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Australian Securities and Investments Commission (ASIC)
GPO Box 9827
Brisbane QLD 4001

By email: referencechecking@asic.gov.au

Dear ASIC,

AFA Submission – CP 333: Implementing the Royal Commission Recommendations: Reference Checking and Information Sharing

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a code of ethical conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

The AFA acknowledges that reference checking has not universally been applied at the required standard in the past and that it is appropriate to put in place a consistent standard across the financial advice sector. Whilst reference checking has in many cases been done well in the past, including through the ABA Protocol, the standard has been inconsistent and this seems to have led to some poor outcomes, as was demonstrated in some of the Royal Commission case studies. We support the utilisation of measures such as reference checking to assist in the removal of inappropriate people from the financial advice profession. This is in the best interests of clients and the advice profession as a whole.

It is however already the case that the level of diligence in the recruitment process has increased substantially over the last couple of years, and we anticipate that much of the problem has already

been addressed through changes in attitudes and practices. Nonetheless, the AFA supports increasing the standard for reference checking and the application of a consistent high standard across the advice profession.

In the past, the fear of defamation has been an important obstacle for some in providing negative feedback as part of a reference check. The protection that this Bill provides is important in overcoming this complication. It is important that it does apply as broadly as possible and is seen by participants to apply.

We note that the focus of this reference checking process is on fact based data. Whilst we understand that this is an important principle to ensure that the process has integrity and to reduce the risk of vexatious references, it will also limit the capacity for discussion about ‘gut-feel’ issues. In addition, if this reference checking process is going to become an entirely written exercise, then this will also limit that informal type of discussion that may influence the way a recruiting licensee considers a prospective adviser, and what further checks they may consider. It will be important, at a cross industry level, to assess the effectiveness of the new reference checking regime.

With all things related to financial advice, there is a need to find a sensible balance in the design and implementation of rules and standards to ensure that the cost impact is not excessive. Finding this balance is a key requirement and often in the past, these solutions have been overly conservative and costly. One suggestion that we are aware of, that we believe has merit, is the idea that there could be a check box at the top of the Reference template form for someone who is a ‘clean skin’ and no issues are present. This would prevent the referee from needing to respond to each individual question.

This reference checking standard will need to apply to all licensees, including those who are self-licensed or very small businesses. Large licensees will have dedicated staff to manage this process, however, that will not be the case for small businesses and they will, as a result, be under additional strain to ensure that they are capable of complying on a constant basis. We are concerned that the design of this solution does not adequately take into account the additional complexity and the resultant complications for small business licensees. We address this further below.

We find it interesting to note that this formal reference checking process applies only to financial advisers who provide personal advice to retail clients and mortgage brokers, and does not apply to financial services company executives or advisers who only provide personal advice to wholesale clients. We find it surprising that it would not apply to executives who represent most of the people who sat in the witness stand as part of the Royal Commission hearings. Like many of the Royal Commission recommendations, it has much more impact on the individual and small business end of the market, not the large institutions.

Review of Financial Sector Reform (Hayne Royal Commission Response) Bill 2020

We note that the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 did not include a Regulation Impact Statement, but instead included the following comment:

The Financial Services Royal Commission Final Report has been certified as being informed by a process and analysis equivalent to a Regulation Impact Statement for the purposes of the Government decision to implement this reform.

In our view, this statement incorrectly suggests that the Royal Commission did something similar to a regulation impact statement. From our understanding, the Royal Commission did not look at the impact of the recommendations, despite the fact that paragraph k of the Letters Patent stated:

We direct you to have regard to the implications of any changes to laws, that you propose to recommend, for the economy generally, for access to and the cost of financial services for consumers, for competition in the financial sector and for financial stability.

In addition, many of the recommendations were defined at a high level and did not involve specific solution design. There is no basis to suggest that the Royal Commission met the needs of an RIS.

We are also very conscious that there was no parliamentary inquiry to consider this Bill and in fact there was no debate at all in the Senate. For such an important Bill, that is a disturbing pathway, and therefore we are supportive of ASIC undertaking consultation on this matter and seeking broad input. As always, finding the right balance in terms of the cost of reform is critical.

We note that ASIC has repeated this claim by the Government in paragraph 136, that a process equivalent to a Regulation impact Statement has been undertaken through the Royal Commission. As mentioned above, we totally reject this proposition.

We are not in a position to provide an estimate of the cost of compliance with this reference checking process, however we trust that licensees will provide useful input on this issue. In aggregate, we continue to be very concerned about the amount of cumulative reform and the cost of complying with it and the resultant impact on both accessibility and affordability of financial advice for all Australians.

AFA Response to CP 332 Questions

B. Proposed Legislative Instrument—Obligations for Licensees

Obligations for Recruiting Licensees

Taking Reasonable Steps to Obtain a Reference

B1Q1 - Do you agree with our proposal? If not, why not?

The AFA supports the proposal with respect to what references are required, however we are cautious in terms of the value that will be derive by seeking a reference from an individual licensee on themselves. We also raise the prospect of someone who is an individual licensee for less than 12 months, and whether their previous licensee should also be required to provide a reference. It would be beneficial to understand how many individual licensees exist in the Australian AFSL market, to understand the significance of this group of licensees.

We support the approach with respect to flexibility in the timing of obtaining a reference, as some advisers will be hesitant to have the recruiting licensee contact their current licensee prior to having an offer of employment or appointment. This provides a sensible balance. We were surprised that there were no consultation questions on this approach.

B1Q2 - Do you think the obligation should be limited to obtaining a reference from the current licensee or—if a prospective representative is not currently with a licensee—their most recent former licensee in the five years before a request? If so, please give reasons why.

We agree with what has been proposed in that it would cover the current or most recent licensee, and where a person has been with their current/former licensee for less than a year, then the previous licensee as well. We think that this provides a sensible balance, acknowledging that a period of less than 12 months may not be enough time to form a comprehensive view.

B1Q3 - Do you think the obligation should be extended to all former licensees who employed or authorised the prospective representative in the five years before the request? If so, please give reasons why.

No, we do not think that this should be necessary. What has been proposed provides a sensible balance. The current or most recent licensee, should have done a reference check on the former licensee at the time of the previous appointment, and this information can be passed on through this process.

B1Q4 - If the prospective representative is a current licensee, do you think the recruiting licensee should be obliged to obtain a reference from them? If not, why not?

We agree that this is a bit of a questionable exercise, however the process needs to be applied consistently and someone needs to provide a reference for an individual licensee. As noted above, where they have been individually licensed for less than 12 months, then we would suggest that a former licensee should also be asked to provide a reference. We also note that recruiting licensees can choose to seek additional references, and where there are any warning signs, then we think that this would be appropriate.

B1Q5 - Do you think a recruiting licensee should be able to obtain from a current or most recent former licensee previous references provided to them under the ASIC protocol? If so, should a recruiting licensee still be required to obtain a reference directly from the additional licensee(s) about the prospective representative?

We have reservations about this, and how it might meet the consent requirements. We would suggest that the recruiting licensee should go directly to the former licensees if they felt that this was necessary. Issues can emerge over time and it may be wrong to place too much reliance on older references.

B2Q1 Do you agree with our proposal? If not, why not?

Yes. The licensee is ultimately responsible for any sub-authorised individual, so we certainly agree that they need to be central to any recruitment process and decision.

Seeking Consent of Prospective Representative

B3Q1 Do you agree with our proposal? If not, why not?

Yes, we agree with this proposal and support the importance of obtaining and only acting on the basis of a consent from the prospective financial adviser.

B3Q2 Do you think ASIC should prescribe a consent form? If not, why not?

We believe that standardisation is a positive and we would support ASIC prescribing a consent form.

B3Q3 Should the template consent form prescribed by ASIC require any further information to be disclosed to the prospective representative so they are better informed in providing consent? If so, what other information should be required?

We are not aware of any additional information that should be included.

B3Q4 Will this proposed obligation to obtain and provide written consent cause practical problems for licensees during the recruitment process? If so, please outline these problems and set out any views on how ASIC or industry can address these problems.

We do not believe that this requirement should cause a problem. The consent form should be built into the application process and included as part of the preliminary paperwork.

Requesting a Reference

B4Q1 Do you agree with our proposal? If not, why not?

We believe that it makes sense to have a written reference request form, that will ultimately be part of the record for the recruitment process.

B4Q2 Should the protocol require a request for a reference to include any other information? If so, what other information should be required?

The template reference request form is already very comprehensive. We do not have any suggestions for additional information. We are concerned that there is too much in the request form and that some of the elements, such as remedial action, do not adequately distinguish minor matters from material matters. The completion of a reference will become a much more complicated and costly exercise as a result of the implementation of the ASIC Protocol.

We believe that additional assistance is required in the definition of 'unprofessional conduct'. It may be necessary to include some examples of what should be included and what is not necessary.

Additional Requests for a Reference from the Same Licensee

B5Q1 Do you agree with our proposal? If not, why not?

We do not fully understand the requirement or importance of additional requests for a reference from the same licensee. If the questions are not going to change, then why is this required. It also seems inefficient to expect them to provide answers to all the questions that they have previously responded to.

Additional References from Other Licensees

B6Q1 Do you agree with our proposal? If not, why not?

We support the idea of seeking further feedback, particularly when there might be a reason for concern about the prospective representative. Licensees should be empowered to seek as many references as they deem appropriate, and to have the protection of the process.

No limitation on Requesting Additional Information

B7Q1 Do you agree with our proposal? If not, why not?

We are somewhat uncertain about the distinction between additional references as referred to above in B5 and additional information.

We are concerned that seemingly the defence of qualified privilege does not apply when requesting additional information. This is a poor outcome, and may discourage a licensee from seeking or responding to requests for additional information.

Obligations for Referee Licensees

Giving References

B8Q1 Do you agree with our proposal? If not, why not?

Whilst we agree with the proposal, we are also conscious that these timeframes might not always be possible. This is one area where thought needs to be given to small businesses. A small licensee, maybe with just one RM, does not have the resources to commit to always deliver to these timeframes. What might happen when they are on leave, including in the future going overseas? What if the key person is unwell and in hospital? Even the extension to 20 days would require an agreement between both parties, and this might be difficult to resolve for someone who is out of contact. We need to consider the implications for meeting these timeframes during the end of year holiday period.

As noted above, where the responses are entirely written and are 'complete, accurate and based on documented facts', it might limit the flow of some information that would be useful for the recruiting licensee.

B8Q2 Should we allow verbal responses to be given under the ASIC protocol? If so, why? How would the licensees manage the potential risks associated with the provision of verbal references?

We would agree that it is preferable to have responses in writing, however we also acknowledge as discussed above, that there may be reasons why a referee is not readily available and a verbal reference may be the only way that they can respond within the time limit.

B8Q3 Are there other ways to facilitate references being given by referee licensees under the protocol? If so, please explain.

One option might be for the recruiting licensees to take a verbal reference and then put that in writing for the referee to subsequently confirm or modify.

Updating a Reference

B9Q1 Do you agree with our proposal? If not, why not?

We support the concept of updating a reference with further information on matters that are unresolved, however we are cautious about this responsibility resting with the referee when they are a small licensee that lacks dedicated resources. In our view, we believe that it is more appropriate for this obligation to follow up, to rest with the recruiting licensee

B9Q2 Is the proposed six-month timeframe for an updated reference appropriate? If not, what timeframe would be appropriate?

In considering this we wondered whether there was some relationship between the six month limit on the consent form and the timeframe for follow up. We were wondering if this was scheduled for six months, in order to do it before the consent period ran out. This would probably prove to be problematic, as the consent may expire sooner than the follow-up occurs.

More broadly, we agree that most outstanding matters should be resolved within six months, although complaints that have been submitted to AFCA can often take longer. Other matters can sometimes take longer to be resolved. Nonetheless, it is sensible to define an end point, and six

months is reasonable.

B10Q1 Do you agree with our proposal? If not, why not?

We support the four grounds where the update would not be required, however note that there is a level of administration and investigation that would need to be followed to comply with this. The referee would need to check ASIC registers and their own records to assess whether they need to take any further action.

Obligations for All Licensees

Agents Acting on Behalf of Licensees

B11Q1 Do you agree with our proposal? If not, why not?

Yes, and we accept the fact that the licensee must remain ultimately responsible, even when appointing an agent.

B11Q2 Will this requirement cause any practical problems for carrying out a reference check? If so, please outline these problems.

We are not aware of any practical problems that are likely to emerge as a result of appointing an agent to manage the reference checking process.

B11Q3 Do you think a prospective representative must consent to a recruiting licensee using an agent to collect, use, disclose or store personal information on their behalf to undertake a reference check under the ASIC protocol? If not, why not?

We agree that this should be subject to consent by the prospective representative, and we note that this has already been built into Schedule 1 – Template Consent Form. This ensures that the Privacy Act considerations have been addressed.

Permitted Use of Information

B12Q1 Do you agree with our proposal? If not, why not?

We agree with the proposal which aligns with the requirements of the Privacy Act.

B13Q1 Do you agree with our proposal? If not, why not?

We are hesitant about the prospect of sharing the reference check report with the prospective representative. In our view, this might have a range of downsides, including acting as a constraint on the referee providing full and frank feedback. It might also expose the referee in the event that the prospective representative wanted to share information from it.

If the reference is supportive information then, there should be no need to share. If it contains information that is critical, then it might be best for the recruiting licensees to provide a summary of this information in a verbal form.

B13Q2 Should the protocol require a recruiting licensee to provide the prospective representative with the reference obtained from a referee licensee(s)? If so, please give reasons why.

We do not believe so. We understand that there is a right to request a copy, however we are

concerned that such a model would be counter-productive. Some employers are now hesitant to provide references for this exact reason.

B13Q3 Should the reference only be provided to the prospective representative with the consent of the referee licensee(s)? If so, please give reasons why.

If both parties consented to the provision of a copy then that would be fine, however this would need to be built into the process, possibly with a check box at the top of the reference template for the referee to note a willingness to share with the prospective representative.

B13Q4 What other mechanisms could be included to ensure fairness for the prospective representative?

We believe that the best way to approach it is for there to be disclosure of the types of issues that emerged in the reference check (i.e. complaints, audit issues, remediation), rather than provision of the actual reference or details on the issue. Prospective representatives should have the opportunity to discuss any reference feedback with the recruiting licensee, rather than getting a copy of the reference. Providing copies of references is not normal commercial activity.

No Arrangements or Agreements to Limit Information

B14Q1 Do you agree with our proposal? If not, why not?

We agree with this point, however we question why this prohibition has been limited to entering an arrangement or agreement with any individual. Why doesn't this also extend to companies and other entities?

Maintaining a Contact Point for Reference Checking

B15Q1 Do you agree with our proposal? If not, why not?

We appreciate that ASIC has based some of their protocol on the ABA protocol, however it is important to note that members of the ABA are not representative of the broader financial advice licensee population. The vast majority of financial advice licensees are small businesses and many of them will not have their own website. Paragraph 112 states that when a licensee does not have a website, they will need to have other arrangements to ensure that a recruiting licensee can readily identify how to make contact. What are the options that are both simple and low cost? The information sheet does refer to the main phone line, however this is not ideal.

ASIC already maintains a register of AFSLs. Why can't the reference checking contact details be added to the AFSL register?

A single central register is the best solution. A requirement to include this information on a company website will not make it easy to find. With space on the website precious, it is unlikely that licensees will be happy to devote a lot of room for details on the reference checking point of contact.

Another option would be to place a responsibility on the prospective representative to provide the contact details.

B15Q2 Will this requirement cause any practical problems for carrying out a reference check? If so, please outline these and any possible solutions.

We believe that searching for the contact details for a referee licensee could be challenging and

might get very complicated when there are licensees with similar names, or have recently changed names and where they are unknown and there is little information on them. Where they are difficult to find, this brings us back to the question of what ‘reasonable steps’ might involve. This should be addressed. At what point is it reasonable to stop looking?

Keeping Records

B16Q1 Do you agree with our proposal? If not, why not?

We agree with what has been proposed, however, we would add to this the point that dates are important. The date that the consent was provided, will dictate the date of expiry of the consent. The timeframe for responding to a request for a reference will be dependent upon the date it was requested, and the date that a reference report was provided, will dictate the six month update deadline.

B16Q2 Should licensees be required to keep any other records relating to reference checking and information sharing? If so, what other records should be kept?

The records would also need to include details of any extensions agreed between the recruiting licensee and the referee licensee on the submission of a reference.

Further, it may be appropriate to maintain records of any complaints with respect to the reference checking process.

C. Proposed legislative instrument—Template Reference Request

Whilst the Consultation Paper repeatedly seems to suggest that the ASIC Protocol will be very similar to the ABA Protocol, in our view this is not the case. The ASIC template is seeking much more information and going into much more detail. The ASIC template will be much more demanding and time consuming to complete.

We note the definition of compliance audit and the inclusion of a reference to an observation:

compliance audit, in relation to a representative, means an audit, review or observation by a financial services licensee ...

We are concerned about the potential implications of this, as question 2(b) simply refers to the last compliance audit, which presumably could be an observation. This is problematic if an observation is less detailed than an audit and could therefore result in less issues being reported. We would suggest that an audit needs to be discussed in terms of a detailed review of client files, and not left as vague as an ‘observation’.

Background Information on a Prospective Representative

C1Q1 Do you agree with our proposed questions? If not, why not?

Yes, however we are conscious that in a larger organisation, the person providing the referee report may not have had a direct working relationship with a former representative, and in any case, given the information is largely fact based, personal knowledge of the representative may be less important. This detail on the person completing the reference is not required in the ABA protocol.

C1Q2 Can you suggest any additional or alternative questions?

No. We have no additional suggestions.

Compliance Audits of a Prospective Representative

C2Q1 Do you agree with our proposed questions? If not, why not?

Please note our point above on the definition of a compliance audit. The questions on compliance audits have no sense of materiality. A failure to provide a copy of an updated FSG would probably lead to the same outcome (boxes ticked) as a failure to include a product replacement table in an SoA (if the advice was still in the client's best interests). Remedial action has many different elements and levels of intervention. A discussion during the audit debrief, on a better way to do something, might be viewed by some licensees as remedial action. They are certainly not all the same. In our view it is most probably increasingly unlikely that many advisers would get through an audit without some items arising. The objective of the reference checking process is to reveal major issues, not minor routine matters. The complexity of this section will make the assessment of reference checks much more complicated and time-consuming.

The ABA Protocol is much shorter in this section and does not seek any information on remediation.

C2Q2 Can you suggest any additional or alternative questions?

We do not propose any additional or alternative questions.

Conduct of a Prospective Representative

C3Q1 Do you agree with our proposed questions? If not, why not?

We accept that it is appropriate for the reference process to ask questions about significant breaches reported to ASIC under the current breach regime. The new regime that is due to start on 1 October 2021 will, unless addressed by regulation, lead to an exponential increase in the number of breaches reported to ASIC for financial advisers. All civil penalty provisions such as a failure to issue an FDS on time, or to have an incorrect figure in an FDS, along with any breach of the best interests duty (including inadequate record keeping) would result in a reportable breach and would therefore need to be included in a reference check. What has happened in the changes to breach reporting is in our view a big mistake and will need to be addressed by sensible regulation, to remove relatively minor civil penalty provisions from the breach reporting regime. This mess would be further expanded by the impact that it will have on reference checking.

We also support the inclusion of what the ABA describes as material incidents. We note that ASIC have tried to further define this. In our view further explanation or alternatively examples would be beneficial for 'unprofessional conduct' and 'gross incompetence or gross negligence'.

We also question whether there is a need for some level of materiality to apply in terms of a breach of the FASEA Code. This area is untested at this stage, however it is possible that breaches could arise as a result of relatively minor matters.

We also question the requirements under Question 3(c) for additional information, the matter of which seems to be excessively detailed and likely to require a licensee to disclose information that might be commercially or otherwise confidential. What does it mean when it says 'provide details, including but not limited to, all internal assessments, external notifications or complaints against the representative'? This sounds like the referee licensee would need to provide copies of investigation reports, breach reports and copies of complaints. In our view, this is excessive and problematic. This requirement needs clarification.

C3Q2 Can you suggest any additional or alternative questions?

Whilst financial advisers remain under the oversight of the TPB it may be appropriate to ask questions about any disciplinary action arising from investigations by the TPB.

There is no question about client complaints, other than with respect to ongoing complaints in the Ongoing Matters section. Complaints are separate to the audit outcomes and the answers in this section. How information on complaints is captured should be reviewed.

Ongoing Matters

The heading for this section may be better described as unresolved matters rather than ongoing matters.

Once again, it appears that the ASIC template requires more detail on these ongoing or unresolved matters as compared to what is required by the ABA. The ABA is not seeking details on these matters, but instead a high level summary, which would seem to be more appropriate.

C4Q1 Do you agree with our proposed questions? If not, why not?

We agree that it is appropriate to ask questions about unresolved investigations and complaints. It is questionable as to whether unresolved matters related to a compliance audit should be reported in two sections in the reference (it is already addressed in section 2). This could cause confusion.

We are concerned that the requirements in this section could lead to the provision of information that may be confidential if too much detail is required.

C4Q2 Can you suggest any additional or alternative questions?

No. We do not believe that it is necessary to ask any further questions in this section.

D. Proposed Information Sheet

Guidance for Licensees

As discussed above, we think that more guidance could be provided, including examples on 'unprofessional conduct' and 'gross incompetence or gross negligence'.

The concept of a representative of a licensee who is not a financial adviser might require some further explanation to ensure that all licensees understand their obligations in this area.

We note with amazement that an adviser who provides personal advice to wholesale clients only is excluded from the reference checking process. It is remarkable how little of the obligations that reasonably apply to financial advisers who provide personal advice to retail clients do not apply to financial advisers who only provide personal advice to wholesale clients. It is little wonder that the ASIC Funding Levy for licensees who provide wholesale advice only is a total of \$29 per licensee, with no further fee applying to individual advisers.

D1Q1 Do you agree with our proposal? If not, why not?

We agree with the proposal, subject to the suggestion of more examples and the addition of information as discussed in the next question.

It was important to explain the 'Defence of qualified privilege' although we note that it will cause some concern for licensees that this does not apply for additional information or for information that is older than five years. It might be beneficial to explain how licensees can minimise this risk.

D1Q2 Can you suggest any further or additional guidance that should be included in the information sheet?

We suggest that the guidance address the requirements in the following cases:

- When an employee within a licensee is being promoted from a service role to a financial adviser role, is it necessary to complete a reference, even if the referee and the recruiting licensee is the same organisation?
- Is it necessary to complete the reference checking process when an adviser moves from one licensee to another within the one group, or where a group rationalises some of their licensees and therefore moves a group of advisers from one licensee to another.

Concluding Comments

The AFA supports a standardised reference checking process that is universally followed. We have provided feedback above that some of the questions might result in an unnecessary level of detail being requested and we ask that ASIC consider the impact of this on the overall cost of the process.

The AFA welcomes further consultation with ASIC should clarification of anything in this submission be required. Please contact us on (02) 9267 4003.

Yours sincerely,

Phil Anderson
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Association of Financial Advisers Ltd