FSR Wrap

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July 2020 Edition

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Welcome to the July 2020 edition of

FSR Wrap

The start of a new financial year in the middle of a pandemic seems like the perfect time to launch a new financial services regulatory update publication – welcome to FSR Wrap. Gadens has extensive knowledge and expertise across the financial services sector. We work closely with a range of financial services clients from Big 4 banks to insurers and super funds covering all manner of financial regulatory issues, as well as with financial services regulators. 2020 has already been a busy and exciting year for Gadens' FSR practice and in some ways, it feels it is only just getting started.

This edition of FSR Wrap focuses on the forced changes to an already changing regulatory landscape. In the wake of the Financial Services Royal Commission the sector was preparing for significant change; coronavirus has derailed some changes, fast tracked others and brought about some new, unexpected and (dare I say) unprecedented developments.

Few would have predicted at the start of 2020 that continuous disclosure obligations would be relaxed but we have seen exactly that (although as Glenn McGowan QC and co explain, a free pass should not be assumed). Similarly, insurers would hardly have thought that they would be rushing through the vulnerability and financial hardship aspects of their new code, while delaying aspects of the code like claims investigation standards.

Perhaps less surprising to those who followed the Royal Commission are complicated and onerous breach reporting requirements that are currently working their way through parliament, which is Liam Hennessy's focus in this edition.

In non-COVID related developments, the financial industry welcomed a new dawn around the transparent and efficient sharing of consumer data with the big 4 banks being subject to the new Consumer Data Right regime as of 1 July. Dudley Kneller takes us through how other organisations can take advantage of this by becoming an Accredited Data Recipient.

There is, even more than usual in financial services, a pressing need to stay on top of changing regulatory requirements with expected Royal Commission and regulatory reforms being delayed to varying degrees. We have tried to capture these here in the interest of starting out the new financial year with a focus on what will happen, when.

Please get in touch if you have any feedback or if you would like any further information on any issues discussed in this edition, or to tell us what you might like covered in future editions.

Edward Martin
Editor

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Briefing – changes to breach reporting

Liam Hennessy (Director) and Jasmia Bavaresco (Lawyer)

Background

In February 2020, the Government released draft legislation (set to be introduced into parliament later this year and to come into effect on 1 April 2021) that aims to implement certain recommendations of the Royal Commission, in relation to breach reporting and remediation.

The new regime is complicated and onerous. It should be a paramount consideration for Australian financial licensees (**AFS**) and Australian credit (**AC**) licensees aligning and preparing their breach reporting processes and systems with the new legislation prior to its implementation.

Summary of amendments to the Law

The proposed key variations to legislation, which impose increased obligations on AFS licensees and AC licensees (a new development, for the latter) in respect of their breach reporting and client remediation responsibilities, are covered below.

These changes will dramatically increase the reporting burden on financial services entities. One of our industry peers expects industry participants to unload the equivalent of a dump truck's worth of breach reports on ASIC each day under the new laws. He was probably exaggerating for effect, though perhaps not by as much as people may think…

New thresholds

As under current legislation, AFS licensees must report to ASIC significant and likely breaches of financial services laws, e.g. the duty to act 'efficiently, honestly and fairly' or have 'adequately trained' representatives under s 912A of the *Corporations Act 2001* (Cth) (**CA**), however, in addition to this, they will soon need to report any investigations into whether a significant breach has occurred.

That is going to increase the number of reporting incidents right from the start. Often-times it is usual to have a months-long investigation into whether a significant breach has indeed occurred and, if so, then report that fact at the end of the internal investigation. Accordingly, ASIC is going to have eyes on the process much earlier.

Matters that may need to be reported to ASIC are now to be referred to as 'reportable situations' and split between 'core' and 'non-core' reportable situations. A core reportable situation will arise where the licensee or its representative has breached or is likely to breach a 'core obligation' or the licensee has commenced an investigation into whether the licensee or its representative has breached a core obligation and, in either case, the breach or likely breach is 'significant'.

The primary 'core' reportable situation is where there has been a breach of the general conduct obligations on licensees under section 912A of the CA (as noted above).

A breach of a core obligation is taken to be 'significant breach' and thus reportable when:

1. the breach is punishable on conviction by a penalty that may include imprisonment for a maximum period of:
   a. if the offence involves dishonesty — 3 months or more; or
   b. in any case — 12 months or more;
2. the breach constitutes a contravention of a civil penalty provision; or
3. the breach results or is likely to result in loss or damage to clients, or in the case of a managed investment scheme, members of the scheme.

Otherwise, the normal subjective test applies to whether a breach is a 'significant breach' and thus reportable. The factors relevant to that determination include the number or frequency of similar previous breaches and the impact of the breach among other things.

Additional reportable criteria not linked to the significance test have also been included to determine whether a breach or likely breach is significant, such as when the breach involves conduct constituting gross negligence or serious fraud.

The new laws extend the obligations for AFS licensees to report reportable situations about *external* financial advisers to ASIC and the relevant licensee responsible for the financial adviser. This amendment is aimed at addressing misconduct and compliance concerns within the financial advisory industry by incorporating a positive obligation on others in the industry to report identified misconduct. This strikes us as more US-style regulatory drafting i.e. incentivise the industry to help the regulators to do their job (which has its drawbacks, to be sure). Perhaps the most famous US example is allowing whistle-blowers whose actions result in the Government recovering money to keep a portion of those funds.

Taken together, these changes will indeed increase the general complication surrounding and most likely incidence of breach reporting. Perhaps the greatest factor is the prescriptive nature of what now constitutes a 'significant breach' of core obligations – civil penalty provisions abound in the CA and *National Consumer Credit Code 2009* (Cth) (**NCCP**). As but one example, it is a civil penalty provision under s 12 of the NCCP not to provide a credit guide, a relatively generic home loan document, to a customer when providing credit activities. Would that omission, on just one home loan, technically trigger a reportable event?

ACLs are now included

AC licensees will be subject to a breach reporting regime that is comparable to the new regime for AFS licensees, and must report serious compliance concerns about mortgage brokers to ASIC and the relevant licensee. This mirrors the above-mentioned obligations apropos separate financial advisers.

That is a massive development. As at June 2020, there are about 6,168 AFS licensees. There are about 4,950 AC licensees. So immediately, the number of entities who are under an obligation to identify and report significant breaches to ASIC has dramatically increased. That dump truck may be needed after all...

Other notable amendments

Such reportable situations must be reported to ASIC (in the form prescribed and approved by ASIC) within 30 calendar days after the AFS licensee reasonably knows the matter has arisen. Outcomes of any investigation into a breach must be reported within 10 calendar days.

AFS licensees and AC licensees commit an offence (with a maximum penalty of 2 years) if:

1. an AFS licensees and AC licensees does not lodge a report with ASIC within 30 calendar days after developing reasonable grounds to suspect that a reportable situation has arisen about another licensee;
2. a report that is required to be lodged with ASIC is not lodged in writing in the prescribed form; or
3. a reporting AFS licensee or AC licensee does not provide a copy of the report to the other licensee within 30 calendar days after developing reasonable grounds to suspect that a reportable situation has arisen about the other AFS licensee or AC licensee.

Financial penalties for contravention of civil penalty provisions can also be imposed on non-complying AFS licensees and AC licensees.

The new legislation also places a duty on ASIC to publish the data in relation to the reports it receives from financial services licensees. The publication must contain information about the AFS licensees and AC licensees that have lodged reports about their own significant breaches and likely breaches of core obligations. Those reports should make for fascinating reading.

Remediation with clients

In addition to the above matters, the new laws mandate that AFS licensees and AC licensees must:

1. notify clients of suspected misconduct;
2. conduct investigations into suspected misconduct; and
3. remediate affected clients.

Non-compliance with these obligations is also subject to civil and criminal penalties. There is also an obligation on AFS licensees and AC licensees to maintain records of compliance with the new remediation responsibilities to notify, investigate and remediate misconduct.

Implications and considerations

The new regime will cause an increase in the number of incidents that are reported to ASIC, as the amendments cast a considerably wider net in respect of what is reportable.

Due to the complications brought about by COVID-19, the draft legislation introduction to parliament has been delayed until after 11 August 2020, notwithstanding, it is not yet clear whether these changes will be implemented in accordance with the original proposed time frame. On 1 April 2021, AFS licensees and AC licensees may have a heightened responsibility in respect of their obligations under the strengthened reporting regimes and in respect of remediation with clients.

This causes the need for AFS licensees and AC licensees to review their breach reporting processes and systems to ensure that they are complying with the onerous and time sensitive new regime requirements. Such an increase in reportable events also dictates the need for a simplified, standard model report, which incorporates the content required by ASIC, in the form prescribed by ASIC. Consideration should also be given to the potential necessity for breach reporting requirement compliance training. These considerations should start now.

Erring on the side of caution: continuous disclosure obligations in light of COVID-19

Glenn McGowan QC (Partner), Philip O'Brien (Associate) and Rebecca Di Rago (Associate)

Publicly listed companies and their directors are facing unprecedented challenges in the wake of COVID-19. One such challenge is the release of earnings guidance and related announcements in the midst of uncertain market conditions. Many entities have elected to withdraw forecasts on future earnings and prospects.

On 25 May 2020, the Treasurer exercised his recently granted instrument-making power under the *Corporations Act 2001* (**the Act**) to amend the continuous disclosure obligations on listed entities for a period of 6 months commencing from 26 May 2020. The amendments aim to shield companies and their officers from the risk of shareholder class actions founded on breaches of continuous disclosure obligations.

The Treasurer's amendments have been welcomed by company directors concerned with the heightened risk of shareholder class actions in recent times. Despite the intent of these amendments, however, directors and company boards should exercise caution in adapting to the new provisions.

Listed entities and their directors remain at risk of civil and criminal liability for breaches of the existing and amended legislation. Consequently, ensuring compliance with these obligations will remain a key focus of listed entities' risk-management frameworks.

Changes to Continuous Disclosure Obligations

On 25 May 2020, the *Corporations (Coronavirus Economic Response) Determination (No. 2) 2020* (**Instrument**) was made by the Treasurer. The Instrument is intended to temporarily ease the continuous disclosure obligations on listed entities under sections 674 and 675 of the Act, to enable companies and their officers to 'more confidently provide guidance to the market during the Coronavirus crisis'.

The Instrument commenced on 26 May 2020 and will remain in effect until 25 November 2020.

Under the previous s 674 of the Act (and s 675 of the Act, which relates to entities not listed on the ASX), listed entities were required to notify ASX upon becoming aware of information which is:

- not generally available; and
- is information that a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the entity's securities.

The above provisions apply an objective test to the determination of whether information is 'material' and therefore needs to be disclosed to the market. An entity will breach the civil penalty provisions of sections 674 and 675 if it fails to disclose information which a hypothetical 'reasonable person' would expect it to disclose concerning such a material effect.

The Instrument temporarily modifies the operation of sections 674 and 675 of the Act by replacing the existing objective test in subsections 674(2)(b) and 675(2)(b) with a new, more subjective test based on a disclosing entity or its officers' knowledge, recklessness or negligence.

Under the new temporary test, an entity will breach the continuous disclosure obligations if it fails to disclose to the market information which:

- is not generally available; and
- the entity knows or is reckless or negligent with respect to whether the information would, if it were generally available, have a material effect on the price or value of the entity's securities.

The Explanatory Statement to the Instrument provides that knowledge, recklessness or negligence will be found if an entity or its officers know that, or are reckless or negligent as to whether, the information would or would be likely to influence persons who commonly invest in securities to acquire or dispose of the securities.

The Instrument adopts the definitions of the *Criminal Code Act 1995* (**Criminal Code**) for the terms 'knowledge' and 'recklessness'.

Importantly, as the Instrument is a legislative instrument, the modified provisions will apply to any future civil actions arising from allegations of breaches of continuous disclosure obligations occurring during the lifetime of the instrument.

On the repeal date of 25 November 2020, the amended provisions will immediately cease and revert to the former sections of the Act.

Rationale for the change

The intended purpose of the amendments is twofold: the changes are intended to ensure investors continue to invest in listed entities during the COVID-19 crisis (upon which the continuation of many businesses will heavily rely), whilst temporarily shielding companies and their officers from the threat of 'opportunistic class actions'.

Mr Frydenberg has stated that:

> *"The heightened level of uncertainty around companies' future prospects as a result of the crisis also exposes companies to the threat of opportunistic class actions for allegedly falling foul of their continuous disclosure obligations if their forecasts are found to be inaccurate. In response, companies may hold back from making forecasts of future earnings or other forward-looking estimates, limiting the amount of information available to investors during this period. The changes announced… will make it harder to bring such actions against companies and officers' during the Coronavirus crisis while allowing the market to continue to stay informed and function effectively."*

Anticipated impact

Whilst a stated objective of the Instrument is to increase protection for companies and their directors from shareholder class actions, the scope of the Instrument is limited. The amendments are restricted to the continuous disclosure provisions under sections 674 to 677 of the Act. The Instrument narrows the scope of the continuous disclosure obligation to include elements of knowledge, recklessness or negligence, but this test will likely still oblige entities to disclose broad categories of material information which they would have been required to disclose under the previous provisions. Of course, each of these new elements is not wholly subjective. A company (or officer) cannot wilfully maintain ignorance. And recklessness and negligence have always been judged by the reasonable person in the shoes, and with the knowledge, of the defendant.

Importantly, the Instrument has no impact on claims for misleading or deceptive conduct under s 1041H of the Act or s 12DA of the *Australian Securities and Investments Commission Act 2001* (**ASIC Act**), which often form the basis for shareholder class actions. Nor does the Instrument preclude a claim for false or misleading statements under s 1041E of the Act (although this provision also applies a subjective test involving elements of knowledge and/or recklessness) or false and misleading representations under s 12DB of the ASIC Act.

Listed entities should also note that they will still be required to comply with ASX listing rule 3.1, that is, the entity must immediately notify the ASX of any information that a reasonable person would expect to have a material effect on the price or value of the entity's securities.

Additionally, the risk of criminal liability for breaches of the previous (unamended) subsections 674 and 675(2) remains unaffected. The amendments impact all civil consequences for breaching the continuous disclosure provisions, including, for example, infringement notices issued by ASIC under Part 9.4AA of the Act. However, the amendments do not alter the operation of the criminal penalty provisions of subsection 674(2) or 675(2), and subsection 1311(1) of the Act. The Deputy Chairman of ASIC has recently issued a timely reminder to listed entities that these criminal offences are unchanged, and that directors can also be prosecuted under section 11 of the Criminal Code for breaches of the criminal penalties under the Act (extensions of criminal responsibility to specific criminal offences).

Conclusion

The practical effect of the above is that the Instrument may fall short of its intended purpose. Listed entities and their officers remain exposed to significant liability, both civil and criminal, for market disclosures and non-disclosures which contravene the Act and/or other legislation, such as the ASIC Act. Boards should proceed with caution in assessing the materiality of information required to be disclosed to the market and, to the extent reasonably possible, aim to comply with the former continuous disclosure obligations under the Act.

Consumer Data Right – becoming an Accredited Data Recipient

Dudley Kneller (Partner) and Gabe Abfalter (Associate)

*The Consumer Data Right (**CDR**) reached a further milestone on 1 July 2020, as the Big 4 banks are now required to share consumer data in response to a consumer request.*

At present, this includes data from debit and credit cards, and savings and transaction accounts, and from November 2020 will include data from home loans and personal loans, joint accounts, closed accounts, direct debits, scheduled payments and details of payees.

A proposed timetable for the rollout of the CDR in the banking sector has been published, and if no further delays are experienced, it will be fully implemented by February 2022. The CDR presents significant opportunity (and challenge) to those organisations wishing to become an Accredited Data Recipient (**ADR**).

Accredited Data Recipients

Under the CDR, consumers can request that Data Holders (currently the Big 4) share their data directly with the consumer themselves or with an ADR.

Becoming an ADR is a voluntary process which requires entities to comply with stringent accreditation requirements.

The Australian Competition and Consumer Commission (**ACCC**) is responsible for accreditation, and applications are made through the CDR Participant Portal.

Accreditation guidelines have been released to assist applicants submit valid applications and become accredited.

Accreditation requirements

Requirements to receive accreditation include:

- the applicant and any associated person be a fit and proper person to manage CDR data;
- compliance with information security requirements;
- adherence to dispute resolution procedures; and
- insurance requirements.

The accreditation requirements are comprehensive and will require potential ADRs to carefully consider how they can effectively demonstrate the regulatory obligations to progress. There are particular challenges around information security compliance and assurance.

Accreditation can be suspended or revoked by the ACCC in a variety of circumstances, including where a person contravenes a law relevant to the management of CDR Data, contravenes the CDR Rules or a data standard, or where the person is no longer a fit and proper person. The ACCC may also impose conditions on accreditation including limiting scope to particular products or services and requiring regular reporting to the ACCC.

There are currently only two ADRs, however the ACCC has stated that they have received 39 further applications.

Consumer Data Standards

Participation in the CDR requires entities to adhere to data standards, which are set out by Data61. The data standards are comprised of CX Standards and guidelines, the information security profile, API standards, and non-functional requirements.

These standards largely dictate the consumer experience – how consumers interact with the CDR, how information and interactions are presented, consent flows, and the language that is used.

CDR Rules, Privacy, Compliance and Enforcement

In addition to accreditation requirements and data standards, entities are required to comply with the CDR Rules and Privacy Safeguards. Further, the ACCC and Office of the Australian Information Commissioner have released the Compliance and Enforcement Policy, which ADRs need to navigate to ensure compliance with the CDR.

Reciprocity

As the CDR continues to rollout, the principle of reciprocity may apply in relation to data that is obtained by an ADR through the CDR. ADRs may themselves be subject to obligations similar to those of Data Holders, in particular the requirement to transfer data to consumers and other ADRs.

The extent to which the reciprocity mechanism within the CDR is implemented remains to be seen, however ADRs should be on notice that the CDR may not operate as a one-way street, and consumers may be able to require that their data be transferred both to and from ADRs.

To become accredited?

As the financial industry welcomes a new dawn around the transparent and efficient sharing of consumer data, interested parties will need to carefully weigh up the pros and cons of becoming an ADR. There are significant regulatory requirements which will no doubt require a level of organisational and operational change for a prospective recipient. Fast moving businesses which can adapt quickly are positioned well to take advantage of the opportunity. The question remains whether the benefits of becoming an ADR outweigh the significant costs of participation and regulatory compliance obligations.

Gadens is well placed to assist entities understand their obligations as Accredited Data Recipients, the accreditation process and ongoing compliance.

Financial services providers rest easy… for now: ASIC deferrals of new regulatory reforms

Jade Matthews (Senior Associate), Philip O'Brien (Associate) and Kalidu Wijesundara (Lawyer)

*In line with the Federal Government's economic response to the COVID-19 crisis, the Australian Securities and Investment Commission (**ASIC**) has announced it will defer the commencement dates of a raft of new reforms being implemented in response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.*

The deferrals of financial reporting obligations, design and distribution obligations, and the mortgage broker best interest duty, will provide financial services providers (**FSPs**) with some respite over the short to medium term. FSPs should, however, take care and use the additional time still available to familiarise themselves with their new obligations and ensure they are not caught out when the reforms kick in, which in some cases will come around very quickly.

Introduction

ASIC has announced a new policy approach to assist companies and FSPs to comply with their existing obligations and focus on the immediate needs of their customers. This approach included the deferral of current deadlines for existing and obligations and commencement dates for reforms previously slated to commence throughout 2020 and early 2021.

ASIC has further extended financial reporting deadlines for listed and unlisted entities and has taken a 'no action' position on the holding of Annual General Meetings. Additionally, the commencement date of the mortgage broker reforms and design and distribution obligations (**DDO**) have been deferred for a period of 6 months. A summary of the deferrals is outlined in the following table:

	Old Date	New Date
Financial reporting obligations – unlisted entities	Depends on type of entity (refer to tables below)	Depends on type of entity (refer to tables below)
Financial reporting obligations – listed entities	Within 3 months	Within 4 months
AGM deferrals	Within 5 months from financial year ends	Within 7 months from financial year ends
Mortgage broker reforms	1 July 2020	1 January 2021
Design and distribution obligations	5 April 2021	5 October 2021

Further extension of financial reporting deadlines

ASIC has extended the deadline for both listed and unlisted entities to lodge financial reports under Chapters 2M and 7 of the *Corporations Act 2001* (Cth) (**Act**) by one month for certain balance dates up to and including 7 July 2020 balance dates. This means entities will have an additional month to lodge their financial reports. However, entities can only rely on the relief where the normal reporting deadline has not already passed.

Unlisted entities will have an additional month to lodge financial reports for financial year ends from 31 December 2019 to 7 July 2020. Listed entities with balance dates from 21 February 2020 to 7 July 2020 will have an extra month to lodge full year and half-year financial reports.

A summary of the extended lodgement periods for entities under Chapter 2M of the Act is as follows:

Full year financial reports

	Chapter 2M deadline	Extended deadline
Listed entity	3 months	4 months
Unlisted disclosing entities and registered schemes	3 months	4 months
Proprietary company and other non-disclosing entities	4 months	5 months

Half-year reports

	Chapter 2M deadline	Extended deadline
Listed entity	75 days	Plus 1 month
Unlisted disclosing entity	75 days	Plus 1 month

ASIC has extended reporting deadlines under Chapter 7 of the Act, which apply to Australian Financial Services Licence holders, as follows:

	Chapter 2M deadline	Extended deadline
Unlisted AFS licence holder – disclosing entity or registered scheme	3 months	4 months
Unlisted AFS licence holder – not disclosing entity or registered scheme	4 months	5 months
AFL licence holder (non-body corporate)	2 months	3 months

Importantly, listed entities will still be required to lodge their Appendix 4E under ASX Listing Rules 4.3A and 4.3B by the due date. The ASX has not extended this deadline.

Even though ASIC has granted extensions, entities should strive to prepare and lodge their financial reports within the normal deadline.

Amendment to 'no action' position for AGMs

Section 250N(2) of the Act mandates that a public company hold an Annual General Meeting (**AGM**) within five months after the end of its financial year.

As public companies may find it difficult to hold physical AGMs due to the restrictions imposed because of COVID-19, ASIC has adopted a 'no action' position so that public companies will have to seven months instead of five months after the end of their respective financial year to hold their AGM. The 'no action' position only applies to public companies with financial year ends that fall between 31 December 2019 and 7 July 2020.

This means that ASIC will not take action against a company for failing to comply with section 250N(2) of the Act, as long as a public company holds their AGM within seven months of the end of their financial year. ASIC had to take a 'no action' position as opposed to extending as ASIC does not have the power under the Act to grant extensions on a 'class basis'.

Example of 'no action' position

Financial year end	Section 250N(2) deadline	'No action' position deadline
31 December 2019	31 May 2020	31 July 2020
31 March 2020	31 August 2020	31 October 2020
30 June 2020	30 November 2020	30 January 2021

It is important to note that ASIC's 'no action' position does not prevent third parties from taking legal action against a public company for failure to hold an AGM within the legislated time period.

Deferral of commencement of Design and Distribution Obligations (DDO)

ASIC has deferred the commencement of the DDO regime until 5 October 2021. The Design and Distribution Obligations were to commence on 5 April 2021 following a two year transition period.

The DDO regime will effect almost every part of the financial services industry, from banks, credit provides, superannuation providers and insurers. The regime imposes obligations on issuers and distributors in relation to the design and distribution of retail financial products.

Issuers of financial products must:

- make publicly available target market determinations in relation to retail financial products;
- review the target market determination as required to ensure it remains appropriate;
- keep records of the person's decision in relation to the new regime; and
- notify ASIC of any significant dealings in a product that are not consistent with the product's target market determination.

Distributors of financial products are obliged to:

- not engage in retail product distribution of a product without a target market determination;
- not engage in retail product distribution of a product where a target market determination may no longer be appropriate;
- take reasonable steps so that retail product distribution conduct is consistent with the target market determination;
- collect information specified by the issuer and complaints related to a product and provide both to the issuer; and
- notify the issuer of a product of any significant dealings in the product that are not consistent with the products target market determination.

ASIC will have powers to enforce the DDO regime, including the powers to request necessary information and issue stop orders to prohibit specified conduct in relation to financial products. ASIC will also be able to utilise its product intervention powers when a financial product is likely to result in significant consumer detriment. ASIC has released a regulatory guide that explains the scope of its product intervention powers and provides guidance on how it may exercise those powers. For example, ASIC may ban a product or order that a product only be offered to specific classes of consumers.

There are also civil and criminal penalties that apply to the contravention of the regime.

Therefore, it is important that issuers and distributors of financial products use the time before the commencement of the DDO regime to:

- ensure products have a target market
- develop product governance frameworks to ensure new and existing product designs are suitable for their target market;
- understand the requirements under the DDO and implement appropriate policies and internal systems (e.g. training staff, record keeping; distribution controls and systems to promptly notify ASIC of any significant inconsistent dealings)
- renegotiate distribution contracts so issuers and distributors account for DDO obligations;
- review websites and marketing material; and
- ensure appropriate IT systems are in place to facilitate compliance with DDO obligations.

Deferral of mortgage broker reforms

ASIC has deferred the commencement date of the mortgage broker best interest duty and remuneration reforms.

The mortgage broker best interest duties will impose new obligations on mortgage brokers to:

- act in the best interests of their consumers; and
- prioritise their consumers' interests when providing credit assistance.

The best interest duties require mortgage brokers to:

- gather relevant information from consumers;
- consider products holistically to assess whether they are in the consumer's best interests;
- to take on an educative role and appropriately present a range of options;
- disclose any conflicts of interests and not provide credit assistance where it would not be possible to prioritise consumer interests; and
- maintain appropriate records demonstrating that they acted in the consumer's best interest.

The remuneration reforms will:

- ban mortgage brokers and mortgage intermediaries from accepting conflicted remuneration; and
- ban employers, credit providers and mortgage intermediaries from giving conflicted remuneration to mortgage brokers and mortgage intermediaries.

Civil penalties are prescribed for any breaches of the mortgage broker reforms. Mortgage brokers and financial service providers should take the time to familiarise and understand their new obligations and seek legal advice where necessary.

Conclusion

ASIC's decision to defer these new of regulatory regimes will alleviate the burden on FSPs and allow them to focus on more immediate business concerns. Given the broad scope of the reforms, however, the impact of these obligations will be significant. FSPs would be well placed to take active steps as we enter the new financial year to ensure they are ready to comply with their obligations when the time comes.

Royal Commission commitments on hold as coronavirus delays new legislation

Edward Martin (Partner), Philip O'Brien (Associate) and Katie White (Lawyer)

In response to the impact of COVID-19, the Morrison Government announced the deferral of its commitment to implementing recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Most of the new legislation was due to commence on 1 July 2020. This has now been pushed back to January 2021, meaning the financial services industry has a temporary reprieve from its new obligations.

It is important to keep the key deferred legislation and revised commencement dates in mind and ensure plans to be compliant by January 2021 continue to be implemented.

Of the 76 key recommendations to come out of Commissioner Hayne's final report, 54 called for Government action, 40 of which required the implementation of new legislation. As part of its response, the Government also announced a further 18 commitments to address issues raised in the Royal Commission.

On 19 August 2019, Treasurer Josh Frydenburg released the *Financial Services Royal Commission Implementation Roadmap*, setting out the Government's planned approach to delivering its response to the majority of the recommendations and additional commitments by 30 June 2020.

Treasury released a package of draft legislation for public consultation on 31 January 2020, which proposed to execute 22 recommendations and two additional commitments. The proposed original commencement date for the majority of the legislation was 1 July 2020. Then COVID-19 hit.

On 8 May 2020, Treasury announced a six month deferral of the commencement dates, as it aims to strike a balance between the need to implement the recommendations with the more immediate challenge of ensuring Australia's financial institutions are able to respond to the challenges posed by the COVID-19 pandemic.

The following table sets out the draft legislation that is now expected to commence by January 2021.

Conclusion

The temporary deferrals are consistent with the common sense approach adopted by the Federal Government to the various challenges presently facing the broader Australian economy. Many financial services licensees will have already begun implementing new policies and processes in response to the findings and recommendations of the Royal Commission.

Nevertheless, in-house legal and compliance teams will likely have breathed a sigh of relief as their financial service providers rose to the COVID-19 challenge. It is, of course, important not to let complacency creep in.

Some of the more onerous obligations introduced by the new legislation (for example breach reporting and anti-hawking rules) will require a significant overhaul of current policies and processes for many licensees.

As we gradually (hopefully) emerge from the lockdown over the coming months, financial services providers can begin to re-shift their focus back to the issues raised by the Royal Commission and ensure they are well placed to adapt to the new regulatory regimes.

Draft Legislation with original commencement date of 1 July 2020, now expected 1 January 2021

Exposure Draft / Bill	Recommendation / Additional Commitment covered
Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2 (Reference checking and information, sharing, breach reporting and remediation)	• 1.6 (misconduct by mortgage brokers) • 2.7 (reference checking and information sharing) • 2.8 (reporting compliance concerns) • 2.9 (misconduct by financial advisers) • 7.2 (implementation of the ASIC Enforcement Review recommendations) (partial response)
Financial Regulator Assessment Authority Bill 2020 (Assessment Authority Bill) *Financial Sector Reform (Hayne Royal Commission Response — Stronger Regulators (2020 Measures)) Bill 2020: FSRC rec 6.14 (Financial Regulator Assessment Authority) (Stronger Regulations Bill)*	• 6.14 (new independent oversight authority for APRA and ASIC)
Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 1.15 (Enforceable Code Provisions)	• 1.15 (enforceable industry code provisions)
Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC rec 2.1 (ongoing fee arrangements) *Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers) (Ongoing Fee Arrangements) Regulations 2020: FSRC rec 2.1*	• 2.1 (ongoing fee arrangements: annual renewal and payment)
Financial Sector Reform (Hayne Royal Commission response — Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 2.2 (disclosure of lack of independence)	• 2.2 (disclosure of lack of independence)
Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: RSE licence condition — no other duty (FSRC rec 3.1)	• 3.1 (trustee of a superannuation fund should be prohibited from having any obligations other than those arising from or in the course of its performance of its duties as trustee of a superannuation fund)
Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: fees (FSRC Rec 3.2 and 3.3)	• 3.2 (no deducting advice fees from MySuper Accounts) • 3.3 (limitations on deducting advice fees from choice accounts)
Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Bill 2020: Hawking of Financial Products *Financial Sector Reform (Hayne Royal Commission Response — Protecting Consumers (2020 Measures)) Regulations 2020: Hawking of financial products*	• 3.4 (banning hawking of superannuation products) • 4.1 (banning the hawking of insurance products)
Financial Sector Reform (Hayne Royal Commission Response — Stronger Regulators (2020 Measures)) Bill 2020: ASIC regulation of superannuation (FSRC Rec 3.8, 6.3, 6.4, 6.5) *[Exposure draft Regulations] Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators) (Regulation of Superannuation) Regulations 2020*	• 3.8 (adjustment of APRA and ASIC's roles) • 6.3 (general principles of coregulation) • 6.4 (ASIC as conduct regulator) • 6.5 (APRA to retain functions)

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Insurers to fast-track support for customers experiencing vulnerability and financial hardship: Changes to 2020 General Insurance Code of Practice

Edward Martin (Partner), Philip O'Brien (Associate) and Martha Browning (Legal Assistant)

*Following an in-depth two year review by the Insurance Council of Australia (**ICA**), the updated 2020 General Insurance Code of Practice (**Code**) formally commenced on 1 January 2020. The Code currently sets industry standards above those mandated by law, and replaces the 2014 General Insurance Code of Practice (**2014 Code**).*

Subscribing insurance providers were required to adopt and be compliant with the Code by the prescribed dates of 1 July 2020 (for the family violence provisions) and 1 January 2021 (for all other provisions of the Code).

On 7 May 2020, the ICA announced changes to the implementation of the Code due to the unparalleled impact of the COVID-19 crisis on the insurance industry.

Implementation of the Code

Insurers were required to fast track the implementation of Part 9 (Supporting customers experiencing vulnerability) and Part 10 (Financial hardship) of the Code to bring forward their compliance with the key consumer provisions in these parts to **1 July 2020** at the latest. The ICA agreed to give signatories a six-month deferral, to **1 July 2021**, to implement the remaining parts of the Code fully. The deferral does not prevent insurers from adopting the Code sooner if they are able to do so and insurers are still expected to be compliant with the family violence provisions by **1 July 2020**.

It is useful to focus on exactly what the fast tracked implementation of Parts 9 and 10 will mean as well as consider what has been deferred until this time next year. We will start with a recap of the key amendments.

Key amendments to the Code

To recap, the key amendments of the Code include:

- A re-write of the Code in plain English ensuring it is easy for consumers to understand.
- New provisions for customers experiencing vulnerability, including domestic violence and financial hardship.
- A strengthening of the financial hardship provisions.
- Enhanced sanction powers for the Code Governance Committee (**CGC**).
- Community benefit payments.
- Provisions with respect to cash settlements and scope of works.
- Mandatory investigation standards for claims.

Vulnerability

The provisions regulating support for customers experiencing vulnerability (fast-tracked to **1 July 2020**) are set out in Part 9 of the Code.

A person may be considered vulnerable for the purposes of the Code based on factors such as:

- Age
- Disability
- Mental or physical health conditions
- Family violence
- Language or literacy barriers
- Cultural background
- Aboriginal or Torres Strait Islander status
- Remote location
- Financial distress

Participating insurers are required to display publicly available policies on their websites, setting out how they will support those customers affected by family violence in particular, and internal policies and training appropriate to employees' roles. The Code further provides that providers must work with customers to find suitable, sensitive, and compassionate ways to proceed if a customer is identified as vulnerable. Such support includes allowing additional support from another individual throughout the insurance application and claim process (such as a lawyer, interpreter or friend).

Financial hardship

Part 10 of the Code sets of the new financial hardship provisions (also fast-tracked to **1 July 2020**).

Among other things, insurers will be required to have internal policies and training in place, appropriate to employees' roles, to assist them in identifying whether a customer is experiencing financial hardship. In assessing a request for financial hardship support, an insurer must consider all reasonable evidence, such as:

- evidence of serious illness preventing an individual from earning an income;
- evidence of a disability, including one caused by mental illness;
- Centrelink statements; or
- evidence of unemployment.

If the insurer decides an individual is entitled to financial hardship support, the insurer must work with the individual to implement a suitable hardship arrangement, including delaying payment due dates, payment by instalments, paying a reduced lump sum, delaying instalment payments or deducting the excess from the claim amount due.

Deferred provisions

The following provisions were to be implemented by 1 January 2021, but have now been deferred by 6 months to 1 July 2021. Their deferral will likely have come as welcome relief to insurers.

CGC Sanction powers

Part 13 of the Code expands the CGC's power to sanction insurers in the event of a breach of the Code, and streamlines the process CGCs are required to undertake before imposing any sanctions for a breach of the Code.

In determining whether a sanction should be imposed, the CGC must consider:

- the appropriateness of the sanction;
- the length of time taken to act on a request from the CGC to remedy a breach;
- whether an undertaking given to the CGC has been breached;
- whether adequate steps have been taken to prevent a significant breach reoccurring; and
- whether the insurer has acted with the utmost good faith.

Types of sanctions the CGC may impose include requiring an insurer to:

- take rectification steps within a specified timeframe;
- audit their own compliance with the Code at their own cost; and
- advertise to correct something that the CGC decides needs correcting.

In respect of significant breaches, the CGC may also require the insurer to:

- compensate an individual for financial loss or damage suffered;
- publish the fact they have committed a significant breach; or
- pay a community benefit payment.

The decisions and sanctions of the CGC are binding on subscribing insurers.

Community benefit payments

The Code introduces new community benefit payment provisions. The CGC will be able to require an insurer to pay a maximum payment of $100,000 if the insurer is found to have committed a significant breach of the Code. The amount to be paid will be determined in accordance with the insurer's gross underwritten premium and number of customers. Under the Code, a significant breach is determined to be so, by reference to:

- the number and frequency of similar previous breaches;
- the impact of the breach, or likely breach, on an insurer's ability to provide their services;
- the extent to which the breach, or likely breach, indicates that the insurer's arrangements to ensure compliance with the Code are inadequate;
- the actual, or potential, financial loss caused by the breach; and
- the duration of the breach.

Claims investigation standards

While the Code maintains similar standards for making a claim to those under Part 8 of the 2014 Code, Part 15 of the updated Code implements mandatory standards for claims investigators.

The new investigation standards relate to timeframes, information requests and interviews. A claims investigator must only investigate those matters they 'need to investigate' and any requests for more information or documents must be reasonable and relevant to the claim.

If an insurer requires a formal interview with an individual in relation to the investigation of a claim, then the insurer must comply with the terms of the Code prior to, during and after the formal interview.

Relief for small business: Australian Financial Complaints Authority amends its rules to reflect COVID-19 small business relief measures

Edward Martin (Partner), Philip O'Brien (Associate),
Alberta McKenzie (Paralegal) and Kate Mylott (Paralegal)

*On 25 April 2020, the Australian Financial Complaints Authority (**AFCA**) amended its rules on dealing with complaints from small business borrowers with respect to certain COVID-19 relief measures.*

The amendments are intended to ensure that the making of complaints to and the handling of complaints by AFCA does not operate to stifle government efforts to support small to medium-sized enterprises in the face of COVID-19 pressures. They will come as some relief to lenders.

Recent amendments

In April of this year, the Federal Government announced the *Coronavirus SME Guarantee Scheme* (**SME Scheme**), under which the Federal Government will guarantee up to 50% of unsecured credit issued by participating lenders to small to medium-sized enterprises (**SMEs**) experiencing financial distress (up to maximum loans of $250,000 over 3 years). The SME Scheme is intended to support the flow of credit to assist SMEs in managing the financial impact of COVID-19.

To support the SME Scheme, the Australian Securities and Investments Commission has directed AFCA to amend the AFCA Rules by implementing a new 'Section G – Complaints about SMEG Loans and COVID-19-related Repayment Deferrals' (**Section G amendments**).[1]

AFCA Rules

For the uninitiated, AFCA is an independent dispute resolution scheme designed to assist consumers and small businesses with financial services disputes. AFCA is governed by a set of rules which are approved by the Australian Securities and Investments Commission in accordance with requirements set out in the *Corporations Act 2001* (Cth) (**AFCA Rules**). The AFCA Rules are updated regularly to respond to current events and changes in the economy that have an impact on small businesses and loan serviceability.

Section G amendments

The Section G amendments act as a limit on the matters that AFCA may take into account as part of its Complaints Resolution Process when it considers a complaint about a business loan provided under the SME Scheme. These amendments are applied to all complaints that have been lodged with AFCA on or after 25 April 2020.[2]

The amendments mean that AFCA and its Decision Makers, including an Ombudsman, an Adjudicator or an AFCA Panel, must consider loan complaints on the basis that:

- the lender was permitted to disregard the impact of COVID-19 when assessing the borrower's financial situation;
- the lender is required to comply with the terms of the *Guarantee of Lending to Small and Medium Enterprises (Coronavirus Economic Response Package) Act 2020* (**SMEG Act**) in providing loans covered by a guarantee granted under the SMEG Act to borrowers; and
- the considerations above are given priority by AFCA and the AFCA Decision Makers.[3]

When considering any complaint, the AFCA Panel or Adjudicator must also have regard to the purpose of the SMEG Act, that being to encourage the quick and efficient provisions of loans to borrowers as a response to the impact of COVID-19.

AFCA and the AFCA Decision Maker must not consider systemic issues relating to loans covered by a guarantee granted by under the SMEG Act and must give the above considerations priority over other matters, barring any serious contraventions of law having occurred, when making any preliminary assessment or determination with respect to a loan complaint.[4] Importantly, the Section G amendments provide that in the event of inconsistencies between the provisions of the Section G amendments and the other provisions of the AFCA Rules, the Section G amendments will prevail.[5]

In addition, AFCA is required to exclude complaints about deferrals of loan repayments. Where a lender decided to approve repayment deferrals for businesses in response to COVID-19, AFCA is, for the time being, not empowered under the Act to consider complaints in relation to such decisions, nor any complaint with respect to any consequential change to amounts payable under the loan, or the duration of the loan.[6]

In effect, the Section G amendments seek to inoculate SMEs from the financial impact of the COVID-19 global pandemic (or at least to lessen it). To this end, the SME Scheme will apply to loans made by participating lenders until 30 September 2020. Whether the Federal Government will extend the operation of the SME Scheme, and the concomitant amendments to the AFCA Rules, remains to be seen.

What does this mean for SMEs and lenders?

SMEs will be reassured that AFCA is legislatively required to consider the impact of COVID-19 on small businesses, and give effect to the intent and requirements of the SME Scheme, when assessing complaints.

Inevitably, lenders will be assuming additional risk in extending credit to SMEs experiencing financial distress. In many cases, credit may be extended to borrowers that would not otherwise satisfy lenders' strict loan approval processes pre-COVID-19. The Federal Government's 50% guarantee will account for some risk mitigation, but there remains the considerable risk of defaults and restructures over the course of the loans.

The Section G amendments will provide lenders with additional protection from the more onerous provisions of the AFCA Rules in respect of any complaints relating to SME Scheme loans, except in cases of serious contraventions of the law.

[1] Under the *AFCA Scheme Authorisation (Additional Condition) Amendment 2020 to the Corporations Act 2001* (Cth).
[2] *AFCA – Rules 25 April 2020, G.1.2.*
[3] *AFCA – Rules 25 April 2020, G.2.3.*
[4] *AFCA – Rules 25 April 2020, G.2.3. and G.2.4.*
[5] *AFCA – Rules 25 April 2020, G.1.1.*
[6] *AFCA – Rules 25 April 2020, G.3.1 and G.3.2.*

Contributors

Dudley Kneller
Partner
Intellectual Property & Technology
T: +61 3 9252 7748
E: dudley.kneller@gadens.com

Glenn McGowan QC
Partner
Disputes
T: +61 3 9252 2587
E: glenn.mcgowan@gadens.com

Jade Matthews
Senior Associate
Disputes
T: +61 2 9163 3018
E: jade.matthews@gadens.com

Philip O'Brien
Associate
Disputes
T: +61 3 9252 2549
E: philip.obrien@gadens.com

Edward Martin
Partner
Disputes
T: +61 2 9163 3086
E: edward.martin@gadens.com

Liam Hennessy
Director
Banking and Finance
T: +61 7 3114 0291
E: liam.hennessy@gadens.com

Gabe Abfalter
Associate
Intellectual Property & Technology
T: +61 3 9252 2580
E: gabe.abfalter@gadens.com

Rebecca Di Rago
Associate
Disputes
T: +61 3 9252 7710
E: rebecca.dirago@gadens.com

With special thanks to our other contributors:

Jasmia Bavaresco, Lawyer, Corporate Advisory

Kalidu Wijesundara, Lawyer, Disputes

Katie White, Lawyer, Disputes

Alberta McKenzie, Paralegal, Disputes

Kate Mylott, Paralegal, Disputes

Martha Browning, Legal Assistant, Disputes

Design: Ailsa Pender, Business Development & Marketing

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