FSR GPS Podcast Series
Episode 3 – Breach reporting reflections on disclosure errors & LPP

Michael Vrisakis	Hi everyone. I'm Michael Vrisakis, a Partner in the Herbert Smith Freehills Financial Services Team. Welcome to our podcast series called the FSR GPS. This series focuses on topical and emerging issues in financial services regulation which we think are the most strategic and important issues for our clients. Feel free to suggest topics you would like us to cover in the future but for now, we hope you enjoy today's episode.
Shan-Verne Liew	Hi, thank you for joining us on today's episode. I'm Shan-Verne Liew, a Senior Associate in our FSR practice here at HSF. I'm joined today by my colleagues Abby Sutherland, who's solicitor in our FSR practice and Henry Gallagher, a solicitor in our Disputes practice.
Abby Sutherland	Thanks Shan, we are the new kids on a block. In Episode 1, 'Once more into the Breach', we dove into the new breach reporting regime including legal and industry insights post implementation and some common reportable breaches. In today's episode, we will reflect on some real-life examples of potentially reportable situations with the focus on the reportability of inadvertent system errors.
Henry Gallagher	We also touch on legal professional privilege and why it's important to keep in mind when investigating potential breaches.
Shan-Verne Liew	It's worth mentioning that we have an online blog called FSR Australia Notes where we publish key articles and issues facing the Australian financial services industry. That covers our introductions. Abby, I've noticed that some of the articles on our blog refer to a breach reporting chasm. Can you explain what we mean by that?
Abby Sutherland	So we call it the breach reporting chasm because I guess post implementation of the new regime, there appears to be a mismatch between the breach reporting practices of licensees across the industry on the one hand. And ASIC's expectations with regard to breach reporting on the other. As our team mentioned in episode 1, one of the most important changes in the new regime is that certain breaches are automatically deemed to be

	significant and therefore, reportable without any further significance assessment being required.
Henry Gallagher	This is a really helpful difference to point out Abby. In the old breach reporting regime, minor and isolated breaches that did not cause any detriment to clients would not have been reportable. But under the expanded regime, most, but not all civil penalty breaches and misleading or deceptive conduct breaches are deemed significant. And are therefore, automatically reportable to ASIC. That's a case even if there is no appreciable impact on a client.
Shan-Verne Liew	Thanks, Henry. That's right. Given the breadth of the new regime, an assumption we occasionally get, is that if an error has been made whether it's a system's error or an error in a regulated disclosure document such as a PDS or FSG, then there must be a breach of the prohibitions against misleading or deceptive conduct. And therefore, the error must be reportable to ASIC. In this episode, we are going to unpack that assumption. Abby, can you give us an example of an error that is not necessarily reportable?
Abby Sutherland	Yeah for sure. So I think poor old M&D gets picked on a lot but an error is not always reportable. My example relates to pricing. So I'll simplify the facts but one real-life example we encountered involved a systems error where the algorithm that sat behind a new insurance underwriting calculator contained a flaw. As a result, the new underwriting calculator produced inaccurate premium and deductible values for proposed insurance cover. However, on a closer investigation of the facts, it turned out that the insurer had only used the old calculator to populate the value of premiums and deductibles in renewal notices. And in discussions that the underwriting team had with customers. And these numbers produced by the old calculator were in fact correct.
Henry Gallagher	So customers were actually given the correct premiums and deductibles?
Abby Sutherland	Yeah, so the error was actually never communicated to the customer. Meanwhile, the incorrect values produced by the new calculator was stored

	in the insurer's system but were never used in the assessment of any claim. In that specific scenario, it turned out that there was no reportable situation because no misrepresentation or incorrect statement had actually been communicated to the customer.
Shan-Verne Liew	That's a really good scenario Abby. Goes to show that in some cases, it can pay off to do more digging to get a precise understanding of what's actually been communicated to customers. Perhaps it's also worth pointing out that even if the value stored in the system is incorrect, that will not necessarily determine the customer's rights and obligations in relation to the product. It is the product documentation or agreement sets up what a customer is entitled to and that information will often prevail whatever value stored in the system.
Abby Sutherland	For sure.
Shan-Verne Liew	Let's now talk about what happens when an accidental mistake is actually communicated to a customer. For example in a PDS or FSG. Because of the level of detail that needs to be included in many of these documents, minor misstatements with respect to trivial detail can happen. For example, a typo in an FSG might say that a licensee can be contacted by phone from 9:00am to 5:00pm every day. When in fact the call centre will actually operate until 6:00pm.
Henry Gallagher	Surely we don't need to prepare a report to a regulator to disclose that our FSG said that our contact centre closed just one hour later.
Abby Sutherland	Yeah, so I think in this case, we were fortunate. There are a few important exceptions and defences to be aware of. The first exception can be found in a definition of when a regulator disclosure document is deemed to be defective, and these can be found in sections 925(b) and 1021(b) of the Corporations Act. This exception provides that a document will not be defective as a result of a misstatement. If the misstatement is not materially adverse from the point of view of a reasonable person considering whether to rely on the document. So in Shan's example, the FSG may have contained an error about when the call centre closed but this may not amount to a defective disclosure breach on the basis that disclosing an

earlier closing time for a call centre is not actually a misstatement that is materially adverse to a customer.

Shan-Verne Liew — The other important point to note is that the deemed significant misleading or deceptive conduct prohibitions in section 12DA of the ASIC Act and section 1041H of the Corporations Act do not apply to regulated disclosure documents such as PDSs, FSGs, SOAs or ROAs. The defective disclosure regime that we just discussed applies instead.

Henry Gallagher — The other important defence can be found in the strict liability prohibition against giving a defective regulated disclosure document. There is a defence in sections 952E(3) and 1021E(3) of the Corporations Act which provides that the prohibition is not triggered if the person took reasonable steps to ensure that the disclosure document or statement would not be defective. So if the licensee had conducted a thorough and diligent review of a regulated disclosure document before it is given to a client. In some circumstances, this defence can be relied on to sustain a position that the prohibition has not been triggered. These exceptions are important to keep in mind because they reflect the original policy position for the defective disclosure regime, but not every single misstatement, however innocent and trivial is intended to trigger a breach of the legislation.

Abby Sutherland — Sounds like we've covered quite a few scenarios where an error may not have actually resulted in a reportable situation. So I guess to recap, in the first scenario the error was stored in admin systems but not actually communicated to the customers. In the second scenario, the error was contained in an FSG so the broad prohibitions against misleading or deceptive conduct do not apply. There may have been no breach under the defective disclosure regime because reliance on the error was not materially adverse from the perspective of the customer. And finally, Henry also mentioned that there is a defence which applies when reasonable steps have been taken to ensure that regulated disclosure document is not effective. I think it's important and helpful for licensees to be aware of these nuances in a regime because they can protect against inadvertent over-reporting of M&D breaches.

Shan-Verne Liew — Thanks Abby. Let's now turn to the very important topic of legal professional privilege. Many licensees have clear procedures for assessing incidents

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	which may be reportable to the regulator. It can be helpful to understand at each step/stage of the breach reporting procedure whether any new information that is produced will be covered by legal professional privilege. Henry, again, can you set out some key principles for when legal professional privilege will apply?
Henry Gallagher	Thanks, Shan. Well, legal professional privilege is a big area, but I'll touch on a few important considerations regarding breach reporting. As many listeners may know, privilege refers to a confidential communication between the client and another person or between a lawyer acting for the client and other person that was made, or the contents of a confidential document that was prepared for the dominant purpose of the client then provided with professional legal services relating to a proceeding or an anticipated or pending proceeding or alternatively, in respect of legal advice, privilege refers to a confidential communication made between the client or the lawyer or between two or more lawyers acting for the client or the contents of a confidential document prepared by the client, lawyer or another person for the dominant purpose of the lawyer or one or more of the lawyers providing legal advice to the client. Courts have applied that dominant purpose test reasonably strictly. Courts will not necessarily accept that an internal investigation commenced with a stated objective of enabling a company to obtain legal advice or litigation services will cover those investigation documents to be privileged. Instead courts will carefully scrutinise the purpose said to underlie each document in the context of the investigation.
Shan-Verne Liew	So if the licensee brings material into existence to assess whether there was a reportable situation to ASIC, will legal professional privilege apply?
Henry Gallagher	Well, that's a good question Shan. It's important to keep in mind that material will only be protected by legal professional privilege if it is both confidential and it can be objectively shown that its dominant purpose was for legal advice or an existing or reasonably anticipated legal proceedings. And to answer your question more specifically, if the dominant purpose was to obtain legal advice on whether a reportable situation has occurred or and what if any compensation the licensee is legally required to provide, then yes, privilege should apply. However, advice from someone who was not acting as a lawyer such as a representative in a compliance function would

not be privileged. The dominance purpose test may be difficult to establish if there are other plausible purposes such as obtaining commercial input of a border operational risk and compliance reasons leading to the creation of the document.

One thing that may be considered is running two separate investigations – one by the legal team for the purpose of the company obtaining legal advice being a privileged workstream and the other confined to technical or purely factual findings to enable the company to respond to the incident being the non-privileged the work stream.

Abby Sutherland

That's quite relevant in a breach reporting context I think, Henry, whereas a first step a compliance team might perform an initial BAU fact finding exercise in response to an internally reported incident before a breach reporting investigation commences. So are you suggesting here then that the initial BAU fact finding exercise might not be covered by LPP, that the breach reporting investigation will be?

Henry Gallagher

Yes, that's right Abby. It may be difficult to sustain a client for privilege in relation to a purely or predominantly factual investigation even if it's procured or conducted by client's lawyer. As I've mentioned, the question is what was the dominant purpose of the investigation? A further point to consider is that clients must take care to avoid waiving privilege when referring to the results of findings of an investigation. Privilege will often be waived where the gist, substance or conclusion of the privileged communication is published or communicated.

Abby Sutherland

So can a licensee communicate the findings of an investigation within the business without waiving privilege? I'm thinking for example what if a legal or compliance team shares privilege information with a product owner within the same entity or a related entity within the corporate group?

Henry Gallagher

Privilege will generally not be waived, fortunately, where legal advice is shared within a company or between companies in the same corporate group. However, of course care must be exercised as waiver is a very fact specific exercise in question. It's important that any legal advice is shared on a confidential basis and ideally on a restricted access or need-to-know basis. It should be clear that the recipient does not further disclose the

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information. There is also a practical issue to keep in mind, which is that the more people you tell, the more people that might breach confidentiality. The more people you tell means that there's a large number of people who may subsequently use the information not for the original purpose but to some other purpose or that may subsequently use the information in a non-confidential way, and that subsequent use deprives the information of its confidential character. There's also a separate issue of what you can tell a regulator. For example, if a report informs a regulator that you have obtained legal advice that the company has not breached a particular law, that statement will likely waive privilege over that advice. On the other hand, privilege will generally not be waived where you disclose that you had received legal advice but without disclosing either expressly or impliedly the substance of the advice. However, it's important to keep in mind that all of these considerations are factually and contextually dependent, and it's important to get expert legal advice on these matters depending on the context of the particular issue.

Shan-Verne Liew — Thanks Henry. Some really useful insights. I think that's all we have time for today. Thank you for listening.

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