FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

14 October 2015

Corporations and Schemes Unit (CSU)
Financial System and Services Division
The Treasury
100 Market Street
Sydney NSW 2000

Email: asicfunding@treasury.gov.au

Dear Sir / Madam

Re. Industry funding model for ASIC

The Financial Planning Association of Australia (FPA) welcomes the opportunity to provide feedback on the proposed industry funding model for ASIC.

The Regulator plays a fundamental role in ensuring the confidence and protection of consumers which is paramount to the effective and sustainable operation of the financial service sector in Australia.

However, we are very concerned about the inequity of the proposed funding model, in particular its impact on small licensee businesses.

The FPA would welcome the opportunity to discuss with you the issues raised in our submission.

If you have any questions, please contact me on 02 9220 4500 or dante.degori@fpa.asn.au.

Yours sincerely

Dante De Gori
General Manager Policy and Conduct
Financial Planning Association of Australia[1]

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[1] The Financial Planning Association (FPA) has more than 11,000 members and affiliates of whom 9,000 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Mark Vincent, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board

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Industry funding model for ASIC

FPA submission to:

The Treasury

14 October 2015

INTRODUCTION

The FPA's submissions to the FSI called for significant reform of the conceptual and legal framework in which Australian regulators operate. Our call for greater collaboration and co-regulation between regulators and the financial services sector included closer alignment of the goals and mechanisms of regulators and industry.

The Murray Report recommended that the Government introduce an industry funding model for Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.[2] In our final submission to the FSI, we provided in principle support for an industry funding model as a way to improve transparency and collaboration between ASIC and the financial service sector.

When considering an appropriate industry funding model for ASIC, it is important to understand the restricted resources of ASIC given its responsibilities in overseeing the regulation of all corporations operating in Australia. The FPA believe the need to balance respectively limited resources and regulatory oversight responsibilities has pushed ASIC to operate more as an 'after-event' or reactionary Regulator with limited operations in proactive oversight or ongoing supervision, monitoring and education. An industry funding model should reflect ASIC's actual regulatory activity and focus.

It is also important to consider the ASIC funding model in the context of the larger reform agenda. This is being driven by the Financial System Inquiry, Parliamentary Joint Committee Inquiry into proposals to lift education and professional standards in the financial services industry, and the ASIC Capability Review, all of which call for an increase in ASIC powers and / or the Regulator's activity in specific areas. The industry funding model for ASIC must clearly link to the broader reform agenda and the recommendations of these inquiries specifically.

Transitioning to a user-pays model, in whole or in part, requires that the cost of regulation is borne in an equitable, risk-based manner across the entire financial services sector. The recent transition of AUSTRAC's funding to a user-pays model provides an excellent example, as providers of designated services are required to pay according to their size and the complexity involved in regulating them.

The proposed ASIC funding model will have a significant impact on all financial advice businesses, however our analysis shows that it does not achieve the objective of being equitable across the entire financial services sector.

The FPA notes ASIC's role as the Regulator overseeing the Corporations Act extends beyond the financial services sector to govern all corporations and companies. While our submission focuses on our concerns as a professional body in the financial services sector, and particularly in relation to the impact of the proposed model on financial planning licensees, the issues we raise and the recommendations we propose may benefit all industries governed by ASIC.

[2] FSI, above n 2 at p 250.

1. PROPOSED LEVY

The FPA understands that there are three main components that make up the proposed levy that would need to be calculated for a provider of tier 1 personal advice – a company levy, an authorisation levy (both advice authorisations and dealer authorisations), and a business activity levy. Additional flat annual levies also apply for certain business activity.

The FPA is concerned that the compounding effect of the three main components of the levy are inequitable. The total levy will create a significantly larger burden for small licensee businesses that have the least capacity to absorb such high additional costs. Though there will also be significant impacts on larger financial advice licensee businesses, they do have greater scope to manage such levies through the economies of scale of their business operations, for example, they can cross-subsidise across other departments and/or distribute the costs across a greater number of advisers under their licence.

The FPA has done calculations of the total levy that different sized advice businesses would pay. To demonstrate the inequitable impact the levy would have on single-adviser and small licensee businesses, we have used the following common assumptions applied to different sized licensees and calculated the rate per adviser each business would pay.

- No parent company
- Hold own Australian Financial Services License (AFSL)
- Provide tier 1 personal financial advice
- 6 advice authorisations
- 6 dealing authorisations
- No MDA operators
- No credit license
- No IDPS operators
- No margin lending

	Levy type	Description	Amount	Levy for single-adviser licensee	Levy for small licensee of 5 advisers	Levy for medium licensee of 50 (authorised representative) advisers	Levy for large licensee of 250 advisers
1	Company levy	Small proprietary company	$5	$5	$5	$5	
		Large proprietary company	$350				$350
2	A levy for authorisations	a) a flat base levy for the license authorisation	$250	$250	$250	$250	$250
		b) levy for each advice authorisation held by an AFSL	$250 x number of advice authorisations	$1500	$1500	$1500	$1500

		c) levy for each dealing authorisation held by an AFSL	$250 x number of dealing authorisations	$1500	$1500	$1500	$1500
3	A levy for the business activity	Levy for providing Tier 1 Financial Advice	$1,350	$1,350	$1,350	$1,350	$1,350
		Levy for each financial adviser on the Financial Adviser Register (FAR)	$470 x each adviser on the FAR	$470	$2350	$23,500	$117,500
4	Additional annual levy	Securities Dealers (flat annual levy)	$1,600	$1,600	$1,600	$1,600	$1,600
TOTAL				**$6,675**	**$8,333**	**$29,705**	**$124,070**
Cost per Adviser				**$6,675**	**$1,666**	**$594**	**$496**

The results reveal that small licensee businesses (those with 5 advisers or less) will end up paying at least twice as much per adviser than medium and larger licensee businesses.

We also conducted a survey of our members who hold their own Australian Financial Services License (AFSL). The results showed that of the small licensee businesses who responded nearly 70% would incur an additional annual cost of $3,000 to $8,000 as a result of the proposed funding model.

To put this into perspective, the typical licensing costs for a small licensee business are currently approximately $20,000 per annum and include:

PI Insurance	$8,000 to $12,000
Compliance support	$3,000 to $5,000
Annual audit	$1,500 to $3,000
Research	$1,000 to $2,000
Training	$400 to $1,000
ASIC (current)	$600
EDR Scheme	$300
Austrac	Exempt

The additional annual cost of $3,000 to $8,000, as a result of the proposed levy, would see costs for a small licensee business rise from $20,000 to as much as $28,000, representing a 40% increase.

a) Inconsistencies within the levy components

The FPA acknowledges that the company levy component recognises the constraints of small business by imposing a nominal levy of $5. However, this principle is not applied across all three components of the levy. The authorisation and business activity levies are the same regardless of the company size or definition.

The fixed cost element of the license authorisations and business activity components of the levy could be exacerbating this issue. The fact that these costs are fixed and not scaled, mean they do not take into account the size of the licensee. For example, the business activity fixed cost for providing tier 1 personal advice of $1,350 calculates to $270 per adviser for a small licensee business of 5 advisers; and $5.40 per adviser for a licensee with 250 advisers. This clearly demonstrates that each fixed cost will have a greater impact on small licensee businesses.

The compounding result of the levy is that <u>per adviser</u>, small licensee businesses will pay an exponentially higher total levy than medium and large businesses.

b) Inconsistent with Government policy

From the introduction of its industry funding model, AUSTRAC has provided an exemption for small licensee businesses. In the May 2014 Federal Budget, the Government announced it would extend this exemption further with the removal of the $300 base component fee for AUSTRAC's smallest regulated entities. Under the new arrangements, only the largest (around 1,029) reporting entities would be required to pay the AUSTRAC industry levy.

This clearly demonstrates the Government's policy position in relation to imposing industry levy's on small business.

The Australian Government Guide to Regulation also states that:

> *The cost burden of new regulation must be fully offset by reductions in existing regulatory burden.*

However, the ASIC industry funding model just imposes additional costs with no additional regulatory relief or benefit. As stated below, it also does not match ASIC's regulatory activity.

c) ASIC activity

While the levy will have a significant impact on all licensee businesses, it is expected to have a greater impact on small licensee businesses (based on per adviser analysis). This is not consistent with ASIC surveillance and education activity. Feedback from our members who are small licensee businesses state that ASIC rarely engage with them – the majority stating that they had no interaction with ASIC for more than 12 months. Rather small licensee businesses are predominantly supported by the professional and industry associations and small compliance firms, not ASIC. The Regulator's focus is typically on larger licensees.

ASIC have understandably allocated substantial resources to large licensee businesses over the last few years. This can be seen through Enforceable Undertakings, ongoing surveillance activity and submissions to various Parliamentary committees and inquiries.

It is also likely that this will continue for the foreseeable future. The first action noted in the ASIC Corporate Plan for financial advice is that ASIC '*will act to address conflicted advice, misaligned incentives and risk management, particularly in large vertically-integrated institutions*.'

It is recognised that this is entirely consistent with the risk based approach that any regulator must adopt with limited resources – the focus of its activity is on those businesses that pose the highest risk to consumers. The FPA supports this approach.

It is also acknowledged that ASIC did undertake a program of work with small licensee businesses in 2012 and 2013 where they visited one quarter of all new licensees providing personal advice. Importantly however this program of work did not lead to ASIC dedicating more resources to this part of the market. However, the same is not true of ASIC's review of the mid and large licensees which was undertaken about the same time and which led to further and more detailed surveillance work.

The additional costs being incurred by ASIC in regulating large licensees should be better reflected in the proposed funding model. The levy paid by each part of the market should be proportionate to the ASIC resources and work dedicated to those market segments.

d) PJC report and recommendations

The Parliamentary Joint Committee on Corporations and financial services (PJC) Inquiry into lifting education and professional standards in the financial services industry recommended that "*the government consider proposals to increase fees for organisational licensees to reflect the scale of their financial advice operations….*"(Recommendation 6).

However, the proposed funding model will introduce a levy that on a scale imposes greater costs for smaller licensees on a 'per financial adviser' basis than larger licensees with large advice operations.

The FPA is also concerned the additional costs will divert funds away from education, training and business improvement, and reduce the capacity of licensees and their advisers to adhere to higher standards, a key recommendation of the PJC and Financial System Inquiry.

2. LICENSE FEES

The FPA is also concerned about the proposed fees for Australian Financial Services License applications, variations, revoking and other license related fees.

License applications (for, body corporate, personal, and limited AFSL applications)	$11,000
License variations	$6,900
Voluntary suspension of AFSL	$2,300
Revoking an AFSL	$2,200

The FPA notes that it is proposed to remove some existing fees including:

Appoint AFSL authorised representative	$37
Ceasing an AFSL authorised representative	$37
Vary the details of an AFSL authorised representative	$37
AFSL profit and loss statement and balance sheet – body corporate	$563
AFSL profit and loss statement and balance sheet – person	$231
AFSL profit and loss statement and balance sheet – super fund trustee	$563
AFSL profit and loss statement and balance sheet – body corporate non-disclosing	$563

However, the fees to be removed, which range from $37 to $563, would be more relevant to large licensees than smaller licensee businesses and are disproportionate to the new fees proposed for all licensees.

The impact of the proposal to increase in the ASIC licence application fee from $1,600 to $11,000 will have a significant impact on market competition and business models. This is an increase of over 500%. The licensee application fee has already been increased in recent years from approximately $350 to the current $1,600.

These proposed licensing fees are exorbitant and will have an extreme impact on the market. They are counter to professionalisation of financial services in Australia and will significantly impact those striving to meet the Regulator's definition of 'independent'.

The impact of the proposed license application fee on the financial advice profession and the government's drive to address conflicted financial advice should not be underestimated. This fee will force financial planning practices to remain with large dealer groups as evident in our survey results - 69% of FPA small licensee businesses stated that they would not have applied for a license if the $11,000 fee applied at the time.

The FPA understands the purpose of the proposed heavy upfront licensee fee is to create an entry barrier for unscrupulous advisers. However, this upfront license fee will undermine the development of an independent profession and the separation of financial product and advice. Government policy should incentivise the right behaviour and adherence to higher professional standards. This is the key premise of the PJC recommendations. The FPA suggests there needs to be a greater balance between encouraging independence in the market and deterring those who intend to do the wrong thing.

The ASIC funding model also proposes the same flat fee for all new AFS licence applications with little regard to the costs involved in assessing different types of applications. This is counter to the PJC recommendation that "*the government consider proposals to increase fees for organisational licensees to reflect the scale of their financial advice operations*…."

It is our understanding that ASIC devote significantly more resources to assessing complex or large scale licence applications compared to simpler smaller scale applications. Again, this is in keeping with a risk-based approach and considered entirely appropriate.

Under the proposed funding model, a licence application for a small financial planning practice which does not issue financial products will be charged the same fee as a large business that is looking to establish a dealer group model (hundreds of financial advisers), provide advice on complex products (foreign exchange, MDA services, contracts for difference) and issue financial products (property development schemes, hedge funds). This is clearly not an equitable approach and will mean small businesses are disadvantaged.

A scalable model that aligns the complexity and risk associated with an AFS license application would be a more equitable model. A flat rate fee, with no regard to the business applying is not appropriate. As with the proposed levy, the licensing fees should be a risk-based model rather than based just on the size of the business.

A similar approach could be considered for other proposed licensing fees such as a variation to authorisations and revoking a license.

3. RISK-BASED FUNDING MODEL

The FPA believes that the model does not go far enough in considering all the possible risk measures that could be included in the funding model.

The model is heavily weighted on the number of authorisations and the number of financial advisers as the key measure for risk. What the model does not consider is that not all licensees with the same number of authorisations and the same number of financial advisers are the same or present the same risks.

An industry funding model for ASIC should be based on the measurable risks the regulated businesses pose to consumers, and should encourage such businesses to adopt the right behaviours when providing services to consumers.

Measurable risks associated with the provision of financial services could include:

i) Complaints history – To identify a pattern of behaviour, consideration should be given to the number of complaints lodged about the licensee, both through internal dispute resolution (IDR) and external dispute resolution (EDR) over a number of years. It is important to consider complaints lodged through IDR as some licensees may settle claims to avoid EDR. Consideration may need to be given to IDR reporting requirements.

ii) Professional membership – Professional association membership is also a risk differential as members have to adhere to higher professional, education and ethical standards than those prescribed in the law. For example, of the 22,000 advisers registered on the ASIC Financial Adviser Register nearly 10,000 practicing advisers are FPA members. This means FPA membership represents approximately 45% of the adviser population. However, FPA members have accounted for significantly less than 10% of financial advisers banned by ASIC since 2009.[3] The fact that more than 90% of financial advisers banned by ASIC were providers who are not members of the FPA and therefore not subject to the additional regulatory oversight of our professional obligations, clearly demonstrates the consumer protection benefits of professional standards[4].

Statistical under-representation when compared to the total financial adviser population subject to ASIC banning, is a proof point of the positive effect of professional obligations and membership. It demonstrates the vital role professional bodies play in 'norming' good professional behaviour beyond legal minimum standards, and managing risk for the protection of consumers. It also provides a measurable risk for an industry funding model for ASIC.

It must be noted however, that as highlighted in the PJC Report, not all associations are professional bodies.

[3] This figure drops to less than 6% for Certified Financial Planner® members, which highlights the benefits of higher education standards.
[4] ASIC bannings analysed against FPA membership data between 2009 – 2015 financial years

iii) 'Independent' licensees - There are licensees that meet the definition of 'independent' in s923 of the Corporations Act which means they do not accept or receive any form of conflicted remuneration.

These suggested risk-based measures not only encourage good professional behaviours, but directly relate to a reduction of ASIC activity:

- No complaints history – EDR complaints always relate to misconduct or breaches which are reportable to ASIC and require ASIC activity
- Professional membership – proven to relate to lead to less ASIC bannings
- Independent – receive no conflicted remuneration which have historically been linked to significant breaches and increased regulatory activity.

A risk-based industry funding model for ASIC is vital to deliver a fair and equitable mechanism that, importantly, links with and responds to the larger reform agendas of the FSI and PJC inquiries and the ASIC Capability Review.

A risk-based funding model can also be used for removing bad-apples from providing financial advise and improve the quality of advice by encouraging professional membership and adherence to higher education standards.

The FPA suggests concessions be applied to the ASIC funding model based on a set of risk measures, to provide relief to those licensees who activity reduce the risk to consumers of their business, and ultimately the regulatory activity required by ASIC.

Licensee activity would need to be reviewed annually to ensure concessions are applied appropriately. For example, if a licensee with high risk improves, it should be rewarded in the future by receiving concessions. Similarly if a licensee who receives concessions breaches requirements, the concessions should be removed.

4. IMPACT OF PROPOSED FUNDING MODEL

a) Barrier to entry

The additional costs will be a barrier to entry for small licensee businesses and single-adviser licensees, and financial advisers will be more likely to remain with large financial institutions.

The disproportionate cost the proposed funding model would impose on small licensee businesses will restrict trade and negatively impact on the ability for them to compete in the advice market. FPA survey respondents indicated that:

- 46% would cost the levy directly into the fees charged to clients
- 29% would not be able to employ new people
- 20% would potentially reduce staff numbers
- 54% said they would restrict business growth
- 37% said they would have to restrict their client offering
- 7% said their business would become unprofitable/unviable
- 7% would cancel their license and join a dealer group

Small licensee businesses and single-adviser licensees may be forced to either restrict client service offerings or cancel their license and join a dealer group.

b) Price competition

Though the proposed funding model will significantly impact on all financial advice businesses, the small licensee businesses don't have the capacity to absorb these additional costs and will be forced to pass these additional costs on to consumers in the form of higher fees for their professional services (as indicated in our survey results). This will make these small licensee businesses less price competitive than their counterparts who are aligned to large licensee businesses. There is a risk that they will be priced out of the market.

c) Number of advisers

The proposed funding model will impact all licensees with two-thirds of medium sized licensees surveyed indicating the additional costs would lead to a potential reduction in the number of advisers.

d) Cost of advice

Most concerning is the that ultimately the proposed funding model will drive up the cost of financial advice for consumers, with 46% of those surveyed stating they would have to pass on these additional costs in the advice fees they charge clients. Of the medium sized licensee businesses surveyed, 69% said they would pass the additional cost on to the financial adviser and their clients.

5. PHASE-IN ARRANGEMENTS

While we note that the government has planned in the Federal Budget for the introduction of an industry funding model for ASIC to be introduced from the 2016-2017 budget year, we have serious concerns about the impact particularly on small licensee businesses, of the timing of the proposed new costs.

It is proposed that the ASIC funding model commence 1 July 2016. This comes not only at a time when all financial advice businesses are recovering from the implementation costs of FOFA and TASA, but also meeting the new demands of the government's pending response to the FSI, PJC inquiry into education and professional standards, and the Financial Crime inquiry; and are expected to transition to new business models under the new Life Insurance framework. It is expected that the government will require higher education standards for financial advisers, adherence to a code of conduct, and potentially the introduction of the AML tranche 2 requirements, all of which will create significant costs for financial services businesses.

It would better serve consumers if businesses invested in meeting these new standards and requirements, rather than funding the Regulator.

6. FPA RECOMMENDATIONS

The FPA recommends that Treasury consider re-working the industry funding model for ASIC and in doing so consider the following:

- The model to appropriately reflect ASIC's activity necessary to oversee the risk posed to consumers based on the scale of the advice operations and other risk factors.
- Comply with government policy regarding small business
- Ensure the funding model link to the larger reform agenda, particularly the FSI, PJC Inquiry, and ASIC Capability Review.

The FPA would welcome the opportunity to work with Treasury to explore alternative funding possibilities. Below are some suggestions that could be considered and worked through to help develop an alternative approach.

Annual funding levy

The FPA suggests the annual funding levy should be made up of two parts:

A. Part A – a revised model that is equitable across the financial services industry and supports the role of small business.

B. Part B – an overlay of risk-based concessions that incentivise professional behaviour and encourage businesses to reduce their consumer risk, and the regulatory activity required by ASIC .

Part A – annual levy structure

To achieve an equitable funding model for the financial services industry, the annual levy must be scalable and inline with government policy. The FPA recommends:

1) The removal of fixed costs from the levy for financial advice licensees. All costs should be scalable. Rates per adviser and per authorisation would need to be reviewed to compensate for the reduction in the levy caused by the removal of the fix costs.

2) An exemption from the annual funding levy for small licensee businesses with 5 advisers or less.

3) Consideration should be given to whether the principle of scalability could be applied to the sub sector flat annual levies.

These changes could be restricted to the Australian Financial Services Licensee (AFSL) component of the model to retain the integrity of the rest of the proposed funding model.

Part B – Overlay of Risk-based measures

The FPA recommends concessions apply to the annual levy and be available for licensees who adhere to measures to reduce the regulatory and consumer risks of their business activity. For example:

1) 10% discount for licensees who provide independent financial advice as defined by s923 of the Corporations Act.

2) 10% discount for licensees with 90% of advisers voting members of a recognised professional body (90% of advisers will give licensees flexibility to cater advisers leaving and new advisers entering the industry and need time to meet professional body criteria).

3) 10% discount for licensees with clear complaints history over a set period of time, such as 5 years.

Licensees who receive levy concessions should be assessed each year to determine any change in their adherence to risk measures and the impact on the levy they should pay.

Fee schedule

The FPA recommends the proposed fees related to Australian Financial Services Licenses (AFSLs) reflect the scale and complexity of the financial advice operations of the applying business, and therefore the ASIC resources required to assess the application. For example, the model could consider a license fee range that separates issuing of products versus no product. There could also be alternate segmentation that could help in scaling the licensing fees.

- Applicant does not issue financial products
  - a license application with less than 5 authorised representatives and no products
  - a license application with 5 – 19 authorised representatives and no products
  - a license application with 20 – 49 authorised representatives and no products
  - a license application with 50 – 99 authorised representatives and no products
  - a license application and 100 and over authorised representatives and no products

- Applicant issues financial products
  - a license application with less than 5 authorised representatives, issues products
  - a license application with 5 – 19 authorised representatives, issues products
  - a license application with 20 – 49 authorised representatives, issues products
  - a license application with 50 – 99 authorised representatives, issues products
  - a license application and 100 and over authorised representatives, issues products

Appropriate fees should apply to each category.

FPA Recommendation – Phase-in arrangement

The introduction of an industry funding model for ASIC be delayed by at least 12 months due to the uncertainty of the PJC and FSI recommendations. The funding model should then be introduced in stages.