The cost of regulation

The ballooning ASIC levy, borne by advisers, begs the question: How do you put a price tag on regulation? **Karren Vergara** writes.

The corporate regulator justified the staggering 160% jump in the adviser levy, from the time it was introduced in 2017-18, as a consequence of advisers abandoning the industry.

The levy for the 2019-20 financial year, which is charged retrospectively based on ASIC's enforcement activity, amounts to $1500 per licensee plus $2426 per adviser (see Table 1).

Ross Smith, the director of advice firm Shenton, operates two AFSLs, one of which is based in Hong Kong and the other in Brisbane.

ASIC is billing Smith for two sets of levies for each AFSL: $24,534 and $14,288.

Smith, who is fighting the government tirelessly to have the levy removed, says one unintended consequence of the legislation will force advisers to increase their fees and pass this on to clients, which was not the intent of the legislation.

"We are not the guilty party," he says, pointing out that it feels as though the good advisers are paying for the sins of bad advisers of the past.

Smith has made several complaints to ASIC about the levy, but only receives a "standard generic, bureaucratic reply". He has also submitted complaints to the Commonwealth Ombudsman, but also receives the same reply.

Smith has even applied for a waiver based on economic grounds.

"I've had to stop contributing to superannuation and I cannot afford to retire," he says.

"I owe $273,000 on my home loan in Australia and at the end of March, working capital for one practices had increased from $11,000 to $18,000 which was still not enough to pay ASIC."

Other advisers, like PCH Financial principal and business owner Paul Herring, do not understand why advisers have to pay a levy in the first place, which is making it more challenging for advisers to stay in business.

"It adds to the challenges of being in business. I am the only adviser in my business and I have to pay that levy, which is a solid slug," Herring says.

ASIC deputy chair and commissioner Karen Chester[01] acknowledged the significant uptick at a Parliamentary Joint Committee on Corporation and Financial Services in March.

> *We are not the guilty party.*
> **Ross Smith**

While Chester lent a sympathetic ear to advisers needing to fork out an unprecedented amount of money, she ultimately blamed the increases to the "denominator effect" of advisers exiting the industry.

"Indeed, when we look at the numbers, it has gone from $276 million, which is the total amount recovered, to $320 million. It is important to look at the drivers of that increase. The lion's share of the increase were the costs related to the Royal Commission, and a large part of that is enforcement," she says.

There were 19,992 ASIC-registered financial advisers as at June 3, which according to Rainmaker analysis is a five-year low not seen since the pre-financial services Royal Commission days.

In keeping the levy down, Chester hopes that adviser numbers will stabilise, but also hints that the "numerator should come down over time [in] several ways".

The hearing also found that ASIC typically recovers the costs incurred in prosecuting the

01:
Karen Chester
deputy chair
ASIC

02:
Ashley Murphy
co-founder
The Global Financial Planning Institute

03:
Paul Cullen
advice group executive
Centrepoint Alliance

major financial institutions and offsets these against the levy.

The problem is that a massive lag exists between the time ASIC recoups such costs to the offset trickling down to the smaller players.

"So, when we recover from the big end of town, the small end of town doesn't see that coming off their bill until a couple of years later," Chester said.

The Global Financial Planning Institute co-founder Ashley Murphy[02] says the regulation of financial advisers in Australia has gone too far.

"While the regulations are consumer friendly and have raised the standards in the industry, the fact that financial advice is becoming out of reach for many is unfortunately the sad side effect of over-regulation," he says.

In the US, there are tiers of advisers overseen by different jurisdictions and regulators.

They are regulated based on the size of their book of business and which particular financial products they offer, Murphy says, who has practised as an adviser for many years in the state of California.

"If the advised amount is less than US$100 million, the adviser is regulated by their state of residence. If the amount is over US $100 million, the adviser is regulated by the Securities and Exchange Commission (SEC)."

Financial products are also defined differently.

"In the US, a financial product can be thought of as a product that is financial in nature where capital is invested, and the possibility of a capital loss exists," he adds.

Interestingly, the SEC does not regulate financial products per se, that is done by the Financial Industry Regulatory Authority (FINRA), a self-governing organisation that oversees brokerage firms and exchange markets.

There are also different types of financial advisers – fiduciary advisers which are mostly fee-only and advisers who accept commissions for the sale of financial products.

The latter 'advisers' are also known as product salespeople, Murphy says, and are not regulated as fiduciaries.

So, how much fees does Murphy pay to the US regulator that is equivalent to ASIC's levy? It is about US$300 per year.

US researchers found that porous boundaries dividing regulatory regimes are conducive to bad advisers to "wandering".

Academics Colleen Honigsberg, Edwin Hu and Robert Jackson, Jr. analysed 1.2 million advisers across four major regulatory regimes and found wandering advisers with a prior record of misconduct have a "heightened" tendency to commit future wrongdoing.

Such advisers are more than 40% more likely to re-offend compared to other advisers with misconduct who do not change regulatory regimes.

"Most Americans experience financial advice as an undifferentiated product, making no distinction among the individuals who execute their stock trades, advise them on their 401(k) investments, and sell them life insurance linked to the performance of a stock-market index indeed - even though each of these three individuals is subject to a different legal regime," the authors found.

The financial services Royal Commission unearthed the ineffectiveness of ASIC and APRA as regulators, failing to escalate matters to the courts and instead relying on enforceable undertakings by negotiating fines with perpetrators, which in some instances, took place over long lunches.

After the Royal Commission, both regulators received a funding boost worth hundreds of millions of dollars to carry out their functions effectively. The 2019-20 budget allocated to them $606.7 million over the next five years.

"Why is ASIC charging financial advisers when it was a super trustee that broke the law?"
Ben Marshan

On top of this, ASIC's industry funding levy charged to super trustees, custodians, market intermediaries, listed companies and a slew of others operating in the financial services and insurance subsectors amounted to $320.33 million for the same period.

Given the cash injection ASIC received right after the Royal Commission, it leaves many scratching their heads and asking why this was not enough to help it carry out its enforcement duties.

The Financial Planning Association of Australia is not opposed to an industry levy because it believes it helps drive better behaviour and increased professionalism.

The problem, FPA head of policy, strategy and innovation Ben Marshan says, is the legacy issues ASIC is taking so long to deal with.

"What's disappointing is that over 50% of the costs relate to court action ASIC is taking against super trustees, and Evans Dixon [now E&P Financial Group] for example. These problems arose five-plus years ago. Now, professional financial planners are being asked to pay for ASIC's legal work," he says.

"There is a problem in the way the formula works – not that there is a levy in the first place. We want the levy restructured so that the right fee is charged to the right organisation."

Another example is ASIC's court action against BT. "Why is ASIC charging financial advisers when it was a super trustee that broke the law?" he asks.

Centrepoint Alliance advice group executive Paul Cullen[03] says: "The levy is one more thing that will increase the cost of advice and we are concerned that people who really need it are being marginalised as it is becoming even more expensive for them to obtain."

The licensee solutions provider, which immediately pays ASIC's levy on behalf of clients, has given advisers three months to repay Centrepoint, extending the original one-month deadline with an additional two months in a bid to help them manage their cashflow.

Cullen predicts adviser numbers will continue to dwindle as some advisers he engages with indicated they will not take the exams and are rethinking their future in the industry.

Furthermore, he cannot foresee the levy going down this year.

"Unless someone steps in and says, 'we can move away from this formula', we will probably see another increase next year," he says.

Shenton's Smith has to fork out $39,000 for running two AFSLs. His PI insurance premiums cost another $19,738 on top of other overheads.

He describes the levy as a "wholly non-productive loss in national wealth to Australia".

"I am 68 years of age and I would love to put that money into my superannuation account. But I can't. I have to pay it to ASIC to pay for its bank-fix-up job," he says. FS

Table 1: ASIC industry funding for some sectors

Subsector	Actual levies FY 2019-20 (m)	No. of entities	Levy metric
Financial advice			
Retail advice on financial products	$56.19	2991	Adjusted number of advisers on the adviser register and number of days authorised
Retail advice on non-financial products	$1.26	625	Number of days authorised
General advice only	$2.09	1004	Flat levy
Wholesale clients only	$0.05	1624	Flat levy
Insurance			
Product providers	$18.13	91	Gross premium and net policy revenue
Product distributors	$3.88	3242	Flat levy
Risk management product providers	$0.28	64	Number of days authorised
Listed corporations	$51.02	2112	Market capitlisation and number of days authorised
Superannuation trustees	$23.82	114	Adjusted total assets and number of days authorised
Custodians	$0.56	1126	Flat levy
IDPS operators	$0.71	86	Revenue from IDPS activity

Source: ASIC