

ASIC REPORT ON FEES FOR NO SERVICE

31 October 2016 | Australia

Legal Briefings - By **Michael Vrisakis** and **Cameron Hanson**

ASIC Report 499 *Financial advice: Fees for no service* has now been released.

This Discussion Paper focuses on:

- explaining the key findings of the report (in Part A); and
- explaining the key repercussions for licensees and the industry more broadly (in Part B).

This Discussion Paper does not seek to comment on the findings ASIC made in relation to the specific organisations' review exercises but rather, to extrapolate points of principle. It is noted in the case of Macquarie that it had found no systemic failures in this area and in the case of Westpac, the only failure was found in relation to one adviser. The reviews of the relevant organisations are ongoing (ASIC expects the organisations to complete their review and compensation exercises by 30 June 2017 or earlier), and it will announce further progress in the first half of 2017.

PART A

Focus of the Report

The Report examined the conduct of 6 institutions; namely, AMP, ANZ, CBA, Macquarie, NAB and Westpac in relation to ongoing advice fees charged by their licensee entities ('entities' or 'organisations').

The specific focus is on systemic failure of the entities to discharge obligations to ensure that ongoing advice services were provided to customers who paid for such services. It also deals with systemic failure of product issuers to stop charging these fees to customers who did not have a financial adviser.

ASIC notes its efforts in imposing compensation outcomes for affected customers, in terms of the number of customers compensated, amount of compensation (ASIC's estimate is over \$178 million) and further reviews initiated by these entities.

It also notes the lack of evidence of these issues in other licensees but encourages those other licensees to review for these issues.

ASIC also notes the need for system changes to prevent future failures.

Key Findings

ASIC notes that it had previously identified the prevalence in the industry of customers who had not received advice or services in the previous 12 months (termed 'passive customers'). The Report relates to fees charged to such passive customers.

There are 3 prongs to ASIC's review, being compensation, further review by the organisations and systems changes.

The relevant criteria for ASIC's examination were:

- licensees who are authorised to provide financial advice to retail clients;
- product issuers that identified failure to provide ongoing advice services to customers or the incorrect charging of ongoing advice fees; and
- a period of review covering at least the 7 year period between 1 July 2008 and 30 June 2015.

Compensation

The two areas of compensation were:

- failure of the provision of service;

- charging of fees to customers who did not have an adviser attached.

The latter category included customers who requested that the advice service be discontinued and customers in respect of whom fees were charged from a member package that did not include advice.

The compensation methodologies ASIC expounds are:

1. refund of fees;
2. lost interest on earnings;
3. clear communication;
4. using the above-mentioned minimum 7 year period.

The Report notes that methodologies utilised to identify affected customers included random as well as risk-based approaches. ASIC scrutinised these approaches to ensure that the results would be able to identify, with an acceptable degree of confidence, whether there was a 'similar systemic failure'.

ASIC notes that there are circumstances where calculation of lost earnings will be problematic and that in such cases it is sometimes acceptable to apply an approximation at a rate which is:

1. fair and reasonable rate and which should be 'reasonably high';
2. relatively stable; and
3. objectively set by an independent body.

A suggested example is the Reserve Bank cash rate plus 6% per year.

The compensation figures and progress for each of the organisations are detailed in the Report.

Identification

ASIC notes the problems that the relevant organisations had in identifying affected customers, ranging from lack of proper records to the extended duration of the time period involved, to the resourcing applied to the identification exercise.

Systems Charges

A key focus of ASIC in this area was to obtain feedback from the organisations as to the changes proposed to systems to:

1. resolve the cause of failure;
2. reduce the likelihood of similar failures; and
3. increase the likelihood of detection.

The Report goes on to examine the changes implemented/proposed by the various licensees.

ASIC'S CONCERNS

Remuneration

1. **Prioritisation of revenue over services:** Organisations' systems had more effective systems for recording incoming revenue over evidence of service.
2. **Too many customers:** Some advisers had more customers on their books than they had the capacity to service.
3. **Services of limited value:** Some organisations charged fees for services that arguably had limited value, such as for the retention of records.
4. **Fee maximisation:** ASIC notes that:

- a. some licensees did not regard there as being any obligation to provide advice to customers for a fee (which was automatically deducted);
- b. some licensees considered their obligations were satisfied if the adviser offered or attempted to offer an annual review. In this regard, ASIC notes that, regardless of any legal justification, this approach was, in their view, indicative of cultural issues that need to be addressed (see Part B for further discussion).

Record Keeping and Monitoring

ASIC notes the failure to keep adequate records or data to enable monitoring and analysis of ongoing service. This manifested itself in the following impacts:

- significant difficulties/delays in identifying affected customers;
- absence of customer files;
- inability to accurately calculate refunds/compensation.

Policies and Procedures

ASIC's concern is that advice licensees failed to develop and enforce appropriate policies and procedures to ensure that:

1. ongoing services were provided to relevant customers;
2. fees would not be charged for ongoing advice services not provided; and
3. fees would be switched off (and customers compensated) for customers not receiving advice.

Review and Remediation

ASIC notes that whilst there were positive responses from organisations, some organisations adopted processes which in their view were 'legalistic and not focussed on customers' interests' (see Part B for further discussion).

Cultural Indications

ASIC notes that, in their view, the systemic failures they identify were contributed to by cultural factors.

They encourage the organisations to consider how culture may have supported the identified system failures.

ASIC notes that 'The role of the board, senior executives and management is critical in setting the right culture'.

PART B

Background

The Report refers primarily to adviser service fees; that is, fees relating to services provided by the entities for which fees were being charged.

Often the fee was charged for the offer of services by the entity. In other words, it was charged where the client could get access to the service but even when they didn't avail themselves of that service.

A related fee to the adviser service fee is the employer plan service fee which was typically a fee negotiated between the employer of relevant members of the superannuation fund and an adviser.

Key issues raised

The Report raises a number of issues which, broadly, concern the nature of the contractual arrangement between the client and the adviser.

The relevant contractual terms may have been contained in a product disclosure statement or could have been contained in a separate agreement.

The first issue is the contractual basis for charging fees for the accessibility of the service rather than the service itself.

If the terms of the contract provide clearly for this, then legally this would be, prima facie, valid. As indicated in Part A above, ASIC regards this approach as indicative of problematic cultural issues. As it transpires, such an approach was not uncommon and because the service is a personal service, one cannot naturally compel the customer to take up the offer of service. As to whether a fee should be deducted for an offer of service, rather than the service itself, this seems to be the issue ASIC is criticising.

The second issue is whether the fee was charged when the entity did not necessarily have sufficient evidence that the service was provided/offered.

ASIC considers that if a licensee does not have sufficient evidence of service, then compensation should be paid without further investigation or delay. In this context, ASIC's position is that a licensee cannot compensate on an opt-in basis.

Broadly, ASIC may justify these conclusions on the basis of the duty of a licensee to act efficiently, honestly and fairly.

This raises issues of whether and how a statutory duty interacts with duties arising under contract. Suffice to say that there are quite strong differences of legal opinion on this issue.

In relation to ASIC's view that an opt-in compensation approach is not acceptable, opt-in approaches are routinely used in other jurisdictions. ASIC may be seeking to differentiate a service fee scenario on the basis that it is a more definitive situation than other situations (such as poor advice).

An approach where the customer needs to effectively make a claim for compensation may be more cogent where the customer could well have received the service but service records fall short of conclusively establishing this.

Repercussions of the Paper

The likely repercussions of the Paper are significant.

The first is a possible interpretation of the ASIC findings that licensees have acted, at best, inefficiently or at worst, in bad faith. The point here is that much depends on the specific circumstances of the offering, including the relevant contractual terms.

The second is the creation of informal rules for remediation and charging based on ASIC's regulatory stance.

For example:

- period in which the remediation must go back;
- use of opt-in methodology (which as discussed above, ASIC rejects);
- interest rate methodology (which ASIC is likely to be prescriptive about).

Even though these rules for compensation may not have been tested in Court, ASIC clearly wishes them to be applied as the norm. One repercussion of this is that rules then emerge which can be different from the compensation rules for business as usual complaints. For example, in business as usual complaints, one would expect that compensation would depend on a claim being lodged by the customer and being processed by the licensee. Again, ASIC may seek to distinguish a service fee scenario based on the point that if service was not provided, a customer should not need to complain.

STRATEGIC RESPONSES

The reality is that these issues are historical. They relate to organisations transitioning and restructuring from commission payments to a fee for service.

The key feature of these fees were that they were typically charged for accessibility (ie the ability to get advice), not just when the advice was provided.

Clearly, ASIC's position will be based on concepts of unconscionability and misleading/deceptive.

It is noted that high penalties can apply for proven conduct in these areas.

There is inevitably an element of hindsight in this type of characterisation.

In many cases, the relevant organisation changed the structure for valid reasons, to get away from an outdated commission structure.

An irony is that there were no legal reasons compelling this change. It was done usually for reasons of being more transparent to the client. It is therefore ironic that those organisations which did not transition from commission would not be captured by the current ASIC review and in fact, would not be in breach of the law.

This point links to the issue of whether it was fair to charge for an offer of service. In this context it needs to be factored in that the previous commission regime often had no service component.

There is no doubt that ASIC will continue to strenuously enforce compensation from affected organisations.

A key issue therefore is how that interaction with ASIC is managed, noting individual circumstances of affected organisations can differ.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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