AFIA

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10 July 2020

Mr. Ashley George
Financial Systems Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Ashley.George@TREASURY.gov.au

Dear Mr. George.

***Strengthening Breach Reporting*- Proposed Amendments to Exposure Draft Legislation**

The Australian Finance Industry Association (AFIA) appreciates the opportunity to respond to Treasury's targeted stakeholder consultation and the chance to discuss first-hand on 2 July, some of your proposed changes.

AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia including retail banks, finance companies and fintechs, which provide innovative consumer products and specialised finance to meet small to medium enterprises (SMEs) working capital, cashflow and investment needs. For more information about AFIA, please see Attachment A.

AFIA's role as an industry body is to drive industry leadership and represent members' views, facilitate self -regulation through industry codes, and to work with the Federal Government, financial regulators, and other stakeholders to promote a supportive environment for the financial services industry.

OUR SUBMISSION

We note that while members have contributed to our submission, the position being put by AFIA may not reflect a particular member's organisationally-specific position on all of the issues. These will get captured through a submission from that organisation.

In principle, we support Treasury's amendments to the *Strengthening Breach Reporting* exposure draft legislation. It will be very important to ensure implementation of this legislation is done in a manner that does not negatively impact on the broader economy, limit access to credit, or reduce innovation and competition.

We commend and thank Treasury for listening and adapting its response to our initial and industry's broader feedback, and its engagement with key stakeholders on the proposed legislation. However, we are concerned that in the event the breach reporting regime is extended to credit licensees in the proposed form, especially to parts of the industry and emerging sectors (even before taking into account the impact of COVID-19) where significant risks have not been evidenced to justify additional regulation,

it will be detrimental to growth, competition, innovation, and create further barriers of entry to the market.

KEY RECOMMENDATIONS

In principle, we support the approach Treasury has taken in regard to the

- Changes which have been made to the 'significance test';
- Change to only require investigations that have been ongoing for more than 30 days to be reported to ASIC; and
- Simplifications to the obligation to report (in sections 912DAB and 50C).

However, due to Treasury's required response time to these changes, we have been unable to further develop and explore in more detail the key proposals and potential solutions with our members. As a result, we would welcome the opportunity to further discuss our recommendations with Treasury, and work with our members to provide a further, potentially more fulsome, response.

Attachment B provides a full summary of all our recommendations with the key ones highlighted below.

Key Recommendation 1 – Proposed breach recording needs to include wording to exclude retrospective obligations being implemented

We understand that Treasury proposes to change the recording of a breach to when the licensee became aware of the breach, rather than when the breach occurred, and this will determine under which regime they will have to report . For example, if an entity becomes aware of a breach after commencement of the new regime, then it will report the breach under the new regime.

The challenge by allowing this is that it has inadvertently created a retrospective obligation to report breaches where there is no existing breach reporting legislation. For example, if a client was provided their FSG one day late when signing up to be a customer of an ACL holder in July 2020, but the organisation did not become aware of this breach until the new regime commenced, it may have to report this breach, even though there is no current obligation to report to ASIC of such a breach.

We believe that this may not have been the purpose that Treasury was intending when re-drafting this provision, so we recommend that Treasury include wording to exclude retrospective obligations being implemented. If left unamended, providing for such obligations would introduce unnecessary, unreasonable and disproportionate regulatory and compliance burdens as opposed to any benefit that ASIC would gain from receiving such data.

Key Recommendation 2- What is 'not an investigation' needs to be better defined

We understand from our conversations with Treasury, on 2 July 2020, that the drafting was purposefully kept broad. However, to ensure consistency and clarity, we recommend that Treasury provides a non-exhaustive list of factors describing what is not an "investigation" and thereby keeping the definition relatively broad. Due to time constraints, we are unable to provide a comprehensive list of factors at this stage, but upon request, are happy to work with members to provide a list of factors.

Key Recommendation 3 – Inclusion of a materiality threshold will be important to ensure greater consistency across the financial services community

As currently drafted, there is a concern that failure to provider further guidance as to the 'material threshold' will cause inconsistency and leave licensees likely to inadvertently breach the legislation.

We therefore recommend the inclusion of a materiality threshold and for this to be percentage based, focusing on the overall investment amount (i.e. loss against asset/investment amount), of the client's positions at the time of origination, rather than a set dollar amount.

In addition, the definition of material should be determined by each organisation's individual risk appetite statement, which will allow for a tailored and more flexible approach to be adopted. This in turn will cascade through the organisation and allow for closer alignment.

Key Recommendation 4- Civil penalty provisions deemed significant should be subject to a materiality test

In our conversations with Treasury, we discussed that Treasury would look to exclude certain civil penalty provisions under section 50A4(b), to provide for situations where the outcome of the breach is not likely to amount to consumer detriment (for example, a customer being provided their FSG one day late). We understand that Treasury will be separately consulting with industry on the provisions to be specifically excluded.

We support this approach and recommend that as part of this discussion, breaches of civil penalty provisions deemed significant should be subject to a materiality test, which is a combination of a de-minimis threshold along with specific excluded provisions to ensure that the provisions included are ones likely to amount to a material loss and/or significant consumer detriment. We suggest that the de-minimis threshold should be a civil penalty of 50 penalty units or less, and these provisions should not be deemed significant and excluded from 50A(4)(b). We suggest that the specifically excluded provisions are defined by ASIC in the relevant regulatory guidance, rather than in the legislation, so that the provisions can be dynamically amended to reflect the current environment.

It is important that only the civil penalty provisions which are likely to cause significant consumer detriment are included. Failure to do so will be unduly burdensome for licensees and will have the industry focused on complying with reporting obligations, rather than focusing on the actual breach and assessing the detriment and harm to the customer. Further, it would encourage a 'tick-a-box' mentality and culture that Commissioner Hayne recommended moving from as one of the factors leading to poor customer outcomes.

As before, because of the short timeframe requested for a response, we have been unable to, at this stage, provide all the exact provisions to be excluded but would be willing to work with members to provide Treasury with a comprehensive list at a subsequent time.

Key Recommendation 5- Obligation to report on another licensee should be limited to only instances of fraud/breaches pertaining to fraudulent and misleading conduct.

We note that an obligation to report on another licensee was not a recommendation in the Royal Commission Final Report.

Whilst we do not support the general introduction of the extension of the reporting obligations of one licensee to another licensee, we understand the importance of including such a provision if it was limited to instances of fraud/breaches pertaining to fraudulent and misleading conduct.

By limiting the scope as proposed, it will take into account the newly implemented Whistleblower Regime and reduce unnecessary compliance complexities and costs. We also recommend that Treasury amend the wording so that reporting to ASIC would only occur for investigations where a breach was found to have occurred. If this additional point is not included, we believe it could cause undue reputational harm under ASIC's publications of breach reports, and is likely to increase barriers to entry for new competitors.

CONCLUDING COMMENTS

By adopting our recommendations, we believe that policy settings would be more appropriately balanced and may not unnecessarily impose practices that are unduly burdensome on business, so we continue to:

- Promote simple, convenient, innovative, and affordable credit to finance Australia's future, including maximising access to credit for customers able and willing to service their commitments and minimising the likelihood or incidence of customers entering unsuitable credit contracts
- Foster competition and innovation in Australia's financial services industry, which enables our members to grow, expand and thrive as key participants in the lending market and other markets, and
- Generate greater financial and economic participation by consumers and small businesses in Australia's financial system and economy, and social participation to create financial wellbeing

This is even more important in a post COVID-19 environment where the focus needs to be on accelerating job creation and growth opportunities so as to fast track the broader economy.

We would appreciate the opportunity to discuss our recommendations and provide further feedback in a meeting with Treasury. Should you wish to discuss our submission or require additional information, please contact me or Chalisa Parekowhai, Associate Director, Policy at chalisa@afia.asn.au or 02 9231 5877.

Yours sincerely,

Karl Turner
Chief Operating Officer

ANNEXURE A: AFIA BACKGROUND

The Australian Finance Industry Association (AFIA) is the voice of a diverse Australian finance sector. AFIA represents over 100 providers of consumer, commercial and wholesale finance in Australia which includes:

- major, regional and mutual/community owned banks
- providers of consumer finance, including home loans, personal loans, consumer leases, credit cards, buy now pay later services, and debt purchasers
- providers of land finance, including residential and commercial mortgages and bridging finance;
- equipment financers, including commercial equipment financing ranging from agri-equipment to small ticket equipment financing
- motor vehicle financiers, including consumer motor finance, novated motor finance, small business motor finance and heavy vehicle finance
- fleet leasing and car rental providers, and
- providers of commercial finance, including secured and unsecured loans and working capital finance to businesses, including small businesses.

AFIA's members range from ASX-listed public companies through to small businesses providing finance, which operate via a range of distribution channels, including through 'bricks and mortar' premises (physical branches and other outlets), via intermediaries (including finance brokers, dealerships, retail suppliers), and through online access or platforms (traditional financial institutions and fintechs).

AFIA's members collectively operate across all states and territories in Australia and provide finance to customers of all demographics from high to low-income earners and to commercial entities ranging from sole traders, partnerships and across the corporate sector in Australia.

AFIA's members provide a broad range of products and services across consumer and commercial finance, a snapshot of these include:

- consumer: home loans, personal unsecured loans, revolving products (including credit cards and interest free products coupled with lines of credit), personal secured loans (secured by land or personal property); consumer leases of household assets (including household goods, electrical/IT devices or cars) and buy-now, pay later services;

- commercial: land, asset or equipment finance (finance/operating lease, secured loan or hire-purchase agreement or novated leases); business finance and working capital solutions (secured loans, online unsecured loans; debtor and invoice finance; insurance premium funding; trade finance; overdrafts; commercial credit cards), together with more sophisticated and complex finance solutions.

For further information about AFIA, please see here.

ANNEXURE B: SUMMARY OF RECOMMENDATIONS

Section	Comments	Recommendations
Section 50A(1)(a) Reportable situations	It would be helpful if Treasury could give clarity as to what makes a breach "significant".	• We recommend Treasury adopts the approach that ASIC took in its ASIC Enforcement Review Taskforce Report – Recommendation 1 in relation to the "significance test"
Section 50A(1)(b) Reportable situations	It would be helpful if Treasury could give clarity on the reason for changing "likely" to "no longer able" and the scenarios it intends the change to capture.	• We recommend Treasury adopts the approach that ASIC took in its ASIC Enforcement Review Taskforce Report – Recommendation 1 in relation to the "significance test"
Sections 50A(1)(c) and (d) Investigations	The term investigations could be read broadly and cover a wide range of investigative actions taken by a licensee (for example, it could cover the compliance department asking an employee a question on a particular matter to a formal file being opened on a matter). We understand from our conversations with Treasury that the drafting was purposefully kept broad, however, to ensure consistency and clarity, further guidance should be provided.	• We recommend that Treasury provides a non-exhaustive list of factors describing what is not an "investigation" and thereby keeping the definition relatively broad.
Section 50A(2)(b) Reporting for serious fraud	It would be helpful if Treasury (or ASIC) provided guidance on what might be considered a reasonable level of proof required in respect of the licensee or representative before a reporting requirement is triggered. This would be helpful for situations where it is not clear whether the broker, the customer or someone else has falsified the documentation.	• We recommend that Treasury provides clarity as to what differentiates serious fraud from regular fraud or one-off cases.
Section 50A(4)(b)	Breaches of civil penalty provisions which are deemed significant should be subject to a materiality test. This is even more relevant	• We recommend that materiality threshold to be a combination of a de-minimis threshold along with specific excluded provisions. This will ensure that the

Civil penalties	given the wording expands s50A(4)(b) to cover breaches of any laws with a civil penalty provision. In our conversations with Treasury, we discussed that Treasury would look to exclude certain civil penalty provisions 50A4(b), to provide for situations where the outcome of the breach is not likely to amount to consumer detriment (for example, a customer being provided their FSG one day late). We support this approach and understand that Treasury will be consulting with industry on the provisions to be specifically excluded.	provisions included are ones likely to amount to a material loss and/or significant consumer detriment. • We recommend that provisions which attract a civil penalty of 50 penalty units or less should not be deemed significant and excluded from 50A(4)(b). • Further, we recommend that additional provisions are specifically excluded. For example, a non-material breach of an enforceable code provision would not cause detriment to a consumer, however under the current Exposure Draft, each offence would be classed as a significant breach and need to be reported. • AFIA is willing to work with our members and provide to Treasury a list of the provisions that are likely to not amount to significant consumer detriment and should be specifically excluded. We suggest that the specifically excluded provisions are defined by ASIC in the relevant regulatory guidance, rather than in the legislation, so that the provisions can be dynamically amended to reflect the current environment.
Section 50A(4)(d) Materiality threshold	We support the inclusion of a materiality threshold and for the materiality threshold to be percentage based, focusing on the of the overall investment (i.e. loss against asset/investment amount), taking into perspective the client' positions at the time of origination, rather than a set dollar amount. However, there is concern that failure to provider further guidance as to the 'material threshold' will cause inconsistency and leave licensees likely to inadvertently breach the legislation.	• We therefore recommend the inclusion of a materiality threshold and for this to be percentage based, focusing on the overall investment amount (i.e. loss against asset/investment amount), of the client's positions at the time of origination, rather than a set dollar amount. • In addition, the definition of material should be determined by each organisation's individual risk appetite statement, which will allow for a tailored and more flexible approach to be adopted. This in turn will cascade through the organisation and allow for closer alignment.
Section 50C(4) Period within which report must be lodged	The insertion of the words "or is reckless in respect to whether" may create ambiguity on licensee actions and what those words are intended to capture. Further the current wording proposes that for past breaches that have occurred which not currently reportable, nor regarded as a significant breach, may be a significant	• We recommend that further guidance is provided by Treasury and/or ASIC as to what those words are intended to capture. • In particular, further guidance and examples should be provided for the consideration of earlier historical information relating to a breach. • We strongly recommend that Treasury include wording to exclude retrospective obligations being implemented.

	breach and reportable to ASIC under the new regime, causing unnecessary compliance burdens and costs.	Only reportable breaches that have occurred in the new regime should be in scope when determining materiality/significance.
Section50C(1) Reporting obligations	This should be a subjective test and based on the licensee's assessment of reasonable grounds rather than the proposed approach which may be apparent to one party may not be to another party.	• We recommend amending section 50C(1) to state "*If the licensee has reasonable grounds to believe that a reportable situation has arisen in relation to the licensee*". • This is consistent with the drafting in s50C(4.)
Section 50C(4) Reporting a reportable situation to ASIC	It would be helpful if Treasury (or ASIC) could provide some clarity as to what constitutes when a reporting licensee "knows that, or is reckless with respect to whether, there are reasonable grounds to believe that the reportable situation has arisen".	• We recommend that Treasury and/or ASIC provide examples as to situations where a licensee first knows that, or is reckless with respect to whether, there are reasonable grounds to believe that a reportable situation has arisen
Section50D(1) Reporting obligations	This is based on the licensee's assessment of reasonable grounds rather than the proposed approach which may be apparent to one party may not be to another party.	• We recommend that a subjective approach is provided for, with ASIC providing further guidance on the matter. • We propose amending s50D(1) to: "*A licensee (the reporting licensee) must lodge a report with ASIC in accordance with this section if the licensee has reasonable grounds to believe that*". This is consistent with the drafting in s50D(3).
Section 50D(3) Period for lodging report	It is unclear as to what constitutes when a reporting licensee "knows of or is reckless with respect to the circumstances…" and further clarity should be provided to ensure consistency.	• We recommend that Treasury and/or ASIC provides examples as to these time frames and how they interplay with section50A(2)(b).
Section 50D Application to commercial lending and wholesale clients	Specifically, it is unclear whether the proposed wording applies to commercial lending. The unstated intent of the amendments to the NCCP Act appears to be that the provisions target consumer lending, given that the substantive provisions of the NCCP Act are directed at consumer credit provided to retail clients.	• We recommend that clarification is provided in section 50D specifically stating that it will not apply in relation to commercial loans for mortgage brokers that are also providing credit assistance i.e. will apply to in relation to consumer loan portfolio only. • We recommend that clarification is provided stating that these amendments do not apply in relation to commercial lending, nor wholesale clients.