Association of Financial Advisers

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Senate Standing Committees on Economics
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Senate Economics Committee Inquiry - Financial Sector Reform (Hayne Royal Commission Response—Better Advice) Bill 2021

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 75 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

With the exception of Independent Directors, the Board of the AFA is elected by the Membership and Directors are practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

We thank the Senate Economics Committee for the opportunity to provide feedback on the Financial Sector Reform (Hayne Royal Commission Response - Best Advice) Bill 2021. We welcome the opportunity for this Bill to be reviewed by a Parliamentary committee, noting that this is the first of the financial advice related Banking Royal Commission Bills to be considered by a Parliamentary committee. In the absence of a Regulation Impact Statement, this is a very important step to help ensure that unintended consequences are minimised.

The AFA supports the introduction of a pragmatic disciplinary system and one where the disciplinary body has access to a broader range of penalties in order to take action in situations that don't warrant a banning. It is our view that the Single Disciplinary Body should be focussed upon more serious misconduct. A focus that includes minor and administrative issues will lead to a significant increase in unnecessary complexity and cost. Finding the right solution is an important balancing act, however we believe that there is still more that could be done to ensure the right balance is achieved.

The AFA has been very vocal about our concerns with the new breach reporting regime that was introduced as part of the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 and is due to start on 1 October 2021. In our view, this will lead to an exponential increase in matters reported to ASIC by financial advice licensees. We also believe that it is an extremely complex piece of legislation that will inevitably be very challenging for financial advice licensees to comply with in the absence of significant initial and ongoing legal expense. We are concerned that the matters that will come under the focus of the Single Disciplinary Body will substantially exceed those that are captured under the reportable breaches regime. This is due to the fact that the SDB regime will consider all breaches of financial services laws. We recognise that the Government has made changes to enable ASIC to consider some matters, rather than everything going to a Financial Services and Credit Panel (FSCP), however we remain very concerned about the efficiency of this model. We address this issue in more detail below.

We recognise the changes made to the Better Advice Bill since the exposure draft version that was released in April 2021. In particular we note the government's proposal to provide advisers who have not passed the FASEA exam by the end of this year, who have already had two unsuccessful attempts, with the opportunity to sit the exam again in 2022. In the context of the ongoing COVID 19 challenges and the enormous amount of regulatory reform impacting financial advice, this is a sensible and welcome amendment.

We also recognise the change that has been made to facilitate the transition to an individual registration model for financial advisers. We anticipate that this is the first step in a broader, more substantial change to the model for oversight and licensing of financial advisers. This is a complex matter with extensive regulatory implications. We will await, with interest, further developments in this area.

We note that this is a large Bill, and some of the drafting is expressed in a complicated manner. We trust that in this submission we have understood the operation of this legislation and we have addressed the key issues.

Recommendations

Our key recommendations are as follows:

- Minor and administrative matters should not be reported to or considered by the FSCP.
- The inclusion of matters considered by the Single Disciplinary Body (SDB) should more closely align with the scope of the new breach reporting regime, even though in our view there will inevitably be major issues with what is being captured under breach reporting.
- All FSCPs should have at least 3 members for all decisions.
- There should be maximum timeframes stipulated in the law for suspensions and prohibitions.
- There needs to be greater certainty with respect to what the likely penalties might be for specific types of matters.
- Infringement notices should not be used for minor and administrative matters, nor for breaches of the Code of Ethics.
- The costs of operating the Single Disciplinary Body need to be sensibly controlled.
- The proceeds of any infringement notice penalties should be applied to offset the cost of the SDB scheme.
- There should be no additional education and training standard for tax (financial) advisers.
- In the context of the scale of this reform, the commencement date of the SDB should be deferred until 1 July 2022.

1. Single Disciplinary Body for Financial Advisers

Our primary concern with the proposed legislation to establish the Single Disciplinary Body (SDB) is with respect to the potential cost and complexity of running the regime, where even some of the most minor and administrative matters, may inevitably end up in front of either ASIC or the FSCP. This is based upon our understanding that the SDB regime would need to consider all matters that contravene a financial services law (Section 921K(d)). This is more than the new breach reporting regime that will only consider, amongst other things, breaches of civil penalty provisions (other than those which are exempted by regulation). In our view, the breach reporting changes will lead to an exponential increase in matters that are reported to ASIC. It makes no sense for the SDB regime to be looking at matters above and beyond what the breach reporting regime will be looking at. In any case, it is not evident how these matters would be reported to ASIC, if there is no obligation for the licensee to report them to ASIC. It is essential that the SDB regime only focus on the more significant matters, otherwise it will be unwieldy and excessively expensive to operate. We also expect that it will be applied in an uneven fashion, with some licensees complying more carefully and others less so, creating an unlevel playing field. This would be substantially counter-productive.

Whilst those outside financial advice, who lack a basic understanding of financial advice, will demand that the SDB should consider all breaches of the law, this is simply unwarranted and prohibitively expensive. To explain this, it is necessary to reflect upon the processes that licensees operate to supervise and monitor the activities of their advisers. Issues that need to be investigated by a licensee might emerge through one of the following means:

- All advisers will have an audit at least once per year that normally involves a full review of up to six client files. Any non-compliance with the law or licensee rules will be identified and reported to the licensee. It would be rare for nothing to be picked up across all the files. Issues could be minor and administrative matters like not providing the client with a recently updated Financial Services Guide or Product Disclosure Statement, a fee disclosure statement being issued one day late, or a failure to document action taken and evidence relied upon to demonstrate compliance with one of the seven Best Interests Duty safe harbour steps.
- Issues may be identified as a result of supervision checks by licensee management.
- Licensee originated investigations of focus issues.
- Self-reported issues that arise as a result of an adviser seeking guidance or discovering an historical matter.
- The application of new artificial intelligence automated detection tools.
- Complaints from clients.

The Australian Law Reform Commission has recently published their initial thinking about the size and complexity of Chapter 7 of the Corporations Act. An officer of the ALRC was recently quoted as saying "Just about everyone thinks the Corporations Act is too complex and that it's probably always been too complex. It is the second largest Act of parliament and accounts for four per cent of all commonwealth statute law. Chapter seven alone, regulating financial services, would be the eleventh or twelfth largest Act of the commonwealth parliament if it stood on its own". Financial advisers operate in a very complex and demanding regulatory regime, where mistakes do happen from time to time.

As a result of the above licensee processes, a number of issues will emerge each year. Triggering one of these routine matters that come as a result of an audit, supervision review or as a result of self-reporting, does not suggest misconduct or a major issue. The laws applying to financial advice are very complex, extensive and easily breached. Very few of these matters involve any form of client detriment. The demanding nature of this is something that can only be demonstrated by spending a few hours in the office of a financial adviser, which is something that we recommend all politicians do at some stage.

We should all encourage these rigorous processes being employed by licensees and within advice practices. Where even the most minor of matters are reported to ASIC or the SDB, and involves unavoidable additional cost, this only discourages the application of rigorous processes. This is certainly compounded by the incredible complexity of the new breach reporting regime, that will unfortunately make it so easy for licensees to take no action on the grounds of extreme confusion.

Whilst we remain very concerned about the wide scope of the new breach reporting regime, we nonetheless recommend that the SDB legislation be amended to better align with matters that are reported through the breach reporting regime. This will to some extent reduce the number of matters that might be considered by the SDB. Sections 921K(d) and (e) could be amended accordingly to capture matters reported as a result of the obligations under breach reporting in Section 912D.

It is our view that the Single Disciplinary Body should focus on significant issues and that minor matters should not need to be reported to the FSCP or acted upon. We believe that there needs to be a sensible and efficient mechanism for matters to be triaged and that only significant matters should end up being reviewed as part of the Panel process.

Alternative Treatment of Minor Matters

We recognise that the mechanism for ASIC to deal with some matters through Section 921S has been added to the regime. This should streamline the management of some minor and administrative matters. We welcome this, however, note that this only applies in the context of ASIC issuing a written warning or reprimand. We further note that according to Section 922Q(3)(b), subject to a regulation, such matters could be recorded on the Financial Adviser Register. Advisers do not have the option to have Section 921S matters considered by a hearing, or to make a submission as part of the process, and therefore cannot defend themselves. We therefore recommend that changes are made to allow ASIC to have the option to take no further action with minor and administrative matters (rather than issue a written warning or reprimand) and that any matters where ASIC does choose to issue a written warning or reprimand, should not be recorded on the Financial Adviser Register (FAR). In the absence of the ability to provide a defence, this is unreasonable.

It is unclear to us from reading the Exposure Draft legislation and the Explanatory Material how all matters will be directed to ASIC. This does not appear to have been addressed. Whilst it is apparent how matters that result from consumer complaints to ASIC and breaches reported to ASIC will be captured by this regime, it is less obvious how other matters will flow through to ASIC. For example, AFCA only pass on certain matters to ASIC at present, including those that are considered to be "systemic". There is no current model for professional associations to pass matters on to ASIC. How will the flow of these matters be regulated? We believe that this needs to be explained and privacy issues with the passing on of personal information needs to be considered.

Composition of FSCPs

We question the fact that the Minister appoints someone to the FSCP, yet ASIC can then terminate them at any time, seemingly without reason. In the context that ASIC makes the decision to appoint individuals to specific FSCPs, our concern is that ASIC could choose to use panel members who hold similar views to them and can then choose to terminate panel members who have opposing views.

In our view, there should always be at least three members on a panel, and if someone is disqualified due to conflicts of interest, then they should be replaced. It appears possible that a panel could be reduced to as few as the Chair (Section 151(2)), and in our view, this is not appropriate. We also suggest that it would be beneficial to provide guidance on the application of the conflicts of interest requirement. Would the fact that a panel member knew, or was aware of a person subject to review by the FSCP, be sufficient grounds for them to be disqualified from participating on the Panel?

Operation of FSCPs

We question the appropriateness of Section 154 of the ASIC Act. Rather than each panel having the ability to regulate proceedings as it considers appropriate, we believe that all panels should follow a consistent approach.

We note the provision for decisions to be made without meetings (Section 156). Whilst this might be good for administrative efficiency reasons, we are concerned that this could lead to an outcome where some matters proceed without appropriate deliberation, and this could lead to decisions being dominated by the views of ASIC. It might be that these matters that are decided without a meeting, should be limited to less significant matters and lower-level penalties.

Scope of Matters Addressed by the Financial Services and Credit Panel

Section 921K, which addresses the types of matters that might be considered by an FSCP is a combination of serious matters, such as conviction for fraud and insolvency, but also other matters that could be very minor or administrative in nature. The inclusion of 921K(1)(d) and 921K(1)(e), that address any contravention of a financial services law, is in our view very problematic (as discussed above). In terms of Section 921K(1)(e), and the prospect of a financial adviser being involved in the contravention of a financial services law by another person, we question how this concept of “involved” would be assessed and how it could be proved.

For context, it is important to note that the majority of cases of non-compliance with the law are likely to be with respect to inadequate documentation of compliance with the seven steps in the Best Interests Duty safe harbour or minor differences or delays in the issue of Fee Disclosure Statements. These minor and largely administrative issues do occur on a regular basis, and they make up a large percentage of total breaches, however they do not involve client detriment and should not be the focus of the FSCP.

We are also concerned that any breach of the FASEA Code of Ethics could be captured, as this would include any breach of Standard 1 of the FASEA Code of Ethics, which is “You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent”. Seemingly, any breach of the law, is a breach of the FASEA Code of Ethics and therefore subject to consideration by an FSCP. Breaches of the Code of Ethics are also considered restricted civil penalty provisions and therefore potentially subject to an infringement notice.

Penalties

We question how the FSCPs will make decisions on the penalties that they impose. For example, how will they have the knowledge to work out what written directions might be most appropriate in certain situations? In what situations would they recommend “specified counselling”? When it comes to “specified supervision”, this would normally require the involvement of the licensee, so how is this likely to be arranged?

We note that there are no maximum timeframes stated for an adviser to be suspended or subject to a prohibition order. We believe that it is appropriate to set maximums, particularly with respect to a suspension. In our view a suspension should not last for longer than 6 months.

We are concerned that an adviser could be banned by either ASIC or alternatively be subject to a prohibition order by an FSCP. We question the reason for what is effectively similar disciplinary actions being taken through different processes. We question whether the banning penalty should be available to the FSCP, however if it is, then maybe it should be limited to a maximum period of 2 or 3 years. Otherwise, potentially all matters should be considered by FSCPs, rather than having a banning matter managed by ASIC.

We are concerned that there is a lack of clarity on how similar matters will be handled. There is no guidance on the likely outcome for specific types of common matters. For example, what could a financial adviser who, by accident, missed the CPD requirement for the “Professionalism and Ethics” category by one hour, despite having achieved the total required number of hours, expect as an outcome? What is the likely penalty for an adviser who had a minor issue with non-compliance with the record keeping requirements related to the Best Interests Duty? Equally what is the type of penalty that might apply for someone who provided inappropriate advice that resulted in material client detriment? We recommend the inclusion of some examples in the Explanatory Memorandum, so that advisers have some sense of the likely penalties. We would not like to see an outcome where there was a lack of consistency in the penalties that are applied. In addition, we would like to avoid the scenario where the penalties are much more extreme than might have been expected at the outset.

Infringement Notices

We note the prospect of an infringement notice being applied, which we understand would currently involve a fine of $2,664. This is not an insignificant sum of money, particularly for a financial adviser or financial advice practice that is struggling. We therefore recommend that this should only apply to more significant issues and not to minor and administrative matters.

We also recommend that the proceeds from any infringement notices should be used to offset the cost of running the Single Disciplinary Body. This would at least be one way to reduce the significant financial impact of the introduction of the SDB. In our view, it would be totally unacceptable for these fines to end up in consolidated revenue, as is the case with the ASIC legal action that financial advisers are funding on the basis of Banking Royal Commission enforcement activity.

We are concerned about the prospect of infringement notice provisions applying to minor matters that have been specifically included in this ‘restricted civil penalty’ regime. In particular, we use the example of someone who accidentally fails to meet one of the elements of their CPD obligations. This is a restricted civil penalty matter. A fine of nearly $2,664, for an adviser who for example has completed a total of 50 hours of CPD in a year, however, only has 8 out of the 9 hours required for “professionalism and ethics” is, in our view, excessive and unjustified. We see no basis for these minor matters to be considered infringement notice matters.

We note that Section 922Q(ud) refers to the inclusion of an infringement notice in a financial advisers record on the FAR, however we question the appropriateness of this, given that the disclosure would need to include a statement that “compliance with the notice is not an admission of guilt or liability” and that “the relevant provider is not regarded as having contravened the provision specified in the notice”. We cannot see what the purpose of including this on the FAR is, when it is subject to such fundamental disclaimers.

We note that a breach of the Code of Ethics is included amongst the restricted civil penalty provisions. We are not sure that it is appropriate that breaches of a Code should be matters to be dealt with by an infringement notice. This does not seem to be consistent with how breaches of Codes would be treated by other professions. If the matter was caught through another mechanism, then this would be more understandable.

Funding of the New Regime

We note that the funding of the Single Disciplinary regime would be through the introduction of a new adviser registration fee and an increase in the ASIC Funding Levy. In the context of the substantial increase in the ASIC Funding Levy for the 2019/20 year and the prospect for further substantial increases, including as a result of the number of financial advisers declining, we are very concerned about the implication of the Single Disciplinary Body for future increases in the ASIC Funding Levy. In an environment of rapidly rising costs of financial advice practices and increased costs to clients, a reform of this nature should be on the basis of careful projections.

We would like to see an estimation of the cost of this new regime. We do not accept the suggestion on page 8 of the Explanatory Memorandum, that there is a low compliance cost.

2. Registration of Financial Advisers

We are supportive of the proposal with respect to the registration of financial advisers, including the decision to delay annual renewal of registration until the modernising business register project is complete. We note that one of these declarations that will be required as part of registration is with respect to tax (financial) advisers being compliant with additional education and training standards for tax (financial) advisers. As discussed below, we do not see any need for a separate education and training standard for tax (financial) advisers, and we would therefore recommend that this declaration should not be required.

3. Winding up of FASEA and Transfer of its Standards Functions to the Minister and ASIC

The AFA supports the proposal with respect to the winding up of FASEA and the transfer of responsibilities to the Minister. We note the scheduled transition date of 1 January 2022. We also note the importance of the delivery of the FASEA exam until the ultimate deadline for existing advisers. It is important that this transition will be achieved in a careful manner to ensure the ongoing availability of the exam and support for those still completing the exam.

We are strongly supportive of the amendment to enable financial advisers more time to complete the exam. The prospect of being forced out of the profession at the end of this year is causing a huge amount of anxiety and stress for those impacted, and is also likely to be impacting their performance at the exam. This will better allow them to focus on passing the exam in 2021.

4. Regulation of Tax (Financial) Advisers

We note the provisions that have been added with respect to additional education and ongoing training requirements for tax (financial) advisers, however we question whether this should be necessary. In our view the FASEA/Minister education and training standards, as changed over time, should ensure that there is adequate knowledge on taxation matters and therefore it should not be necessary to have a separate education/training standard for tax (financial) advisers.

It is a broadly held view that virtually all financial advisers would need to provide tax advice of some form when advising clients, even if this is a basic explanation of the benefits of salary sacrificing, estimation of capital gains tax obligations, or the explanation of tax deductibility of income protection premiums. The only financial advisers who are able to operate without being registered with the TPB, are those who operate under the "sufficient numbers" model and are supervised by someone who is registered with the TPB. There is no equivalent "sufficient numbers" model under the Single Disciplinary Body regime, so all advisers will need to be sufficiently educated/trained and therefore in our view it is not appropriate to suggest that there would be financial advisers who are not operating as tax (financial) advisers. Only one education and training standard should apply.

Financial advisers have for too long been bound by different requirements under the Corporations Act as opposed to the TASA regime, and we strongly assert that the continuation of parallel regimes should be avoided. This is not just in terms of the education standard, but also in terms of the ongoing Continuous Professional Development requirements. We are not suggesting that advisers should not have to comply with taxation-based education and training requirements, however this should be incorporated into the core education and training requirements.

Tax (Financial) Adviser Education and Training

We also note the reference in Section 921BB that the Minister may include the requirement for "the completion of one or more specified bachelor or higher degrees". This is potentially more than is currently required by the FASEA regime, which in our view, for tax (financial) advice is totally unnecessary, as financial advisers only provide peripheral tax advice services. We do not agree that this reference to one or more degrees should be necessary at all, however if additional study were to be required for tax (financial) advisers, it should be set at a very measured level and not discussed in terms of degrees. Advisers are already expected to be degree equivalent under the FASEA regime.

Membership of Professional Associations

The Tax Agent Services Regulations 2009 (TASR) provide four registration options for tax (financial) advisers. Item 304 is for members of professional associations with 6 years full time experience out of the last 8 years, and provides a registration option, where financial advisers are not required to do additional courses that are required under each of the other three registration options. This is an intentional recognition of the value of experience and of membership of professional associations. This type of model is similar to registration options available for accountants. Therefore, if the Minister was to introduce additional education standards for tax financial advisers from 1 January 2022, this would need to adequately take into account those covered under the existing arrangements.

Tax (Financial) Adviser Recommendation

We recommend that all obligations and requirements for tax (financial) advisers be rolled into the existing Corporations Act requirements for financial advisers. We also recommend that in the event that the Government does not accept this argument, that any changes to education standards be subject to grandfathering arrangements to reflect the current model for experienced members of professional associations and provides transition arrangements for those who are currently covered under the "sufficient numbers" model.

Commencement Date

We note the scheduled start date for the new Single Disciplinary Body is 1 January 2022. We are concerned that this might be too soon, given that the Bill will not be considered until August 2021 at the earliest, and that this will leave very limited time for the advice profession to prepare for this regime. This needs to be considered in the context of all the other changes that are happening in the financial advice sector at the same time. We therefore believe that the commencement should be deferred until 1 July 2022.

Concluding Comments

The AFA supports the establishment of a Single Disciplinary Body and the rationalisation of regulatory oversight of financial advisers. It is our view that the disciplinary body should play a key role in taking action in the event of serious misconduct, including through having access to a broader range of penalties. Importantly, however, we would not like to see the SDB involved in minor and administrative matters. It is also particularly important in ensuring that the costs of the Single Disciplinary Body are kept under control. Otherwise, this will be another factor in driving up the cost of financial advice and taking it out of the reach of everyday Australians.

We would be happy to present to the committee to expand on this submission.

Yours sincerely,

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