FINANCIAL ADVICE ASSOCIATION AUSTRALIA

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Committee Secretariat
Select Committee on Productivity in Australia
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Canberra ACT 2600

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Dear Committee Secretariat,

Senate Consultation – Productivity in Australia

The Financial Advice Association of Australia[1] (FAAA) welcomes the opportunity to provide feedback to the Select Committee on Productivity in Australia on issues with respect to productivity in the financial advice sector.

It is our view that the financial advice sector is an ideal case study of how regulation and regulatory reform can undermine productivity and whilst much of the change in recent years was driven with a view to boosting consumer protection, ultimately a material proportion of it has done very little to achieve that outcome, and instead resulted in financial advice becoming significantly less available and much more expensive.

The FAAA strongly supports the need for consumer protections when it comes to financial services and financial advice in particular. We are not opposed to consumer protections, however they need to be both effective and deliver more benefit to consumers than they cost.

The financial advice sector has been subject to a long running and extensive program of regulatory reform in the last 15 years, including the following major reforms:

- June 2012 – Future of Financial Advice reforms
- February 2017 – Life Insurance Framework reforms
- February 2017 – Professional Standards of Financial Advisers reforms
- 2019 – 2021 – various Banking Royal Commission reforms
- June 2023 – Compensation Scheme of last Resort reform

[1] The Financial Advice Association of Australia (FAAA) is the largest association representing the financial advice profession in Australia, with over 10,000 members. It was formed in 2023 following the merger of the two leading financial planning/advice bodies in Australia – the Financial Planning Association (FPA) and the Association of Financial Advisers (AFA). With this merger, a united professional association that advocates for the interests of financial advisers and their clients across the country was created.

- July 2024 – Delivering Better Financial Outcomes reforms

The financial advice profession has also been subject to a range of broader reforms that have caused a significant impact, including the legislation related to the introduction of the ASIC Funding Levy in 2017.

Whilst this long list of reforms was undoubtedly well intentioned, the consequences have been substantial. The number of financial advisers in Australia has declined by 48% since the start of 2019 and the cost of financial advice has doubled in this timeframe. In this submission, we will set out some examples to assist in understanding the consequences of regulatory reforms that often fail to fully consider the implications and often lack any focus on the impact that it will have on productivity.

The Australian Law Reform Commission undertook a multi-year exercise - “Review of the Legislative Framework for Corporations and Financial Services Regulation”. In the final report in late 2023, they found that the Corporations Act 2001 (Cth) and related financial services legislation are a "tangled mess" of "tortuous," "labyrinthine" laws that are costly to comply with and difficult to enforce. There can be no stronger reference to the negative impact of the financial services regulatory regime on productivity.

One of the factors that is most evident in these major reforms to the financial advice regulatory regime is the lack or inadequacy of the necessary regulation impact assessment. The Banking Royal Commission reforms stand out as an absolute low point in this regard, where often no regulation impact statement was undertaken at all, on the grounds that the Royal Commission was considered to be akin to a regulation impact statement. This is despite the fact that the Royal Commission undertook no obvious assessment of the impact of their recommendations even though the Letters Patent included a specific reference to doing so. Regrettably, during this period of time, the focus on this dimension of good regulatory change governance was missing.

We make the point that it is very difficult to fix drafting mistakes. Our experience is that even those drafting errors that are acknowledged early, can take at least a couple of years to fix. Removing ineffective legislation is another level of complexity and can take a decade or more to be addressed. It is so important that legislative change is appropriate and correct at the time it is legislated, rather than needing to be fixed up later.

One recommendation that we have is that too often the solution to a new occurrence of misconduct is to undertake a review and then put in place additional prescriptive regulatory obligations. One alternative pathway to further legislation, which we believe deserves further consideration, is a greater focus on co-regulation or self regulation. The principles can be in the legislation. In some cases, we believe that there is merit in the implementation being delegated to the profession, where appropriate governance models can be employed. It is necessary to consider a range of options to solve a problem, including issues with respect to inadequate consumer protections. We should not always seek further regulatory change, rather than consider self regulation options.

In the following section we have addressed some failings in the more recent key financial advice reforms.

FAAA Feedback

Future of Financial Advice Reforms

The Future of Financial Advice reforms represented a fundamental set of reforms following the Global Financial Crisis that significantly elevated the financial advice sector into being recognised as a profession. Reforms such as the banning of conflicted remuneration and the introduction of a best interests duty had particular merit. Other elements of the reforms had more negative impact on the productivity of the profession with little improvement to consumer protection. One of these changes was the introduction of an obligation for financial advisers to provide an annual Fee Disclosure Statement and to get all new clients to renew their ongoing fee arrangement every two years. Whilst there was strong justification in seeking to avoid what became known as “fee for no service” conduct issues, the solution ultimately turned out to be particularly effort intensive and costly for clients. This problem was further complicated by the recommendation of the Banking Royal Commission that renewal of ongoing fee arrangements should apply to all clients on an annual basis and that clients should also be required to sign fee consent forms each year that were sent to the product providers. There was no consideration of how this could be done electronically.

There was an important consumer protection issue that generated the need for reform in this space, however what was put in place was particularly labour intensive and not the least bit client friendly. As an outcome, some clients could end up signing half a dozen forms each year. The inefficiency of this arrangement was recognised during the 2022 Quality of Advice Review and as a result the 2024 Delivering Better Financial Outcomes (DBFO) reforms removed the need to do Fee Disclosure Statements, leaving the need to get clients to sign ongoing fee arrangements and client consent forms each year. A further complication was introduced in these 2024 DBFO reforms, in the requirement to include an account number on the fee consent form, however the account number may not be known at the time of commencement of the fee consent arrangement and may change during the course of a year, should a client transition from accumulation to pension phase or undertake a pension refresh for example. The legislation allows for the Minister to mandate a standard fee consent form, which would have assisted with efficiency by avoiding different processes for each product provider, however the Minister never enacted this mandatory standard form. Thus, in an area that has no competitive advantage, the entire financial services industry is left to follow complex effort-intensive processes that deliver very questionable benefit to consumers. This is an example of regulatory reform that has been thrust onto the entire profession, when its purpose was to address misconduct that occurred in respect to a very small percentage of the advice sector. This is now an ongoing obligation, despite the underlying issue having largely been fixed. Other solutions should be considered.

Life Insurance Framework

The 2017 Life Insurance Framework reforms introduced a cap on the payment of commissions for advice on life insurance business. In effect, this reduced the upfront commissions from as high as 120% (plus GST) of the initial year's premium to 60% (plus GST), which was introduced under a transitional arrangement between 1 January 2018 and 1 January 2020. This is the only form of commission that is still permitted in retail financial advice. The payment for risk advice by means of a commission remains the most popular option for risk clients, as it reduces the cost in the first year, means that they do not need to pay a high fee if they are ultimately unable to get suitable insurance cover and enables access to support and advice from their adviser at the time of claim, should an insurance event affect them.

The outcome of this reduction in life insurance commissions has seen a substantial decline in the number of financial advisers providing life insurance advice and a more than halving of new life insurance business through financial advisers. One of the consequences of this reform is that it is no longer possible to economically provide advice to younger clients, who will pay lower premiums and therefore generate lower commissions. Since the cost to provide financial advice has increased so significantly in this time, the end outcome is that younger Australians now have substantially less access to financial advice to put their life insurance arrangements in place. APRA data shows that the number of Australians with advised life insurance death cover has declined by 37% since the middle of 2018. During this period, premiums have increased substantially. Arguably these reforms have only created greater problems for the life insurers and consumers.

Professional Standards for Financial Advisers

The FAAA strongly supports the process to professionalise financial advice. This process has played out over many years, however received a substantial impetus with the 2017 Professional Standards for Financial Advisers reforms. These reforms introduced additional requirements, including a degree standard, an exam, a professional year, a code of ethics and a legislated continuing professional development standard. To set the standards and to oversee these reforms, the Government established a new body which was known as the Financial Advisers Standards and Ethics Authority (FASEA). FASEA existed from April 2017 through to the end of December 2021. The FASEA Board included consumer representatives, industry representatives, an academic and an ethicist. This Board was in place during the time of the Banking Royal Commission, which generate a lot of media attention and set expectations for further reforms. The prevailing environment and the strong consumer representation led to some particularly challenging standards being set by FASEA. One of these was the education standard that applied to existing financial advisers. The standard, that was set in late 2018, was an eight subject Graduate Diploma, with some provision for exemptions for prior relevant study. In many cases, this left advisers in their 50s and 60s, with 20 or 30 years of experience, facing the prospect to doing two years of study to simply continue doing what they had been doing for decades. This is despite the Explanatory

Memorandum to the Bill describing how ongoing CPD could be taken into account. It was FASEA who chose to set such a high standard, that put the future of so many at risk. The law did not require this.

The current Government took action to address this in 2023 by legislating for an Experienced Adviser Pathway, that was based upon 10 years of experience across the 15 year period to the end of 2021 and a requirement to have a clean track record. For those who met these criteria, no further study was required. Many who would have been eligible for this pathway had already commenced or even completed their study by the time it was legislated. This was hugely frustrating for them as they had incurred a significant cost and consumption of time to achieve something that was no longer required. It is very regrettable that this change in approach was required so late in this important transition period. Ideally, FASEA would have adequately allowed for consideration of experience at the commencement of this process. This is clearly one area where a greater utilisation of existing expertise was appropriate. We would argue that this was one area where self-regulation would have been much more beneficial.

Royal Commission Reforms

Whilst there are many of the reforms that emanated from the Banking Royal Commission recommendations that are worthy of discussion, the one that we feel is most relevant in this context of productivity, is the changes that were made to breach reporting. Breach reporting in financial services is a matter of firms self-reporting their breaches to ASIC. Prior to the Royal Commission changes, Australian Financial Services Licensees (AFSLs) were required to report “significant” breaches. This arrangement limited breach reporting to more material matters and not every single breach of the law. The concern by some stakeholders at the time was that the breach reporting obligations were not being treated in a consistent manner and some entities were late in reporting.

The changes that were made as a result of the Banking Royal Commission not only resulted in much more granular reporting, however also added substantial complexity to the requirement. At the core of the new obligation was a requirement to report all civil penalty provision matters, however a regulation was issued that exempted certain civil penalty provisions from being reported. There are other complex elements in the law that need to be considered to assess if a breach report is required. From what had been a principle-based piece of law, the new breach reporting (reportable situations) obligation had become incredibly complex and much more granular, resulting in the need for small AFSLs to seek legal advice before submitting a breach report. This was entirely counter-productive, as rather than improving consistency in reporting, it increased the disparity between larger better resourced organisations and smaller entities, who were more reliant upon external advice. It also added to the cost of running an AFSL.

A further component of the breach reporting reforms was the introduction of an obligation for AFSLs to report financial advisers from other licensees where the AFSL became aware of a reportable matter by a financial adviser from the other licensee. Whilst improved reporting of serious misconduct is something to be supported, this was a matter of reporting at a granular level. Financial advice licensees and financial

advisers may observe breaches of the law when they meet a new client who provides a copy of a Statement of Advice provided by a previous adviser or where a licensee undertakes an audit of client files as part of the due diligence process when deciding to appoint an adviser who is transferring from another licensee. Where this law became totally counterproductive was the inclusion of an obligation for the reporting entity to provide a copy of the report to the entity that they were reporting. This is a huge disincentive for reporting the other entity, particularly where the matter might be relatively minor.

Overall, the changes to breach reporting have been counterproductive. ASIC get too many reports for them to action, and they should instead be receiving reports with respect to material breaches that warrant investigation, not thousands of relatively minor matters which they will never investigate. From an AFSL perspective, this has added significantly to the cost, including the need to seek advice from a lawyer to assess if a relatively minor matter fits within the complex criteria defined by the new law. More recently ASIC have sought to provide further relief to reduce the circumstances when breach reporting was required. This is positive, however this mess could have been avoided if the reforms had been more sensibly designed and positioned in the first place.

Compensation Scheme of Last Resort

The Compensation Scheme of Last Resort (CSLR) was legislated in June 2023 to enable the payment of compensation to clients who have obtained a determination from the Australian Financial Complaints Authority (AFCA), however the firm responsible for payment has gone into liquidation. A Treasury consultation paper from July 2021 suggested that the ongoing cost of the CSLR to the financial advice sector would be in the vicinity of $6.2m per year. The latest conservative estimate by the CSLR operator for the financial advice sector for the 2026/27 financial year is $126.9m. This figure is 20 times the original estimate, however it does not include claims for Shield and First Guardian, so the true cost is likely to end up being much higher.

Financial advice is one of four sectors that are covered by the CSLR. Other financial services sectors, such as Managed Investment Schemes (MIS), are not captured, despite the fact that they have contributed significantly to consumer losses in many recent cases. As a result, in order to access compensation, where losses result from the collapse of an MIS, it is essential that the client is able to demonstrate that they received financial advice and that this advice failed to meet the requirements of the law. A further complication exists in that the law does not allow for client loss to be attributed to any other contributing party where financial advice was involved. Financial advisers are therefore held responsible for 100% of the loss. The AFCA rules also prevent them from considering a complaint against the management of a fund or scheme as a whole. As a result, all these client complaints are pointed in the direction of the financial advice sector in order to be eligible for compensation from the CSLR. The Shield and First Guardian matters involved failings across the entire financial services value chain, however it is only where poor advice was involved that claims will be paid. The CSLR is funded by industry and as a result, it is the financial advice sector who will contribute the most to fund claims against insolvent firms.

This is both unjust and unreasonable and represents a significant financial burden on the mostly small business owners that make up the majority of the financial advice sector.

The FAAA is supportive of a compensation scheme of last resort for consumers in situations where a determination from AFCA has not been paid. However, the cost of the CSLR poses a major threat to the financial advice profession, providing a reason for older advisers to retire early and for potential new entrants to avoid joining the profession. This is all counter to the productivity of the financial advice profession and likely to reduce the number of advisers and increase the cost of financial advice to consumers.

Other Feedback

The FAAA is unable to provide any input on Terms of Reference items a, b, d, e, f, i, and j.

We believe that productivity improvement in the financial advice sector can come from both regulatory change, as discussed in detail above and through improved use of technology. The provision of financial advice is dependent upon being able to compile a full understanding of the client's position. A meaningful proportion of this information is held by the Australian Government, either through the ATO Portal, Centrelink portals or the Consumer Data Right. Despite the financial advice profession long having argued that as recognised tax advisers, we should have access to the ATO Portal, this has not yet been provided. This access would make a meaningful difference to the cost and efficiency of providing financial advice and would reduce the risk of providing poor advice. The Consumer Data Right may well be more useful for financial advisers in the future, should it eventually contain information on superannuation, insurance and investments. AI is already an important factor in improving the productivity in financial advice practices. This can be expected to continue to contribute to efficiency improvements.

The regulatory tax burden factors most directly confronting the financial advice profession, as opposed to other businesses, is the exposure to the ASIC Funding Levy and the CSLR Levy. In the 2026/27 financial year, both of these levies are likely to be in the vicinity of $3,000 each per financial adviser. This is a particularly material cost that will impact the cost of financial advice to retail clients and as discussed above lead to a reduction in the number of financial advisers.

Financial advice is not subject to overseas competition in any material sense, as financial advice to retail clients in Australia must be provided by a person who has met the Australian professional standards and has been registered with ASIC. Other persons cannot legally provide financial advice to Australians living in Australia.

Conclusion

The FAAA welcomes the opportunity to provide feedback to the Select Committee on Productivity in Australia. We have specifically sought to explain the substantially negative impact of over-regulation and inappropriate regulation to the financial advice profession.

If you have any questions about our submission, please do not hesitate to contact me on (02) 9220 4500 or phil.anderson@faaa.au.

Yours sincerely,

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