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Australian Securities and Investments Commission
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AFA Submission - Cost Recovery Implementation Statement: ASIC industry funding model (2020–21)

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 ASIC Cost Recovery Implementation Statement for the 2020/21 financial year.

The following table illustrates the stratospheric, unjustified and unsustainable changes to the ASIC Funding Levy since its inception in 2017/18:

Year	Levy Amount	Annual % Increase	Cumulative % Increase
2017/18	\$934		
2018/19	\$1,142	22%	22%
2019/20	\$2,426	112%	160%
2020/21	\$3,138 [^]	29%	236%

[^] The 2020/21 Levy amount is a projection and likely to be materially underestimated.

Financial advisers were told in June 2020 that the per adviser levy for the 2019/20 year was expected to be \$1,571. When the final levy was announced in November or December 2020, without any publicity, it had more than doubled since the previous year to \$2,426. The invoices for the 2019/20 year were delayed and the final amount was only confirmed in March 2021. By this time many licensees had already recovered the lower figure of \$1,571 from exited advisers, only to discover that they had to cover the gap. Given the current high level of turnover, this was a large unexpected cost for many licensees. This is just one factor that has driven a great deal of anger related to the ASIC Funding Levy.

What the AFA Recommends

This situation is untenable and will have a hugely negative effect on the advice profession and the clients it serves; many Australians will be locked out of receiving great financial advice as the cost of advice inevitably rises to meet exponential increases in compliance costs.

In the interests of fairness and good regulation, the AFA asks that the cost of enforcement (including related indirect costs), along with the cost of investigation and action against unlicensed operators, is permanently removed from the ASIC Funding Levy, effective from the 2020/21 financial year.

Financial advisers should also still benefit from any cost recovery and penalties arising, related to the costs already incurred in 2018/19 and 2019/20, but should not be required to continue to fund this litigation in future years. If the Government chooses to continue with this approach, in the face of industry and adviser concerns, and financial advisers are expected to fund litigation against large institutions, then any penalties should flow back into the financial adviser ASIC Funding Levy pool, including those penalties that have already been applied. Further, if financial advisers are expected to fund Government litigation against large institutions, then they should receive adequate disclosure and reporting on the outcome for the contribution that they are being forced to undertake.

Within the advice profession and broader advice community, the ASIC Funding Levy's precipitous rise is seen as contributing to some very negative consequences, including:

- Falling capacity to afford financial advice in the face of greater need, as unreasonable compliance costs impact on the cost of seeking advice. ASIC Report 627 is evidence of this consequence as over 35% of those surveyed, indicated that financial advice is too expensive, which was a significant barrier to getting financial advice. Importantly this survey was in 2019 and costs have risen sharply since.
- A rapidly declining number of financial advisers. Supply cannot meet demand at a time when one of the largest transfers of inter-generational wealth ever to occur in Australia is underway, and the pandemic and related economic uncertainty has driven higher demand for advice.
- There has never been a time when professional financial advice has been more needed and yet this levy and the inequitable and unfair funding methodology that underpins it has left the adviser profession with the sense that ASIC has become an oppressive regulator and that the Government is impervious to the well-reasoned arguments put forward about this and other regulatory changes
- Financial advisers feel they have no voice and no consideration is being given to the impact on those clients wishing to secure their futures, and reduce their reliance on Government funding, through receiving good financial advice.

The ASIC Funding Levy is a lag indicator as it reflects the problems of the past. It fails to incorporate what is likely to happen over the next couple of years, including:

- Significant additional costs from the introduction of the Single Disciplinary Body.
- Significant additional costs from the Compensation Scheme of Last Resort.
- A continuing decline in adviser numbers, due to the FASEA exam deadline, increased education requirements and the introduction of additional compliance obligations.

The ASIC Funding Levy has become a lightning rod for the financial advice community, generating intense heat. Whilst most of that heat has been directed at ASIC, the reality is that it is the Government who designed

and legislated the funding model, and allocated additional funding following the Banking Royal Commission. Despite the warnings about inequity and a flawed model which was evident in June 2020, and strongly communicated by numerous stakeholders, the Government has not done anything to rectify the significant issues with the funding model.

In this submission, we are seeking to do the following:

- Explain what has happened over the last three years.
- Set out why the outcome has been both inequitable and unfair.
- Explain what we have done to address this issue.
- Highlight inaccuracies in the 2020/21 Cost Recovery Implementation Statement.
- Highlight other issues with the ASIC Funding Levy.

The ASIC Funding Levy is now a fundamental problem that the Government must fix.

Analysis of the Increases in the Costs of ASIC

The following table sets out an analysis of the changes in the costs that ASIC attributes to financial advisers who provide personal advice to retail clients on relevant financial products across the last three years. This drastically shows the increase in the total cost from \$33 million in 2018/19 to a projected \$71 million for the 2020/21 year. It also reveals a more than trebling in the cost of enforcement over this time from \$9.5 million to \$31.4 million and the substantial increase in the allocation of indirect costs, which is undoubtedly linked to the increase in enforcement costs.

ASIC Funding Levy - Financial Advisers					
\$'million	2018/2019	2019/2020	2020/21 CRIS	Variance 20/21 - 19/20	Variance 20/21 - 18/19
Core Activities					
Supervision & Surveillance	3.793	7.187	8.549	1.362	4.756
Enforcement	9.459	19.864	31.397	11.533	21.938
Financial Capability	1.25	1.332		-1.332	-1.25
Sub Total	14.502	28.383	39.946	11.563	25.444
Other regulatory activities					
Industry engagement	0.811	0.24	0.27	0.03	-0.541
Education	0.21	0.272	1.524	1.252	1.314
Guidance	0.288	0.455	0.539	0.084	0.251
Policy Advice	0.05	0.824	1.022	0.198	0.972
Sub Total	1.359	1.791	3.355	1.564	1.996
Indirect Costs					
Governance, central strategy and legal	3.86	6.755	7.838	1.083	3.978
IT Support	3.286	5.353	5.146	-0.207	1.86
Operations support	1.779	3.28	3.563	0.283	1.784
Property and corporate services	4.835	6.762	7.927	1.165	3.092
Sub Total	13.76	22.15	24.474	2.324	10.714
Total operating expenditure	29.621	52.324	67.775	15.451	38.154
Allowance for capital expenditure	4.03	4.902	3.514	-1.388	-0.516
Less costs funded by own-source revenue	-0.566	-1.15	-0.584	0.566	-0.018
Adjustment for prior year under /(over) recovery	-0.059	0.122	0.647	0.525	0.706
Sub Total	3.405	3.874	3.577	-0.297	0.172
Total costs to be recovered by levy	33.026	56.198	71.352	15.154	38.326

It is therefore evident that it is enforcement costs that have driven the substantial increase. It is also well understood that this is based upon action taken as a result of the Banking Royal Commission. It is also relevant to note that the vast majority of cases at the Royal Commission hearings were with respect to the large institutions. In response to a Question on Notice from Senator Brockman at the 2 June 2021 Senate Estimates hearing, ASIC confirmed the impact of enforcement activity with the following statement:

“The increase in the levy in 2019-20 is primarily due to the increase in enforcement activity in this sector following the Financial Services Royal Commission.”

Inequity and lack of Fairness

It is appropriate that we set out our reasons for why we believe that the ASIC Funding Levy for the financial advice sector has become deeply flawed, inequitable and unfair. At the core of this is the treatment of the cost of these enforcement actions being taken against large institutions, who predominantly are no longer participants in the financial advice sector. There are numerous reasons, which we have set out below:

- Financial advisers are funding a very large amount of money (we have estimated around \$50 million over the last three years) to fund investigations and litigation against large institutions. Should these litigation matters succeed, any penalties are paid to Consolidated Revenue. That means that the Government gets to keep it. Put simply, small business financial advisers are funding litigation against big institutions, and the ultimate beneficiary is the Government. If this was to happen in any other sector of the economy, the media would be screaming about it.
- Should ASIC win the matter in court, they may recover costs, which will offset the Funding Levy, however we have been advised that this could be only two thirds of the costs incurred in a particular matter. Where ASIC ultimately decides to take no action, such as the recent decision with respect to Fees for no Service at AMP, or they lose the case, then there is no cost recovery at all. So, at best, financial advisers stand to recover a small portion of their contribution to the cost of this litigation.
- Any cost recovery is likely to be deferred for a number of years. In a recent response to a Senate Estimates Question on Notice about the action ASIC took in the High Court against Westpac for the conduct of their super funds, they published the following, but went on to say that in August 2021 the High Court will decide what penalties to award and then at a later time decide on any costs. Costs will have been incurred across four financial years before the prospect of any recovery, hopefully in FY 2022. This lag in the recovery should not be how a funding model is applied to small businesses.

FY2020	FY2019	FY2018	Allocation
\$264,712	\$75,449	\$261,419	Advice-T1 personal 60% Superannuation trustee 40%

- Most of the actions that arose as a result of the Royal Commission were with respect to large institutions and not individual advisers. For example, the Westpac High Court matter was with respect to an institutional decision to have a call centre seek to get members to consolidate their superannuation on a general advice basis. In the case of the AMP Fees for no Service matter this was centred around the charging of fees to orphaned (no adviser) clients. In other cases, the issue has been the institutions supervision of the conduct of their advisers. How is it equitable that small business individual financial advisers are paying for the cost of litigation against large entities? It is the companies that should need to pay for this, not the individual financial advisers.
- The big four banks have now almost entirely left financial advice. Before the Royal Commission, they were responsible for over 5,000 advisers, and now employ a tiny fraction of advisers. Westpac was the first to leave, having exited financial advice entirely within nine months of the release of the Banking Royal Commission final report. Despite their exits from advice, presumably many of these litigation matters are directed towards the banks, yet it is the small business financial advisers that remain in the sector, who are paying for the cost of this action. For those who argue that the advisers who were previously licensed by the big banks are still in advice and should pick up the cost, we

would respond by saying much of the litigation was about the conduct of the institutions, not their advisers and this cost should not be picked up by those small business advisers who remain in the sector.

- Financial advisers are required to pay for investigation work and litigation against unlicensed operators, including some recent highprofile cases. Where people operate outside the law, in many cases to avoid the additional costs of operating in a compliant manner, it is not reasonable for those who are doing the right thing to pay for those who are not.
- With respect to the action that ASIC took against Westpac in the High Court, this related to Westpac's super funds who were running a call centre to get members to consolidate their superannuation on a general advice basis. This was an institution which was not setting out to provide personal advice, who were taken to court because ASIC believed that what they were doing was personal advice, because it was reasonable to assume that clients believed that the Westpac consultant had taken their personal circumstances into account. Westpac never set out to provide personal advice. ASIC have nonetheless decided to charge 60% of the cost of this case to small business financial advisers. This is in our view a most remarkable decision. Put plainly, 60% of the cost of a court action against a large institution super fund, that never set out to provide personal advice, has been charged to individual financial advisers. ASIC have justified it in their response to the Senate Estimates Question on Notice, as set out below. To put it bluntly, we do not accept this proposition, and certainly not in the context that the conduct in question was that of one of the big four banks.

"ASIC's role is to enforce the law, and this includes regulating the boundaries of permitted conduct. ASIC action in relation to unlicensed conduct in a sector is in the interests of the licensed participants in that sector because it maintains integrity and trust in the licensed sector and deters competition from unlicensed and unregulated competitors."

Lack of Transparency and Disclosure

Whilst financial advisers know that they are funding litigation against the large institutions, they do not know what cases they are funding, or how much is being spent on each case, or what the outcomes of the matters are. We have been advised that any cost recovery will be shown in the 'Less costs funded by own-source revenue' line in the CRIS. For the 2020/21 year, this amount was \$566,000, which is a very small fraction of the expenditure on these litigation matters. We have no visibility of which matter or matters this relates to. The only specific case that we have had some visibility on is the Westpac Super High Court matter that was revealed through the Senate Estimates process.

The Westpac High Court case is in our view incorrectly being charged to financial advisers. In the absence of greater visibility, we are rightly concerned that there are a number of other matters that have unfairly and incorrectly been charged to the financial advice sector.

In any other context, where Australians were investing, there would be consumer protections, disclosure obligations and regular reporting requirements. Financial advisers have no such protections or disclosures to rely upon relating to the ASIC Funding Levy.

Issues in the 2020/21 Cost Recovery Implementation Statement

We have detailed our serious concerns with the increase in the enforcement costs and the resultant increase in the indirect costs that are undoubtedly linked to the increase in the enforcement costs.

We are also surprised that ASIC have based the per adviser Levy amount of \$3,138 on a total of 21,308 financial advisers, when ASIC operates the Financial Adviser Register and they know that the actual number of financial advisers on the register, is currently closer to 19,000. We are concerned that this once again will expose ASIC to the risk of criticism for underestimating the cost per adviser. We believe that, based on a total spend of \$71 million, the cost per adviser is likely to be closer to \$3,450 for 2020/21.

We have noticed that the Cost Recovery Implementation Statement (CRIS) is coming out later and later each year. In 2019 it was issued in March. In 2020 it was issued in early June, and now in 2021 it has been issued in late July after the year has concluded. This seems contrary to the original intent which we understood was to provide an indication of what was likely to be the case during the year. We understand that ASIC was exposed in 2020 by issuing the CRIS in June, but then needing to issue a revised levy six months later based upon an additional \$16 million in expenditure. The fact that the CRIS could be released only a few weeks before the end of the financial year, and end up being so wrong, raised concerns that decisions were made late in the process about which costs to allocate to financial advisers (as discussed above with respect to the Westpac High Court case). These issues, and the delay in releasing the CRIS, only contribute to a reduced level of trust and confidence in the process.

We note this year that the CRIS breaks down the Levy into statutory recovery levies and cost recovery levies in further detail. We are not sure why this has been done, and we do not believe that it makes any difference as both are included in the levy that will be charged.

This seems to add a new layer of complexity with the prospect for cross-subsidisation. Whilst this concept of statutory levies was referred to in the 2019/20 CRIS, it was not included in the presentation of the breakdown of cost for each subsector. It would appear that a better explanation of the ASIC Enforcement Special Account would also be appropriate.

AFA Advocacy on the ASIC Funding Levy Flaws

Over the course of the last 16 months, since the commencement of the COVID 19 pandemic, we have approached the Government on several occasions to address the issue of cost pressures on the financial advice sector and the inequity of the ASIC Funding Model, including:

- In April 2020, in the context of COVID 19, we requested that the ASIC Funding Levy be waived for that year. Despite extensive relief measures in other areas, nothing happened.
- In July 2020, following the release of the 2019/20 CRIS and the significant jump in the projected ASIC Funding Levy to \$1,571 per adviser, we wrote to the Assistant Minister for Superannuation, Financial Services and Financial Technology and the Assistant Minister to the Prime Minister and Cabinet, who is responsible for red tape reduction, and requested action to address this problem.
- In December 2020 we wrote again to the Assistant Minister for Superannuation, Financial Services and Financial Technology and to ASIC seeking an explanation of how the ASIC Funding Levy had leaped to \$2,426 for the 2019/20 year (from \$1,571 in the projection) and asked for this to be explained and the funding model fixed to ensure a more equitable outcome.
- We have also raised the issue of the ASIC Funding Levy with several other politicians.

We have had several discussions over this time with relevant Ministers and their staff. We have also observed that the ASIC Funding Levy has been a subject debated during Senate Estimates hearings and other Parliamentary hearings. Most recently at the House of Representatives Economics Committee it generated very strong comments.

It is evident that it is broadly understood that it is an incredibly inequitable and unfair model and that small business financial advisers are being poorly impacted, yet even now some 16 months since we first requested action, nothing has changed, and there is no indication that the person ultimately responsible for this will do anything to address the underlying flaws in this model or the unfair treatment of financial advisers.

Concluding Comments

We thank ASIC for releasing the Cost Recovery Implementation Statement for 2020/21, however we are asking the Government to fix what is a very flawed model. It is essential that the Government listen to this feedback from the financial advice sector and act.

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,

Helen Morgan-Banda
Chief Executive Officer
Association of Financial Advisers Ltd