Association of Financial Advisers Ltd
ACN: 008 619 921
ABN: 29 008 619 921
PO Box Q279
Queen Victoria Building NSW 1230
T 02 9267 4003 F 02 9267 5003
Member Freecall: 1800 656 009
www.afa.asn.au

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Adviser and Brokers Unit
Financial System Division
Treasury
Langton Crescent
Parkes ACT 2600

By email: SDBconsultation@treasury.gov.au

Financial Sector Reform (Hayne Royal Commission Response—A New Disciplinary System for Financial Advisers) Bill 2021

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 75 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

With the exception of Independent Directors, the Board of the AFA is elected by the Membership and Directors are practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

We thank you for the opportunity to provide feedback on the exposure draft Financial Sector Reform (Hayne Royal Commission Response - A New Disciplinary System for Financial Advisers) Bill 2021.

The AFA supports the introduction of a pragmatic disciplinary system and one where the disciplinary body has access to a broader range of penalties in order to take action in situations that don't warrant a banning. Finding the right solution is a fine balancing act, however we fear that this Exposure Draft legislation has not got that balance right.

The AFA has been very vocal about our concerns with the new breach reporting regime that was introduced as part of the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020. In our view, this will lead to an exponential increase in matters reported to ASIC for financial advice licensees. We are concerned that the same outcome, or an even more unmanageable outcome will result from the current

proposal for the introduction of the Single Disciplinary Body. In this case, any individual matter of non-compliance with the law, including those of a minor or administrative nature, would end up being considered by a Financial Services and Credit Panel (FSCP). This is likely to involve a large volume of matters, most of which are of an insignificant nature, and this would simply be impossible to manage and end up being extremely expensive. As we discuss below, the FSCPs should focus upon significant disciplinary matters, and not minor or administrative matters.

We have separately presented our feedback to each of the four elements of this exposure draft in our response below.

Recommendations

Our key recommendations are as follows:

- Minor and administrative matters should not be reported to the FSCP.
- All FSCPs should have at least 3 members for all decisions.
- The FSCP should have a secretariat team to triage matters, to support the panels and to ensure consistency across panels.
- There should be maximum timeframes stipulate in the law for suspensions and prohibitions.
- There needs to be greater certainty with respect to what the likely penalties might be for specific types of matters.
- Infringement notices should not be used for minor and administrative matters, nor for breaches of the Code of Ethics.
- The costs of operating the Single Disciplinary Body need to be carefully considered. An estimate of the number of matters and the resourcing requirements for the FSCP must be considered before the criteria for matters to be reviewed by an FSCP is finalised.
- There should be a Governance forum set up to ensure that there is a level of industry oversight of the operations and outcomes of the FSCP.
- Annual registration of financial advisers should be deferred until after the Modernising Business Registers project is complete.
- There should be no additional education and training standard for tax (financial) advisers.
- In the context of the scale of this reform, the commencement date should be deferred until 1 July 2022.

1. Single Disciplinary Body for Financial Advisers

Our primary concern with the proposed legislation to establish the Single Disciplinary Body is with respect to the potential cost and complexity of running a regime, where even some of the most minor matters, may inevitably end up in front of the FSCP.

It is our view that the Single Disciplinary Body should focus on significant issues and that minor matters should not need to be reported to the FSCP and matters of a more moderate nature should be able to be dealt with through an administrative process, rather than a Panel. We believe that there needs to be a sensible and efficient mechanism for matters to be triaged and that only significant matters should end up being reviewed as part of the Panel process. Also FSCPs should be set up to consider multiple issues, and not just single matters.

We note that it is proposed that ASIC will triage all matters. We have reservations about the impact of this on the timing of the FSCP dealing with matters. We address this further in our recommendation that an FSCP secretariat be established, and they be the body responsible for triaging.

It is unclear to us from reading the Exposure Draft legislation and the Explanatory Material how all matters will be directed to ASIC. This does not appear to have been addressed. Whilst it is apparent how matters that result from consumer complaints to ASIC and breaches reported to ASIC will be captured by this

regime, it is less obvious how other matters will flow through to ASIC. For example, AFCA only pass on certain matters to ASIC at present, including those that are considered to be "systemic". There is no current model for professional associations to pass matters on to ASIC. How will the flow of these matters be regulated? We believe that this needs to be explained and privacy issues with the passing on of personal information needs to be considered.

Composition of FSCPs

We note in Section 141(2) of the ASIC Act that FSCP members could include those with experience in business, administration of companies, or law. We are not convinced that people with these backgrounds would have the necessary skills to consider disciplinary matters against financial advisers in the context of the extremely complex laws that apply to financial advisers. In our view, it is people who have a strong understanding of financial advice who would be best placed to participate in FSCPs.

We question the fact that the Minister appoints someone to the FSCP, yet ASIC can then terminate them at any time, seemingly without reason. In the context that ASIC makes the decision to appoint individuals to specific FSCPs, our concern is that ASIC could choose to use panel members who hold similar views to them and can then choose to terminate panel members who have opposing views.

In our view, there should always be at least three members on a panel, and if someone is disqualified due to conflicts of interest, then they should be replaced. It appears possible that a panel could be reduced to as few as the Chair, and in our view, this is not appropriate. We also suggest that it would be beneficial to provide guidance on the application of the conflicts of interest requirement. Would the fact that a panel member knew a person subject to review by the FSCP, be sufficient grounds for them to be disqualified from participating on the Panel?

Operation of FSCPs

We question the appropriateness of Section 153 of the ASIC Act. Rather than each panel having the ability to regulate proceedings as it considers appropriate, we believe that all panels should follow a consistent approach.

Clearly minutes should be kept at FSCP meetings, however who would be expected to take these minutes? The FSCP should have a secretariat to undertake this function.

We note the provision for decisions to be made without meetings. Whilst this might be good for administrative efficiency reasons, we are concerned that this could lead to an outcome where the system is set up to rubber stamp the recommendations of the FSCP Chair and that this would lead to decisions being dominated by the views of ASIC. It might be that these matters that are decided without a meeting, should be limited to less significant matters and lower level penalties.

Resourcing the FSCP

It is not evident that there is a plan for the creation of a secretariat function for the Financial Services and Credit Panel. Seemingly other than the part time participants in the Panels, there will be no other resources that directly belong to the FSCP. We pose the prospect of there being some dedicated FSCP people that could constitute an FSCP secretariat and thus provide the resourcing to support FSCPs and to ensure that there is support and training provided to the FSCP members and that there is some consistency in how matters are assessed. The FSCP secretariat could also be the party to triage matters when they are received, including passing the more serious matters to ASIC, if a banning is a likely outcome. Further to the point that we have raised above, it might be this team that could provide support to FSCPs, such as taking the minutes at meetings.

Scope of Matters Addressed by the Financial Services and Credit Panel

Section 921L, which addresses the types of matters that might be considered by an FSCP is a combination of serious matters, such as conviction for fraud and insolvency, but also other matters that could be very minor or administrative in nature. The inclusion of 921L(1)(d) and 921L(1)(e), that address any contravention of a financial services law, is in our view very problematic. This would include a range of very minor matters that would not even be picked up by the new ASIC reportable breaches regime. There needs to be some level of consistency between the breach reporting and disciplinary regimes. As an example, if the failure to provide an FSG to a client, is to be excluded from the civil penalty section of the new breach reporting regime, as has been proposed in a recent draft regulation, then why would this be included under the Single Disciplinary Body model?. If licensees do not need to report this to ASIC under Section 912D, then how will ASIC even be informed of such matters? This is in our view totally unworkable, and as discussed above, we strongly recommend that this regime focus upon significant matters. In terms of Section 921L(1)(e), and the prospect of a financial adviser being involved in the contravention of a financial services law by another person, we question how this concept of "involved" would be assessed and how it could be proved.

For context, it is important to note that the majority of cases of non-compliance with the law are likely to be with respect to inadequate documentation of compliance with the seven steps in the Best Interests Duty safe harbour or minor differences or delays in the issue of Fee Disclosure Statements. These minor and largely administrative issues do occur on a regular basis, and they make up a large percentage of total breaches, however they do not involve client detriment and should not be the focus of the FSCP.

In terms of the matters addressed in Sections 921L and 921R, is it expected that matters that occurred before the regime commenced would be included in this deliberation? Some of the items in Section 921L appear to be focussed on matters that arise after commencement, however others seem to include matters that might have happened prior to the regime commencing. Section 921R is entirely backward looking, however it is in some cases limited to the last 10 years. Nonetheless, matters from the past could be introduced to the deliberations under Section 921L where they impact the assessment of fit and proper. Is it the intention of this legislation that existing advisers could be excluded from the profession on the basis of historical problems or mistakes that they have made in the past?

We are also concerned that any breach of the FASEA Code of Ethics could be captured, as this would include any breach of Standard 1 of the FASEA Code of Ethics, which is "You must act in accordance with all applicable laws, including this Code, and not try to avoid or circumvent their intent". Seemingly, any breach of the law, is a breach of the FASEA Code of Ethics and therefore subject to consideration by an FSCP and also potentially subject to an infringement notice. We question whether this is the intent of this legislation.

Complexity of Requirements for Matters to be Addressed by the Financial Services and Credit Panel

In our view the model for matters to be considered by an FSCP is complex. The primary grounds are set out in Section 921L, however this is supplemented by Section 921Q which refers to the restricted civil penalty provisions and Section 921R which addresses the fit and proper person test.

Section 921R defines the fit and proper person test and sets out 11 separate categories of matters to be considered. Section 921R seems to be inconsistent in whether matters that are older than 10 years will be considered in the assessment of fit and proper. For example, why is conviction of an offence only applicable if it is within the last 10 years, however there is no time limit on a banning? Item (k) includes "any other matter the panel considered relevant". In our view this is too open ended, and when dealing with such an important consideration, we don't believe that the grounds for this should be left so open.

Penalties

We question how the FSCPs will make decisions on the penalties that they impose. For example, how will they have the knowledge to work out what written directions might be most appropriate in certain situations? In what situations would they recommend "specified counselling"? When it comes to "specified supervision", this would normally require the involvement of the licensee, so how is this likely to be arranged?

We note that there is no maximum timeframes stated for an adviser to be suspended or subject to a prohibition order. We believe that it is appropriate to set maximums, particularly with respect to a suspension. In our view a suspension should not last for longer than 6 months.

We are concerned that an adviser could be banned by either ASIC or alternatively be subject to a prohibition order by an FSCP. We question the reason for what is effectively similar disciplinary actions being taken through different processes. This also seems to conflict with the concept that FSCPs will consider all matters other than those which are likely to lead to a banning. We question whether the banning penalty should be available to the FSCP, however if it is, then maybe it should be limited to a maximum period of 2 or 3 years. Otherwise, potentially all matters should be considered by FSCPs, rather than having a banning matter managed by ASIC.

Section 921Q(2) seems to suggest that both an infringement notice penalty and another penalty could be applied in the circumstances where an adviser has breached a restricted civil penalty provision. We do not accept that an adviser should be penalised twice for the same matter. This would give the appearance of this being a revenue raising measure. We also question the prospect of infringement notice provisions applying to minor matters that have strangely been specifically included in this restricted civil penalty regime. In particular, we use the example of someone who accidentally fails to meet their CPD obligations, by a small amount. A fine of nearly $2,500, for an adviser who for example has a total of 50 hours of CPD in a year, however only has 8 out of the 9 hours required for "professionalism and ethics" is, in our view, unjustified. We see no basis for these minor matters to be considered civil penalty provisions.

We are concerned that there is a lack of clarity on how similar matters will be handled. There is no guidance on the likely outcome for specific types of common matters. For example, what could a financial adviser who, by accident, missed the CPD requirement for the "Professionalism and Ethics" category by one hour, despite having achieved the total required number of hours, expect as an outcome? What is the likely penalty for an adviser who had a minor issue with non-compliance with the record keeping requirements related to the Best Interests Duty? Equally what is the type of penalty that might apply for someone who provided inappropriate advice that resulted in material client detriment? We recommend the inclusion of some examples in the Explanatory Memorandum, so that advisers have some sense of the likely penalties. We would not like to see an outcome where the penalties that arise are much more extreme than had been expected at the outset.

We note that a breach of the Code of Ethics is included amongst the restricted civil penalty provisions. We are not sure that it is appropriate that breaches of a Code should be matters to be dealt with by an infringement notice. This does not seem to be consistent with how breaches of Codes would be treated by other professions. If the matter was caught through another mechanism, then this would be more understandable.

Funding of the New Regime

We note that the funding of the Single Disciplinary regime would be through the introduction of a new adviser registration fee and an increase in the ASIC Funding Levy. In the context of the substantial increase in the ASIC Funding Levy for the 2019/20 year and the prospect for further substantial increases, including as a result of the number of financial advisers declining, we are very concerned about the implication of the

Single Disciplinary Body for the future ASIC Funding Levy amounts. It is concerning that there is no indication of what the impact is likely to be, however it would obviously be very substantial.

Regulation Impact Statement

It will be critical to know in advance of the legislation being tabled in the Parliament, exactly how many matters are likely to be put forward to a Financial Services and Credit Panel every year and what resources would be required to manage such a workload. Based upon the current draft and Section 921L in particular, we suspect that the scale of matters would be an unmanageable volume and the impact on the ASIC Funding Levy would be substantial. This would be a very poor outcome. It is critically important that an estimate of the number of matters and the likely cost of the regime is worked out, before the criteria for what matters are to be considered by a FSCP is finalised.

Governance Model

Further to our points above about the lack of any secretariat to manage the Financial Services and Credit Panel, we would also like to discuss the issue of the Governance model for the oversight of the FSCP. We believe that it would be appropriate to consider some form of consultative body to provide industry insight into the operations of the FSCP and as a vehicle to channel feedback. This forum, could provide input to ASIC and Government on the effectiveness of the regime.

2. Registration of Financial Advisers

We are conscious that the key changes in this part of the Exposure Draft are the introduction of an annual renewal process for financial advisers and the addition of annual declarations from the licensee and financial adviser. Whilst we do not oppose the annual renewal requirement, it is important to note that this is another administrative process that will need to be followed and it will add further to the costs of running a licensee and being a financial adviser. We note that one of these declarations is with respect to tax (financial) advisers being compliant with additional education and training standards for tax (financial) advisers. As discussed below, we do not see any need for a separate education and training standard for tax (financial) advisers and we would therefore recommend that this declaration should not be required.

We are aware that there are some financial advice stakeholders who will suggest that registration with ASIC should be done by individual advisers, rather than by licensees. We are aware of the arguments for this, however, this is a more fundamental issue with respect to the entire licensing regime, and we believe that it should be addressed as part of the 2022 Quality of Advice Review.

We understand that one of the expected outcomes of this reform is tidying up the register of relevant providers. This would be a good outcome. We also note that the register of relevant providers will continue to be what is currently known as the Financial Adviser Register. We understand that this proposal does not involved the creation of a new register.

Technical Considerations

Paragraph 1.182 of the Explanatory Memorandum refers to an example of a licensee taking into account, in the fit and proper declaration, a disciplinary outcome made against an adviser by the Financial Services and Credit Panel. Paragraph 1.184 states that where a licensee provides a declaration that they are aware of reasons why the financial adviser may not be a fit and proper person this is not, by itself, grounds for ASIC to refuse to register the adviser. The legislation does not deal with what ASIC should do if the declarations provided by the adviser or the licensee are negative. It also appears to be the case that the grounds for ASIC to refuse an application are limited (Section 921X(2)). Paragraph 1.184 then goes on to suggest that ASIC must convene a Financial Services and Credit Panel when ASIC reasonably believes that an adviser is not a fit and proper person. There are some grounds for concern here, in that a previous matter that resulted in action being taken by a Panel and a penalty being applied, could then result in an issue with the

fit and proper assessment, and then lead to another Panel being constituted. This seems like a case of the adviser being punished twice for the same event. We believe that there needs to be greater clarity on the grounds under which a licensee would be expected to provide a negative fit and proper person declaration and for what action might be taken when an adviser is seeking renewal, after previously being subject to an FSCP disciplinary outcome.

We note that under section 921X(2), ASIC may refuse to register a financial adviser if they have not met the education and training standards in subsections 921B(2) and (3), however the requirement for existing advisers to pass the education standard in Section 921B(2) does not apply until 1 January 2026, and it is not evident that the transition arrangements adequately cater for this. In addition, with Section 921X(2)(d), the requirement to do a professional year does not apply to existing advisers. It seems that in these situations, ASIC must automatically reject the registration/renewal.

Licensee Registration Years

We further note that it appears that licensees will have a registration year and that all advisers authorised by that licensee will need to align with that year. This means that an adviser who joins a licensee during the year will have an initial registration year that could be much less than a full 12 months. We understand that ASIC may set the registration year for specified classes of licensee and that this might apply in an arbitrary manner. We expect that this might cause complications, particularly for the large number of small financial advice licensees who may not be as focussed on the regulatory reform changes as the larger licensees are. It is also relevant to note that those licensees who have a later commencement date, will have an advantage over those who might need to renew sooner. Given the prospect for misunderstanding and mistakes to be made in the early stages, we recommend that greater flexibility be applied in the first year or two.

Paragraph 1.196 states: "However, it will not become an offence to provide financial advice while unregistered until 1 January 2023. This ensures that there is a transition period before penalties apply". Whilst we understand the intent of this statement in terms of the completion of the registration/renewal process, we completely expect that anyone who is not authorised and recorded on the FAR, cannot provide financial advice. A statement like that in paragraph 1.196 could readily be misunderstood.

Modernising Business Registers

With respect to the transition arrangements for the annual renewal of financial advisers on the FAR, we note that the register will be transferred to the ATO over the next couple of years as part of the Modernising Business Registers project. We question whether the introduction of the annual renewal requirement, which could include the need for significant systems changes, should in fact be deferred until after the Modernising Business Registers transfer has been completed. In the context of other demands on the financial advice profession, we believe that a deferral of the commencement of annual registration would be a reasonable outcome.

3. Winding up of FASEA and Transfer of its Standards Functions to the Minister and ASIC

The AFA supports the proposal with respect to the winding up of FASEA and the transfer of responsibilities to the Minister. Setting this date as 1 January 2022 is a sensible outcome as this means that FASEA will remain responsible for the administration of the FASEA exam through until the deadline date of 1 January 2022 that applies for existing financial advisers.

We note that the approval of Financial Advice courses will reside with Treasury, with decisions being made by the Minister, however the approval of foreign qualifications will be done by ASIC. It would appear that as a result, both Treasury and ASIC would need to have people with similar skills in the assessment of financial advice education courses and that it may be more efficient to have this activity undertaken within

the same organisation. We would suggest that the responsibility for approving courses and foreign qualifications should reside within Treasury.

4. Regulation of Tax (Financial) Advisers

We note the provisions that have been added with respect to additional education and ongoing training requirements for tax (financial) advisers, however we question whether this should be necessary. In our view the FASEA/Minister standards, as changed over time, should ensure that there is adequate knowledge on taxation matters and therefore it should not be necessary to have a separate education/training standard for tax (financial) advisers.

Financial advisers have for too long been bound by different requirements under the Corporations Act as opposed to the TASA, and we strongly assert that the continuation of parallel regimes should be avoided. This is not just in terms of the education standard, but also in terms of the ongoing Continuous Professional Development requirements.

Tax (Financial) Adviser Education and Training

We also note the reference in Paragraph 1.231 of the Exposure Draft Explanatory Materials document that the Minister could include the requirement for “the completion of one or more approved bachelor or higher degrees”. This is potentially more than is currently required by the FASEA regime, which in our view, for tax advice is totally unnecessary, as financial advisers only provide peripheral tax advice services. We do not agree that this reference to one or more degrees should be necessary at all, however if additional study were to be required for tax (financial) advisers, it should be set at a very measured level and not discussed in terms of degrees.

Provision of Tax (Financial) Advice Services

It is a broadly held view that virtually all financial advisers would need to provide tax advice of some form when advising clients, even if this is a basic explanation of the benefits of salary sacrificing, estimation of capital gains tax obligations, or the explanation of tax deductibility of income protection premiums. The only financial advisers who are able to operate without being registered with the TPB, are those who operate under the “sufficient numbers” model and are supervised by someone who is registered with the TPB. There is no equivalent “sufficient numbers” model under the Single Disciplinary Body regime, so all advisers will need to be sufficiently educated/trained and therefore in our view it is not appropriate to suggest that there would be financial advisers who are not operating as tax (financial) advisers. Only one education and training standard should apply.

Membership of Professional Associations

The Tax Agent Services Regulations 2009 (TASR) provide four registration options for tax (financial) advisers. Item 304 is for members of professional associations with 6 years full time experience out of the last 8 years, and provides a registration option, where financial advisers are not required to do an Australian Taxation Law course and a Commercial Law course that are required under each of the other three registration options. This is an intentional recognition of the value of experience and of membership of professional associations. This type of model is similar to registration options available for accountants. Therefore, if the Minister was to introduce additional education standards from 1 January 2022, this might create a problem for those financial advisers who have not previously been required to complete these taxation law and commercial law courses, due to this exemption.

TFA Recommendation

We recommend that all obligations and requirements for tax (financial) advisers be rolled into the Corporations Act requirements for financial advisers, so that there is no difference and that financial

advisers can be completely removed from the TASA regime. We also recommend that in the event that the Government does not accept this argument, that any changes to education standards be subject to grandfathering arrangements to reflect the current model for experienced members of professional associations or those who are currently covered under the "sufficient numbers" model.

Where the TPB receives a complaint about a financial adviser, they should be able to forward that to ASIC/the Financial Services and Credit Panel for action. After all, this reform is supposed to result in a Single Disciplinary Body, and not a model where matters could be considered by either or both the TPB and the FSCP.

Other Matters

We note that Division 4 of Part 10.23A (i.e. Section 1546ZB) of the Corporations Act is proposed to be repealed, and whilst we understand why a review of Division 8B and 8C of Part 7.6 of the Corporations Act may no longer be required, we question why a review of Division 8A of Part 7.6 would no longer be proposed to be pursued. We would like to see this review proceed.

Commencement Date

We note the proposed start date for the new Single Disciplinary Body is 1 January 2022. We are concerned that this might be too soon, given that there are still many key elements of the regime that need to be resolved and the FSCP infrastructure still needs to be built. If the legislation is not passed by 30 June 2021, and this seems highly unlikely, then we believe that commencement should be deferred until 1 July 2022.

Concluding Comments

The AFA supports the establishment of a Single Disciplinary Body and the rationalisation of regulatory oversight of financial advisers. It is our view that the disciplinary body should play a key role in taking action in the event of serious misconduct, including through having access to a broader range of penalties. We would not like to see the FSCP involved in minor and administrative matters. This is a critical consideration in the context of the objective of focussing on misconduct. It is also particularly important in ensuring that the costs of the Single Disciplinary Body are kept under control. Otherwise, this will be another factor in driving up the cost of financial advice and taking it out of the reach of everyday Australians.

In the context of the significance of this reform and the potential impact that it will have on the financial advice sector, we strongly recommend that the final legislation is subject to the completion of a full Regulatory Impact Statement and that the appropriateness of the proposed solution is subject to a parliamentary inquiry. This would help to minimise the prospect of unintended negative consequences, which we have seen with other Royal Commission recommendation legislation.

We would be happy to discuss this matter further, or to provide additional information if required. Please contact us on (02) 9267 4003.

Yours sincerely,

Phil Anderson
Acting Chief Executive Officer
Association of Financial Advisers Ltd