminal sanctions. The high burden of criminal conduct has resulted in one only prosecution since the current regime was introduced in 2003.[4]

Publishing data on breach reporting

We support the proposed requirements under s912DAD of the Corporations Act and s50E of the Credit Act for ASIC or APRA to publish data on breach reporting. This is essential in restoring consumer trust in the financial system. ASIC must release all breach reports. If financial institutions are truly serious about reforming their conduct after the scandals of the Royal Commission, then they will be supportive of this measure. The Australian Financial Complaints Authority (AFCA) now publishes the names of financial firms in determinations.

We recognise that in some circumstances, early release of data could have a negative impact on ongoing ASIC investigations. There is a case to establish a process to delay the release of reports based on ASIC's discretion, rather than to not release all reports.

However, if ASIC decides to not release individual reports, the regulator should require the release of aggregated data including data naming the institution and a breakdown of the types of breaches by category. This would add greater accountability to the banking system. It would also provide valuable information to consumers regarding the activities of financial firms and will also be an important source of data to public policy makers and consumer groups about non-compliance trends that will assist in better targeting proposals for reform.

Expanding breach reporting requirements to credit licensees

We strongly welcome the expansion of breach reporting requirements to credit licensees. This aligns with Recommendation 2 of the Taskforce. It is essential that credit licensees are captured by this legislation. The Royal Commission clearly revealed that credit providers have caused widespread consumer harm with the provision of harmful loans.

The current breach reporting requirements for credit licensees is insufficient and ad-hoc with credit licensees are only required to lodge an annual Compliance Certificate. We strongly support the Taskforce's conclusion that:

"*However, the Compliance Certificate regime is no substitute for the self-reporting obligations that AFS licensees are subject to because:*

- *The information in the certificate is high-level, generalised information;*
- *ASIC is not able to ascertain the veracity of credit licensee responses in certificates without undertaking surveillance or issuing notices to obtain additional information and*

[4] ASIC Enforcement Review Taskforce 2017, p.11
https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf

- *There is no obligation to provide ASIC with information about breaches in a timely way, as certificates are provided annually."*[5]

We strongly support the proposed expansion of breach reporting obligations for credit licensees. This will ensure that breaches committed by credit licence holders can be quickly and adequately dealt with.

Breach reporting obligations regime need to be streamlined

The breach reporting regime needs to be streamlined. Under the current proposal, any breach that occurs after 1 April 2021 will be subject to the new breach reporting regime. However, if a breach occurred before this date but is discovered after 1 April 2021, it will be subject to the previous, weaker beach reporting regime. This will create an unnecessary loophole. Breaches will slip through the cracks and not be reported by licensees.

The key to breach reporting should be how a financial firm acts when a breach is discovered not when the breach occurred.

This is particularly problematic for credit licensees. There is no legal obligations on credit licensees to report breaches after 1 April 2021, if the breach occurred before the date. As is evident from a number of ASIC investigations, it often takes institutions a number of years to discover breaches. This means that many breaches discovered by credit licence holders will be allowed to go unreported by this proposed regime.

The legislation needs to be amended to clearly state that after 1 April 2021, all breaches discovered are subject to the new breach reporting obligations.

Breach reports must be made within 30 working days

We support the proposal for breach reports to be lodged within 30 days with the proposed trigger that an entity must report to ASIC when they "first reasonably know that there are reasonable grounds to suspect a reportable situation has arisen"[6].

Under the existing regime, entities are allowed ten working days from when the entity subjectively determines a significant breach. This often has taken many months, or even years for firms to determine subjective significance. The clearer threshold of reasonable grounds to suspect a reportable situation is a more appropriate trigger point and will lead to more timely breach reporting.

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[5] ASIC Enforcement Review Taskforce 2017, p.7
https://treasury.gov.au/sites/default/files/2019-03/ASIC-Enforcement-Review-Report.pdf

[6] *Corporations Act 2001* S912DC(3) and *National Consumer Credit Protection Act* 2009 50(DC)

Any extension of this time frame would introduce unnecessary risk to the reporting system as it gives businesses time to destroy evidence or otherwise hide further misconduct. This is ultimately a question of what the financial services industry value. If the industry prioritises treating their customers fairly and reforming their conduct after the scandals of the Banking Royal Commission, then a 30 working day time frame is easily manageable.

Expanding s50D reporting obligations to all credit licence holders

We support the Treasury's proposed requirement for AFSL's to lodge a breach report in relation to suspected reportable situations observed in other licensees. Licensees regularly work closely with each other and are often aware of the misconduct of other entities.

However, we hold deep concerns that many credit licensees are carved-out in the current exposure draft. The S50D reporting obligations of the exposure draft only captures mortgage brokers and not other ACL holders. This contravenes the Taskforce's recommendation to introduce a streamlined self-reporting regime for *all* credit licensees.

It's unclear why there is a carve-out for most credit licence holders. This reporting obligation is especially suited to lenders and other forms of brokers who have to engage with each other in the provision of credit. For example, a lender works very closely with a car loan broker and is likely to observe potential misconduct. It is imperative all ACL holders are held to the same standards as mortgage brokers. This loophole must be closed. The reporting obligations of s50D of the Credit Act must apply to all credit licensees, not just mortgage brokers.

Recommendations 1 - 3

1. That Treasury amend the draft legislation to state that any breach that is discovered after 1 April 2021 is subject to the new breach reporting obligations. This can be achieved by amending s1670A of the *Corporations Act* 2001 and Schedule 16 of *National Consumer Credit Protection Act* 2009

2. ASIC should be required to release all breach reports on a regular basis. If individual reports are not released, ASIC, at a minimum must release of breach reporting data including by institution and a breakdown of the types of breaches by category.

3. That Treasury expand the proposed s50D reporting obligations under the *National Consumer Credit Protection Act* 2009 to capture all Australian Credit Licence (ACL) holders.

2. Reference checking and information sharing protocol

We are strongly supportive of the proposal to create Reference Checking and Information Sharing Protocol ('the Protocol'). This reform will be important in raising standards and ensuring that all individual firms are accountable for the conduct of the entire industry.

The financial advice industry fostered a harmful culture of "rolling bad apples", where individuals who were engaged in unscrupulous behaviour simply shopped around to a different licensee for employment.

The Royal Commission shone a spotlight on the failings of industry to adequately communicate between themselves about the improper conduct of advisers. It was revealed that Financial Planning Australia and the Association of Financial Advisers, which are Australia's two largest industry association groups, do not communicate with each other about disciplinary information.[7]

There is a conflict inherent to any industry with multiple industry associations. This occurs in both the financial advice and mortgage broking sectors. Any individual employee who gets reprimanded by an industry association can simply threaten to shop around to another association. This threat weakens the power of industry associations to self-regulate their members and leads to weak enforcement and oversight. Industry associations become less likely to share information with other associations for fear of losing the revenue of paying members. They simply turn a blind eye to misconduct for fear of losing revenue.

It is imperative that industry participants have legislated obligations to reference check and share information, as it's clear they are unable to share information freely.

The Treasury can strengthen the Protocol in the following ways:

Expanding obligations to all credit licence holders

The Treasury must ensure these obligations apply to all credit licensees.

The current drafting of the Protocol creates a glaring loophole where the obligations only apply to individuals who:

(a) provide credit assistance in relation to credit contracts secured by mortgages over residential property; and
(b) be a mortgage broker or a director, employee or agent of a mortgage broker.[8]

[7] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, FInal Report, 2019 p.218
[8] *Corporations Act 2001* S912A(3D) and *National Consumer Credit Protection Act* 2009 47(3C)

This means that all credit licensees with the exception of mortgage brokers will be exempt from the Protocol. This will contribute to a culture of 'rolling bad apples' across the credit sector, and will contribute to unscrupulous operators continuing to trade and taking advantage of people. The Treasury must expand obligations in s912A(3D) and 47(3C) to include all credit licensees.

A failure to provide consent

The proposed Protocol relies on the consent of an employee for their information to be shared with former or current employers. The draft legislation states that,

(3B) The Reference Checking and Information Sharing Protocol must not:

(a) *Require or permit personal information (within the meaning of the Privacy Act 1988) to be shared, other than with the consent of the individual to whom the information relates*[9]

This creates an inherent conflict. If an individual does not grant consent, then an entity cannot conduct reference checking and information sharing. Thus, we recommend that if an individual refuses consent, then there must be a presumption of misconduct or improper behaviour by the individual.

A business must not hire an employee who refuses this request. This needs to be codified in law. The law must clearly state that a failure of an individual to grant consent to share information pertaining to the Protocol must be grounds to not hire that individual.

The Protocol must be expanded to ten years

The Protocol must be extended to sharing information amongst industry participants for the past ten years, not five years. A five year time period is too short and will allow unscrupulous industry participants to return into the market.

Recommendation 4 - 6

4. That Treasury expand Reference Checking and Information Sharing Protocol to include all Australian Credit Licensee holders. This can be achieved by amending obligations in s912A(3D) of the *Corporations Act* 2001 and s47(3C) of the *National Consumer Credit Protection Act* 2009 to explicitly capture all credit licensees.
5. That Treasury amend the law to clearly state a failure to provide consent to the Protocol must be grounds for an entity to not hire that individual.

[9] *Corporations Act 2001* S912A(3B) and *National Consumer Credit Protection Act* 2009 47(3B)(a)

6. That Treasury expand the the Reference Checking and Information Sharing Protocol to ten years.

3. Investigating and remediating misconduct

We strongly support the introduction of this obligation that makes it a condition of AFSL and ACL licensee holders to notify, investigate, and remediate misconduct.

The industry has a terrible track record of identifying misconduct and remediating clients. We remain deeply sceptical that the industry is capable of remediating customers without strong oversight and enforcement from ASIC. The incentive exists that the less a firm offers in remediation to customers, the greater the profit they stand to make.

The Royal Commission highlighted that many financial services licensees argued to ASIC that remediation procedures should be "opt-in", rather than compulsory.[10] Former ASIC Commission Peter Kell testified that,

> *"We had discussions with some firms who wanted to suggest that a remediation program where consumers had to actively opt in to get remediation was appropriate."*[11]

This shows that licensees were more interested in profit than righting the wrongs they had done to all customers.The shocking fees for no service scandal is a clear example of how an industry's reticence to remediate leads to long delays in refunds to customers. We remain deeply sceptical that without strong regulatory oversight and enforcement, that industry will significantly reform the quality of the remediation programs. We strongly support the introduction of civil and criminal penalties for a failure to comply with the obligation to notify, investigate, and remediate misconduct.

The Treasury's proposal can be strengthened in the two following ways:

Obligations must apply to all credit licence holders

We are deeply concerned that these obligations apply only to mortgage brokers and carves out other ACL holders. This means that banks, and other credit providers will have no obligations to investigate, notify and remediate misconduct. There is no justification why banks should be exempt from these important consumer protections.

[10] Mike Taylor, 2018, 'Licensees wanted remediation 'opt-in' says ASIC', April 17, Money Management, available at https://www.moneymanagement.com.au/news/financial-planning/licensees-wanted-remediation-%E2%80%98opt-%E2%80%99-says-asic

[11] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2018, transcript, P-1034

S51A and S51B of the Credit Act must be amended to explicitly state that all credit providers are subject to obligations to investigate, notify, and remediate misconduct.

Affected individuals must be notified of their right to go to EDR

The Treasury must amend the legislation so that people are clearly notified of their rights to access external dispute resolution. While it is important that remediation processes conducted by firms are significantly improved, this reform should not restrict or hinder an individual's ability to have their case heard at the Australian Financial Complaints Authority. Firms may be incentivised to promote their own remediation programs and obfuscate the rights of individuals to dispute the remediation at AFCA

Affected customers must be explicitly notified of their right to go to the external dispute resolution. This can be amended by adding an additional clause in s912EB(1)(5)(c) of the Corporations Act and s51A(2)(d) of the Credit Act:

The financial services licensee must take reasonable steps to notify the affected client of the outcome of the investigation:

(a) in writing; and
(b) if ASIC has approved the form in which the notice must be given - in the approved form;
(c) within 10 days after the completion of the investigation; and
(d) clearly inform consumers of their rights to access external dispute resolution.

Recommendations 7 - 8

7. That Treasury amend S51A and S51B of the *National Consumer Credit Protection Act* 2009 to explicitly state that all credit providers are subject to obligations to investigate, notify, and remediate misconduct.
8. That Treasury add a section to the exposure draft s912EB(1)(5)(c) of the *Corporations Act* 2001 and s51A(2)(d) of the *National Consumer Credit Protection Act* 2009 to state that licensees must:
   "clearly inform consumers of their rights to access external dispute resolution"