FSR GPS Podcast Series
Episode 14 – Remediation

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.
Hugh Paynter	Hello everyone, I'm Hugh Paynter, a Partner in the Disputes practice at Herbert Smith Freehills in Sydney. I focus on litigation, investigations and contentious matters, including in the financial services sector.
Michael Vrisakis	I'm Michael Vrisakis. I'm a Partner in the Financial Services Regulatory team at HSF, specialising in superannuation, insurance, financial advice, as well as regulatory strategy.
Danielle Briers	And I'm Dani Briers, an Executive Counsel in the Disputes practice in Sydney. I specialise in investigations and enforcement action in the financial services sector and engagement with regulators, particularly ASIC and APRA. In today's episode, we're focusing on customer remediation in financial services, and this is a topic increasingly on the radar of our clients and their regulators in recent years. So this is where a mistake or some sort of misconduct has occurred and has caused customer loss, and in that situation, ASIC expects financial service providers to remediate affected customers proactively, promptly and fairly, and in line with ASIC's Regulatory Guide 277, consumer remediation. This is such an important topic for licensees and done properly it can have a lot of benefit. Remediation can reduce exposure to potential litigation and enforcement action, whether by the affected consumers or the regulator itself. It's also increasingly viewed as a key indicator of whether the licensee is complying with its obligation to act efficiently, honestly and fairly under section 912A(1)(a) of the Corporations Act. I believe Hugh will say a bit more about that shortly. It's also a really important factor for courts. If worse comes to worse and down the line you are facing enforcement action in the form of court proceedings, courts will

look closely at how the licensee has remediated customers and that will be a factor that could reduce a potential penalty against the licensee.

Michael Vrisakis

That's right, Dani, and we know from ASIC's recent review of remediation policies that ASIC has renewed its focus on compliance with Reg Guide 277. In particular, the regulator emphasised the need for proactive remediation after misconduct has occurred or other failure has been identified. Furthermore, a licensee should have robust consumer centric policies which enable their staff to comprehensively investigate scope and respond to issues once they're identified. The remediations objective should be to produce, quite simply, good consumer outcomes. Now, before we get into the details of what a licensee's remediation program should look like, we should discuss the meaning of remediation and when the expectation to remediate arises. Hugh, would you like to talk to this point?

Hugh Paynter

Yeah, sure. Thanks, Michael. Remediation has two core limbs: it involves, firstly, investigating the scope of misconduct or failure and, secondly, where appropriate, returning consumers who've suffered loss due to that misconduct or failure as closely as possible to the position they otherwise would have been in. Examples of such misconduct or failure include a breach of financial services laws or contractual terms and common law negligence or fraud. For example, internal systems errors which result in miscalculated consumer fees or other incorrect outcomes would require remediation.

The duty to remediate, even absent a complaint or claim by the customer, can come from a number of places. For example, the licensee's own policies may require pro-active remediation where loss or damage to customers is detected, rather than waiting for the customer to bring a complaint or claim. In some cases, there might be a specific statutory duty to remediate, although this is quite rare. As Dani mentioned, the efficient, honest and fair duty is increasingly viewed as both a source of a duty to remediate and a concept that affects how you remediate.

ASIC says in its Regulatory Guide that complying with this duty includes licensees taking responsibility for the consequences of their misconduct or other failures and remediation, consumers – sorry, remediating consumers who have suffered loss as a result. Another source, of course, is the regulator's expectations. It's clear that ASIC expects a robust and proactive

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remediation program when something has gone wrong that may have caused consumer loss.

Now, ASIC's expectations don't always have the force of law, but are obviously very important from a practical, reputational and risk management perspective. ASIC has provided guidance on the general process for conducting a remediation. Dani, would you like to speak to this?

Danielle Briers

Sure, Hugh. So as you'll recall, ASIC's guidance on remediation was actually given an overhaul in September 2022. That was when RG 256, the former Regulatory Guide which had been written back in 2016, was replaced by RG 277. Now, under RG 277, ASIC breaks down the remediation process into three broad stages and says that there are nine overarching principles which govern how you conduct each of those stages. In terms of the three broad stages, ASIC says that the first one is that the licensee must determine whether it has engaged in some form of misconduct or other failure that has caused or may have caused consumer loss. Note that at this stage it's a threshold of caused consumer loss or may have caused, it's not necessarily that you know for sure it has caused consumer loss to particular people.

If it may have caused loss, then you're in the realm of having to devise a remediation program. The next broad stage is about fleshing that out a bit, and so this can sometimes be the most challenging stage because it involves scoping out the misconduct or failure and the customers affected by it. This involves analysing the nature, cause and extent of the issue, including how long it lasted for, and identifying the customers who were impacted – a very large task in itself, particularly when systems issues, for example, can date back quite some years.

The final broad stage is what ASIC calls "determining an appropriate outcome", and this is really the crux of it – developing your remediation methodology. Once you've identified the affected customers, what is your method to try and get them back into the position they would have been in if not for that misconduct or other failure. Now, in all three of these stages, the licensee is expected by ASIC to follow the nine key principles for conducting a remediation, which are set out in RG 277. Michael, perhaps you'd like to speak a bit about these principles.

Michael Vrisakis

Absolutely. As you mentioned, Dani, ASIC has published nine principles which should guide licensees to achieve fair and timely remediations. So I'm

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just going to go through those numerically. The first principle is that remediation should seek to return affected consumers as closely as possible to the position they would have been in if the failure had not occurred.

The second principle is for the licensee to identify the class of consumers who have or may have suffered a loss as a result of the misconduct. This may require route cause analysis testing. And, thirdly, as we mentioned before, the licensee should adopt beneficial consumer assumptions in scoping and calculating loss, and we are going to come to that principle and delve into it in a bit more detail shortly. The fourth principle is to appropriately document all key decisions and outcomes, and principle five, coming to this, it requires the licensee to use reasonable endeavours when making remediation payments. Sixth, the licensee should ensure the remediation is timely and prompt, avoiding delays to the identification of failures to reduce costs, and to minimise potential hardships to consumers, which leads then to the seventh principle, which is that remediation should be made easy and free for consumers. Number eight is that the licensee must not profit from their misconduct, and the final principle is that licensees should ensure their remediations are adequately resourced and that they have appropriate governance and accountability frameworks. All very sensible.

I'm going to pass to Hugh in a second but, just as a disputes specialist who deals a lot with calculation of compensation and damages. Hugh, could you speak to us a bit about how that first principle can play out in practice, putting the customers back into the position that they would have been in, had it not been for the misconduct or error.

Hugh Paynter

Yeah, thanks, Michael. That throws light on a key difference between the remediation scenario and other compensation scenarios where you would have a specific complaint or claim by the customer that you're responding to. In a remediation program, you're trying to compensate a group of customers, sometimes a very large group, in a way that is fair and appropriate for all, but cannot necessarily be tailored to each client's claim. Calculating the customer's loss can be difficult. For example, where a breach involving misleading and deceptive conduct may have occurred and caused a customer to enter into a contract that they arguably would not have otherwise entered into.

There can be difficult scenarios in play, but I think a lot of this comes down to the nature of the conduct or the legal wrong that's been allegedly

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committed. Take a financial advice scenario. There may be a suggestion that the advice provided was not appropriate, but then the issue is, do you assume that the advice was never given so that if the consumer has made losses, you put them back in the position they would have been in without those losses. Or you could have a case where the consumer suggested that the investment strategy that was advised was not risky enough so that the consumer has not made the gains it would have expected to make had the advice been properly given. In that scenario, the consumer does not want to be put in the position they would have been in before the advice, but rather put in a position they should have been in had proper advice been given. Now, Dani, no doubt you've seen lots of other examples with those sorts of themes in play.

Danielle Briers

Absolutely. Yeah, I would agree with those observations, and I've seen similar challenges in the lending space. So let's say, for example, you've found a responsible lending breach, firstly, it's hard to even know what would have happened differently had the breach not occurred, for example, it might still have been fine to grant the loan if the breach was of a type that did not actually make the loan unsuitable. It's really hard to assess that on anything other than a customer-by-customer basis, you know, looking at … or what would have been assessed differently on the affordability assessment for that customer absent the breach.

Even if the licensee can get to a point where they know they shouldn't have granted the loan, you get the challenge of well, how do you put the customer in the position they would have been in if the loan hadn't been granted, and will that actually be a positive outcome for the customer because they might actually be coping fine with the repayments and actually not want to return the item that they got the loan for, so sort of putting them back in the position they were in, isn't really practicable in that situation.

So, this is just an example of how you often find yourself needing to make assumptions in remediations, and you have to devise and make appropriate defensible assumptions because you'll never have all the facts or be able to do a customer-by-customer analysis. Devising those assumptions can be really challenging, but one thing we do know is that ASIC requires them to be beneficial to the customer. So we might talk briefly about how that can play out.

So one application is that when in doubt ASIC will expect the licensee to overpay, rather than under pay. This could mean including an amount in the compensation calculation, rather than excluding it if there are different views

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on whether it's needed or whether every customer should have that amount. It could involve making beneficial generous assumptions in calculating interest, given that there are various ways interest can be calculated, or it could involve including more people rather than fewer in the group to be compensated. And it may be that a number of different specific assumptions get you to that point because you have imperfect information in a number of different ways.

Now, if the sum total of all the assumptions you need to make is that more people rather than less are in the cohort, then in my experience, ASIC will typically be pretty happy with that approach. So, I guess this shows that even though you are looking to compensate those actually affected by the problem, sometimes you do end up compensating those who only may have been affected, simply because you need to make these assumptions and you have all these gaps in information. And sometimes over-compensating may actually be cheaper and more practicable than spending more money to pinpoint the exact cohort of customers or the exact loss suffered.

Michael Vrisakis

Just to pick up on what Dani said, not over-compensating for the sake of it, but rather an expediency because of either the cost of calibrating the exact remediation or sometimes there is actually an impossibility of precise calculation.

Another vexed issue is the ability of a licensee to claw back any over payments to the customer that resulted from a remediation issue or [net] off any over payment against the relevant under payment. Sometimes you've got situations where the licensee wishes to do this and does view it as an appropriate outcome, but the regulator disagrees. I'd also like to highlight the references to reasonable steps or reasonable endeavours in RG 277.

For example, on the topic we've been discussing of calculating remediation amount, it's relevant that RG 277 says "licensees should take all reasonable steps to access and secure the evidence, records and data necessary to complete the remediation". When it comes to the remediation payments, a similar cost of the reasonableness is used in RG 277 where it says that ASIC expects licensees to use reasonable endeavours to contact and make reasonable payments to affected consumers.

In this context of reasonableness, the question of materiality will come up with some regularity. Applying reasonable endeavours to make a payment to the customer may not be required if the compensation amount is considered to be low value compensation. For example, ASIC has stated

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that if former customers are owed $5 or less, and there's no current payment information on file, then it's appropriate for the licensee to automatically allocate the amount to a charity or a not for profit organisation on the basis that the party who's committed the breach would not benefit from their breach. I mean, partly that then leads into the fact that the regulator does not want the licensee to obtain any windfall benefit if that remediation payment cannot be made to consumers in particular circumstances.

But this course is limited, and it doesn't apply where current customers or former customers are owed more than that figure of $5. As well as this, any charitable payments do not extinguish any potential legal liability owed to the customer. It's interesting that ASIC actually lowered that low value compensation threshold in September of 2022 where it used to be $20, but now, as you indicated, Dani, it's $5, so there potentially could be thousands of impacted consumers and it could take a licensee a long time to scope out the extent of the consumer loss, especially if many of these amounts are relatively low in value.

Hugh, do you have any tips from a disputes perspective, particularly on the timeframes associated with remediations, the relationship between remediation and class actions and whether anything in the context of remediation could constitute an admission?

Hugh Paynter

Yeah, thanks, Michael. I think as we said before, some of the principles that are in play in the conduct of remediations come back down to the principle of complying with the duty to act efficiently, honestly and fairly. So on timeframes, ASIC has not given a definitive limitation period for remediation, but has said that they should be initiated and conducted promptly, as long as there is no trade-off in quality, they say. What is a reasonable timeframe will depend on the nature and complexity of the matter and the availability of data, the number of affected consumers and the type of loss suffered.

Record retention requirements may affect what can practically be done by the licensee. For example, if the relevant records are kept for only seven years – there used to be a permitted look back period of seven years in ASIC's previously Regulatory Guide, but that has been removed since September 2022. Now, ASIC's expectation is that the remediation starts where the licensee reasonably suspects the misconduct or other failure first occurred and caused loss to a customer. But ASIC does acknowledge that if the misconduct or failure extends back further than record retention

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requirements and records have been destroyed in good faith, the remediation review period may be limited.

If that is the case, ASIC expects the licensee to consider whether it is possible to apply assumptions to fill the gaps in in information and compensate customers who suffered loss further back in time. It's not unheard of for ASIC to also argue an ethical duty backed by the efficiently, honestly, and fairly obligation to remediate beyond the statutory limitation period. And, of course, that statutory limitation period, which is often six years, but can be longer, and the calculation of which can be actually complicated in different facts and circumstances, is also a consideration for licensees.

On class actions and admissions, one of the commercial objectives in a remediation is to compensate fully for the customer's loss so there is no loss remaining that could be the subject of a class action. If done well, that should minimise, if not eliminate, the prospect of a class action or other litigation arising from the same facts. This ties in with the question of whether you can get a settlement deed from the customer in the context of a remediation. Settlement deeds are typically a prudent measure of course to make it clear that the parties have resolved the whole of the dispute between the customer and the licensee, but they are challenging in a remediation program because the customer often hasn’t brought a claim. The licensee is proactively remediating them, rather than engaging in settlement negotiations to resolve a dispute.

In addition, ASIC has made it clear in the Regulatory Guide that as a general rule, licensees should not require settlement deeds in a remediation. So if you decide to take that precaution, it's important to be aware of ASIC’s guidance around that and frame the deed in a way that minimises your regulatory and reputational risk.

On admissions, this can be a very tricky area. You're obviously remediating because something has gone wrong, or you think may have gone wrong, but you aren't testing each customer's claim to the point where you can necessarily admit to specific breaches. So the remediation communication needs to be carefully crafted to balance these factors. Now, as disputes lawyers, Dani and I often see a matter when it has been breach reported to ASIC, a remediation is underway, and ASIC is starting an investigation which can then lead to enforcement action.

In that context, ASIC will sometimes seek to rely on statements made in the breach report as an admission and will see the remediation more as a

positive factor if done well and promptly, rather than a source of an admission by licensees. But it's reasonably clear that ASIC cannot merely rely upon a breach report in order to establish a breach. Regardless of any admission made in a breach report, ASIC will need to establish the elements of the breach when it brings enforcement action against the licensee. Dani, no doubt you've got some comments on this too.

Danielle Briers

Yeah, absolutely. I agree with that, and I've seen in practice that breach reports don't always get it right in terms of naming the provisions that have been breached, for example, and that's understandable given that often breach reports have to go in on a tight timeframe and you're investigating extremely complex facts. But just going back to that seven year look back point, Hugh, I think it's also worth noting that ASIC's view is that if a remediation does need to go further back than seven years, this could indicate broader systemic failures within the licensee's frameworks, essentially, that the licensees should have detected the issue sooner.

Now, I would query whether this is fair or not because sometimes issues do go undetected simply because of their nature until some catalyst causes them to be detected, and depending on the issue involved, it could be a longer or a shorter period until that occurs. But certainly, ASIC sees an issue going undetected for seven years as too long a period and expects those detection periods to improve following learnings from the Banking Royal Commission, and in light of some recent law reforms. For example, when ASIC was consulting on Reg Guide 277, it said it expected that the recent reforms in 21 on breach reporting, design and distribution obligations and internal dispute resolution would actually enable licensees to pick up issues much earlier, and such that you wouldn't be seeing those seven year look back periods.

Hugh, you also touched on the topic of communication to customers, and I agree that these have to be framed very carefully in a remediation. A couple of points I'd make. Firstly, the challenges in a remediation can depend a lot on the type of licensee you are and what records you have in order to actually contact customers. So, for example, if a customer group is comprised of former customers or customers you're not in regular contact with anymore, it's often a lot harder to remediate than if they are current customers where you have contact details and you may even have a current bank account to which you can make an automatic payment.

Secondly, when it comes to engaging with customers, as Michael mentioned, ASIC wants it to be as easy as possible for the customer. So,

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ASIC says the licensee should minimise complexity and minimise the need for the customer to take action. I think the optimal arrangement from ASIC's perspective is where all customers who are within the scope for the remediation receive a payment automatically with no need to opt in and no need to provide any further information, but this can be difficult depending on the scenario.

For example, what if you actually can't calculate or even estimate their loss, or a reasonable proxy for their loss, without at least some further information from the customer? What if you have no bank account details for the customer, so can't make an automatic payment? In that situation, there may be a discrete short communication that does need to go out to customers, and then it's a matter of making sure that's crafted suitably. It's often a real balancing act between the principle of making the remediation easy for the customer and the practical challenges that arise on the facts of the particular remediation.

Hugh Paynter

Absolutely, Dani, and if go back far enough we've seen a lot of these principles in play for a long period of time, including some of the longstanding enforceable undertakings that we've been involved in doing. But looking to today, ASIC encourages licensees to have a communications plan to set out how and when it will communicate with customers about the remediation. Now, there's a bit of guidance on this in RG 277, but also in the publication that ASIC released alongside that Regulatory Guide, which is entitled "Making it Right, How to Run a Consumer Centric Remediation". A lot of this is common sense and would make sense to us as consumers as well. For example, people don't want to have to go to the bank to process a cheque and people are unlikely to read every communication from a bank, so you shouldn't just assume they will.

Communication with regulators is another important topic we advise on in the context of remediations. Often there is a regulator wanting updates because the remediation may have stemmed from a breach that has been reported to the regulator, whether that be ASIC or APRA, for example. If you're not in that scenario, there is the question of how much to proactively inform the regulator and when and how to do that. This is an area where external legal advice can be useful as the external lawyers can give a sense of what they've seen in industry, and what they see the regulators respond well to and what doesn't work so well. Now, Michael, do you have anything to add on the regulator piece?

Michael Vrisakis Thanks very much, Hugh.

One of the current topics in this area is the ability of the product or service provider to adopt an opt-in approach from the client, and that has become somewhat of a vexed issue. It's not necessarily impossible, but it will be very hard to justify.

Suffice to say the regulators don't love this approach, and it should be assumed as a starting point that they would oppose it, but it's worth assessing and discussing with the relevant regulator because it's not unheard of. And in terms … just in terms of those discussions and the regulatory communications more generally, licensees may need to engage with a variety of regulators, ASIC, APRA, AFCA and the ATO, and ASIC may become aware of the remediation through the breach reporting regime as we've touched on earlier, or through targeted surveillance, or reports from external parties, including competitors sometimes.

Licensees are expected to cooperate with ASIC throughout that remediation process, and then as far as APRA regulated bodies are concerned, it may also be necessary to notify APRA of relevant breaches and cooperate with APRA throughout the relevant remediation. Licensees have to be members of AFCA, and consumers have a right to make a complaint to AFCA related to the licensee and the remediation process, and licensees also have an obligation to take reasonable steps to resolve complaints with AFCA, and AFCA, of course, has a much broader jurisdiction than strictly legal principles.

Licensees may also need to engage with the ATO where there are tax impacts or uncertainties connected to the remediation payments. One area of importance from a regulator perspective is to consider how available sources of funding for remediation purposes are going to be identified and deployed. So, for example, in the case of superannuation remediations, a trustee may have a duty to remediate because of its trustee fiduciary duties, but it may also have an ability to be indemnified out of the fund assets in accordance with a trust deed, the governing rules and its right to general law in relation to indemnification.

That, of course, can depend on the nature of the conduct that gave rise to the loss and, for example, just one example, would be unavailable if the loss arose from a failure of the trustee to act honestly. However, typically with retail super funds, the regulators have the propensity to want to see the shareholders fund the remediation rather than calling on fund assets, including access to risk reserves. Funding may also be available through

professional indemnity insurance cover depending on the type of cover that the licensee holds, but you then need to look at conditions that might attach to that insurance, in particular, whether it's a voluntary compensation, whether it's a regulator required compensation, and whether remediation is otherwise would have been required by law.

Alternatively, if the loss can be attributed in part or in whole to a third party service provider, then clearly the licensee may be able to pursue a claim against that third party to recover costs depending on the scope of indemnities. In the case of the trustee, it may have an obligation to consider and/or to access and pursue liability against third parties.

And finally, in some circumstances, funding may be available for a parent or related entity, or that parent or related entity may carry out the remediation on behalf of the licensee. There are limits to those principles, of course. Even if external funding is used, the licensee will remain ultimately accountable for ensuring the customers are adequately compensated, and, of course, this will require resources.

Hugh Paynter

Quite right, Michael. A very important factor is to consider the importance of ensuring that remediations are adequately resourced which assists to ensure that the process is efficient and fair. This would depend on the size and complexity of the remediation, but includes appropriate financial resources, the number of people with sufficient knowledge, skills, experience, support and expertise, sufficient technology and data infrastructure, and appropriate recordkeeping systems – all really important practical issues. Adequate resources are crucial to avoid unjustified delays and adhere to the efficient, honest and fair duty.

Danielle Briers

Absolutely, Hugh, There's also a really big focus on governance around remediations. The regulator will be looking to see is there is appropriate governance and oversight of the remediation program by senior executives and directors of the organisation, are there measures in place to review and test the design of the remediation, and that might be internally or by an external party such as an expert consultant, and, importantly, are any governance measures appropriately documented because those documents will be really important in showing the positive remediation culture within the organisation that the regulator is looking for.

I think that's all we have time for today. Thanks very much Michael and Hugh for the discussion, and thank you to all the listeners for joining us today.

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