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Ms Brooke Stewart
Senior Analyst
Financial Advisers
Australian Securities and Investments Commission

By email: brooke.stewart@asic.gov.au

16 May 2016

Dear Ms Stewart,

AFA Submission – Consultation Paper 254: Regulating digital financial product advice

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 69 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

The Board of the AFA is elected by the Membership and all Directors are required to be practising 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 wealth.

Summary of the AFA's position

The AFA supports ASIC's proposal to regulate digital financial product advice and considers the guidance proposed by ASIC to be relevant to the issues of delivery and systems. Accordingly, the AFA has only a small number of recommendations to add to the proposed guidance to strengthen consumer protections and the integrity of the reforms recently undertaken.

AFA recommendations

1. Responsible Managers of digital advice providers be required to be registered on ASIC's Register of personal advice providers.
2. The education and professional standards obligations upon Responsible Managers of digital advice providers be consistent with individual financial advice providers.
3. The language used in the proposed Regulatory Guide be framed consistently with the proposed *Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016* to ensure that an "existing provider" is not prevented from being a Responsible Manager of a digital advice provider.
4. No transition period should be permitted for Responsible Managers to obtain the required competence and education levels to oversee digital product advice.
5. More frequent monitoring and testing of digital advice algorithms take place where the potential loss (or size of potential losses) for consumers is greater.
6. At least one Responsible Manager of a digital advice provider must have the skills and experience needed to understand the technology and algorithms underpinning the digital advice, regardless of outsourcing arrangements.

Feedback on ASIC's specific questions

Section A – Background to the proposals

A1Q1 Overall, is the proposed guidance helpful? If not, why not?

A1Q2 Is our proposed guidance (in Section D of the draft regulatory guide) helpful in assisting digital advice providers to provide scaled advice that is in the best interests of clients? If not, why not?

Aside from the exceptions we have outlined below largely relating to education, professional standards, competence and monitoring frequency, the AFA considers that the guidance is helpful and consistent with other Regulatory Guides.

- **More examples of digital financial advice would be helpful**

We recommend additional practical examples be outlined for licensees and advisers on scaled digital advice in the proposed Regulatory Guide. The three examples distinguishing factual information versus general advice versus personal advice are helpful. However these may not provide enough depth to give clear guidance to future digital advice providers about where the advice line is, where the main delivery vehicle of financial product advice is through 'robo-advice'. We recommend breaking down the guidance the way that RG244 has by outlining different examples of different digital services segmented into factual information, general advice and personal advice.

- **Financial adviser register**

The AFA agrees that the law relating to delivery of financial product advice is technology neutral, largely due to the law placing obligations mostly on licensees. We query though how digital advice licensees who are authorised to provide personal advice to retail clients will be represented on ASIC's financial adviser register if a person is not directly involved in the delivery of the personal advice to consumers.

The proposed Regulatory Guide defines digital advice at RG 000.1 as:

> "*Digital advice (also known as 'robo-advice' or 'automated advice') is the provision of automated financial product advice using algorithms and technology and* ***without the direct involvement of a human adviser****."* (emphasis added)

Will digital advice providers who do not use an individual to deliver personal advice be represented on the register? This is important because "relevant provider" is currently defined as:

> *"a person is a* ***relevant provider*** *if the person:*
>
> *(a) is* ***an individual****; and*
>
> *(b) is:*
>
> *(i) a financial services licensee; or*
>
> *(ii) an authorised representative of a financial services licensee; or*
>
> *(iii) an employee or director of a financial services licensee; or*
>
> *(iv) an employee or director of a related body corporate of a financial services licensee; and*
>
> *(c) is authorised to provide personal advice to retail clients, as the licensee or on behalf of the licensee, in relation to relevant financial products.*
>
> *Note: For rules about when relevant providers can use the expressions "financial adviser" and "financial planner", see section 923C."*

The AFA considers that consumers should be able to use the ASIC Register to equally search for digital advice providers as they would an individual advice provider. The Explanatory Statement to the *Corporations Amendment (Register of Relevant Providers) Regulation2015* says the purpose of the register is to:

> *"enable consumers to verify that their individual financial adviser is appropriately authorised to provide advice and find out more information about the financial adviser before receiving financial advice.*
>
> *The benefits of the new public register include:*
>
> - *providing an easily accessible central record of the competency, employment history and misconduct of individual financial advisers;*
> - *assisting ASIC in its compliance activities and ability to respond to problem advisers; and*
> - *providing broad support for industry efforts to improve professionalism of the industry."*

The AFA considers that these principles apply equally to digital advice providers because consumers should have transparent access to a relevant history of competency, misconduct, compliance issues, and movements of responsible people of digital advice providers.

Accordingly, the AFA recommends that as Responsible Managers of digital advice providers are ultimately responsible for any personal advice provided under the

AFS licence of a digital advice provider, those people should also be represented on the ASIC Financial Adviser Register.

Section B – Complying with the organisational competence obligation

B1Q1 Do you agree that, if the changes proposed in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 become law, at least one responsible manager should:

(a) meet the new higher training and competence standards (i.e. have a degree or equivalent, pass an exam, complete a professional year and undertake continuing professional development); and

(b) comply with the proposed ethical standards (i.e. comply with a code of ethics and be covered by an approved compliance scheme)?

The AFA considers that the obligations upon digital advice providers must be consistent with the obligations upon human advice providers regardless of the method that the financial product advice is provided. The financial advice profession has been through significant regulatory change to raise trust and confidence of consumers. Any inconsistent application of standards to be applied to 'robo-advice' could lead to unintended consequences creating incentives to avoid regulatory costs, compliance and lowering consumer protections. We consider that all responsible managers must meet the same standards proposed for personal financial advice providers.

- **The current proposed framework to be aligned with the Professional Standards updates**

B1Q3 Are there any aspects of the proposed higher training and competence standards in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 that should not apply to at least one responsible manager of a digital advice licensee?

Paragraph 21 of the consultation paper says that ASIC believes that "at least one responsible manager should hold a degree or equivalent qualification, pass an exam, complete a professional year, and undertake continuing professional development."

The current proposed framework does not expect existing providers to complete a professional year and the recent second version of the framework proposes to give the Standards Body the discretion to exempt highly expert advisers from passing the exam requirement. Further, the Standard Setting Body is currently proposed to have the discretion to set (and exempt) the exam and syllabus requirements of existing advisers.

It is important that the education and professional standards applying to digital advice providers and their Responsible Managers must be consistent at all times with those applying to human advice providers. Accordingly, we recommend that the proposed Regulatory Guide **not** state that "at least one responsible manager should hold a degree or equivalent qualification, pass an exam, complete a professional year, and undertake continuing professional development." Instead, we recommend that the Regulatory Guide say that "all responsible managers should meet the registration standards for financial advice providers at the time of appointment – as set by the *Corporations Amendment (Professional Standards for Financial Advisers) Bill 2016*."

- **Transition period**

B1Q4 Is the proposed transition period of six months long enough for existing AFS licensees to comply with the requirement to have a responsible manager who meets the minimum training and competence standards? If not, why not?

Another concern we have is with the transition period to apply to digital advice providers to meet the AFS Licence competency standards under s912A. The consultation paper and proposed Regulatory Guide both say (at RG 000.51):

> *We are giving existing AFS licensees a transition period of six months, from the date of issue of this regulatory guide, to comply with the requirement to have at least one responsible manager who meets the training and competence standards.*

We are concerned that the advice provided during the proposed six month transition period may not be competently provided if an appropriately qualified Responsible Manager is not overseeing all advice and algorithm consequences. Consumers of such digital advice may be exposed to potential financial losses if they rely on advice that has not been based on strong foundations and oversight, constantly monitored for nuance and implications arising from 'real world' variables and events unpredicted by the algorithms. We consider that financial product advice should be measured against the same high standard at all times, whether delivered by 'robo-automation', humans or a combination of the delivery methods.

Consistent with the principle behind our recommendation above, we recommend that where digital financial product advice is provided to retail clients, there must be a Responsible Manager supervising that advice who meets the same education, skills, knowledge and experience requirements that Responsible Managers of other advice licensees must comply with.

Section C – Monitoring and testing of digital advice algorithms

C1Q1 Do you think we should be more detailed in our guidance on the ways in which we think digital advice licensees should monitor and test algorithms? If so, what additional guidance should we provide?

- **Frequency of monitoring**

The AFA considers that monitoring and testing of digital advice programs should be required by ASIC to be **more frequent** where:

- changes to the algorithm are made;
- the algorithm or decision tree is more complex;
- the algorithm involves more complex products – such as margin lending, derivatives, foreign exchange contracts, hybrids or where gearing is involved; and
- the consumer-input variables are greater.

We consider this to be important because of the absence of a human in the actual delivery of the financial product advice. There is significant risk for consumers if digital advice provided by algorithm is flawed because there is no human to check the resulting advice prior to being consumed. Where an individual is involved to 'sense-check' outcomes, there is an opportunity to pick up errors.

Accordingly, we consider that the above circumstances warrant more frequent testing or use of third party testing to ensure that where the potential for loss (or the potential size of losses) to consumers is greater, a more rigorous testing and monitoring regime has been put in place to capture any unintended errors.

- **Responsible Managers to have some technical skill requirement**

Further, we agree that failure to have at least one person with the skills and experience needed to understand the technology and algorithms underpinning the digital advice increases the risk that clients are exposed to poor quality advice or that there could be undetected issues with systems. We agree that digital advice licensees be able to outsource functions that relate to their digital advice business. However, without **a senior person** who has the skills to thoroughly monitor the ongoing performance of outsourced service providers it would not be fair to say that AFS licensees who outsource functions remain responsible for the financial services provided to clients.

A standard of "at least one person" who has the skills to understand the technology and algorithms underpinning the digital advice does not necessarily mean that *management* of the AFS Licensee will understand the same. Understanding can be lost in translation without the necessary skills or experience to apply a management or risk oversight to the information provided. As organisational culture comes from the top and filters down, it is important for those at the top to understand what those below are doing and subject to.

The AFA sees there are likely situations that may result where the AFS Licensee says "I didn't know and could not have known because of the technical nature of the reports provided by our chosen outsourced provider".

Accordingly, we recommend that the minimum standard is that **at least one Responsible Manager** of the digital advice provider must have the skills and experience needed to understand the technology and algorithm behaviour and sensitivities underpinning the digital advice, regardless of outsourcing arrangements. This will bring technological understanding (which is different to technological skills) in-house and ensure that those who make the decisions within digital advice providers have increased capacity to assess the risks involved with delivery of digital product advice.

Opportunity for more Australians to start their advice journey, but digital delivery requires greater oversight

The AFA believe passionately in the value of advice and the value that advice delivered by humans brings to both the financial outcomes and well-being experienced by clients. Consumers who have benefited from an experienced financial adviser beside them, when establishing financial plans, as well as navigating through the financial implications of key life stages, report greater well-being (*source: AFA White Paper Money, 'Well-being and the Role of Financial Advice', in conjunction with the Beddoes Institute, May 2016*). Those who receive financial advice improve their ability to manage their finances which, in turn, has been reported to lead to better health, happier relationships and an increased sense of well-being, especially for people with low financial literacy.

However, Australia has an 'Advice Gap', with only two out of every ten Australians receiving financial advice (*source*: *www.afa.asn.au/resources/afa-white-paper-july-2010 -back-basics*). If technology-based offerings can somewhat fill the gap, this could be a helpful stepping-stone to drive the uptake of full, personally delivered financial advice. As more Australians start to seek advice, human advisers are best placed to deliver upon clients' more complex advice needs, taking into account relationship nuances and risk tolerances, with empathy and holistic oversight of financial and lifestyle goals for clients and their families.

Closing remarks

It is critical to increasing confidence amongst consumers in financial advice, whether this be delivered by humans or digital automation, that the industry embraces education and professional standards equally across all channels, and that digitally-delivered advice and their providers and responsible managers are also subject to the same high requirements. While supportive of innovation and the potential for efficient solutions to be developed, we believe additional regulatory oversight and checks be required of digitally-delivered advice to help protect consumers from the heightened risk that this nascent channel represents.

If you require clarification of anything in this submission, please contact us on 02 9267 4003.

Yours sincerely,

Brad Fox
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Association of Financial Advisers Ltd