



8 October 2019

Ms Neena Pai  
Principal Adviser  
Financial Services Reform Taskforce  
The Treasury

By email: [Neena.Pai@treasury.gov.au](mailto:Neena.Pai@treasury.gov.au)

Dear Ms Pai

## **FINANCIAL SERVICES ROYAL COMMISSION (FSRC) IMPLEMENTATION — REFERENCE CHECKING**

Stockbrokers and Financial Advisers Association (SAFAA) appreciates the opportunity to attend the Roundtable conducted by Treasury in Sydney on 2 October 2019 to discuss implementation issues concerning the FSRC Recommendations relating to Financial Advice.

We are writing to amplify comments that we made in relation to Recommendation 2.7 dealing with Reference Checking. In SAFAA's view, there is a model in existence in the United States which addresses the policy question of how to prevent the spread of "bad apples" throughout the industry, and how to communicate to prospective employers/licensees the existence of prior compliance issues concerning an adviser during a potential recruitment process.

The US model is well understood and has been working in that jurisdiction for some time. This model would avoid many of the difficulties that were highlighted at the Roundtable as arising in relation to the ABA model.

SAFAA presumes that the US model may not have been drawn to the attention of the FSRC during its deliberations. The fact that Recommendation 2.7 only refers to the ABA

Model should not, in our view, limit the range of options being considered under this Recommendation, and the Treasury should give full consideration to the US model in the current implementation process.

## **Brief Outline of US Model**

The US Financial Industry Regulatory Authority (FINRA) is the relevant regulatory authority having oversight of broker-dealers in the US.

FINRA has created an online database of information (the Central Registration Depository or CRD) relating to employees of firms engaged in the investment industry.

The information available on a Registered Person’s CRD record includes their employment history, customer complaints and findings of illegal activity.

### **(a) Reasons for Leaving a firm**

Within 30 days after terminating a Registered Person’s employment, a firm is required to file a Form U5 – Uniform Termination Form, which sets out prescribed information regarding the reasons for the termination. This includes sufficient detail to enable persons who search the CRD to understand all of the issues that gave rise to the termination. The specified information includes **any compliance issues or misconduct** that occurred.

The General Instructions issued by FINRA which explain how Form U5 is to operate can be found online at <https://www.finra.org/sites/default/files/AppSupportDoc/p015113.pdf>.

Because of the detriment that this information can cause a Registered Person in obtaining employment, there are strong provisions dealing with incorrect false information filed by a firm in relation to a departed employee, including grounds to seek compensation.

An employer will routinely obtain the consent of the prospective hire to search their CRD record as part of the recruitment process.

### **(b) CRD Information generally**

The information on a Registered Person’s CRD record includes their employment history, customer complaints, criminal history, civil proceedings and findings of misconduct. When a firm hires an employee, the firm must submit a Form U4 to FINRA. This updates the CRD information about that person.

The General Instructions issued by FINRA which explain how Form U4 is to operate can be found online at <https://www.finra.org/sites/default/files/AppSupportDoc/p015111.pdf>.

## **Advantages of US Model**

In SAFAA’s view, the US Model overcomes many of the issues that have been identified with the ABA model.

### **1. Severe implications of reference checking on advisers currently employed**

It is difficult to argue with the proposition that a request for a reference check made by a prospective employer where the adviser is still employed by their existing employer has the potential for dire consequences for the adviser. Retribution and harm to the adviser would be a serious possibility in many cases.

This form of reference checking would only be potentially practical if the adviser was no longer employed. Even then, there is potential for vindictive behaviour by a former employer when a reference check is made.

The US model removes any interaction between the prospective and former employers. Checks can be made of the Central repository in an anonymous way. An informed decision whether or not to recruit an adviser can be made without involving the existing/previous employer, while providing access to information on the adviser supplied by the existing/previous employer.

### **2. Defamatory implications**

There is a serious risk of litigation arising from references provided to the prospective hirer. At the very least, there will be a need for a privilege to be conferred by legislation on the providers of a reference, regardless of the model that is employed.

The advantage of the US Model, again, is that the interaction between the prospective and former employers is removed, reducing the scope for claims of defamation.

Provisions safeguarding against false and misleading information being provided by the existing/terminating employer, comparable to those in the US Model, should be incorporated in any such arrangements.

## Appropriate changes

If the US model were to be adopted, it would not be difficult to tailor the information that was required to be filed with the central depository to ensure that all of the matters of relevance to the spread of “bad apples” is incorporated into the reporting requirements, and can be accessed by the appropriate recruiter.

Appropriate obligations should be placed on the adviser and on the employer to ensure that their record is kept up to date by the inclusion of any compliance or other relevant matters within a reasonable period of time.

If suitable safeguards are in place to ensure the accuracy of the information, consideration could be given to opening the record for search by the investing public.

SAFAA would be only too happy to identify members with US experience to provide further background information about the US model should Treasury find that helpful.

If there are any issues arising from any of the above documents, could you please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email [pstepek@stockbrokers.org.au](mailto:pstepek@stockbrokers.org.au).

Yours sincerely

A handwritten signature in black ink, appearing to be 'JF' with a large flourish and 'Gx' below it.

Judith Fox  
Chief Executive Officer