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Royal Commission and Financial Planners – What's Next?

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The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry is due to hand down its final report by 1 February 2019. The Commission has dissected the way some of our biggest institutions do business, causing shockwaves in the process.

In his interim report tabled to parliament on 28 September 2018, Commissioner Kenneth Hayne provided some detailed reflections, including on the financial advice sector and has given some guidance about the areas in which his recommendations may focus.

The main areas are:

1. Fees for no service

The charging of fees for services not provided has been identified as a problem within the industry and continues to be a hot topic in the final round of hearings. The Commissioner was damning in his views:

> '*Charging for doing what you do not do is dishonest. No-one needs legal advice to tell them that. The root cause for what happened was greed; the greed of both licensees and advisers.*' (page 122).

The Commissioner concluded that institutions had been able to charge fees without providing a service because:

1. The financial industry had a culture of reliance on automatic periodic payments such as sales commissions and adviser service fees;
2. Some entities prioritised advice revenue and fee generation over delivering appropriate services;

3. Some entities did not keep accurate records to allow monitoring and analysis; and
4. Some entities did not properly supervise their advisers and the services to be provided were vague and ill-defined.

We expect to see a number of recommendations in the Commissioner's final report, which deal with this issue, including in relation to:

1. Whether ongoing fees need to be renegotiated annually;
2. Whether investment entities should be able to deduct fees and commissions without express client authority; and
3. The speed of a remediation response.

2. Platform fees

Many platforms are offered in a vertical integration model in which advisers are incentivised to sell their principals' products to the client. This gives rise to a potential conflict with the duty the adviser owes to their client to provide advice in the client's best interest. The Commissioner concluded that in such situations, conflicts are often '*managed*' in a way that aligns with the adviser's interest rather than the client's.

The Commissioner was critical of circumstances where clients' funds are invested in products available through platforms, and noted that:

1. The arrangement was often on a '*set and forget*' basis, with ongoing fees being charged despite no real service being provided;
2. The advice to invest was often provided by advisers promoting their licensees' products, which often were not the most appropriate or cost-competitive;
3. Platform operators often deducted licensees' fees from clients' accounts without clients' express authority; and
4. Fees are often charged by reference to the amount of funds under administration, and not as a fixed fee.

In the final report, we expect to see a number of recommendations regarding conflicts of interest, and in particular, a strengthening of an adviser's statutory duty to their client. The Commissioner may also recommend that product manufacturers' ability to provide financial advice be limited or eliminated.

3. Inappropriate advice

The Commissioner identified the following factors which give rise to inappropriate advice:

1. Advisers proposing actions that benefitted the adviser or their licensee. The Commissioner stated that as long as advisers or licensees stand to benefit financially from clients acting on the advice given, then the adviser's interest conflicts with the client's interests;
2. Advisers lacking skill and judgment. The Commissioner went on to address the importance of the education of advisers (discussed below); and
3. Licensees being unwilling to find out whether poor advice had been given, and if it had, to take timely steps to remediate.

We are interested to see whether the Commissioner will recommend a positive duty on a licensee to ascertain whether, and to what extent, its advisers are providing poor advice.

4. Improper conduct and discipline

Following on from inappropriate financial advice, the Commission concluded that there are three components of improper conduct and discipline:

1. *Prevention*. Education and training of advisers is the first step in preventing improper conduct, including poor advice. Advisers should understand why certain procedures are required, so that the likelihood of their following the procedure is increased;
2. *Detection*. In conjunction with prevention, detection is vital to minimising improper conduct. The chief means of detection of inappropriate advice is the regular and random audit of advisers' files; and

3. *Consequences.* The Commissioner was critical of the failure of some entities to penalise bad work or encourage good work. The possible consequences presently include:

    a. Regulatory consequences, which include the imposition of penalties (such as fines or banning orders) or clients seeking compensation through litigation;

    b. Industry consequences such as monitoring via professional associations. Professional associations do not presently have significant roles in enforcing proper standards of conduct but may become code monitoring bodies under the Corporations Act in the future.

The Commissioner is likely to make recommendations regarding ASIC's enforcement actions, in particular whether there should be a greater focus on deterrence, as well as the obligations of a licensee in relation to the advice provided by its advisers. There is also a possibility that the Commissioner may recommend that a licensee be the focus of criminal proceedings rather than individual advisers.

Conclusion

In his interim report, the Commissioner concludes that the above issues arise from:

1. The culture of the financial advice industry (particularly the remuneration of advisers);

2. Conflicts of interest and duty; and

3. The effectiveness of the regulators.

In light of the focus in the final round hearings on accountability, we expect some significant recommendations in the Commissioner's final report regarding the industry's conduct over the last few years. While we await the Commissioner's final report, the financial advice industry has some time to consider how to best meet its clients' needs and demonstrate to the public that it is deserving of its trust.

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