FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

INQUIRY INTO CAPABILITY OF ASIC

Submitted to:
Senate Economic Committee

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Introduction

The Financial Planning Association (FPA) has well documented views about various aspects of the Australian Securities and Investments Commission (ASIC) and how it interfaces with financial planners and consumers. We aim to use this submission as an examination both of the important work that ASIC undertakes but also where it fails to protect Australians from malfeasance and malpractice.

Terms of Reference

The capacity and capability of the Australian Securities and Investments Commission

to undertake proportionate investigation and enforcement action arising from reports of alleged misconduct, with particular reference to:

(a) the potential for dispute resolution and compensation schemes to distort efficient market outcomes and regulatory action;

(b) the balance in policy settings that deliver an efficient market but also effectively deter poor behaviour;

(c) whether ASIC is meeting the expectations of government, business and the community with respect to regulatory action and enforcement;

(d) the range and use of various regulatory tools and their effectiveness in contributing to good market outcomes;

(e) the offences from which penalties can be considered and the nature of liability in these offences;

(f) the resourcing allocated to ensure investigations and enforcement action progresses in a timely manner;

(g) opportunities to reduce duplicative regulation;

(h) the effectiveness of ASIC's enforcement measures in protecting vulnerable Australians; and

(i) any other related matters.

Summary of FPA recommendations

The FPA recommends:

- the government resource and recommence that PI review, and ASIC collect evidence of current compliance with PI requirements.
- key consumer protection provisions in the Corporations Act should apply to all financial services, and not limited to the provision of financial advice as per the current application.
- the CSLR should have broad coverage that reflects the AFCA's jurisdiction to hear complaints for multiple financial services classes, including advice and product providers, appropriately apportioning responsibility between them; with funding that reflect the broad risk of different financial services classes and the exposure each class brings - all classes of financial services need to contribute.

- a move to a principles-based approach relying on professional judgement and professional standards for the provision of financial advice is appropriate; and the operating framework for financial advice (including the AFS licence structure) should be re-examined.

- the obligations of the licensee and individual accountability of the financial adviser be clarified to remove unnecessary duplication and maintain appropriate consumer protection.

- ASIC work with industry to offer enhanced engagement opportunities between financial planners and ASIC representatives with a focus on education and preventative measures to protect consumers.

- the current process for reporting suspicions of misconduct be simplified process with a priority hotline giving financial planners and other financial services professionals the ability to report inappropriate conduct or advertising.

Professional indemnity insurance

To ensure dispute resolution and compensation schemes do not distort efficient market outcomes and regulatory action, the government must address the role of professional indemnity (PI) insurance in the regulation of financial services. Financial services firms and practitioners are required to hold PI insurance as a condition of their license.

In part, PI insurance is intended to cover liabilities from financial services complaints and ensure that licensees are able to pay compensation when a complaint is made against them. In practice, failure to hold adequate and appropriate PI insurance is a major cause of licensees not paying compensation when it is due.

The final report of the Review of Compensation Arrangements for Consumers of Financial Services by Richard St. John[1] (the St John Review) considered these issues in 2012 and made recommendations to improve the effectiveness of PI insurance. These included addressing the quantum and coverage of PI insurance and recommending ASIC take a proactive role in monitoring whether licensees are complying with their PI insurance obligations.

The previous Government undertook to conduct a review into PI insurance and we are disappointed no action took place. Nor has there been any actions taken on this review by the new Government and problems with PI insurance continue to be a major cause of unpaid determinations. Further, ASIC have confirmed to the FPA that they do no proactive monitoring of PI insurance obligation compliance by AFLSs or the effective operation of PI market for financial advice more broadly.

Given the relatively narrow focus of the Government's proposed Compensation Scheme of Last Resort (CSLR), and its limitation of the scheme to contributions from product distributors and financial planners, it is important to reflect on the recently released Australian Financial Complaints Authority (AFCA) determination statistics. Of the 72,358 complaints AFCA received in the 22/23 financial year, those relating to financial advice showed a decline from 534 to 241 (down 54%) for complaints about inappropriate advice and from 525 to 281 (down 46%) for complaints about failure to act in clients' best interest. Further, the AFCA data demonstrates that in the half year 1/7/2021 to 31/12/2021, that of the 636 complaints progressed, only 96 related to financial planners, of which only 25% were resolved in favour of the complainant.

[1] Final Report of the Review of Compensation Arrangements for Consumers and Financial Services, Richard St. John, 5 April 2012, https://treasury.gov.au/consultation/review-compensation-arrangements-consumers-financial-services-consultation-final.

These most recent statistics from AFCA indicate the number of advice related complaints to the authority is incredibly limited and further that less than a third of those complaints are actually upheld. It therefore appears incongruent for the government to propose a CSLR that disproportionately targets financial advice for contributions to the scheme and which would leave consumers of products - relating to significantly higher numbers of complaints to AFCA - completely unprotected. It is also important to note that the financial planning sector has undergone significant structural changes since the *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*. The number of financial planners is historically low and the profession and industry has been rapidly professionally in line with changes made to professional standards following the Royal Commission.

The FPA recommends the government resource and recommence that PI review, and ASIC collect evidence of current compliance with PI requirements.

Ineffectual provisions of the Corporations Act

In addition to the CSLR and dispute resolution requirements, the following provisions in the Corporations Act include requirements that apply only in cases where personal financial advice has been to a retail client in relation to relevant financial products:

- 912DAC Obligation to lodge a report—reportable situations in relation to other financial services licensees
- 912EA Reporting to clients affected by a reportable situation
- 912EB Obligation to investigate reportable situations that may affect clients

The Royal Commission heard evidence of misconduct affecting consumers in relation to all financial services. It is therefore concerning that key elements of the Corporations Act that serves to address this misconduct applies only to situations where personal financial advice has been provided. For example, sections 912EA(1)(a) and 912EB(1)(a) restrict the obligation to notify the affected client of a reportable situation, and the requirement to investigate the reportable situation, to situations where personal advice has been provided to the affected client. This effectively provides an exemption from these obligations to all other financial services creating a significant gap in consumer protection, including the provision of personal advice to sophisticated investors and wholesale clients, general advice, the issuing of a product and other financial services.

The focus on misconduct and reportable situations involving just those (retail) consumers who received personal advice, creates a significant risk for the 80% of Australians who interact with the financial system without receiving financial advice from a registered relevant provider.

The FPA recommends key consumer protection provisions in the Corporations Act should apply to all financial services, and not limited to the provision of financial advice as per the current application.

Compensation Scheme of Last Resort

ASIC has oversight of the entirety of the financial services industry and corporations. However, the CSLR established under the Financial Sector Reform Act 2022 and the Financial Services Compensation Scheme of Last Resort Levy Bill 2022 and Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2022 currently before parliament excludes the majority of sectors operating under ASIC's regulatory remit.

When assessing claims, we acknowledge that AFCA seeks to appropriately apportion claims between inappropriate advice and product. However, the CSLR that would be established under the above legislation places a spotlight on advisers for the allocation of fault. In contrast, serious misconduct, misrepresentation or fraud of a product issuer or manufacturer, is ignored given their specific exclusion from the proposed scheme.

The scheme would exclude significant segments of the financial industry, such as managed investment schemes (MIS) which will leave many consumers affected by financial misconduct without adequate protection or avenue for compensation. In essence, the scheme will only apply to five financial products and services:

- personal advice on relevant financial products to retail clients,
- credit intermediation,
- securities dealing,
- credit provision, and
- insurance product distribution.

As such, it will mean that a large number of financial institutions and product providers will not be part of the scheme. Hence many market participants will not be required to contribute to the costs of the scheme and resulting consumer compensation. This creates two issues in regard to market outcomes. Firstly, it distorts the financial viability of those businesses required to be a member and cover the costs of the CSLR. Secondly, adds to the consumer cost of the services provided by the members of the CLSR.

Paying compensation must primarily be the responsibility of the party whose behaviour gave rise to the complaint. Holding financial services firms and practitioners responsible for their own behaviour is an essential component of professionalisation, necessary to raise standards and critical to improve outcomes for consumers of financial services. However, it is an unreasonable outcome if the mere cost of doing business in the industry covered by the CSLR becomes, by itself, prohibitive.

Excluding a large segment of the financial services market from compensation scheme obligations, with the cost of operating such a scheme substantially imposed on one small portion of the market, will undoubtedly distort an ‘efficient market outcome’.

The FPA recommends the CSLR should have broad coverage that reflects the AFCA’s jurisdiction to hear complaints for multiple financial services classes, including advice and product providers, appropriately apportioning responsibility between them. The funding of the CSLR should reflect the broad risk of different financial services classes and the exposure each class brings - all classes of financial services need to contribute, broadening the current proposal of just distributors of financial products to include financial products themselves. Financial product failure is ultimately the largest cause of financial loss for consumers.

Regulatory duplication and uncertainty

ASIC is tasked with regulating the financial services sector based on laws that, since commencement, have undergone constant changes with every regulatory reform layering additional requirements on

top of the existing obligations, without removing or simplifying how the obligations work together. This view is supported by the Australian Law Reform Commission (ALRC)[2].

This overlay has flowed down to the Regulator's oversight and enforcement action. There is significant duplication of requirements for financial planners required to meet the education and professional standards including the Code of Ethics, as well as the more prescriptive and duplicative financial advice requirements in the Corporations Act. This overlap is created within the law, and therefore understandably is in ASIC guidance and the surveillance and enforcement approaches used by the Regulator.

For example:

- registration required on the Financial Adviser Register (FAR) as well as authorisation by a licensee
- inconsistent education and training standards for 'registered relevant providers' and 'qualified tax relevant providers'
- inconsistent CPD requirements for 'registered relevant providers' and 'qualified tax relevant providers,' as well as misalignment of registration CPD requirements and the licensee CPD year obligations in the law
- applying professional judgement to meet the standards in the Code of Ethics, while still meeting the prescriptive best interest duty and associated requirements in the Corporations Act
- confusing conflict of interest obligations in the Code of Ethics and the law
- confusion as to whether the Code permits conflicted remuneration that is allowable under the Corporations Act
- the conflict between whether advice is able to be scaled between the Code of Ethics (Standard 6), s961B of the Corporations Act, and RG175
- disclosure of the same information to clients multiple times and in multiple documents
- gaining client consent for client fees and services on numerous occasions (up to eight in the first year)
- client consent forms for using third party suppliers
- different forms and processes for lodging client consents for each product
- requiring reporting of planners' own potential breaches, no matter how small, plus those of other planners and licensees under standard 12 and in s912DAB
- record keeping obligations under standard 8, in the law, and in ASIC regulatory guidance

Due to this approach to law reform, changes to the regulatory environment over the past decade primarily focus on new clients, often disregarding the unintended consequences for existing clients of

[2] Australian Law Reform Commission, Risk and Reform in Australian Financial Services Law (FSL5), 21 March 2022

financial planners. Forcing new obligations designed for new clients onto existing clients has created significant expense and workload for financial planners with little benefit for the existing client.

Law reform has also meant ASIC must resource and action the regulation of financial planners through multiple oversight touch points including:

- Listing of individual practitioners on the Financial Advice Register (FAR)
- AFS Licensing and practitioner authorisation requirements
- Single disciplinary body (SDB) – Financial Services and Credit Panel (FSCP) oversight of the Financial Adviser Code of Ethics and professional standards
- via licensee regulatory obligations
- ASIC banning and enforcement action on the individual in addition to FSCP and professional standards requirements
- Mandatory reporting of suspected non-compliance by another adviser or licensee.
- Financial planners also report the provision of unlicensed advice via ASIC's general complaints portal.

It is unclear how ASIC manages the inflow of information to ensure all misconduct and consumer protection issues are clearly identified and appropriately assessed, prioritised and actioned by those with the relevant expertise, in a timely manner while ensuring no vital piece of information is overlooked to the detriment of consumers.

Historically, ASIC has heavily relied on the self-reporting aspects of the regime and the licensee to act as 'psuedo auditor' to provide 'first level oversight' of the services provided to consumers by its representatives. With the introduction of the SDB, Code of Ethics, and the new reportable situations regime, if a planner reasonably suspects another planner or licensee of misconduct or non-compliance, the practitioner would need to:

- report their suspicions to the SDB directly in order to meet their obligations under Standard 12 of the Code of Ethics, and
- report it to their licensee, and the licensee should notify ASIC under the reportable situations requirements.

The duplication and uncertainty in the law significantly impacts not only how ASIC regulates, but also the expectations, trust, and experience financial planners and other stakeholders have with the Regulator as the overseer of the law. This begs the question as to the impact of the law on the efficiency of market outcomes and regulatory action. However, this issue will ultimately impact consumers as it puts consumer protection mechanisms at risk of failing; and cost recovery of this regulatory oversight is borne by AFS licensees and passed onto financial planners and ultimately consumers.

Regulatory certainty needs to be introduced and duplication removed to ensure the regulatory environment provides consumer protection without adding significant cost and complexity to the provision of advice.

The FPA recommends the obligations of the licensee and individual accountability of the financial adviser be clarified to remove unnecessary duplication and maintain appropriate consumer protection.

The FPA supports the current ALRC review of the Legislative Framework for Corporations and Financial Services Regulation and its inquiry into the operating framework for financial advice (including the AFS licence structure) and a move to a principles-based approach relying on professional judgement and professional standards for the provision of financial advice.

Transition and timeliness of Regulator response

With each change in financial services laws and regulations, financial planners and licensees spend significant time and money to assess and update their systems and processes to ensure compliance with new requirements.

ASIC also must interpret and put in place appropriate mechanisms to monitor, supervise and enforce the new requirements. One would assume this would usually include systems and process changes that must work within or alongside existing regulatory oversight mechanisms, all of which takes time, resources, and funding to execute appropriately and effectively. While ASIC is an extremely large and well-funded organisation, there are examples of transition periods granted to the Regulator to prepare for the commencement of regulatory reforms not being met, impacting on industry's preparedness for and the benefits consumer are expecting from the reforms. The Regulator's timeliness in releasing guidance has impacted the efficiency of industry's responsiveness to past reforms. For example:

- FOFA - delayed 12 months
- 'Relevant provider' individual registration - delayed 6 months
- SDB / FSCP - delayed 15 months (pending)
- Design and Distribution Obligations – delayed 6 months

This issue is exacerbated by the uncertainty in the law and the layering of regulatory requirements over time. Addressing the duplication and complexity in the law and moving to a principles-based approach relying on professional judgement and professional standards for the provision of financial advice, will assist in addressing this issue.

ASIC over-reach

There is a disconnect between ASIC's regulatory guidance and the Regulator's enforcement action. Licensees have often tightened their requirements and implemented changes to processes and systems for financial planners which are not required under the law or in regulatory guidance because of enforcement action taken by the Regulator. For example, as detailed in Report 515, ASIC audited and reviewed the financial advice files of the largest five licensees. As a result of the review, the Regulator mandated additional training standards that went beyond the requirements in the law and their own regulatory guidance.

There are also examples of ASIC action taken for a breach of s961B against financial planners even though they had complied with the best interest duty safe harbour steps as set out in regulatory guidance. Whether it is within the Regulator's mandate to impose such conditions on licensees is not the issue. It is the uncertainty that this enforcement action creates that is concerning and is having a significant impact on the profession. Additionally, in many circumstances, ASIC does not publish detailed explanations of their regulatory enforcement unless it is specifically captured in a report.

ASIC's over-reach is evident in some guidance such as *ASIC RG 277: Consumer Remediation*, which set new obligations even though no regulation making power was given to ASIC in the relevant provisions of the Act.

Industry support and engagement

From the perspective of the 'regulated population', ASIC's regulatory approach differs significantly to that of other regulators relevant to financial services in Australia. For example, in the 2019/2020 financial year only $1.324m, or 3 percent of ASIC's estimated total operating expenditure of $36.329m (without adjustments) for regulating licensees that provide personal advice to retail clients on relevant financial products, was spent on industry engagement, education, guidance and policy advice. Given the positive, preventative potential of such proactive activity and the importance of and need for guidance and policy advice particularly to assist smaller licensees, the FPA suggests the expenditure and activity in these areas appears very low. Feedback from FPA members also indicates that ASIC will frequently tell planners and licensees to seek legal advice in response to enquiries seeking clarity on regulatory guidance that has been issued by the Regulator.

> *In relation to trying to get assistance from there it is just not worth calling at all. Unless you have a specific contact that can provide you with assistance, we find we don't even bother calling them now and just rely on external compliance consultants or financial services lawyers.*

This contrasts with other regulators which frequently issue both public and private rulings on matters of regulatory interpretation. FPA members has also indicated commented on their interactions with other regulators:

> *I have found our dealings with the TPB and Austrac to be very good. You can call them up and get a straight answer on the question that you're looking for.*

Consultants play a vital role in the financial advice sector, providing a range of expertise to AFS licensees of all sizes particularly on regulatory and compliance matters. However, as the following feedback from FPA members indicates, ASIC engagement with the financial advice sector does not often include consultants:

> *I have been running a compliance consulting business for small AFSLs for over 10 years. I have tried numerous times over the years to engage with ASIC. This has been to seek clarification on their position, provide feedback, etc. In almost all cases I have found that ASIC have been unwilling to interact. It got to the point a few years back that I gave up. If need be, I now work via the FPA to interact with ASIC. I work with over 100 small financial planning licensees and I'm willing to share information and knowledge on how they operate.*

The FPA encourages the use of preventative measures to reduce the risk of consumer detriment via proactive engagement with industry, rather than a hard-focus on enforcement. For example:

- ASIC review all professional indemnity insurance policies to make sure adequate protection for consumers
- interactive education opportunities with industry with ASIC representatives permitted to engage openly on the relevant topic.
- improved industry accessibility to ASIC expertise would be helpful in identifying issues before they arise and cause consumer detriment

- clear and consistent regulatory guidance
- public/private rulings

It is important to note the style of Information Sheets recently released by ASIC have been welcomed by industry as a marked improvement from historic ASIC regulatory guides. The subtext in recent guidance (such as the Record of Advice Information Sheet) has shifted – previous regulatory guides focused on the practices and behaviours ASIC wanted to stop and were often lengthy, cumbersome and complicated to read, confusing and even inconsistent (challenging to differentiate between what is ASIC opinion and what is fact referenced by the appropriate Act of Parliament); more recently ASIC guidance provided via accessible web-based information sheets has been more even-handed, addressing practices and behaviours which are acceptable and encouraged and underpin the provision of quality advice.

This approach makes the ASIC guidance much more relevant, practical and useful for financial advice practices that are providing quality advice in the best interests of their clients. It also facilitates the use of practical and innovative compliance solutions, which have the potential to reduce costs in advice processes and documentation making financial advice more affordable for consumers.

The FPA will continue to work with ASIC to offer enhanced engagement opportunities between financial planners and ASIC representatives with a focus on education and preventative measures to protect consumers.

Tools for enforcement

The penalties in the law should provide ASIC with the tools and flexibility to tailor penalties to suit the circumstances and level of the misconduct. The penalties should be designed to incentivise good conduct, and strongly disincentivise misconduct.

Critically, the penalty regime needs to be tough on the perimeters. The unlicensed, unqualified, and inexperienced should face powerful sanctions to deter unlawful participation. The penalties for unlicensed operators should exceed those of licensed and authorised operators. Currently, the regime does not provide ASIC with adequate tools to sanction those who operate on the perimeters of the law.

The existing restrictions on using the terms ‘financial planner’, ‘financial adviser’ and like terms under s923C of the Corporations Act should be maintained. However, there is some evidence that incidence of people misusing these terms is increasing and the government should take action to ensure consumers can have confidence when they see those terms used. It is important that consumers are not misled about whether the professional they are seeking advice from is qualified to provide that advice.

ASIC should review the use of the terms ‘financial planner’, ‘financial adviser’ and like terms (including ‘financial coach’, ‘financial mentor’ and ‘financial guru’) to determine if restrictions on the use of these terms are effectively protecting consumers from unqualified financial advice.

The enforcement regime should also be tough on offenses of fraud and dishonesty.

It is currently unclear to many FPA members as to why ASIC pursues some matters so forcefully and ignores others with no rationale as to why. For example, ASIC pursues self-reporting very aggressively, but anecdotal feedback from FPA members indicates that has a poor record on acting on reports lodged by a financial planner or licensee about another individual or entity, which is required under the Code of Ethics and Corporations Act. It must be noted that the single disciplinary

body within ASIC only recently commenced its jurisdiction over the enforcement of the Code of Ethics, which may address this issue.

The current process for reporting suspicions of misconduct is longwinded. A simplified process with a priority hotline giving financial planners and other financial services professionals the ability to report inappropriate conduct or advertising, would help protect consumers. Financial planners should be accepted as reliable sources of reporting given their understanding of the law.

Conclusion

ASIC performs a vital role in protecting consumers and detecting and eradicating unlawful behaviour. The FPA supports the efforts of the Regulator and will continue working with ASIC to drive enhancements in consumer protection.