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Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Committee Secretary,

AFA Submission - Australian Securities and Investments Commission Investigation and Enforcement Inquiry

We thank you for the opportunity to provide a submission to your inquiry.

The relationship between a regulator and the regulated population is a very important one. It is essential that licenced participants take their obligations seriously and are fully aware of the requirements of the law and the expectations of their regulator. An ineffective regulator is counterproductive and can at times lead to systemic issues with non-compliance. In recent times we believe that this has been demonstrated with respect to other professions and industries. In the case of ASIC, we have sought to highlight in this submission our views on where they may have got the balance wrong in recent years.

General Feedback

In our view, ASIC was subject to unfair criticism of being a soft touch regulator as part of the fallout from the Hayne Royal Commission. That has certainly not been our experience. In fact, we believe that ASIC is a very vigorous regulator who has been very tough on many in the financial advice sector. We believe that this criticism was framed in order to force ASIC to be tougher than they already were.

It is interesting to contrast the criticism that ASIC received about their approach, with the approach to regulatory oversight in other sectors, including the medical profession, where recent media coverage would suggest that there is a much looser regime. A comparison of the penalties that have been applied to financial advisers for misconduct with those that apply to doctors, sometimes for very serious misconduct, highlights some significant differences (Reference: ABC Four Corners Program, Do No Harm, 6 February 2023). Over recent years there has also been coverage of other regulatory regimes, including the gambling sector and the construction industry, that highlights how vigorous ASIC has been in comparison.

Our feedback to the inquiry is based upon a few key themes:

- ASIC's use of their powers that could be deemed to have gone above and beyond what the legislation enables.

- The approach that ASIC has taken to the use of the powers they have.
- The aggressive pursuit of remediation programs that have deep and sometimes unfair consequences. We have used the example of the Fee for No Service matter below. We are not understating the importance of this issue, however it has not been fairly described and has clearly been pursued with a very aggressive approach and what has seemed to be a guilty until proven innocent methodology.
- An excessive pursuit of the regulated population seemingly without the same level of focus upon the unregulated population, some of whom could do much more damage.

We have provided more context to each of these points below.

ASIC Setting Rules Through Guidance and Information Sheets

ASIC has in the past set the rules for the financial services industry where they did not necessarily have the power to do this. Regulatory Guides and Information Sheets are not rules, nor legislated obligations, however they are often enforced in a vigorous manner. Some examples of Regulatory Guides and Information Sheets that have been subject to criticism for regulatory overreach have included:

- Regulatory Guide 277 – Consumer Remediation, which sets out a range of demanding obligations, including a $5 threshold for the remediation of individual clients. In our view this is excessively low and unwarranted in the context that the investigation of something that small would involve many multiples of the compensation paid.
- Information Sheet 256 – Ongoing Fee Arrangements, that defines annual reviews as the only meaningful service that advisers must provide, and in the absence of this an expectation that fees will be reimbursed. This Info Sheet defines what ASIC expects in a commercial relationship between an adviser and their clients, where there seems little regulatory basis for the level of precision that they have taken.
- ASIC Information Sheet 206 - Advice on self-managed superannuation funds – Disclosure of Costs (now replaced), that effectively set a threshold of $500,000 for the establishment of an SMSF.

Each of the above have been factors in investigations and enforcement activity, and have undoubtedly received more emphasis than may have been warranted.

ASIC's Use of Their Powers

We know that ASICs approach to investigations and enforcement creates a lot of angst and anxiety in the financial advice population, although impacted parties are often cautious about disclosing this to other parties, including professional associations. The handling of the Fee for No Service remediation programs (as discussed in more detail below) is something that we have been well aware of through repeated complaints from our members.

We are also aware of one member who was the subject of an ASIC investigation and enforcement action that seemingly went for two and a half years, and ultimately ended in an enforceable undertaking. During this process, this member, despite receiving multiple ASIC notices, struggled greatly with having any meaningful interaction with ASIC, and ultimately chose to escalate the matter. They also reported to us the experience of having a joint AFP/ASIC raid that went for 15 hours. They have advised us that there was no consumer detriment, which makes the actions that ASIC have taken seem excessive and unduly drawn out. We have been briefed on this and appreciate the huge toll that this matter has had on this individual, their family and their business. This is not the right vehicle to go into this matter in detail, however the comparison of what this person endured and the Melissa Caddick matter provides a remarkable contrast in terms of the severity of the matter from a client perspective, yet similar regulatory intervention.

In our view, there needs to be some form of appeal channel or ombudsman for someone who is stuck in the middle of an investigation that they consider to be ineffective or excessive.

Focus on the Licensed and Unlicensed Operators

ASIC has devoted as much as $70m a year on the financial advice sector, which has resulted in substantial increases in the ASIC Funding levy that was or was to be charged to financial advisers. This seems a very large sum of money for what has been a declining population of financial advisers. Financial advisers report to us that they could be investigated for relatively minor matters, yet there is much more serious misconduct that takes place that does not seem to have the same level of focus. Advisers feel that there should be more balance in this, with greater focus on unlicensed operators and serious matters such as fraud and Ponzi schemes. They also often comment that serious matters like Storm Financial and more recently Dixon Advisory were reported to ASIC years before they became severe, however no action was taken. This might imply deficiencies in how ASIC leverages intelligence from within the financial adviser population to identify serious matters.

Fee for No Service

We have repeated below some of the content that we included in our submission in response to ASIC Consultation Paper 350 on Remediation from 11 February 2022. We believe that this is a case study where ASIC's actions, through the large institutionally owned licensees resulted in substantial overpayment of compensation and huge costs to investigate, often in areas where there was no evidence of wrongdoing. We were more directly concerned with the implication that this had on the authorised representatives of these licensees.

There has been some common themes in the complaints about these programs:

- Judging what advisers did in the past on the basis of the current guidance (Info Sheet 256).
- The onus of proof turned around from an assumption of innocence to a requirement to demonstrate that they did comply in all respects.
- Demanding proof over a period that goes beyond the legal requirement to retain records.

"At the AFA, over the last few years we have received a number of complaints from members about how Fee for No Service remediation projects have been conducted. At the outset, we must make it very clear that in no way do we condone charging fees when not providing any services. That is not in dispute, and remediating clients in this situation is a must. We are pleased that many financial advice clients who were genuinely impacted by Fee for No Service conduct have been compensated. The remediation projects have had a much deeper impact. Many of these complaints that we have received from members, have been with respect to the impact on those who have always done the right thing. In this context we make the following points:

- The remediation programs have been negotiated between ASIC and the licensee, however there have often been significant consequences that flow on to the authorised representatives, and often where there is no basis to assume any wrong-doing. Most of these programs appear to have taken a similar pattern, which suggests that ASIC has employed a hard negotiation approach with each group. We assume that these negotiations have addressed issues such as the scope, the review approach and the basis to determine the amount of any compensation.

- The prospect of an adviser proving that they have met all their contractual servicing obligations to all their clients over the last 10 years, can be a daunting prospect. This is compounded by the reality that some of these client records (particularly in the earlier years), may be in paper form. Some advisers have needed to spend a substantial amount of time and money proving that they have done nothing wrong.
- We have seen former authorised representatives of a licensee be contacted by the licensee demanding client lists and proof of service many years after having left the licensee. In one case, we observed the situation where the adviser had left this licensee ten years beforehand, yet were in receipt of a particularly demanding letter from the former licensee.
- We are aware of a number of cases where clients have received large payouts with respect to a Fee for No Service remediation project, when they were completely happy with the service that they had received. In some cases, they expressed concern for the implications of this refund on their adviser and sought return the money. Clearly this outcome made many of them feel very uncomfortable. We expect that there are a large number of people who have received windfall gains that they never expected and do not believe that they deserve.
- Automatic remediation programs for clients who have paid less than $400 or $500 per year over a 10 year period, without checking whether the agreed services have been provided, creates doubt in the mind of the client as to whether misconduct has actually occurred on the part of their adviser. This could damage the ongoing client relationship.
- The fact that a licensee could choose to automatically pay out as much as $4,000 or $5,000 per client, in order to avoid the need to review the client's file, paints a picture of the extent of the workload in these remediation projects. In some cases, huge amounts of expense was incurred to prove that nothing was done wrong. This was a very hollow victory for those involved. We are aware of cases where the adviser has incurred costs of well over $100,000 in responding to the requests for information from their licensee.

The Fee for No Service remediation programs have placed a huge burden on many of the advisers in the large institutional licensees and the expectations that have been placed on some of these advisers have been extreme and unfair. In our view, this places a spotlight on the manner in which the scope of these reviews have been expanded, and the apparent lack of consideration of the fairness or implications of this for those further down the line.

As stated above, we do not dispute the existence of the Fee for No Service problem and the necessity of the actions to address it and to remediate impacted clients. Charging a fee, and then not providing the agreed services, was never acceptable and should never have happened. If these remediation programs were able to precisely focus on wrong-doing, without having a huge detrimental impact on those who did nothing wrong, then we would have no objections.

In our view it would be better if there was more data on these Fee for No Service remediation programs and the compensation payments that have been made. Most of the reporting has focussed on just one number, however we know that there are a number of different categories. From what we can tell, there are a range of different elements, including the following:

- Salaried advisers, where agreed services were simply not provided.
- Cases where the documentation does not exist or cannot be located to adequately prove that agreed services were provided, or where it does not meet the standards of the present day.
- Cases where services were provided, however it is questioned as to whether the required services were completely provided.

- Advisers who have since left the licensee, and accessing the files might be complicated by the fact that the business or the client book might have been on-sold. There have also been cases where an adviser has purchased a book of clients and been held responsible for matters that relate to the time prior to the purchase.
- Licensees agreeing to automatically pay out amounts below a certain defined threshold.

We ended up talking to a number of advisers who were in the situation where they had been subject to a detailed review of a large number of files and they had been assessed as compliant with respect to the vast majority of their clients, yet were facing the need to explain why review meetings did not happen in certain years with some clients or trying to find certain documents to prove specific points. Often, if they were unable to respond to these points, they might have faced a significant financial cost. This process had a huge personal and emotional impact on these advisers. Across all those who were impacted, we believe that for most of them, there was no question that they had always sought to do the right thing by their clients.

Some common issues that emerged as part of this process were as follows:

- What clients signed up for in their initial agreement, may not have been ultimately what they wanted from their adviser. Whilst a client might have signed up for an annual review, they might have put more importance on a quarterly conversation about the state of investment markets, and the ability to ring their adviser in the event that they had any urgent questions. They might have declined some of their annual review meetings. Clients often have other priorities. Advisers cannot force clients to attend a review meeting.
- Some of these file reviews went back to 2008. It was not common for licensees to have any rules or standards on servicing clients back then, and ASIC had no guidance on this either. The legal basis for these remediation programs was the high level and general obligations in Section 912A(1)(a) of the Corporations Act (i.e. efficiently, honestly and fairly). File notes to set out the nature of a review meeting were often briefer in the past, and it was less common for a Record of Advice to exist, where the advice was for the client to hold their current investments. In almost all cases, these advisers had passed their annual audit at that time without any of these servicing issues being raised and were completely unaware of the risk of this becoming an issue at a much later time.
- Record keeping has improved over the years, with all records now held on electronic systems, whereas back in 2008, paper files were most common. In many cases these files had been archived or even in some cases destroyed, either because of their age or the fact that the client was no longer a client of the adviser. The work involved in retrieving files from archives and finding specific documents cannot be understated. We heard stories of advisers spending days, if not weeks, searching through archive boxes in off-site storage.

The Fee for No Service Remediation projects were essential, however our sense is that they could have been designed and operated in a manner that was fairer and where the onus of responsibility should not have been placed on financial advisers to prove that they had done nothing wrong, when there was no evidence to suggest that they might have.

The Fee for No Service scandal has done untold damage to the financial advice sector. This is not just in terms of reputational damage, but also in the impact that it has had on advice professionals, who have been diverted from servicing their clients to undertaking activity to investigate and search for documents, in order to help prove that they have met their obligations. This has involved a huge cost in time and often in situations where there was no evidence of any wrong doing. There has also been a substantial mental health toll. It has also been one of the major factors in financial advisers losing faith in their profession and choosing to leave financial advice.

Addressing the Terms of Reference

a. the potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action

We agree that this is an issue and would suggest that this is highlighted by the Fee for No Service example. Interestingly AFCA found this to be a much smaller issue than ASIC did, which suggests that the regulatory intervention and remediation programs far exceeded the level of complaints directed to AFCA (or FOS), even after this issue received such a high level of media focus at the Hayne Royal Commission. The Fee for No Service issue evidently led to the preparation of Information Sheet 256, which set an even higher bar. The management of this program has caused significant and non-value adding activity and cost to many.

b. the balance in policy settings that deliver an efficient market but also effectively deter poor behaviour

ASIC has little policy setting power, however there are some powers delegated to them through the Corporations Act. Instead, they use Regulatory Guides and Information Sheets to explain their understanding of the law and to set their expectations. In our view this is not necessarily the most effective way to operate, particularly when they are demanding more than the law would require.

The cost of providing financial advice has increased significantly over recent years. One of the drivers of this is increasing compliance obligations. Some of this is due to law change, and some of it is due to ASIC requirements. One example is how ASIC Report 515 changed the expectations of the sector with respect to demonstration of compliance with the Best Interests Duty obligation. Another example is where ASIC in ASIC Report 636, Compliance with the fee disclosure statement and renewal notice obligations, acknowledged particular issues with the production of Fee Disclosure Statements and recommended "logging into the product issuer or product platform website or portal to check when fees were deducted from each client's account. This is an incredibly inefficient method of producing Fee Disclosure Statements, and in our view demonstrated a lack of commerciality, since these costs would need to be charged to clients, who would not have valued these checks simply to avoid small differences.

Deterring poor behaviour is an important outcome, however in financial advice this has often been made more difficult by unnecessarily complex legislation and regulatory requirements. As always, getting the balance right is the most important thing. It is also important to do it in an efficient way where the operating expenditure is largely directed at areas that are generating value for consumers and not just creating additional non-productive overheads.

c. whether ASIC is meeting the expectations of government, business and the community with respect to regulatory action and enforcement

Our perception of this is distorted by the impact of the Hayne Royal Commission and the resultant flow of enforcement and litigation activity. This was an outcome of the media circus that was created by the Hayne Royal Commission that substantially separated the perception of financial advice from the reality. It also led to the "why not litigate" approach, which we always thought was excessive. It also resulted in substantial expenditure by ASIC in the financial advice space, often seemingly with respect to action against large institutions who had since left the advice sector. This causes great dissatisfaction, as financial advisers ended up paying for some of this enforcement activity. The focus on regulatory activity is now seemingly going back to a more sensible level of investigation and enforcement, however we would have expected ASIC staff numbers to have fallen more in line with the reduction in financial adviser numbers.

d. the range and use of various regulatory tools and their effectiveness in contributing to good market outcomes

It is our view that the Hayne Royal Commission and the resultant media coverage pressured ASIC into a "why not litigate" operating model. This was a very poor outcome, as it provided insufficient graduation in regulatory response. It was not our experience that other regulatory options, such as enforceable undertakings were ineffective. We always though that ASIC drove a very hard bargain with many of these previous settlements through enforceable undertakings. There are other regulatory tools that can deliver a more timely response, and we think that they all have a role to play in the right circumstances.

e. the offences from which penalties can be considered and the nature of liability in these offences

The Corporations Act has been modified in recent years to create more offences and to increase the penalties that apply. It is still relatively early days in terms of seeing penalties that have been applied on the basis of the FoFA and more recent reforms. This is a matter to continue to monitor.

f. the resourcing allocated to ensure investigations and enforcement action progresses in a timely manner

We certainly understand that ASIC has a lot of resources to focus on the financial advice space, if the information behind the Industry Funding Model is relied upon, however we don't know any detail on how many resources they have now or how they resource this type of activity. In the context of how much they have spent, we would expect them to be able to respond in a timely manner. The example of our member who was subject to a two and a half year investigation might suggest otherwise. It is difficult for us to comment further on this.

g. opportunities to reduce duplicative regulation

Duplication and triplication of Regulatory oversight has been an issue with financial advice, particularly whilst under both the ASIC and TPB regimes. That was addressed by the Better Advice Bill 2022, with removal of financial advisers from the TPB regime, however duplication of regulatory oversight remains an issue with the existence of other regulators in the financial advice space (APRA, Austrac, OAIC etc), and they do cross over on certain issues (i.e. ASIC and APRA on charging advice fees from super accounts and life insurance)

h. any other related matters

We do not have any other comments.

Concluding Comments

We thank you for the opportunity to provide feedback as part of your ASIC Investigation and Enforcement Inquiry.

ASIC plays a very important role in the financial services sector and it is essential that they find the right balance between encouraging good conduct and responding to misconduct. As with any organisation there is room for improvement. We have focussed upon some specific cases where we were unhappy with how ASIC has responded and the impact upon financial advisers.

We would be happy to discuss this submission further, or to provide additional information if required.

Yours sincerely,

Phil Anderson
Chief Executive Officer
Association of Financial Advisers Ltd