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Justice K M Hayne AC QC  
 Commissioner

By email: [FSRCSolicitor@royalcommission.gov.au](mailto:FSRCSolicitor@royalcommission.gov.au)

Dear Taskforce Members

**AFA Response – Consultation: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry**

We refer to your letter of 15 December 2017 and the invitation to make a submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 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

The Board of the AFA is elected by the Membership and all 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 plays a vital role in helping Australians reach their potential through building, managing and protecting wealth.

## Introduction

Since the Global Financial Crisis, the financial advice sector has been the subject of extensive scrutiny, media coverage and numerous inquiries and regulatory reforms. Whilst these reforms have already had a significant impact on the financial advice profession, the full consequences of these reforms are yet to play out. In fact, some of the most significant reforms are still in the process of being implemented. The financial advice profession of today is very different to the industry that existed at the time of the Global Financial Crisis. These major reforms include:

- The introduction of a best interests duty and other advice quality obligations from 1 July 2013 (Corporations Amendment (Further Future of Financial Advice Measures) Act 2012 – (referred to as FoFA).

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- The banning of commissions on investment and superannuation products from 1 July 2013 (FoFA).
- The introduction of an Opt-in obligation and Fee Disclosure Statement requirement from 1 July 2013 Corporations Amendment (Future of Financial Advice) Act 2012 - (also commonly referred to as FoFA).
- Coverage of financial advisers under the Tax Agent Services Act from 1 July 2014.
- The introduction of caps on commissions for life insurance business from 1 January 2018 through the introduction of the Life Insurance Framework (Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017).
- The introduction of a degree requirement, professional year and registration exam for new advisers from 1 January 2019 (Corporations Amendment (Professional Standards of Financial Advisers) Act 2017) (referred to below as Professional Standards).
- Commencement of a universal code of conduct and code monitoring requirement for all advisers from 1 January 2020 (Professional Standards).
- All existing advisers to complete the registration exam by 1 January 2021 (Professional Standards).
- All existing advisers to achieve a degree equivalent standard by 1 January 2024 (Professional Standards).

The last 10 years has resulted in significant changes to all parts of the financial advice sector. Membership of professional associations has increased as licensees have promoted membership and as a result the expectations of professional associations has increased significantly. There is also much greater reform in the pipeline as a result of the Professional Standards legislation, which requires all financial advisers to belong to a compliance scheme and be subject to monitoring by a code monitoring body. These reforms are yet to be finalised, however it is expected that professional associations will be responsible for code monitoring and will have a much more proactive role in the oversight of members.

The financial advice sector is subject to a specific regulatory framework that is governed under the Corporations Act. All financial advisers are either Australian financial services licensees (AFSLs) or authorised representatives of AFSLs, (either as employees or contracted agents). The Corporations Act imposes significant obligations on the licensee, including with respect to the quality of advice, dispute resolution and a requirement to report significant breaches to the regulator – the Australian Securities and Investments Commission (ASIC). ASIC undertakes surveillance of the sector and is the primary agency that takes action when an AFSL or their advisers breach their obligations under the Corporations Act. Where such a matter comes to the attention of ASIC they will work with the licensee to gather the required information to take action. It is important to note that the currently applicable legislation includes no provision for ASIC or the licensee to share information with a professional association.

The AFA is one of a limited number of professional associations in the financial advice sector. Our members may also be members of other financial advice professional associations or even accounting professional associations.

As at 8 January 2018, the AFA had approximately 4,300 members, the majority of whom are practising financial advisers who are authorised representatives of licensees. The AFA has grown rapidly in recent years, as a result of a range of factors, including the growing professionalism of the financial advice sector. In January 2008, the membership of the AFA was less than 1,200 and the size of the employee team running the AFA was only three (none of whom are still with the AFA). The AFA employee team is now 16 and includes a range of functions that were not present back in 2008.

Over the last 10 years the AFA has developed into a genuine professional association, where we now have our own internationally recognised professional designation, a code of conduct, formal

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complaints processes and disciplinary procedures. These developments, along with the growth in membership have had a significant impact on the role that the AFA plays in terms of the oversight of our members. This will expand further as the Professional Standards for Financial Advisers regime is implemented over the next few years.

Licenses have an obligation under the Corporations Act to monitor and supervise their advisers and report any significant breaches to ASIC. Professional Associations have not had access to this information although the Professional Standards legislation will fundamentally change this from 1 January 2020, and as a result, professional associations will take on the role of a code monitoring body with responsibility for proactive and reactive monitoring of conduct.

We respond to your questions in the context of the way the sector has operated to this point.

### Response to Questions Raised by the Royal Commission

#### Question 1 – Misconduct by Member Entities

1. **Excluding cases of theft from member entities, has the body identified or become aware of any misconduct by member entities (including by directors, officers or employees or by anyone otherwise acting on their behalf) which occurred at any time since 1 January 2008? If so, what was the nature, extent and effect of that misconduct?**

There are two key concepts expressed in this question: “misconduct” and “member entities”. Further, we note that you have asked for the “nature, extent and effect” of the misconduct, which we construe as meaning that you are not, at this time, seeking the names of relevant member entities.

#### *Misconduct*

We note that “misconduct” is defined in the Terms of Reference in very wide terms. Hence, for example, quite apart from the Corporations Act provisions to which we have referred, it could conceivably cover such matters as incorrect disclosures to the Australian Taxation Office, a breach of contract, a breach of a professional code and the list could go on.

With the limited time in which to respond to your request and the limited availability of staff over the holiday period, we have focused our response on matters that pertain to:

- (a) breaches of our by-laws;
- (b) disclosures and actions taken by ASIC which are in the public domain; and
- (c) complaints to us about our members.

For the second of these, there is an effective materiality test under section 912D of the Corporations Act. At this stage, we are not otherwise aware of misconduct by members which, but for its lack of significance, would have had to have been disclosed to ASIC or for which ASIC decided to take no action that is subject to public notice.

We are not aware of any misconduct by directors, officers or employees of the AFA or of those who have been acting on behalf of the AFA.

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### *Member entities*

We note the reference in this question to “member entities”, which has not been defined in your letter. We have assumed this to mean our individual members and not our partners who are predominantly financial product providers and financial advice licensees, for whom we have very limited visibility of their activities. Our partners purchase an annual package of goods and services, that includes participation in, and representation at, our major events (including our annual conference) and promotion in our magazine and on our website. We have further taken this to mean our individual members who are financial advice practitioners, as we have no visibility of the conduct of the staff of our individual members, who are non-advising employees.

As noted above, our members are either individually licensed or are employees or authorised representatives of AFSLs and they have a primary responsibility to their AFSL, who has a legal obligation to report significant breaches to ASIC. AFSLs have no obligation to report breaches or other matters to professional associations and neither does ASIC.

### **By-laws**

In October and November 2017, the AFA updated its Constitution and By-Laws as part of the process for enabling us to take a more active role in monitoring our members, which will become an essential part of being a code monitoring body. As part of these changes we have updated and expanded the requirement for members to notify the AFA of any change in their circumstances by providing specific examples such as where they have been the subject of a banning, enforceable undertaking or are aware of an investigation by a regulator or have been terminated by a licensee for misconduct. By-Law Clause 5 states:

*Both new and existing Members will be required to be of good fame and character. Specific questions are raised in the application form and personal declaration form in respect of this, and Members must notify the AFA on an ongoing basis of any changes to their circumstances that may reflect on the AFA's assessment of their fame or character. This includes a banning or enforceable undertaking, awareness of any investigation by a regulator or termination by a licensee for misconduct.*

Prior to February 2017, there was no requirement for members to notify the AFA of changes to their circumstances that might reflect on their good fame and character.

In late December 2017 we became aware, via ASIC media release, that two of our members had agreed to an enforceable undertaking with ASIC. As they had not notified us of this matter, or the investigation that must have led to this outcome, we have written to them asking for an explanation and for copies of relevant documentation.

Given the history of licensees and ASIC not notifying us of matters related to our members and advisers not until recently having been required to notify us of such actions by ASIC, the AFA has typically found out about these matters by reference to ASIC media releases or trade media stories. Thus, in terms of the AFA identifying or becoming aware of misconduct by practitioner members, this is typically achieved by either reading an ASIC announcement or alternatively by receiving a complaint. The AFA has not undertaken proactive monitoring of our members to this point, although we recognise that this is likely to change in the future.

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**ASIC Announcements**

In recent years the AFA has monitored ASIC media releases on banned advisers and enforceable undertakings in order to identify impacted members and then to take appropriate action. In order to respond to your question, we have undertaken a data matching exercise of our member records against the ASIC banned and disqualified register and the Enforceable Undertaking register. Given the period involved in this exercise, and the fact that the AFA membership system has changed a number of times over this period, we have undertaken this matching exercise against the following three sources:

- An October 2008 member listing.
- The current January 2018 member listing.
- A listing of all contacts, which includes current members and former members.

This analysis has identified the following:

- Financial advisers who were members at the time they were subject to a banning or an enforceable undertaking.
- Financial advisers who became members after they had been subject to a banning or an enforceable undertaking.
- Financial advisers who had been subject to a banning or an enforceable undertaking after the time which they had been a member of the AFA.

We have considered the specific question and have interpreted this as requiring us to respond in terms of financial advisers who were members at the time the misconduct occurred. For this reason, we have excluded members who were subject to a banning or enforceable undertaking prior to joining and those who were subject to a banning or enforceable undertaking after they were no longer a member unless the ASIC announcement refers to conduct during the period that they were a member.

The following table covers the results of our review:

**AFA Members and Former Members^ Banned or Subject to an Enforceable Undertaking Since 1 January 2008**

| Date             | ASIC Action                                      | ASIC Reference | Nature, extent and effect of misconduct  |
|------------------|--|----------------|--|
| 9 February 2009  | Banned for four years                            | AD09-17        | Inadequate investigation and consideration of the risks when recommending identified products.                 |
| 1 October 2009   | Banned for three years                           | 09-178AD       | Insufficient due diligence prior to recommending investments in an identified product.                         |
| 3 October 2010   | Enforceable Undertaking and removed for 10 years | 10-235AD       | Recommended clients invest in investment companies controlled by the adviser that later went into liquidation. |
| 22 December 2011 | Enforceable Undertaking with additional training | 11-315AD       | The adviser was a representative at Storm Financial. Invested clients in accordance                            |

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| Date              | ASIC Action  | ASIC Reference | Nature, extent and effect of misconduct   |
|-------------------|--|----------------|---|
|                   | and supervision for 2 years.                                   |                | with the Storm model without considering other options.   |
| 22 October 2012   | Banned for 3 years   | 12-259MR       | Failed to have a reasonable basis when recommending margin lending facilities, yet left funds in cash investments for up to 3 years. Non-provision of Statements of Advice (SoA).                       |
| 15 October 2013   | Banned for 9 months  | 13-322MR       | Initially banned after becoming an undischarged bankrupt but later charged with fraud.  |
| 22 September 2014 | Banned for 5 years   | 14-243MR       | Failed to take into account clients existing insurance when recommending new products and failed to disclose why client's portfolios were not invested in accordance with asset allocations in the SoA. |
| 6 January 2016    | Enforceable Undertaking with 12 months supervision and vetting | 16-008MR       | Inadequate inquiries into the client's circumstances. Inadequate product replacement advice. Excluded issues that should have been addressed.   |
| 23 May 2016       | Enforceable Undertaking with a permanent removal               | 16-153MR       | Used a 'one size fits all' advice model. Inappropriate superannuation product switching. Incorrectly disclosed product cost comparisons. The adviser was not a member at the time the EU was announced. |
| 3 November 2016   | Banned for 5 years   | 16-374MR       | Failed to provide sufficient details on advice, keep records, make reasonable inquiries, disclose remuneration or determine if the level of recommended insurance was appropriate.                      |
| 10 February 2017  | Banned for 5 years   | 17-026MR       | Misleading and deceptive conduct in failing to disclose medical conditions. Recklessly made misleading product comparisons.   |
| 14 August 2017    | Banned for 5 years   | 17-270MR       | Failed to provide sufficient details on advice, keep records, make reasonable inquiries, or determine if the level of recommended insurance was appropriate.  |
| 9 November 2017   | Enforceable Undertaking and removed for 5 years.               | 17-382MR       | Advised clients to switch products without demonstrating why appropriate. Inadequate investigation of client objectives.  |

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| Date             | ASIC Action  | ASIC Reference | Nature, extent and effect of misconduct  |
|------------------|--|----------------|--|
| 19 December 2017 | Enforceable Undertaking and removal for 2 years  | 17-447MR       | Failed to appropriately consider client's existing arrangements and failure to disclose relationships with external parties and remuneration. Failure to provide Statements of Advice. Mr Fraser was not a member at the time of the EU being announced.       |
| 21 December 2017 | Enforceable Undertaking with independent oversight for 3 years                                       | 17-454MR       | Failed to act in the best interests of the client. Inappropriate insurance switching advice. Failed to consider all costs, risks, benefits and disadvantages. Used generic Statements of Advice.   |
| 21 December 2017 | Enforceable Undertaking with independent oversight for 3 years                                       | 17-454MR       | Failed to act in the best interests of the client. Inappropriate insurance switching advice. Failed to consider all costs, risks, benefits and disadvantages. Used generic Statements of Advice.   |
| 18 January 2018  | Enforceable Undertaking with additional training and 12 months vetting of all advice by the licensee | 18-014MR       | Inadequate inquiries into the client's circumstances. Inadequate product replacement advice. Recommending insurance that was too expensive for the client. Failure to consider the long term consequences of the advice on the clients superannuation account. |

The AFA uses screening questions to assess new member applications, which include questions about criminal convictions, bankruptcy, complaints, terminations by licensees and administrative action by ASIC. Members who have been subject to such issues need to disclose these matters as part of the application process. The AFA also undertakes reference checks.

An ASIC banning or enforceable undertaking is certainly taken into consideration in assessing applications. Depending upon the circumstances an application may be rejected. Where it relates to less significant matters, particularly where they are not recent, an application may still be approved

### **Complaints against Members**

The AFA has a complaints process that is set out in the By-Laws and is referred to on our website. The website also has an online form that allows people to make complaints. Complaints might come from a client of a member or from another adviser, accountant or lawyer representing the client or former client of a member.

The AFA complaints records show the first complaint received during the requested period was in August 2013. Since that time, we have received a total of 14 complaints. An analysis of these 14 matters indicates the following:

- 4 matters where the investigation revealed no grounds for taking any action against the adviser.

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- 2 matters where the investigation has been completed and the member was reprimanded. One involved a member using designations that were no longer applicable, and the other involved a member using inappropriate language in an email to another member.
- 4 matters where the complainant declined to provide sufficient information to commence an investigation or decided to withdraw the complaint.
- 2 matters where the investigation is on hold whilst the matter is being considered by another party, such as the Financial Ombudsman Scheme (FOS). One involves apparent dishonesty that has occurred as part of a marriage breakup and the other involves claims of mishandling of insurance arrangements that have left the client unable to obtain insurance cover. The second of these matters involves a complaint that was rejected by the licensee and has now been forwarded to FOS for review.
- 2 matters that remain in the process of being investigated. One matter involves a complaint by one financial advice business against another with respect to inappropriate business practices. We are currently in the process of gathering the necessary information and approvals to proceed. The second matter relates to the ongoing receipt of commissions by one adviser when another adviser is now servicing the client. This is a historical legacy contract issue that the life insurer has been seeking to resolve.

### Question 2 – Conduct, Practices, Behaviour or Business Activity

2. **Has the body identified or become aware of any conduct, practices, behaviour or business activity engaged in by member entities (including by directors, officers or employees, or by anyone otherwise acting on their behalf) since 1 January 2008, which it considers has fallen below community standards and expectations?**

In responding to this question, we believe that it is important to define what we believe “fallen below community standards and expectations” means in the financial advice space. We have focussed upon this from the perspective of financial advisers providing financial advice to clients and have defined it as follows:

- The provision of financial advice that is not in the best interests of the client.
- A financial adviser who prioritises their interests above those of the client. In this respect, we exclude the mere receipt of disclosed commissions as an instance of an adviser prioritising their interests over the interests of their clients.
- Failing to apply the necessary level of diligence to genuinely understand the needs and objectives of the client.
- Taking short-cuts in the financial advice process which might place the interest of the client at risk.
- Providing financial advice that they are not qualified or capable of providing.
- Charging for services that have not been provided.

Our view as to community expectations has been informed by a number of product provider and business collapses in the lead up to and in the period following the Global Financial Crisis. These collapses have included:

- Westpoint, Bridgeport and Fincorp, which were all mortgage lending businesses that were used to fund building developments in the 2006 – 2007 timeframe.
- Storm Financial, a financial planning business that promoted highly geared client portfolios (2009).
- Trio Capital and Astarra Asset Management (collapsed in 2009), where assets were transferred overseas and misappropriated.



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- Agribusiness investments, including Timbercorp and Great Southern (both collapsed in 2009), Willmott Forests (collapsed in 2010) and Gunns (collapsed in 2012), where the schemes collapsed and investors lost a significant proportion of their investments.

With the exception of Storm Financial, which represented a flawed financial advice business model, the remainder of the above collapses were product failures. Financial advisers were caught up in these collapses as they were involved in the distribution of these products. They all existed prior to the introduction of the Future of Financial Advice reforms and the commencement of the ban on commission for investment and superannuation business.

It is notable that high commissions were a factor with respect to the distribution of products such as Westpoint, Trio and Agri-business.

Other key events in the financial advice sector over recent years have included the following:

- ASIC Report 413 on life insurance advice, which highlighted a high level of non-compliant advice and placed a focus upon inappropriate replacement of life insurance business. This report was a key driver of the Life Insurance Framework legislation that eventually resulted in caps being placed on the payment of upfront commission for life insurance advice.
- ASIC's Wealth Management Project that has scrutinised the financial advice businesses of the four major banks, AMP and Macquarie that has generated a number of spin-off projects and also resulted in the banning of around 40 advisers.
- ASIC Report 499 on large licensees charging for services that are not provided. ASIC has updated the market on this on a number of occasions as they have reported updated amounts for compensation paid to impacted clients.

There have been other matters reported in the media that are more specific to individual organisations. Those related to the larger organisations have attracted the greatest attention.

The AFA is not aware of any member entities caught up in these collapses or other matters above and beyond what has already been reported.

### Question 3 – Further Details

#### 3. If yes to either or both of questions one and two:

- a) Is the identified conduct, practice, behaviour or activity the subject of another inquiry or investigation, or a criminal or civil proceeding?**
- b) Does the body attribute any of the identified conduct, practice, activity or behaviour to broader cultural or governance practices in the relevant industry or sector of the relevant industry? If so, describe those cultural or governance practices.**
- c) Does the body consider that the identified conduct, practice, behaviour or activity result from other practices (including risk management, recruitment or remuneration practices)? If so, describe those practices.**

With respect to the answers that we have provided for question 1, the further details are as follows:

- All the matters that we have identified as a result of a banning or enforceable undertaking against an AFA member have been investigated by ASIC and have resulted in administrative action being undertaken.
- As noted above we have had limited visibility of the matters related to the banning or enforceable undertaking for AFA members other than what is publicly available. Each of these matters have very separate circumstances and it is not obvious that common themes apply.

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- We don't have sufficient knowledge of these matters to provide further comment, although it is inevitable that recruitment and remuneration will be factors that apply in some cases.

With respect to the answers that we have provided for question 2, the further details are as follows:

- All the major product collapses and Storm Financial have been the subject of a parliamentary inquiry of some form, including the Parliamentary Joint Committee on Corporations and Financial Services (Ripoll) Inquiry that took place in 2009. It closely examined the Storm Financial matter. There have also been PJC inquiries into Trio/Astarra and a Senate Economics References Committee Inquiry into the Agri-business sector.
- We are not in a position to add to the information that is publicly available on these key themes in terms of conduct, practices, behaviour or business activity.
- As stated above it is inevitable that recruitment and remuneration has been a factor in the financial advice sector. It is essential that the financial advice sector does more to ensure that unsuitable advisers are removed from the sector and this will be achieved by improved screening and reference checking.

**Concluding Remarks**

The AFA welcomes further consultation with the Royal Commission should it require clarification of anything in this response to the Commission's questions. If required, please contact us on 02 9267 4003.

Yours faithfully



**Philip Kewin**  
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Association of Financial Advisers Ltd