9 July 2018

Kelly Fung
Lawyer
Financial Advisers
Australian Securities and Investment Commission
GPO Box 9827
Sydney NSW 2000

Email: policy.submissions@asic.gov.au

Dear Ms Fung,

SMSF ASSOCIATION SUBMISSION ON APPROVAL AND OVERSIGHT OF COMPLIANCE SCHEMES FOR FINANCIAL ADVISERS

The SMSF Association (SMSFA) welcomes the opportunity to make a submission on ASIC's proposal for the approval and oversight of compliance schemes for financial advisers in response to the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017*.

The SMSFA believes ASIC's proposal for the approval and oversight of compliance scheme reflects the aims of the Act and ensures compliance with the FASEA code of ethics is enforced and monitored in a fair and effective manner.

Our most significant comments are provided in relation to questions

- B1Q1 (compliance scheme approval process),
- C2Q3 (Independence of governing body chair) and ;
- C2Q4 (role separation of monitoring body).

QUESTIONS

B Compliance scheme approval application process

B1Q1 – Are there better ways for ASIC to run the application process that will help to give certainty about resources required and enable all approvals to be announced at the same time?

The SMSFA believes the 'if not – why not' checklist provides a comprehensive overview of the resources required.

The feedback process, proposed to be run from 1 January 2019 to 31 March 2019, where ASIC provides feedback to applicants is a transparent and valuable process. This will allow applicants to make any required changes to the scheme proposal before final applications are due to be submitted.

B1Q2 – Does the proposed process create any particular risks that we will need to manage? If so, please provide details.

The draft compliance scheme approval is finalised over the Christmas break, when many entities are shutdown, making sign off for the final submission difficult. This may result in a minor risk of late submissions or submissions that need to be rushed to be completed before businesses is shut for Christmas.

It is suggested that the draft application for scheme approval be extended to mid-January.

B2Q1 – Do you agree with the information we will be required as part of the application?

The information requested as part of the application is comprehensive.

The 'if not, why not' checklist provides flexibility for entities to design a scheme which is reflective of their membership and provide alternative arrangements where appropriate.

C Governance

C1Q1 – Do you agree that the governing body should be permitted to delegate all of its responsibilities described in Table 2, other than the responsibilities described in paragraphs 63(a)-(b).

We agree that governing body should be permitted to delegate its responsibilities to the monitoring body. As the responsibilities which are described in 63(a) – 63(b) are key decisions it is important that these remain the responsibility of the governing body.

Given the requirements to continually monitor resources and expertise within the monitoring body there is minimal risk in delegating the remaining tasks. Given the likely resources available to the monitoring body, they will be best placed to complete these tasks.

C1Q2 – Are there any matters other than those set out in paragraph 64 that should be addressed in the charter or terms of reference for the governing body.

No, the SMSFA agrees that this is a comprehensive list.

C2Q1 – Do you agree that the governing body should be compromised only of non-executive members?

The SMSFA supports the governing body being only comprised of non-executive members as this promotes independence and impartiality.

C2Q2 – Do you agree that the governing body should include an independent chair and a balance of industry and consumer representatives?

The SMSFA supports the appointment of an independent chair and a balance of industry and consumer representatives as this ensures the monitoring body's activities are carried out within natural justice principles.

C2Q3- Do you agree the criteria listed at paragraph 70 should be applied to determine the chair's independence?

We agree that it is important that the governing body should include an independent chair.

However, we do not agree that the criteria that a chair of the governing body cannot be a member of a professional association or currently be a financial adviser should be applied to determine the chair's independence.

Independence can be achieved by allowing a chair to be a member of financial industry association of which they do not chair. This will allow the non-executive body to maintain the appropriate expertise and continue to be across issues that face the industry. We believe that membership of professional associations should be encouraged as part of professionalising the financial advice industry. This requirement can be interpreted as a signal that professional association membership is not an element of being a respected professional.

C2Q4 – Do you think that the existence of an independent governing body and role separation will be effective?

The SMSF Association supports that some role separation is necessary to minimise potential conflicts of interest. However, we propose that each compliance scheme should have a procedure for identifying and dealing with conflicts where and if they arise.

The Association supports that monitoring staff should not be involved in lobbying on behalf of a financial adviser member, where this role causes a conflict of interest. There are many examples where lobbying on behalf of scheme members promotes the integrity of the financial advice sector. For example, code monitoring staff lobbying for a change in financial advice laws that improves the quality of financial advice and integrity of the sector does not create a conflict.

Further, where an association is also a monitoring body, there may be occasions where marketing and administration are incidental to the activities which contribute to membership retention and advocacy in some way.

A procedure for identifying potential conflicts will improve efficiency and enable lower costs for members of the scheme are minimised as the monitoring body will need to employ less staff on some routine administrative and marketing activities.

C3Q1 – Do you agree with our proposed approach of assessing the expertise of monitoring bodies by assessing the matters outlined in paragraph 76?

The Association supports the process in paragraph 76 as an appropriate way to assess the expertise of the proposed initial governing body.

C3Q2 – Will it be practical to provide information about the members of the proposed initial governing body in an application for approval of a compliance scheme?

It may be difficult in a short time frame for an entity to know with certainty the proposed non-executive members for the governing body and their particular expertise. Code monitoring bodies are unlikely to begin to appoint members of their governing body until they receive approval to operate a scheme. It is suggested that the compliance scheme proposal agree in principle to appoint members with the expertise as outlined in paragraph 78 and compliance with this requirement be checked once the scheme is in operation.

C3Q3 – Do you agree that there should be one member of the governing body who, at some point in five years before being appointed to the governing body met the training and competence standards that would have allowed them to give personal advice to retail clients on 'Tier 1' or relevant financial products?

We support that one member of the governing body who, at some point in five years before being appointed to the governing body, met the required training and competence standards on relevant financial products. This ensures there is an appropriate level of expertise relating to financial advice provision on the body.

C3Q4 – Do you agree that there should always be one member of the governing body who has experience in and knowledge of the principles of procedural fairness and administrative law?

The SMSFA supports this position as it ensures that when making decision the governing body follows the necessary procedural fairness and administrative law principles. This will potentially minimise disputes or appeals of decisions on rounds of a lack of procedural fairness.

C3Q5 – Are there other aspects of a monitoring body's expertise that we should assess before granting approval for a compliance scheme.

We think that it is reasonable for ASIC to assess the relevant expertise of monitoring body staff. However, given monitoring bodies may not have hired all their staff by the time they submit their scheme approval we agree that it is appropriate to rely on job descriptions and training procedures to assess their expertise.

C4Q1 – Do you agree with the proposal that it will be the responsibility of the governing body to ensure that the monitoring body has the appropriate expertise to carry out its responsibilities on an ongoing basis

We agree that this responsibility should lie with the governing body.

C5Q1- Are there factors, other than those listed at paragraph 88, that would affect the human, financial and technological resources required for the monitoring body to effectively carry out its role?

The SMSF Association agrees that ASIC does not need to set specific expectations in regards to compliance scheme resources and agree that each compliance scheme proposal will address their ability to appropriately monitor and enforce compliance.

Flexibility and discretions as to how a code monitoring body is resourced should be allowed for by ASIC. This will encourage innovation, the potential use of "regtech" and reduce costs for members of code monitoring schemes through efficient resourcing. Also, it is likely that different code monitoring schemes may have different membership characteristics which could affect how the scheme is resourced. For instance, a smaller scheme with 1000 members who have a specialist field of advice would require different monitoring and resources than a scheme of 5000 members open to a broader set of advisers

C5Q2 – Do you agree with our proposed approach of asking the monitoring body to set out a statement to ASIC the basis on which it considers its resources to be adequate.

Yes, we agree with the approach, noting that the size of each scheme's membership will reflect the resources needed on a scheme by scheme basis.

C5Q3 – Should we set a specific benchmark for the financial resources that monitoring bodies should have initially (e.g. that monitoring bodies should have at least 12 months cash against an outlined program of work?)

The SMSF Association does not agree that ASIC needs to set specific benchmarks for the financial resources that monitoring bodies should have initially. Each organisation will have a different shape to its scheme and differing level of financial risks.

For example, a proposal for a small scheme monitoring 500 advisers or less will have minimum risk to the industry if it fails in the first year.

C6Q1 – Is the definition of 'core function of the compliance scheme' set out in paragraph 93 appropriate?

Yes, we agree that the core functions in paragraph 93 are appropriate. It is likely to be common practice for monitoring bodies to outsource functions such as data hosting and marketing, and this should be allowed.

C6Q2 – Are there key matters other than those listed in paragraph 97, that monitoring bodies who outsource their activities should address in their contractual arrangements with outsourced providers?

We agree that the matters listed in paragraph 97 are relevant and ensure that the monitoring body still maintains responsibility for the activities and ensures integrity in regards to confidentiality.

Monitoring and enforcement

D1Q1 – Should monitoring bodies carry out both proactive and reactive monitoring?

We agree that the monitoring bodies carry out both proactive and reactive monitoring as this reflects the intent of the legislation. A combination of both approaches also has the best possibility of improving standards of behaviour.

D1Q2 – Would it be preferable to delay any aspect of the monitoring and enforcement requirements to facilitate transition to the new regime (e.g should we delay the requirement that the monitoring body conduct proactive monitoring activities)?

It is appropriate to start enforcement from the beginning of the scheme implementation. It is suggested that the first year focus on education and support for financial advisers. However, where there is a serious breach of the code, appropriate sanctions should be placed on advisers.

Given the rigorous application process it is suggested that monitoring bodies should be in a position to begin monitoring in the first year of the scheme.

D1Q3 – Could monitoring bodies work together to develop a uniform approach to monitoring and enforcement, and would this be appropriate?

It may be appropriate for monitoring bodies to work together and develop a uniform approach to monitoring and enforcement. This should be left to industry participants and not mandated. We note that different schemes are likely to have different membership cohorts. This will mean that those with homogeneous memberships are likely to have different approaches as to how they conduct monitoring compared to those with a mix of industry representatives. Therefore, caution should be taken where membership differs between schemes.

D1Q4 – Could a single body carry out these activities for all or a number of compliance schemes and would it be appropriate.

Yes, however it is suggested that a number of compliance schemes in the market could allow for schemes that have homogenous membership. Homogenous membership may allows for more cost effective schemes as monitoring processes may be able to be streamlined..

Annual work plan

D2Q1 – Do you agree that a monitoring body should prepare a risk-based annual work plan?

The risk-based annual work plan provides opportunities for each monitoring body to prepare risk-based plans which reflect their membership.

There is a risk by setting and publishing a risk-based annual work plan that this could encourage "scheme shopping". Advisers may review annual work plans and attempt to leave a code monitoring scheme where they believe there is a risk that any non-compliance with the code by them could be detected in the coming year.

We would support a scheme where there are overarching risks or themes set by ASIC each year, with individual schemes also focusing on their own risk based annual work plan.

D2Q2 – Do you agree that annual work plan should be provided to ASIC each year from 1 January 2020.

The first annual work plan will have a tight schedule where the scheme is not approved until October 2019.

This would provide limited time to undertake own-motion inquiry. However, as each monitoring body should already have knowledge based on previous observations of current risks in the industry an annual work plan from 1 January 2020 is reasonable.

D2Q3 – Do you agree that the annual work plan should be made public?

A public annual work plan assists with transparency and confidence in the compliance scheme and may assist with client education and reporting of behaviour which breaches FASESA code of ethics. However, as explained above, this needs to be balanced with the potential it could promote code driven scheme-hopping.

D3Q1 – Will a minimum of one thematic own-motion inquiry and one compliance statement process each year, with associated verification activities, be sufficient proactive monitoring activities to ensure that compliance with the code is appropriately monitored and enforced under a compliance scheme?

Yes, as this is a minimum standard and each compliance scheme will have the flexibility to undertake further activities if required.

D3Q2 – Are the proposed proactive monitoring activities appropriate for monitoring compliance with the standards set out in the draft code?

Yes, the proposed monitoring activities are appropriate for monitoring compliance standards – noting that verification activities in paragraph 113 (questionnaire activities to financial advisers) rely on financial advisers' adherence to standard 12 of professional commitment within the FASEA code of ethics, that is report and be aware of any breaches made by their peers.

Receipt and initial assessment of reports

D4Q1 – Is it reasonable for monitoring body staff to complete their initial assessment of the report within 28 days of receiving a report?

Yes, however this timeframe should be regularly reviewed to ensure it adequately reflects best practice.

D5Q1 – Do you agree with the proposal for monitoring bodies to have a communications strategy?

Yes, we agree that monitoring bodies should have a communication strategy as it is reasonable for consumers to understand how to make a report and the fact that consumer outcomes or redress are not provided under the scheme.

Investigation Process

D6Q1 - Is it reasonable for investigations to be completed within 90 days of the initial assessment recommending that further investigations should take place?

Yes, however should be reviewed as noted above.

D6Q2 - Should the governing body regularly review a random sample of matters that were investigated but not referred to it, as proposed in paragraph 134?

Yes, it is agreed that governing bodies should regularly review a random sample of matters that were not referred to it. This will ensure that policy and procedures can be regularly updated and ensure that any systemic risks within the industry can be monitored.

D7Q1 – Do you agree that the governing body should be responsible for making the final determination about whether a financial adviser has failed to comply with the code?

Yes, as this is a key decision making process. The expertise required on the governing body will also ensure they have the relevant skills to be able to make these final decisions.

D7Q2 – Is it reasonable to expect the governing body to make a determination within 45 days of a matter being referred to it?

At this stage of consultation, the SMSFA sees no issue with a determination being made within 45 days of a matter being referred to it, assuming all information and hearings have been received and conducted.

D7Q3 – Do you agree the governing body should comply with the principles set out in Table 4 in carrying out its decision-making activities?

We believe that the principles set out in Table 4 comply with the principles of procedural fairness and give financial advisers confidence in the fairness and soundness of the decision-making process and to give credibility to the decisions of the governing body.

Sanctions

D8Q1 – Does the list at paragraph 145 capture all of the sanctions that might be appropriate to impose?

We believe that the sanctions in paragraph 145 are appropriate to impose.

D8Q2 – Are there matters other than those listed in Table 5 that a governing body should take into account when determining which sanctions to apply

We agree that the factors in Table 5 are appropriate when considering the sanctions to impose.

We do note that further guidance should be given as to when personal hardship as a result of imposing the sanction should be taken into account. We believe that this should only be a minor consideration

to ensure that the needs of the client are paramount to the overall scheme and reflect the FASEA code of ethics.

Appeals and dispute resolution

D9Q1 – Are there matters, other than those listed in paragraph 152, that should be covered in a monitoring body's documents appeals process?

No, paragraph 152 provides an adequate list in the appeals process. Given the recommendation for the monitoring body to prepare a guide for covered financial advisers.

D9Q2 – Should there be another party, aside from the governing body, that can hear appeals from covered financial advisers?

The SMSFA supports another party, aside from the governing body, should be able to hear appeals from covered financial advisers.

This will improve integrity to the system, to ensure that governing bodies have a check and balance. Such approach will also ensure financial advisers can seek recourse where they are aggrieved and have access to natural justice.

It is suggested that ASIC or an organ of FASEA could take on this role.

Enforceability

D10Q1 – Is a legally binding agreement an appropriate way to make the compliance scheme enforceable between the monitoring body and financial advisers.

Yes. Membership of a monitoring body should form a contractual arrangement.

However, the SMSF Association notes that ASIC should consider if there are any privacy concerns for clients of financial advisers and if there is a further requirement that clients will need to agree or be aware that their personal information is shared with monitoring bodies.

This express agreement could be obtained where an action is due to a direct complaint from a client. However, requiring bodies to share information for monitoring and random sampling will not always have the express agreement from clients.

D10Q2 – Do you agree with the proposed process for dealing with non-compliance by a covered financial adviser outlined in paragraph 161?

We agree that the proposed process for dealing with non-compliance.

It is suggested that the time for a financial adviser responding in a reasonable time be set out in the notice of compliance to ensure transparency in the process. However, the time to respond set by the monitoring body should be flexible and on a case by case basis. Complex requests may require more than 10 days for the financial adviser to comply with the notice request.

Data collection, analysis and reporting

E1Q1 – Do you agree that monitoring bodies should produce public annual reports covering the matters outlined in paragraph 167?

The SMSFA supports the production of annual reports as it assists in improving the behaviour of financial advisers as outlined in paragraph 173, as well as ensuring transparency and accountability for the code monitoring body.

We agree that not all information, such as that relating to serious contraventions, need to be made public. This is also necessary where information would reveal confidential information in relation to a client.

E1Q2 – Do you agree that monitoring bodies should produce quarterly reports for ASIC and meet with ASIC on a quarterly basis to discuss the matter outlined in paragraph 167?

We support quarterly reporting on the condition that reporting requirements do not become a compliance burden for monitoring bodies. If the level of reporting required is substantial, than 6 monthly-reporting is more appropriate.

We support meeting with ASIC on a quarterly basis, especially in the first year or two of code monitoring being in effect.

We agree that these requirements be reviewed by ASIC after a compliance scheme has been operating for a few years and its processes embedded. Quarterly meetings may need to be resumed where there are significant changes to a compliance schemes processes.

E1Q3 – Do you agree with our proposed 45-day timeframe for monitoring bodies to report serious contraventions or systemic issues to ASIC?

We agree with the proposed 45-day timeframe for monitoring bodies to report serious contraventions or systemic issues to ASIC.

We suggest that all proposed timeframes be regularly reviewed and adjusted where necessary.

E1Q4 – Would it be preferable to delay the commencement of some or all of the data collection, analysis and reporting expectations?

Given the rigorous application process and the need to carry out the “if not, why not” checklist, compliance schemes should be in a position to provide data collection, analysis and reporting expectations.

It is expected that as each scheme progresses the quality of this data will increase in future years.

E1Q5 – Would it be appropriate to reduce, or consider reducing, the proposed requirements for reporting to ASIC over time.

This should be an option open to ASIC after reviewing the system.

E1Q6 – Would it be feasible for monitoring bodies to work together to develop a reporting standard and would this be appropriate.

The SMSFA believes this option should be considered by monitoring bodies through consultation to determine if an agreed reporting standard is feasible. Consistency in reporting would help ASIC and monitoring bodies to analyse data efficiency and with greater value.

E2Q1- Do you agree with the proposal that ASIC expect monitoring bodies to consult with them about the terms of the independent review they propose to commission and the appointment of the independent reviewer.

Yes, this is appropriate.

E3Q1- Do you agree with our proposed expectation for consulting about the compliance scheme

We support the proposed expectation for consulting with stakeholders that may be affected by the content of a compliance scheme. This will ensure that the scheme has aimed to consider all relevant issues.

E3Q2 – Are our expectations for consultation and information sharing between monitoring bodies appropriate?

ASIC's expectations for consultation between monitoring bodies, especially during the creation stage, should not cause any significant issues.

E4Q1 – Do you agree that monitoring bodies should offer support to covered financial advisers to help them comply with their ethical obligations?

Monitoring bodies should offer support to covered financial advisers to help them comply with their ethical obligations. It is suggested that these forms of support are appropriate for the monitoring body and to reflect the membership base and annual risk appraisal of each scheme.

Also, noting that under the FASEA education guidelines it is likely that members will have to complete an ethics course, therefore such assistance in the form of workshops may not need to be provided by monitoring bodies in the short term. These workshop scenarios are likely to be undertaken in the further education requirements.

E4Q2 – Are there any forms of support not listed in paragraph 189 that we should suggest

We suggest that it is appropriate for the support offered to financial members to be designed by the monitoring bodies. This will ensure that it is relevant to the membership base and reflecting the needs of members at any given time.

The form of support could change as annual risks plans are developed and the changing nature of the financial advice space. For example, the increase of "robo-advice" may need different forms of support as it develops and risks are identified.

Information we will use to make a decision

F1Q1 – Is there information other than that set out in paragraph 193, that we should take into account when deciding whether to exercise ASIC's powers to revoke approval of a compliance scheme or vary or impose a condition on approval?

The information required pursuant to paragraph 193 adequately informs ASIC of the requirements in s921K to revoke the approval of the compliance scheme.

Proposal

F2Q1 – Are there matters other than those set out in paragraphs 197 and 198 that we should take into account when deciding whether to exercise ASIC's powers to revoke approval of compliance scheme or vary or impose a condition on approval?

We agree that these conditions are reasonable in deciding whether to exercise ASIC's powers to revoke approval of a compliance scheme.

We support the open and transparent approach taken by ASIC in overseeing the scheme.

F2Q2 – In what circumstances should we exercise ASIC's power to revoke a compliance scheme's approval or impose conditions on our approval?

We support the proposal that the power to revoke is exercised where there is a direct effect on the ability to continue monitoring or where the failure is due to a deliberate or reckless act.

It is appropriate to impose conditions on approval where the failure is not serious and the period of the failure is only within a small time frame. Working with the scheme operators to resolve any discrepancies will ensure a cost effective system for its members and ensure that they are able to continue within the same scheme monitoring body where appropriate.

.

Declaration to require AFS licensees and authorised representatives to provide information to monitoring bodies

G1Q2 – Will our proposed amendments be sufficient to enable monitoring bodies to carry out the activities we are proposing to expect?

The SMSFA supports the proposed amendments.

However, it is important for clients to also understand these amendments and what happens with their information.

Significant reductions in resources and expertise

H1Q1 – Is it reasonable for monitoring body to notify ASIC of a 'significant' reduction in the resources or expertise it uses to monitor and enforce compliance with the code within 45 days of becoming aware of the reduction?

It is reasonable for notification to occur where the reduction in resources or change in expertise level would pose a material risk of impacting the monitoring body's ability to manage he scheme effectively. This risk assessment would take into account the factors set out in paragraph 209-210.

H1Q2 – Are there any matters, other than those set out in paragraphs 209-210, that monitoring bodies should be required to consider when deciding whether a reduction is significant?

We have no suggestions.

H2Q1 – Do you agree with our proposed guidance? If not, please provide details.

We support the proposed guidance.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

John Maroney
CEO
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have $712 billion of funds under management and a diverse

range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisers and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.