AIOFP
ASSOCIATION OF INDEPENDENTLY OWNED FINANCIAL PROFESSIONALS

CREATING A FAIRER COMPLIANCE REGIME

for Consumers and all stakeholders

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PETER JOHNSTON
AIOFP Executive Director

> The compliance requirements imposed onto Financial Advisers are complex, costly, bureaucratic, demanding, unnecessary and substantially inefficient.

Professional Planner magazine – Opinion piece 3/9/20
– Remember that thing called the Code of Ethics

Author **ROBERT MC BROWN AM,** Chartered Accountant, Independent chair of the Australian Defence Force Financial Services Council and a member of the Federal Governments Financial Literacy Board.

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1. Executive Summary

The objective of this Paper is to work with all industry stakeholders to develop an Adviser retail compliance regime that benefits Consumers whilst simultaneously and fairly works for all parties. We believe the fundamental problem are differing interpretations by stakeholders of the legislation which has led to a costly bureaucratic regime that ultimately Consumers are paying for.

The stakeholders we are referring to are:

- **Politicians**
- **Australian Securities and Investments Commission [ASIC]**
- **Australian Financial Complaints Authority [AFCA]**
- **Product Manufacturers [PM]**
- **Financial Advisers Standards Authority [FASEA]**
- **Financial Advisers [Advisers]**
- **Professional Indemnity Insurers/Brokers [PI]**
- **Consumers.**

The current compliance regime is not broken; in our view it just needs readjusting and coordinating to meet its obligatory and mandatory objectives of protecting Consumers from poor advice, product failure and excessive cost. The other important aspect is having sufficient practicing Advisers to service current and future consumer demand in a post COVID world.

An elementary facet to our discussion is ALL costs of compliance imposed onto Advisers is factored into their business model and ultimately Consumers are paying for it, this reality seems to be lost on some key stakeholders.

The other reality is Advisers have no choice but to inform their clients of why their fees have escalated and this may have wider political ramifications going forward.

The provenance of compliance legislation lays with Politicians, policed by ASIC/FASEA, implemented by Advisers/PM Compliance officers/lawyers and assessed by AFCA/PI if consumer complaints/losses occur. As previously suggested, we believe there needs to be more collaboration and coordination between all stakeholders to avoid confusion, bedevilment and/or disconcertion going forward.

Our intention is to conduct a Round Table discussion during October 2020 in Canberra [COVID permitting] and invite all stakeholders to attend either in person or via Zoom. The immediate objective is to present a restructured compliance regime for retail Advisers which will impact all stakeholders to varying degrees. We will invite and welcome stakeholder comment.

It should be noted that up to 1.5 million current clients are predicted to be disengaged from their Adviser within the next 6 months due to affordability factors. The average annual cost to maintain a client is over $6,000 per annum largely due to the current compliance regime, this must be reduced by at least 50% to retain most client engagement and supplemented with other incentives like the tax deductibility of advice.

Recently we sought feedback from our 6,000 Advisers in the AIOFP network on their views with compliance obligations and what can be done to improve the circumstances.

It has become very clear that there is significant confusion, variance and redundancy across the industry over the compliance fundamentals and their interpretation by compliance and legal Advisers.

In addition, the sensationalist manner in which regulatory concerns are conveyed have had a drastic effect on the operations of the PI industry in this country, substantially driving up PI insurance premiums which ultimately impacts consumers.

The outcomes are Licensees adopting 'over-the-top' compliance requirements believing it is better to have redundant, unnecessary measures in place than face the possibility of lengthy and expensive regulatory review and the possible inability to obtain or retain their PI insurance – a legal requirement for a Licensee to hold to be able to continue to operate.

Unfortunately, the overall result is a vicious circle of substantially increased compliance costs encouraged by third parties in an atmosphere of fear which ultimately Consumers are paying for.

We think it is time for Regulators such as ASIC, AFCA and FASEA to move away from their policy paradigm of not directly giving practical direction to Advisers on compliance matters. This culture has increased the uncertainty amongst the Adviser community and driven commercial opportunism by some parties to install a superfluous expensive compliance bureaucracy where the cost is being passed back to Consumers. The contribution of Regulators giving some meaningful direction to Advisers will significantly help to reduce the cost of advice for Consumers by demystifying the expectations and trepidations around the direction of regulatory policy.

The key Regulator to perform this task must be ASIC, they are feared and respected by the industry. The industry needs ASIC to be more interactive and move away from the current 'them and us' culture that has been cultivated over the decades by both sides.

We also believe that as part of the way forward more credence needs to be given to the experience of those giving advice (as is referenced in the Corporations Act section 961). Regulators may feel they are being treated as 'the enemy' by Advisers, but we can assure you that Advisers feel the same way with their treatment by all Regulators over many years.

Considering all Advisers and Regulators have a similar obligation to act in the best interests of consumers, it makes perfect sense for all to collaborate on a regular basis to assist each other to achieve this outcome – not wanting to involve COVID terminology but "**we are all in this together".**

We would like to implement a genuine round table quarterly discussion group going forward with ASIC where issues are tabled and discussed in an open Q&A format where Advisers can detail the practical implications and unintended consequences on any change's ASIC are contemplating. Decisions that impact the operations of a small business should not be done via press release and/or without consultation. These decisions are potentially affecting around 20,000 Advisers, 60,000 employees [who are predominately female] and 3,000,000 clients around the nation. For instance, ASIC latest **UNMET ADVICE NEEDS** project should be discussed with a committee of Advisers before going to the wider industry for comment, it will save everyone copious amounts of time, energy and confusion.

Advisers are at the coal face dealing with consumers and are highly respected by them [as demonstrated by ASIC's 627 Paper – 'What Consumers Think']; these people become 'family' and the last thing Advisers want is poor advice/capital loss or having to cut them off due to compliance costs. All regulators/stakeholders must understand and appreciate this axiom – Advisers want happy clients other wise they leave, its not good for business to have dissatisfied customers!

A constant theme in this discussion is the cost of compliance imposed by various stakeholders onto Advisers is immediately passed back to Consumers. We do not regret constantly stating this fact, it is at the very crux of why around 95% of Consumers will be deprived of Advice going forward and why Advisers are leaving the industry if the current trajectory is maintained.

The secondary objective of this paper is to create a level playing field for all Advisers to operate in. The carve outs from FOFA and recent legislation for some stakeholders has created a prejudiced landscape for retail Advisers to operate in.

2. Retail Adviser Concerns

The AIOFP agrees with the theoretical direction of FOFA and FASEA over the past 10 years but inconsistencies caused by contradictory approaches badly needs addressing. This confusing, overarching and inefficient environment is driving up compliance costs for Advisers who have NO choice but to pass this cost back to consumers.

The following are concerns raised by our members:

1. SOA vs ROA vs Letter

THE PROBLEM

The approach by the various parties when scrutinizing advice provided is the inconsistencies in that scrutiny; while Advisers are told that on one hand scaled advice is an acceptable form for advice provision, assessments made by Regulators regularly posit that additional material and disclosure is required, seemingly negating the acceptance of the use of scaled advice.

This scenario of regulatory contradiction causes great confusion within the advice community – what constitutes 'significant change', then by what manner should the situation be documented? Can the situation be dealt with utilizing a ROA or a short letter outlining the advice position, or is a SOA called for? If a SOA is called for, to what extent can the advice be scaled, or is a full situational advice SOA required?

While one would suggest that the situation should be relatively simple to decide an approach on, the inconsistency of treatment by Regulators causes this not to be the case. This leads to varying responses across the industry to reduce the regulatory risk on a business, ultimately leading to the adoption of an approach to have more compliance rather than less.

This need for such an approach is reinforced by having to demonstrate over the top compliance measures to PI insurers whose underwriting policies are directed at the results of the inconsistent regulatory approach and sensationalist messaging undertaken by Regulators.

Requiring more work throughout the advice process and its administration, the result is the creation of a substantial number of essentially unnecessary processes which subsequently drives up the cost of the advice service to the Consumer.

We note recent criticism in the financial press of "conservative licensees" creating this issue of an overburdening of compliance, and while this situation might be the cause, any conservative approach adopted is the direct result of a regulatory and enforcement experience that does not appear to take into account the practical considerations of the advice process.

THE SOLUTION

The Corporations Act 2001 (Cth) ("The Act") section 961 talks about the need for a person with a "reasonable level of expertise" determining the subject matter and exercising judgement on the clients situation and objectively assessing the clients relevant circumstances. We believe that such "reasonable level of expertise" includes experience in the actual provision of advice and what may be encountered during the advice process.

With reference to this aspect of the legislation we submit that the judgement of such issues by Regulators does not include such a 'reasonable level of expertise' and is not in keeping with the spirit of what the Act requires. While this situation continues there will always be a contradiction in the message communicated by Regulators and the way in which they actually regulate.

Because of this we believe it is necessary for those Regulators, when assessing the quality of advice in any given circumstance, also take into account how the advice process works in practical terms. It is our belief that this requires round-table consultation between all parties (Advisers, Regulators and Politicians) to determine a common approach to guide the future of the advice process.

We believe the outcome of this will be to give confidence to Advisers to act in a manner that is appropriate, give Regulators the confidence that (i) their message will be heeded as it is no longer contradictory; and (ii) provides better protection to both Consumer and Adviser alike, and removes the stress for Politicians by promoting a robust financial advice industry Consumers will have confidence to seek advice.

2. SOA Content

THE PROBLEM

A subset of the previous point, contradictory regulatory experience has driven the production of an advice document (SOA or ROA) away from being a tool to effectively communicate advice recommendations to a person with little or no knowledge of things financial. Instead, concern for meeting the requirements of legislators have driven advice documents to being weighty tomes that tick boxes from a list of inclusions, and fill Consumers with dread at the thought of having to read through it.

Indeed, with Regulators looking at how advice has been given it appears they do not pay attention to sections 947B (6) or 947C (6) of The Act:

"The statements and information included in the Statement of Advice must be worded and presented in a clear, concise and effective manner."

That this statement is made identically in each of the two sections of The Act noted above, it would suggest that this is an important point to adhere to when writing advice documents, and for Regulators to consider when documentation is presented to them. Experience though is that regulatory scrutiny, even of long and complex documents, consistently finds that additional materials should have been included.

We do note that Regulators have promoted the provision of scaled advice; unfortunately the regulatory regime does not appear to give credence to an Advisers "reasonable level of experience" when assessing what the important inclusions are in scaling and providing the written advice. More weight needs to be given to the actual advice experience and process; different clients have different needs which follows that different approaches and SOA inclusions will be required.

THE SOLUTION

While Regulators continue to state their acceptance for scaled advice this should be reflected by all players in the regulatory process. This includes the application of regulatory scrutiny to recognize the viability of scaled advice documents, based on the situation at the time of which they have been presented (i.e. not making any determination using hindsight that was not available at the time the advice was given).

Furthermore, work must be undertaken by the Regulators to educate the industry on their perception of what scaled advice should look like, when it is acceptable and a format by which it would be accepted (ASIC's Regulatory Guide 90 is a good start, but only a start). This should be an important part of the round table discussions recommended for point one, with ongoing input from industry to ensure a common view and communication of scaled advice in the marketplace.

3. Service Definition

THE PROBLEM

There is much confusion around the industry over what Regulators expect in terms of the 'fee for no service' issue. This is driven by what is seen as vague and contradictory determination by of what constitutes "service" by Regulators making determinations on where a 'fee for no service' issue has arisen.

We need to point out that during their interaction as part of the advice process a consumer and an Adviser generally know what they want in a service sense, and what this will actually include. However, in trying to meet perceptions of what a Regulator determines is required can involve the inclusion of additional service items that subsequently drives up the cost of Advice which when instigated may not necessarily be in the best interests of the client.

Regulatory involvement in this area we find to be troubling; with Regulators getting involved from a distance in a 'carte blanche' manner this is not only expensive for the consumer but unheralded in the history of Public Service interaction with business. Indeed, we question whether such actions are anti-competitive and should be referred to the ACCC.

THE SOLUTION

A less invasive and prescriptive approach by Regulators. We need to discuss the content of Information Sheet 232 and point out that both Consumers and Advisers are capable of deciding what level of service they want and price it accordingly; if Consumers don't like an Advisers service going forward they simply don't pay it and move on. With all due respect, Regulators must realize that having their own prescriptive approach is an overarching intrusion that is generally unwanted by both Consumers and Advisers and only serves to increase the cost of advice.

4. LIF and Risk Advice Specialisation

THE PROBLEM

The ramifications of the LIF Legislation can only be described as a dismal failure for all stakeholders. Government must realize that Consumers do not necessarily seek out risk advice, and regard premiums as a burden and not a necessary expenditure. The devastating affects across the industry has hurt consumers. Premiums have risen, Company losses has led to workplace redundancies clearly indicating that the 'dropping of commission experiment' is a disaster. The UK and NZ also tried this and failed too - commissions are back to 240% and 180% respectively.

The current level of commission is generally not enough to cover the costs of delivering risk advice to Consumers when considering the Regulators expectation of long and complex advice documents to deal with specific issues that would easily be dealt with under a scaled advice situation. Unless commission levels are addressed, having to meet the costs of advice by charging additional fees will further deflate the industry from the position it has already succumbed to under the imposition of LIF.

Australia has a major problem with underinsurance which unless these issues are addressed will only get worse in the future. This will in turn translate to a burden on the government purse with those under- and uninsured seeking support from social security.

THE SOLUTION

Return the commission back to pre LIF conditions. Off-shore research in countries like UK and New Zealand will confirm that a 'no commission' environment is not what consumers or Advisers want. Former Minister Shorten recognized this when excluding Risk products from the FOFA commission ban. If such a move were to include capping commissions at the higher pre-LIF level we would support this, as capping removes the conflict element from this remuneration (if no company can offer more than another there can be no incentive that would create a conflict).

A philosophical idealist approach to wanting a 'no commission' Risk Industry environment will be the ultimate disaster to an already devastated LIF affected industry.

5. Consent Forms

THE PROBLEM

The proposed Consent Forms are another expensive and unnecessary imposition of paperwork that will drive the cost of compliance up by around $1400 per annum on top of the current $6,000+ cost. They not only duplicate existing information but are arguably an invasion of privacy for Consumers and will cause administration and compliance difficulties in order to produce the additional documentation that PMs are proposing, who will in turn need to increase their costs to Consumers via their Management Expense Ratio [MER] to fund it.

THE SOLUTION

We recommend the requirement for consent forms is dispensed with; it is an unnecessary and expensive imposition on the industry that will only drive up costs for Consumers with the time that will need to be spent in.

If Regulators do introduce a requirement for this, PMs should be aware that any attempt to implement measures excessively beyond the requirements stipulated will ultimately create additional costs for Consumers. In order to act in the clients' best interests, we expect an Adviser will have to reconsider the use of such a product and act to move to a different, more overall cost effective PM to ensure a Consumer is not disadvantaged by the resulting cost of prohibitive measures.

6. Opt In

THE PROBLEM

The proposed Opt In measures are considered another overarching, unnecessary and duplicated imposition on the industry, creating additional compliance procedures that Consumers will pay increased costs for. All fees are disclosed on at least 4 different occasions through the SOA, FSG, FDS and application forms and having to do it again is bordering on absurdity.

THE SOLUTION

We strongly suggest it an unnecessary imposition on the industry that clients are paying for and it needs dispensing with. Regulators should review the current legislation and guidance in place to satisfy themselves that advice costs are disclosed in a timely manner at all stages, providing more than adequate opportunities for clients to understand what is being charged and from what source.

7. A Level Playing Field For Advice

THE PROBLEM

The carve out in-house Superannuation Advisers received for delivering limited scope advice [i.e. intra fund] to members should either be scrapped or made available to all Advisers. It is unfair allowing in house Superannuation Advisers to operate in a conflicted vertically integrated environment to circumvent the retail compliance regime and not give retail Advisers similar conditions where appropriate for client's needs.

It should be noted that in the Money Management Magazine dated 27/8/20 an article titled 'Industry Funds cite ASIC, FASEA and Hume on Intra Fund advice' the Industry Fund lobby addresses the Parliamentary Committee saying ASIC, FASEA and Minister Hume respectively stated 'limited scope advice can be delivered in a compliant manner', FASEA specifically assured a SMSF seminar that 'limited scope advice can be compliant with FASEA Code of Ethics'....and Minister Hume recently suggested there should be 'a far more prominent role for single issue advice'.

THE SOLUTION

Allow all Advisers to operate under the same rules. If retail Advisers are permitted to operate in a similar fashion to intra fund conditions with current and future clients, the cost of advice for Consumers will reduce.

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3. Compliance Costs – Current vs. Ideal

Compliance expert Phillip Osborne has constructed two tables of current compliance costs for an initial engagement and then an ongoing relationship with a single or couple for consideration. The comparison is based on an average client profile and costed at $250 per hour.

The 'CURRENT' numbers take into account the existing compliance regime and including the proposed Consent Forms and OPT IN. The 'IDEAL' numbers represent eliminating the duplication and irrelevant measures which in our view does not compromise consumer security or transparency.

This comparison clearly highlights the costly role the SOA plays with client engagement and why it is critical ASIC gives the market clear unequivocal direction on what should and should not be included in this document.

Initial Engagement

Hourly rate $ 250.00

Compliance task	Current Hours involved	Ideal Hours involved
Record contact details	0.5	0.5
Pre-appointment administration and follow up	1	1
Initial interview	1.5	1.5
Post interview admin (notes, input data to CRM)	1	1
Due diligence	4	4
Review due diligence and strategies	2	2
Product comparison (where required)	3	3
Production of Statement of Advice	10	4
Presentation of Statement of Advice	1.5	1
Post interview file notes	1	1
Implementation of agreed financial products	3	1
Administration of consent form remuneration	6	1
Establishment of ongoing review process	2	2
	36.5	**23**
	$9,125.00	**$5,750.00**

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Ongoing Engagement

Hourly rate $ 250.00

Compliance task	Current Hours involved	Ideal Hours involved
Administration of financial product	2	2
Response to client initiated contact	1	1
Collation of supporting information for review	2	2
Client data gathering on personal situation	1	1
Due diligence	3	3
Review due diligence and assess current strategy	1	1
Product comparison	1	1
Produce Statement of Advice/Record of Advice	8	2
Presentation of Advice Document	1.5	1
Post interview file notes	1	1
Implementation of agreed changes	2	2
Administration of consent form remuneration	6	1
Administration of Opt In	6	1
Adjustment to ongoing review process	1	1
	36.5	**20**
	$9,125.00	**$5,000.00**

The comparison tables clearly demonstrate why most Consumers cannot afford advice if the current Compliance regime is maintained, this simply cannot go on. A constructive ongoing dialogue between all Regulators and Advisers needs to be augmented to rescue the industry from excessive cost and consequently irrelevance to consumers.

4. Summary

As we have indicated many times in this paper, stakeholders must understand that ALL compliance costs imposed on Advisers are ultimately levied onto the Consumer. In the past Grandfathered revenue was used to offset these costs to service smaller clients, unfortunately this no longer applies. It is predicted there will be 1.5 million clients soon to be left without their Adviser as a direct result of this legislation, Consumers are starting to ask why their Adviser fees have escalated and who is to blame.

The current direction on compliance will eventually lead to 95% of consumers being priced out of the market and a greatly reduced Adviser population only servicing wealthy clients who can afford the compliance costs will be left. We do not think this was the vision Politicians originally had. In addition, the global consumer experience with digital/robo advice is highly questionable, it is a conflicted digital version of vertical integration and we believe humans prefer to deal with humans face to face over private financial matters rather than machines.

Even though we will not dwell on this issue, the grossly unfair blaming of Advisers for past product failure has also contributed to this imposition of a complicated and time-consuming compliance regime full of redundancies. It is rather ironic that consumers are paying for this unwieldy regime that was implemented to supposedly protect them, but the reverse is now happening - 95% cannot afford the advice costs and will now be left alone in a complicated post COVID market without assistance. A very worrying outcome for the Nation going forward.

Some stakeholders need to understand that the past culture of Advisers recurring income streams/ trailing commission was not generally understood by Consumers BUT they do understand paying directly for a service and whether it is value or not. The gross over reaction to this has been the questionable invasion into the adviser/client relationship with prescriptive measures. This almost infantile encroachment is simply not wanted by either parties and the irony is its driving up the cost for those it is meant help – Consumers.

In order to keep costs down, Consumers need ASIC to give clear direction to Advisers on the compliance fundamentals they expect. In turn, Advisers need to take more direct responsibility to understand and question the many varying opinions and direction from third party legal or compliance consultants and whether what is being proposed is redundant or required.

Unfortunately, it will be the less well-heeled clients that arguably need advice [more than the higher net worth individuals] but they will suffer going forward with an unaffordable advice environment. This emerging reality has huge ramifications for the Nation's future welfare conundrum where over $200 billion is spent annually on welfare payments today. To protect the future financial position of the nation for generations to come, all Consumers need access to professional financial advice.

The carve out for Superannuation Fund Advisers has created a distorted advice environment. We agree that limited scope of advice should be utilized to keep the price of advice down BUT it should be made available to ALL Advisers not just Superannuation Fund employee Advisers.

The next question is 'who funds this advice?' Commissioner Hayne castigated the 'fee for no service' culture of the Institutions; we suggest all members of a Super fund getting levied a margin to fund an Advisory service that only a fraction of members use is just that – fees for no service. We also suggest these Superannuation Advisers getting bonuses for keeping members cash in the fund is tantamount to receiving a commission for conflicted advice, a clear breach of FOFA rules and quite possibly a contravention of the need to provide advice in the client's best interests.

If all stakeholders' objective is to lower the price of advice for Consumers without detracting from security and transparency, the irrelevant, invasive and redundant compliance functionality aspects needs to be removed. We believe Advisers who operate in this space 24/7 are the best option for the Regulation consultation process.

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