FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

28 February 2020

Mr James Kelly
Division Head
Financial Services Reform Taskforce
Treasury
Langton Cres
Parkes ACT 2600

Email: FSRCconsultations@treasury.gov.au

Dear Mr Kelly

FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2 (Reference checking and information sharing, breach reporting and remediation)

The Financial Planning Association of Australia[1] (FPA) welcomes the opportunity to provide feedback on the draft legislation to implement Commissioner Hayne's recommendation in regard to reference checking and information sharing, breach reporting, investigations and remediation.

The FPA supports the intent of the draft legislation and explanatory memorandum and provides feedback to improve the workability and effectiveness of the proposed obligations. Our submission relates to financial advice and the Australian Financial Services licensing regime only.

The FPA would welcome the opportunity to discuss with the Treasury the issues raised in our submission. If you have any questions, please contact me on ben.marshan@fpa.com.au or on 02 9220 4500.

Yours sincerely

Ben Marshan CFP® LRS®
Head of Policy and Professional Standards
Financial Planning Association of Australia

[1] The Financial Planning Association (FPA) has more than 12,919 members and affiliates of whom 10,618 are practising financial planners and 5,540 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:
- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent Conduct Review Commission, chaired by Dale Boucher, dealing with investigations and complaints against our members for breaches of our professional rules.
- We are recognised as a professional body by the Tax Practitioners Board.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 26 member countries and the more than 188,104 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 18 Australian Universities for degrees in financial planning. Since 1st July 2013 all new members of the FPA have been required to hold, or be working towards, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally.

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Financial Sector Reform Bill:

FSRC rec 1.6, 2.7, 2.8, 2.9 and 7.2

Reference checking and information sharing, Breach reporting and remediation

28 February 2020

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Treasury

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Reference checking and information sharing framework

The FPA supports this measure as it enables greater sharing of information between AFS licensees, and between AFS and Credit licensees, to enhance the ability of businesses to carry out more thorough and reliable reference checks on prospective representatives.

The FPA would welcome the opportunity to work with ASIC to ensure the Regulator's Reference Checking and Information Sharing Protocol supports the intent of this measure.

The FPA provides the following feedback on the draft legislation to implement Royal Commission recommendation 2.7.

The FPA understands from consultation and further engagement on this issue that the following recommendations regarding the draft legislation on reference checking and information are also supported by other key professional bodies.

Representative protections

Section 912(3B)(a) of the draft legislation states that "the Reference Checking and Information Sharing Protocol must not require or permit personal information (within the meaning of the *Privacy Act 1988*) to be shared, other than with the consent of the individual to whom the information relates...". As discussed in the Explanatory Memorandum, this is consistent with the Privacy Act 1988 (1.31).

The draft legislation introduces transparency to the job market for financial advisers by requiring reference checks about the formal compliance records of individuals. While openness of an individual's desire to change employer may be well established in some professions, such as teaching, this is not common practice in the financial services sector. This creates a concern that there may be implications or repercussions for the person wanting to leave an organisation if they request their current licensee share information with a potential new licensee, therefore divulging to their current licensee that they are intending to leave the organisation.

This measure requires the sharing of objective information to identify if an individual has previously breached a legal obligation, rather than subjective views about a person. The focus of the reference checking on compliance information creates some degree of natural controls in the system as many instances of non-compliance and breaches would have been reported to ASIC by the licensee under the breach reporting regime. In some instances, compliance issues will also be recorded on the Financial Adviser Register. However, there may also be compliance matters that are not required to be reported to ASIC. While the focus of the requirement is on the sharing of factual, objective information, and therefore there are some natural controls in place, it does not eliminate the risk of vexatious motivations.

The FPA suggest an avenue for recourse should be considered for representatives who notify their current licensee of their intent to leave the organisation for the purposes of the reference checking requirements, including against the sharing of unfounded negative information and repercussions for the individual. This could be achieved by including the in Protocol the ability for the representative to make a complaint to ASIC for investigation should the individual face repercussions or an unfounded negative reference from the former or current licensee.

As part of this process, consideration could be given to requiring the former or current licensee to provide ASIC with a copy of the shared information in cases where an unfounded negative reference is provided. In addressing the complaint, ASIC should consider whether the unfounded negative reference was not objective nor based on fact.

> Recommendation – The FPA recommends the Reference Checking and Information Sharing Protocol include the ability for the representative to make a complaint against a former or current licensee, to ASIC for investigation, should the individual face repercussions or an unfounded negative reference from the former or current licensee.

Designated reference checker

The FPA notes and supports that the draft legislation creates obligations for licensees to participate in a 'compliance check' of prospective representatives, on top of the 'referee check' about the individual's performance.

It is understood that ASIC will not be creating or maintaining a register of 'designated reference checkers' in each licensee. Rather, it has been suggested that each licensee could publish contact information of the individual responsible for providing reference-checking information on the licensee's website. Concerns have been raised that this may have the effect of mandating that all licensees have websites, which may not currently be the case, particularly for some small licensees and sole traders. There are also example in the industry of financial planning practices having websites but their licensees do not have a website.

The FPA suggests flexibility should be given to the means in which licensees make available relevant information about the 'designated reference checker'.

The FPA recommends one-off funding be provided by Government to ASIC to make this register available if it is currently outside their capabilities. The FPA considers ASIC should be responsible for the 'designated reference checker' register as it is imperative that the Information Sharing and Reference Checking Protocol works well and consistently in order to deliver protection benefits for consumers.

However, to ensure any ASIC register is cost effective and does not create additional costs for industry of Government, consideration could be given to including the licensee's nominated contacts for compliance reference checking ('designated reference checker') in the ASIC professional register for AFSL holders. This register lists all the authorised representatives operating under the license and should be extended to include the licensee's 'designated reference checker'.

> Recommendation – The FPA recommends one-off Government funding be made available to ASIC to establish and maintain a register of 'designated reference checkers'. This information could be incorporated into ASIC's existing Professional Register for AFSLs.

Application of the reference checking requirements

The FPA notes that in relation to financial advice, the protocol will only apply to financial advisers who will potentially be providing personal advice to retail clients under the new licensee. Whereas, in relation to the credit licensees, the application of the protocol is significantly broader and applies to a "…mortgage broker or a director, employee or agent of a mortgage broker" (s912A(3D)).

Evidence provided at the Royal Commission and discussed by Commissioner Hayne in his final report included potential misconduct in relation to representatives providing general advice, directors, management and other employees of AFS licensees.

The FPA has clear examples of financial advisers who have been banned from providing financial advice by ASIC who move into management overseeing the provision of financial advice by employed or authorised financial advisers of the licensee.

The FPA recommends the Reference Checking and Information Sharing Protocol should therefore be extended to include individuals:

1. employed or authorised by AFSLs to provide general advice, and
2. with the responsibility or ability to influence the advice process, and
3. in management and directorships, including responsible managers.

The FPA notes that Commissioner Hayne identified cultural, behavioural and misconduct issues by other participants in the financial services industry such product providers including insurers and superannuation entities. Like all industries, there is also mobility in the financial services industry whether individuals may move across the sectors within financial services. The FPA suggest consideration should be given to extending the principles of the reference checking requirement to all AFSLs.

> Recommendation - The FPA recommends the Reference Checking and Information Sharing Protocol:
>
> 1. should be extended to include individuals:
>   a. employed or authorised by AFSLs to provide general advice, and
>   b. with the responsibility or ability to influence the advice process, and
>   c. in management and directorships, including responsible managers.
> 2. apply to all financial services and AFS licensees.

Record keeping

Section 912A(3A)(c) of the draft legislation permits ASIC to determine the protocol for the "keeping and retaining records of information shared, and the circumstances under which the information is shared". The Explanatory Memorandum explains that ASIC may also determine the types of information that should be sought and shared about an individual.

The draft legislation references the Privacy Act in regard to the meaning of 'personal information'. However, the Privacy Act 1988 also includes an exemption from certain aspects of the Act in relation to an employee's personal information. It sets meanings of the 'employment relationship' and what constitutes an 'employee record'[2].

> *"This means that the exemption will not apply to the collection of personal information about prospective employees who are subsequently not employed by an organisation, such as unsuccessful job applicants. However, once an employment relationship is formed with an*

[2] https://www.oaic.gov.au/privacy/privacy-for-organisations/employee-records-exemption/

individual, the records the employer holds relating to that individual's pre-employment checks become exempt."[3]

The FPA recommends the legislation and Explanatory Memorandum should appropriately reference the Privacy Act 1988 beyond just the meaning of personal information. It should include references to the requirements and exemptions in relation to the collection and retention of personal information about a former, current or potential employee/representative. This will ensure the ASIC protocol will incorporate and enable licensees to comply with the requirements of both the Privacy Act and Corporations Act.

> Recommendation - The FPA recommends the legislation and Explanatory Memorandum appropriately reference the Privacy Act 1988 and include references to the requirements and exemptions in relation to the collection and retention of personal information about a former, current or potential employee/representative.

Corporate Authorised Representatives

The Privacy Act includes an exemption in regard to the sharing of personal information in relation to current or former 'employee relationships'.

The draft legislation places the reference checking and information sharing obligations on the licensee.

However, it is unclear whether a licensee is the most appropriate entity to participate in the reference check of a current or former representative when a Corporate Authorised Representative is the authorising organisation.

It is also unclear how the following aspects of the Privacy Act apply when a Corporate Authorised Representative authorises or employs the representative, not the licensee:

- the definition of 'employment relationship'
- the application of the employee records exemption
- Contractors of employers.

> Recommendation - The FPA recommends consideration be given to situations where the authorising entity is a Corporate Authorised Representative.

Transition arrangements

The proposed transition arrangements should provide ASIC with appropriate time to undertake the required consultation to develop a robust protocol in line with the intent of Commissioner Haynes recommendation. It should also provide industry with sufficient time to implement any changes necessary to meet the new obligations.

[3] https://www.oaic.gov.au/privacy/privacy-for-organisations/employee-records-exemption/

However, industry's ability to prepare for the introduction of the requirements is dependent on when the Protocol is finalised, and an appropriate 'designated reference checker' register is developed.

The FPA suggests consultation is needed to ensure the lessons identified through the implementation of the ABA Protocol, can be considered.

> Recommendation - The FPA supports the proposed commencement for the new Reference Checking and Information Sharing Protocol of 1 April 2021.

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Breach reporting, investigating and remediating misconduct

The FPA supports measures to enhance consumer protections by improving the identification, investigation and reporting of breaches of the Corporations Act.

The Regulator plays a fundamental role in ensuring the confidence and protection of consumers, which is paramount to the effective and sustainable operation of Australia's financial service sector. ASIC enforcement role in the breach reporting regime must be consider in the development of these legislative changes.

Improvements in the breach reporting system must be consumer focused, and balance the need to enhance transparency, increase ASIC's ability to be made aware of breaches in a timely fashion to protect consumers, support investigative due process, and ensure the finite resources of licensees and the Regulator are spent on issues at risk of causing significant consumer detriment.

The FPA provides the following feedback on the draft legislation and Explanatory Memorandum to implement Royal Commission recommendation 2.8 and 7.2 in relation to the Corporations Act requirements for financial advice providers.

Interaction with IDR / EDR requirements

The FPA seeks clarity on how the proposed breach reporting, investigation and remediation requirements interact with the similar requirements for internal and external dispute resolution. Both the draft legislation and the IDR/EDR obligations mandate licensees to undertake the same type of action, which is to investigate, report and remediate. However, the specific requirements on how licensees should undertake such action differs slightly. This creates the potential for expensive duplication and oversight and potential confusion for consumers and industry.

The FPA suggest Treasury, ASIC and AFCA consider how these two sets of requirements can be rationalised to ensure the intent of both measures is achieved in a manner that improves consumer outcomes through cost effective and efficient regulation.

> Recommendation – The FPA recommends the interaction of the proposed breach reporting, investigation and remediation requirements be clarified and rationalised.

Application of the legislation

The implementation of the Royal Commission offers an opportunity to increase the accountability of all participants in the financial services sector to improve consumer outcomes. However, the draft legislation includes the following requirements that apply only in cases where personal financial advice has been to a retail client in relation to relevant financial products:

- 912DAC Obligation to lodge a report—reportable situations in relation to other financial services licensees
- 912EA Reporting to clients affected by a reportable situation
- 912EB Obligation to investigate reportable situations that may affect clients

The Royal Commission heard evidence of misconduct affecting consumers in relation to all financial services. It is therefore concerning that key elements of the draft legislation proposing to address this misconduct applies only to situations where personal financial advice has been provided. For example, sections 912EA(1)(a) and 912EB(1)(a) restrict the obligation to notify the affected client of a reportable situation, and the requirement to investigate the reportable situation, to situations where personal advice has been provided to the affected client. This effectively provides an exemption from these obligations to all other financial services creating a significant gap in the consumer protections this legislation is intended to provide, including the provision of personal advice to sophisticated investors and wholesale clients, general advice, the issuing of a product and other financial services.

The FPA understand these provisions make it clear that where personal financial advice has been provided licensees must undertake certain action. However, the legislation should be drafted so that it does not, by default, then exempt other financial services and licensees from the requirement.

> Recommendation – The FPA recommends the breach reporting, investigation and remediation requirements should apply to all financial services and all AFSL holders.

Dual regimes and transitional arrangements

Section 1670A of the draft legislation proposes that the existing breach reporting requirements continue to apply "…*in relation to breaches or likely breaches that occur before 1 April 2012*". The transitional provisions in Part 10.43 apply the new breach reporting, investigation and remediation requirements to reportable situations arising on or after April 2021.

The FPA is concerned that tying the transitional arrangements to the time the breach (or reportable situation) occurred will create dual breach reporting regimes. This will add to the complexity of the regime as licensees will be required to meet the breach reporting requirements that apply to each breach or likely breach depending on the date of the breach occurred. This will require licensees to operate two separate systems and processes for identifying and reporting breaches and likely breaches.

The proposed breach reporting requirements will however significantly increase the reporting and record keeping obligations for all licensees. This will require industry to review and upgrade processes and system to meet the new obligations.

The FPA believes more time is needed for industry to upgrade compliance systems to meet the new breach reporting, investigation and remediation requirements and therefore consideration should be given to extending the transitional arrangements.

> Recommendation - The FPA recommends the new breach reporting, investigation and remediation regime should apply to all reportable situations from 1 July 2021 regardless of when the breach or likely breach occurred.

APRA regulated entities

ASIC is the Regulator with oversight of the provisions in the Corporations Act relating to financial advice, conduct and licensing. APRA is the prudential regulator. The FPA supports efficient regulation and acknowledges that some licensees are also regulated by APRA. Equally, financial advisers are regulated by the Tax Practitioners Board, FASEA, registered with ASIC, and will soon be regulated by a single disciplinary body.

Sections 912DAB(6) and 912DAC(4) of the draft legislation allow APRA regulated entities to give the breach report to APRA as a means of meeting the new breach reporting requirements. The FPA opposes this element of the draft legislation.

A great deal of the evidence received by the Royal Commission related to breaches of the Corporations Act by APRA regulated entities and, in many instances, involved the views and interpretation of the significance test by such entities resulting in no or little action, investigation, reporting or consumer compensation.

In his final report, Commissioner Hayne also raised concerns about the ability for ASIC and APRA to share information and work effectively together. While legislative changes will permit ASIC and APRA to share information and cooperate more broadly on regulatory matters, it is yet to be seen whether this will overcome the cultural differences in how the two regulators enforce and oversee industry to enhance their working relationship and improve the regulatory oversight of the financial services sector.

The FPA supports measures that reduce the burden of dual-reporting. However, we are concerned about the ability of regulators to effectively share information in a timely manner and decide which of them should look into which breach. This creates an unnecessary risk that breaches may fall down gaps, or a lack of consistency to enforcement and in actioning breaches between ASIC and APRA may lead to licensees selecting a preferred Regulator.

The FPA is concerned that the issues in relation to breach reporting and the application of the significance test, even under the proposed strengthened test, will not be overcome if APRA regulated entities are permitted to report to APRA such breaches of the Corporations Act.

> Recommendation - The FPA recommends all breaches of reportable situations under the Corporations Act must be reported directly to ASIC by all licensees in the first instance, and sections 912DAB(6) and 912DAC(4) of the draft legislation be removed.
>
> It is reasonable to expect such reports to also be provided to other regulators, including APRA and the TPB, by the licensee or ASIC. This should not be an onerous task as long as the breach report is accepted by other regulators in the form prescribed by ASIC.

Proportionality

Schedule [1.6, 2.8, 2.9 and 7.2] of the draft legislation introduces a significant increase in the mandated requirements in relation to breach reporting, and investigating and remediating misconduct.

The FPA is concerned that the draft legislation poses the following issues, which will hinder achievement of the intent of the measure:

- A rapid increase of breaches reported to ASIC, and
- Obligations on licensees are too onerous.

Investigating and reporting breaches to ASIC is only one part of this measure. For the intent of the legislation to be achieved, ASIC must have the capability to respond to licensees, and filter through the breach reports efficiently and effectively to identify serious breaches and systemic issues for enforcement action in a timely manner. The expected rapid increase in breach reports will make it

more difficult for the Regulator to undertake effective and timely enforcement action, and creates the potential for some breach reports to fall through the cracks.

The FPA is also concerned about the potential to misunderstand the new requirements and that this could create onerous obligations for licensees, disproportionate to the breach or likely breach, including spending an increased amount of time and resources on investigations where no breach is found. The following example serves to illustrate this point.

> *An adviser bought a new investment for a client (an ASX traded ETF) and soon after a distribution was paid to the client, however it was paid before the paperwork the adviser has submitted to the registry with the client's bank payment details had been processed (hence there were no bank account details to pay it to). The registry then charged the client a $50 fee to re-issue the payment to the client's banks account. Once made aware of this issue, the adviser contacted the registry to resolve the matter and the paperwork with the client's bank details were processed quickly, the client was remediated for the $50 fee and the distribution paid to the client within days of the adviser being notified of the matter. The client was satisfied with the action taken.*

Under the proposed s912D(5) in the draft legislation, the above scenario may be required to be investigated as personal advice had been provided to the client (912EB(1)(a)), while this was an administrative error it could be viewed that it is a potential breach of s912A(1)(a) if the financial service was not provided efficiently, and it is significant as it has resulted in loss to the client.

As the share registry is also an AFSL holder, the adviser's licensee would need to investigate if the adviser or the licensee had breached its obligations, as well as if there were reasonable grounds to suspect that the registry breached its core obligations.

The licensee would have 30 days to commence an investigation from the time the breach or likely breach was known to them. As the licensee is investigating the matter it must report to ASIC within 30 days of commencing the investigation. If the investigation disclosed no reasonable grounds that a breach had occurred, it has 10 days to notify ASIC of this finding. If the investigation disclosed reasonable grounds to suspect that the share registry breached its obligations, the adviser's licensee has 30 to report this finding to ASIC and the share registry. Civil penalties apply to some of these requirements.

While it is reasonable to expect an organisation to look into matters that impact consumers, the proposed requirements to undertake an investigation and report to ASIC have the potential to create a significant burden particularly for administrative errors and matters resulting in low value consumer loss, which can be resolved quickly and simply. It brings into question whether the time and resources spent on meeting the new breach reporting and investigation requirements exceed the loss incurred by the client and offer any consumer benefit. In the above example, the investigation and reporting requirements would not likely deliver any improvements to the outcome for the client. It would however significantly increase the cost of resolving the issue and providing advice to consumers.

Similarly, a late Fee Disclosure Statement (FDS) would trigger a breach report to ASIC and an investigation as the provision to give an FDS is both a core obligations and significant under proposed s912D(5)(b) as it attracts a civil penalty. However, the impact to the affected client of receiving an FDS two days late may be minimal.

The FPA has long raised concerns about the subjectivity of the current significance test. The evidence provided at the Royal Commission reinforced these concerns. We agree the current significance test must be amended. However there is a need to streamline the proposed investigation and breach reporting requirements to improve the draft legislation for licensees, ASIC, and consumers.

There are various compliances methodologies used by licensees to monitor the provision of financial advice by their representatives. Licensees maintain a register of compliance matters and audits as part of the record keeping requirements. To meet the proposed breach reporting requirements licensees would be required to duplicate this data entry into ASIC's prescribed form.

Recommendation - The FPA recommends:

- the investigation required to be undertaken by licensees must be proportionate to the breach, or likely breach, and the significance of the breach, particularly in relation to consumer loss of damage and frequency of the breach. The legislation should allow licensees to take reasonable steps to achieve the intent of the legislation.

- It is also suggested that ASIC's prescribed form must clearly identify the information required, be flexible to cater to different business models and different types of breaches, and be automated and reliable with the capacity for an open data format. The Regulator would require appropriate data mining capacity to search breach reports and identify the most serious breaches and systemic issues for enforcement action. This may require ASIC to improve the speed and reliability of its current licensee portal.

- Examples in the Explanatory Memorandum may assist in improving industry understanding regarding when an investigation is required and a breach report is necessary.

Meaning and understanding of 'investigation'

An investigation is "the process of trying to find out all the details or facts about something in order to discover who or what caused it or how it happened"[4].

The draft legislation requires licensees to report to ASIC if a breach or likely breach has occurred, and if the licensee has commenced an investigation to determine if a breach or likely breach has occurred. This is likely to result in licensees reporting even slight variations in their compliance audits in an effort to comply with the new requirements. The reason for this approach may be due to the practical interpretation of the word 'investigation'.

For example, in practice a licensee may conduct an 'initial investigation' to determine if a breach has occurred; and then, if a breach is confirmed, an 'in-depth investigation' to examine the breach in detail and how the breach occurred. However, if the 'initial investigation' discloses no reasonable grounds to believe a breach has occurred, no further investigation is undertaken.

Placing reporting requirements on investigations that disclose reasonable grounds that a breach or likely breach has occurred would significantly reduce the risk of issues arising from unnecessary breach reporting (discussed below).

[4] https://www.macmillandictionary.com/dictionary/british/investigation

Recommendation - The FPA suggests consideration be given to separate definitions and requirements for 'initial investigations' to determine if a breach has occurred, and 'investigations' involving confirmed breaches.

Timeframes

The draft legislation sets the following timeframes for investigating and reporting breaches and remediating clients:

An investigation must commence within 30 days after the licensee first reasonably knows that there are reasonable grounds to suspect that the affected client has suffered or will suffer loss or damage as a result of a significant breach of a core obligation, or gross negligence or serious fraud (s912EB(1)).

Within 30 days:

- A report must be lodged with ASIC if:
    - the licensee has reasonable grounds to believe a reportable situation has occurred
    - the licensee has commenced an investigation
    - the investigation discloses no reasonable grounds to believe that the financial services licensee or a representative of the financial services licensee has breached the core obligation (912DAB(4))
    - if a licensee has reasonable grounds to suspect that the reportable situation has arisen in relation to another licensee (912DAC(3)). The licensee also has 30 days to provide a copy of the report to the licensee suspected of the reportable situation (912DAC(7)).
- Client notification and remediation, within 30 days:
    - after the licensee first reasonably knows that there are reasonable grounds to suspect that the affected client has suffered or will suffer loss or damage, notify the affected client of the reportable situation (s912EA(2)(c))
    - after the completion of the investigation, pay compensation to the affected client for loss or damage (s912EB(6)).

Within 10 days:

- A report must be lodged with ASIC if the investigation discloses either there are reasonable grounds, or no reasonable grounds, to believe that a breach of the core obligation has occurred (912DAB(5)(c))
- of completing an investigation, notify the affected client of the outcome of the investigation 912EB(5).

Section 912EB(4) requires the investigation to be "completed as soon as is reasonably practicable after it is commenced". To understand what is "reasonably practicable", consideration should be given to the following matters and practices used to identify and investigate potential breaches:

- Complexity of investigations - Investigations can involve thousands of files and advice provided more than a decade ago. For example, feedback from an FPA member cites a review of Agribusiness advice prepared in May 2007 that the client raised concerns about in 2010, with the client loss officially crystallised in 2015. The duration of the advice, and the associated evidence adds to the complexity and timeliness of the investigation. Another example involving an investigation of a single client file that covers 6 years of advice and the review of over 1,200 separate documents - covering all communication to/from an adviser, all paperwork, advice documents, and file notes etc.

- Changes in the law – There has been significant changes in the legal requirements for providing financial advice over the past decade including the FoFA reforms, Life insurance Framework, Tax Agent Service regime, and the new education and professional standards currently being implemented. These changes add to the complexity of investigations as consideration must be given to the laws in place at the time the advice was provided.

- External consultants - It is common for small licensee to outsource compliance and investigations to an external compliance consultant. To meet the proposed timeframes would require the external consultant to be able to start immediately, undertake their investigation, report back to the licensee and a decision to be made.

- Board approvals - For some licensees, it is likely that organisational governance includes decision-making processes requiring Board approval prior to the payment of remediation, for example.

- PI insurers – PI insurers commonly become involved in the investigation process. This often results in the PI insurer taking over the running of the matter. It is common practice for the licensee to inform the PI insurer; the PI insurer informs the insurer's lawyer; the lawyer then can contact an external consultant to review the advice and provide its conclusion back through the chain of communication. The PI insurer recommends which course of action the licensee should take, for the licensee to consider. The completion of this process can take time.

The FPA is concerned that these timeframes ignore the role of professional indemnity insurers in the investigation of breaches and may not provide adequate time for investigative due process, particularly for small licensees.

The FPA supports the intent of the proposed timeframes to improve consumer outcomes, to ensure matters are investigated and addressed to minimise consumer harm, and that affected clients are appropriately remediated. The FPA is particularly concerned about the impact of corporate governance and organisational Board arrangements on the ability of licensees to meet the timeframe for paying remediation to clients following the completion of an investigation.

> Recommendation – The FPA recommends the proposed timeframes include flexibility to allow for PI insure involvement, corporate governance arrangements of licensees, and the complexity of some investigations, particularly in relation to completing investigations and remediating clients.

Significance test

The FPA has long raised concerns about and called for changes to the existing significance test for reporting breaches to ASIC. As shown at the Royal Commission, the variance in licensees' interpretation of the current significance test has proven to be at the heart of inaction at the hands of some licensees and under reporting of breaches to ASIC.

The FPA welcomes the proposal to amend the significance test and supports a test that is consumer focused (rather than focused on the impact of the potential breach on the licensee) and able to be applied consistently across the industry regardless of licensee scale, nature, structure, and complexity of the business.

The FPA believes the replacement of s912D(1)(b)(iv) with the proposed s912D(5) in the proposed significance test will significantly shift the way in which industry assesses the impact of breaches and likely breaches, toward consumer impact and potential contraventions of key consumer protection provisions in the Act, such as the best interest duty and conflicted remuneration. The FPA supports the removal of the requirement to consider the "actual or potential loss to the licensee".

However, we are concerned about the risk of ASIC becoming inundated with breach reports and licensees undertaking investigations that disclose no reasonable grounds to believe there was a breach, and for administration errors where the minimal loss to the consumer is addressed and the issue resolved quickly, as discussed above.

The FPA notes s912D(5)(b) introduces a contravention of a civil penalty provision as a measure of the significance of a breach of a core obligation. Reliance on the penalty provisions in the Act offers a clear link between the breach of a specific legal obligation and the need to report. This includes provisions relating to the best interest duty for financial advice providers, conflict remuneration obligations, giving defective disclosure documents to clients, among other core financial services obligations. It also includes the requirements related to giving a retail client a fee disclosure statement (FDS).

Under s912D(5)(c) of the draft legislation a breach, or is likely to result, is significant if it results in loss or damage to clients. The FPA supports the inclusion of this element of the proposed significance test. However, as discussed above, the proposed requirements to undertake an investigation and report to ASIC have the potential to create a significant burden particularly for administrative errors and matters resulting in low value consumer loss, which can be resolved quickly and simply. It brings into question whether the time and resources spent on meeting the new breach reporting and investigation requirements exceed the loss incurred by the client and offer any consumer benefit in some circumstances.

This issue may be because there is no materiality test on consumer loss or damage. However, it is difficult to attach a materiality test to consumer loss or damage as materiality is subjective and varies significantly depending on each person's circumstances and worldview. It also creates a risk that such a test could be interpreted inconsistently by industry, as evidence has shown is the key issue with the current significance test that these amendments are trying to address.

The FPA supports the intent of the proposed amended significance test and recommends consideration must be given to the whether it will deliver improved consumer outcomes.

Recommendation - In addition to the recommendations provided above (see Proportionality section), the FPA recommends further consultation on the significance test could assist Treasury with improving the test to ensure the new significance test will deliver benefits for consumer.

Reportable situation

The FPA supports the definition of *reportable situation* in the s912D(1) of the draft legislation. Section 912D(2) expands the definition of reportable situation to include "conduct constituting gross negligence" and "serious fraud". The FPA supports such conduct being included in a separate section of the reportable situation definition as it means such behaviour is not reliant on the significance test.

Civil penalty provisions

It has been proposed to apply a civil penalty provision to s912DAB(8), s912DAC(8), s912DAD(4) and s912EA(3) of the draft legislation. The FPA notes that the Regulator may also impose a financial penalty or issue an infringement notice. The FPA questions who a penalty of imprisonment would be imposed upon if the licensee in breach of a provision was an entity.

The FPA is particularly concerned about the application of a civil penalty to s912DAC(8) which applies a civil penalty when a licensee breaches the proposed requirement to report on a suspected breach by another licensee to ASIC and the other licensee. This raises concerns of fairness and equity given the licensee who is suspected of the breach may only incur a maximum of a financial penalty or infringement notice depending on the provision of the Act it has breached, yet the reporting licensee could incur a civil penalty for failing to report the suspicion that the breach occurred.

Recommendation - The FPA recommends s912DAC(8) be removed and the legislation consistently apply an offence under s1311(1) to s912DAC.

Reporting on other AFSL's adviser

The FPA supports the concept of requiring a licensee to report to ASIC on advisers of other AFSLs. This is consistent with the requirement placed on financial advisers to "….*hold each other accountable…*" as required under Standard 12 of the Financial Planners and Advisers Code of Ethics 2019[5].

The Explanatory Memorandum acknowledges the potential gaps in information in breach reports under s912DAC given the reporting licensee will not have access to all of the relevant information on the suspected breach.

The FPA is also concerned about the potential for vexatious reports or anti-competitive behaviour in relation to reporting advisers of other licensees.

Recommendation - The FPA reinforces the need for the ASIC's prescribed form for reports on advisers of other licensees to allow for information gaps without penalty to the reporting licensee.

[5] https://www.legislation.gov.au/Details/F2019L00117

The FPA recommends ASIC be required to discourage and investigate potential anti-competitive behaviour in relation to reporting advisers of other licensees.

Reporting to clients affected by a reportable situation

Section 912EA(1) of the draft legislation requires licensees to take reasonable steps to notify affected clients that a reportable situation has arisen and there are reasonable grounds to suspect that the affected client has suffered or will suffer loss or damage as a result of the reportable situation.

The FPA acknowledges that a key intent of the draft legislation is to ensure that clients are protected and to eradicate past practices that left some clients uninformed of investigations regarding their advisers for a number years. This put the clients at significant risk and was unacceptable.

The FPA supports the intent of the legislation to ensure affected clients are appropriately remediated, and the requirement for licensees to notify affected clients following the completion of the investigation under s912EA(5).

However, the FPA is concerned about the fairness in requiring a licensee to notify affected clients a reportable situation has arisen prior to an investigation confirming that there are reasonable grounds to believe a breach has occurred, and how the client may be affected by the breach. Notifying clients that the licensee is investigating their financial adviser will have significant and long-lasting effects on the adviser-client relationship, the adviser's reputation, and the goodwill and reputation of the adviser's business. This is an unreasonable impact to impose on an adviser prior to an investigation confirming a breach has occurred, the seriousness of the breach, and the impact to the client, and is counter to the principles of natural justice.

For example, the licensee errs of the side of caution and reports all compliance anomalies to ASIC. This has the potential to trigger an investigation on each anomaly and the requirement to notify the affected client their adviser is being investigated for a reportable situation. The investigation discloses no reasonable grounds that a breach occurred however, the client is left feeling insecure about the performance of their adviser.

Paragraph 3.79 of the draft Explanatory Memorandum states that at the completion of an investigation, there may be circumstances where "the client does not have a cause of action, or does not have a legally enforceable right against the licensee in relation to the reportable situation, or the client suffered no loss or damage as a result of the reportable situation".

Recommendation - The FPA recommends there needs to be an appropriate balance in the requirement to notify the client that the adviser is under investigation, to ensure consumers are protected and the principles of natural justice are applied, as this is currently unclear in the draft legislation and the Explanatory Memorandum. For example, consideration could be given to limiting the requirement to notify affected clients to incidents where an 'initial investigation' has confirmed a breach or likely breach has occurred and has identified how the affected client has been or is likely to be impacted, and to the completion of an investigation.

Product distribution and design obligations

Example 2.5 of the Explanatory Memorandum describes a product issuer auditing an adviser and reporting the adviser to ASIC for inappropriate advice. The new Product Design and Distribution obligations require product manufacturers to develop a target market determination for each product

that describes the client circumstances for which the product is most suited. However, financial advisers are exempt from the product design and distribution requirements as s961B of the Corporations Act requires financial advisers to recommend products that are in their client's best interest.

This raises the question as to whether the product issuer suspected the advice was inappropriate based on their own product target market determination, or because it may not have met the financial adviser's best interest obligations.

Recommendation - The FPA suggest an alternative example should be considered.

Publication of data

Section 912DAE of the draft legislation requires ASIC to publish licensee-level data on breaches with the stated intent to inform consumers and industry of bad behaviour. Section 912DAE(1)(a) requires ASIC to publish details of reports it receives in relation to s912D(1)(a)(i) and (ii) – that is, reports of a breach or likely breach of a core obligation.

The FPA supports the omission from the ASIC publication under s912DAE of s912D(1)(a)(iii) – "…licensee has commenced an investigation into whether the financial services licensee or a representative of the financial services licensee has breached a core obligation".

The draft legislation requires licensees report to ASIC within 30 days after the licensee first reasonably knows that there are reasonable grounds to believe a reportable situation has arisen (s912DAB(4)). However, the licensee will not know if an actual breach has occurred until the investigation is complete, or the 'initial investigation' discloses the occurrence of a breach or likely breach. This raises questions about the fair use of the information reported by licensees under s912DAB(4). For example, the FPA suggest it would be against procedural fairness for ASIC to record reports under s912DAB(4) as a breach, publish data against the licensee in relation to reports under s912DAB(4), or take any other action, until the licensee's investigation has, at a minimum, progressed to a stage where it can be confirmed that a breach or likely breach has occurred or that no breach has been found.

The FPA suggest a balance is needed between transparency and potential impacts to innocent parties.

The draft legislation also requires licensees to lodge a report with ASIC if the licensee commences an investigation, including investigations where the resulting investigation found no breach had occurred. Consideration should be given to potential negative implications for licensees and advisers who were subject to an investigation reportable to ASIC and where the investigation found no breach had occurred.

As stated above, the FPA supports the omission from s912DAE of licensees' reports of the commencement of an investigation (s912D(1)(a)(iii)) as it would be against natural justice for ASIC to include investigations in ASIC's publication of breach reporting data. The FPA notes s912DAE(3) allows for the regulations to prescribe circumstances in which information need not be included in the information published by ASIC. However, to make it clear, the FPA suggest the legislation should include a provision that ASIC should not include reports about investigations in its publication unless it has been confirmed that the investigation initial investigation disclosed that a breach had occurred.

The FPA questions why ASIC is not also required to publish data in relation to reports of conduct constituting gross negligence and serious fraud, which are reportable situations under s912D(2)(a) and (b). These are matters of serious and deliberate misconduct that result in negative consumer outcomes, and in most circumstances attract a criminal penalty.

ASIC breach reporting data should clearly articulate the severity of different breaches.

As previously mentioned, a key intent of the breach reporting legislation is to improve the enforcement of the Corporations Act. This can only be measured by transparent reporting of how ASIC responded to the breach reports received. The FPA recommends ASIC be required to publish its enforcement action taken in response to reported breaches in the Regulator's breach reporting data report.

To ensure the intent of this requirement is achieved, the information should be readable and accessible to all stakeholders to so it is not open to misinterpretation or disadvantages some parties over others.

ASIC is currently responsible for the AFSL register and the Financial Adviser Register (FAR), among others. It is suggested that information on breaches published by ASIC in a formal report should also be appropriately recorded on the licensee register in a consistent manner. This will improve the accessibility to information about misconduct for stakeholders who may not access a formal document such as an ASIC report.

The FPA appreciates the need for transparency in relation to ASIC enforcement in regard to consumer protection, evidence to inform effective policy development and regulatory oversight, and the impact ASIC's action and resource allocation has on the industry funding levy.

Recommendation – The FPA recommends:

- that ASIC does not record reports under s912DAB(4) as a breach, publish data against the licensee in relation to reports under s912DAB(4), or take any other action, until the licensee's investigation has, at a minimum, progressed to a stage where it can be confirmed that a breach or likely breach has occurred or that no breach has been found.
- the legislation should include a provision that ASIC should not include reports about investigations in its publication unless it has been confirmed that the investigation disclosed that a breach had occurred.
- ASIC publish data in relation to reports of conduct constituting gross negligence and serious fraud, which are reportable situations under s912D(2)(a) and (b).
- ASIC be required to publish its enforcement action taken in response to reported breaches in the Regulator's breach reporting data report
- information on breaches published by ASIC in a formal report should also be appropriately recorded on the licensee register in a consistent manner, to improve accessibility.

ASIC data analysis

An intent of the legislation is to stop misconduct in the provision of financial services. The FPA suggests ASIC should undertake appropriate analysis of the breach reporting data to track the impact of reforms on industry practices and identify potential emerging issues.

In particular, ASIC should track changes in breach reporting patterns and report on issues addressed by the Future of Advice (FoFA) reforms, Life Insurance Framework (LIF), and changes in regulatory requirements as part of Government's commitment to implement the recommendations of the Royal Commission.

> Recommendation – The FPA recommends ASIC be required to:
>
> - conduct data analysis to track the impact of reforms on industry practices and identify potential emerging issues.
> - report its findings as part of its annual breach reporting publication.

Gross negligence

The FPA notes s9 of the Corporations Act provides a clear definition of serious fraud. However, we seek clarity about the term 'gross negligence' and whether reliance on case law is sufficient for the breach reporting, investigation and remediation purposes.

While the FPA supports the use of case law in identifying 'gross negligence' at this time, we suggest consideration should be given to monitoring this practice to ensure a consistent interpretation of case law is being relied upon by industry and all matters of 'gross negligence' are being appropriately identified, investigated, remediated and reported, as required under the draft legislation.

> Recommendation – The FPA recommends monitoring the reliance on case law for the identification, reporting, investigation and remediation of matters involving 'gross negligence'.

Review of breach reporting requirements

> Recommendation - The FPA recommends the breach reporting, investigation and remediation regime should be reviewed annually to assess its effectiveness and workability. Consideration should be given to the following matters:
>
> - Is ASIC's metadata capability appropriately identifying breach reports involving conduct where consumers are at most risk?
> - Is ASIC spending unnecessary resources on oversight of the breach reporting regime with no noticeable benefit to consumers?
> - How has the breach reporting regime impacted the ASIC industry funding levy?
> - How much time are licensees spending on breach reporting?
> - Is ASIC's prescribed form appropriate and does it assist licensees to provide breach reports efficiently, consistently and in a timely manner?
> - Is there evidence of the new significance test being consistently interpreted and applied by licensees?
> - How the breach reporting interacts with IDR/EDR requirements and processes and whether any issues have been identified by licensees, advisers or clients.