

Quality of Advice Review

Submission to Treasury's Issues Paper
Australian Financial Complaints Authority

June 2022

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Introduction

The Australian Financial Complaints Authority (**AFCA**) is the independent external dispute resolution (**EDR**) scheme for the financial sector. AFCA's purpose is to provide fair, independent and effective solutions for financial disputes. It does this not only by providing fair dispute resolution services, but also by working with financial firms to improve their processes and industry standards of service, thereby minimising complaints.

In addition to providing solutions for financial complaints, AFCA has responsibilities¹ to identify, resolve and report on systemic issues and to notify the Australian Securities and Investments Commission (**ASIC**), and other regulators, of serious contraventions of the law. More broadly, AFCA plays a key role in restoring trust in the financial services sector.

AFCA welcomes the opportunity to provide a submission² in response to the Quality of Advice Review (the Review) consultation by Ms Michelle Levy (the Independent Reviewer) and Treasury. The Review is looking at the current financial advice regulatory framework and potential realignment of regulation from predominantly rules based, to a principles-based framework.

AFCA notes that the review will consider the full scope of financial advice and the forms in which it is provided, from comprehensive personal advice provided by financial advisers to general advice provided by product issuers.

We also note that in addition to considering whether the regulatory framework provides appropriate safeguards, the Review will explore whether changes should be made to facilitate the delivery of advice that achieves a greater balance between key advice factors of quality, accessibility and affordability.

AFCA's submission is informed by our experience and that of our predecessor schemes. Given our role as an EDR scheme, AFCA considers we can be most useful to the Review by focusing our submission on the following areas:

- 1 Observations on advice issues identified through our complaints handling process and considered under our systemic issues function;
- 2 General comment on the proposed changes to the financial advice regulatory framework; and
- 3 Provision of data on advice related complaints captured since AFCA was formed (November 2018).

¹ Refer to Part C, Reporting Requirements, of [ASIC Regulatory Guide 267: Oversight of the Australian Financial Complaints Authority](#).

² This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

Key points

AFCA welcomes the proposals put forward by Ms Levy and Treasury that look to simplify the regulatory framework and, subsequently, make obtaining quality advice more attainable for all.

To this end, we note the Review's reference to the gap between the real cost of financial advice as opposed to what consumers are willing to pay (depending on the scope of advice)³, and its inquiry into what elements of meeting the regulatory requirements contribute most to costs. AFCA supports greater consumer access to affordable quality advice, including to types of advice that may be relevant to all life stages. However, amending the regulatory framework from predominantly rules-based to a principle-based environment, comes with challenges. These include:

- Ensuring consumer rights and safeguards are maintained.
- The Review's Issues Paper affirms that there are trade-offs involved in balancing a flexible, simple, principle-based approach with providing clarity and certainty to stakeholders.

If a principle-based regulatory approach is adopted, AFCA supports the provision of clear guidance to assist with understanding. We consider the provision of well-drafted guidance to be a win/win situation for financial firms, consumers and relevant bodies, to ensure a reasonably uniform understanding of rights and obligations.

- AFCA notes that the Review will consider whether it is appropriate to remove safe harbor provisions and the potential for reduced regulatory costs as a result⁴. AFCA makes no comment on whether the safe harbor provisions should be removed. However, if these provisions are removed, as suggested above we would suggest more guidance be provided to assist advisers to understand their obligations. This guidance should be provided in as practical, informal and easy to read way as possible, ideally with consultation.

Complaints relating to financial advice are a relatively small proportion of the total complaints received by AFCA in any year. While the volume of complaints may not be significant compared to other industry sectors, issues do occur, and they can have a significant impact on consumers. We refer to some of these issues in our submission.

³ ASIC's Consultation Paper 332 Promoting access to affordable advice for consumers (CP 332)

⁴ Financial Services Council White Paper, p 7.

A. Overview

AFCA's Complaints process

In order to provide financial advice a person is required to hold an Australian financial services licence (AFSL) or be a representative of a licensee. All AFSL holders must be a member of AFCA, by way of their license conditions.

As an independent not for profit EDR scheme, and as mentioned above, AFCA has several functions that include investigating and resolving consumer and small business complaints.

Individual complaints lodged by consumers and small business are considered as part of our complaint resolution process. In these complaints, we consider the specific circumstances that each complaint presents, in accordance with our Rules and Operational Guidelines (OG).

AFCA's Systemic Issues obligations

In accordance with section 1052E of the *Corporations Act 2001* (the Act), and ASIC *Regulatory Guide 267: Oversight of the Australian Financial Complaints Authority* (RG 267), AFCA has an obligation to identify and report contraventions, breaches and systemic issues.

Most of the systemic issues investigations conducted by AFCA are initiated after a consumer or small business complaint we are considering indicates that the financial firm's conduct, processes or systems etc. have resulted in or caused a systemic issue. A systemic issue is defined in our Rules as an issue that is likely to have an effect on consumers or Small Business beyond the parties to a complaint.

In these instances, AFCA refers the issue to the financial firm for a response. If a definite systemic issue is ultimately identified by AFCA, we work with the financial firm to resolve the issue, including any remedial activity that should be undertaken.

B. Advice complaints and systemic issues

Complaints

The complaints data provided in Annexure 1 provides a point in time breakdown (since AFCA's inception in November 2018) of the number of advice related complaints we have received and considered, their outcome and average compensation awarded.

The data tables capture all complaints recording 'Advice' as an **Issue** for the relevant **Product Type** (complaints can have multiple issues). The data tables represent a high-level snapshot of complaints in which advice issues were raised in some form

and should not be taken as the definitive number of complaints relevant to the Quality of Advice Review's Terms of Reference.

Most traditional financial advice related complaints fall under AFCA's "Investment and Advice" product and issue stream.

As indicated in AFCA's 2020/21 Annual Review, we received a combined total of 3,888 complaints about investments and advice⁵ in this financial year, which represented 6% of the total complaints received by AFCA. In the same period, we closed 3,465 investments and advice complaints.

Of these complaints the majority were closed at the initial stages of our process through referral to the financial firm or by agreement between the parties. Only 13% of these complaints proceeded through to an AFCA decision.

Year on year, AFCA has not seen a proportionally significant change in complaints related to investments and advice. In the 2019/2020 financial year, investments and advice complaints totalled 4,615 (6% of total complaints) and in the 2018/2019 financial year we received 2,518 (5%)⁶.

As indicated, complaints raising an issue about advice more broadly, for the period November 2018 to date, are tabled in Annexure 1.

Systemic Issues

AFCA provides quarterly reports to ASIC on the systemic issues and serious contravention cases we consider. More broadly, AFCA publishes information about the volume of cases considered under this function in our Annual Review.

In the 2020/21 financial year, across all products and issues, AFCA assessed 1,086 possible systemic issues and possible serious contraventions of the law, conducted 147 detailed investigations into possible systemic issues and 36 possible serious contraventions of the law. This led to a range of enforcement actions taken by regulators and provided more than \$31 million in financial remediation to consumers and small businesses.

In relation to systemic issues involving advice, we have seen a decrease in cases in the past two years. Advice issues previously identified and reported to regulators included:

- Insufficient monitoring and supervision of authorised representatives by licensees (general obligations and conduct of authorised representatives);

⁵ AFCA's investments and advice statistics cover complaints relating to matters such as stockbroking, contracts-for-difference, traditional trustees and foreign exchange as well as advice complaints. Statistics on advice complaints alone are provided in Annexure 1.

⁶ Noting that AFCA commenced on 1 November 2018, so these stats are for the period 1 November 2018 to 30 June 2019.

- Issues relating to SOAs and record keeping (as discussed below);
- SMSF related advice, including recommendations to establish a SMSF where it was not suitable due to a range of issues including insufficient funds, client goals/timelines and asset diversification etc.;
- Fee for no service issues (leading to significant remediation activities); and
- Ineffective policies and procedures to ensure the provision of personal and general advice consistent with legislative requirements. This includes issues relating to a financial firm's compliance governance framework and lack of operational clarity about which entities within a group are providing advice and the nature of that advice.

C. AFCA observations

As indicated above and as per the complaint tables in Annexure 1, AFCA has not seen a proportionally significant change in complaints relating to advice from November 2018 to date.

However, we see and acknowledge the impact that poor advice has on consumers. We also see first-hand the significant financial impact on large numbers of often vulnerable consumers when advice related firms enter administration and avenues of redress become restricted. We therefore see the importance of ensuring such avenues remain open to consumers in such circumstances.

We provide commentary on several aspects of advice, relevant to the questions posed in the Review's Issues Paper.

Statements of Advice

How successful have SOAs been in addressing information asymmetry?

It is AFCA's experience that SOAs are of limited value in addressing information asymmetry. Many retail clients do not read or comprehend SOAs in full (as they are lengthy, use financial / legal jargon and contain information that does not assist their decision making).

AFCAS's experience is that SOAs also are primarily drafted with an eye to legal requirements (for example, s947C or s947D of the *Corporations Act 2001* (the Act), as the case may be) and the needs of the advisory firm's compliance department, rather than a consumer-centric document drafted to assist a client to decide whether to take up particular advice.

Many SOAs seen by AFCA in financial advice complaints still exceed 50 or more pages, are difficult to navigate, contain irrelevant information and do not use plain

English to explain the advice, or its benefits and risks. In most instances, there appears to be no focus by the person preparing the SOA toward securing their client's informed decision to accept or reject the advice. The focus generally seems to be on meeting legal and compliance standards.

To what extent can the content requirements for SOAs and ROAs be streamlined, simplified or made more principles-based to reduce compliance costs while still ensuring that consumers have the information they need to make an informed decision?

The content requirements for SOAs and ROAs should be focused on ensuring the client makes an informed decision about the advice. An SOA or ROA cannot be said to be effective unless the client understands it.

SOAs and ROAs should be limited to deal with the advice, the basis of the advice, how the advice will achieve objectives (having regard to the client's needs and financial situation), and an outline of the benefits and risks associated with the advice. If further detail is required, the document could have links to information sheets on particular topics, such as those found on ASIC's MoneySmart website.

It is also AFCA's experience that financial literacy throughout the community is relatively low and some consumers absorb information more readily when provided pictorially or verbally. AFCA is open to any recommendations which incorporate such an approach. AFCA can also see benefits in not restricting SOAs to written documents only.

To what extent is the length of the disclosure documents driven by regulatory requirements or existing practices and attitudes towards risk and compliance adopted within industry?

See our above comments. Overall, most SOAs we see remain lengthy due to the use of pro-forma documents prepared by legal and compliance departments to manage risk to the adviser's business. They continue to contain information that does not aid the client's understanding of the advice. Therefore the focus does not appear to be on the client making an informed decision. Any recommendation made should encourage the AFS licensee to think of the document as a document designed to assist the consumer's understanding of the advice, rather than a compliance document, as the two purposes can contradict each other.

How could the regulatory regime be amended to facilitate the delivery of disclosure documents that are more engaging for consumers?

Are there particular types of advice that are better suited to reduced disclosure documents? If so, why?

We, in principal, support a recalibration of the legislation to a principles-based disclosure regime. In other words, the legislation should:

- a. clearly set out what clear, concise and effective means and prioritise this obligation
- b. require SOAs (and ROAs) to be prepared with the aim of having the client make an informed decision about the advice
- c. require SOAs (and ROAs) to be drafted using plain English
- d. proscribe the use of information in SOAs (and ROAs) that does not reasonably assist a client's understanding of the advice, including (but not limited to) irrelevant information.

Having regard to feedback from financial firms and concerns about our complainant's understanding of complex information, AFCA and its predecessor schemes went through significant work and training in order to reduce the length of our decisions. This included adoption of Plain English principles to explain our reasoning.

We also utilise a cascading approach to information provision by providing a one-page summary of key information, then further detail in the body of the document (explaining the conclusions reached and the reasoning), and information on primary documentation (such as contractual provisions or legislative references) in a "supporting information" section. These documents are generally less than 10 pages in length with an ideal length of about 7 pages. We have found that this has assisted all parties understand the reasoning and conclusions we have arrived at, a lot more readily than when the same information was provided in more lengthy documents. Similarly, we are of the view that consideration should be given to requiring advice documents to be no more than 10 -12 pages in length using a default font and size (i.e. Arial 12 point).

This approach would hopefully focus adviser's attention to only including important information and to being concise. This approach also ultimately has the benefit of supporting clients increased understanding of the advice provided and adviser assurance that clients are making informed decisions based on that advice.

AFCA's experience is that most consumers place much more emphasis on what the adviser tells them, over the written documentation. The written documentation must be seen in this context.

Records

The provision of timely and detailed advice with clear records (fact finds, notes, signed SOAs, notice to proceed etc) ultimately has the potential to reduce the volume of complaints received by AFCA. This may also reduce the time taken to reach informed decisions on the conduct the subject of complaints at IDR and EDR.

Best Interest Duties (Safe Harbor provisions)

The Review intends to consider whether it is appropriate to remove safe harbor provisions and the potential for reduced regulatory costs as a result.

AFCA supports any framework that simply and effectively provides information that aids compliance with the intent of regulatory obligations. AFCA will continue to consider advice related complaints consistent with our Rules and our fairness approach. As mentioned above, AFCA supports the provision of clear guidance if a principle-based approach is adopted.

Limited Scope Advice

AFCA also sees issues with the provision of limited advice. Many advisers are unclear what is within scope when such advice is provided and are unclear as to the extent of the inquiries they need to make to satisfy their obligations under the best interest's duty.

For example, a consumer may approach an adviser to establish an SMSF to invest in property, assuming that the adviser will consider whether property is a suitable investment. The adviser has a completely different understanding of the brief. A dispute is then brought against the adviser when the property performs poorly, because the consumer says they understood the adviser was endorsing the property investment. The adviser defends the matter as they say the advice was limited to merely assisting the consumer with the SMSF. We have many examples which we could provide of this on request.

Another difficulty can arise when the financial firm makes inquiries into a consumer's circumstances that are unnecessary having regard to the type of advice being sought, which in turn, unnecessarily drives up the cost of advice. For example, a consumer may approach an adviser merely seeking a cheaper insurance premium, being completely satisfied with their level of cover. Irrespective of the clear instruction the adviser determines the terms of engagement require them to do a comprehensive fact find. Such behaviour drives up the cost of advice, and dissuades consumers from obtaining limited advice, often, ultimately to their longer-term detriment.

AFCA considers that any recommendations made must encourage limited advice and be clear on the inquiries that need to be made when limited advice is being provided.

Client Classification (retail/wholesale)

Should there be a requirement for a client to agree with the adviser in writing to being classified as a wholesale client?

Clear information should be provided to the client about the consequences of becoming a wholesale client, whichever class of wholesale being considered. The current legislation establishes different triggers for the change from the retail client environment. These triggers being:

- a) an automatic change to 'wholesale' if the product or service exceeds \$500,000 in value
- b) certification from an accountant or assets in excess of \$2.5m or income in excess of \$250,000 per annum for each of the prior two financial years (this certification lasts 2 years under Corporations Regulations)
- c) an automatic change to 'professional' if the s9 definition is met
- d) a change to 'sophisticated investor' status requires the licensee to make a reasonable assessment of the client's understanding, experience and expertise and confirm its assessment in writing.

There are issues with the current operation of these tests in a variety of circumstances including where:

- a) the client is not financially literate or experienced and has recently come into a significant amount of money, such as through inheritance or retirement, and has more than \$500,000 to invest
- b) the accountant is part of the same business group as the adviser and certification can be provided without the client's knowledge or
- c) the adviser places the responsibility for the sophisticated investor assessment on the client to self-assess.

Professional investors should already be aware of the consequences by virtue of the characteristic which serves to make them a professional investor. Other types of retail client however should have to be fully informed of the impact of a change to wholesale and be properly assessed before proceeding.

Are any changes necessary to the regulatory framework to ensure consumers understand the consequences of being a sophisticated investor or wholesale client?

The challenges with this arise from the same issue which occurs with any other advice or disclosure document – consumers do not always read the information, preferring to rely on what they are told verbally by the adviser and to focus on the potential gains from engaging with these higher risk products and services. Further, as noted above, there should be different standards applied to professional and other types of wholesale investor.

As a result, a wholesale client agreement should be clear, concise, written in Plain English and should be totally separated from any discussion of the benefits of becoming a wholesale client.

Should there be a requirement for a client to be informed by the adviser if they are being classified as a wholesale client and be given an explanation that this means the protections for retail clients will not apply?

Yes, for the reasons set out above. There should also be clearer guidance for industry about the consequences of providing inappropriate advice to a wholesale client. While the Act is silent on the standards expected of licensees in respect of wholesale clients, common law and general legal principles are not.

Annexure 1 (Advice complaint data)

Investments

Cal. Year	No. of complaints received	No. of complaints closed	Number of complaints resolved in favour of the adviser	No. of complaints resolved in favour for the client	Average compensation awarded	No. of complaints withdrawn	No. of complaints closed with other outcome
2018	160	130	6	16	\$39,009	7	101
2019	1,239	965	61	140	\$44,999	111	653
2020	1,262	1,198	122	163	\$67,674	132	781
2021	955	799	98	86	\$57,867	86	529
2022	229	201	22	33	\$75,005	20	126

No of complaints closed with 'other outcome' includes complaints resolved by the financial firm, through negotiation/conciliation, or falling outside AFCA's Rules.

Life Insurance

Cal. Year	No. of complaints received	No. of complaints closed	No. of complaints resolved in favour of the adviser	No. of complaints resolved in favour for the client	Average compensation awarded	No. of complaints withdrawn	No. of complaints closed with other outcome
2018	27	19	2	1	\$19,104	2	14
2019	218	168	20	26	\$24,093	22	100
2020	215	232	38	28	\$22,875	44	122
2021	151	161	29	26	\$29,240	16	90
2022	156	64	9	3	\$15,949	8	44

Superannuation

Cal. Year	No. of complaints received	No. of complaints closed	No. of complaints resolved in favour of the adviser	No. of complaints resolved in favour for the client	Average compensation awarded	No. of complaints withdrawn	No. of complaints closed with other outcome
2018	35	6	0	0	\$0	0	6
2019	159	126	7	3	\$8,939	14	102
2020	126	140	17	4	\$21,375	23	96
2021	112	108	21	3	\$25,827	13	71
2022	35	42	7	1	\$2,092	8	26

Superannuation complaints raising issues of advice include issues about account information provided by phone about benefit rollovers, preservation status (and access to withdrawal), investments and investment switches etc. Consumers are often unsure if the information provided was advice, if it was – the nature of the advice (general/personal) and who provided the advice (i.e. trustee, a wholly owned subsidiary or an external partner).