25 February 2016

Ms Xenia Quinn
Lawyer
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Australian Securities and Investments Commission
Melbourne, VIC 2000

Via email only: xenia.quinn@asic.gov.au

Dear Ms. Quinn

CP247: Client review and remediation programs and update to record-keeping requirements

The Financial Services Council (**FSC**) has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than $2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

Thank you for the opportunity to provide a submission in relation to the Australian Securities and Investments Commission (**ASIC**) Consultation Paper 247: Client review and remediation programs and update to record-keeping requirements (**Consultation Paper**) released in December 2015.

The FSC's financial advice licensees (**Licensees**) welcome this consultation process, seeing it as a valuable opportunity to provide guidance that would provide certainty and comfort in the interests of both industry and consumers. The FSC's members are committed to ensuring consumers are fairly dealt with, acknowledging there have been a number of cases where financial loss has resulted from poor advice.

The FSC and its members believe that appropriately designed and implemented large scale client review and remediation programs (**Review Programs**) are important to the public's confidence in financial advice, and stand ready to work with ASIC to achieve this. We also note that there is much work currently being undertaken to improve professional standards in the industry, including raising the educational level of financial advisers. We believe that this enhanced framework will help to improve the quality of advice, and improve outcomes for consumers.

This submission, on behalf of the FSC's Licensee members, is structured as follows: summary; general comments; key issues; and next steps.

As a general overview comment, we believe that a Review Program needs to be constructed and operated in a way that is fair and reasonable to all relevant parties. This translates in key areas to not being overly prescriptive but rather setting a standard based on those principles. This would apply to key areas such as:

- time periods for notification;
- utilisation of an independent reviewer;
- ability to pinpoint the number of affected clients through client input (such as surveys);

- time periods over which the remediation program should extend;
- determining what documentation will constitute sufficient evidence of service;
- compensation methodology; and
- whether or not a Licensee in all the circumstances should insist on strict adherence to legal rights (such as limitation periods and prior execution of settlement deeds).

1. Summary

- ASIC guidance should not be overly prescriptive, allowing Licensees the flexibility to tailor Review Programs, including appropriate timeframes, and clarity that the guidance is prospective in application;
- ASIC's proposed definition of "systemic" is extremely broad - i.e. two potentially affected customers could be sufficient to trigger a formal Review Program, which does not allow for human error to occur without triggering a Review Program;
- The proposed 90 day timeframe (45 days when a claim is subject to internal dispute resolution, IDR) for a Licensee to make a decision on remediation is highly ambitious and does not take adequate account of the complexities of obtaining and reviewing client files going back years, often involving products from multiple providers;
- ASIC should give further consideration to the professional indemnity insurance implications of its proposed approach – Licensees are likely to waive their ability to claim under policies if they were to comply with ASIC guidance as currently drafted;
- Licensees should not be required to agree Review Programs with their EDR scheme, particularly given Licensees will typically undertake remediation with ASIC involvement;
- Clarification is sought regarding ASIC's proposed record-keeping requirements.

2. General comments

a. Principles-based scalable approach appropriate

Given the complexity of Review Programs, the FSC believes that a one-size fits all strategy is not appropriate. Instead we encourage ASIC to adopt a principles-based, scalable approach. It is important that Licensees have flexibility to tailor the Review Program to the particular circumstances they and their customers face, rather than be bound by prescriptive requirements which may well not produce appropriate outcomes for either consumers or industry.

Indeed as currently drafted, the Consultation Paper sets out a framework which would be particularly onerous upon smaller Licensees, especially given the (apparent) low threshold for the triggering of a Review Program, and expectation of independent, external oversight in many cases. Accordingly, ASIC's proposed approach could have a negative impact upon competition which would disadvantage smaller Licensees.

Further, when drafting its guidance, ASIC should bear in mind that there is a strong public policy rationale for ensuring the cost of advice does not increase, thereby reducing its accessibility.

b. Guidance should be limited to personal advice

We note that the Consultation Paper is *focused* on personal advice to retail clients (paras 3 and 12), however the proposed guidance also states apply that "the principles in the proposed guidance should be applied to these other [e.g. superannuation] review and remediation

programs, to the extent relevant. The implementation of these principles, however, may differ between the various types of programs" (para 12).

Whilst there are elements of the Consultation Paper that may be informative to other (non-personal advice related) Review Programs, we do not believe it is appropriate to extrapolate the approach taken to personal advice across the board (e.g. remediation programs for superannuation trustees or relating to simple low risk products such as deposit or non-cash payment facilities). If ASIC wishes to provide guidance in such areas, it should undertake a separate, focused public consultation and create a tailored approach which is relevant in the circumstances.

This is so especially in the case of funds subject to the *Superannuation Industry (Supervision) Act 1993*. Such funds must establish an inquiries and complaints process under the Act and advise members of that position. These funds also are subject to the prospect of review of certain decisions on a "fair and reasonable" basis by the Superannuation Complaints Tribunal. These funds would all have established inquiries and complaints processes in place which are likely to cover the same ground as that set out in the Consultation Paper. Accordingly, it is not appropriate to overlay principles set out in the Consultation Paper to this area.

In summary, to adopt the same approach to all forms of remediation programs risks unintended consequences and inconsistencies between current processes and legislation and that set out in the Consultation Paper. Moreover relevant stakeholders such as superannuation trustees are highly unlikely to be aware that the principles set out in this Consultation Paper are also intended to govern their Review Programs and complaints and inquiries processes.

c. Guiding compensation principle

We note that ASIC's guidance states that the aim of a Review Program is to place affected clients in the position they would have been in had the misconduct not occurred. While in most cases the application of this principle will be straight-forward (if not the precise calculation of compensation), in instances where inappropriate advice has not resulted in any financial loss (or in some instances financial gain), determining appropriate remediation may be more difficult. In such cases, we agree that remediation could be non-monetary in nature, for example providing disclosures not previously given and/or offering to move clients into more appropriate products (para 35, Consultation Paper).

We also note that ASIC's guidance does not specify whether compensation can be made directly to the client or paid into the relevant investment vehicle (e.g. a client's superannuation fund). This issue is complex and may raise tax issues for the Licensee, fund and client. We would appreciate the opportunity to discuss this further with you.

3. Key issues

a. Definition of "systemic"

The draft Consultation Paper states that "generally a review and remediation program is a project set up within an advice licensee to review personal advice, where a *systemic issue* in relation to the advice has been identified, and then to remediate those clients who have suffered

loss as a result" [emphasis added] (para 32). The Consultation Paper goes on to define a systemic issue as "an issue that may have implications beyond the immediate rights of the parties to a complaint or dispute, or that may have implications for more than one client" (para 36).

The FSC submits that this is a very low threshold for the creation of a Review Program. For example, this definition would capture a situation whereby one adviser had provided deficient advice to two separate customers. In such circumstances, we consider that it would be appropriate for the Licensee to remediate the affected customers according to its usual procedures, while offering the option of free external dispute resolution (EDR) should the customer be dissatisfied with the outcome.

Indeed if ASIC's guidance was to be followed in this case, a Review Program could be required involving, amongst other things, multiple layers of review and oversight (i.e. review, peer review, independent oversight, reporting to ASIC, and possible public reporting).

While we understand the policy intention behind the wide definition of "systemic", the above example illustrates that, in practice, it could mean, a continual process of creating, administering, and reporting on new Review Programs, especially for larger Licensees. We note that in RG 78: *Breach reporting by AFS licensees,* there is discussion of systemic issues. In that context, it seems to be accepted that there must be an ongoing and repetitive issue for a problem to be seen as systemic. However, this type of qualification has not been adopted by ASIC in this Consultation Paper.

As an alternative, with some enhancements, we believe the criteria outlined at paras 40(b) to 40(d) of the Consultation Paper would be far preferable, including as they do, an element of a more widespread compliance breakdown on the part of the Licensee. To that end, we propose that the Licensee be allowed to make a business judgment based on materiality, mindful of their obligations to operate their financial services business efficiently, honestly, and fairly (s912A (1)(a), *Corporations Act 2001*). This approach would be consistent with other regulatory guidance such as Regulatory Guide 139: Approval and oversight of external dispute resolution schemes.

Further, given the resources involved in establishing a Review Program, and the existence of current internal dispute resolution (IDR) and EDR arrangements, we believe the scope, scale and level of governance and review should apply flexibly and proportionately to the scale and significance of the incident or issue.

b. Timeframes for remediation of clients

It is in the interest of both clients and Licensees that Review Programs be created and executed expeditiously. We agree with ASIC that "adequate resources should be allocated to a review and remediation program to ensure it is conducted in an efficient and timely way" (Consultation Paper, para 107).

However, we feel that ASIC's proposed time periods for the remediation of affected clients are unrealistic, especially given the complexity typically associated with Review Programs (in our view, the example on page 19 of the Consultation Paper is not reflective of how long it can take for a Licensee to remediate clients, despite the matter being afforded a high priority).

To require that a Licensee make a decision about whether or not to remediate a client within 90 days of the client being notified that they are within the scope of the program (or 45 days where the matter is already the subject of IDR: para 55, Consultation Paper), does not adequately take into account the work involved in undertaking a comprehensive Review Program (para 116). For example, further client input is often required before such an assessment can be made, necessarily requiring them to have adequate time to respond to the Licensee's queries, and any input from a customer advocate. In addition, there may be difficulties in obtaining documentation given the length of time which has elapsed since the giving of the advice or in obtaining complete documents from third party providers such as lenders or insurers. Similarly, many programs will involve external oversight, which can lead to further delays.

By way of comparison, matters considered by an EDR scheme (for example, the Financial Ombudsman Service) typically take over 100 days in order to be resolved.

Accordingly, the FSC believes that it unreasonable for ASIC to mandate a specified timeframe, including as it risks cases being rushed and could lead to poor outcome for clients (e.g. it could create an unintended, perverse incentive to reject claims in order to meet unrealistic deadlines).

Instead, we consider that the guidance should state that the decision whether or not to remediate must be made within a fair and reasonable timeframe, having regard to the complexity of the case's circumstances. Further, triaging should be undertaken by the Licensees so as to ensure that those clients who are most vulnerable or exposed are afforded priority (e.g. clients suffering from poor health or financial hardship). Guidance should be provided in the final regulatory guide that such a triaging process is a legitimate and appropriate course for Licensees.

c. Extent of file review

The Consultation Paper states that ASIC "would expect a licensee to review as far back as the licensee has retained records. This includes where a licensee has retained records for longer than the minimum seven years" (para 87). We have concerns regarding this proposed requirement as it would appear to penalize a licensee that retains records beyond seven years (creating an incentive not to retain records beyond the minimum timeframe), and would create a significant financial and administrative burden.

File reviews are already inherently complicated given they often involve assessments of advice based on the applicable law at various points in time (for example, assessing advice prior to the introduction of the Future of Financial Advice (FOFA) reforms, and then assessing advice post FOFA).

Further, were Licensees required to review files as far back as their records allow (i.e. in some cases beyond seven years), the ASIC proposal could result in clients being treated differently, depending on whether their records have been retained beyond the required minimum timeframe. Instead, this should be at the discretion of the relevant Licensee.

We also note that there are statute of limitation considerations to be borne in mind, and that these rights should not be waived by the Licensee except in exceptional circumstances (see also below regarding professional indemnity insurance matters).

d. Professional indemnity insurance and EDR limitation periods

The FSC supports clients retaining the right to pursue EDR should they be dissatisfied by the outcome of a Review Program. However, we do not believe that ASIC guidance should ask Licensees to consider whether monetary and time limits should be waived to allow clients to access EDR (Consultation Paper, para 178). There are sound public policy grounds for these limitations, including to provide certainty to business regarding the scope of their potential liabilities. Of course, it will be a matter for Licensees to consider whether they wish to rely on such limitations.

We further note that if a Licensee were to waive limitation periods or compensation caps so as to allow a client access to EDR, this would almost certainly allow the insurer to avoid liability and deny that Licensee's right to claim under any professional indemnity insurance policy (PI Insurance) that it holds. This is also the case if unrealistic timeframes for review are imposed on Licensees, i.e. the insurer could avoid liability if the Licensee were to simply resolve a matter within a prescribed timeframe on the basis that the Licensee had not given the matter appropriate consideration and/or the insurer had not had adequate opportunity to review the Licensee's decision.

The outcome is that a Licensee needs sufficient time to liaise with its insurer in relation to matters of liability and the impact of coverage on any proposed waiver **and** to properly review the matter in conjunction with the insurer if required.

By way of general observation, it seems that the Consultation Paper does not take into account the nuances and complexities of PI Insurance, given there are a number of implications of the proposed ASIC guidance which are at odds with common PI Insurance terms.

We suggest that ASIC undertake further consultation with Licensees and PI Insurers to work through the practical consequences of the proposed guidance and consider its consistency with ASIC Regulatory Guide 126 (Compensation and Insurance Arrangements for AFS Licensees). We would be happy to facilitate such a discussion with our members.

e. Relationship with EDR scheme principles

The Consultation Paper evinces an intention that Licensees engage with their EDR scheme (e.g. FOS) when designing a Review Program so as to agree on "relevant documentation, timelines and other arrangements…that will facilitate the streamlined consideration, review and decision by the EDR scheme where necessary" (para 25). It also states that advice should be reviewed in accordance with the principles of the relevant EDR scheme, including compensation methodology (see paras 117 and 122 of the Consultation Paper).

While the FSC's members are comfortable providing their EDR scheme with an overview of their Review Program, they do not believe it is appropriate that Licensees be required to agree arrangements up-front with their EDR scheme. The design of the program should be the prerogative of the Licensee, in consultation with ASIC, where appropriate.

There will be many instances where the Review Program framework is similar to but not the same as that adopted by an EDR scheme, for example, a decision on compensation made by the

Licensee might be made in accordance with policy agreed with ASIC, but not may not align with the EDR scheme's approach.

If a business is putting in place a rigorous Review Program in consultation with ASIC and (often) with independent oversight, we do not believe it is appropriate to expect the Licensee to also "agree" parameters (including around compensation) with their EDR scheme.

Having to engage with an EDR scheme for every Program is likely to increase their cost and timeframes, potentially resulting in inconsistency between Programs. It is also not efficient having regard to FOS's caseload, Licensee's desire to remediate clients as soon as practicable, and ASIC's proposed requirement that Licensees respond to clients within a set timeframe.

Finally, we note that ASIC's proposed guidance states that "clients should be given the benefit of any doubt where the licensee's records are incomplete or insufficient" (para 120). We disagree with this approach, as the Licensee must make a decision based on the evidence available to it and its assessment of all that evidence. It should not be forced to adopt one position over another necessarily because records are incomplete or missing.

f. Scope of review programs – inviting clients to participate

A Licensee's Review Program should have a robust scoping and sampling methodology that ensures that only those clients impacted or who appear to be impacted by inappropriate advice or services participate in the program. This should be done by Licensees on a proactive basis, rather than relying on clients to come forward.

If undertaken appropriately, these actions should embody a strong risk-based approach to the process of identifying affected clients that obviates the need to contact a much larger population of clients that are very unlikely to be affected.

Accordingly, we do not believe it is necessary or appropriate to contact other clients. To do so would merely alarm some individuals, and could invite unfounded claims. This would in turn add to the Review Program's caseload, impacting on timeframes for remediation/resolution.

g. Public reporting

In circumstances where a large number of clients have been affected by poor advice, Licensees understand that there is a public interest in knowing of the creation and progress of a Review Program. However, we believe the threshold for such reporting should be high, as otherwise unnecessary reputational damage could be caused. Further, where a Licensee is part of a listed corporate group, that entity will already be subject to existing continuous disclosure obligations.

It would not be feasible, and would add an unnecessary layer of complexity, and possible delay, were every Review Program to be subject to public reporting. Instead we encourage Licensees and ASIC to discuss whether public reporting is necessary, on a case by case basis.

h. Independent oversight

ASIC has proposed that all Review Programs have some form of independent oversight (in their development and operation), whether it be internal or external of the organization (Consultation Paper, paras 132-133).

The FSC would welcome clarification as to the purpose of oversight: is it to ensure Licensees remediate appropriately *or* to provide some comfort and assurance directly to ASIC?

We further note that the guidance states that an independent expert (i.e. external to the Licensee) may be necessary where, inter alia, the program involves "complex issues" (para 138). In most cases where a Review Program would be necessary, complex issues will arise (for example, calculating the loss suffered by a client). Accordingly, it would seem that ASIC would be requiring Licensees to engage an independent expert in almost all instances. Such a requirement would be particularly onerous upon smaller Licensees.

i. Licensee-funded customer advocates

ASIC's guidance states that Licensees should consider whether it is appropriate to offer assistance to clients who wish to seek their own professional advice (Consultation Paper, para 183). While we believe that this will be appropriate in some circumstances, it should be the Licensee's prerogative to decide on a case by case basis (e.g. where a client has a special vulnerability related to their age, health or financial situation). We do not believe it should be offered more broadly.

Typically, under a Review Program, an affected client would have their advice reviewed, peer reviewed, and possibly subject to further independent (external to the Licensee) oversight. In addition, should the client be dissatisfied with this process, they are able to access an ASIC-approved EDR scheme, which offers free and accessible dispute resolution services (binding on Licensees, but not clients).

j. Settlement deeds

We respectfully disagree with ASIC's proposed approach to settlement deeds (especially para 186, Consultation Paper). In particular, we have concerns regarding the suggestion that settlement deeds should not restrict a client's ability to speak to ASIC, an EDR scheme, an adviser's professional association or have legal representation about a matter if the client has concerns.

If a client has accepted compensation from a Licensee and signed a settlement deed/deed of release, we do not see the rationale for allowing the client to, inter alia, approach an EDR scheme about their case. The rationale behind settlement deeds is that they are confidential agreements designed to bring finality to a matter for both clients and Licensees. It defeats this purpose were clients able to sign a deed, and then seek to re-agitate a matter.

Instead, clients should carefully consider whether they are happy with a settlement amount before signing any deed, and if not satisfied, pursue the matter through EDR and, if still dissatisfied, the courts. As outlined above, there will already be a high level of oversight in the

case of most, large scale Review Programs (i.e. an independent expert, and ASIC) which should provide clients with some level of assurance that their case will be handled appropriately.

Of course, in each case, the Licensee should consider, in all the circumstances, whether it would be fair and reasonable to enforce any settlement with clients (again noting that it may compromise the Licensee's ability to recover under its PI insurance should the Licensee take such an approach).

For particularly vulnerable clients, Licensees may also decide to offer to fund independent legal advice up to a capped amount.

k. Record-keeping requirements

We note that ASIC proposes to amend Class Order 14/923 to clarify that when an advice licensee or one of its representatives provides personal advice, the Licensee must ensure not only that client records are kept, but also that the Licensee continues to have access to these records during the period in which they are required to be retained (para 193, Consultation Paper).

Industry would welcome clarification of this proposed amendment, and recognition of the distinction between Licensee's employees and authorised representatives.

If the proposal means that Licensees can continue to require advisers to keep the records and provide access to them when needed, there will not be a change to current record-keeping obligations and common practice of Licensees. However, if "ensure" the Licensee "continues to have access to these records" means that the records must be obtained by Licensees and held within the Licensee, there is a significant change to the current situation in terms of business practice, practicality and expense.

By way of example, the proposal (at worst case) would mean that if an adviser leaves a Licensee and has 500 clients, the Licensee would need to marshal resources immediately to photocopy/scan 500 files or do a combination of collecting hard copy files and soft copy files to make up the complete set of documents in a file. In reality, advisers sometimes leave suddenly and the practicality of undertaking the document gathering task is almost impossible, particularly if the adviser had left with the files or the Licensee cannot access the premises where the files are kept or the system where the data records are maintained.

As noted above, authorised representatives are not employees of the Licensees. They run their own businesses and while required by Licensees to keep appropriate records, can do so in their own way, on their own systems. The industry has operated on the basis of them being subject to contractual obligations to provide documents. ASIC is aware that there have been past difficulties in ensuring advisers produce those documents, particularly if the adviser departs on other than favourable terms. Accordingly, it is important that what is required and enforced on Licensees takes into account the difference between an employee and an authorised representative.

The FSC suggests that a preferable approach would be to amend the law such that authorised representatives would be breaching the law if they do not provide the records when requested by the relevant Licensee.

The alternative is for Licensees to undertake very significant expenditure on new systems so as to allow *all* advisers to load all information and documents into the system, thereby allowing Licensees to access them immediately. The cost to Licensees network would be extremely high should this be the case and would not account for documents produced by business up to the new system being operational.

Should this approach be adopted, which we would strongly caution against, it would be necessary to introduce any requirements on a prospective basis only. It would be extremely difficult to achieve retrospective compliance. Accordingly, reasonable grandfathering provisions would be required.

Finally, there also is an issue where authorised representatives of a Licensee have referred clients to products of *another* Licensee (which are on the first Licensee's APL). Often it is difficult in the course of Review Programs to obtain access to documents held and produced by the APL Licensee in the absence of express and in the experience of some of our member's, quite specific, client consent. These are documents the authorised representative is unlikely to hold in their entirety. Obtaining client consent may be difficult or impracticable, and will certainly delay the remediation process. This may be particularly relevant where it is necessary to obtain the documents for the purposes of determining compensation amounts.

The FSC would be grateful if ASIC could consider this issue and whether there might be any practical steps which could be taken here. We would be happy to discuss this further with you.

4. Next steps

The FSC and its members are committed to working with ASIC to ensure that Licensees' Review Programs operate in a fair and equitable way, recognizing the important role which financial advice can play in the life of all Australians. We also hope that the work currently underway to lift adviser standards can go some way to restoring consumer confidence in the sector.

We stand ready to offer any assistance it may need to devise appropriate guidance for Licensees, and ensure that consumers are appropriately treated and compensated for deficient personal advice.

Please do not hesitate to contact me on (02) 8235 2520 or via email: cgergis@fsc.org.au if you have any queries in relation to this submission or would like to discuss any matter further.

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