

Senate Economics Legislation Committee
ANSWERS TO QUESTIONS ON NOTICE
Treasury Portfolio
Budget Estimates
2017 - 2018

Division/Agency: Australian Securities and Investment Commission
Question No: 100
Topic: Fees for no service report
Reference: Written
Senator: Ketter, Chris

Question:

In relation to the fees for no service report, can ASIC provide details of the way in which interest is calculated, and the rationale underpinning this?

Answer:

A detailed summary of the methodologies used by the licensees as at October 2016 is provided in Report 499 *Financial advice: fees for no service* (REP 499). A relevant extract is below.

Calculating interest or earnings

70 In relation to the interest or earnings calculation, affected customers were generally compensated in one of the following three ways, depending on the quality of the AFS licensee's customer data.

(1) Where data was available and of adequate quality

71 Most licensees advised ASIC that, for the majority of affected customers, they had been able to accurately calculate the interest or earnings that their customers would have earned if the systemic failure had not occurred.

72 This was possible through data analysis of the source of the fees. For example, AFS licensees were able to track the performance of the investment accounts or funds that the fees were deducted from, and to include an equivalent amount in their compensation payments.

(2) Where data was limited

73 In some instances, the advice licensees had some data about the affected customers that would enable them to calculate an approximate compensation amount in a relatively short period of time, but they had inadequate data to enable them to both perform precise individual calculations of loss and compensate customers reasonably promptly.

74 In these cases, the advice licensees calculated the approximate interest or earnings that customers would have received if the systemic failures had not occurred.

75 For example, an advice licensee that had data about the risk profile of its affected customers (e.g. conservative, balanced, growth) based its compensation amounts on the benchmark returns from those asset classes.

76 All customers, if they are unhappy about the compensation they are offered, can seek a review or lodge a complaint through the AFS licensee's IDR process and the Financial Ombudsman Service.

(3) Where no data was available

77 In some instances, the advice licensees had no data about groups of customers to enable them to apply the approach in either (1) or (2), or to do so in a reasonable period of time.

78 A common example was where advice fees were deducted from financial products issued by third parties that were unrelated to the customer's financial institution or advice licensee, and the institution or licensee did not keep relevant data and was unable to obtain such data from the third party as part of its review and remediation assessment.

79 Another example was where advice licensees provided advice services through their authorised representatives and:

- (a) the licensees did not retain copies of customers' files; and
- (b) the authorised representatives took the client files with them when they departed from the licensee.

Note: To change this conduct in the future, we have amended Class Order [CO 14/923] Record-keeping obligations for Australian financial services licensees when giving personal advice to clarify that, when an advice licensee or one of its representatives provides personal advice, the licensee must ensure not only that client records are kept, but also that the licensee continues to have access to these records during the period in which they are required to be retained.

80 In these instances, some licensees have applied a proxy interest rate that is consistent with the principles outlined in paragraph 83. In other cases we are having discussions with licensees to ensure they apply a fair and reasonable compensation methodology: see paragraph 86.

Note: For an example of how an AFS licensee has applied a proxy interest rate in the absence of adequate data to calculate accurate compensation, see Example 8 in RG 256.

Estimating interest or earnings

81 Our clear preference is for the licensees to apply the approach outlined in paragraph 71. This means that customers are compensated in a timely way with an amount that accurately reflects the interest or earnings they lost as a result of the systemic failure.

82 However, we consider that, for the purposes of this project, where customer records are incomplete, it is sometimes acceptable and provides a better outcome for customers if the AFS licensee promptly compensates customers with an approximation of the interest or earnings forgone, as outlined in paragraph 74. In these instances, it is critical that customers are given information about how they may seek a review of the compensation amount.

83 Where licensees have little or no data to calculate compensation, as described in paragraph 77, they should use a fair and reasonable rate to calculate the lost returns or interest, by applying the following principles which are set out in RG 256:

- (a) the rate should be reasonably high—to ensure that clients will not be disadvantaged by an advice licensee's inability to determine the actual investment returns or interest, and to remove any incentive for licensees to use a proxy to calculate foregone returns or interest instead of working out the actual investment returns or interest that a client would have received;
- (b) the rate should be relatively stable (compared, for example, to market-linked returns); and
- (c) the rate should be objectively set by an independent body.

84 An example of a rate that meets these criteria is the Reserve Bank of Australia cash rate plus a margin of 6% per year.

85 Some of the licensees that do not have adequate data to perform accurate compensation calculations agreed to implement the principles described in paragraph 77, and this is reflected in the compensation payments made to their customers.

86 In other instances, where licensees failed to keep adequate client records and data, we continue to discuss with licensees the interest rates to be applied to provide a fair and reasonable outcome for customers.