

HUGGINS LEGAL

LITIGATION AND REGULATORY RISK UPDATE

EDITION 2 – 2 NOVEMBER 2022

Welcome to the second edition of Litigation and Regulatory Risk Update – a newsletter for AFSL holders about developments in litigation risk (both in a Court and at AFCA) and regulatory risk.

1. **What has happened?**

ASIC has published Report 740: *Insights from the reportable situations regime: October 2021 to June 2022*.

2. **What do I need to know about this?**

The Report sets out ASIC's analysis of Breach Reports that have been made from October 2021 to June 2022. It provides a very useful guide about issues to consider when making a Breach Report (that is, it highlights issues that ASIC is likely to be concerned about when it receives a Breach Report).

3. **What should I do?**

The following issues should be considered when making a Breach Report:

- (1) ***frequency of reports*** - the percentage of AFSL holders lodging Breach Reports is much lower than ASIC expects (the implication being that the Breach Reporting obligation is not being complied with). It appears that ASIC will be taking enforcement action against AFSL holders who fail to make Breach Reports in accordance with their obligations. AFSL holders should consider whether they have adequate systems in place so as to ensure that non-compliance with the Corporations Act is being detected and reported. The *detection* aspect is important. The Breach Report must specify the date of the first instance of the breach. It is not helpful if this date is some years before the breach was detected (as this circumstance raises issues about the adequacy of the AFSL's holders systems with respect to the detection and reporting of breaches);

- (2) **remediation** – financial losses that have been incurred by clients must be proactively remediated (see RG 277). ASIC expects both that remediation will be undertaken and that it will be undertaken quickly. It is therefore unwise to state in a Breach Report that the AFSL holder does not intend to compensate impacted clients. It is also unwise to state that it will take a substantial period of time (for example more than 1 year) for compensation to be paid to all affected clients; and
- (3) **identification of root causes** – the Breach Report must specify the root cause of the Breach. Many Breach Reports identify staff negligence or error as being the *root cause*. ASIC is clearly sceptical about these types of Reports – the issue being that whilst staff error was the proximate cause, the *root cause*, in ASIC’s view, is a lack of training or supervision of the staff member involved. Where there has been a breach (or multiple breaches) in which more than 1 staff member has been involved, ASIC is unlikely to accept that the root cause is staff negligence or error (because if more than 1 staff member makes an error the implication is that the staff members were poorly supervised and/or trained). AFSL holders should be wary about stating that staff negligence or error was the root cause of a breach unless this, unarguably, is the case.

Overall, the messages that ASIC is ending by way of the Report are as follows:

- (1) AFSL holders must be actively determining if they are complying with their obligations – Breach Reports that refer to breaches that are ongoing for many years raise questions about the adequacy of an AFSL’s holder’s systems;
- (2) client remediation must be well advanced at the time that the Breach Report is made and the remediation process should take as least time as possible to complete; and
- (3) AFSL holders must identify the real root cause of the issue that has been identified and at the time of making the Report must have taken steps to address that cause.

If you would like to discuss any of the issues raised in this Update please, of course, don’t hesitate to contact me.

Regards

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HUGGINS LEGAL

CAPABILITY STATEMENT

Huggins Legal has expertise in the following areas:

1. AFCA complaints concerning financial planning, stockbroking, finance broking, irresponsible lending, insurance and superannuation.
2. Financial services related litigation including disputes with advisers and disputes concerning financial services related commercial transactions.
3. Management of issues concerning adviser misconduct including breach reporting.
4. Management of issues concerning client complaints including providing advice about internal dispute resolution, breach reporting and remediation.
5. ASIC investigations.
6. AFSL licensing.
7. Financial services related compliance including issues concerning the ASIC Market Integrity Rules and drafting/reviewing SOAs, FSGs and PDS'.
8. Financial services related commercial work.
9. AML/TF advice and reviews.

Huggins Legal acts for clients across Australia.