Financial Regulator Assessment Authority
The Treasury
Langton Crescent
Parkes ACT 2600

Email: FRAA@treasury.gov.au

Thursday 27 July 2023

Dear FRAA,

Draft Financial System and Regulator Metrics Framework

The Financial Advice Association of Australia[1] (FAAA) welcomes the opportunity to provide feedback on the Financial Regulator Assessment Authority's (FRAA) draft financial system and regulator metrics framework.

The FRAA's proposal sets out a clear framework within which the metrics should be assessed. It is important that clear data points are developed to support the individual outcomes and that the data is published to ensure the regulators can be held to account and public confidence maintained.

The FAAA's submission largely focuses on the assessment of the effectiveness and capability of ASIC in its oversight role of Australia's financial advice profession. Some of our feedback will also be applicable to APRA. We have provided further feedback specific to APRA in terms of life insurance.

We note the parties that FRAA has already consulted with, and as a result encourage consultation with professional associations such as the FAAA, noting that our members represent hundreds of thousands of consumers of financial services.

[1] The Financial Advice Association of Australia (FAAA) was formed in April 2023, out of a merger of the Financial Planning Association of Australia Limited (FPA) and the Association of Financial Advisers Limited (AFA), two of Australia's largest and longest-standing associations of financial planners and advisers. The FPA was a professional association formed in 1992 as a merger between The Australian Society of Investment and Financial Advisers and the International Association of Financial Planning. In 1999 the CFP Professional Education Program was launched. As Australia's largest professional association for financial planners, the FPA represented the interests of the public and (leading into the merger) over 10,000 members. Since its formation, the FPA worked towards changing the face of financial planning, from an industry to a profession that earned consumer confidence and trust, and advocated that better financial advice would positively influence the financial wellbeing of all Australians. The AFA was a professional association for financial advisers that dated back to 1946 (existing in various forms and under various names). The AFA was a national membership entity that operated in each state of Australia and across the full spectrum of advice types. The AFA had a long history of advocating for the best interests of financial advisers and their clients, through working with the government, regulators and other stakeholders. The AFA had a long legacy of operating in the life insurance sector, however substantially broadened its member base over a number of decades. The AFA had a strong focus on promoting the value of advice and recognising award winning advisers over many years. The AFA had strong foundations in believing in advocacy for members and creating events and other opportunities to enable members to grow and share best practice.

We would welcome the opportunity to discuss with FRAA the matters raised in our submission. If you have any questions, please contact me on 02 9220 4500.

Yours sincerely

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FINANCIAL ADVICE ASSOCIATION AUSTRALIA

Draft Financial System and Regulator Metrics Framework

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Assessing Regulator oversight of individual professionals

The FRAA's metric framework must consider and support the structure of the financial advice market and licensing regime.

Financial advice is regulated under the Corporations Act 2001 as 'financial product advice'. A financial planner/adviser must either hold an Australian Financial Services Licence (AFSL) or provide financial advice as a representative of an AFSL holder (a licensee).

A financial planner/adviser must meet the legislated requirements to become a 'relevant provider', be authorised to provide personal financial advice by a financial services licensee and be registered on the ASIC Financial Adviser Register (FAR).

The Corporations Act requires 'relevant providers' to meet education and professional standards determined by the Minister. Compliance with the legislated professional standards is monitored by a single disciplinary body established within ASIC.

However, the proposed framework does not include metrics for assessing the effectiveness and capability of ASIC in relation to its role in the oversight of professionals and professions.

Given the government's commitment and agenda to improving the accessibility and affordability of financial advice for Australian's, it is imperative that ASIC's performance in supporting and monitoring financial advisers/planners is appropriately assessed under the new metrics framework.

The FAAA recommends the FRAA framework include the following metrics:

- Outcome: Markets are Competitive
    - the number of financial advisers. If there are not enough financial advisers to meet consumer needs, then the market will be uncompetitive.
    - Share of market (institutional providers; super funds; large licensees, medium and smaller licensees) - include measure of number of advisers (e.g. not enough to service consumers means inefficient, uncompetitive market) and number of licensees (e.g. percentage of advisers in 10 largest licensees could indicate lack of competition)
- Outcome: New entrants are able to enter financial markets efficiently while meeting entry requirements
    - All metrics for this outcome are based on the licensing of an entity. Similar metrics are required in relation to the registration of individual professional financial planners/advisers, as required under the Corporations Act.

Single disciplinary body and Financial Services and Credit Panel (FSCP)

As previously mentioned, financial planner/adviser compliance with the legislated professional standards is monitored by a single disciplinary body established within ASIC. Under the Corporations

Act, ASIC, as the secretariat to the body, has the power to convene an FSCP Panel to consider conduct issues involving individual financial planners/advisers.

The proposed framework does not include metrics for this separate and distinct function and responsibility within ASIC. The establishment of the single disciplinary body was recommended by the Hayne Royal Commission (2019) and provides critical regulatory oversight of the profession.

A framework to assess the effectiveness and capability of ASIC must be complete and encompass all aspects of the Regulator's oversight of the financial services system.

The FAAA recommends the framework include appropriate metrics for all outcomes to assess the effectiveness and capability of the financial advice single disciplinary body function within ASIC.

Wholistic approach

As suggested in the proposed metrics, it is vital that a framework for assessing the effectiveness and capability of regulators goes beyond a measure of the enforcement activity it has undertaken.

The FRAA's metrics framework should also assess:

- what ASIC is not doing. For example, misconduct referred to/reported to ASIC by its regulated community and professional bodies that is not actioned, responded to, or investigated by the Regulator. Capturing and measuring conduct reports left unaddressed by ASIC is vital to holding the Regulator to account and enabling government to make informed policy and budget decisions to ensure ASIC is appropriately resourced and prioritised to provide effective oversight of financial system participants to protect consumers and the economy.

- how ASIC prioritises its activity. Recent information from the ASIC Funding Model indicates that in 2022/23 ASIC spends $55.5 million on financial advisers who provider personal advice to retail clients, and only $35,000 to licensees who provide personal advice to wholesale only clients. The standards that apply in the wholesale only client sub-sector are much lower, creating substantially greater risks. This distorts the market and creates a very real risk that issues in the wholesale only client space are being missed.

- how well ASIC engages with its regulated community to gather intelligence on potential misconduct. The marketplace is a great source of intelligence, that might not be being fully utilised.

- the timeframes within which ASIC a) investigates reports of misconduct and unlicensed activity; and b) takes action with respect to misconduct and unlicensed activity. Common examples raised by our members include, significant delays in ASIC taking action against Storm Financial, Dixon Advisory, and reports made to the Regulator of banned or unlicensed individuals providing financial services to consumers[2].

[2] Confidential information can be provided to the FRAA on request.

- if ASIC achieves an appropriate balance between prevention and cure. The FRAA's analysis and assessment of ASIC should consider the appropriateness of the Regulator's allocation of its resources. For example, the ASIC Supervisory Cost Recovery regime permits ASIC to recover the cost of its regulatory activity. In 2022/23, for the 'licensees that provide personal advice to retail clients on relevant financial products' subsector, ASIC spent $1.82m on the preventative measures of industry engagement, guidance (to industry) and education (consumer focus), compared with $28m of direct costs on supervision, surveillance, and enforcement. While the FAAA commends ASIC for its recent efforts to improve industry guidance via clear web-based information sheets, anecdotal feedback from FAAA members indicates frustration resulting from the level of assistance received from ASIC in response to enquiries about financial advice regulatory requirements and the clarity of regulatory guidance. An appropriate stakeholder feedback mechanism that includes qualitative and quantitative information from ASIC's regulated population would provide valuable insights on these core preventative regulatory activities.

- whether ASIC's oversight and other activity is effective enough to change the priorities, culture and behaviours of a sector. Effective engagement is critical in driving change.

Consideration should be given to aligning with the categories of regulatory expenses required under the ASIC Supervisory Cost Recovery regime to leverage existing ASIC systems and processes to capture data appropriate for assessing the effectiveness and capability of the Regulator, where appropriate.

Regulator transparency

The FRAA consultation paper states:

> *"The wide range of institutions that influence financial system outcomes provides a further challenge to assessing the impacts of APRA and ASIC's activities." (page 10)*

Whilst this is true in many instances, enforcement is an area where it is possible to provide some certainty. Consumer damage through financial misconduct is assessable. The damage caused by individual actors whose activities ASIC have disrupted is assessable. This regulatory enforcement activity can then be aggregated to give an annual figure for damage curtailed/rectified, as a proportion of the wider consumer harm caused by financial misconduct. This then gives a measure which could be used in conjunction with other metrics to assess wider Regulator performance.

However, it is important for ASIC to publish more detail around its regulatory activity, particularly its enforcement process. Failure to do this currently presents a large and ongoing barrier to objective public assessment of the rigour of ASIC's enforcement activities and leaves ASIC open to the perception that it under enforces on these matters.

Where ASIC is currently developing metrics for assessment, we would encourage the Regulator to undertake an open development process including public consultation, and to commit to ongoing publication of the data it gathers through those metrics.

As stated in the FRAA consultation paper:

- "*ASIC uses a risk-based approach to direct its resources to address the areas of greatest harm to consumers, investors and markets. ASIC is not resourced to investigate every instance of alleged misconduct that comes to its attention, and so must make difficult choices and prioritise its regulatory and enforcement actions to ensure it has the greatest impact on the most serious harms within its remit*".[3]

To ensure public confidence that ASIC is making these judgements appropriately, the FAAA suggests the Regulator publish its criteria for identifying and reviewing instances of alleged misconduct for further investigation, allowing public evaluation of its approach to implementing its priorities.

Information Sheet 151 details ASIC's approach to enforcement. To improve transparency, ASIC should publish details of information gained at each of the steps of its approach to enforcement[4], including:

- The number of instances of alleged misconduct it identifies
- The means/source of identification (see *step 1 of table 1 of the attachment to INFO 151*)
- The categories of issue identified (see *step 4 of table 1 of the attachment to INFO 151*)
- Specific details about the misconduct including:
  - Type of product
  - Type of firm
  - Type of misconduct/area of failing/breach
  - Whether entity/person was a Regulated/unregulated actor
  - Estimated average cost to impacted consumers
  - Numbers of impacted consumers
- Number of reports ASIC reviewed/assessed to establish if further investigation was warranted
- The process by which these decisions are reached
- The number ASIC then investigated

The FAAA recommends that all data (suitably anonymised) is published to allow the effectiveness of the regulators to be publicly assessed and to maintain public confidence in the financial system.

The framework should include metrics to utilise this data. Critically, the metrics should cross-check the 'number of reports ASIC reviewed/assessed to establish if further investigation was warranted' and the 'number of reports AISC then investigated'. For example:

- Outcome: Participants are confident in the financial system
    - Number of complaints lodged with, but not investigated by ASIC
    - *ASIC responsiveness to complaints of market conduct could be an important factor in maintaining public confidence and informing government resourcing of the Regulator*

[3] Page 12/13
[4] https://download.asic.gov.au/media/wrdetvvx/attachment-to-info151-published-22-november-2021.pdf

ASIC should be required to collect and publish data annually under the FRAA metrics framework, even though the FRAA is only required to undertake a review of the regulators every 5 years[5]. This will improve the transparency of ASIC's work.

Targets

The consultation paper states:

> *"The FRAA has not developed targets for metrics. Setting targets poses challenges alongside the complexity of APRA and ASIC's statutory mandates, stated objectives and activities, and the variety of ways regulatory activity may influence financial system outcomes. The FRAA has not developed other benchmarks or international comparisons for the metrics, but is open to exploring this in the future."* (Page 15)

There is concern that the proposed framework and the additional accountability and transparency it will force upon the regulators may create pressure to increase interventions, where such action is not required or would be excessive. The regulators should be encouraged to use their powers appropriately and proportionately to the risks faced.

In the consultation paper, the FRAA proposes Fairness as a characteristic of a well-functioning financial system. A proposed outcome of this characteristic is the "regulators identify and act against misconduct", with the following metrics applicable to ASIC:

- Surveillances completed
- Enforcement activity
- Enforcement timeliness
- Enforcement prioritisation
- Enforcement efficiency measures
- Enforcement results
- Surveillance efficiency

All enforcement action undertaken by the regulators must be justifiable, appropriate action (as opposed to excessive). Fairness must apply to all participants of the financial system (e.g. consumers and financial services providers).

A focus of the metric framework must be to ensure a proportionate regulatory response is applied appropriately and that ASIC applies the principle of fairness to all parties of an investigation. Care must be taken to ensure the metric framework does not lend itself to a culture of target-driven enforcement activity.

The FAAA does not support the FRAA introducing regulator enforcement focussed performance targets as part of the metric framework.

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5 As part of the Federal Budget 2023, the government reduced the frequency of FRAA reviews from every two years to every five years

Efficiency characteristic

The consultation paper proposes the following outcomes for the efficiency characteristic:

1. Markets are competitive
2. New entrants are able to enter financial markets efficiently while meeting entry requirements
3. Finance is available

As stated by the Australian Law Reform Commission (ALRC):

> *"Legislative change is an inherent and desirable feature of legislation. But change also has consequences. The statute book is 'an ever-evolving network of complex information that expands organically and is extremely difficult to map'. This difficulty is exacerbated when legislation is amended regularly in a way that does not make clear how existing and new legislation fit together. Frequent amendment also results in changes to the existing 'scheme structures' which makes both the 'legislative and procedural arrangements' associated with the law more complex."*[6]

As the history of regulatory reform shows, since the introduction of the Financial Services Reform Act 2001 there have been constant and significant changes to the laws and regulations applicable to the provision of financial advice. This has led to the regulations of today being an excessive set of requirements that are expensive to meet, compliance-driven, and difficult to navigate. Guidance from the Regulator is vital for facilitating understanding of and compliance with financial advice regulatory requirements.

This regulatory change will continue with the pending implementation of the Quality of Advice Review recommendations, and the pending Final Report from the ALRC review.

An appropriate metric framework must measure how effective ASIC is in supporting industry through regulatory change. This is a key determinant in the sector remaining both efficient and compliant.

The FAAA recommends the FRAA metric framework include an additional efficiency outcome - *Standards and regulatory guidance supports efficient and confident operations by licensed entities*.

The FAAA would welcome the opportunity to work with the FRAA to identify appropriate measures for this outcome.

The FAAA notes the following proposed metrics for the Outcome - New entrants are able to enter financial markets efficiently while meeting entry requirements:

- Percentage of regulated entities in Supervision Risk and Intensity (SRI) Stage 3 with licence granted within the last 2 years

- Number of licensees subject to a public complaint (i.e., a report of misconduct) or ASIC regulatory action within 2 years of licence being granted

[6] Australian Law Reform Commission, Background Paper FSL2: Complexity and Legislation Design, October 2021, page 28

The FAAA suggests that metrics for new entities who were granted their license in the last two years and are the subject of a complaint or regulatory action, should be extended to new entrants who were granted their license in the last five years. Often problems emerge more slowly.

Fairness characteristic

The consultation paper includes the following proposed outcomes for the characteristic of Fairness.

- Market participants adhere to standards of integrity and fairness
- Regulators identify and act against misconduct
- Where consumers suffer loss or harm because of misconduct, they can secure redress

These proposed outcomes focus on the conduct of market participants. However, the characteristic of Fairness must apply to all stakeholders.

Regulators are tasked with oversight of the laws enacted by Parliament to protect consumers and the financial system. This bestows on them a responsibility to ensure actions they take do not have unintended consequences or create undue risk. The metrics framework should reflect this responsibility.

For example, APRA's individual disability income insurance (IDII) intervention (2019 – 2021) increased the risk of the following consumer detriments:

- The change in the definition of income at risk for clients who have variable incomes (such as farmers), resulted in some clients being unable to fully insure themselves.

- The risk of being in a product that was closed as a result of the IDII intervention, which was subject to a much great exposure to premium increases (as has occurred since the intervention), when they were unable to move to a newer product due to health issues.

- Increased difficulty in accessing life insurance advice as a result of a range of reforms impacting the merits of remaining a risk adviser (Life Insurance Framework, Professional Standards reforms and the IDII Intervention).

The FAAA recommends an additional outcome for the characteristic of Fairness - Regulatory intervention does not unnecessarily place consumers in market segments at increased risk.

We would welcome the opportunity to work with the FRAA to develop appropriate metrics for this suggested fairness outcome.

AFCA complaints data

The FRAA have proposed the following AFCA metrics for the Outcome: Participants are confident in the financial system:

- *Proposed metric - Annual percentage change in complaints to AFCA regarding financial firms*

  "The trends in this metric are a potential proxy for the perceived degree to which service providers act with integrity and fairness. An increasing percentage might signal growing consumer discontent with industry practices. It should not be taken as a perfect indicator, however, an increase in complaints may indicate greater consumer awareness of their rights, rather than necessarily an increase in the level of misconduct."

There are many variables that may impact AFCA complaints data that would warrant a cautious approach to this metrics:

a. AFCA data cube - AFCA's product classification system is a key component to ensuring its complaints are categorised appropriately to enable the reporting of complaints data in a manner that is user-friendly and makes sense to all stakeholders, particularly consumers. We are concerned that financial advice is classified under AFCA's classification system as 'wealth management' or 'investment services'.

   However, consumers do not seek out 'wealth management' or 'investment services' (terms used by AFCA), rather consumers seek financial advice. Similarly, financial advice may or may not include the provision of wealth management or investment services. From a consumer's perspective, the "channel through which the consumer purchased the products or services" (as per the AFCA Operational Guidelines wording) is not wealth management or investment services; it is financial advice. ASIC's FAR and information on its consumer website, MoneySmart, refers to financial advice and planning. It does not use the term 'wealth management' or refer to financial advice as 'investment services'. Similarly, the AFSL issued by ASIC authorises the licensee to 'carry on a financial services business to…provide financial product advice'. It does not authorise the licensee to provide wealth management or investment services. Representatives are also authorised to provide general or personal financial advice.

   The use of different definitions and language by different oversight bodies (that is, ASIC's FAR listing and AFCA product classification system) creates confusion for both consumers and industry.

   Complaint classification that is unclear and inconsistent with consumer and industry understanding and expectations, and other regulatory categorisations, risks tainting the data available under this metric.

   Consistency is key to enhancing consumer understanding and navigation of Australia's complex financial system and the protections within it. Adopting the existing financial advice definitions commonly used within the industry (processes and systems) and by ASIC can assist with simplifying the system for consumers, government and industry and improve the quality of data available to FRAA for assessing the effectiveness and capability of ASIC.

b. The cause of an increase in the number of complaints - This data is at risk of being meaningless if it is done in aggregate as a blowout in a small number of entities could distort the results, even at an overall total level. An aggregate increase in complaints could be the result of a systemic issue at one provider, or a natural disaster, rather than a reflection of consumer sentiment. This was the case in relation to Dixon Advisory, Sterling Trust, and general insurance claims after the floods, for example.

c. Provider behaviour - A falling percentage may indicate firms being better able to negotiate the system to prevent complaints arising or escalating, without necessarily resolving core issues. It is important that ASIC undertake qualitative checks as part of its assessment/supervision, to ensure that firms are continuing to properly rectify matters, rather than simply seeking swift neutralisation. The framework could include a metric of ASIC's oversight of parties to a complaint following an AFCA determination to ensure core issues are addressed.

d. Complaints process – The AFCA complaints process includes several stages at which a complaint may be resolved. This is clearly demonstrated in the AFCA Datacube however, it may impact on aggregate data.

The FAAA suggests a cautious approach is needed for the use of aggregate AFCA data out of context.

- *Proposed metric - The share of AFCA complaints decided in favour of the consumer*

This provides important contextual information as to how firms are handling complaints and whether they are meeting their obligations in any offers of consumer redress made.

Given the introduction of the 'notify, investigate and remediate' obligations under the reportable situations regime[7], over time it would be expected that the proportion decided in favour of the consumer would decline, as firms get better at addressing issues when raised, and preventing issues arising in the first place, leaving a greater proportion of complaints in the pool that AFCA reviews.

An increasing trend in the numbers that are decided in the complainant's favour would indicate that firms are failing to meet their obligations in this space, which might in turn lead to questions about (for example) ASIC's industry engagement and education or supervisory activity.

The FAAA supports this metric.

Outcome – Participants are confident in the financial system

The consultation paper also includes the following proposed metrics for this outcome:

- Average observed financial wellbeing score
- Investors trust in financial services (CFA survey)
- Edelman Trust Barometer

It is important to consider consumers' expectations and perceptions of the level of confidence they can have in the actors they will encounter when accessing the financial system. These metrics are a partial measure of a strong culture of enforcement and regulation by ASIC. They are also consistent with ASIC's object, as defined in the ASIC Act, to promote confident and informed participation of

[7] Sections 912EA, 912EB, 912EC of the Corporations Act

investors and consumers in the financial system. ASIC's actions can both support the achievement of this object, but also in certain cases, through media commentary, undermine it if they cause undue concern amongst consumers.

The FAAA is supportive of these metrics as part of a package of assessment tools that rely on the strong culture of enforcement and regulation by ASIC.

Metric - Surveillances completed

The FRAA proposes the following metric to assess the Outcome: Regulators identify and act against misconduct:

> *Surveillances completed - The number of surveillance activities completed by ASIC.*
>
> *An increase may indicate that ASIC has increased its overall surveillance activity. Surveillance is an important part of ASIC's regulatory toolkit, allowing ASIC to identify potential misconduct or harm, understand and influence behaviours, and drive compliance. ASIC's surveillance is constrained by resource availability and targeted in nature, so a linear increase year on year would not necessarily be feasible or necessarily provide insight on the effectiveness of ASIC's surveillance function or appropriate targeting of matters undertaken.*[8]

The FAAA suggests that ASIC provides contextual information and not just raw data to satisfy this proposed metrics. This metrics should consider the following matters which can influence the data:

- ASIC's criteria for assessing which issues should be reviewed more closely
- the levels of scrutiny ASIC apply and the instances at each level of scrutiny
- Which issues are drawing the most resources
- ASIC's categorisation of issues identified through surveillance and the numbers of issues in each category

The following are all areas where ASIC is listed as developing metrics and it is important that ASIC and FRAA consult publicly about the construction of these. The data once gathered should be made publicly available on an ongoing basis.

- Enforcement prioritisation
- Enforcement efficiency
- Surveillance efficiency

Life insurance

Financial planners/advisers help clients select and implement life insurance products appropriate for the clients' needs and circumstances. Planners/advisers also commonly assist clients with life insurance claims.

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[8] Page 22 of the consultation paper

The FAAA provides the following recommendations to strengthen the assessment of the effectiveness and capability of the regulators oversight of the life insurance market under the metrics framework:

- Outcome - Markets are Competitive – include an appropriate metric related to life insurance premium increases. High premium increases, as we have seen in recent years, is a sign of market failure. This might be in response to profitability problems (i.e. IDII) caused by either increasing claims, inaccurate assumptions, poor risk assessment and excessive levels of competition. In responding to these profitability issues, life insurers may move to an approach at the other end of the spectrum that demonstrates a lack of competition.

- Outcome - Finance is available – measuring the ratio of 'new life insurance business' against 'in-force life insurance business' would provide a clear indicator of the distribution of life insurance and potential pressure on life insurance companies impacting their long term viability. Inadequate new policy holders means that there is a lack of new younger lives coming into the risk pools, resulting in an aging of the pool, and putting greater pressure on the overall life insurance book. The overall framework needs to be supportive of sufficient distribution to avoid an excessive build up of risk in these insurance pools. A fall in new business, as we have seen in recent years, largely as a result of a substantial decline in financial advisers, is a clear sign of risk.

- APRA already produces statistics on the ratio of claims to premiums. These ratios are broken down by insurance lines in order to test for fundamental problems in the market and identify business/product line weaknesses. This was a factor leading to APRA's intervention into the IDII market. Competition might exist at company level, but not within business lines - business lines may be failing. Thus we recommend that the underwriting result metric looks at both individual insurers and also at market wide product line results.

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