Hamilton Blackstone
LAWYERS

In Defence of Financial Planners

Say what now?

Defence of financial planners?

But aren't they evil bankers and salespeople?

Didn't we just conclude a Royal Commission into their misconduct?

Isn't ASIC banning them left, right and centre?

What's to defend?

It hasn't been an easy last 12 years or so for financial planners. The last 12 months have been particularly excruciating. Don't forget, you "caused" the heavy losses sustained by superannuitants and retirees (pre- and post-) during the GFC. That's right, you recommended your clients invest in superannuation and managed funds; you know, those same very arrangements which returned double-digit figures (in some cases in excess of 20% p.a) during the decade or so prior, but which all of a sudden were the devil, because of the actions of a handful of self-proclaimed "Masters of the Universe" some 10,000 kilometres away on Wall Street. Margin lending (and gearing for that matter) went from the doyen to the doghouse. If you implemented a gearing strategy in 2005, you were a genius in 2007. Clients loved you. They got their friends, families and neighbours to engage you to effect the same money-making strategy! But a year later, you were incompetent, self-interested, conflicted, unethical, immoral, and downright negligent, if not criminal.

So the legislature responded in the only way it knows how: more regulation. If Financial Services "Reform" (FSR) in 2002 wasn't enough, we devised another acronym: FOFA. The "Future" of Financial Advice. *Future*, hey? Something about the "best interests duty" and not being allowed to receive "conflicted remuneration" (financial planners caused the GFC, remember?). If those rules weren't enough, we expressly wrote into the legislation that planners' income streams (and therefore their livelihoods) are *presumed* to be unlawful.

And the best part? Because of actions not of their causing, financial planners became subject to a set of laws (the "best interests duty)" which *objectively* assesses whether, *objectively*, the elements which could only be properly determined by the planners themselves (the ones who know the clients and have the relationships with them), have or have not been met. In other words, completely out of planners' control, because it has to be *objective*: that is, pursuant to the imprudent "innocent third party bystander" concocted by the legal fraternity in the days where lawyers got paid by the word.

And, not only that, we'll also make sure that the question of whether or not their source of living – their remuneration – is prohibited ("conflicted remuneration"), is *objectively* determined. Again, outside of planners' control.

FOFA can only be described as an ignominy. I should know – I was involved with the early forms of the legislation during gestation. What is FOFA, ultimately? Apart from an intractable, undecipherable, confusing mass of legislation, regulation and regulatory "guidance", it's basically the forum through which product and platform providers' revenue streams could be maintained, at the expense of financial planners. Planners got lumped with all the restrictions and obligations. Existing platform revenue streams were preserved under the pretence that "grandfathering" provisions were required as a matter of law.

Grandfathering? You mean those very elements which are since being phased out, almost entirely?

So why did we have them to begin with? Oh, it was necessary to grandfather existing arrangements between platforms and dealer groups, we were told, because to prohibit them would amount to an unjust acquisition of property in contravention of the Commonwealth Constitution. One of the big wigs in town went as far as to say that this was based on legal advice from the Commonwealth Solicitor.

OK, how about "sunset clauses", so that we could phase out these arrangements over time? Nope, also unlawful.

But we've since removed grandfathering, right? So if it was illegal to do so before, why isn't it illegal now?

Cue the crickets…

Unjust acquisition? Yep, FOFA started as an intractable mess on the apparent basis that we had no choice because to do otherwise would mean the Government was unlawfully taking away product providers' property by making their existing arrangements unlawful from 1 July 2013, which would have apparently infringed Article 51(xxxi) of the Commonwealth Constitution.

Article 51(xxxi) provides that the Commonwealth can make laws with respect to the acquisition of property on *just* terms from any state or person for any purpose in respect of which the Commonwealth has power to make laws.

For what it's worth, the tobacco "plain packaging legislation" case heard by the High Court in 2012, discussed Article 51(xxxi) in significant detail. The Court applied a very strict and literal interpretation to the words used in Article 51(xxxi): specifically (and somewhat obviously), that there had to be a physical *acquisition* by the *Commonwealth* of existing *property*. There was nothing new or surprising in that decision. Article 51(xxxi) was very literal in its application.

On the basis of that decision, it would have been extremely difficult to conclude that the High Court would (or indeed could) have determined that the FOFA prohibitions constituted an unjust acquisition of property in breach of the Commonwealth Constitution: no "property" (if any) was *acquired* by the *Commonwealth*.

Planners were dudded. The lobbyists got their way. The big end of town, led by their industry bodies, successfully watered down FOFA to the rubble we were forced to live with, and which is now, some 6-7 years later, being cleaned up. But not before they extracted one last golden egg out of the goose. Vested interests trumped clients' interests. Revenue streams were protected. Planners were the "pawns", the "sacrificial lambs" in product providers' pursuits to maintain and protect their revenue streams. The *quid pro quo* was that we screwed the planners, because we lumped them with all the obligations and restrictions on their trade.

This sleight of hand hoodwinked the Government. FOFA was trumpeted as a success, and a new dawn in transparency, ethics, morality, accountability, competence, and professionalism was born!

For the few planners left standing years later, we serve the *piece de resistance*: FASEA. We force planners to go back to school and get a degree (you know, because they're unprofessional, unethical and incompetent, remember?). We force them to do *more* CPD hours (you know, because they're unprofessional, unethical and incompetent, remember?). We mandate a Code of "Ethics" (you know, because they're unprofessional, unethical and incompetent, remember?). We crucify licensees who don't audit every one of their planners' SOAs (you know, because planners are unprofessional, unethical and incompetent, remember?). We subject planners to further laws, the outcomes of which are further out of their control (check out Standard 5 of the Code of Ethics). We oblige them to crystal ball the future (check out Standard 6 of the Code of Ethics). And if markets should fall, we'll remind ourselves once again that planners are unprofessional, unethical and incompetent, and introduce even more laws!

Worse still, we'll allow FASEA to interfere in what otherwise are private contractual arrangements between planner and client (check out Standard 7 of the Code of Ethics).

Again, outcomes are out of planners' control.

Lawyers are nowhere near as heavily regulated as the financial planning "profession". Planners have been legislated to within an inch of their lives. And, sadly, some planners have paid with their health (worse still, their lives) both during, and following, the Royal Commission. COVID-19 has only served

to add to planners' woes. The stress has taken its toll. Mental health illnesses are on the rapid rise. And all the while the legislature and industry & regulatory bodies collude to drive the nail deeper.

But the struggles go well beyond legislation. Planners' income streams are at the behest of the platforms. If you don't play by their rules, they'll cut your access, and switch off your fees. Never mind what your contractual arrangements say about that. Never mind how it impacts your APL and your ability to discharge the best interests duty. Never mind that the platforms interfere in legitimate commercial relationships (ongoing service agreements and the like) between planner and client.

Worse still, you could be an AMP Financial Planning adviser, and have your financial livelihood and retirement plans obliterated at the stroke of a pen, apparently on the basis that "economic circumstances" warranted it. Oh, but those same "economic circumstances" still require you to pay back in full those loans AMP gave you when you bought your book from them at inflated prices to begin with. What's good for the goose evidently isn't so for the hapless gander…

But again, the planners caused the GFC, so it all seems eminently appropriate.

I guess it's academic really, because soon (and in any event) we'll be replacing planners altogether with something call "robo" advice. Yep, robots. Yep, clients' financial interests are now at the behest of service delivery by artificial "intelligence". Yep, we're now reducing the financial planning profession to the by-product of mechanical engagement: what was once financial advice is now a set of scripts capable of being delivered via artificial means. Human planners replaced by artificial counterparts. We don't even call it "financial planning" anymore. We call it "robo advice". Gone are the days of independent thinking. Gosh, that borders on criminal. Conform, or else! Whoops, can't use the word *independent*. That's illegal, too...

We conveniently overlook that "robo advice" services (including the recently-trumpeted "Digital SOA") only serve to compound the regulatory issues facing the industry, because they embed the very thing ASIC wants to eradicate: templated SOAs. And good luck reproducing a digital SOA to ASIC in response to a section 33 Notice! The industry has gone mad. And unnecessarily so. We're not talking rocket-science here: building a relationship with a client and understanding their needs doesn't need whiz-bang digital intervention. It's doing more harm than good. But nor did we need legislation by suffocation.

Let's go back to the Royal Commission. In my view, it disproportionately focused on licensees and their planners. But those players didn't set the rules. Product and platform providers set the terms of engagement. Planners were left with no choice but to play by those rules. If they didn't, they'd lose access to those products and platforms. Much like wholesalers needing to conform to supermarket giants' rules of engagement to be granted "shelf-space" in supermarket aisles. Conform, or your product is banished from existence! But instead of blaming the game, we crucify the players.

Unfortunately, ASIC is compounding the problem. Lambasted in the Commission and across mainstream media for being reactive, soft, benign, inept, and insipid, among other things, ASIC has responded with aplomb, governed by a new seek and destroy mandate to eliminate any and all recalcitrants from the industry. Moreover, ASIC has shifted its stance on what qualifies for expulsion. Minor offences now subject licensees and their planners to oblivion. And bear in mind ASIC is meant to be working with licensees in consumers' interests.

They flexed their muscles on Dover, wiping out hundreds of planners and thousands (perhaps tens of thousands) of client relationships in the process, not to mention abandoning those same thousands of clients and leaving them alone in the woods to fend for themselves. Makes you wonder why we have legislation to purportedly "protect" the consumer if the "watchdog" can throw caution to the wind.

But ASIC wants to impose "New World Order".

And it's not pretty for licensees. It starts covertly. Then it's Armageddon.

Let me pose a scenario to you. You receive a letter from ASIC. Perhaps a standard section 33 notice. Or a section 912C direction. Or they're reminding you of the unlawful usage of the word "independent" on your website (yes, they've got analysts trawling the web looking for dirt). Perhaps they want to

conduct "surveillance". Or perhaps a friendly phone call wanting to ask a few questions and to make time to come in and "do a site visit".

Awwww, what a friendly and proactive regulator! All seems harmless….

Fast-forward 6 months, and you're staring down the barrel of (pick one): Enforceable Undertaking, Licence Conditions, Penalties, AFSL Cancellation, or a Banning Order.

It's all a bit of a blur: what started out as friendly dialogue suddenly sees your AFSL business fighting for its life. You're at a loss as to why. "*We were open and transparent with them*", I hear you say.

Sound scarily familiar? Welcome to the new ASIC. The tough guys in town trying to fool the world into believing that the public humiliation dished out to them under the heated spotlight of the Royal Commission, was merely an aberration.

The analogy is this: ASIC rings your doorbell. They want to come in, and they exercise their right to do so. It seems all "nice". You say to yourself, "*we've nothing to hide, so let's show them what we're all about, and they'll thank us and move on. They're focusing on AMP and the Big Banks, anyway…*". So instead of moving them along after a cup of coffee, you give them a tour of the house. They notice a set of stairs, and you proudly inform them that you have 3 bedrooms upstairs. They ask to see your bedroom. You let them in. They ask to see what's in your wardrobe. Still not having cottoned-on to the fact that your home is being raided, you not only open your wardrobe, but you show them your partner's wardrobe. Next thing you know, they're in your children's bedrooms. And they're still ransacking the place months later.

Again, sound familiar?

I've challenged my clients to reflect back on their own recent dealings with ASIC. Each and every one of them regret their transparency early on.

"*But they can do what they like – they have the statutory power to raid your home*!".

Not quite.

ASIC has released in excess of 100 Regulatory Guides (don't we know it!), several of which set out the legal threshold requirements for the exercise of ASIC's functions and powers. For example, did you know that ASIC simply does not have an unfettered power to cancel an AFSL or issue a banning order? It must be **necessary** to do so: yes, necessary, not because they simply *can*. There's a whole bunch of tests on what "necessary" means. Ultimately, it has to do with preserving the integrity of the financial services system and protecting consumers' interests. Surely, then, mere technical breaches which do not impact clients at all, don't render it necessary to expel you into oblivion?

Also, don't assume the statutory notices issued by ASIC are valid to begin with (for example, do they establish a proper jurisdictional basis to ransack your home, or are they simply issued for something as curiously broad as "*to assess compliance with Chapter 7 of the Corporations Act*", noting that Chapter 7 of the Corporations Act is the entire substratum of a licensee's obligations)?

What is often overlooked is section 1(2)(d) of the ASIC Act (yes, its own Act), which obliges ASIC, in the performance of its functions and exercise of its powers, to strive to *administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements*. Also, the *Financial Management and Accountability Act 1997* imposes criminal penalties on ASIC officials for exercising functions and powers in a way which constitutes an improper use or handling of public monies.

I've observed several instances of ASIC conducting its functions outside its powers, and/or without proper process (for example, exercising "investigation" functions during "surveillance", such as obtaining records or contacting clients: *no, ASIC cannot do these things during "surveillance"*).

The worst recent client experience was that of a Responsible Manager of a licensee, who was contacted by ASIC to come in for a "voluntary" interview (yes, *voluntary*) in relation to *another* licensee under investigation.

"Sure, why not? I'm happy to assist in any way I can".

18 months of no contact from ASIC post-interview. Then, wham! Two statutory notices of intent: one to cancel my client's AFSL; the other to ban my client from providing financial services.

"So let me get this right", I hear you exclaim. *"ASIC called your client in for a voluntary interview in relation to an investigation into another licensee, and they used the information obtained from him in that interview to shut down his own license and ban him from the industry?"*

Bingo!

Naturally, I sought the transcript of the "voluntary" interview. To no one's surprise, at no time prior to, or during, the interview, was my client informed (as was legally required) that:

- He was under no obligation or compulsion to attend the interview;
- His responses in the interview would be used against his own AFSL or otherwise form the basis of surveillance, or investigative or enforcement action against his own AFSL;
- His responses in the interview would be used against him or otherwise form the basis of surveillance, or investigative or enforcement action against him (especially in his capacity as director and responsible manager of his AFSL);
- He could terminate the interview at any time; and
- Being a voluntary interview, and *not* one conducted pursuant to the exercise of ASIC's powers under section 19 of the ASIC Act, this meant that my client was not protected in the event of a breach of confidentiality, and - most importantly - **was not protected by the privilege against self-incrimination, and could not avail himself of the privilege in relation to each question asked of him during the interview**.

Imagine my client's response when I brought these to his attention.

It's all about the Media Release. And, yes, ASIC is on record (I have the emails!) where they have asked licensees to "choose" or "negotiate" their outcome, but on the condition that the outcome is one on which ASIC can issue a media release. In other words, it has to make ASIC look good. ASIC needs to show the world how tough it is. To give you another example, one of my clients had already moved to voluntarily cancel its AFSL (for separate commercial reasons), but ASIC since advised that it still wished to cancel the notice for alleged breaches (so the media release that it so desperately craves could be issued).

"*Ummm, but it's no longer necessary to cancel the AFSL, because the licensee has already done so*".

"*Even though the licensee sought to voluntarily cancel its AFSL, we consider that we should still cancel the AFSL, because of the risk the licensee will breach its obligations in the future*".

I'm not making this up.

ASIC no longer wishes to work with licensees and planners. It has a vendetta against them. ASIC no longer takes heed of its own prescribed mandate: it wants to throw the book and beat its chest. It surely cannot be sustained. It's a disaster waiting to happen. Can we not see the consequences of this regulatory vendetta against planners and their AFSLs? Apart from the obvious, such as fewer AFSLs, fewer advisers, clients being left without advisers (*wonderful demonstration of ASIC's pro-consumer mandate – just ask Dover clients!*), advice priced out of reach for ordinary Australians etc…, what about the inevitable **market failure**?

"Market failure", as we know (at least in an economics sense), essentially arises where there is an inefficient distribution of goods and services in a free market, such that it leads to irrational behaviours and outcomes. Furthermore, the individual incentives for rational behaviour do not lead to rational outcomes for the group. Put another way, individuals make what appear to be correct decision for themselves, but those prove to be the wrong decisions for the market.

Sounds disturbingly like the financial services industry, does it not? Look at ASIC's behaviour. Look at the legislation. Look at the way service providers act in their self-interests (product providers, compliance consultants and lawyers, 8-figure "remediation" programs run by the Big 4 accounting firms, to name a few – where everyone is both out for themselves and acts to protect themselves). In an economics sense, this leads to a net social welfare loss (in this case, consumers suffer greatly, because of the increased costs of, and limited access to, financial advice and services). Stakeholders' pursuits of self-interest lead to inefficient and adverse outcomes for consumers. Ironically, in a traditional economics sense, it is the role of governments to intervene to correct this market "failure": however, ASIC and the legislature appear to be the main protagonists. In any event, the end-consumer loses. Everyday Australians are being priced out of advice and services, and therefore improved retirement outcomes. The social welfare costs (especially the increased reliance on the public purse as a consequence) are immeasurable.

ASIC's "shoot first, ask questions later" approach has crippled the industry. One mistake, and you're out! Recent experiences show that they'll keep looking until they find something. They're no longer about the consumer. They're no longer about educating and working with planners. Rather, we're at the mercy of the equivalent of a top-tier litigation law firm, filled with gun-toting mercenaries governed by a mandate to seek and destroy. And they're comfortable enough to act unlawfully and outside powers, knowing licensees and planners are too exhausted and resource-drained to take up the fight.

What do you think's going to happen when they're given the unfettered power to tap planners' phone calls? That one's going to end well…

A few rotten potatoes have contaminated the entire shipment. ASIC should let the industry self-heal.

Market failure is compounded (and indeed reinforced) by what I have termed the "Rome Effect": much like what happened in the Eternal City, we keep building new on old, in the hope that problems are solved. What then happens is we strip back the "new" and realise the "old" was pretty good to begin with, and we'll do what it takes to preserve it! And then we regret ever covering the "old" to begin with. We have legislative precedent for this in the financial services sphere. Just look at the 8-page Short-Form PDS. Weren't we thereabouts (remember the old KFS?) pre-FSR? We didn't like KFSs, so we created the 100 page PDS. That was a mess, so we reverted to an 8-page document. Today, we have 100 page SOAs. We'll no doubt have the "8-page SOA" legislated in the near future (delivered by robots of course!).

By all means, weed out the crooks. And there are plenty of them! And, yes, there are several who deserve to be expelled. But the industry has been kicked around long enough, and is doing its best to self-heal. So let it do just that as well. Give it time. Give it space. Give it support. And let planners do what they're best at – which is building trusted relationships, and working with their clients to deliver better retirement outcomes. The Australian economy needs good financial planners more than it is prepared to realise.

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