FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

WRITTEN SUBMISSIONS OF THE FINANCIAL PLANNING ASSOCIATION OF AUSTRALIA TO THE ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND INSURANCE INDUSTRY

Second Round of Public Hearings Monday 16 April 2018 to Friday 27 April 2018

1. This submission is made by the Financial Planning Association of Australia ('the FPA') and addresses questions posed by the Counsel Assisting during the closing remarks to the second round of public hearings

2. This submission is based on the following understanding of what financial advice is and why it is fundamentally important to consumers and the national economy.

What is financial advice?

3. Financial advice is about helping people set goals and devise a plan to prepare them for the future, manage their financial affairs, and give them confidence about their financial security.

4. Financial advisers work with clients to identify and consider:

   a. Each client's circumstances including their needs, goals and priorities
   b. The values, attitudes, expectations and financial experiences of their client, particularly in relation to risk tolerance
   c. Their client's ability, both financial and in relation to their level of comfort, to tolerate loss of capital
   d. Their client's financial planning needs across the short term, medium term and long term
   e. Non-monetary matters that may affect their client's financial needs and goals

5. Based on this information, a financial adviser will develop a financial plan with appropriate strategies that their client is comfortable with, to help them work towards their life goals.

6. A financial adviser's responsibilities are to make clear recommendations, outline the risks involved and communicate any possible strengths or weaknesses in the plan. The level of investment risk will be stated in the financial plan and should reflect the risks the client is comfortable with taking.

7. For those receiving long term financial planning (ongoing advice), the financial planner will keep clients updated with changes that could influence their investments or financial plan, such as market downturns; provide regular reviews of the financial plan; and regularly evaluate client's needs, financial goals and strategies.

Consumer benefits of quality financial advice

8. Quality financial advice is important for consumers as it can:
   a. Reduce financial and social exclusion for consumers and help them navigate the financial marketplace and learn how to better manage their finances.

b. Deliver significant consumer benefits including changes in savings behaviour, setting proper budgets, following a plan for paying off debt, and organising finances and building wealth,
c. Change people's behaviour and habits of managing their financial affairs by teaching them sensible and simple practices that can be used in their everyday lives to prepare for their future financial needs.
d. Help improve the financial capability of consumers, enabling them to make informed judgements and effective decisions about the use and management of money throughout their lives.
e. Help consumers with debt management and reduction, budgeting, cash flow management, a savings plan, superannuation, tax planning, home loan repayments, insurance, investments, and estate planning as well as planning for retirement.

A service of national public importance

9. Research shows there are clear societal benefits of quality financial advice which demonstrate that it is in the national public interest to ensure the professionalisation of the following services continues:
   a. Reduced debt - increases disposable income for more productive purposes
   b. Higher rates of return on investments over long periods - building wealth
   c. Insurance protection – minimizes the need for people to rely on social security
   d. Higher levels of savings – reduces reliance on government benefits during and after retirement
   e. Encourages a financially literate and conscientious society that make better long-term decisions[1].

FPA's response to the Royal Commission

10. The FPA is recommending a raft of interdependent measures to:
   a. Ensure adequate and appropriate consumer protections are in place and effectively enforced
   b. Enhance the capacity of the emerging financial planning profession to perform its role in provision of quality financial advice in the interests of the public the profession serves, and
   c. Build trust in the profession.

[1] Rice Warner Actuaries, Value of Advice Research 2008

REMUNERATION

To what extent does the continued legislative condoning of grandfathered commissions shape and influence the culture and attitudes of financial advice licensees so as to create a disconnect between community expectations as to the charging of fees and the tolerance of licensees for the charging of fees for no or little service?

11. We would note however that Commissions are by their nature part of a product cost. In most cases the removal of an adviser does not provide any benefit to a consumer as the provider simply retains the amount that would have otherwise been paid to an adviser. For the removal of grandfathering of commissions to have any effect there would also need to be a substantial shift in the way historic products with commissions are treated by product manufacturers.
12. Ongoing fee arrangements where the ongoing advice is not provided contravene reasonable community expectations, regardless of whether they are technically grandfathered. The FPA would support the removal of grandfathering for ongoing advice fees and all ongoing advice fees being subject to the Opt-in requirement.
13. Grandfathered commissions has led to an environment where many clients are paying fees and yet receiving no services. Ceasing grandfathered commissions and making all ongoing fee arrangements subject to opt-in will result in grandfathered fee arrangements quickly coming to an end where no services are being provided to consumers.

Should grandfathered commissions cease?

14. With FoFA having commenced 5 years ago it is therefore time to review the appropriateness of grandfathered commissions and identify an appropriate means of transitioning these payments either to an alternative remuneration model or out of existence.
15. Commissions are however built in to the fee structure of many older products. It is important to note that the product manufacturer pays the commission from their fees, this is not a specifically client authorised payment.
16. Clients do not have the power to turn off commissions in a product although they can elect to change financial advisers or simply have no financial adviser.
17. For commission based products not paying commissions does not necessarily reduce the cost to the consumer.

FPA Recommendation

18. Grandfathered commissions on superannuation and investment advice should be phased out over a 3-year transition period.

Should the statutory carve-outs to the ban on remuneration, including the recent carve-out in relation to insurance commissions, be maintained. If so why?

19. Yes, in the short to medium term, the carve out in relation to insurance commissions should be maintained.
20. The Life Insurance Framework is still in its infancy, commencing 1 January 2018 and the current transition will not be completed until 2020. Once transition is complete ASIC is required to review the success of the implementation and should review whether any further policy settings which require changing will create a benefit for consumers.

21. Important points to consider are that changing remuneration on life insurance advice will unfairly impact small businesses who are unable to cross subsidise advice costs across services; and that the nature of life insurance products is to never fully cover the risks for the consumer. Therefore the support of a financial adviser who is able to support and educate their clients on the residual risks is a critically important aspect of advice on life insurance products and for the consideration of remuneration models.

FPA Recommendation

22. The insurance commission carve-out to the ban on conflicted remuneration should be reviewed in 3 years' time, once the Life Insurance Framework has been embedded and tested for its effectiveness.
23. This testing should include any changes in the issues impacting on the remuneration of life risk advice and consider the impact of all business sizes and models as well as the role financial advisers provide in assisting clients understand residual risks in relation to insurance products, and though the claims process.
24. There is a need to develop a strategy and a long-term timeline to put in place appropriate steps to resolve current issues and lead to the removal of life risk commissions in the future.

Do remuneration and incentive policies that reward financial advisers for revenue generated for a licensee or employer create an unacceptable risk that financial advisers will prioritise the generation of revenue over the licensee's obligation to provide financial services in a manner that is efficient, fair and honest over their own obligation to act in the best interests of the customer, and over their own obligation to prioritise the interests of the customer above their own interests and the interests of the licensee?

25. It is important to distinguish between a revenue generation culture based on product sales and one based on fees for advice.
26. The FPA supports rewarding advisers for revenue generated in a professional manner, which involves acting in the best interests of the client and putting the client interests first. The FPA believes it is acceptable for advisers to be remunerated based on revenue, where that revenue is independent of product sales. Advisers being paid a share of revenue for fees that are independent of product sales does not in any way compromise the quality of advice. It is appropriate to impose quality criteria on any revenue based remuneration.
27. Reward for results is a fundamental part of our economic system and seeking to exclude some occupations from that is not appropriate. Appropriate mechanisms to ensure that reward is linked to the advice provided not any products recommended is essential.
28. The regulatory regime must address the pressures and potential conflicts created within the licensing structure by the competing interests of the licensee.
29. The absence of a licensee best interest duty to support the adviser's best interest duty creates a significant conflict and tension for the industry. Advisers can be 'stuck' between their legal obligations to the licensee as per their contract, and their 'best interest' legal and ethical responsibilities to the client. The resulting pressure and conflict created for advisers can jeopardise the consumer protection benefits of this measure, which may not be realised.
30. The authorising licensee duty to clients is usually directed towards the licensee's client base as a whole, whereas the duty on the individual providing the advice is directed towards that adviser's individual client.

31. The individual adviser owes duties to their licensee via employment contracts and/or authorising contracts. The contractual duties owed by the adviser to their licensee will often place the adviser's interests in conflict with their client's interests.
32. It should be recognised that the authorising licensee's interests are commercial – to act in the interests of their shareholders. It is the reality of economics that businesses must generate revenue and be viable to survive and be able to provide services to their clients.
33. Licensees should be encouraged to take appropriate measures to ensure that the licensee's commercial interests do not unduly interfere in the individual adviser's performance of his or her best interest duty to their client.
34. The licensee's interests may be constrained by the conditions placed on their license and other consumer protection measures in the Corporations Act, as well as their general law obligations. However, their interests are fundamentally commercial and therefore can be in conflict with the interests of their clients.
35. There will be many circumstances in which it is not possible for the individual adviser to know the (commercial) interests of the licensee. The practical reality is advisers are unlikely to have perfect knowledge of their licensee's commercial interests.

FPA Recommendation

36. The FPA opposes the remuneration and incentive policies that reward financial advisers primarily for revenue generated for a licensee or employer. Where remuneration is linked to a sales-based culture focused on FUM and client numbers, this can influence inappropriate behaviours.
37. The FPA recommends banning other forms of conflicted remuneration including: volume-based payments, rebates, profit sharing and shelf space fees. This was not addressed in FoFA and should be rectified.
38. The removal of the general advice remuneration exemptions under FoFA must also be considered as they encourage an inappropriate sales cultures and create an environment where consumers are at risk of being sold products which may not be appropriate.
39. The FPA also recommends the removal of the current licensing exemption for financial product issuers under regulation 7.1.33H.
40. A best interest obligation should be included under the licensee general obligations in s912A of the Corporations Act (see licensee obligations section below)

VERTICAL INTEGRATION / SEPARATION OF ADVICE AND PRODUCT

Can financial advisers effectively manage the conflicts of interest associated with providing advice as a representative of an institution that also manufactures financial products?

41. While the obligations introduced during FoFA were designed to manage the conflicts of interest between product manufacturers and advice providers within the same institution, it appears that this has not been effective in many instances.
42. There are examples where advice providers are heavily involved in the development of products for their clients which improve client outcomes based on the intimate understanding financial advisers have of clients. However, feedback indicates that the product side and parent companies may push the boundaries of the conflict of interests and place inappropriate pressure on advice businesses, particularly in regard to the distribution of products. The effect on the advice side of the business is however

dependent on the culture of the licensee, the policies of such organisations, and the financial adviser’s individual commitment to professionalism.

43. While the FPA has maintained a position of being business model agnostic in relation to our professional members, this is based on the premise that the advice is provided in the client’s best interest and under the FPA code of ethics client first principle. This presents a challenge for licensees who are not legally obliged to consider clients in this manner - nor are they FPA members, obligated under the FPA’ code of ethics - but rather have general obligations in the law to act efficiently, honestly and fairly (s912A). This issue is significantly exacerbated for institutions that perform multiple and conflicting functions.

FPA Recommendation

44. It is critically important for consumers that there are measures put in place to ensure financial advice representatives can perform the duties they owe to their clients. Strong and measurable barriers must be placed within businesses to ensure that advice practices are not pressured by the expectations of related product manufacturers or platform operators, particularly in vertically integrated business.
45. A best interest obligation should be included under the licensee general obligations in s912A of the Corporations Act (see licensee obligations section below)
46. We note that the ASIC product intervention powers and new design and distribution obligations which the Government are in the process of finalising are designed to address this issue from the product manufacturer side, and FoFA was designed to achieve this from the adviser side. Whether these changes in combination will work effectively to better protect consumers needs to be considered. Given they have been developed in isolation, we have concern they will not work effectively together.

Is it necessary to enforce the separation of products and advice?

47. Yes. There is an inherent conflict of such a degree between the product manufacturers need to sell products and the advice businesses’ legal and professional obligations to act in the client’s best interest, that it is better for the community to restrict the combination of product and advice.
48. The FPA has long held the view that it is necessary to have a separation of advice and product. The reason for our position is the strong tension between the professionally constrained interests of advice businesses and the commercial interests of product businesses. Unless advice businesses are protected from undue pressure from product businesses, the tension between product and advice may not serve the interests of consumers.
49. Although there are benefits to vertical integration, such as economies of scale, adaptability and risk management, we believe these benefits are outweighed by the risks and costs to consumers of biased advice. Consumers are generally not in a position to assess the influence those pressures may have on the quality of advice as demonstrated through a number of ASIC reports (such as Report 279 at [22]) which show consumers are unable to discern advice that is not of good quality (Report 279 at [18]).
50. This must start with a rethink of the legislative definition of ‘personal advice’ being based on ‘financial product advice’ in the Corporations Act which explicitly ties advice to product, and clearly identifying that ‘general advice’ does not take a consumer's personal circumstances into account, but is designed to sell a product to the consumer. Further, the relationship between the advice business and product business within a vertically integrated business must be considered.

51. There are a variety of options that can achieve the outcome of separating products from advice which warrant consideration. These options are included in our recommendations.

FPA Recommendation

52. There are several legislative options that could assist in enhancing the separation of advice and product that require detailed analysis and consideration as to their effectiveness, appropriateness and consequences. These include but are not limited to:
    a. Changing the existing license authorisation to restrict the license function to the provision of financial advice to retail clients only; as well as introducing a Special Purpose Professional Service entity license for related entities (as defined in the Corporations Act) that provide advice, with very specific license conditions, directors best interest duties, and conflict of interest requirements on the licensee.
    b. Legally requiring large licensees to operate their product manufacturer area and their advice area as distinct businesses separate of each other - operating with 'Chinese walls' with different principles, separate systems and management. This would include banning the ability of companies to cross subsidise between the product manufacturing and advice business areas – both the advice and product manufacturing businesses would need to be self-sufficient and sustainable.
    c. At present there is no requirement for products to be "true to label" or an accountability of product manufacturers to ensure products perform to their labels. Introducing such a requirement will assist both financial advisers and improve consumer outcomes and understanding.
53. In addition to the alternatives mentioned in paragraph 54:
    a. Review the definition of 'financial product advice' to consider the benefits and trade-offs of policy options which would separate product and advice at legislative, regulatory, and industry levels.
    b. Review the definition of general advice to better differentiate between advice which takes into account the clients personal circumstances and considers whether a product is appropriate for achieving the clients financial strategy; verse a product sale which aren't constrained by the client's personal circumstance.
    c. Review the definition of independent (and like terms) in the Corporations Act, and enshrine appropriate terms for independent versus non-independent adviser (eg. the Financial Services Authority model in the UK). This will clearly and legally differentiate those advisers operating under an advice-only licence from those operating under an advice licence held by or associated with a product manufacturer.

INDIVIDUAL LICENSING

Is it possible to implement a single system for professional discipline of financial advisers?

54. Yes, we believe that a single system would be possible to implement where all disciplinary bodies adhere to a single body of jurisprudence for discipline.
55. However, the design of a single disciplinary system needs to consider that current action can be taken at any one of the current 6 disciplinary levels. At present disciplinary action is able to be taken at:

a. Licensee level
b. Regulators - both ASIC and TPB (including appeals to the Administrative Appeals Tribunal)
c. Judicial
d. External Dispute Resolution (EDR)
e. New code monitoring bodies (commencing 1 January 2020)
f. Professional Associations.

56. The current system is confusing and difficult for consumers to navigate given it is often difficult to figure out which is the appropriate body to make a complaint to. There is further frustration and stress for consumers due to the time many of these processes take.
57. The multiple levels also increase the regulatory challenges faced by advisers who must keep abreast of all the requirements they must demonstrate compliance with. We have seen inconsistent outcomes at each of these levels.

FPA Recommendation

58. There are several options that could achieve the outcome of individual oversight of financial planners that would require careful consideration as to the pros and cons, efficiencies and effectiveness, in enhancing consumer protection. It is important that the most appropriate and workable framework is identified.
59. Examples of an individual licensing framework could include one of the following:
    a. To be authorised by a licensee, an individual would first need to be issued with a Practicing Certificate by an approved professional association. A Practicing Certificate could only be issued if the individual satisfies a minimum standard set by the general law, and meets the new education and professional standards requirements for financial advisers. ASIC would continue to license organisations under the Corporations Act (similar to the FSA approach in the UK).
    b. A statutory or independent body, separate to ASIC, would be responsible for individual registration. An individual would need to meet - and continue to meet - registration criteria and be registered to be authorised by a licensee. ASIC would continue to license organisations under the Corporations Act.
    c. ASIC would be responsible for licensing organisations and individual financial advisers.
    d. The Tax Practitioner Board tax (financial) adviser registration requirements would be made compulsory for all individuals providing tax (financial) advice services. ASIC would continue to license organisations under the Corporations Act.
        i. Consideration would need to be given to broadening the definition of tax (financial) advisers, tax advice or the TPB regulation of individuals of all financial advice.
60. Registered individuals would be required to comply with appropriate standards such as the professional and education standards now in the Corporations and Tax Agents Services Acts. Monitoring and enforcement of these standards would be the responsibility of the registering body or through outsourcing to an approved professional association.
61. Either of the proposed options would need to be supported by appropriate legislative structures and powers to ensure the obligations are enforceable and consistently applied.
62. If structural changes are introduced to create individual licensing and an individual conduct regulator with the aim of encouraging the emergence of an independent advice profession, ASIC’s role must be reviewed. A different type of AFS license regulator

would be required to compliment the role of individual licensing and conduct regulator. The new role of the regulator for advice licensees should be more akin to a prudential regulator providing supervision and direction to ensure AFS advice licensees govern and risk manage advice corporations to ensure their representatives provide professional services in a manner that prioritises the interests of their clients over any competing interests and duties. The regulatory focus should be on capacity building in advice licensees to meet the obligations in s912A.

Would structural changes to the financial advice industry be required to bring that about?

63. Yes, as identified above.

Would a system of licensing at both an individual and an entity level be more appropriate than the existing system of licensing only at the entity level?

64. Yes, a system of licensing at both an individual and an entity level could be more appropriate than the existing system of licensing only at the entity level. The benefit of individual licensing, where the state or a professional association hands out practicing certificates, makes it more difficult for individuals to hide behind licensees and move around in the event of misconduct. This adds an additional level of consumer protection by encouraging professional behaviours and to punish bad behaviour.
65. The benefits of an individual licensing system with individual accountability is that the professional obligations switch firmly to the individual, and the pressure currently exerted from the licensee onto the adviser is reversed. This creates a licensing regime which empowers the individual financial adviser not to bow to licensee pressure when their own professional future is on the line. Additional licensee obligations (as highlighted above) would also be required to support an individually licensed financial adviser. The question of personal professional indemnity would also need to be considered.
66. A change to individual licensing of financial planners can be a narrow or broad level of change. At the narrower end, current licensee obligations around ensuring an authorised individual has the skill and knowledge to provide financial product advice could be transferred to the individual as an obligation, but other obligations – e.g. best interest duty, disclosure, conflicted remuneration etc. - remain with the licensee. At the other end of the spectrum, all current licensee obligations in relation to the provision of financial advice could be transferred onto the individual.
67. However, there are risks and benefits to both the current system versus a dual regulatory approach that should be considered.
68. It would be beneficial to investigate options such as those used in the UK, US and Canada, for example, or a version of those models, to determine if such a system would work in Australia's regulatory environment and deliver benefits to consumers.

LICENSEE OBLIGATIONS

Are the general obligations set out in section 912A of the Corporations Act expressed at too high a level of generality to be capable of being effectively enforced?

69. No. While the provisions in s912A are general in nature, they present appropriate obligations for licensees and a framework from which the regulator is able to provide regulatory guidance and standards on licensees based on current risks and best practice. However, evidence raised in the Royal Commission highlights issues around the effectiveness of the regulator, reporting by licensees and enforcement action.
70. It is not that licensee are not complying with s912A, or that they are not identifying potential breaches, but issues are arising when considering whether the breaches should be reported, or in a timely manner. This is because s912A is reliant on a system of self-reporting of breaches under the significance test in 912D.
71. Whether a breach or potential breach is reported is heavily dependent on a licensee's application of the breach significance test and its approach to compliance. Some licensees may err on the side of caution and report even borderline breaches, while others may take a different approach. This unfairly impacts on the licensees doing the right thing as it results in increased data held by ASIC about them, and the inconsistency in reporting depletes the value of the consumer protections within the law.
72. It is worth considering if and how professional indemnity insurance cover, and the behaviour/conduct of PI insurers influences self-reporting decisions of licensees. For example, if there were changes to the reporting requirements and the significance test, how would insurers treat any resulting claims - for example, as single claim or a combination of similar claims breaching the aggregate cover for which the licensee is insured for the year and hence would not be covered; or would insurers review exclusions based on breach reporting requirements.
73. A further issue highlighted by the Royal Commission is whether the regulator is either capable or respected sufficiently to perform its duties in relation to s912A. Again, while the obligations are general in nature, they rely on the efficient and effective operation of the Regulator.

FPA Recommendations

74. The significance test should encourage licensees to consider whether the conduct subject of the breach is likely to have been repeated with other clients or poses a potential risk for other clients, particularly in large scale organisations. For example, a technical team creates a tax strategy and makes it available to its adviser network. One client receives a tax penalty on the back of the tax strategy. The licensee fails to realise the tax strategy is flawed and identify a systemic breach putting clients across its network at risk.
75. The efficiency and effectiveness of the regulator in regulating s912A should be considered.

What alternative obligations would be more appropriate?

76. Requirements in s912A focus on the licensee's processes and encourage a tick-a-box approach to compliance. Consideration should be given to the inclusion of a general provision requiring licensees to act in the best interest of clients.

77. Many provisions in the Corporations Act are restricted in their application to the provision of services to retail clients. ‘Retail client’ is defined based on, for example, income, net wealth or product value. Persons outside the relevant thresholds should not necessarily be denied basic protections as these factors are not reliable proxies for the informed consent of the consumer to opt out of the protections. Specific and overarching obligations in s912A are necessary to ensure the licensee as a whole considers the interests of its clients.

FPA Recommendation

78. A best interest obligation be included in s912A, for example:
    a. *That the licensee gives priority to the interests of its clients over its own commercial interests in relation to the activities of the licensee which directly influence the quality of advice provided to retail clients including, the construction of the licensee's approved product list, the arrangements by which it's advisers are remunerated for the provision of advice, and its arrangements for obtaining product research.*
79. The statutory licensee best interest duty should be expressed as additional licence conditions in s912A(1) requiring the licensee:
    a. *To have in place adequate arrangements to support each of its representatives to meet the statutory best interest adviser duty; and*
    b. *To have due regard for the best interest of its clients in the conduct of its activities which relate to the provision of financial product advice, and if there is conflict between its clients' interests and its own interest in relation to such activities, give priority to the interests of its clients.*

Are the steps required by the ABA reference checking and information sharing protocol adequate to protect the public when financial advisers transfer between licensees?

80. The FPA raises the following issues in respect to the ABA reference checking standard:
    a. The standard is limited to subscribers and not universally applied across all licensees. We acknowledge that there are privacy issues and fair work practices which need to be considered for the protection of individuals, but ensuring consumers are protected is important in addressing bad apples moving between licensees.
    b. There are too many exemptions provided within the framework which allows the previous employer to not answer questions.
    c. Professional associations were not included in the process and there is no requirement for employing licensees to consider disciplinary action taken by an association against its members.
    d. There was no mechanism put in place to ensure the subscribing licensees are maintaining records to demonstrate adherence to the required standards.
81. We further note that ASIC in conjunction with Standards Australia released a reference checking protocol in 2007- HB 322 — 2007 Reference Checking in the Financial Services Industry for financial services licensees. This protocol has not been widely adopted across the industry.

FPA Recommendation

82. We recommend ASIC's HB 322 - 2007 be implemented as a standard across financial services licensees as was intended, and consideration should be given to making this mandatory.

Should licensees be required to maintain a minimum degree of satisfaction as to the competence and integrity of applicants to become authorised representatives before authorising? If so, what form should that requirement take, and what minimum levels should be set?

83. Yes, licensees should verify, using only reliable sources that applicants have met the relevant education and training standards set by FASEA. Further, licensees should ensure applicants have not committed serious breaches of the FASEA Code of Ethics; and have not committed such a serious breach of another relevant code of ethics that the licensee can't reasonably be satisfied of the applicant's integrity.
84. We note it is not yet clear how the new FASEA education standards (both qualifications and exam completion) will be tested and recorded, nor the functioning of Code Monitoring Schemes or reporting obligations around these. It would appear however that the ASIC financial adviser register will be the likely source for all this information.

FPA Recommendation

85. Licensees should be obligated to verify that authorised advice providers meet relevant education, ethical and professional obligations as part of their onboarding process. Licensees should also be obliged to check for any past disciplinary action taken against the adviser by the regulators (ASIC and the TPB) and professional associations.

FEE FOR NO SERVICE

Do clients receive any meaningful benefit from ongoing service arrangements?

86. Yes. Financial planning is a dynamic process, it is prudent to conduct regular professional reviews of the client's personal circumstances and the economic environment to reassess and/or confirm the client's objectives, needs and priorities, and to ensure that the client's previously agreed financial planning strategies continue to promote their agreed objectives, needs and priorities. Failure to implement regular reviews of previously agreed financial planning strategies may compromise achievement and satisfaction of the client's agreed objectives, needs and priorities, and may expose the client to financial loss. This may expose the client to ongoing costs (including ongoing professional fees) which might no longer promote the client's agreed objectives, needs and priorities.
87. For these reasons, it is important that financial planners continue to have available the option of delivering and charging for services provided to their clients on an ongoing basis. If those services were only available to the client by payment on a per advice transaction basis, it is highly likely client inertia would operate to deter clients from accessing valuable and necessary services. That is not to say that there are no risks in permitting advice firms to charge for their ongoing services in this way, but where obligations emphasise the need to ensure ongoing services are properly evaluated and assessed as suitable for each client before they are implemented, and are regularly reviewed for suitability, this risk can be minimised.
88. Ongoing service arrangement that are tailored to the needs of the client can help them manage their financial affairs. Financial products can be complex and are subject to changes in regulation, and feature modifications and market or pricing movements. Regulatory changes can have a negative impact on individuals if they:
    a. are unaware of or do not understand new rules, or
    b. do not act as required under new regulations.
89. Practically, not all technical regulatory changes are reported to consumers in a meaningful language in the media. Rather, reporting of many such changes is released by ASIC, APRA or the ATO and are very technical in nature.
90. Particularly, if individuals lack the skills to manage their own financial positions, ongoing service arrangements put in place through a letter of engagement permitting the adviser to closely manage client's changing financial circumstances, further the recommended strategy, ensure product and regulatory changes that may impact on the client's financial plan or investments are managed, and ensure that clients financial position is being monitored and managed by an appropriately trained expert. Consumers also benefit from having someone to call upon in the event of any unexpected changes or for reassurance.
91. The FPA supports ongoing fee arrangements which are simple, transparent and fair:
    a. Advisers should assess the suitability of an Ongoing Fee Arrangement before it is entered with the client, regularly review its suitability with the client, and re-assess its suitability whenever the Ongoing Fee Arrangement is renewed; and
    b. transparently document the arrangement and the services with the client, and
    c. ensure that the services are provided to the consumer as per the agreement.

INAPPROPRIATE ADVICE

How can financial services licensees best incentivise the provision of good-quality financial advice, including in situations where the best advice for a customer is not to change anything at all?

92. There is a concern that some licensees have prioritised advice revenue and fee generation over ensuring they deliver the required services to clients. This may be an indication of the culture within some licensees that have charged fees for no service, which has led to the favouring of short-term profit over ethical behavior. As indicated in ASIC's report, this failure of culture was also manifested by the fact that licenses who had charged fees for no service typically had much more effective systems in place for recording incoming revenue as opposed to tracking the provision of ongoing services.
93. As discussed above, it is possible for licensees to incentivise advisers based on the provision of professional services, but also taking into account compliance results, good conduct, and receiving no complaints. However, advisers should not be eligible for incentives where contracted services have not been provided to clients.
94. While business sustainability performance measures, such as number of clients or revenue are important for the sustainability of an advice business (and therefore an ability to provide ongoing advice services), failure to meet compliance and ethical standards should operate as a gateway to incentive eligibility (i.e. failure to meet the required standards would mean no incentive is payable).
95. The licensee's role should be to ensure they support their financial planners to provide advice that meets their legal obligations, is professional and is in the best interest of the client. This should include ensuring the licensee gives priority to the interests of its clients over its own commercial interests and do not push the boundaries of the conflict of interests and place inappropriate pressure on advisers. For example, licensees should incentivise the practice required under the FPA Code of Professional Practice of analysing and evaluating whether the client's current course is likely to meet the client's agreed financial planning goals and objectives before commencing to develop any alternative strategy to achieve those agreed financial planning goals and objectives and before considering and evaluating any alternative products and services.
96. Financial advisers are best placed to consider whether the tools and implementation solutions for the strategic advice they are providing meet their requirements for providing advice 'in the client's best interest'. Licensees should be required to ensure they provide these tools and solutions to their authorised and employed financial advice representatives.

FPA Recommendation

97. A licensee best interest obligation be included in s912A (see response in section above).
98. Meeting compliance and ethical standards should operate as a gate for payment of incentives within all advice licensees, with a penalty regime introduced for licensees who breach such conditions.
99. There should be a requirement that registered auditors audit the compliance systems and practices of financial services licensees at least once a year. This should include verification that advice standards have been met by advisers who received incentive payments.

How can financial services licensees best ensure that the results of routine compliance measures, such as compliance audits, are appropriately escalated so that potential risks to customers are identified and managed in a timely manner?

100. All individuals, including consultants responsible for compliance should be appropriately trained to assess and analyse audits to identify client risks.
101. Consideration should be given to who in the licensee is the appropriate area/person for escalation of potential client risks. This will differ depending on the size and nature of the licensee's operations. This is an important element to consider as internal compliance departments of large licensees may have conflicting interests; and an escalation of a potential breach within a small licensee would potentially be from a compliance consultant to the licensee's Responsible Officer or owner who may also be the advice provider.
102. Licensees should have in place appropriate policies and procedures, compliance audits, and other compliance activity, to ensure the potential risks for clients are identified and managed in a timely manner. This includes appropriate escalation procedures and timeframes, as well as ensuring that compliance issues for individuals, practices and across the licensee are properly tracked and analysed for trends over time. These policies and procedures should be specific to each organisation to cater for their size, service offering, client base, and geographic spread, for example.
103. All employees and financial advice representatives should be well trained in the compliances requirements to help in the identification of consumer risks as early as possible. This should include a clear understanding of the escalation procedures and processes.

FPA Recommendation

104. There should be a requirement that registered auditors audit the compliance systems and practices of financial services licensees at least once a year. Auditors should be under a legal duty to report inadequately managed risks to the licensee. Licensees should be under a legal duty to remedy gaps in compliance systems within an appropriate period. Any serious risks should be reported to ASIC immediately upon the auditor becoming aware of them.
105. A potential solution is the development of common standards by the entire profession regarding handling of compliance measures and remediation (with oversight from professional associations and regulators). The common standards should be reported to an independent body which will benchmark results and ensure consistent testing by compliance consultants. The performance of each licensee can then be benchmarked to the common standard across licensees and the aggregated compliance and audit results then need to be shared with professional associations and regulators to enable common risks to be identified and called out. An across industry program will improve and normalise procedures regarding escalation and resolution of compliance measures.
106. We note that auditors are subject to AUASB standards and ASIC regulation. Compliance audits are currently not regulated to be conducted by registered auditors. There would be an ability for the Regulator to take action against an auditor where it was found they had not met their obligations to properly audit a financial services licensee. Where the licensee is found to have not remediated compliance issues identified by the auditor, there could also be a requirement for the auditor to report this to the Regulator to take action.

Is it possible for financial services licensees to adequately monitor the quality of advice provided by employees and authorised representatives where that advice is provided in a manual environment?

107. Yes, with the appropriate resources and expertise.
108. However, this is very difficult due to the time and effort to manually review advice against standardised advice quality criteria. Review of advice at scale in a manual environment requires independent review of a Statement of Advice which is an expensive and manual process. Because of this, it's not feasible for licensees to always have perfect knowledge of the quality of advice of employees and authorised representatives. However, if appropriately resourced the licensee can reduce their error rate to a tolerable level - especially with the use of technology-based advice tools that offer both compliance efficiencies, risk rating capabilities and client benefits.
109. We note that regulation technology or regtech is becoming more widely available, however it is both in its infancy and limited by: the technology available to date; computational power; and a general lack of awareness of the broad nature of the six regulators and their regulatory standards required to be met to provide compliant financial advice.

FPA Recommendation

110. All six regulators (ASIC, TPB, AUSTRAC, ATO, APRA, AOIC) of financial advice provision should be encouraged to work with regulatory technology providers and fintechs to enable the efficient and compliant inclusion of regulatory standards in advice and regulatory compliance tools. This will ensure the rapid deployment of such technology which will allow full or broader monitoring of advice quality.
111. Financial advice providers are then able to focus on the professional services they provide knowing the regulatory requirements are compiled with.
112. The Government should fund a program to fast track regulatory technology in financial services to speed up the delivery of the consumer benefits this will provide.

Are improvements in technology the only way to ensure that financial advisers provide quality advice?

113. No, the following measures also improve advice quality outcomes:
    a. deterrence (e.g. threat of liability for harm to clients);
    b. risk-based monitoring;
    c. peer review; and
    d. professional certification and normalisation of practices
114. However, the use of technology based advice tools and regtech can offer both compliance efficiencies and client benefits.

How should financial services licensees ensure that customers of their authorised representatives are adequately protected while the licensee investigates the conduct of the authorised representative?

115. One option is for the authorised representative to be appropriately supervised by the licensee while the investigation is pending. We would expect this would take the form of monitoring of appointments, vetting of advice and coaching and mentoring on a proactive basis.
116. This would ensure the clients are still able to receive advice and services in a timely manner, yet in a closely monitored fashion to ensure they are protected.
117. Further, these clients should be subject to retrospective review depending on the outcome of the investigation.
118. We note the complexity of this for small licensees which may require the services of independent supervision.

FPA Recommendation

119. A licensee requirement could be introduced to fully supervise and monitor authorised advice providers while they are under investigation or subject to a complaint by suspending the authorisation of the adviser. This will require all services provided by the adviser to be countersigned by a supervisor.
120. Licensees should also be required to retrospectively review outcomes depending on the outcome of the investigation.

Taking into account that it may never be possible to reduce the risk to zero, what is an acceptable level of risk that customers will be provided with inappropriate advice?

121. The acceptable level should be no greater than that which a reasonable client would accept, and should be lower than that level if the reduction can be achieved efficiently.
122. This can be achieved through our prior recommendations around introducing a best interest obligation on licensees at s921A.

FPA Recommendation

123. Licensee ‘best interest duty’ in s921A (see recommendations above).

What is an acceptable period of time after identifying that a client has been or may have been provided with inappropriate financial advice to inform the client of that fact?

124. The FPA supports the Internal Dispute Resolution (IDR) timeframes for responding to client complaints as set in Figure 1: Maximum IDR timeframes of Regulatory guide 165: Licensing: Internal and external dispute resolution.
125. Similar timeframes could be considered for notifying the client when the licensee’s compliances measures identify that inappropriate advice has been or may have been provided.

FPA Recommendation

126. Consider using similar timeframes to those set for IDR in RG165, for notifying the client when the licensee's compliances measures identify that inappropriate advice has been or may have been provided.
127. Further, a 90-day standard for remediating the client to their pre-advice position could be introduced to ensure clients are made whole in an efficient manner.

What is an acceptable period after identifying that a client has been or may have been provided with inappropriate financial advice to remediate the client for any losses suffered?

128. Clients should be remediated no more than 90 days (see recommendation above) after identifying that the client has or may have been provided with inappropriate advice.
129. Remediation should focus on putting the client back on track to the same or better position they were in before they acted on the inappropriate advice.
130. Ethically, licensees should be obliged to make a fair settlement offer to the client to assist with the client's remediation. This should be formally required and supported by a positive legal obligation placed on licensees to make a fair settlement offer.
131. The client should be permitted to and assisted in having the settlement offer considered by an independent expert.

FPA Recommendation

132. Clients should be remediated no more than 90 days \ after identifying that the client has or may have been provided with inappropriate advice.
133. The client should be put back on track to the same or better position they were in before they acted on the inappropriate advice as per current EDR practices.

How should financial services licensees balance the need to ensure that employees are held responsible for misconduct against the risk that punishing poor behaviour will encourage employees to conceal that behaviour?

134. Misconduct may be intentional or unintentional.
135. A person who acts with the intent of deliberately doing the wrong thing, will usually also deliberately act to conceal such behaviour. In such cases it is suggested that the licensee's whistleblower policy and internal procedures should be supportive, robust, and well understood by employees and representatives, to encourage disclosure by other parties.
136. For mistakes or unintentional breaches, the punishment regime should encourage cooperative early disclosure by the individual rather than encourage concealment.
137. Early disclosure of an unintentional breach in some cases can minimise the risk of the breach becoming more serious for the client or systemic. If the unintentional breach is detected and resolved early it may increase the likelihood of a lower level penalty being imposed on the adviser. Hence the benefits of early disclosure and cooperation in and of itself could encourage advisers not to conceal the breach.

How should financial services licensees recognise and reward ethical conduct by financial advisers?

138. We do not have a firm view on this question as there is a community and professional expectation that ethical conduct by financial advisers is a mandatory requirement and is therefore rewarded through continued practice. In a functioning ethical culture, ethical behaviour is rewarded by status within the group. If this is not happening the licensee needs to identify and address the reasons

Are there particular characteristics of the financial advice industry that lead to there being a higher incidence of improper, unethical or dishonest conduct than in other industries? If so, what should be done to address that issue?

139. Financial Advice has traditionally had very low barriers to entry. This has seen some unscrupulous people giving financial advice as an easy way to access larger amounts of money. New education and supervision standards through FASEA will substantially lift the entry requirements for financial advisers. This makes financial advice a less attractive option for those looking to behave inappropriately.
140. Access to people’s money also makes financial advice a more attractive proposition to those seeking to behave inappropriately. Increased penalties for dishonest behaviour by financial advisers will make this less attractive.

FPA Recommendation

141. Separation of advice and product (see recommendations above) and individual accountability (see recommendations above) would ensure the appropriate behaviours are adhered to by individuals and supported by licensees.
142. A licensee best interest obligation be included in s912A (see response in section above).

PLATFORM FEES

Does vertical integration of platform operators with advice licensees serve the interests of clients? If so, how?

143. Vertical integration of platform operators with advice licensee may achieve economies of scale that benefit consumers. Conversely if not properly instituted it can lead to clients being recommended in-house products that may not be market competitive.

FPA Recommendation

144. As noted above - we support a structural separation of product and advice due to the inherent conflicts of interest and have offered potential solutions (see recommendations above).

Why should a platform operator continue to receive a fee or rebate from a fund manager calculated by reference to the value of client funds invested in the fund if that fee or rebate is not wholly passed on to the clients whose funds are the basis for the fee or rebate?

145. We believe that there is a community expectation that platform operators would pass on to clients the benefits of fees or rebates from a fund manager calculated by reference to the value of clients' funds invested in the fund, particularly where they also charge the client administration fees for the operation of the platform.

FPA Recommendation

146. Platform operators should pass on to clients the benefits of fees or rebates received from a fund manager calculated by reference to the value of clients' funds invested in the fund.

If platform operators continue to automatically deduct advice fees from clients' investments, why should the platform operator not be required to have controls in place to ensure that subdivision (b) of division (3) of Part 7.7A of the Corporations Act has been complied with? Put another way, why should platform operators not be expected to ascertain that there is a lawful entitlement on the part of fee recipients to the moneys that the operators automatically pay to the fee recipients at the expense of clients?

147. We believe that there is a community expectation that platform operators would have controls in place to ensure that fee recipients are lawfully entitled to such moneys. We also reiterate our earlier comments that there is a remuneration conflict arising out of the need to collect advice fees from the 'from fund'.

FPA Recommendation

148. We support the proposal in principle that platform operators should take reasonable steps to ensure that fee recipients are lawfully entitled to moneys paid by the operator to the fee recipient.

DISCIPLINARY SYSTEMS

Is the current division of responsibility for professional discipline of financial advisers between employers, ASIC and professional associations operating effectively to ensure that financial advisers face appropriate consequences for breaching their statutory and professional obligations?

Does that division of responsibility create gaps in the disciplinary system? If so, what are they?

Is it possible to implement a single system for professional discipline of financial advisers? Would structural changes to the financial advice industry be required to bring that about?

149. No. The system is not operating effectively, which is mainly due to:
    a. Overlapping responsibilities,
    b. Consumer and adviser confusion as to the appropriate body to handle a complaint, and
    c. Lack of information sharing.
150. The current system is confusing and difficult for consumers to navigate given it is often difficult to figure out which is the appropriate body to make a complaint to. There is further frustration and stress for consumers due to the time many of these processes take.
151. The multiple bodies also increase the regulatory challenges faced by advisers who must keep abreast of all the requirements they must demonstrate compliance with. We have seen inconsistent outcomes at each of these bodies.
152. There are gaps in the system, especially in relation to information-sharing. Professional associations aren't necessarily notified by regulators or licensees of breaches by members, regardless of any memoranda of understanding. This can slow down the investigative and enforcement process significantly.
153. There are also tensions between the disciplinary and advocacy functions within associations, suggesting there may be a gap in foundational arrangements. This problem may require changes in governance arrangements and in the constitution of disciplinary panels. In addition, the transparency and accountability of decisions about disclosing information to the public about members breaches may need to be improved.
154. Yes, we believe that a single system would be possible to implement where all disciplinary bodies adhere to a single body of jurisprudence for discipline. However, the design of a single disciplinary system needs to consider that current action can be taken at any one of the current 6 disciplinary levels. At present disciplinary action can be taken at:
    a. Licensee level
    b. External dispute resolution
    c. New code monitoring bodies (commencing 1 January 2020)
    d. Regulators - both ASIC and TPB (including appeals to the administrative appeals tribunal)
    e. Professional associations.
    f. Judicial

FPA Recommendation

155. At present, the licensee and regulatory systems do not place much value on the potential normative effect of professional disciplinary systems.
156. ASIC and the TPB should be obliged to share information it has about the conduct of professional association members with the professional association. Licensees should be under a general law obligation, backed by threat of criminal or civil sanction, to share information about the conduct of professional association members with the professional association.
157. Requirements for approving professional associations should be developed and include consideration of criteria to be met such as:
    a. the separation of their disciplinary and advocacy functions
    b. reciprocal reporting obligations to ASIC and the TPB
    c. a significant level of consumer representation on disciplinary panels
    d. rules for summary disposals
    e. rules for publicly naming those who breach a Professional Code
    f. a means to legally oblige members to remain in the approved professional association for the duration of a disciplinary matter
    g. options to impose financial charges on members

Professional conduct complaints

158. As a further suggestion, consideration should be given to the way conduct issues are dealt with in other professions such as legal and health.
159. Similar to the legal profession arrangements in Australia, a new commonwealth funded Professional Conduct Commission (PCC) could be established independently of ASIC, Licensees and Code Monitoring Bodies to deal with complaints of serious misconduct by individuals providing professional services to retail clients.
160. The PCC should be permitted to consider complaints relating to potential breaches of the law and the FASEA Code of Ethics.
161. The Code Monitoring Body could be responsible for reporting breaches of the FASEA Code of ethics to the PCC for disciplinary action such banning and fines.
162. Similar to the legal profession, the PCC would have the ability to refer complaints to the Code monitoring bodies or the Regulator, to an EDR scheme for potential compensation, or resolve the complaint themselves.
163. The PCC should have statutory powers to suspend and cancel individual licensing / registration and expel an individual from the industry. The PCC should be permitted to publish outcomes and have the power to name individuals.
164. Similar to the legal profession, the PCC should be a statutory body separate from the Regulator.

REGULATORY CULTURE

Is there a particular regulatory culture that has developed in relation to the regulation of the financial advice industry? What is that culture? And what has contributed to its development?

Has the existing regulatory culture in the financial advice industry contributed to the occurrence of misconduct in the financial advice industry? What changes in regulatory culture might assist in reducing the incidence of misconduct in the financial advice industry?

165. Yes. The regulatory culture has been built around the regulation of licensees, and a reliance on the licensee to regulate the conduct of the individual who is providing the financial advice services. This has therefore led to a regulatory culture that has been established by the regulators and the judicial system, focusing on making rules about how things are to be done by the licensee, rather than supporting the professionalism of the individual to do the right thing and not harm the consumer. This has exacerbated the issues related to the inherent commercial conflicts of licensees, as discussed above. This issue is compounded by the high use of administrative sanctions and commercial remediation processes over more robust and independent compensation processes and professional discipline. This has resulted in:
    a. a system that is overly concerned with prescribing and enforcing strict procedures that advice providers must follow (for example, in respect of fee disclosure and opt-in measures);
    b. a system that is not concerned enough with independently and proactively:
        i. monitoring whether advice providers conform to broadly defined professional obligations, which go well beyond the scope of any prescriptive procedural rules, about their conduct and advice, and
        ii. ensuring that advice providers who engage in misconduct towards, or give poor quality advice to, their clients bear the cost to their clients of that misconduct or poor advice; and
    c. in some instances, organisations not being held accountable to community or professional expectations due to resourcing constraints at the regulator.
166. This culture seems likely to have been a reaction to historical failings in the advice sector, and a belief by the Regulator that the threat of having to compensate clients for misconduct or poor advice, was not enough to effectively manage poor advice and conduct. This regulatory focus on process over compensation may have contributed to disproportionate resources being spent on tick-a-box procedural requirements to demonstrate compliance and less being spent on assessing the risk of harm to the client from the misconduct or poor advice itself.
167. ASIC's structure and resources mean that it is easier and a preference for the Regulator to deal with one large licensee than 500 small licensees or with the individual professional. The structure of the licensing regime has created a regulatory culture and system where, in layman's terms, the Regulator oversees the organisation, and the organisation self-regulates its representatives who provide the actual service to the clients. This has perpetuated the focus on a tick-a-box process-based regulatory culture.
168. Shifting the regulatory focus from ensuring compliance with processes, to ensuring through a robust and independent adjudication system that advisers or licensees bear the costs of harm their misconduct causes the consumer is likely to enhance deterrence and redirect resources from ineffective, inefficient and costly compliance procedures which are not protecting consumers.

169. This should be supported by an individual licensing or registration system for advisers. This will have the added benefit of enabling clear demarcation between potential breaches at the adviser versus licensee level.

FPA Recommendation

170. Individual licensing / registration and oversight of advisers (see recommendations above)
171. ASIC to take a proactive role in helping consumers obtain compensation for poor advice, e.g. through court action or EDR. Combined with enhanced monitoring, this enhances deterrence against misconduct and poor advice.
172. Advice businesses should carry greater level of capital or professional indemnity insurance (PII) (or combination of both) to provide proper disincentives against negligence. In addition, ASIC should monitor compliance with capital and PII requirements more actively. This will help ensure that consumers can be compensated fully and that advice businesses properly account for the potential costs from harming consumers.