1st November 2024

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

Email: economics.sen@aph.gov.au

Dear Sir/Madam

SMSF ASSOCIATION SUBMISSION: WEALTH MANAGEMENT COMPANIES INQUIRY

The SMSF Association welcomes the opportunity to provide this submission to the *Senate Economics References Committee for inquiry into Wealth Management Companies.*

This inquiry is important to uncover and understand the root causes that led to the collapse of Dixon Advisory & Superannuation Services Pty Ltd (Dixon Advisory) and identify what actions can be taken by all relevant stakeholders to prevent this event being repeated.

The collapse of Dixon Advisory has impacted thousands of clients who collectively have lost millions of dollars, many of them retired or nearing retirement. Yet, no one has been held accountable. This includes the directors and senior management who were ultimately responsible for the running of the business at the time, nor the financial advisers who provided the financial product advice.

This is not just an issue of a few financial advisers providing poor financial advice to their clients.

The collapse of Dixon Advisory highlights the concerning ability of large listed corporates to enter a subsidiary firm into bankruptcy to avoid paying client compensation. Of further concern is the fact that E&P Financial Group successfully wound-up Dixon Advisory but retained 78% of Dixon Advisory clients and appointed 39 of its financial advisers. On face value this could be seen as internal phoenixing, setting a concerning precedent that must be addressed.

This event also highlights the pending yet unquantifiable contingent liability that perpetually now hangs over the head all financial advice firms.

Importantly, we support the objective of the compensation scheme of last resort (CSLR). Consumers should have access to financial compensation where they suffer a financial loss from poor or negligent financial advice. However, we do not believe a model that holds those who do the right thing liable for the actions that those who do not, is equitable nor just. Even more so when those who are expected to fund the CSLR are powerless to mitigate their potential CSLR liabilities.

For a subsector where more than 80 per cent of all financial advice firms are small businesses with less than 10 financial advisers[1], not large corporates or even listed entities, this threatens the viability of the CSLR and the viability of the retail financial planning sector. This is because the current CSLR model is adjusted annually for the number of financial advisers during that levy period. When the legislation was first introduced into Parliament in 2021 there were approximately 16,500 financial advisers, in 2022 just over 15,800 and in 2023 when the legislation passed, just over 15,600[2].

This levy period saw $18.562 million collected, equating to $1,186 per financial adviser, plus a base levy of $100 per financial advice firm.

The now unpredictable annual costs of the CSLR coupled with the similar unpredictable annual costs of the ASIC Industry Funding model, which notably adds a further $1,500 for each financial advice firm and $3,217 for every financial adviser in 2022/23, is placing significant pressure on many financial advice firms. Importantly, regardless of the quantum or scale of financial advice provided – all financial advice firms are levied in the same manner.

This is forcing many financial advice firms offering financial advice on a part-time basis, such as those with a limited Australian Financial Service (AFS) licence or restricted scope to provide financial advice, to question if they can viably continue to offer financial planning advice to their clients. This is despite client demand and the value their financial advice is providing to their clients.

This outcome appears to be at odds with separate Government reforms to 'ensure Australians have access to quality and affordable advice'[3].

The current CSLR model must be amended to ensure both it and the financial planning sector are viable well into the future. As an example, if a financial adviser lodges a report with ASIC about a financial adviser or financial advice firm, as was the case with Dixon Advisory, and ASIC chooses to not act, or substantially delays any action, the financial planning sector should be indemnified from any future CSLR claims, not expected to foot a bill they tried to prevent.

ASIC must also build stronger engagement channels with the sectors it regulates. This could include establishing dedicated working groups to provide industry insights and share information more readily, including alerting the regulator to potential red flags. Importantly, this must be genuine two-way communication for this measure to be effective.

Another important factor to support the viability of the CSLR is to ensure that all AFS licensees continue to hold appropriate Professional Indemnity Insurance (PII) cover. It is our understanding that ASIC currently only assesses if PII cover is appropriate for an AFS licensee at time of application or as part of a surveillance activity.

To address this, we recommend AFS licensees be required to submit a copy of their PII Certificate of Currency when lodging their annual FS 70 and FS 71 forms. We understand ASIC may not have the

[1] Source: Adviser Ratings. Please refer to the graph on page 12 for AFS licensee distribution by segment.
[2] Adviser Ratings 24 July 2024
[3] New legislation to increase the accessibility and affordability of financial advice The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services 27 March 2024

resources to review each individual certificate of currency for compliance. However, ASIC could analyse samples from each relevant sector to confirm compliance or identify any emerging risks that may need early intervention.

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

If you have any questions about our submission, please do not hesitate to contact Tracey Scotchbrook, Head of Policy and Advocacy via email [redacted].

Yours sincerely,

Peter Burgess
Chief Executive Officer

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak body representing the self-managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members and a diverse range of financial professionals. The SMSF Association continues to build integrity through professional and education standards for practitioners who service the SMSF sector. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial advisers, tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them with access to independent education materials to assist them in the running of their SMSF.

ATTACHMENT

The reasons for the collapse of wealth management companies, and the implications for the establishment of the Compensation Scheme of Last Resort (CSLR) and challenges to its ongoing sustainability, with particular reference to Dixon Advisory & Superannuation Services Pty Limited (Dixon Advisory) as an example, and:

(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;

(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;

The SMSF Association is not in a position to specifically comment on the underlying causes that led to the collapse of Dixon Advisory. However, we do support the objective of this inquiry to achieve this outcome by collectively working together to prevent future cases like this from occurring.

However, given that the collapse has impacted thousands of clients who collectively have lost millions of dollars, many of them retired or nearing retirement, it is deeply concerning that no one has been held accountable for these losses to date. This includes the directors and senior management who were ultimately responsible for the running of the business at the time, nor the financial advisers who provided the financial product advice.

While we acknowledge ASIC has commenced proceedings against one director, this is in respect of their director's duties and failing to consider the interests of creditors when the company was facing potential insolvency.

In fact, the only other regulatory action taken so far has focused on the fact that Dixon Advisory was the responsible AFS licensee of six representatives who did not act in the best interests of eight clients when they advised these clients to acquire, roll-over or retain interests in the US Masters Residential Property Fund (URF) and URF-related products[4].

Notably, this action resulted in ASIC and Dixon Advisory entering into a heads of agreement to resolve the civil penalty proceedings, where, without any explanation, ASIC agreed to seek no further declarations of contraventions in the proceedings[5].

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[4] ASIC Media Release: Dixon Advisory penalised $7.2 million for breaches of best interest obligations
[5] DASS signs conditional Heads of Agreement with ASIC to settle litigation E&P Financial Group ASX Announcement 9 July 2021

Yet, the collapse of Dixon Advisory is far more than just the provision of poor financial advice by a few financial advisers, evidenced by ASIC's own investigation which concluded, among other findings, that:

- It was the Dixon Advisory Investment Committee that determined the financial product recommendations according to its standard parameters and a client's Dixon Advisory risk profile, and
- Dixon Advisory did not provide its financial advisers with the relevant documentation to assist with deciding whether or not the recommendation was appropriate to the client and whether or not to override it, or did so only shortly before this decision was due.

These findings appear to demonstrate that Dixon Advisory failed to appropriately manage the inherent conflicts of interest that exist in a vertically integrated financial advice firm. Yet section 912A(aa) of the Corporations Act 2001 specifically requires that an AFS licensee must:

> *have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative.*

Section 912A also requires the AFS licensee to*:*

- do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly
- comply with the financial services laws, and
- take reasonable steps to ensure that its representatives comply with the financial services laws.

Given the extensive statutory obligations Dixon Advisory Directors, Senior Managers and financial advisers had to comply with, and issues being uncovered such those as outlined above, it is perplexing that ASIC has not been able to pursue further regulatory action against any individual.

We also understand that in the main, Dixon Advisory financial advisers were providing personal advice to retail clients in their capacity as trustees and members of Self-Managed Superannuation Funds (SMSFs).

By law, SMSFs must have an investment strategy that is tailored and specific to the SMSF and its members and explain how the investments meet each member's retirement objectives relevant to factors such as age and retirement needs, which will influence the risk appetite.[6]

While it is the responsibility of the SMSF trustee to formulate, regularly review and give effect to an investment strategy, Dixon Advisory financial advisers should have also ensured that any financial

[6] *Superannuation Industry (Supervision) Regulations 1994* Cth), r 4.09(2): *Investment Strategy* – This operating standard requires SMSF trustees to formulate, review regularly and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to investment risk, returns, composition, diversification, liquidity, cashflow and insurance.

product recommendations in respect of the SMSF complied with the SMSF investment strategy. While it is not clear if this was in fact the case in these circumstances, it is unlikely given the order made by Jude McEvoy in *ASIC v Dixon Advisory* stated that in respect to the in-house Dixon Advisory URF financial products that:

> *It is accepted that these risks made an investment in the financial products highly risky. The parties have also provided the breakdown of the various client's SMSF portfolios both before and after the recommendations. These show that in some instances the client's SMSF portfolio consisted of a quarter to a third of URF financial products*[7].

Of relevance, ASIC stated in its submission that most of the clients in this case were retired or close to retirement age, so did not have the capacity to save extra funds. Further, none of the clients had any professional background in experience in financial investments, and they all sought a variety of different objectives from their investments.

The Australian Financial Complaints Authority (AFCA) has also published a 'lead decision'[8] that it states will assist in decision making in the thousands of Dixon Advisory complaints it has received. Key findings relevant to this inquiry are that Dixon Advisory:

- failed to provide advice within the risk parameters it set
- failed to diversify the portfolios growth assets, with the portfolio too heavily weighted towards property, and
- recommended an overly high proportion of related entity investments without justification.

AFCA also stated in its decision that the fact that the complainant is a trustee of its superannuation fund does not absolve the financial adviser, in whom trust was placed to help manage the SMSF portfolio, from providing appropriate investment advice and adhering to the Conflicts Priority Rule.

Importantly, the challenges of failing to appropriately manage conflicts of interest within vertically integrated financial firms are not new, they have been the focus of previous inquiries, including the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* in 2019 which noted in its Final Report:

> *It is not surprising that, despite the breadth of approved product lists, more than two-thirds (by value) of the investments made by clients of vertically integrated institutions were made in in-house products. And that is not surprising because experience shows, and has shown for decades, that, more often than not, interest trumps duty.* [9]

A further relevant observation from the Final Report was that:

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[7] Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd [2022] FCA 1105 Page 6

[8] AFCA Determination Case 716627, Financial Firm: Dixon Advisory & Superannuation Services Pty Ltd 6 February 2024

[9] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2019, Volume 1, Page 168

Scandals dating back to the GFC began to shed light on the conflicts and culture in the financial advice industry. Regulatory responses, however, focused on the remediation of specific instances of poor advice, rather than seeking to identify root causes within institutions and the industry. Those responses set the tone for future approaches to misconduct by financial advisers, that is, to compensate customers according to arrangements negotiated with ASIC while requiring few changes to the business itself[10].

We believe that this is a commanding observation and goes to the heart of the challenges the financial planning sector continue to face.

Firstly, the vast majority of financial advisers abide by their obligations under the corporations and financial services regulation framework that notably 'is no longer fit for purpose'[11], incurring significant costs to understand and comply with their legal obligations. These costs are ultimately passed on to clients, further impacting the provision of affordable and accessible quality financial advice to the Australian community.

Secondly, they must now fund a CSLR to compensate unfortunate clients of financial advisers and/or financial advice firms who choose to neglect or avoid their responsibilities under the same corporations and financial services regulation framework.

This leaves an unquantifiable contingent liability hanging over all financial advice firms (who are commonly small businesses and not large listed entities), given the levy is adjusted for the number of financial advisers during the levy period and the Minister also has the discretion to raise a 'special levy' in addition to the maximum subsector caps for any annual levy period.

Not only do complying financial advice firms fund the payment of unpaid compensation claims, but they also fund the ASIC investigation costs though the annual ASIC Industry Funding levy, another annual unknown cost in the thousands of dollars. Finally, they must also fund the payment of any unpaid fees incurred by AFCA in assessing and awarding the unpaid compensation claim, which will also be in the thousands of dollars.

These rising and unquantifiable annual costs seem to be at odds with separate reforms the Government is pursuing to 'ensure Australians have access to quality and affordable advice'[12]. In fact, the current CSLR cost recovery model, coupled with the ASIC Industry Funding model, question the viability of both the CSLR and the retail financial planning sector.

[10] Ibid. Page 127
[11] Summary Report Confronting Complexity: Reforming Corporations and Financial Services Legislation Australian Lw Reform Commission November 2023 Page 5
[12] New legislation to increase the accessibility and affordability of financial advice The Hon Stephen Jones MP, Assistant Treasurer and Minister for Financial Services 27 March 2024

(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;

E&P reported that as of 30 June 2022, 78 per cent of Dixon Advisory clients had elected to transition to Evans & Partners[13]. Clients should be able to choose their own financial adviser. However, it is disconcerting that E&P can profit from the clients of its subsidiary, Dixon Advisory, that it chose to place into voluntary administration ahead of mounting actual and possible liabilities, including damages and AFCA claims.

In a further insult to the financial planning sector, E&P will likely further benefit from the compensation it will fund via the compensation scheme of last resort, for the unpaid AFCA claims made by these clients against Dixon Advisory.

In addition, we understand 39 former financial advisers of Dixon Advisory were appointed by E&P between 1 January 2021 and 10 May 2022.

While we have no specific comments on the matter of consideration, we again raise our concerns that no one has been held accountable for the estimated $458 million of client losses yet E&P Financial Group continue to profit from this event.

(e) assessment of the period for which wealth management companies can remain a member of the Australian Financial Complaints Authority;

(f) the role of Australian Securities and Investments Commission (ASIC), including providing consumer information to investors affected by corporate collapse and consideration of the most appropriate arrangements for future cases of insolvency;

A core focus of ASIC's role is to promote confident and informed participation by investors and consumers in the financial system.

We therefore believe it was appropriate for ASIC to publicly release information about how former clients of Dixon Advisory could make a complaint to AFCA with the view to seek possible financial compensation through the CSLR.

However, we note that Dixon Advisory's AFS licence was suspended in April 2022, with the terms requiring maintaining membership with AFCA until 8 April 2023. This condition was then extended until 8 April 2024, with AFCA finally cancelling Dixon Advisory's membership on 30 June 2024.

Given that ASIC also wrote to former clients of Dixon Advisory in August 2022, we question if it was appropriate for ASIC to require Dixon Advisory to maintain its AFCA membership for a further two years after it ceased operation.

[13] E&P Financial Group Limited FY22 Financial Results

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

We note that ASIC's approach to investigation and enforcement has been reviewed many times over many years, including most recently by the Senate Standing Committee on Economics *Australian Securities and Investments Commission investigation and enforcement Report* July 2024[14].

Key concerns raised have included the effectiveness and efficiency of ASIC's approach to handling reports of alleged misconduct, including the ability to respond to issues in timely manner to reduce the scale of loss for consumers.

We acknowledge that ASIC's resources are finite, yet its role and remit has grown significantly over time, likely challenging its ability to be an effective and efficient regulatory agency. As such, we believe consideration should be given to exploring recommendation 2 from the above report[15]:

> *The committee recommends that the Australian Government should recognise, based on the finding of recommendation one, that the Australian Securities and Investments Commission's regulatory failures call into question whether its remit is too broad for it to be an effective and efficient agency, and the government should strongly consider separating its functions between a companies regulator and a separate financial conduct authority.*

Importantly, the only mechanism a financial adviser currently has to prevent future potential CSLR costs is to report any problems they become aware of to ASIC. However, ASIC only investigate approximately one per cent of misconduct reports it receives[16] and has no obligation to report back to the financial planning sector how many complaints it has received, actioned or final outcomes. Yet, ASIC do not bear the risk of no or slow action, rather this is borne by the client/s and financial advice firms through not only the CSLR, but also the ASIC Industry Funding Levy.

We believe that if a report has been lodged with ASIC about a financial adviser or financial advice firm and ASIC choose to not act, or substantially delay any action, the financial planning sector should be indemnified from any future CSLR claims.

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

There are limited options for enforcement action or consumer redress that can be taken once a company has collapsed. However, should ASIC be successful in recovering any fines or penalties from an insolvent entity, we believe any recovered funds should be paid to the CSLR to fund client compensation, rather than continue to go into consolidated revenue.

We also believe that the example of Dixon Advisory highlights the concerning ability of large listed corporates to enter a subsidiary firm into bankruptcy to avoid paying client compensation, among

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[14] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASICinvestigation/Report
[15] Ibid Page 23
[16] Ibid Page 17

other liabilities. In fact, in this case E&P Financial Group successfully wound-up Dixon Advisory, retained 78 per cent of Dixon Advisory clients and appointed 39 of its financial advisers

On face value it could be seen as internal phoenixing, given the redistribution of resources and the retention of customers, resulting in the maintenance of business continuity for E&P Financial Group but only being held accountable for a fraction of the liabilities Dixon Advisory did or was likely to incur.

This sets a concerning precedent that must be addressed.

We acknowledge that insolvency laws are complex, however, consideration must be given to how parent companies of financial advice firms can be held accountable to deter and prevent this behaviour being repeated in the future.

We also believe that ASIC could be taking a more proactive approach to regulating the sector.

ASIC should build stronger engagement channels with the sectors it regulates. This could include establishing dedicated working groups to provide industry insights and share information more readily, including alerting the regulator to potential red flags. Importantly, this must be genuine two-way communication for this measure to be effective.

Another important factor to ensure the viability of the CSLR is to ensure that all AFS licensees continue to hold appropriate PII cover. It is our understanding that ASIC currently only assesses if PII cover is appropriate for an AFS licensee at time of application or as part of a surveillance activity.

The SMSF Association recommends that ASIC requires AFS licensees to demonstrate, on an annual basis, that they continue to hold appropriate PII that meets their statutory obligations. This could be achieved by requiring AFS licensees to submit a copy of their PII Certificate of Currency when lodging their annual FS 70 and FS 71 forms.   While ASIC may not have the resources to review each individual certificate of currency for compliance, it could analyse samples from each relevant sector to confirm compliance or identify any emerging risks that may need early intervention within a sector.

(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; and

The responsibility for funding unpaid consumer losses should be shared evenly across the sector. However, the CSLR does not reflect this shared responsibility as it excludes product manufacturers. We believe this is a significant flaw in the proposed scheme, given that manufacturers whose products are poorly designed and improperly fail do not contribute to the CSLR, yet they have caused significant consumer detriment in the past.

Consumers, particularly direct investors and SMSF trustees, should also have a right to be protected and have recourse where losses are incurred due to misconduct, misrepresentation or fraud by a product issuer or manufacturer.

There is also the risk that future product failings may be deemed to be a "financial advice failure", placing further pressure on not only the sustainability, but the viability, of the CSLR.

The SMSF Association recommends the scope of the CSLR is extended to include financial product providers.

(j) any other related matters.

Further to our above comments, the SMSF Association recommends that the scope of the CSLR is specifically extended to include Managed Investment Schemes (MISs).

We believe the exclusion of MISs from the CSLR regime has created a significant consumer protection gap in the current regulatory settings that must be addressed to protect those who choose to invest in such products without seeking professional financial advice – either by choice or because they may not realise, they are directly investing in a financial product.

Often MISs can be high-risk and / or complex products that are marketed directly to the Australian public, such as:

- Trio Capital (2012): Australia's largest superannuation fraud where Australians lost approximately $176 million from two fraudulent managed investment schemes[17], and
- Sterling Income Trust (2019): marketed as a 'rent-for-life scheme' which was actually a complicated organisation of MIS products that were ultimately mismanaged costing 527 investors more than $30 million and even more concerning, leaving many senior Australians homeless[18].

Excluding MIS products from the CSLR continues to encouraging the creation of inappropriate high-risk products being marketed directly to Australians, including those near retirement who are not able to sustain any incurred financial losses, as in the case of Sterling Income Trust.

The SMSF Association recommends that the scope of the CSLR is amended to specifically include MIS products.

[17] Report: Inquiry into the collapse of Trio Capital
[18] Sterling Income Trust Final Report

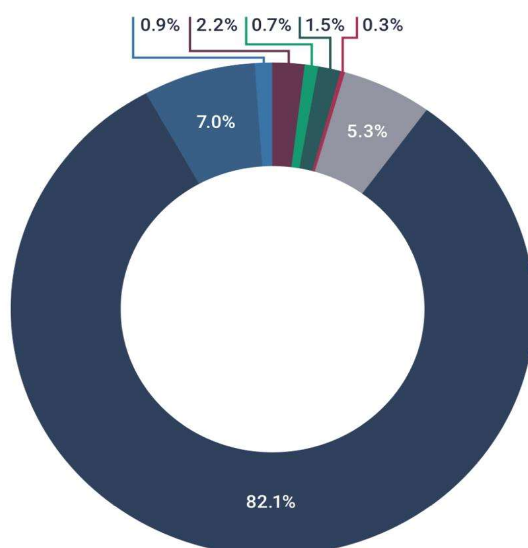
Graph: AFS licensee Distribution by Segment

(As referenced on page 2 of this submission)

Source: Adviser Ratings

Current licensee distribution by segment

Source: Adviser Ratings



Segment	Number	Share
Diversified	41	2.2%
Industry super fund / Not-for-profit	14	0.7%
Stockbroker	28	1.5%
Bank	5	0.3%
Limited licensee	100	5.3%
Privately-owned (1 - 10)	1,542	82.1%
Privately-owned (11 - 100)	131	7.0%
Privately-owned (100+)	17	0.9%