# Dismantling reforms may be the only option

April 30, 2020

**Matthew Smith and Tahn Sharpe**

https://www.professionalplanner.com.au/2020/04/dismantling-reforms-may-be-the-only-option/

The financial advice and indeed the broader financial services industry has found itself holding a basket of reforms and half-cooked regulations which are mostly ill-fitting, plagued both by gaping holes and unfortunate overlaps.

Far from thoughtfully conceived, these reforms have been rushed into existence by a government keen to change the public's perception that it has been weak on policing and regulating the sector.

Rather than spend the time required to design reforms to shape an industry – giving credit for the ground already traversed as well as for the challenges ahead – government has decided to move quickly and base its new regulation roll out solely on the findings of a royal commission that, while desperately needed, was clearly retrospective and focused solely on misconduct.

Experts in policy and government reform who spoke with Professional Planner believe it is unlikely much of what has already begun can be stopped, and that genuine reform won't begin until much of what is currently in the pipeline makes its way through the system and a review is conducted.

Despite all the effort, lobbying and posturing over the last year and a half, many believe that the sector – the fourth largest in the country accounting for close to 10 per cent of total business investment (GDP) – is heading for an inevitable FREXIT (financial regulation exit).

Far from being a victim in the current policy and regulation quagmire, though, the financial services sector and the financial advice industry in particular only really has itself to blame.

## REGULATION SIDESTEP

For 20 years or more, retail financial product manufacturers led by the big four banks have done their best to appropriate advice for the purposes of product distribution. These institutions have used their power and influence as the largest employers in the industry and the most-widely owned by individual and institutional share-holders, to lobby government, to influence regulators and to keep the moral checks and balances at bay.

But when you strip back all of the years of awkwardly designed policy, watered down legislation and layers of regulatory guides, at the core of its guiding principles still exists the beating heart of a fiduciary duty advisers have to their clients.

"Unfortunately the financial advice industry has tried to forget this or pretend it doesn't exist, but it already has the duty of a full and frank disclosure as a fiduciary, without which you can't act," says Scott Donald, University of NSW Law's director of the Centre for Law, Markets and Regulation. Donald points to the so-called 'suitability rule' that came into existence almost 35 years ago in 1986, which made it "pretty clear" back then advisers were fiduciaries.

"Layers of legislative architecture have been put on top of these general fiduciary obligations designed to make clear what it meant, but either through ignorance or deliberately advisers haven't been meeting their obligations and it hasn't been enforced," he says.

It was the regulators ASIC and APRA that came under considerable fire during the Hayne hearings and in the subsequent reports for not regulating effectively and for the close relationships they had built with industry and in particular large institutions.

## STUCK IN THE MIDDLE

At the front line, advisers are finding the residue of decades of reform severely hampering their ability to focus on and service clients.

"In the Corporation Act, one of the headline general obligations is to act "efficiently, honestly and fairly". Legislators and regulators are quick to quote 'honestly and fairly' from the Act but I'm not so quick to quote the efficiently part," says Peter Foley, owner and financial adviser at IOOF-licensed Sydney-based practice, Thirdview.

Foley says from his perspective some of the newer pieces of legislation and codes have actually created conflicts with existing legislation.

He points out the ambiguity of the FASEA (Financial Adviser Standards and Ethics Authority) Code of Ethics is in conflict with other more prescriptive rules advisers are required to meet.

Similarly, Paul Moran, a self-licensed adviser in Melbourne, acknowledges his "overarching obligations to ensure best interests" but then highlights the prescriptive obligations to conduct an annual review every year.

While Treasury has issued draft annual opt-in rules for consultation, this legislation remains in draft exposure stage while government takes a break at least until August.

"We moved to annual engagement [with clients] two years ago, I have no problem with annual engagement, I speak to most of my clients 20 times a year, but the regulator is telling me I still need to conduct an annual review… It's this kind of oversight and double handling that's making it impossible to run a business," Moran says.

He points out that software costs to produce compliance documents in order to satisfy the annual review and other such obligations effectively circumvent the business's capacity to make his clients' best interests a priority.

"Our Xplan costs are up to $60,000 per year, which is actually quite low compared to some other practice I know that are spending as much as $100,000. I have nothing against Xplan other than it's a tool purely for the regulator's benefit and not for the client," he says.

Moran goes on to explain that such costs, combined with the difficulty of bringing new advisers on that are able to contribute revenue to the practice straight away in light of FASEA's new education and professional year requirements, are hampering his ability to service clients along with giving the regulator what it needs and also making a profit.

"The numbers aren't stacking up," Moran says.

"I'd love to do an audit of all the advice legislation that's come through and check how much of it actually helps clients," says Simon Carrodus, solicitor director at The Fold Legal, who has previously had stints as an in house council at CBA as well as ASIC.

"For a long time I wondered about the real value of FSGs (Financial Service Guides), they're pretty harmless but does the client get any benefit from them?"

"You look at the whole thing through the prism of – is this going to help clients? Yes, some of it works towards prohibiting conflicted remuneration. But some of the other stuff makes life really hard for advisers and offers no benefit. Just put a line through it," Carrodus comments.

"I think we should take a leaf from the old Kerry Packer adage: 'You should only be able to pass a law when you take one away'," he says.

## CHASING OUR TAIL

"Regulation has gone too far, but it makes sense as to why because we are constantly trying to chase the tail of fixing a problem and with constant bad behaviour by some," says Bernie Ripoll, the former Labor Financial Services Minister who was the principal architect behind the Future of Financial Advice reforms.

"Have we got too many rules, is it too difficult, does it lose sight of the objective to provide quality advice? Yes, yes and yes," Ripoll says. Ripoll points out that the only outcome of a government using the royal commission as a basis for its reform agenda would be "a lot more rules".

UNSW's Donald agrees the royal commission findings are the wrong basis for policy outcomes.

"The royal commission wasn't given the resources to give a policy review, it was a royal commission into misconduct. The whole process of developing policy takes a lot more than a couple of months and a couple of forensic lawyers and accountants," Donald points out.

"For Hayne to say 'here are the problems I found and here's what you should think about' and then for government to say 'we are going to do all of them' – it was a function of the weakness of government at the time because I believe it felt very vulnerable on that area. It would have been better if they took some time and tried to make something that was coherent and cohesive, not backing away from the royal commission or diminishing the report in any way," he says.

Treasurer Josh Frydenberg's latest reform package based on the 76 recommendations Hayne outlined in his final report is the largest and most comprehensive corporate and financial services law reform package in the three decades since the Corporate Law Economic Reform Program in the 1990s. It includes changes that have already come to bear on financial advisers or are about to be implemented, including the banning of grandfathered commissions, changes to annual opt-in arrangements and independence disclosure. Other changes overarch advisers including the proposed amendments to corporate and financial sector penalties and cooperation directives for regulators. There are also proposed changes that will shape the industry down the track including continuing reforms around the payment of commissions in the insurance industry.

One thing Ripoll, Donald and other policy experts spoken to by Professional Planner highlight is the government's mistiming of the reforms or what Donald refers to as a misreading of the "regulatory dialectic" which represents the ebb and the flow of industry and government's action and reactions to regulatory movements.

Even before Hayne's final report the banks were moving to sell their wealth businesses and restructure their other wealth assets to prepare for a non-institutionally owned advice future.

It didn't matter that Hayne didn't ban vertical integration, the institutions had already moved and they continued to go down the path of breaking up their product distribution networks.

"What you end up with is an imaginary line approach where you design the regulatory system that would have dealt with the last crisis, not recognising that of course, things have moved on," Donald describes.

Frydenberg's office was given the opportunity to comment for this article but had not responded to a request by press time. ASIC declined the opportunity to comment for this article on the basis that reform and policy development are a matter for the government and not the regulator.

## PENNY FOR YOUR THOUGHTS

Whether the pause in the implementation of reforms created by the current COVID-19 crisis

situation results in a rethink or a re-evaluation by government and regulators is a matter for the tea leaves.

Annual opt-in rules were supposed to take effect in July, but this Bill remains in draft exposure status while government remains in hiatus.

Meanwhile, industry has already moved, with product providers including Commonwealth Bank's Colonial First State and advice network IOOF already adapting their communications and systems to reflect the new rules.

Calls for the combining of backward-looking financial disclosure document (FDS) and the forward-looking annual renewal document have begun to mount among practitioners and service providers looking ahead for ways to navigate new requirements.

"Reversing things is very difficult, pausing is exceptionally difficult," Ripoll says, referring to the reform process.

"...But there are a lot of things that haven't been done yet," he adds.

However, UNSW's Donald and Ripoll agree that the recent shift of the government's focus to more immediate issues relating to the stimulus and indeed the survival of the economy following COVID-19 lockdowns is unlikely to work in favour of those wanting a complete regulatory rethink.

"The priorities are different now. The government will be prepared to let a lot more things through as they are. The economy is more important, all the other things are less important... We have an economy to rebuild, jobs to create. When everyone loses their jobs a lot of things become less important," Ripoll says.

"The attention of government has moved to a new set of problems. There's a good chance the opportunity for a rethink of the current reforms has past," Donald says.

What's still missing is a clear vision for what the financial advice industry ought to look like, Donald adds.

“If you don’t know what the objective is it’s very hard to create policy that shapes an industry we all want,” he says.