Response to Financial Sector Reform (Hayne Royal Commission Response – Better Advice) Bill 2021 [Provisions]

AIOFP Submission – complied by
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AIOFP
ASSOCIATION OF INDEPENDENTLY OWNED FINANCIAL PROFESSIONALS

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1. Executive Summary

While we understand that aspects of the Hayne Royal Commission need to be implemented, our Association has some concerns in terms of how this is proposed. We believe that the consequences can be increased costs for advice (which will ultimately be passed onto consumers) and inadequate expertise in pertinent areas at a time of significant change in our industry.

In relation to the specific issues in the document for which feedback has been requested, we would bring to attention the following:

- The introduction of the Financial Services and Credit Panel needs to be sure that any "eligible person" appointed to a panel has expertise not just in a particular subject area, but also has experience to ensure consideration of the correct context of the advice in question.

- That any penalties set that may be imposed by the Panel have a sufficient range and type that allow any sanction to be appropriate to the level of severity of the action that is being investigated.

- The issue of product failure be recognised as not that of the adviser (assuming all reasonable measure for research have been taken) but that of the product provider, and that research houses and ASIC take measures to take responsibility for the issue of documents such as product profiles and Product Disclosure Statements.

- That the role of the licensee in providing administration and compliance assistance be recognised and utilised to assist in reducing compliance costs that are ultimately passed on to clients.

- That the streamlining of regulatory function does not lose the current expertise required to support a major transition period in the industry, while also recognising the manner in which advice services are delivered.

A concern that we have with this overall is that such changes will be the catalyst for an increase in compliance costs, which will only increase the cost of advice to the consumer. Further, we hold the concern that consultation on implementation measures needs to be across a wide demographic of financial advice business – not simply those from the "top end of town". This way the implementation would truly represent the interests of all client types, and not simply the wealthy.

We would like to offer our assistance in providing access to members who represent this wide range of client interests for any consultation or implementation, and are happy to answer any questions you may have in terms of this submission.

2. Introduction

The Financial Sector Reform (Hayne Royal Commission Response – Better Advice) Bill 2012 [Provisions] (the Bill) provides an excellent road map as to how it is intended that Commissioner Hayne's recommendations in these areas will be implemented.

As an Association we understand the basis for making the recommendations, however we do hold some concerns for their proposed implementation as per the Bill. Our concern is that while the Bill has good intentions that there are:

- Some unintended consequences – mostly to due to costs raised from duplication; and
- Past issues that have not been addressed

The sections following outline our concerns for what is proposed and our rationale for that concern.

3. Expansion of the Financial Services and Credit Panel (FSCP)

We have no problem per se with the establishment of the FSCP. The process outlined for how this panel would operate appears to offer sufficient opportunity for any individual brought before the panel to provide a defence against allegations where one exists.

One issue we do wish to point out is the consistent raising of "conflict of interest" in relation to dealing with the financial services profession. One of the justifications for such a panel is that financial services licensees have a "conflict of interest" in the discipline of authorised representatives on the basis that they do not wish to punish people in their own group – that they instead do not provide any sanction that would reduce the fee payments received by the licensees.

While this may be the position of the major institutions, such a conflict is not the position of the non-institutional licensees. The concern for such licensees is not as great for the loss of an adviser's fees, but the application of sanctions against the licence or its loss – as a result, an adviser seen to breach licence protocols is more likely to be asked to leave that licence than to have a blind eye turned to inappropriate conduct.

The concern we hold with the establishment of the FSCP is for any inequity that would see bias against the individual under scrutiny. While we do not suggest any bias would be intentional, consideration needs to be given to the following aspects of the operation of the FSCP.

Application of "Eligible Person"

The Explanatory Memorandum to the Bill provides a list of potential industries for panel members from which to be appointed from of which a "person has experience or knowledge in at least one of the following fields". Reading the list, it appears to provide wide coverage of areas that would be applicable to consideration of a matter brought before the FSCP. That this is the intention of the list is articulated in the Explanatory Memorandum where it states that those included on an FSCP will provide:

> *"a diverse range of relevant knowledge and experience required to make informed decisions on misconduct committed by financial advisers"*

Lack of context

A major concern in the establishment of an FSCP is that the list of "experience or knowledge" will see people who, while knowledgeable on a particular subject, do not hold expertise that will allow them to put into the context the subject be adjudicated.

While an individual may be knowledgeable in an area such as economics (for example), and able to judge the circumstances that has given rise to a complaint about the appropriateness of investment product recommendations, such expertise does not necessarily mean that the individual on the panel will be adequately able to understand the circumstances surrounding the manner in which the advice was provided.

This being said, we believe it is vital for any FSCP that is convened to have expertise in dealing with clients - particularly on a retail basis. This is to ensure that there is no unintended bias against the manner in which any advice was given.

When considering the manner in which the advice was given, further context must be considered in terms of the sophistication of client.

A panel member with retail client advice experience may deal primarily with high-net-worth clientele. Someone with such expertise may have difficulty relating to a client that does not have a high net worth, and consequently may quite unintentionally apply bias against the adviser under scrutiny.

Therefore, we recommend that it not be simply areas of business that might determine who sits on an FSCP. As well as the business area there should be some consideration of the demographics of the clients and their situation, to ensure that those who sit in judgement of the situation are in fact peers of the adviser under scrutiny and will deliver a judgement that is well considered, fair and reasonable.

<u>Setting of Penalties</u>

The Bill explains that the process for the establishment of an FSCP will be to deal with situations that ASIC do not believe it appropriate to issue a banning order, however they believe that enough evidence exists that the situation should be considered, and a lesser penalty be applied.

Our concern for the establishment of potential penalties is that sufficient consideration is given to what is regarded as “less serious misconduct” and such a position be clearly defined for the FSCP terms of reference. Once terms of reference have been established, our concern then is that a wide enough range of sanctions is established to ensure any penalty given to a relevant provider is commensurate to the issue for which they are being sanctioned.

As noted earlier in this paper, we believe the licensee is in the best position to handle such disciplinary action and that they are not subject to the conflict-of-interest issues that have been alleged. However, if the FSCP is to proceed, we would expect that any penalty regime will account for variances in alleged offences so that any sanction is appropriate to the action being investigated – that the “punishment fits the crime”.

To do this we believe that any panel convened to set penalties will come from a wide variety of advice demographic and not just include large institutions or advisers with a high-net-worth clientele. We believe there should be adequate representation from licensees and smaller practices representing advice for "mum and dad" clients – the main source of where issues arise from.

Establish and dismiss issues of product failure

An area of major concern over many years now is the fact that advisers are being held responsible for the failure of financial products simply because they have recommended them to a client. This situation is unjust, unfair and is viewed by many as pandering to the major institutions – the very groups responsible for such failures and ultimately the cause of hardship for those investors affected.

At no point are we suggesting that such failures should be unpunished, however recognition needs to finally be given to the fact that such products are recommended by an adviser only after research has been performed on the documentation made available to determine the suitability for making such a recommendation. This includes:

- Research provided by professional research houses; and
- Product Disclosure Statements (PDS) given approval by ASIC

That product failure has played such a significant issue in advisers being disciplined by complaints bodies is a travesty, in that no focus has been placed on the practices of the institutions or the processes employed by research houses engaged (quite often at significant cost) to provide an opinion on such products.

Further, it is ASIC who approve a PDS to be issued for consideration by investors, and it is this document that advisers are required to direct potential clients to when making their final decision as to whether to invest or not. While ASIC are quick to point out that they don't verify the content of a PDS – only the necessary inclusions - they need to be made aware that many investors regard the fact that ASIC has approved the document gives an indication that a financial product has in fact been vetted by the regulator; this provides a sense of security around entering into the product.

The establishment of the FSCP provides a significant opportunity to finally get this situation right. It is our hope that in setting the terms of reference and establishing penalties the panel will identify the significance of this problem and seek to identify in its initial investigation where product failure is at fault. From there it would be expected that any investigation of misconduct committed by financial advisers be turned to the product provider to ensure that those actually responsible for the problem are held accountable.

Further, while ASIC can continue to justify their position in relation to the issue of PDS's they should realise the position they hold requires greater care and responsibility. As regulator they should be engaging in (at the very least) a basic due diligence of the product in front of them; not simply checking the document for essential inclusions. In this way they will be meeting their perceived obligations in terms of consumer protection within the financial services industry.

4. Registration of Financial Advisers

While we appreciate that an ongoing declaration of being a "fit and proper person" to continue to provide financial advice is an important part of ensuring a high quality and ethical ongoing industry, the provisions being put forward in the Bill are essentially doubling up on the services that licensees provide. This can only have the effect of increasing the cost of advice due to advisers having to spend extra time in the administration process.

For large institutional licensees whose advisers are employees this will be little imposition, however for those advisers who operate their practices not as employees but as small businesspeople, the imposition of these extra requirements will detract from the time spent being able to provide the service to their clients, that supposedly the Hayne Royal Commission was intent on delivering better outcomes for.

In this case, time spent on the extra registration that can easily be performed by licensees will reduce that time spent in client service. A reduction in time spent with clients will mean an increase in fees to clients to cover the fixed costs of running a business – a fact that we believe has not been accounted for when designating the "Compliance Cost Impact" of the Bill as "Low compliance cost".

As the cost of advice is a key concern for government and a major focus of ASIC, we believe the additional impost of adviser registration to be short sighted and contradicts this important issue.

Further, we believe that recommending such a process highlights the concern for many in the industry that neither government nor regulator fully understand the role of the licensee and the important part they play in helping reduce costs for consumers. It is the licensee that allows the adviser to focus their time on providing service to their clients and maintain their knowledge and skills. In most instances it is the licensee that ensures ongoing obligations for professional development are met and provides the interface between the regular changes to policy and the adviser, ensuring they are kept up to date.

If the trend is to continue that advisers become quasi licensees, the trend will also continue for the cost of advice to increase and that less of the Australian public will be able to afford advice at a time when the government can least afford to have more of its citizens relying on the public purse.

We urge the government to review this part of the Bill and find a way to allow licensees to continue to provide the service they are engaged for while transitioning to having the Australian Taxation Office administer registration.

5. Transfer of FASEA and streamlining regulatory functions

We welcome the consolidation of areas that govern the activities of financial advisers. We fully believe that by combining departments it will allow a clearer focus on what is happening in the advice industry and provide a more effective governance model that will ultimately be of benefit to the consumer.

Our concern is that in winding up FASEA and the oversight of the Tax Practitioners Board (TPB) and transferring their responsibilities to the Ministry supported by ASIC is that it will lose the expertise in the areas that their respective Boards provide.

FASEA – while it has been a difficult transition overseen by this group, they do bring expertise to the area of education that is vital given the transitional education requirements for advisers. It is our hope that the Ministry and ASIC will include and be guided by similar expertise through the remaining education transition process.

TPB – the inclusion of the TPB as part of the governing of the financial advice industry has been of mixed success and we hope that their removal from governance brings some clarity to the issue of how the consideration of taxation issues is treated by advisers. Contrary to the TPB belief that any consideration of taxation is tax advice, we believe that taxation is an important part of due diligence when making recommendations (it would be negligent not to consider it), however it is not necessarily the basis of advice that would meet the normal definition of "taxation advice". We fully believe that an adviser giving advice on the basis of taxation and charging fees for giving specific tax advice should be a registered tax agent; we also fully believe that after the transition to the Ministry there should be recognition that simply meeting due diligence obligations for the consideration of tax is not providing tax advice, but is part of an adviser meeting the best interests of the client.

The other major concern for this consolidation and streamlining of functions is that this will be a means by which the regulator will further increase their costs to the end user. The exorbitant increase in fees levied on advisers by ASIC since the introduction of the 'ASIC levy' have industry participants uneasy that fees from the regulator will be the subject of significant increase again due to the proposed consolidation; an impost that will only further increase the cost of advice for consumers.

We would ask that any fees levied by any regulator are fully explained and totally transparent – in much the same manner that financial advisers are being asked to quantify and justify the cost and services that they are providing with the introduction of annual opt-in and fee consent as recommended by Commissioner Hayne.

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6. Conclusion

This paper has been constructed after consultation with our members and we believe accurately reflects their views. While it may be considered that these views are from a position of bias or conflict of interest, we believe that it instead provides a view from the perspective of:

- What clients are actually seeking in terms of service from their financial adviser;
- Hundreds of small business operators (i.e., financial advisers) trying to keep their cost of doing business affordable to ensure they can remain in business to be able to provide clients with the services they are seeking; and
- Ensuring that clients can continue to afford their advice despite the rising costs of compliance associated with constant regulatory change.

We believe we understand the intent of what is proposed by the Bill and support many of the inclusions. However, we are concerned that consultation with industry will only focus on feedback provided by the major institutions and not consider the position of those people who actually serve the clients that the government claims they want to protect.

It is to this end that we express our hope that further consultation will include a wide demographic of financial advice professional that will in turn represent the interests of the wider community that seek financial advice.

For this purpose we offer our assistance in transition and implementation to help represent these clients, as well as representing the views of non-institutional adviser groups, to ensure that a fair process is followed and that the government cannot be accused of bias toward any particular group or demographic.

Please feel free to contact me for any clarification or to ask any questions on any matter raised in this response. I can be contacted by email at [redacted] with any enquiry.