FSC FINANCIAL SERVICES COUNCIL

Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures) Bill: Strengthening breach reporting. (FSRC Recommendations 1.6, 2.7, 2.9 and 7.2): Exposure Draft (ED).

Submission

28 February 2020

Contents

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC welcomes the opportunity to provide a submission on the Exposure Draft **(ED)** legislation relating to the proposed strengthening of breach reporting obligations for Australian Financial Services Licence **(AFSL)** holders by implementing the following Financial Services Royal Commission's **(FSRC)** Recommendations:

- Recommendation 7.2 – Implementing the outstanding recommendations of the ASIC Enforcement Review Taskforce in December 2017
- Recommendation 2.7 – Reference checking and information sharing for financial advisers
- Recommendation 2.8 – Licensee obligations to report compliance concerns
- Recommendation 2.9 – Licensee obligations where there is misconduct by financial advisers

The FSC is not submitting on the provisions relating to Recommendation 1.6 on mortgage-broking.

The FSC is submitting on the advice-related components of the ED (Recommendations 2.7, 2.8 and 2.9) as well as Recommendation 7.2; that recommended implementation of the outstanding recommendations of the ASIC Enforcement Taskforce Report in December 2017 **(the Enforcement Report)**, relating to an ASIC Directions power. We are lodging a separate submission on the ASIC Directions Power, which is a component of Recommendation 7.2.

The FSC supports these recommendations in principle. This submission proposes technical changes formulated by our members to ensure the legislation is practical, effective and serves the interests of consumers. It aligns with the FSC's broader priority of ensuring accessible and affordable financial advice.

The proposed timelines for commencement of various provisions should be revised to allow for an orderly transition and update of compliance systems, and a seamless experience for consumers. Concepts should be clear so that the legislation is practically implemented to achieve the results and standards the public expect. There are several areas in the proposed legislation that could be amended to best achieve this and these are outlined in the latter sections of this submission.

The implementation of the above FSRC recommendations occurs against the backdrop of over a decade of continual financial services reform. In this time the breach reporting regime has been the focus of inquiry for ASIC and various taskforces and committees.

Technical changes to the proposed legislation now will ensure the implementation of the Royal Commission recommendations legislation is fit for purpose and sophisticated in meeting the expectations of Australian consumers in the long-term.

3. Summary of our views

In summary, our views as to the major matters to be considered are as follows-

FSRC Recommendation 7.2: Enforcement Report Implementation

1. **Provisions relating to the implementation of Recommendation 7.2 – ASIC Enforcement Taskforce Review 2017**: The ED in certain respects differs significantly from the Enforcement Report recommendations. These departures give rise to a range of practical issues which will cause unnecessary cost to providers for little identifiable consumer benefit. Further, these costs ultimately are likely to be consumers;
2. **Multiplicity and Duplication of Reporting:** The proposals under the ED are likely to give rise to multiple and duplicate obligations to report;
3. **Lack of Significance or Materiality in Obligation to report Commencement of Investigation:** The absence of any objective test is likely to give rise to an excess of reporting which neither industry nor ASIC is resourced to address appropriately or adequately. In turn this will give rise to increased costs at both the public and private sector levels for little discernable benefit.
4. **Reportable situation" as one which where a licensee has committed "gross negligence or serious fraud":** These expressions require appropriate definitions.
5. **Reporting the outcome of an investigation within a timeframe of 10 business days:** This was not recommended the Enforcement Report and in a practical sense is neither realistic nor achievable.
6. **Reportable breach "which causes loss or damage to clients":** As currently drafted, this requirement appears to capture any loss and has no materiality threshold. Again, this is an unfair and unrealistic outcome and will result multitude of reports; which again neither the regulator nor industry has the capacity to address.
7. **Infringement Notices and Civil Penalties:** As presented in the ED, these appear to be draconian and should be revisited.
8. **Reporting on other financial services licensees (financial advisers) to ASIC**: We have reservations as to the practicality of this requirement (which did not form part of the Enforcement Report). In a number of instances, we suspect that it will be difficult to identify if a licensee has "reasonable grounds to suspect" that a reportable situation has arisen in relation to another licensee. Unfortunately, this is a civil penalty provision so the consequences of a perceived breach are not insignificant.
9. **When an AFS licensee reasonably knows that there are reasonable grounds to believe a reportable situation has arisen:** This will require significant input from ASIC as to how in practical sense these provisions are to be interpreted and applied by industry.
10. **Calendar days versus Business days:** For consistency, the final legislation should refer to Business days.
11. **Commencement:** Given the nature of these changes, and the very significant redesign steps industry and the regulator will need to undertake, we suggest a commencement date of 12 months after the date of Royal Assent.

FSRC Recommendation 2.7 – Reference checking and information sharing for financial advisers

1. **General comment:** The FSC supports these changes with some minor amendments.
2. **Civil Penalty Regime:** The FSC questions the appropriateness of applying the civil penalty regime to what is in broad terms, a rigorous compliance regime.
3. **Definition of representatives:** This requires refinement and clarification.
4. **Commencement:** We suggest the final legislation, commences one year from the date of Royal Assent to allow a reasonable transition for financial services businesses to ensure their compliance systems are updated.

FSRC Recommendation 2.8 – Licensee obligations to report serious compliance concerns

1. **General comment:** We support these changes with some minor amendments.
2. **Reportable Breach:** Elements of objectivity and definition need to be introduced in the proposed provision to address issues of potential over-reporting.
3. **Commencement:** Again, we suggest that commencement is one year from the date of Royal Assent to allow a reasonable transition for financial services businesses to ensure their compliance systems are updated.

FSRC Recommendation 2.9 – Licensee obligations to report misconduct

1. **General comment:** We support these changes with some amendments.
2. **Remediation and the reporting of loss:** So that multiple reports are not made; we suggest a threshold dollar amount for loss to clients be set**.**
3. **Commencement:** This should be one year from the date of Royal Assent to allow a reasonable transition for financial services businesses to ensure their compliance systems are updated.

Additional Observation: ASIC's capacity

ASIC will have significant resourcing and other imposts placed on it in terms of implementing the proposed regime. As with industry, it will need to proceed to implement the new rules in an orderly, effective and efficient way. Government will need to ensure that ASIC has appropriate resources to manage this implementation.

4. Provisions relating to the implementation of Recommendation 7.2 – ASIC Enforcement Taskforce Review 2017 (Enforcement Review)

The ED differs significantly from the recommendations of the Enforcement Report which were endorsed in the Final Report of the Financial Services Royal Commission. The key differences include:

- reporting commencements and outcomes of all investigations where has been a breach or likely breach;
- reporting instances of "gross negligence" (where there is no nexus to a breach of financial services law);
- deeming breaches "significant" when they result in any loss or damage to clients; whereas the Taskforce referred to "material loss" to clients.

The FSC does not support these departures from the ASIC Enforcement Report and seeks technical changes relating to the following issues:

- The 10-day requirement for licensees to report outcomes of an investigation, which as defined under the ED, is shorter than the 10 business days currently allowed and much shorter than the period the Enforcement Report recommended
- Need for reduced duplication and multiplicity of reporting under the new regime
- Need for a materiality threshold to be added for assessing "loss or damage" to a client" within the objective test of "significance" – the provision as worded risks excessive breach reporting and a risk that this larger volume of reporting means the Regulator's capacity to identify serious matters is constrained

There are a number of further technical and drafting areas set out below.

4.1 Reporting an "investigation" is more extensive than the ASIC Enforcement Review Report

Recommendation 4 of the Enforcement Report recommends that licensees or AFS licensees should be required to report to ASIC if they are investigating a breach and have not determined, within 30 days, whether it meets the significance threshold.

The ED differs significantly from the Enforcement Report's recommendation described above. It does not appear to support or justify these departures from the Report's recommendation.

It purports to give effect to Recommendation 7.2 of the Royal Commission Final Report – which simply stated that the *"recommendations of the ASIC Enforcement Review Taskforce made in December 2017 should be carried into effect*". The FSRC neither suggested nor recommended departing from the ASIC Taskforce's recommendations. The ED departs, in the areas identified above, from the ASIC Enforcement Review Taskforce recommendations. The ED requires licensees to report to ASIC if they have commenced an investigation into whether a breach of a core obligation has occurred.

4.2 Reporting the commencement of every investigation and the outcome of all investigations

The Enforcement Report made no recommendation to report the commencement of an investigation and the outcome of all investigations (including investigations where ultimately no significant breach was found). This is likely to lead to over-reporting, significant increases in overhead costs to factor in the time and resources involved in the increased breach reporting, and inefficiencies both for industry participants as well as ASIC which will be expected to have the capacity to review and action the reports.

Under subsection 912D(1)(a)(iii) of the ED, a "reportable situation" arises if "the licensee has commenced an investigation into whether the licensee or a representative of the licensee has breached a core obligation". Subsection 912DAB(5)(c)(ii) states that the outcome of such an investigation must be reported, even when there are no reasonable grounds to believe that a core obligation has been breached. Under subsection 912DAB(2), a licensee must report the outcome of an investigation even when the investigation "discloses no reasonable grounds to believe" that the licensee has "breached a core obligation".

These provisions in effect would require most investigations (irrespective of their size or materiality) to be reported to ASIC – and both the commencement and outcome of every such investigation to be reported. There is no definition of what an "investigation" is and this requirement potentially applies to a broad range of pro-active and investigative activities conducted by compliance, risk and legal staff, or Line 1 (business) risk analysts. Without clarification of what constitutes an "investigation", the reporting obligation could be interpreted by licensees to apply to all and every type of investigative and incident management type activity. This could lead to substantial over-reporting of matters at an inquiry, fact finding or investigation state and significant increases in licensee's overhead costs related to the time resources associated with this additional reporting.

Under the ED, a licensee has an obligation to report to ASIC if the licensee "reasonably knows" that a reportable situation has occurred. This is triggered when the licensee is aware of "substantial risk" and it is "unjustifiable to take the risk". These terms are ambiguous, and licensees do require additional guidance to help them determine what is likely to be considered a significant risk and when this risk is unjustifiable risk to take.

The reporting obligation likely applies to all and every investigation – and the requirement to report investigations will involve a monumental increase in the level of reporting of matters at an inquiry, fact finding or investigation stage. The breadth of the reporting of all investigations also duplicates the other breach reporting obligations and will duplicate many reports. If the ED is enacted in its current form, the FSC would welcome Treasury consulting with ASIC and industry on any resourcing constraints and regulatory resources required to administer the receipt and processing of a substantially increased number of breach reports.

The Enforcement Report did not recommend reporting the commencement and outcome of each and every investigation by a licensee. Rather, the Enforcement Report expressly stated:

> *that reporting requirements should extend to circumstances where a breach is being investigated by the licensee but the investigation has not concluded within the prescribed time limit*; and
>
> *Should the licensee determine, during the period of investigation that no significant breach has occurred, there would be no obligation to report to ASIC*.

Therefore, it is unclear how this obligation aligns with the intention and objective of the breach reporting regime as set out in the Enforcement Report.

The other reporting obligations (reporting of significant breaches of core obligations, which provides that all civil penalty provisions are significant) will result in a wider set of breach reporting to ASIC. If the Government is minded requiring reporting of investigations, then the Government could provide that only investigations which meet the Enforcement Report criteria of reporting investigations, be required to be reported, namely:

> *that reporting requirements should extend to circumstances where a breach is being investigated by the licensee <u>but the investigation has not concluded within the prescribed time limit</u>* (i.e. 30 days); and
>
> *should the licensee determine, during the period of investigation that <u>no significant breach has occurred</u>, there would be <u>no obligation to report to ASIC</u>.*

Alternatively, the obligation to report investigations should be limited to reporting investigations where there are reasonable grounds to believe that a core obligation has been breached and the investigation finds (or has reasonable grounds to believe) that the breach is significant (see our comments below about the reporting trigger where any client suffers any loss). This obligation should only apply when those investigations are not completed within a certain timeframe (say 30 days) – this meets the policy rationale of ensuring inquires and compliance fact finding occur diligently and promptly. Treasury might turn its mind to the wording of 'probable' or 'actual' grounds rather than reasonable given the severity of the consequences for a breach.

4.3 The Enforcement Report made no recommendation to report the outcome of an investigation within a timeframe of 10 business days

The Enforcement Report considered a 10 business day timeframe (for reporting breaches and investigations generally), but upon stakeholder feedback decided this was not appropriate:

> ***Initially, the Taskforce suggested that the current 10 business day timeframe*** *should commence from when* ***a licensee becomes aware or has reason to suspect that a significant breach*** *has occurred, may have occurred or may occur… Numerous stakeholders did not support the extension to require reporting of suspected or potential breaches****, with concerns that this would lead to over reporting and an increased burden on licensees…*** *Others suggested that if the test was modified* ***10 business days may not be sufficient.*** *The Taskforce considers that Recommendation 4 provides an objective element to the trigger for the reporting time frame****, an expanded timeframe***

in which to report, and achieves greater certainty for licensees, with little or no additional regulatory burden.

There is no justification in the Explanatory Memorandum **(EM)** for departing from the timeframe that applies to other "reportable situations" (i.e., 30 days). In practice, even large financial institutions with robust and extensive compliance frameworks will find it difficult for to comply with a 10-day timeframe.

AFS licensees are required to lodge a number of reports, typically within either 30 days or 10 days. It would be preferable (especially in the case of the 10 day requirement) that this is amended to refer to business days rather than calendar days.

4.4 Enforcement Report did not make recommendations resulting in lodgement of numerous reports relating to the same incident

In practice, under the ED, the obligation to report an "investigation" will result in numerous overlapping and duplicated reporting obligations relating to one incident/situation:

(a) the obligation to report an "investigation" has commenced;

(b) the obligation to report the "investigation" has ceased" (and the outcome, even if the outcome is there is no significant breach or client loss);

(c) to report a breach of core obligations that are significant – if this is the outcome of the investigation.

The obligation to report all investigations will result in the licensee lodging numerous reports in relation to the one incident or situation or investigation. The requirement to lodge multiple reports creates complexity, and operational inefficiencies such as duplication and increased risk of reports not being lodged due to unintentional oversight.

As described above, the proposals in the ED go beyond the recommendations of the Enforcement Report in that the ED triggers more, and additional and duplicative, reporting, including reporting that there is (in fact) no reportable situation (i.e. reporting that the outcome of the investigation is that there is no significant breach and/or no client loss). There is no foreseeable benefit to the consumer in this respect. It is highly likely that there will be increased cost and time expended on compliance for ASIC, licensees and advisers for reporting investigations. The focus of legislation should be on significant breaches and any loss to a client.

4.5 "Reportable situation" as one which where a licensee has committed "gross negligence or serious fraud"

Under subsection 912D(2), a "reportable situation" is one where, a licensee has committed gross negligence or serious fraud. However, there is no requirement within this subsection, that such a situation involve a breach of financial services law.

The Enforcement Report recommended that serious misconduct by employees and representatives should be deemed "significant". However, the ED includes a concept of

"gross negligence", which is not defined. This lack of causal connection should be remedied in the final legislation.

4.6 Reportable breach "which causes loss or damage to clients" – this captures any loss and has no materiality threshold

Under subsection 912D(1), a breach or likely breach of a core obligation that is significant must be reported. Under subsection 912D(5)(c), such a breach is taken to be "significant" if it results in "loss or damage to clients"; and this would capture any loss or damage.

There is no guidance given as to what constitutes "loss or damage to clients", although we assume this means financial loss. Under the ordinary meaning of the term "loss" in the ED, reporting obligations will attach to each and every loss of any kind suffered by a client regardless of materiality (e.g., over-charging an administration fee by $5). The legislation also could capture low-level information about complaints by a single customer who suffers a small loss. These generally are currently dealt with at the customer-facing end of a business, without legal or compliance input. As we have said, the concept of "damages to clients" is defined neither in the ED nor in the EM.

The policy intention of breach reporting is not to capture information about small monetary losses to clients which occur on a one-off basis. There should be a materiality threshold that applies to determine whether "loss or damage" is "significant" or "material". This view aligns with the recommendations contained in the Enforcement Report.

We note that Recommendation 1 of the Enforcement Report indicated that the "significance" test should be clarified to ensure that the significance of breaches is determined objectively. It stated:

> *To provide greater certainty for licensees and ensure particular matters are always reported to the regulator… the nature of matters that should be deemed to be significant includes: … Breaches that result in or have the potential to result in in* ***material loss to clients having regard to the amount invested and the circumstances of the client/s in question.***

Thus, it cannot have been the intention of the Taskforce that objective criteria would require no assessment at all of materiality.

To address this, what constitutes a "material loss to clients" could addressed in the legislation by reference to the emphasised wording. This could be expanded on if necessary by an ASIC instrument or ASIC guidance and in any event should be subject to consultation with the industry.

In summary we suggest the ED is redrafted to refer to "material loss or damage to clients"; and that further guidance is subsequently provided by ASIC on this matter.

Even if a loss to a client is below any determined materiality threshold, licensees would be required under current law to appropriately remediate customers (and this does not turn on whether or not the matter is reported to a regulator).

4.7 ASIC Prescribed Form for breach reporting – ensure ability to provide context and detail of breach

Under section 912DAB(3), breaches must be reported using an ASIC prescribed form. The FSC agrees in principle with the inclusion of a prescribed form for reporting.

However, the current ASIC form (ASIC Form FS80) is very prescriptive and narrow, and does not readily cater for the need to provide full information, detail and context of breaches. As the draft legislation broadens the scope of activities to be reported, any prescribed form should be flexible and allow for context and additional information to be provided, rather than dropdown options and simple or binary "yes/no" answers, where full information to ASIC requires more detail, context and explanation. It may be useful if ASIC were to consult with the industry to develop such a prescribed form – to ensure that the form is workable, flexible and effective.

The prescribed reporting form for investigations (for example, a short form notification) should be different to reporting a breach of a core obligation (which would require substantive notification).

4.8 Infringement notice regime

It is unclear why an infringement notice regime is an appropriate avenue for addressing a licensee's failure to report breaches. Infringement notices should be applied to offences which are determined on the basis of objective criteria (e.g., lodging a financial report by a particular timeframe). This regime should not be applied to breach reporting obligations, where a level of subjective assessment is required to determine whether a situation is reportable, (i.e., to determine whether there is a "significant" breach under the factors described in subsection 912D(6)).

An infringement notice regime allows ASIC to issue fines without an offence being established in a Court and necessarily is not as such subject to a standard of proof. Such infringement notices have significant reputational consequences for licensees, which are not tested in Court (unlike civil penalties).

If the Government were to extend the infringement notice regime to breach reporting, then consideration should be given to the regulator being required to report on its use of powers to the recipient of the infringement notice and afford the recipient natural justice by providing:

1. provide reasons for its decision; and
2. the evidence and basis of the notice.

Normal review and appeal rights should apply in relation to these decisions.

Infringement notices (see the Attorney General's Department **(AGD)** Guide to framing offences[1]) are more conducive to clearly determined breaches of a minor and entirely

[1] 'A Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers'. Source:

objective nature (such as timeframes to lodge a financial report) and which are strict liability offences.

It is concerning that infringement notices, which are not subject to the testing of the matters in a Court, are applied to provisions involving some level of assessment, judgement or subjectivity (albeit the refinements to breach reporting provide for a more objective test).

4.9 Maximum Civil Penalties

Civil penalty provisions apply to the contravention of breach reporting obligations under the draft legislation. For bodies corporate, the maximum penalty would be the greater of:

(a) 50,000 penalty units;

(b) If the Court can determine – the benefit derived or detriment avoided by the body corporate because of the contravention, multiplied by three;

(c) 10 per cent of the annual turnover of the body corporate, but to a maximum monetary value of 2.5 million penalty units.

Under section 44A(1) of the Crimes Act, a "penalty unit" is $210. Therefore, a licensee is subject to a maximum civil penalty exceeding half a billion dollars ($525,000,000) for each contravention of the breach reporting obligations. This seems excessive for what is a civil) and not a criminal sanction.

There is a question whether the ability to use 10% of annual turnover as a limit on a civil penalty, correlates to the seriousness of the offence or the actual benefit obtained or detriment caused by the contravention. Prior period turnover for a financial institution would bear little or no relationship to the conduct of failing to report situations under breach reporting laws.

4.9.1 Reporting on other financial services licensees (financial advisers) to ASIC

Section 912DAC requires a licensee to report to ASIC if the licensee has reasonable grounds to "suspect" that a reportable situation has arisen about an individual who:

(a) provides personal financial advice to retail clients; and

(b) is operating under another licensee's licence.

Under subsection 912DAC(8), if a licensee contravenes this obligation, the civil penalty provisions will apply.

This was not recommended by the Enforcement Report. The ASIC Enforcement Review Taskforce did not seek submissions on this issue.

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https://www.ag.gov.au/Publications/Documents/GuidetoFramingCommonwealthOffencesInfringementNoticesandEnforcementPowers/A%20Guide%20to%20Framing%20Cth%20Offences.pdf

In practice, it is difficult for an advice licensee or other financial services licensee (such as a product manufacturer) to know all the relevant facts about another licensee's reportable situation. It is difficult to determine in what circumstances a licensee would have "reasonable grounds to suspect" that a reportable situation has arisen in relation to another licensee.

4.10 Determining when an AFS licensee reasonably knows that there are reasonable grounds to believe the reportable situation has arisen

The EM in example 2.2 provides practical guidance as to when an AFS licensee is taken to reasonably know that there are reasonable grounds to believe the reportable situation has arisen. In the example provided, the trigger point was that a Senior Staff member of the AFS licensee was provided adequate reporting. We believe the legislation, or alternatively the ASIC guidance, should provide clarity on the types of roles and individuals that would likely be considered to be Senior Staff for the purposes of the reporting obligations (similar to the clarity providing in RG 78 in relation to individuals responsible for compliance being made aware). For example, it would be useful to clarify whether it the intention that these individuals would be of a similar level and accountability as those roles prescribed under the BEAR or proposed FAR regimes.

4.11 Gross negligence is not defined

AFS Licensees are required to report to ASIC if the licensee or a representative has engaged in conduct constituting gross negligence. "Gross negligence" is not defined in the ED . Whilst guidance on the interpretation of gross negligence can be drawn from case law, without further guidance from ASIC, determining this in practice would require a subjective assessment by the licensee. Guidance from ASIC on what constitutes gross negligence may provide helpful clarity for licensees and increase consistency in reporting.

4.12 Commencement

FSC Recommendation: That the legislation implementing FSRC Recommendation 7.2 with regard to the Enforcement Review recommendations occur one year from the date of Royal Assent.

5. Provisions implementing Recommendation 2.7 – Reference checking and information sharing for financial advisers

The proposed legislation implements Royal Commission 2.7 by:

- Establishing a compulsory scheme for checking references for prospective financial advisers, modelled on the existing Australian Banking Association **(ABA)** Reference Checking Protocol.[2]
- Establishing a specific obligation on AFSL holders to undertake reference checking on prospective employees ASIC will be empowered to prescribe the manner in which this needs to be completed with civil penalties for breaches.

The FSC supports these changes with some minor amendments. The FSC welcomes the defence of qualified privilege to ensure alignment with and protection under defamation law or breaches of obligation to ensure licensees are protected when sharing information to meet their obligations under this Bill.

This was a matter raised by the FSC at Treasury Roundtables and our members welcome the proposed legislation accommodating this proposal.

5.1 ASIC's role and 'key contacts'

Clarity is needed as to ASIC's role in the enforcement of reference checking. Until this is known, it is likely advice businesses will undertake an unnecessarily conservative approach to breach reporting to which the Regulator might not be equipped to respond. Time should be allowed for industry to respond to ASIC's protocols relating to reference checking.

The proposed legislation outlines a system by which licensees will provide a 'key contact' for reference checking. If the objective is to ensure compliance with the protocol[3] a central register and protocol might provide a more practical and effective system over time for facilitating this compliance. For example, the legislation is unclear as to how contacts should be communicated or what constitutes adequate communication. Greater clarity on this point would be welcomed.

Civil penalties apply for breaching what are much higher standards and obligations designed to generate a better culture across industry and improved consumer outcomes. Clear concepts and streamlined processes for information sharing are needed to ensure that the expectations of advice providers are clear. Clarity is also needed as to how this process will link up with the incoming single disciplinary body to be introduced later this year.

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[2] 'Strengthening breach reporting'. Australian Government The Treasury: https://treasury.gov.au/consultation/c2020-48919b)

[3] Page 6, Explanatory Memorandum. Australian Government The Treasury https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf

5.2 Civil penalties

The legislation imposes civil penalties for breaching obligations under what is a substantially more rigorous regime of compliance.

The information sharing requirements set out in the Bill state that:

> *…the protocol must not require information to be provided in relation to conduct that occurred more than five years before the information is shared*[4]
>
> *...*
>
> *…However, the protocol may provide that, if a person is able to do so, the person may voluntarily provide relevant information that relates to conduct that occurred more than five years ago.*[5]

It is unclear what information "must" and "may" be provided, i.e. how the requirement interacts with the provisions relating to reportable situations. For example, if outside the five year window, if an issue were to arise in five years and one day, it is unclear as to whether this would be subject to the voluntary requirements of the above provision, or possibly subject to a significance test relating to reportable situations (See Section 4).

Item 1.33 of the EM establishes that the protocol must not require information to be provided in relation to conduct that occurred more than five years before the information is shared.[6] There is likely to be ambiguity around this. Licensees will need to be clear on when the five year period commences (i.e. financial adviser signs consent; from date of receipt for a reference; date of response) and whether it relates to concluded matters or those in progress (i.e. event may have occurred 10 years prior, client lodged a complaint 6 years prior, matter concluded 5 years prior, or yet to be concluded). As such clarity is needed in two ways:

- *Clarity on expectations where previous licensees no longer operate.* This may extend to providing clarity on requirements when licenses cease in the future
- *Clarity on expectations and obligations of licensees if new information comes to light after the reference is issued, or if an 'open' matter is subsequently concluded* (i.e. an investigation or customer complaint)

5.3 Definition of representatives

The ED refers to individuals who are former, current or prospective representatives of a financial services licensee. However, the EM consistently refers to individuals who are

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[4] Page 10, Explanatory Memorandum. Australian Government The Treasury: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf
[5] Page 10, Explanatory Memorandum. Australian Government The Treasury. https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf
[6] Page 10, Explanatory Memorandum. Australian Government The Treasury: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf

becoming “employees”. Not all representatives are employees and it does not cover situations where an individual is currently an employee and is becoming an Authorised Representative **(AR)** or Credit Representative. It also allows a person to seek employment with an AFSL in a role that does not require them to be an AR or Authorised Credit Representative **(ACR)** at that time, however, later becomes authorised and thereby circumvents the need for a reference check. This should be clarified.

5.4 Additional requirements

In time, detailed steps on the requirements and process for when a previous licensee has gone into administration and there is no licensee staff to provide a reference will be needed. Consideration by regulators to scenarios such as this are important as they seek to professionalise advice further.

Under the protocols, a question should be added to the Reference Check about ARs meeting their CPD requirements. Licensees have 30 business days to update the Financial Advisers Register **(FAR)** with ARs that have failed to meet their Continuing Professional Development **(CPD)** requirements. This creates an opportunity for a licensee to appoint an AR that has failed to meet their CPD requirements because the licensee has not updated the FAR as the licensee is still operating within less than 30 business days after the licensee’s CPD year).

5.5 Commencement

FSC Recommendation: That the commencement of the legislation implementing Recommendation 2.7 commences one year from the date of Royal Assent to allow a reasonable transition for financial services businesses to ensure their compliance systems are updated.

Higher reference checking and information sharing rules are not an insignificant change to the culture and professionalisation of financial advice. It is important that compliance systems properly adapt these changes and put in place robust standards of best practice. While it is likely industry could adapt these changes before commencement, an accommodation that ensures some licensees do not end up breaching the law because of the timeframe in which they have had to comply, is recommended.

This acknowledges the need for an orderly transition, consistency and minimal disruption to consumers. It also anticipates that ASIC will require time to bed in a considerably revised mandate and that the disciplinary body for financial advisers is yet to be introduced.

6. Provisions implementing Recommendation 2.8 – Licensee obligations to report serious compliance concerns

The ED amends the Corporations Act by introducing requirements on financial services licensees to report serious compliance concerns about financial advisers.[7]

The FSC supports the implementation of Recommendation 2.8. However there are several areas for consideration prior to the Bill being introduced into the Parliament.

6.1 Reportable situations

The ED establishes that a reportable situation arises if an advice provider has 'reasonably knows' there are 'reasonable grounds' to believe a 'reportable situation' has arisen.[8] The definition of 'reasonably knows' outlines that a person is aware of 'substantial risk' and it is 'unjustifiable' to take the risk. These latter terms should be defined. The result is that the requirement to investigate hinges not on the fact of a breach occurring but whether an adviser might think one has occurred.

The subjectivity of this provision is open ended and could result in costly and unnecessary levels of breaching reporting to be processed by ASIC.

6.1.1 Worked examples and reportable situations

There are a number of worked examples contained within the exposure draft legislation to inform determinations on a reportable situation arising.

The new reportable breach categories as proposed risk substantial numbers of breach reports. For example, advisers who have breached a civil penalty provision will be considered to have breached a core obligation and are therefore reportable. Civil penalty provisions are covered in Table 1 in 1317E and cover areas include:

- Financial Service Guides **(FSGs)**
- Statements of Advice **(SOAs)**
- Best interest and related obligations
- Fee Disclosure Statements **(FDSs)**
- Charging of fees after an FDS ends

An FSG contains information about the entity providing a client with financial advice.[9] Example 2.3 of the EM is somewhat limited about when an FSG should and should not be

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[7] Explanatory Memorandum, Australian Government The Treasury: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf
[8] Page 21, Explanatory Memorandum, Australian Government The Treasury https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf
[9] Definition of Financial Service Guide MoneySmart https://moneysmart.gov.au/glossary/financial-services-guide-fsg

used.[10] It should explain the financial service offered, the fees charged and how the person or company providing the service will deal with complaints.[11]

It is not clear to us how rigorously these scenarios should be applied when determining whether a reportable situation has arisen. Critically, and in the first instance, the legislation here should be as clear as possible before other documents and publications such as Regulatory Guidance or FASEA's Guidance on the Code of Ethics are used, as a method of interpreting it.

Conflicting or confusing directives could make achieving systemic improvements in consumer outcomes more difficult and should be avoided.

6.1.2 Interactions between licensees around reportable situations

Example 2.5 in the EM relating to Item 2.81 requires a licensee to advise another licensee when a 'reportable situation' is identified. This raises a number of issues requiring further clarity including:

- Expectations when the financial adviser is the AFSL holder and will be so informed of the reportable situation that has arisen
- Expectations when the licensee has ceased to exist, or the financial adviser has exited the industry, or has temporarily ceased (do licensees need to keep monitoring financial adviser movements) and
- Expectations once the licensee is informed (i.e. suspend financial adviser, terminate, or investigate? How would this apply where a licensee has ceased?)
- Whether it is required, and if it is, how the reporting licensee protected against potential defamatory circumstances where they inform another licensee of a reportable event

These issues should be clarified in the final legislation the Government progresses later this year.

6.2 Engagement with consumers

The FSC welcomes efforts to ensure the requirements on licensees are made in the interests of generating a culture of better informing consumers.

The proposed legislation will incentivise much deeper engagement with consumers when problems arise at the outset which will promote confidence and trust. It is equally important to consider that implementing these requirements should always be done so in a manner that relieves stress for consumers.

In practice, the review of file notes takes time and is a costly process. To notify consumers as well as regulators of *suspected* serious compliance concerns could lead to a culture of

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[10] Page 28, Explanatory Memorandum: (Source: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf)
[11] MoneySmart. 'Definition of Financial Service Guide': (Source: https://moneysmart.gov.au/glossary/financial-services-guide-fsg)

unduly alarming consumers about breaches that might later not have been found to have occurred.

This is particularly true for a profession that is engaged by consumers to relieve stress and complexity and ultimately help them navigate a complex financial services landscape.

6.3 Commencement

FSC Recommendation: That the commencement of the legislation implementing Recommendation 2.8 commences one year from the date of Royal Assent to allow a reasonable transition for financial services businesses to ensure their compliance systems are updated.

7. Provisions relating to the implementation of Recommendation 2.9 – Licensee obligations to report misconduct

The ED imposes requirements on AFSL holders to[12]:

- make whatever inquiries are reasonably necessary to determine the nature and full extent of the misconduct.
- licensees are required to investigate potential and actual misconduct engaged in by financial advisers and to inform and remediate affected clients.

7.1 Remediation and the reporting of loss

The language establishing the significance test for situations resulting in loss or likely to result in loss[13] will have to be reported immediately. As with the language for reportable situations, it is not clear for licensees how this should be applied which could make transitioning compliance systems to the application of the new law difficult.

The objective test may result in a substantial volume of breaches reported, even for minor technical breaches. As noted in earlier in this submission, it would capture breaches of almost any nature including the most minor.

FSC Recommendation: The FSC advocates a threshold dollar amount for loss to clients.

Without a threshold dollar amount, organisations would need to report on compensation to the cent of the loss. There is also limited clarity as to how loss is assessed.

The FSRC recommendation as proposed could require licensees to inform and remediate clients promptly. Clarity is needed as to whether this would be prospective or retrospective. Further, remediation does take time, depending on processes underway or remediation already committed to and the level of perspectivity and retrospectivity.

7.2 Commencement

FSC Recommendation: That the commencement of the legislation implementing Recommendation 2.9 commences one year from the date of Royal Assent to allow a reasonable transition for financial services businesses to ensure their compliance systems are updated.

[12] Page 57, Explanatory Memorandum (Source: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919b-explanatory-memorandum.pdf)
[13] Ibid.

8. Additional comments

6.1 ASIC's capacity

As a general comment, there will be a considerable workload placed on ASIC under these changes and other legislation implementing the Royal Commission's and Taskforce's recommendations.

For example, whereas licensees currently have their own processes for reporting a breach, ASIC will under the proposed legislation be responsible for prescribing a standard format for this breach report.

The need for the law to be applied clearly and fairly as the expectations and standards on industry are heightened is critical. It is important that as the Regulator transitions to a new regime this does not risk errors due to resourcing issues.

It is equally important ASIC can respond in a timely manner so that all parties (including licensee, adviser and client) can have confidence in the system that all will be treated fairly and with adequate transparency of the process. Making adequate preparations for this and active consultation by ASIC with industry will be necessary to alleviate such risk.

In addition it is self-evident that ASIC must be appropriately funded and resourced by government to implement these changes.