1 November 2024

Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

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

Dear Sir/Madam

Inquiry into wealth management companies

Chartered Accountants Australia and New Zealand (CA ANZ) welcomes the opportunity to make a submission to the above inquiry.

We are not able to provide a view about the underlying causes for the collapse of wealth management companies; the actions of directors, related entities or senior management; or the placement of these companies into administration and related insolvency issues except in passing.

Our comments instead focus on the impact on consumers from these collapses; how consumers can be protected; and, if necessary, compensated for their losses; and importantly the role and operation of the Compensation Scheme of Last Resort (CSLR).

It is essential that there is an appropriate external dispute resolution (EDR) framework for the financial services sector that ensures industry participants are accountable for the financial products and advice they provide. The framework should appropriately protect consumers and, where necessary, allow them to access adequate compensation and redress.

CA ANZ has been supportive of the establishment of a Compensation Scheme of Last Resort (CSLR), which will help fulfil this objective while also supporting confidence in the financial sector's dispute resolution framework.

However, the scheme as introduced has significant shortcomings, which are now being highlighted by the collapse of Dixon Advisory. Further, the Dixon Advisory collapse has exposed flaws in the dispute resolution framework.

A well-functioning dispute resolutions system should provide consumers with appropriate opportunity to seek recourse and restitution from financial services providers where there are disputes, or where losses have occurred.

This is underpinned by an internal dispute resolution framework to allow providers the opportunity to respond to and resolve customer complaints; supported by an independent EDR

scheme to adjudicate unresolved disputes and make binding decisions regarding compensation; backed up by a compensation scheme that should only be used as an absolute last resort once all other avenues have been exhausted to recover compensation for consumers.

Paying compensation must primarily be the responsibility of the party whose behaviour gave rise to the complaint. The EDR framework should have safeguards in place to ensure providers are in an adequate financial position to compensate their clients when necessary. These safeguards should include minimum capital adequacy requirements and ensuring adequate levels of appropriate professional indemnity insurance are held.

If these safeguards exist and functioning adequately then the majority of complaints should be resolved, and any compensation paid at the EDR stage and a compensation scheme of last resort would be a genuine last resort.

Unfortunately, the Dixon Advisory case has demonstrated that the CSLR as implemented is not fit for purpose and may not be sustainable.

Approximately 87 per cent of AFS Licensees have 10 or less financial advisers or hold a limited licence. This represents approximately 29 per cent of all financial advisers[1].

A significant proportion of the CSLR levy will fall upon small practitioners. The retrospective nature of the scheme means financial advisers will be faced with the burden of covering over 40 per cent of Dixon Advisory claims with an approximate cost of $135 million,

Combine the CSR levy with the ASIC and AFCA levies along with professional indemnity insurance levies and small practitioners face a significant financial burden.

The financial advice sector does not have the capacity to pay for large losses. Another big failure like Dixon Advisory would push annual CSLR levies even higher for longer, which would force more financial advisers out of the sector jeopardising the long-term sustainability of the CSLR.

It is inappropriate that small financial advice practices should bear the brunt of the compensation payments for the failure of a large financial services firm. Nor is it appropriate that new entrants to the financial advice sector should be forced to pay for the failures of their predecessors for many years to come.

We strongly urge the government to indemnify financial advisers against claims for losses that were incurred before the formal commencement of the CSLR.

Our detailed responses to the terms of reference contained in Attachment A.

For any questions in relation to this submission, please contact me at [redacted] or on [redacted].

[1] Adviser Ratings, October 2024.

Yours sincerely,

Michael Davison
Financial Advice & Government Affairs Leader
Chartered Accountants Australia and New Zealand

Appendix A

About us

Chartered Accountants Australia and New Zealand (CA ANZ) represents more than 139,000 financial professionals, supporting them to build value and make a difference to the businesses, organisations and communities in which they work and live.

Around the world, Chartered Accountants are known for their integrity, financial skills, adaptability and the rigour of their professional education and training.

CA ANZ promotes the Chartered Accountant (CA) designation and high ethical standards, delivers world-class services and life-long education to members and advocates for the public good. We protect the reputation of the designation by ensuring members continue to comply with a code of ethics, backed by a robust discipline process. We also monitor Chartered Accountants who offer services directly to the public.

Our flagship CA Program, the pathway to becoming a Chartered Accountant, combines rigorous education with practical experience. Ongoing professional development helps members shape business decisions and remain relevant in a changing world.

We actively engage with governments, regulators and standard-setters on behalf of members and the profession to advocate in the public interest. Our thought leadership promotes prosperity in Australia and New Zealand.

Response to Terms of Reference

(a) The underlying cause of the collapse of wealth management companies such as Dixon Advisory, including the business model and influence of the sale of related party products, for example the US Master Residential Property Fund.

(b)How the actions of directors of wealth management companies and related entities, senior management and the individual advisers contribute to the collapse of these companies.

No comment.

(c) The role of the financial services regulatory regime in the context of how matters involving the collapse of an investment product promoted by a vertically integrated business are assessed and how fault is attributed.

(d) Evaluation of the placement of wealth management companies into administration and the related insolvency issues, including with respect to the appropriateness of actions by directors and senior management and the transfer of advisers and clients to a related party entity for no consideration.

If financial services are being provided to retail clients, there must be arrangements in place to compensate aggrieved clients for breaches of Chapter 7 of the *Corporations Act 2001* (Corps Act). The primary way for AFS licensees to comply with this obligation is to require them to have Professional Indemnity Insurance (PII) cover.

The role of Professional Indemnity Insurance (PII)

If financial services are being provided to retail clients, there must be arrangements in place to compensate aggrieved clients for breaches of Corps Act. The primary way for AFS licensees to comply with this obligation is to require them to have Professional Indemnity Insurance (PII) cover.

A contributing factor to the need for the CSLR is the failure of PII to respond appropriately to disputes, often leading to awarded decisions by AFCA remaining unpaid. Accessibility and affordability of PII for the retail personal financial advice sector have been challenges for many years, with the impact of the Financial Services Royal Commission resulting in some PII providers exiting the market.

The shrinking nature of available cover and the rise in associated risk premiums have resulted in many AFS licensees increasing their excess payable or accepting exclusions in cover to secure PII on an ongoing basis. It is also not uncommon for the approval process for PII to take three to six months. To ensure adequate consumer protection and the viability of a true CSLR, AFS licensees must be able to access affordable cover that is adequate for the nature of the AFS licensee's business, and which can adequately meet the potential liability for compensation claims.

We recommend that Treasury undertakes a review of PII for the retail personal advice sector, focusing on keys risks including:

- accessibility
- adequacy
- exclusions, and
- impact on capital adequacy of the AFS licensee.

To ensure the viability of a true CSLR all AFS licensees must continue to hold appropriate PII cover. It is our understanding that ASIC only assesses if the professional indemnity insurance (PII) cover is appropriate for an AFS licensee at time of application or as part of a surveillance activity. As a result, awarded compensation by the AFCA will often remain unpaid due to insufficient, unsuitable or no PII held by the AFS licensee.

In contrast, registered tax agents and BAS agents are required to provide details of their PII policy at time of application and must demonstrate at renewal of their registration that they continue to hold appropriate PII that meets Tax Practitioners Board requirements.

We recommend that ASIC adopt a similar model for AFS licensees. This model would have many benefits, including:

- ensuring that the AFS licensees continue to hold appropriate PII cover

- sending a signal to all participants that the regulator will be proactively regulating this obligation, motivating some non-complaint, or at risk, AFS licensees to retain appropriate cover
- ensuring awarded AFCA claims can be paid, and
- providing insight to the regulator on trends and issues that may be occurring in the PII market.

We recommend that ASIC require all AFS licensees to submit their PII cover details as part of their existing annual compliance obligations. ASIC should audit a random sample across market participants to ensure there is adequate consumer protection for the users of financial products and advice.

Capital Adequacy and vertical integration

Beyond satisfying minimum PII requirements, we believe consideration should be given to how else AFS Licensees can meet minimum capital adequacy requirements to ensure compensation can be provided to aggrieved clients. One example could be to model similar requirements to those under APRA's prudential standard SPS515 Strategic Planning and Member Outcomes, where superannuation funds are required to maintain a level of financial resources necessary to meet their business needs.

In the case of a vertically integrated business, where there is common ownership and/or directorship, the responsibility to ensure adequate capital resources to fund compensation to aggrieved clients should fall on the parent entity.

In the case of Dixon Advisory, ASIC found that its representatives breached the best interest duty to a number of clients and was penalised $7.2 million. Dixon Advisory had already been placed into administration, and its parent entity E&P Financial Group ultimately entering into a heads of agreement with ASIC to pay the penalty.

Subsequent to this E&P appointed 80 per cent of Dixon Advisory Advisers to a subsidiary, Evans & Partners and transitioned 78 per cent of clients to Evans & Partners.

We believe the parent entity of an AFS Licensee should assume responsibility of the Licensees commitment to clients, similar to a licensee being responsible for their authorised representatives' actions. Similarly, where the operations of a Licensee are transferred to a related party, as was the case with Dixon Advisory, the parent entity should assume responsibility for any complaints and compensation claims against the former subsidiary.

(e) Assessment of the period for which wealth management companies can remain a member of AFCA.

AFS Licensees should remain members while complaints against them are being resolved.

Dixon Advisory is a special case in that its membership continued after the CSLR had commenced. With the CSLR being retrospective, i.e., there is no limit on how far back historical claims can go, those additional claims made to AFCA before membership was cancelled will

have a profound impact on the cost to the CSLR and the fees paid by the financial advice sector.

If claims against the CSLR were only prospective from when the CSLR commenced, and requirements for greater capital adequacy were strengthened then the future impact on the CSLR would be considerably less and more likely to be sustainable.

(f) The role of ASIC, including providing consumer information to investors affected by corporate collapse and consideration of the most appropriate arrangements for future cases of insolvency.

(g) ASIC's role investigating corporate collapse and the appropriateness of any regulatory intervention that may reduce scale of loss for consumers.

(h) Options for enforcement action, including litigation, that ASIC has available to it in relation to wealth management companies following collapse.

Part of ASIC's remit is to provide consumer education. In the case of Dixon Advisory this extended to advising the public that affected clients should lodge complaints with AFCA before Dixon Advisory's AFCA membership ceased, while at the same time requiring AFCA to maintain their membership.

Due to the retrospective nature of the CSLR, i.e. there are no limits on historical claims, the claims against the CSLR and the subsequent financial impact on the financial advice sector are much higher than they otherwise would be.

It is important that clients are appropriately compensated for losses they have suffered. However, given this late influx of claims we believe financial advisers should be indemnified against claims for losses that were suffered before the CSLR commenced.

Similarly, where ASIC has taken no action against a financial service provider or taken an excess period of time to take action against a provider, financial advisers should not bear the cost and should be indemnified against the additional claims on the CSLR.

Where ASIC has successfully taken action against a financial services provider, any fines or penalties paid should contribute to funding compensation to affected clients instead of going into consolidated revenue.

(i) The implications of the collapse of wealth management companies on the establishment of the CSLR, including with respect to design considerations and the potential implications for future matters.

CA ANZ has been supportive of the establishment of the CSLR. However, the scheme as introduced has significant shortcomings, which are now being highlighted by the collapse of Dixon Advisory.

First and foremost, is the retrospective nature of the scheme whereby there is no time limit on how far back historical claims can go. This is despite recommendations by the Ramsay Review and the Royal Commission into Misconduct in the Banking, Superannuation and Financial

Services Industry, and initial suggestions by the government, that the scheme would be prospective and only apply to claims made to AFCA after the commencement date.

With over 40 per cent of Dixon Advisory claims being lodged after the pre-CSLR cut-off date of 7 September 2022, it is estimated that financial advisers will be liable to cover the cost of approximately $135 million in claims, which will progressively be finalised from 1 July 2024.

Approximately 87 per cent of AFS Licensees have 10 or less financial advisers or hold a limited licence. This represents approximately 29 per cent of all financial advisers[2]. As such, a significant proportion of the CSLR levy will fall upon small practitioners. With the CSLR levy for the financial advice sector being $18.5 million for 2024 -25 and the annual levy capped to $20 million per sector, the impact of the Dixon Advisory claims will have a significant flow on effect on the levy paid by small businesses for years to come. That is before taking into account future claims that become payable by the CSLR.

The CSLR levy for 2024-25, which AFS Licensees were invoiced for in August, is $100 plus $1,186 per financial adviser. Combine this with the AFSL ASIC levy for 2023-24 of $1,500 plus approximately $2,878 per financial adviser; along with the AFCA levy and PII premiums and small practitioners face a significant financial burden that many may not be able to bear.

The financial advice sector does not have the capacity to pay for large losses. Another big failure like Dixon Advisory would push annual CSLR levies even higher for longer, which would force more financial advisers out of the sector jeopardising the long-term sustainability of the CSLR.

It is inappropriate that small financial advice practices should bear the brunt of the compensation payments for the failure of a large financial services firm. Nor is it appropriate that new entrants to the financial advice sector should be forced to pay for the failures of their predecessors for many years to come.

We strongly urge the government to indemnify financial advisers against claims for losses that were incurred before the commencement of the CSLR.

(j) Any other related matters.

No comment.

[2] Adviser Ratings, October 2024.

Chartered Accountants Australia and New Zealand

Acknowledgement of Traditional Owners

Chartered Accountants ANZ acknowledges the land throughout Australia as the Traditional Lands of Aboriginal and Torres Strait Islander peoples and we respect their spiritual relationship with their Country and to to their Elders past and present.

We also acknowledge them as the custodians of the Land and Waters, and that their cultural and heritage beliefs are important to Aboriginal and Torres Strait Islander peoples today.

Artwork acknowledgement: Rhys Paddick, a Yamatji/Noongar digital artist from Boorloo (Perth, WA)