

## SUBMISSION TO THE QUALITY OF FINANCIAL ADVICE REVIEW

by

ROBERT M C BROWN AM FCA

### The Writer

*I am a chartered accountant and registered company auditor with over 50 years of experience in public practice, including auditing, taxation, personal financial advice and superannuation. Throughout that time, I have written extensively about ethical and structural reforms in financial advice and in superannuation laws and practice.*

*I am the author of “Reinventing Financial Planning” (Institute of Chartered Accountants in Australia) which outlines a model for trusted, conflict-free, high quality, accessible and affordable financial advice in the profession. I am co-author of “Australian Superannuation Practice” (Law Book Company/Australian Tax Practice).*

*I have acted as a trustee director of several large superannuation funds. In 1994 I was awarded the inaugural Trustee of the Year Award by the Conference of Major Superannuation Funds. I was a member of the Australian Government’s Financial Literacy Board, a director of The Ethics Centre and a member of the National Executive and Council of the Institute of Chartered Accountants in Australia (now Chartered Accountants Australia New and Zealand).*

*Between 2007 and 2022, I was Chair of the Australian Defence Force Financial Services Consumer Centre a body within the Department of Defence which designs and presents over 200 “through career” independent financial education programs annually to Australian Defence Force members, families and veterans, including education on accessing quality financial advice.*

*I am a member of ASIC’s Consumer Consultative Panel and the Technical Working Party on Financial Planning of the Accounting Professional and Ethical Standards Board. I am a director of Ecstra Foundation Limited, a charitable grant making body which supports community-based programs in financial capability education.*

*In 2013 I was awarded membership of the order of Australia (AM) for my significant contribution to the superannuation industry.*

## **Executive Summary**

**This submission proposes that the key strategy required to achieve the objective of the Quality of Financial Advice Review, namely widespread access to high quality, accessible and affordable financial advice, is to rid the industry of conflicts of interest, especially those inherent in all forms of product-based remuneration and related incentives.**

Successful execution of this strategy requires proper enforcement and interpretation of the mandatory **principles-based Code of Ethics** for which ASIC became responsible from 1 January 2022. In that regard, it will be most important that the Code is not diluted in its words and/or interpretation (especially, but not only, Standard 3) which would allow the continuation of certain forms of conflicted remuneration that are not currently banned by the Corporations Act, but are effectively precluded by the undiluted Code. These include %-based asset fees (currently banned on gearing only), life insurance commissions, profit shares on in-house or white label products and similar product/platform based incentives.

Provided the Code is properly enforced and is not diluted, the industry's culture and behaviour will change to that of a true profession. As a result, much of the complex, costly, compromised and ineffective regulatory regime in the Corporations Act could be repealed (including the safe harbour provisions), thereby substantially reducing the cost of delivering financial advice.

This strategy would also lead to the creation of trust by the public in the new profession of financial advice, encouraging many more people to seek advice at a reasonable cost. That is, financial advice would become the high quality, accessible and affordable and trusted professional service that the Review is seeking to create.

However, if government were to reduce or dilute the regulatory regime (and therefore, the cost of advice) without the adoption of the "conflict-free" strategy outlined above, the result would be an even greater amount of conflicted advice. That would be a poor outcome for the industry, for government and for the Australian community. It would be the opposite result sought by the Hayne Royal Commission and the mandatory Code of Ethics.

Importantly, the strategy outlined herein requires **no additional legislation**. In fact, it relies on the repeal of much of the existing regulatory regime in the Corporations Act which is complex, costly and ineffective (indeed, if the existing regulatory regime were effective, this Review would not be taking place). It would be replaced by the mandatory Code of Ethics which, provided it is properly enforced and is not diluted, would be effective in achieving the desired objective of this Quality of Financial Advice Review.

### **The Current Regulatory Burden**

A day rarely passes without someone in the financial advice industry publicly complaining about the regulatory burden imposed on advisers. One industry leader has even claimed the burden has become so great that several large advice groups are now moving away from servicing retail clients in favour of wholesale clients where the regulatory requirements and commercial risks are considerably lower.

Given widespread, if not universal acknowledgement that the industry's complaints are reasonable (even though, ironically, the industry has caused much of the problem in the first place), why hasn't the burden been lifted? Indeed, why is it continuing to grow, for example, with claims of an additional impost on advisers arising from the new product design and distribution obligations?

### **A Deficit of Trust**

**The uncomfortable answer is that the Australian community doesn't trust the financial advice industry to deliver on what amounts to a 'social contract'. The terms of the contract would be that the industry must behave as a true profession in return for lifting much of the costly, complex and substantially ineffective regulatory burden on its participants about which it so strongly complains.**

### **Code of Ethics**

The community's hesitation is hardly surprising, given the revelations of the Hayne Royal Commission and the negative attitude of many in the industry towards FASEA's mandatory principles-based Code of Ethics which commenced on 1 January 2020. This attitude is regrettable because the Code offers a wonderful opportunity for financial advisers to break free from overbearing regulation about which they so strongly complain and to

transform themselves into true professionals based on an individual's judgement about the meaning and consequences of a short set of ethical principles.

Does the industry really want to grasp that opportunity? I suspect that with the benefit of hindsight, some advisers are having second thoughts. They may be wondering whether all the rhetoric about the 'journey to professionalism' has been worth the cultural and behavioural change that they now realise must necessarily follow. It's not just a case of claiming to be a profession and it will be so. There is a price to pay. It seems that for some, the price may be rather too high.

### **Conflicts of Interest**

The principal sticking point in the Code of Ethics continues to be Standard 3 which requires financial advisers to avoid, not just to disclose, conflicts of interest. The plain English words in this "Ethics 101" standard unavoidably lead to the commercially inconvenient conclusion that %-based asset fees, life insurance commissions and other forms of product sales incentives are unacceptable in nearly all circumstances where financial advisers purport to offer professional advice in a client's best interests.

Realising this, some participants in the industry are now seeking "clarity" from government. Many of these calls for "clarity" are disingenuous. They are not due to a lack of understanding of the meaning of the words in the standard. On the contrary, most of the complainants know exactly what the standard means, but they are not prepared to accept the inevitable conclusion.

In this context, the word "clarity" is code for diluting, reinterpreting or rewriting the words of the standard so that its meaning aligns with those participants' business models. If that outcome happens, the industry will be back to "business as usual", the mandatory Code of Ethics will become little more than another ineffective overlay of red tape and the public interest will not have been advanced.

The industry can't have it both ways. It can't expect government to remove the regulatory burden about which it complains, while retaining the conflicts of interest which caused the problem in the first place. This must never happen.

## The Solution

**However, if the industry were to embrace the principles in the Code of Ethics and the behavioural consequences that follow, it would be in a strong position to argue (and government should feel confident to accept) that the Code should replace much of the tortuous and ineffective regulatory regime in the Corporations Act (including the safe harbour provisions). Put simply, much of that regime would become unnecessary.**

The future is substantially in the hands of the industry. Do financial advisers want to be treated (unfairly or not) as a product salesforce and distribution network whose lives are controlled by a government's ever-expanding, intrusive and costly regime of rules and regulations? Do they want to continue advising clients under the pressure and influence of conflicts of interest? Do they want to be participants in a demoralised, shrinking industry, servicing a sceptical community that can't or won't pay their ever-increasing fees?

Or do financial advisers want to be treated as members of a trusted profession in which they are given the freedom, privilege and responsibility of making professional judgements in the context of a short principles-based Code of Ethics? Do they want to be participants in a confident, growing and respected profession? Do they want to service a community that can afford to pay its professional fees (thanks to substantially reduced costs of regulation)? And do they want to see young people joining their ranks, confident that they are joining a genuine profession that is making a positive contribution in the community?

In posing these questions, it is important to acknowledge that many financial advisers are making judgements every day in their clients' best interests. I'm certainly not suggesting that the financial advice industry is full of dishonest people. In fact, there are many fine people in the industry whose honesty, integrity and professionalism is admirable.

However, it's undeniable that the industry's culture and practises continues to be affected by deeply embedded conflicts and other ethical issues which are addressed in the Code. We're not just talking here about the actions of a few bad apples.

## **Impact of the Code**

Ultimately, the question is whether the principles-based Code of Ethics can resolve these problems and transform the industry into the genuine profession that the community expects it to be. Without doubt, it can. I submit that those who believe that the industry can survive and prosper without the Code (or with a diluted version of it) are unrealistic and out of touch with what the Australian community expects and deserves.

The principles-based Code of Ethics is the future of a **genuine profession** of financial advice. Therefore, it should be embraced by the industry in good faith, with enthusiasm and confidence.

Furthermore, the Code is the key to achieving the objective of this Quality of Financial Advice Review, namely **high quality, accessible and affordable advice**.

If that objective is achieved:

- 1) advisers will be thankful because the regulatory burden will be substantially reduced;
- 2) the cost of advice will be substantially lower;
- 3) widespread and justified public trust will be created;
- 4) more consumers will seek out financial advice in the knowledge that it can be trusted and is reasonably priced;
- 5) more young people will enter a profession in which they can believe; and
- 6) government will be able to properly claim (after many decades of failures) that a true and trusted profession has been created.

## **A Practical Strategy**

This strategy is not theoretical and impractical. In fact, I submit that we are deluding ourselves if we conclude that the industry's culture, behaviour, trust and cost of service delivery can be improved by more regulation and without the adoption of an undiluted principles-based Code of Ethics.

Failing this, we will continue to play around at the edges of reform, creating more disingenuous workarounds, compromises and delays (as we have for the last 40 years). This process has achieved little or nothing for consumers, financial advisers and governments alike. In fact, arguably, it has been detrimental to the interests of all of those stakeholders and its failure will

inevitably lead to more scandals, more conflicted behaviour by the industry and to more ineffective, costly and complex regulation.

ASIC's scarce resources should be directed to regulating poor behaviour, not overseeing the technical compliance of financial advisers who are acting in the best interests of consumers. The Code of Ethics (provided it is not diluted) offers that opportunity because it will change the industry's culture, ethics and behaviour in a way that a compromised and complex regulatory regime can never do.

Importantly, I stress that **no new legislation** is required to adopt the strategy discussed in this submission, save for that which is needed to repeal much of the current ineffective and costly regulatory regime in the Corporations Act.

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