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AFA Submission - Single Disciplinary Body: Policy Paper

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 Single Disciplinary Body Policy Paper.

The AFA is supportive of the concept of a Single Disciplinary Body (SDB), as long as it is efficient and focussed upon more serious matters. Where the SDB is focussed upon minor and administrative matters, this will simply lead to an inability to focus on what is important, and a delay in taking action against the financial adviser. Our concerns relate not just to what must be referred to a Financial Services and Credit Panel (Panel), but also to what matters need to be considered by ASIC, even if they don't choose to refer it to a Panel. Any matter that is considered by ASIC, no matter how minor in nature, will consume resources. The SDB legislation needs to also recognise the role of Licensees in addressing minor and administrative matters as a reputable alternative to all matters being addressed by ASIC or a Panel.

The AFA's view is the legislation should not have been allowed to get to this point, without a regulation impact statement and an assessment of how many matters might be considered each year and what the overall cost will be. Even at this late stage, our submission is that it still needs to be sensibly modified to ensure that this does not become an inefficient, ineffective and costly regime.

The AFA has previously provided three submissions on the Single Disciplinary Body. The first one in May was in response to the Exposure Draft Legislation. We also provided a submission and a supplementary submission to the Senate Economics Committee Inquiry into the Better Advice Bill in July. These are appended to this submission.

We were particularly disappointed to see that the Senate Economics Committee did not support any of our recommendations that would have made a material difference in reducing the administrative complexity and costly nature of the regime that has been designed in the Bill.

We have set out our responses to the policy paper below.

When a Financial Services and Credit Panel must be convened

We note the statement on page 3 about matters where ASIC does not choose to refer to a Panel – "This ensures that where misconduct has occurred, but no other disciplinary action is taken, the misconduct does not go unaddressed". This is a flawed statement for two reasons. First, a breach of the law is often very minor or administrative in nature and therefore does not warrant being described as misconduct. Second, where an adviser has breached the law, their licensee will take action and will typically require them to remediate the matter. This was recognised in the Hayne Royal Commission final report.

Our feedback, to this point, has been to sensibly limit the number of matters that go to a Panel, and more broadly, to limit the number of matters that go to the SDB as a whole, which would also mean limiting the number of matters that need to be considered by ASIC. One sensible mechanism to achieve this is to ensure that breaches of the law addressed in Section 921K of the Corporations Act are limited to matters reportable under Section 912D, rather than applying a limitation in terms of matters that are referred to a Panel through Section 139 of the ASIC Act.

We note the following statement on page 4 with concern. This is incorrect. There would be a range of serious matters that would not constitute a banning matter that would still be considered by a Panel. This statement applies an unrealistic view on what should be a banning matter. This also highlights the lack of clarity on which types of matters would be subject to the different disciplinary options available. As currently designed, the Panels will be reviewing a large number of matters.

> *If only the most serious of matters require ASIC to convene an FSCP, ASIC would continue to focus on matters that are serious enough to warrant a banning order and the FSCP would not be considering a 'broader range of cases'.*

We note the following statement which implies a mindset of escalating the level of disciplinary intervention, seemingly even for minor and administrative matters. This highlights the obvious lack of awareness of the impact of the proposed regime.

> *This may result in circumstances where because a matter has not been referred to the FSCP, ASIC's limited enforcement toolkit may not be the appropriate response to financial adviser misconduct.*

There needs to be an awareness, and the application of, a distinction between unintended mistakes and deliberate misconduct. To suggest that every unintended mistake requires disciplinary action, is setting the bar far too high.

It would be worth reflecting on the likely impact on the mindset and thinking of advisers, when they are aware that even the most minor of matters could see them in front of ASIC or a Panel, which is likely to lead to an excessive level of risk aversion.

The Policy Paper includes the following statement on page 4, which, in our view, is not consistent with what the Hayne Royal Commission final report had to say.

> *While introducing a threshold so that only the most serious matters require ASIC to convene an FSCP would limit the number of matters referred to the FSCP it would be contrary to Commissioner Hayne's recommendation that minor misconduct should not go unaddressed.*

Recommendation 2.10 includes the following specific statement which makes it very clear that the information being passed to the SDB should relate to serious compliance concerns and not minor and administrative matters and minor misconduct, however that might be defined.

> *requires AFSL holders to report 'serious compliance concerns' to the disciplinary body*

Page 217 of the Hayne Royal Commission final report makes two references to the role of licensees in disciplining advisers for doing the wrong thing. The SDB legislation provides no recognition of the important role that licensees must and do play in disciplining compliance breaches and misconduct.

> *AFSL holders should continue to have primary responsibility for monitoring and disciplining advisers.*
>
> *The disciplinary body may decide to take no action in relation to a particular adviser if it considers that the consequences already imposed by the adviser's licensee are appropriate.*

It is inappropriate to incorrectly imply expectations of the Hayne Royal Commission and leave out important and relevant points made in the Hayne Royal Commission final report, which the Government has failed to incorporate in the legislation.

Circumstances under which ASIC must convene an FSCP: Criteria to be prescribed in Regulations

What is proposed is once again complex, and leaves a lot of discretion with ASIC in terms of what they choose to refer to a Panel. Breaches of the Code of Ethics **may not** result in a referral to a panel unless they otherwise meet the criteria. This is a complex design that creates uncertainty and leaves a lot of flexibility for ASIC to make the decision.

We assume that the criteria in paragraph 3, should be on the basis of 'any of the following'.

1. Should the criteria include other specified breaches of the law such as other restricted civil penalty provisions or circumstances prescribed in section 921K of the Bill?

Whilst we are not suggesting that we support the way these criteria have been defined, they do broadly address the most important issues that should be considered in terms of misconduct matters to be referred to a Panel.

We find the reference to 'resulting in a material benefit to the relevant provider' to be an unusual criteria. If there is also a material benefit to the client, then is this an indicator of misconduct? If the client has a lot of money to invest, or a large insurance premium, and a lot of work is required to provide the advice, then the benefit (fee or commission) to the adviser is more likely to be material. It cannot be assumed that this automatically suggests misconduct.

We believe that the criteria have already, in some way, addressed all the restricted civil penalty provisions.

In terms of the circumstances prescribed in Section 921K, it appears that insolvency has not been mentioned, and rather than referring to fit and proper, there is a reference to an adviser's suitability. We cannot see the reason for introducing a new concept such as suitability.

The one obvious gap is bankruptcy or insolvency, which is a matter that should be considered by a Panel.

2. Should the proposed criteria be linked to the 'significance test' in the breach reporting regime?

- **The effect of this would be that every breach reported by a licensee to ASIC would then be required to be referred to the FSCP, if ASIC does not take other action (such as banning).**
- **Complaints received by the public would also be subject to the 'significance test' in the breach reporting regime.**

There is merit in linking this test to the significance test in Section 912D of the Corporations Act, as this avoids the need for two different definitions of significance or material matters. It should also be noted that ASIC is much less likely to be aware of a breach, if it was not reportable to ASIC under Section 912D in the first place. We remain totally confused about how ASIC will be advised of matters that are not required to be reported and how matters can be expected to flow from other sources such as professional associations and AFCA.

Linking the criteria to the significance test in Section 912D does not necessarily mean that all matters that meet that test would need to be referred to a panel. There could be other criteria that are applied on top of the Section 912D significance test, such as those related to materiality and client detriment.

In terms of complaints from the public, whilst they would not come with the same self assessment that licensee reportable breaches do, ASIC could equally form the view as to whether they would be reportable, if assessed under Section 912D.

3. Should the terms 'serious' and 'repeated breach' be defined in Regulations? If so, how should they be defined?

If they are to be used in this regulation, then they should be defined in the regulation, particularly if this is to be a core part of the requirements. It is important to note the Hayne Royal Commission recommendation that licensees should refer 'serious' compliance concerns to ASIC, which highlights the importance of the term 'serious'.

The concept of repeated breaches is difficult to apply a universal measure to. The repeated breach of an administrative obligation may not be as important as a repeated breach of a critical obligation that determines the client outcome. For something more serious, two or more times may quality as a repeated breach, however for something minor, it might be more appropriate to use four or more times. It is also relevant to consider the timeframe. Something that happens twice a year is very different to something that happens twice in five years.

4. Should the proposed criteria in (a) and (b) above be included as part of the definition of 'serious'? For example, "the contravention is a serious breach taking into account:

- **the material loss or damage to clients;**
- **the benefit gained by the relevant provider; and**
- **repeated breaches of a similar nature."**

We would agree that a material loss or damage to clients is a key indicator of a serious breach. As discussed above, we do not accept the assertion that a benefit, in the form of fees or commissions, is in any way an indicator of misconduct and should not be part of this criteria.

In the absence of material loss or damage to clients, the fact that a breach is a repeated breach would also be a good indicator that a matter was a serious breach. This reflects the way that licensees traditionally assessed significant breaches.

5. Should a repeated breach be interpreted as similar breaches that have occurred on two or more occasions and in a specific timeframe, such as in a 12-month period?

As we have discussed above, the concept of repeated breaches needs to be viewed in the context of the type of breach. A repeated mistake in something administrative should not be assessed in the same manner as a repeated issue with inappropriate advice. Thus, 'repeated' may be as few as two or more times for something more serious and it may also be appropriate to look at a longer period than every 12 months. Financial advisers who have annual audits, may have a repeated issue that occurs in consecutive audits, that may occur slightly more than 12 months apart.

6. Should the proposed criteria in c) specify breaches that may affect the suitability of a person to provide financial product advice? For example, the person is not a fit and proper person taking into account the fit and proper criteria in the Bill, or the person has been involved in conduct that is dishonest or fraudulent.

As discussed above, we have questioned the introduction of a new concept of suitability of a person to provide financial advice. It might be appropriate to link this to the fit and proper test in Section 921U, however this is not all that useful either. For example, someone who has previously been banned, insolvent or been the subject of a FSCP decision, may in some circumstance still be suitable to provide financial advice in the future, once they have complied with their penalty. Otherwise, these matters would become a lifetime banning outcome. There is a risk of a double penalty being applied for the same contravention of the law.

Sanctions to be listed on the Financial Advisers Register

Whilst there were no specific consultation questions for this section of the policy paper, we have nonetheless set out our response below.

We find it remarkable that a prohibition, a much more serious contravention of the law, may not be recorded on the Financial Adviser Register (FAR) (in the absence of a regulation to mandate this) when an infringement notice must be recorded on the FAR. We also believe that the inclusion of an infringement notice on the FAR is ridiculous, when it needs to come with the following disclaimers:

- "that the adviser has complied with the notice;
- that compliance with the notice is not an admission of guilt or liability; and
- the individual is not regarded as having contravened the provision specified in the infringement notice."

How will the inclusion of this message on the FAR be helpful for consumers? What should they interpret from this other than they may have done something wrong or they may not, however it takes up a huge amount of space on the FAR?

We are disturbed that Treasury would pay attention to those stakeholders who suggested that all disciplinary action (even where a sanction was not imposed) should be made public. To penalise someone for what could be the most minor of matters, for the long term, is unwarranted.

The fact that a record of a sanction cannot be removed, is evidence of a fundamental flaw in the system. It is not uncommon that people early in their careers make mistakes and they learn from these mistakes. The fact that a sanction could stay on the FAR for the rest of their career is unjust. As an example, if a young

adviser was to receive a sanction that included the requirement to conduct further training and this was the only sanction that they ever received, it would still need to stay on the FAR for the rest of their career.

Responding to the Proposal for Listing Sanctions

We strongly support the outcome where written warnings and reprimands would not be recorded on the FAR. That is a good outcome and one that we welcome. We also accept that suspension or prohibition orders should be recorded on the FAR, although we would argue that there should be a time limit, at least for suspensions.

In terms of a 'written direction by the FSCP to report specified matters to ASIC', surely the appropriateness of this being recorded on the FAR depends upon whether it is for a more material matter or not. If it is for a less material matter, such as completion of a small remediation matter, this should be unnecessary.

Equally with written directions to undertake specified training or receive specified counselling, or to receive specified supervision, we believe that the requirement to record them on the FAR should depends upon the severity of the matter and the significance of the training, counselling or supervision. Once again, we do not believe that it is appropriate to set a hard and fast rule on this.

If these items were mandatory to include on the register, then it might influence Panels in choosing the sanctions that apply.

We believe that recording suspensions and prohibitions should be mandated, written warnings or reprimands should not be recorded and all of 'reporting specified matters to ASIC', 'written directions to undertake specified training' or 'receive specified counselling', or 'to receive specified supervision' should be subject to the discretion of the Panel, and dependent upon the severity of the matter. They should also be able to take into account if it is a first-time offence.

Flow Chart Feedback

We note that the flow chart refers to matters that will not be investigated as they are past the statute of limitations or have been referred to another agency. It is not clear to us that these exclusions have been stated in either the legislation or the Explanatory Memorandum.

We also make the point that the box on investigations is confusing in terms of what matters might result in particular penalties.

In the reporting box, there is a statement about ASIC recording on the Financial Adviser Register a warning or reprimand (as per regulations), however the proposal paper suggests that a written warning or reprimand would not be recorded on the FAR. This appears to be inconsistent.

Concluding Comments

The AFA supports all measures to sensibly reduce the volume of minor and administrative matters that will need to be considered by either ASIC or a Financial Services and Credit Panel. The proposed regulation addressed in this policy paper may contribute to some reduction in the matters that would be considered by a Panel, however it is complex and adds a range of additional concepts. We would prefer to see an outcome that is straight forward and not subject to such a high level of discretion on the part of ASIC.

Until the legislation is passed, the Government still has the chance to fix the underlying legislation to ensure that the SDB regime does not become overwhelmingly complex and costly. We refer the Government to our recommendations that were provided to the Senate Economics Committee.

We strongly urge the Government to pay more attention to the practicality of this regime, the cost and application of reasonable consequences for advisers. The time has come for the Government to focus on making good decisions in the interests of all Australians, not just appeasing those who are making the loudest noise and have the attention of the media.

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