Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and services in Australia

Submission by the Financial Planning Association of Australia

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Preamble

The Financial Planning Association of Australia (FPA) is pleased to provide a submission to the Parliamentary Joint Committee Inquiry (the PJC Inquiry) into financial products and services. The FPA is the peak professional association for financial planners in Australia with nearly 12,000 members representing both individual financial planners, and Australian Financial Services Licensees (AFSLs).

The FPA has as its primary goal the development and implementation of a professional framework, over and above the requirements of Corporations Law, by which our members deliver professional, ethical, quality financial advice to their clients. The FPA is also the only professional association in Australia licensed to deliver the CERTIFIED FINANCIAL PLANNER™ program which provides the peak certification for financial planners globally, with some 118,000 CFP® professionals operating in 23 countries.

Members join the FPA as a mark of professional commitment to the FPA's Code of Ethics and Rules of professional conduct, and membership of the FPA provides additional safeguards to consumers in terms of the professional integrity and accountability of their financial planner and AFSL.

Our response to the PJC Inquiry has been developed by our members and includes evidence and input based on direct experiences with clients, interaction with the regulatory environment, and an understanding of the corporate collapses that have prompted the PJC Inquiry, where FPA members have been involved.

FPA members were directly involved in Westpoint, Storm Financial and MFS and we acknowledge that many clients have lost significant amounts of money or experienced hardship as a result of these corporate collapses.

Our submission responds directly to the Terms of Reference and the issues that contributed to the various collapses. We also take the opportunity to highlight a number of areas where greater understanding and education is needed or regulatory reform is necessary, to ensure progress toward reducing the risk of corporate collapses and investor losses from occurring again.

Summary of key recommendations

The role of financial advisers

1. We urge the Government to undertake a detailed consultation process with industry and other stakeholders to determine the most effective mechanism to restrict individuals who do not meet robust requirements from using the term 'financial planner[1]'. Careful consideration should also be given to the use of other terms incorporating the word 'advice' and any definitions allocated to such terms. Consideration should also be given to the definition of 'financial planning service,' in contrast to 'financial product advice.'

2. Those who are qualified to use the term 'financial planner' should undertake professional obligations over and above the requirements of the law, enshrining a fiduciary responsibility along with ethics and integrity in their interactions with clients, effected by a legal or regulatory mandate to join a professional body.

3. Regulations should be amended to recognise the role of professional bodies in "co-regulating" financial planners. The amendment should make clear the responsibilities and authorities such bodies would possess with respect to professional financial planners that become members of an 'accredited' professional body, thus empowering them to fulfil their roles.

4. The Corporations Act s945A(2) should be amended in relation to the suitability of advice, to include as a defence the demonstration of compliance with an approved professional body's code of practice.

5. Minimum competency requirements for financial planning advice should be strengthened and raised through professional obligations and mandatory professional membership requirements as stated above.

Regulatory reform

6. Regulations should be amended to provide for a simplified disclosure documentation regime.

[1] Note that the term 'financial planner' and 'financial adviser' are often interchanged. We would be quite willing to incorporate both terms under a set of obligations as long as the service provided reflected a professional financial planning process with the higher set of obligations.

7. A fiduciary responsibility should be enshrined in professional obligations under the principle of “Client First” which builds on the legal requirements to provide appropriate advice, delivering beneficial consumer, market, and regulatory outcomes.

8. The criteria, requirements and assessment process to gain an AFS licence, should be strengthened.

9. A public register should be established, managed by the Australian Securities and Investment Commission (ASIC), of all AFSLs and their Authorised Representatives, and employed planners. Such a register should detail licensing conditions and professional obligations for the provision of financial planning advice and possibly for all other types of ‘financial product advice,’ as well as information about bans by ASIC or a relevant professional body.

10. The ASIC Act and associated regulations should be amended to encourage greater information sharing and co-operation between the Regulator and professional bodies where it can be established that there is mutual interest and community benefit.

Remuneration and conflicts of interest

11. Remuneration practices in financial planning should be regulated through professional obligations, which are supported by requirements set out in Corporations Law.

12. ASIC and relevant professional bodies, such as the FPA, should work collaboratively on strategies to improve avoidance, management, and disclosure, to mitigate conflicts of interest in the financial services industry through complementary government and professional regulations.

13. Fees for advice should become an income tax deduction, including fees for initial advice. Consideration should be given to a tax rebate to provide for an income tax rebate of 30 percent on a fee up to $2,000.

Availability, advertising, and promotion of poor products

14. Advertising controls should be tightened to ensure truth in advertising, and the use of appropriate and realistic assumptions.

15. The Government should work with product providers and research houses to establish a comprehensive system of rating for product risk that ensures disclosure of key product risks.

Information, education and consumer capability

16. Government and industry should work collaboratively on an industry-wide approach to improving consumer financial capability and literacy.

17. The definitions of retail and non-retail clients, in respect of delivery of financial services, should be reconsidered.

Professional Indemnity Insurance

18. The retail client compensation system has fundamental flaws and should be urgently reviewed through extensive public consultation with industry, consumers and other stakeholders.

1. The PJC Inquiry Terms of Reference

1.1 The role of financial advisers[2]

The Financial Planning Standards Board (FPSB), the global licensing authority for Certified Financial Planners, defines financial planning as "the process of developing strategies to assist clients in managing their financial affairs to meet life's goals." Financial Planning provides significant benefits, both individual and societal. The individual benefits include improved financial wellbeing, the ability for an individual to meet his or her life goals, and peace of mind. Societal benefits include a population that has greater interest in issues of finance and investment, communities that make more effective use of their resources, and reduced government entitlement expenditure.

Financial planners make plans and provide comprehensive, strategic advice, across a range of financial activities, which may be unrelated to product recommendations. They differ from financial product advisers, a term which includes a variety of financial intermediaries such as stockbrokers, insurance advisers, and general advisers, because they follow a detailed financial advice process, offer strategic advice and need to understand their client's circumstances, and are not limited to product advice or single product recommendations. Some financial planners specialise in one area such as retirement planning, but they would provide strategic advice in relation to this specialty. We discuss the terms 'financial planner' and 'financial adviser' and make recommendations in **section 5**.

In Australia, there are approximately 45,000 authorised representatives who are licensed to provide 'financial product advice.' Such people might work as bank tellers, financial advisors, or fully-fledged financial planners. We estimate that of the 45,000 authorised representatives, 15,000 to 17,000 are financial planners.

Following the recent high profile financial collapses, the media has taken particular interest in the role of financial advisers. Chief among these collapses for financial planners have been the collapses of Westpoint, Storm Financial, and MFS, each of which have involved FPA members. In each case, financial planners recommended products or strategies to their clients which ultimately failed. However each case has

[2] 'Financial planner' and 'financial adviser' are interchangeable terms that are used in the financial planning industry, and by consumers. We have referred primarily to financial planners in our submission, in contrast to financial product advisers, but accept that we might need to consider both 'financial planner' and 'financial adviser' in the context of financial planning advice, as long as both are protected, and have higher professional obligations.

different reasons for failure, ranging from poor advice to fraudulent behaviour by the Directors of the corporate entity promoting the product. The details of Storm Financial are discussed in **section 2**.

1.2 The general regulatory environment for these products and services

The regulatory regime relating to financial services and products, including financial advice, is not fundamentally flawed, but some finetuning is required to address certain deficiencies. Setting aside margin lending, the Corporations Act and the Financial Services Reform (FSR) Act constitute the primary regulatory framework for the financial products and services of interest to this Inquiry. The regulatory approach involves licensing the providing entity, establishment of minimum competence and training standards for authorised representatives, provision for adequate disclosure, requirements to manage conflicts of interest, and provision of remedies in case of breach. Internationally, Australia's regulatory approach is regarded as one of the furthest reaching and most thorough, compared to its peers. Indeed, other jurisdictions frequently emulate our approach, for example New Zealand has expanded its recently announced Financial Advisors Act 2008, many of the proposals of which are based on FSR.

Notwithstanding these qualities, there remain some deficiencies or 'gaps' in the following areas:

1) The entry requirements for providers of financial advice are too low, which has led to some incompetent and ill-equipped advisers being able to provide financial advice on sophisticated and risky products;

2) The lack of clear differentiation between financial planners, on the one hand, and other financial advisers and financial product advisers, on the other hand, confuses and misleads consumers in terms of services offered and standards of professionalism;

3) The absence of a mandatory professional framework to underpin the differentiation between financial planners and others, the lack of which enables some financial intermediaries to opt out of additional commitments if they find them too expensive or difficult to meet, to the detriment of their clients;

FPA

4) The lack of a requirement to provide advice on a "client first" fiduciary basis and a confusing obligation to the AFSL, who provides authorisation, and the client;

5) Disclosure requirements which are compliance-focused and not useful to clients, hindering them from making informed decisions;

6) Licensing standards that are inadequate, permitting licensing of those who should not be licensed or allowing banned or failed individuals to provide advice through alternative arrangements.

7) Insufficient risk disclosure and product categorisation that reduces the abilities of consumers to determine whether products are appropriate for their circumstances;

8) Inadequate oversight of many of the 16,000 products in the market, before issuance. The responsibilities placed on licensees and planners under the Corporations Act, and ASIC's approach to consumer protection in relation to poor products has demonstrated a preference to shift the regulatory burden for ensuring the validity of all products onto the individual planner, leaving product providers in some cases unaccountable and unpunished.

We make recommendations for addressing each of these issues in **section 5**.

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1.3 The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers

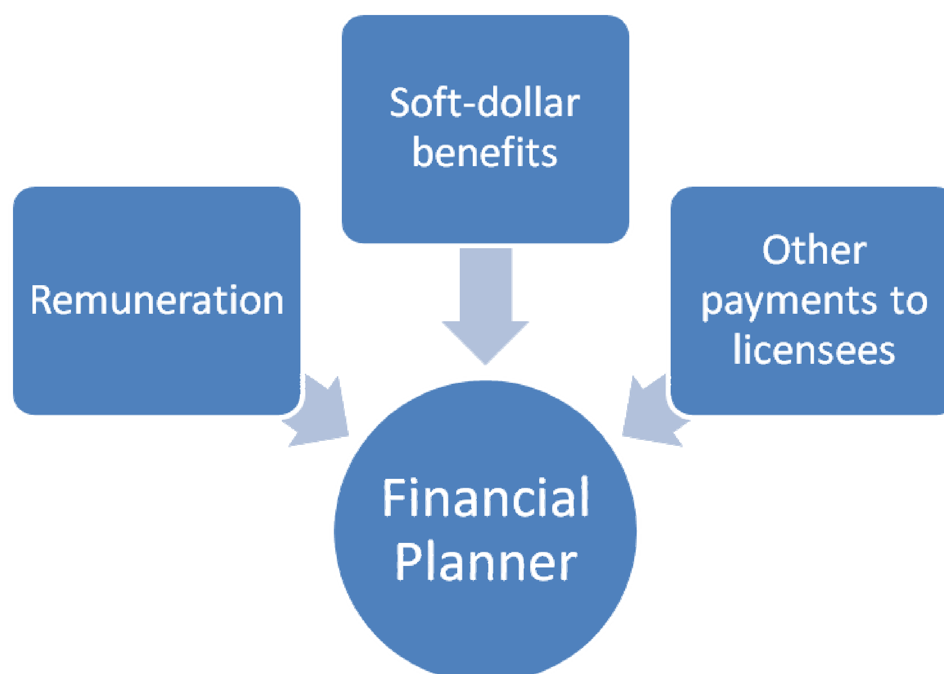
Remuneration continues to dominate the public discourse, largely because a number of high-profile corporate collapses involved products that featured significant upfront fees and commissions, and also because of advertisements resulting from competition in the superannuation sector between retail and industry superannuation funds.

The Corporations Act (including Section/s 942C and 947C) details the obligations for disclosure of remuneration of financial advisers. The Financial Services Guide (S942C) sets out the terms of business for the AFSL, and the Statement of Advice (S947C) sets out the actual payment for the advice.

In considering conflicts of interest, the issue of remuneration is often cited as a key issue. A new approach to remuneration is necessary. To this end, the FPA has been engaged in a program of progressive reform that positions the Australian Financial Planning profession at the pinnacle of world's best practice in financial services.

As a profession, we are concerned with any form of influence (monetary or otherwise) that may bias or appear to bias the advice a consumer receives. To address this concern, we have established rules and professional expectations of avoidance, management, and/or disclosure of conflicts of interest.

We broadly categorise the different payments that might be paid/received, as remuneration, soft-dollar benefits, and other payments to licensees.



'Remuneration' is the payment of fees, including commissions, by a client to a financial planner, through the AFSL, for advice and related services. Remuneration payments are governed by the FPA's Conflict of Interest Principles and Practice Standards that set out appropriate behaviour in relation to the payment of such fees.

'Soft-Dollar' benefits are payments made by a product provider to the AFSL and/or financial planner that are non-monetary and might include a meal or tickets to a sporting event. Behaviour in relation to these payments is governed by a joint *IFSA/FPA Industry Code of Practice on Alternative Forms of Remuneration in the Wealth Management Industry*. The Code requires both providers and recipients to record the benefits valued over $300 on a publicly available register.

'Other payments to licensees' include shelf space fees, volume bonuses, rebates, and any other payments between product providers and AFSLs. Such payments are made by a product provider to the AFSL or other intermediary, ostensibly to cover marketing, education, training, and other such services. These payments are governed by the FPA's Principles to Manage Conflicts of Interest, requiring avoidance and management of conflict, as well as the joint *IFSA/FPA Industry Guide on Rebates & Related Payments in the Wealth Management Industry*, which is intended as industry practice to require disclosure of such payments.

This double layering of regulation (Government and professional practice) is more robust than in any other market-based profession and ensures improved clarity and

equity for consumers, with a strong enforceable base for breaches of professional and regulatory obligation. More explanation of such a collaborative regulatory approach is provided in **section 4**.

FPA remuneration policy

Continuing its proactive approach, the FPA has developed a client directed remuneration policy, based on a set of six principles. Payment for advice should align with the service delivered, and the negotiation of both is a matter that is best managed by individual financial planners and their clients. For these reasons, it is important for the FPA to phase out commission payments by 2012.

Tax deductibility of fees

This also creates some need for changes on the part of Government. Commissions are tax deductible and therefore provide an incentive for clients to continue to use products that finance advice through the use of commissions. Fees are only tax deductible where directly related to income producing activities and only where this relates to ongoing, not initial, advice. In this regard, a change in the tax regime would be necessary to accommodate the deductibility of fees for initial advice. We discuss this further in **section 6.5**.

1.4 The role played by marketing and advertising campaigns

Advertisements in daily newspapers reveal a plethora of financial products available to consumers, both directly and via intermediaries. Most marketing and advertising campaigns for financial products and services are primarily conducted by product providers. Though such advertisements sometimes include a tagline encouraging consumers to seek professional financial advice, their primary purpose is not the promotion of advice.

The FPA conducted a 3 year campaign to promote the value of advice from 2006 to May 2009 which achieved strong consumer engagement. Apart from that and some campaigns conducted by institutions, there is little direct advertising for which the primary purpose is to promote the benefits of professional financial advice in Australia.

Advertisements often focus on extravagant returns and guarantees. Many such advertisements are targeted directly at consumers who might not have the capacity to assess the suitability of particular products. While advertisements can be a valuable means of educating consumers, FPA members are concerned about the lack of accountability of product providers and research houses when products do not perform as advertised.

Negative advertising campaigns, such as those run by the Industry Superannuation Network (ISN), further complicate matters. The ISN's advertisements seek to demonise financial planners and the advice they offer as being irrelevant and expensive. The campaigns are misleading and deceptive, basing their conclusions on the highest possible fee structures and most conservative balanced product, for example, and are thus not reflective of real client situations. These campaigns merely depreciate financial advice in the eyes of the public, resulting in a public that is less informed about their financial options and suffers potential worsening financial health.

For these reasons, we recommend the adoption of stronger advertising controls to ensure truth in advertising. Moving in the right direction, the Investment and Financial Services Association (IFSA) recently released its Superannuation Charter, which calls for better controls relating to the promotion of superannuation investment performance. We support the charter and encourage the extension of its recommendations to all products across the industry.

FPA

1.5 The adequacy of licensing arrangements for those who sold the products and services

In our view, there have been some deficiencies in the licensing regime that enable unscrupulous operators to enter and remain in the financial services industry. ASIC has identified similar concerns but has acknowledged limits on the actions it can take.

The licensing of financial services providers serves as a mechanism by which ASIC sets a minimum entry standard, conducts surveillance, and monitors reports of breaches.

The delegated licensing approach is an efficient model, even if only because 4,500+ corporate entities are easier to regulate than 45,000 individual authorised representatives. However, a licensing approach that requires licensees to be responsible for nearly all activities that occur in the marketplace has created a commercial layer of legal delegation that has done little to encourage innovation or promote the provision of varying models of quality practise. The unintended consequence of a corporate compliance regime has had the effect of confusing personal professional obligation to a licensee's business imperative. Whilst we recognize that these two imperatives are usually aligned, where the business imperatives pervert the professional process (as is arguably the case in Storm Financial) then an important layer of potential protection is removed.

We recognize that the regime may be both constitutionally appropriate and efficient but if licensing continues to attach to the level of corporate entity, then it should be substantially improved to require a deliberate and detailed approval process that ensures appropriate corporate governance arrangements, appropriate research capacities, an appropriate supervision and conduct regime that can ensure licensing, legal, and professional obligations are met. Some changes in regulation are needed to improve the licensing regime, and are detailed more fully in section 5.

1.6 The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served

One of the roles of a financial planner, as a professional intermediary, is to protect their clients from unscrupulous and misleading advertising by providing informed, professional opinions. According to FPA professional obligations, financial planners are expected to put their clients' interests first.

In the specific instances of Storm and Westpoint, consumer injury came in part through the provision of poor advice. In the case of Storm, FPA investigations have identified evidence of the application of high pressure sales techniques being applied to clients in order to maintain sales volume and the company's transactional income. This business model is fundamentally at odds to the *Client First* approach, because it puts clients at risk for the benefit of their financial planners. This breach of the FPA's professional ethics requirements was grounds for Storm's expulsion from the FPA, which was effected earlier this year.

In the practice of providing professional financial advice, professional service and client relationship skills are important to the profession. In this regard, high pressure sales tactics are unacceptable.

In addition, the number of documents required to be provided to a client is a significant barrier to the delivery of quality advice and to client understanding. Clients who wish to buy a product as a result of advice are given three documents:

1. A Financial Services Guide which sets out the terms of business for that licensee;

2. The Statement of Advice (SOA) which encompasses details of the scope of the advice, remuneration, conflicts, and other relevant information by which the client can make an informed decision to proceed with the advice. In some cases the client might receive a Record of Advice (ROA) or a Statement of Additional Advice (SOAA) depending on the nature of the advice. The differences exist to attempt to shorten the documentation where limited advice is provided; and

3. A Product Disclosure Statement which outlines the features and benefits of the product.

Each document differs greatly in terms of style, language and user-friendliness. They focus on compliance with the disclosure regime, rather than the needs of the client. While compliant with applicable laws and regulations, this approach can interfere with the effective transmission of information and does not help clients make better decisions.

The FPA recommends revising the regime to make disclosure more client focussed and thus better address the client's informational needs. We offer solutions to these problems in **section 5**.

1.7 Consumer education and understanding of these financial products and services

Consumer capability and understanding is fundamental to the ability to make informed judgements and effective decisions about the use and management of money. It is an essential skill for functioning in modern society and is becoming increasingly important to the long-term wellbeing of individuals and communities.

However, research consistently confirms that overall consumer understanding of financial matters is patchy at best and particularly low for certain groups. Financial literacy, or lack thereof, strongly correlates with certain characteristics of age, gender, education and socioeconomics. Of most significance is the vulnerability of Australians with low levels of financial literacy to be influenced by poor quality advice and the advertising and promotion of financial products promising high returns. Such promotions typically do not adhere to the fundamental principles of financial planning.

When put into use, the principles by upon which financial planning is based provide an effective approach for making appropriate and beneficial long term investment decisions, regardless of whether a consumer receives advice. Understanding concepts such as credit, diversification, and risk are essential to all financial decisions. There exist real opportunities for the financial services industry, financial planning profession, regulators, and Government to work together to improve financial literacy. The financial planning profession already performs its part in educating consumers and leveraging its specific skills and relationships in support of national financial literacy.

In the case of Storm Financial it is clear that some clients did not understand the promoted strategies and the associated risks. Accordingly, it is important to improve the quality of consumer education about financial services and the role of advice, so as to ensure that consumers are able to make informed choices and identify dangers.

The FPA and its members embrace their role in pursuing the education of clients in the provision of advice. Our activities, in this regard, are discussed in greater depth in **section 6**.

FPA

1.8 The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers

Retail client compensation in Australia is based on the use of Professional Indemnity (PI) insurance as the primary mechanism for compensating investors, and the Financial Ombudsman Service (FOS) as the means to resolve complaints that can not be resolved by internal dispute resolution procedures. PI insurance is for the benefit of protecting a financial planner and AFSL from claims made by clients, and FOS is a consumer compensation mechanism which is free for the consumer, and is only available to consumers with claims against FOS members.

It is a requirement of all licensees that Professional Indemnity (PI) insurance is in place, and that it meets with requirements set out in Regulatory Guidance (RG) 126. Membership of the FPA also requires that PI insurance is in place. The FPA established a PI service with leading broker Jardine Lloyd Thompson that combines the requirements of RG 126 with professional obligations, as well as pooling members' risks, to deliver competitive PI cover to members.

The difficulty for the Government and the community is that the incidence of poor advice, and poor products or businesses leading to investor losses, most often occurs through unlicensed advisors, Self Managed Super Funds (Westpoint) and product providers that are not covered by either PI insurance or FOS. Whilst the prudential system underpins the deposit, super and insurance sector, compensation for all other forms of financial product falls within this limited licensing net and places inappropriate pressure on the single point in the system where advice is provided. Moreover, the availability of insurance coverage is becoming extremely limited.

The retail client compensation system should be simple, clear, accessible, and affordable for all users. The FPA therefore recommends that the system be reviewed to address fundamental flaws. We recommend that Treasury initiate a review of the Retail Consumer Compensation system and undertake extensive non-confidential consultation with industry, consumers, and other stakeholders. This is addressed in greater detail in **section 7**.

1.9 The need for any legislative or regulatory change

In this submission, we have identified several areas where legislative and/or regulatory change is necessary and urgent. However, for such changes to be effective, they must be accompanied by proper professional regulation. Such an approach is the best way to address concerns raised by corporate collapses and to help consumers make better investment decisions, whether advised or not.

Rather than increasing the scope and complexity of government involvement, there is an enormous opportunity for a more robust regulatory system to emerge by achieving a collaborative, balanced approach between government regulation and professional regulation.

These systems are already at work in financial services, as they are in every regulated profession. However, the enactment of the Corporations Act (Chapter 7) in 2003 brought a splintering of these systems that government and industry never reconciled.

Proper regulation in most professions consists of a dynamic interaction between government-imposed legal requirements, business-imposed rules of work, and the expectations of professional participants, as codified in professional obligations.

Better integration of professional regulation into the system of regulatory obligations will achieve greater consumer, regulator, and marketplace benefits. However, in order for this integration to be effective, legislative and regulatory changes are needed to further legitimise the non-government sources of regulation. Ideally, the approach would support clear framework, cooperation, communication, control and support. The necessary legislative and regulatory changes are discussed in greater detail in **section 5**.

1.10 The involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses

The role of lenders has come under greater public scrutiny as a result of statements from lenders identifying shortcomings in their own lending practices. This shift in focus, albeit late, is appropriate as there was a significant role played by banks with regard to the daily management of the portfolio at the point of margin call, the subsequent extent of exposure of Storm clients and the consequent impact on them as a result of market shifts. The high level of credit exposure along with the lack of diversification of the assets of Storm clients was a significantly contributing factor to the extent of the impact to Storm clients' portfolios. This has clearly identified the Storm scenario as not simply an advisory issue, as was maintained for a significant period of time. It is clearly important that the roles and responsibilities of banks, operational issues, sales and marketing structures, and incentives need to be considered. While we certainly acknowledge the role of advisers and have responded in recognition of the failure of our professional expectations, lenders must plausibly account for their activities with regard to these collapses.

Although the Government has established a new regulatory framework for credit and margin lending, these arrangements were not in place at the time that margin lending facilities were offered to Storm clients. Credit is covered under the ASIC Act, and misleading and deceptive conduct in relation to margin lending is, and was, capable of being regulated by this means. Thus, although limited, there was some regulatory capture for misrepresentation with regard to credit and margin lending activities.. However, regulation of margin lending did not include specific requirements applicable to lenders and the Uniform Consumer Credit Code and associated State and Territory legislation governing consumer credit excluded investment loans. Lender's obligations were limited under the Australian Bankers' Association (ABA) Code of Banking Practice, which required members to exercise care and skill in determining a customer's ability to repay the loan.

The new regulatory framework establishes obligations on the banking and financial services industry to provide specific protection to consumers of credit and margin lending products. Compared to the previous regime the major difference for margin lending is the requirement to be licensed and the application of Chapter 7 requirements to lenders. For advisers, although advice in relation solely to a margin

loan was not subject to the Chapter 7 requirements, the Chapter 7 advice regime applied where a margin loan is included as part of an overall investment arrangement.

The cornerstone of the new policy is the requirement for responsible lending assessments to be undertaken to ensure that credit and margin lending products are not unsuitable for borrowers. In addition, there are requirements applying to margin lending to determine the extent of gearing that a potential margin lending client can be exposed. In addition, the regulatory changes do have important implications for clients' ability to obtain restitution as licensing conditions require licensees to have in place appropriate compensation arrangements for retail clients, including membership of an EDR Scheme.

There is some question as to how far even the new regime would have addressed the Storm issue. The requirements envisage that the assessment will determine that clients should be able to meet their contractual obligations from income and available liquid assets, rather than from long-term savings or from equity in a fixed asset such as a residential home. While it appears that in the most extreme cases the existence of such assessments would have resulted in a lower exposure, it would not necessarily have helped the majority of Storm clients. The extreme market movements meant that their financial situation at the time of the assessment was significantly different than when the margin call was required. This necessitates a close monitoring of the development of the portfolio during market stresses.

While clearly a very welcome step forward, the regulatory regime cannot of itself deliver a system whereby failures such as Storm cannot happen again. There is a role for a combination of legislative requirements, professional obligations, and licensee responsibilities. Further consideration needs to be given to lending practices and informed client decision making, both when initiating a margin lending relationship and when margin calls are made.

The legislative and regulatory changes needed to accomplish this are addressed in **section 5**.

2. The FPA's professional accountability process in relation to members involved in recent corporate collapses

The FPA has a mechanism for enforcing breaches of the professional obligations applied to its members. The results of these proceedings are published quarterly. In the most recent report, the number of investigations varied between 40 and 28, with 15 new investigations for the quarter. Some 27 investigations were closed, and five members were expelled.

While we recognise that Westpoint has not been named as a corporate collapse of interest to this PJC Inquiry, we outline the FPA's actions in relation to Westpoint and issues emerging from Westpoint because these will demonstrate actions that we have taken over the past two years that we can make public, as follows:

Number of FPA Members	Complaints discontinued	Members Expelled	Members Suspended	Members fined	Membership terminated as a result of actions
13	2	1	1	7	11

The above actions reflect different sanctions depending on the type of breach that occurred. Each investigation went through the FPA's professional accountability process, culminating in Hearings conducted by the Conduct Review Commission (CRC).

2.1 Professional accountability actions in relation to Storm Financial and Victorian Families Pty Ltd

Storm Financial was a Principal member of the FPA for 10 years. Storm completed annual audit reviews, and no complaints had been lodged with the FPA that resulted in any disciplinary action until late 2008.

The FPA initiated a complaint against Storm Financial on 6 November 2008.

Specifically, the FPA was interested in the allegations raised in a media article concerning the widespread use of a high risk gearing strategy and possible client exposure to margin calls in the then volatile market environment.

Further, the FPA sought particulars concerning the use of the pro-forma letter which was sent to Storm clients. The letter included a blanket recommendation couched as general advice which, when delivered in this manner, was potentially in breach of

several of the FPA's Rules of Professional Conduct, including the requirement to disclose fees and the appropriateness of advice.

The FPA raised direct concerns about potential breaches of the FPA's Rules of Professional Conduct 106 (Disclosure); 110 (suitability of the financial strategy for the client); and 118 (adequacy of the justification for the advice to switch from equities to cash contained in the Storm general client letter dated 8 October 2008).

These complaints lead to the FPA issuing a Breach Notice to Storm Financial. In particular, the Breach Notice alleged a breach of Rule 110 of the FPA's Rules of Professional Conduct:

In preparing written recommendations, the member shall develop a suitable financial strategy or plan for the client based on the relevant information collected and analysed.

There were other more specific claims in relation to a particular client.

Under FPA procedures Storm Financial had until 20 January 2009 to respond to the charges. However, on 12 January 2009 Storm Financial entered into voluntary administration.

Principal membership is automatically terminated pursuant to cl.16.1(a) of the FPA Constitution where a Principal member appoints a third party and enters into voluntary administration. This also resulted in the termination of the disciplinary proceedings against Storm.

2.1.1 Victorian Families

On 16 March 2009 the FPA issued a Breach Notice to Storm subsidiary Victorian Families Pty Ltd based upon a former client's complaint alleging inappropriate advice. On 24 April 2009, Victorian Families entered voluntary administration, and as a consequence its membership of the FPA was automatically terminated and any pending disciplinary actions were halted.

2.1.2 Individual Members of the FPA

Eleven FPA members were authorised by Storm Financial, out of 34 authorised representatives or employed advisers. Storm employed 150 staff in total.

The FPA has received 21 complaints from former clients of Storm in relation to the conduct of eleven FPA members. Investigations are being considered in each of

these instances, however at this point, complaints against three Storm representatives have progressed to the issuing of charge notices, and recommendations have been made to the CRC concerning alleged breaches of FPA Rules of Professional Conduct.

Until such time as any professional prosecutions are concluded, the FPA is restricted in its capacity to disclose the outcomes or details of investigations.

2.1.3 Emerging Lessons from Storm[3]

The following information has been gleaned during the course of the FPA's inquiries and does not relate specifically to any matter currently under investigation, nor does it represent the FPA's concluded view on Storm.

There are two aspects to the situation that warrant greater understanding: the Storm business model, and the Storm advice model.

2.1.4 The Storm business model

Herewith is an overview of the business structure covering fees, investment strategy, business expansion, and business practice.

2.1.5 Fee structure

The fee structure was a combination of the following:

- Upfront fees, calculated on the basis of total funds and approved margin lending limit under advice of 6-7%.
- Trail commission, payable to Storm Financial from the relevant fund manager of between 0.22 – 0.385% per annum.
- Trial commission, described as a 'Royalty' to a related service company, Storm Financial Research P/L of 0.33%.
- Identifiable re-servicing triggers: 10% or 20% index movement in either direction.
- Upfront fee + trail commission fee structure often repeated on each re-servicing.

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[3] The FPA expects that further detailed evidence may emerge in the course of our investigative activity. It also does not wish to in any way prejudge the outcome of those actions which will proceed in accordance with FPA Disciplinary Regulations.

- Other market Index Funds were “badged” by Storm, allowing them to charge a management fee of 1.15% discounted to 0.87% (compared with, for example, the Vanguard Retail Index Fund – Australian Equities Management Fee of 0.35%).
- Some client cash was also held in Macquarie CMT accounts and these funds were paying commission at 0.275% p.a. to Storm.

2.1.6 Investment strategy structure

The investment strategy can best be described as a Margin Loan facility where securities (shares and potentially other assets) were used as collateral for a credit facility that was then used to purchase additional securities. This strategy has the effect of multiplying a client’s securities portfolio (delivering strong asset and potential income growth) on the back of a credit facility. As securities values go up, so does the credit available to purchase more securities. The negative consequence, however, can also occur that should securities values decline, the portfolio value would also decline, but the credit to be repaid would remain at the highest level drawn.

The Storm scenario was essentially a “worst case” scenario for this form of investment, where all of the securities that underpinned the portfolio plummeted in value and left every client with debt that exceeded their assets and insufficient income available from those assets to repay any debt.

Other features of the Storm investment model were:

- Encouragement to double gear, where clients would borrow against their homes and any other assets to contribute to the margin loan pool.
- A single class of product – A Storm badged index fund was emphasized. Whilst an index fund normally offers index benefit of market spread and less olatility, in this instance the entire market collapsed.
- Further, the index fund nature allowed Storm to identify market triggers (either up or down in value) and automatically then trigger a request from Storm for more investment funds from the client. In this way, clients were intended to always be held at a maximum limit of exposure (potentially this leads to increased income and assets for clients, but it definitely creates greater risk for the client and also guarantees greater income for Storm).
- Some funds held aside in cash in a cash management trust to allow investment flexibility and easy access to further investment funds triggered by movements described above.

2.1.7 Business expansion

Storm was clearly on an expansion path leading up to its proposed float in 2007, which was subsequently abandoned. This involved:

- Seeking partnership opportunities with other firms so as to dramatically expand their client pool and create more clients dedicated to the Storm strategy.
- 3,000 clients were in the original structure, the additional 11,000 clients had been acquired through acquisition and had not yet been 'Stormified'.
- Negotiating better arrangements with their product partners that allowed:
  - lower borrowing costs which enabled higher profits to be retained or used to incentivise clients.
  - higher margin limits which enabled higher borrowings and higher fees to be generated to the business.

2.1.8 Business practice

The business practices of Storm were unique and appeared to focus on a very aggressive wealth creation strategy that involved:

- High pressure sales and education practices to encourage clients to use the model, supported by psychological influences revolving around being part of a 'family'
- Intense and regular customer service
- Strong formal legal compliance
- A Board with credible Directors
- Clients being "challenged" to become extremely wealthy and the Storm experience is one that will teach you to be wealthy
- Lavish offices
- Promotion of the unique 'Storm' experience with overseas trips with clients – Alaska, Tuscany and Africa
- Storm success stories that publicly identified with the business: e.g. John Buchanan, former Australian Cricket Team coach and many well known sports people

- Ultra successful clients being identified as part of an inner circle that newer recruits to ‘the journey’ aspire to emulate
- Business owners participating in the advice model
- Staff participating in the advice model.

2.2 The Storm advice model

Our understanding of the Storm advice model is based upon our examination of multiple Statements of Advice provided to the FPA by clients who have raised concerns about Storm with the FPA or other FPA members.

For the most part clients who have made complaints to the FPA either received initial advice from Storm late in the share market boom – i.e. around October/ November 2007 and further advice during 2007-08. In a few instances we have complaints concerning clients who invested on initial advice received earlier than October/November 2007, but have lost money overall.

We are yet to identify any single longer term client who would have been successful as a result of the share market boom prior to 2007 and may have successfully terminated the strategy either on Storm’s advice or otherwise prior to October/ November 2007.

2.2.1 Overview

The Storm advice model included:

- The only qualification to use the strategy was that the client must have some existing equity, and an investment time horizon of 7-10 years
- All clients were advised to borrow money against existing assets to acquire a margin loan
- Borrowing between 40% and 60% of total assets was recommended and the only legitimate purpose for holding capital is its value as a tool for wealth creation.
- Gearing which maximises the efficient use of capital for wealth creation leveraging it to produce higher returns on that capital
- Generally interest was pre-paid
- Owning property was deemed to be unproductive – the only benefit was to leverage it for investment
- Lending obligations would be met through receiving investment income

- A proposition that the only legitimate purpose of financial planning is wealth creation. It does not matter what stage of life the client is in – massive increases in wealth solves all problems
- All clients were recommended index funds
- As the value of the product rises, the value of underlying security rises relative to the value of the client's borrowings. This enabled the client to borrow additional funds at the same Loan to Value Ratio (LVR). Clients were encouraged to borrow more via a margin loan to acquire more income producing assets on trigger points of a 10% or 20% rise in the index fund value
- As the value of the product falls, the units in the product become relatively less expensive to buy, and clients were encouraged to utilise the opportunity to acquire more units cheaply
- Blame shifting and uncertainty appears to now be an issue around who had obligation to monitor the index and margin facility – Client/Storm/Lending Institution
- Storm made no apology for the high costs of advice, which were fully disclosed, and were justified as a result of performance and service
- Cost comparisons were done against a standard industry upfront fee and trail scenario which indicated that the client would be in front over time if they paid higher fees up front.

2.2.2 Risks associated with this advice model

- Because the investment recommended was an index fund, in a general bear market the investment value must fall, and there is no control over the extent of the fall
- Each client strategy had a degree of dependency on the income generated from the index fund to provide cash flow to service the loans. The degree of dependence does not necessarily reflect client tolerance for risk
- In almost all instances, the clients' capacities to repay the loan from other sources of income would place the client in hardship and in some extreme cases there was no basis for income outside these investments.
- Cash flow from the index was highly dependent on property related stock which had high cyclical exposure to the global credit crunch

- Single provider risk in the badged indexed fund approach although we note that there were two providers
- All the investors in the fund had margin loans and were towards 'the end' at the limit of LVRs. Normally, listed index funds have the stability of institutional investors to act as buffers but it seems these funds were entirely retail investor driven through Storm clients, and fund risk was therefore magnified
- Fund value fell significantly putting a significant number of investors into margin call simultaneously
- Fund profitability and capacity to pursue fund mandate on a reduced balance triggered the fund closure.

2.2.3 Impact on Storm clients

- Because clients were encouraged to leverage all their assets for the investment strategy, once the investment strategy collapsed, clients with significant existing assets and limited liabilities, pre-storm suddenly had investments worth little against significant liabilities.
- Many are unable to service the debt on their family homes, and are at risk of foreclosure.
- There is limited capacity to service the recommended liabilities other than via income generated from the investment, which may be non existent at the moment, or very low.
- Clients with funds converted to cash have security treated as 100% LVR. Re-investing funds immediately alters the LVR treatment of the security.
- Clients who have pre-paid interest and who no longer have funds invested have a tax issue.
- In addition, the concentration of Storm clients in regional communities has led to widespread community and client impacts, affecting people's retirement, lifestyles, housing prices, and employment decisions.

2.3 Lessons for the FPA as a result of Storm

The following is a summary of lessons that the FPA has learned or had confirmed and many have lead to or will lead to improvements in the way the FPA monitors members, and interacts with consumers.

- The community has clear expectations of the role of the FPA and membership of the FPA, and where identified, the brand is a stamp of approval, authority and credibility.
- The strength of the FPA brand means the FPA must ensure, where possible, that trust is well placed, and that bearers meet the highest expectations of ethical practice. This means that the FPA will continue to improve our entry standards, our audit processes, and our complaints and disciplinary mechanisms.
- Principal membership of the FPA and use of the Principal Member logo does not mean that all authorised representatives are individual members of the FPA. This was seen to be misleading for Storm clients because they thought that all financial planners must be members. It is critical that individual financial planners commit individually to professional standards because they sit in front of clients, and cannot outsource their professional obligations to the licensee. The FPA will be looking closely at what we can do to increase individual membership within a Principal member, or restrict the use of the Principal brand where individual membership is below an agreed level.
- Members need encouragement (and have an obligation) to participate in the protection of their own professional reputation but we need to demonstrate how this can occur. One avenue is a whistle blowing strategy – a safe mechanism to encourage staff, members and clients to step forward with concerns in a reasonable and appropriate manner
- The FPA is looking at issuing guidelines on margin lending, and gearing in general with the potential for further guidelines on other high risk strategies. This will to a certain extent depend on ASIC guidelines in relation to margin lending which are imminent.
- We are implementing changes to professional conduct and audit models with more targeted and active audit campaigns as well as risk based campaign. The sensitive issue of appropriate business models is an important feature of genuine risk analysis and the community expects us to be able to comment

on models that are out of the ordinary or might contain higher than average risk.

- We are reviewing the potential for "positive auditing" for members that genuinely *demonstrate* their adherence to FPA requirements.
- We are preparing improvements to the FPA Constitution, regulations and investigative powers to provide greater and more immediate triggers for audit, investigation and suspension.
- We want to Improve and fast track the bad apples requirements into FPA regulation and ASIC compliance and note that licensees are still not using the framework effectively for recruitment and screening.
- The FPA is releasing in July 2009 a streamlined set of professional obligations which combines some nine sets of requirements into the one Code of Professional Practice. This is an important stake in the ground for the profession and needs to be championed within and without the profession.

2.4 Lessons for financial planners

- Storm represented a failure of fundamental investment principles – diversification, risk tolerance, long term strategy, and exit strategies for clients. We must go back to basics.
- The importance of client first irrespective of earnings potential through some strategies and emotional client servicing tactics. For example, for some clients there is no reward worth the risk. If a client says "I don't want to risk my house" that simply means do not risk the house.
- The importance and value of the Six Step Financial Planning process and FPA Practice Standards which clearly set out the steps to be taken in advising clients, the appropriate processes, and rules. There are no short cuts with comprehensive and complex strategies.
- Charging structures should be commensurate with the advice given, the client should understand them and be able to compare them, and they should comply with our conflict of interest principles
- Compliant does not mean professional nor ethical, nor appropriate for the client

Being an FPA member is important and valued – it increases obligation, scrutiny and community protection but also increases the trust expected in the delivery of advice.

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2.5 Lessons for consumers

- Financial literacy and education is very important especially with complex investment strategies
- If it sounds too good to be true – it probably is
- There are no shortcuts to wealth – good advice requires patient adherence and long term thinking
- The importance of diversification
- Ask – is my adviser a member of the FPA and do I know who to complain to if something goes wrong
- Do not sign documents you do not understand
- Do not let documents be falsified or amended after your signature
- All strategies have risk – ask about them

2.6 Lessons for government

- More regulation is not the answer – better regulation is the answer and we specifically encourage improvements in credit regulation and margin lending, which is now being addressed
- Complexity of compliance requirements creates barriers for consumers – not greater protection
- Commission based remuneration alone did not lead to the collapse of Storm
- Volume of disclosure has led to failures in consumer protection
- Product comparability and genuine transparency is important
- ASIC's supervision and monitoring capabilities have been challenged and there must be a number of other actions that ASIC should be allowed to take to proactively address licensing and related failures, more quickly and effectively.

2.7 Client referral hotline

At the height of the initial collapse of Storm the FPA was asked by the Commonwealth Bank to establish a referral service offering independent advice to Storm clients, paid for by the CBA. It was made clear that the payment would not be encumbered in any way, and it was offered because clients needed advice that was objective and not biased toward Storm or the CBA/ Colonial Geared Investments.

The FPA sought support from members and some 600 clients called the referral service and received advice from members. In some cases it was provided pro bono, in some cases CBA covered the costs, and in some cases clients paid for it.

This proved to be a very successful initiative and also assisted the FPA in better understanding what went wrong. Further, members encouraged clients to complain to the FPA and ASIC and assisted clients with access to Centrelink, the Banks, counselling services, and other related aspects to assist their circumstances.

3. Professional financial planning in context: What is quality advice?

This section explains financial planning and quality advice to demonstrate the service provided by financial planners as opposed to financial product advisers and the myriad of other intermediaries in the marketplace otherwise categorised as 'authorised representatives'. This distinction is key to determining the appropriate regulatory and professional framework for successful advice, leading to better outcomes for consumers.

3.1 What is financial planning advice?

Financial planning is the process of developing strategies to assist clients in managing their financial affairs to meet their individual life goals. The role of a qualified professional financial planner is to look at all aspects of a client's lifestyle, goals, and requirements and to use that information in developing a financial strategy suitable for the client's needs. The recommended strategy should help individuals reach their financial goals effectively and efficiently.

This highlights important differences in the definitions and roles:

- A financial planner plans and is focused on providing strategic planning advice, which may be unrelated to product recommendations.
- Personal advice, as defined in the Act, speaks to advice on products, which clearly relates to advice in relation to product selection.

When developing a financial plan, a financial planner follows a structured six-step process to understand the client's needs and recommend an appropriate strategy. The financial planning process involves:

1. Establishing and defining the client-planner relationship;
2. Gathering client information, including a determination of client goals;
3. Analysing and assessing the client's current financial status;
4. Identifying suitable financial planning strategies and developing financial planning recommendations;
5. Implementing the financial planning recommendations; and

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6. Monitoring the financial planning recommendations and reviewing the client's situation.

Using these steps, a financial planner determines the client's current financial situation, the client's potential future needs, and actions the client must take in order to reach the goals. Using a holistic approach, the financial planning process empowers the client to understand the effects of each financial decision on personal finances. By considering each financial decision as part of an entire process, a client can consider both short and long-term effects on life goals, adapt more easily to life changes, and feel secure in being on track to meet life goals.

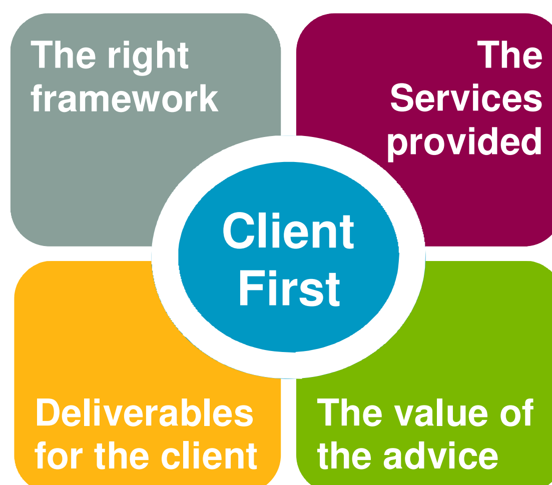
3.2 Delivering quality advice

Financial planning advice involves planning for the future. Therefore, by its very nature, the advice is impacted by many variables, including market conditions, the regulatory environment, and changing consumer needs. The results and success of the advice can only be measured retrospectively as client goals are achieved or not. Whilst the client may form an opinion on the quality of the advice at the time it is received, the opinion may vary, based on the success of the advice over time, often without taking into account changes in the values of the variables. For this reason, the client/planner relationship is important to quality advice.

The client/planner relationship is at the core of the benefits of financial planning advice. The relationship is based around complex personal dynamics resulting from the sharing of private personal and financial information. To demonstrate how the profession delivers 'quality advice', the FPA has identified a multi-dimensional representation of what constitutes quality advice. This includes the key dimensions of:

1. The right framework – the regulatory, professional, licence and practitioner obligations needed to support the delivery of quality advice.
2. The services provided – the tangible services planners provide clients when delivering quality advice (often misunderstood as a definition of advice).
3. Deliverables for the client – the outcomes of the process of financial planning necessary for the delivery of quality advice.
4. The value of the advice, from the client's perspective – a vital component to quality advice.

All the dimension of quality advice are interrelated and underpinned by the principle of **Client First** and the client/planner relationship.



The right framework	The services provided	Deliverables for the client	The value of the advice
1. Client First 2. Planner is a member of a professional body which has: • Code of Ethics • Practice Standards • Rules of Professional Conduct • Conflict of Interest Principles 3. Appropriate competence 4. Tools used to enable the giving of quality of advice, rather than dictating advice, themselves	1. Scope of advice and terms of client/planner relationship 2. Client needs and risk appetite 3. Advice might include: • Strategies to achieve goals • Projections, cash flow and budgeting • Tax strategies • Legal entities • Protection strategies • Debt/gearing • Estate planning 4. Implementation including product recommendations 5. Ongoing advice and coaching	1. Advice meets client needs and objectives within an agreed timeframe 2. Advice underpinned by clear, consistent strategic rationale 3. Client understands benefits and ramifications of the advice, both now and in the future 4. Client can make an informed decision relating to the advice 5. Client understands any influences on the advice, yet is comfortable the advice is right 6. Client understands all risks to success over time and how they are managed 7. Clarity of advice and service provided 8. Clarity around client payments for all advice and services	1. Trusts financial planner 2. Confident with the advice and likelihood of success 3. Feels 'peace of mind' 4. Knows the planner is looking after the client's interests 5. Believes needs well understood 6. Expectations clearly set out 7. Consistent with client values 8. Value for money

4. The professional framework for financial planning advice

This section outlines the FPA's professional framework and sets out how and why a professional association has a significant role to play in the regulation of financial planning as a profession.

4.1 The FPA's professional framework

The FPA is the largest professional association in Australia for the financial planning industry with nearly 12,000 individuals and AFSLs as members. Approximately 9,000 of these are practising financial planners. The FPA provides leadership and a professional framework to provide for the delivery of quality financial advice to clients.

Recent FPA research identified that FPA members are now 16 times less likely to face ASIC investigation for breaching financial advice regulatory requirements than are non-FPA members and CFP® members in particular are now 32 times less likely to trigger a breach of financial advice obligations from ASIC.[4] This statistic clearly illustrates the effectiveness of FPA membership and the overt effects of professional obligations and the role of a professional association.

4.1.1 The FPA's global standing

The FPA is an Affiliate member of the Financial Planning Standards Board Ltd (FPSB)[5], a global organisation that develops and promotes rigorous international competency, ethics and professional practice standards, and rules for financial planning professionals. FPSB owns the CERTIFIED FINANCIAL PLANNER™ and CFP® marks, which represent the pinnacle certification program for financial planners in 23 Affiliate countries, with some 118, 000 CFP[6] practitioners.

The FPSB's robust educational and professional standards[7] are implemented by the Affiliate members, which are, in turn, audited by the FPSB. The FPA plays an active role in developing, promoting, and enforcing the FPSB's global standards within the Australian financial planning industry. The FPA is the only association in Australia that is licensed to provide the CFP program and our most recent FPSB audit, which is conducted every 3 years, occurred in August 2008. In addition, the Financial

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[4] Based on cross referencing ASIC data with FPA membership data.

[5] See www.fpsb.org

[6] , CFP® and CERTIFIED FINANCIAL PLANNER™ are the FPSB's marks of excellence in financial planning.

[7] See http://www.fpsb.org/site_docs/060515_FPSBstandards.pdf.

Planning Association of Australia (FPA), is recognised as a robust and respected global leader in the financial planning profession, acknowledged by even the Financial Services Authority in the UK as a *case study of a strong professional body* (FSA – DP07/1).

4.1.2 Certified Financial Planner – the global symbol of excellence in financial planning

A Certified Financial Planner has achieved the highest level qualification in financial planning, having completed a rigorous program that focuses on ethics, education, experience, examinations, and applying knowledge and skills to help clients. The CFP® designation is the most common universally recognised mark of professionalism for financial planners around the world.

Education is a fundamental and vital part of obtaining the CFP certification. In Australia the educational component of the CFP program is delivered in partnership with Deakin University, and it is a requirement that a student achieve a tertiary qualification either before entering the CFP program, or at the same time as completing the CFP program.

The FPA and the FPSB is committed to ensuring that graduates of the CFP Certification Program have the skills and technical knowledge necessary to provide the highest level of strategic financial planning advice to their clients.

4.1.3 Overview of FPA's professionalism framework

In most professions, regulation is a dynamic interaction between government imposed legal requirements, business imposed rules of work, and the expectations of professional peers, as manifested in professional obligations. Each of these systems of regulation have the potential for overlapping with each other, but it is the goal of FPA's professional regulation to deal with those issues that are not covered in law or for which the profession feels the law does not provide a sufficient standard for professional financial planning practice.

The FPA's professionalism framework applies to CFP practitioners, Associate Financial Planners (AFPs) and AFSLs, along with General members. Whilst the framework aligns with the FPSB's requirements, it also sets additional standards in the areas of AFSL practice and compliance, conflicts of interest, remuneration practice, consumer complaints, and enforcement.

The FPA's professional framework is based on three pillars as described below:

Professional Membership ensures that only the right people can become members of the FPA.

Professional Conduct ensures that members adhere to the high standards set for the profession and that they are supported in following professional ideals.

Professional Accountability protects the reputation of all members by putting in place an independent, peer driven disciplinary mechanism.

The FPA adopted its first Code of Ethics and Rules of Professional Conduct in 1997. Many of the principles and provisions of these professional obligations were incorporated into the Corporations Act in 2001. The FPA has since undertaken extensive engagement with the industry, regulators, and the groups that represent consumers, to develop higher professional obligations to meet ever-changing market and legal environments.

The FPA is harmonising nine separate layers of obligation for members into a Code of Professional Practice, with all rules and regulations being captured through:

1. Code of Ethics – enshrines the high standards of professional behaviour that a member presents in the course of the provision of professional services.

2. Practice Standards – establishes the benchmark of expectations in professional practices, and promotes the six-step financial planning process in delivering quality advice and the professional conduct of FPA members that enhances the reputation of the profession.

3. Rules of Professional Conduct – underpins the minimum requirements with which a member must conform in order to demonstrate professionalism.

4. Guidance – provides guidance to members in interpreting elements of the single code framework and establishes best practice models that assist the members' day to day activities in providing professional services.

4.1.4 Enforcement

The FPA has a robust program to enforce, examine and ensure its members comply with their professional obligations on an ongoing basis. The program, known as the National Quality Assessment Program (NQAP), adopts proactive and reactive approaches for ongoing assessment of member initiatives and active compliance with the FPA's requirements. All FPA members sign up to the accountability process, which requires strict adherence to this comprehensive set of professional obligations that are rigorously enforced through our independent and efficient disciplinary mechanism, the CRC, chaired by Dimity Kingsford-Smith, Professor of Law, University of NSW[8]. Any alleged breach of the FPA's professional requirements by a member may trigger the professional accountability process.

Every year, the FPA receives complaints from a wide variety of stakeholders against the conduct of a member, for example:

- Consumer – a client or potential client lodges a complaint directly with the FPA about the behaviour or service of the member.
- FPA Member – another FPA member becomes aware of activity of a peer which may warrant investigation, or lodges a complaint on behalf of a consumer.
- FPA – a member fails to maintain and comply with obligations.
- Media – allegations about an FPA members' behaviour or service are reported in the media
- Regulators and the Financial Ombudsman Service (FOS) – while improvements could be made in this area, the FPA considers a vital element of consumer protection is to work closely with Regulators and FOS to ensure inappropriate behaviour is identified and addressed through a tripartite mechanism in a timely manner.

[8] Professor Kingsford-Smith conducts research and teaches in the areas of financial regulation and corporate governance.

The FPA Investigating Officer responds to identified concerns and any complaints that have been initiated or received, and then undertakes an investigation of the member(s) involved. This may include communicating with the complainant, the member, and third parties, reviewing documents provided by various parties, conducting research into the subject matter, and preparing a report of findings. The report will be referred to the Independent Chair of the CRC for consideration.

The Chair will determine whether the matter should progress to hearing by a panel consisting of three CRC members (which may include the Chair). The hearing is conducted in an informal, effective and efficient manner whilst preserving the rules of natural justice for the member about whom the complaint was received. If the matter progresses to a hearing, the CRC will provide the member with detailed reasons for its determination. Should the member be dissatisfied with the determination, the member may appeal to the CRC Appeals Panel.

The CRC has a number of sanctioning powers, including expulsion of the member, suspension of member rights and privileges, fines, and remedial activities (e.g. requiring a member to undertake a course of education). The CRC does not award or compel members to provide financial compensation for complaints. The FPA publishes each of the decisions of the CRC, as well as a quarterly report of complaints.

4.2 Using the professional framework to address regulatory deficiencies

A professional body can address a number of key gaps, without the need for additional specific government regulation, in areas such as:

- Fiduciary obligations;
- Conflicts of Interest; and
- Remuneration.

4.2.1 Fiduciary obligations – understanding “best interest” and “client’s interests first”

The FPA holds that financial planners and members of the FPA have a fiduciary obligation to their clients, which is upheld in many court actions and observed in practice. This is evident in our first principle of “Client First” and is described in our Code of Professional Practice.

Clarification is needed to address some of the confusion that has emerged around the fiduciary relationship as it translates from Common Law concepts of the body of Trust Law to more general applications in financial services. In the context of Trust Law, there is a concept of fiduciary that is described as "best interest" that has become popular with media and other commentators. In these relationships, it is held that the fiduciary cannot profit from the fiduciary position. The 'not-profit' rule of the fiduciary obligations in Common Law requires the fiduciary to report such profit to the principal, and the fiduciary may only keep it where the principal consents. If a fiduciary retains the profit without the principal's consent, courts will find that the fiduciary is holding the profit in constructive trust for the principal.

Legitimate questions have been raised as to whether "best interest" implies the existence of fiduciary roles wider than those applicable to trustee structures, when many see "fiduciary" as self-defining and not requiring a "best interest" simplification. In some situations, however, "best interest" can be an appropriate obligation, where the role of the trustee is formally identified and codified in the supporting legal framework. For instance, in the superannuation trustee environment (as codified in the SIS Act), "best interest' is that of the collective members of the fund.

In practice, however, "best interest" is too narrow to apply in the context of financial planning, where the obligation attaches to a specific individual client, fraught with complex persona, familial, and financial needs, all of which often compete. In this context, the problem is that "best interest" has been repeatedly misinterpreted to suggest an obligation to recommend the *optimum* financial strategy and product in all circumstances. However, financial planning relationships and the financial planning process employed are inherently subjective and whilst there might be approaches to any given client situation that are patently incorrect there is an element of judgement involved in deciding the most appropriate advice for any client. In other words there *is always more than one "right" strategy* where the client's best interests might be served.

The FPA's key concerns with "best interest" include:

- As *financial planning* is not transactional (such as law, medicine or even broking) and usually involves a lifetime view of the client where the value of advice has different weight at different life points, it is not appropriate to assess the "best" version of lifetime advice using any "single point in time" perspective. A "best interest" argument assumes that there is an overriding "best" interest of client. However, a financial planning context involves long

term planning for multiple events, potentially capturing the entire lifetime of a client, and including children and other parties.

- There is no such thing as a "best" strategy or product for any client and there is no way to objectively assess a "best" piece of advice. Given the law interacts with the financial advice community at the point of "product" advice, there needs to have been a product recommendation made to trigger the assessment of a "best interest" perspective. This assumes then that once the indefinable, temporal nature of a client's "best interests" can be ascertained, there is a further expectation that there is a "best" strategy and "best" product for a client and that an adviser should be able to discern those choices. However, there may be multiple opinions on what is "best".

- It is impossible to objectively assess a "best interest" fiduciary model of advice. Such a hurdle makes it impossible for a regulator (or any party) to determine with any legal confidence that a "best interest" standard has been met in the context of financial advice. Failure to be able to determine an objective judgement would create regulatory, legal, client and industry uncertainty that would undermine consumer outcomes and regulatory efficacy.

- The legal structure for advice provision in Australia requires that limitations are placed on the planning process. Any limitation on product or advice naturally defeats the capacity for "best" to be provided and so "best interest" is defeated by the legal framework. Given the sheer breadth of products in the marketplace (currently over 16,000) and the open regulatory product space that exists in Australia, Licensees cannot (and should not) have all possible products available for their clients in an open platform. Limitations of product pool, through the use of an Approved Product List, are necessary and beneficial as they include only those products deemed appropriate following extensive due diligence and research. They protect clients by minimising the risk of inappropriate products being recommended and by ensuring that clients with specialised needs get specialised advice that might then deal with specialised products. However, any form of limitation on product range defeats a "best interest" obligation because a planner cannot provide the "best" product, only the best product from their Approved Product List. A similar limitation (and for similar reasons) exists at the level of strategic advice (specialist needs require specialist advice). Similar limitations are necessary at Law, at a business level for particular licensees

with a defined business approach, at the planner level through competence limitations, with accreditation limitations, for example.

We acknowledge and willingly accept the fiduciary obligation and propose that a fiduciary relationship based on an obligation to put the "Client's interest first" is more relevant, tangible and measurable. Placing "Client's interests first" is consistent with the fiduciary duty of loyalty and trust, which suggests that a planner who undertakes to act on the client's behalf must not misuse the position to their own or a third party's possible advantage.

The FPA's fiduciary standard and professional obligations extend from this base and have been adopted by the FPSB's 23 Affiliate members and the CFP Board in the United States.

4.2.2 Conflicts of interest and mitigation strategies

Conflicts of interest are inherent in various lines of business, but they can be mitigated by avoidance, disclosure or management measures. Specific examples include educational incentives offered by pharmaceutical companies to physicians, payments made by suppliers to retailers for shelf space, commissions paid by tour operators, hotels, and airlines to travel agents, and commissions paid to buyers' real estate agents, based on sales price.

From a consumer's perspective, the most significant perceived conflict of interest when seeking advice is remuneration. However, due to the development and structure of the industry, there are other conflicts in the financial planning industry such as the ownership by institutions of financial advice businesses and product distribution arrangements.

There are significant mitigation measures for the conflicts of interest in the financial planning industry. While the requirements of the Corporations Act serve to address many of the structural conflicts through disclosure, the FPA's professional obligations go further to deal with all conflicts at a practical level and support licensees and practitioners to mitigate potential conflicts.

FPA's professional obligations take into account governance structures, business models and rules, and the compliance regime at the licensee level, and they flow on to practitioners in providing advice to clients.

The following examples demonstrate how these obligations complement legal requirements to support providers to mitigate conflicts, beyond the requirements of the law:

- FPA's Conflicts of Interest Principles require separate corporate governance arrangements to govern FPA Principal Members (such as dealer groups) and all or any related financial services provider and/or entity. To adhere to this professional obligation, licensees divide the advice side of their business from the product side and have in place a separate Board of Directors, management structure, independent structures for advice, and research and investment committees (governance structures for the development of Approved Product Lists). The majority of licensees include independent directors on the Board and independent experts on their governance committees to ensure a client focus is achieved.
- The Conflict of Interest Principles and Code of Ethics require advice to conform to the obligation of "client interest first" and the product recommendations to suit the needs of the client. Authorised Representative financial planners are self-employed, but are authorised by the licensee, under contract, to provide advice. Licensees are not involved with the advice or recommendations provided to the client, outside of putting in place compliance monitoring systems to ensure adherence to legal and professional obligations. To ensure a client focus is maintained, the advice provided is between the planner and client, independent of the licensee.

The relationship between the individual planner and the client is of paramount interest to the profession, but has no standing in the Corporations Act. Professional obligations apply to both licensees and financial planners dealing directly with clients to protect the client / planner relationship and ensure the delivery of quality advice which puts the "client interest first".

The FPA suggests the focus by many commentators on conflicts of interest in the financial planning profession emerges due to a lack of awareness of the measures in place to protect consumers as well as unrealistic expectations in relation to avoiding conflicts. Communicating conflict of interest measures to consumers and stakeholders would help address this issue, and a broader debate as to how best this may be achieved would be welcome.

4.2.3 The profession's approach to remuneration

In the financial planning profession, the Corporations Act requires the disclosure of fees, charges and commissions, other benefits, relationships, and influences, to facilitate fiduciary responsibilities and help consumers to assess the value of the advice received and ensure it is in their interest to agree to that advice. Importantly, these legal requirements are supported by the package of FPA's professional obligations, as already outlined.

In July 2008, the Board of the FPA commenced a review of financial planner remuneration and in May 2009 released a Financial Planner Remuneration paper for consultation. With a focus on consumer directed fees and charges, the draft remuneration policy includes proposals which require:

- The disclosure of comparative charging models to increase transparency, improve the ability of consumers to understand how a planner's fee structure and charges compares to industry practice, and therefore allow consumers to make informed decisions.
- That, from 2012, fee based remuneration becomes the standard model for financial planning advice, encouraging the profession to transition away from commission paid advice.
- Payment for financial planning services should come from the client, not the product provider.
- The use of fee-for-service or direct-charge model where the consumer is billed directly by the financial planner based on an agreement with the client. The product provider might be required to facilitate or execute the payment on behalf of the client, but this becomes an administrative issue rather than one of perceived influence or control.

Professional obligations are concerned with the client/ planner relationship and target the individual planner. Addressing conflicts of interest in remuneration can in part come from behavioural change at the practitioner level and therefore must be driven through professional obligations, not legislative force. FPA's membership is diverse and as such our professional obligations also require AFSLs to support individual practitioners to conduct themselves in a professional manner and adhere to obligations within an environment of peer review and scrutiny.

5 The regulatory framework for financial advice and products

In 2001, the Government introduced the Financial Services Reform Act to overhaul the regulation of financial services in Australia. Since then, financial advice has been regulated under the Corporations Act 2001, the Corporations Regulations 2001, and relevant ASIC regulatory guides and Class Orders. Chapter 7 of the Corporations Act and related regulations detail licensing conditions, disclosure and documentation obligations, and research requirements on both the client and subject matter of the advice, reporting requirements, minimum education standards, dispute resolution, consumer compensation measures, and other relevant matters regarding financial product advice. The regime imposes regulatory obligations on the licensee who is responsible for ensuring its own compliance and that of its Authorised Representatives. Market participants are also subject to requirements of common law and trade practices.

It is important to note that the Corporations Act regulates companies, not individuals, and is based around a definition of financial product advice. While the regulatory regime is applied to financial planners, financial product advice differs from financial planning advice which we discuss later in this section.

Under the Corporations Act the ASIC grants AFS Licences to companies. In line with licence conditions, the licensee is permitted to grant Authorised Representative status to companies and individuals. Under this licensing structure, a licensee, has significant power in negotiation with product providers and in the regulation of its Authorized Representatives, and through this mechanism can impact commissions and soft dollar arrangements. Licensees are responsible for their Authorized Representatives' compliance with legal obligations. All monies, including advice client fees and charges, are collected by the AFSL and paid to the Authorised Representatives and practitioners.

A model of regulation that delegates responsibility for compliance of individual professional participants to a corporate entity with its own business imperatives places unnecessary compliance pressure on the entity and discourages innovation of practise. Though we acknowledge the efficiency of this regulatory model, it has diminished individual professional obligations that represent the third leg of good regulatory practise.

Regulatory obligations

Professional	Government	Business
• Code of Professional Practice	• Corporations Law (Statute and Common Laws)	• Licensee compliance requirements

Better integration and recognition of professional regulation in the system of regulatory obligations will achieve better consumer, marketplace, and regulator outcomes. Properly implemented, it would provide greater clarity in the relationship between government and professional regulation. While a mutually supportive relationship now exists, government and profession should work together to better leverage their respective strengths for greater regulatory efficiency, and to ultimately achieve greater confidence and professionalism in the industry.

5.1 Strengthening licensing standards

The licensing of financial services providers should serve as a preventative measure, or filtering process, to help protect consumers from unscrupulous operators, and in the advice space, from poor quality advice. However, this is not actually the case. Tony D'Aloisio, Chairman of ASIC, in his testimony before the PJC on 24 June 2009, noted that, particularly among retail investors, there is a misconception that licensed individuals will always provide "top quality service and there can never be any fraud or anything of that nature." The Chairman explained that the licensing regime simply functions so that "you know the people are there and that they have met the minimum standards that the Corporations Act requires."[9] The FPA concurs with the Chairman's statement and highlights the need to tighten requirements and the assessment process to gain an AFSL.

At the moment, consumers do not have access to a register of all AFSLs and their Authorised Representatives, nor a register of banned operators. ASIC only offers the capacity to search the status of particular providers. Access to a list of all AFSLs and Authorised Representatives with their licence status (e.g. banned or compliant; enforceable undertaking) would assist consumers in researching and selecting providers.

[9] Commonwealth of Australia, Parliamentary Joint Committee on Corporations and Financial Services 2009, 8.

The FPA is also concerned that individuals banned by the FPA have remained licensed by ASIC, either as an Authorised Representative or a licensee. The FPA encourages the Committee to consider a collaborative approach between regulators and professional bodies. Such an approach would improve consumer protection and ensure inappropriate behaviour is identified and addressed through a tripartite mechanism in a timely manner.

The FPA recommends:

- Strengthening the criteria, requirements and assessment process to gain an AFS licence, to include:

    - Office based audits to finalise licensee authorisation on a random basis to facilitate greater prevention rather than cure, when it is often too late.

    - Segregation of duties for key responsibilities which should take into account the nature, scale and complexities the licensee undertakes. Strict separation may apply to firms above a specific size, such as those with 20 planners or more.

    - Consideration of Independent Directors for licensees with 20 or more financial planners.

    - Stronger governance around the development of Approved Product Lists (APL), to ensure the methodology used is robust, research-based, and professional, and is not subject to any monetary influence.

    - A check of whether applicants or their Responsible Manager have had complaints upheld against them with a professional body, dispute resolution service, or other relevant jurisdiction. Consideration should be given to the nature of the complaint and severity of any planner/licensee action that led to the complaint.

    - A review of the roles and competencies of Responsible Managers and others in the company making application, and apply minimum guidelines or qualifications.

    - Agreement to ongoing regulatory supervision requirements to facilitate more proactive action based on deeper market intelligence, once granted.

- Establishing a public register which is managed by ASIC, of all AFSLs and Authorised Representatives, that details licensing conditions and professional obligations for the provision of financial planning advice and possibly for all other types of 'financial product advice'. The register should include whether the provider has been banned by ASIC or a relevant professional body.

- Amending the ASIC Act and ASIC Regulations to encourage greater information sharing and co-operation between the Regulator and professional bodies where it can be established that there is mutual interest and community benefit.

5.2 Use of the term financial planner

There is a high level of confusion in the market, within industry, media, Government and consumers about the definitions and roles of financial planners, advisers, and those that sell financial products. Some incorrectly use the term financial planner, seemingly unaware of the specific competency, training, licence, professional standing and services provided.

The Law defines the act of providing financial product advice, specified as general advice and personal advice, while the global professional body for financial planning, the FPSB, has defined the provision of financial planning advice:

- Financial product advice is defined under s766B of the Corporations Act 2001 and refers to a recommendation or a statement of opinion that is intended to influence a person in making a decision in relation to a particular financial product or class of financial products.

- Personal advice (s766B) is given when the provider of the "financial product advice" has considered one or more of the consumer's objectives, financial situation and needs.

- General advice is financial product advice that is not personal advice.

- The FPSB defines financial planning as "the process of developing strategies to assist clients in managing their financial affairs to meet life goals, which involves reviewing all relevant aspects of a client's situation across a large breadth of financial planning activities, including inter-relationships among often conflicting objectives."

The definitions lead to important differentiation in the associated roles:

- A financial planner plans and is focused on providing strategic planning advice;

- Personal advice as defined in the Act speaks to product based advice; and
- While the term adviser is not defined, the FPA suggest that advisers advise on a transactional basis.

Under the Corporations Act 2001, there is no constraint on individuals calling themselves financial planners irrespective of their training, competence, and even licensing. This puts consumers' at risk of receiving poor advice from incompetent providers and creates consumer confusion as to the difference between financial planners, professional advisers, and others. It also commonly results in all financial planners suffering reputational damage when tainted by the actions of incompetent providers who should not have the legal capacity to call themselves financial planners.

The term financial planner or financial adviser is also increasingly being used in marketing and promotional material by persons who provide non-traditional ancillary services, such as realtors, stockbrokers, financial counsellors, life insurance agents or brokers, mortgage brokers, property brokers, sales agents of various investment vehicles, and unlicensed advisers. Such use further erodes the value of the term. The lack of restrictions on the use of the term is a significant gap in consumer protection, as it leaves trusting consumers open to influence by unprofessional and inappropriately qualified individuals calling themselves financial planners. One option to overcome this issue would be to restrict the use of the term financial planner in s923B of the Corporations Act. This is achieved through s923B for the protected terms stockbroker and insurance broker. Including financial planner in this section of the Act would also create a level playing field for with other professions who are permitted to operate in the advice space.

The FPA therefore recommends that Government undertake a detailed and substantial consultation process with industry and other stakeholders to determine the most effective mechanism to restrict individuals from using the term financial planner (or financial adviser). Careful consideration should also be given to the use of other terms in the advice space and any definitions allocated to such terms. Consideration should also be given to the definition of financial planning service.

5.3 Requirements to adhere to professional obligations and the role of a Professional Body

All advisers are subject to the requirements of law and regulation, but not all are required to adhere to professional obligations that provide additional consumer protections. Professional obligations only apply to those who choose to accept those

obligations through professional membership, which is voluntary. Core obligations such as those set out in the law must be supplemented by a culture of professionalism to ensure that meeting legal obligations is not seen merely as a matter of compliance but more as a commitment to best practice in providing services to clients. The significance of this professional decision is strongly evidenced in the quality of market participants and in the reduced instance of enforcement action against FPA members and CFPs, as illustrated in section 4.1.

The Government already recognises the important role of professional obligations in the regulatory framework for other sectors and in the provision of consumer protections. With reference to tax agents, the Income Tax Assessment Act (s251LA) requires membership of a professional body, recognised by the regulator, that is not-for-profit, has higher than the minimum standards for competency, academic, and experience for entry, maintains ongoing professional development requirements, has enforced codes and rules of conduct for the profession, operates a disciplinary process for breaches, offers a complaints mechanism for its members' clients, and follows annual reporting procedures.

As a professional body, the FPA requires its members to adhere to enforceable professional obligations which go beyond the requirements of law and demonstrate a higher commitment to consumer protection. As illustrated in section 4.1, this results in better regulatory outcomes.

To incorporate professional obligations within the broader regulatory framework and improve consumer, market, and regulatory outcomes, for all providers operating as financial planners, the law should be amended to require professional membership for all people operating as "financial planners".

The FPA recommends:

- Legislative change to require that financial planners must belong to a professional body, where the professional body has certain functions that are prescribed by the Regulator.

- Those who are qualified to use the term 'financial planner' should undertake professional obligations over and above the requirements of the law, enshrining a fiduciary responsibility along with ethics and integrity in their interactions with clients, effected by a legal or regulatory mandate to join a professional body.

- Amending the Corporations Regulations to include detailed requirements to receive recognition as a professional body, including the need for the body to:
    - Operate on a not-for-profit basis;
    - Have an appropriate governance structure including representatives of good character and standing;
    - Require a minimum of 1,000 financial members who have the right to vote at meetings;
    - Impose minimum academic and competency requirements for members, including minimum Continuing and Professional Development (CPD) requirements;
    - Ensure that professional obligations including a code of ethics and professional standards, complaints and disciplinary requirements, and professional indemnity insurance are in place;
    - Impose disciplinary procedures where professional obligations are breached; and
    - Have reporting procedures to ASIC, and the membership.
- Establish a fiduciary responsibility enshrined in professional obligations under the principle of "Client First" which builds on the legal requirements to provide appropriate advice, will deliver beneficial consumer, market, and regulatory outcomes.
- Amending the Corporations Act s945A(2) regarding defences relating to the suitability of advice, to include as a defence the demonstration of compliance with an approved professional body code of practice.

5.4 Competency requirements

Competency requirements for providers of advice are set in ASIC *Regulatory Guide 146 - Licensing: Training of financial product advisers* (RG146), which includes "training standards of sets of knowledge and skill requirements that vary depending on the adviser's activities". Under RG146 a person can undertake a short course to gain "generic knowledge on products and markets" and be able to become an Authorised Representative permitted to provide personal financial advice to consumers.

The minimum standards required under RG146 are inadequate for the delivery of quality advice and therefore create a risk of consumers acting on information provided

by providers that are not appropriately or professionally qualified, may not have the skills required to explain complex concepts, and may pass on inappropriate advice without consideration of the principles of financial planning.

As detailed in the table, the FPA requires significantly higher levels of training, education and competency for a provider to become a member than the requirements of RG146. This is based on the professions' understanding of the minimum competencies needed to deliver quality advice. Once membership has been obtained, FPA members must adhere to the principles of financial planning via professional obligations and continued professional development requirements.

A comparison of minimum entry levels between RG 146 and the FPA requirements

Status achieved	Requirements
RG146 compliant to operate provide personal advice on Tier 1 products[10].	Has completed courses on the ASIC Training Register that meet the relevant training standards, i.e. they are at the Tier 1 level and cover: • the generic knowledge relevant to the products you advise on and the markets in which you operate, • the specialist knowledge about the specific products you advise on and the markets in which you operate: and • the relevant skills requirements **OR** Must be individually assessed by an authorised assessor against the relevant training standards ASIC does not prescribe a minimum number of hours per year that an adviser should spend on continuing training.
FPA Associate Financial Planner (AFP) member	• Has completed Diploma Financial Services (DFS) and RG146 compliant • Holds Authorised Representative status. • Minimum one (1) year plus approved practitioner experience including Authorised Representative status for the full period. • Minimum of 90 hours Continued Professional Development every three years. • Must comply with FPA's professional obligations
FPA Certified Financial Planner (CFP) member	• An Undergraduate degree, Masters degree or Doctorate. • Completion of CFP Certification Programs 1 to 5. • Minimum three (3) years approved practitioner experience including Authorised Representative status for 12 months prior to application. • Minimum of 120 hours Continued Professional Development every three years. • Must comply with FPA's professional obligations

RG146 states that ASIC has "set minimum training standards only and encourage industry and professional associations to build on the training standards. [ASIC] recognise[s] industry's important role in the development and promotion of best practice relating to training and competence", giving further support for the

[10] Tier 1 products are all financial products except those listed under Tier 2 which include general insurance products, except for personal sickness and accident (as defined in reg 7.1.14); consumer credit insurance (as defined in reg 7.1.15); basic deposit products; non-cash payment products; FHSA deposit accounts.

recommendation to make membership of a professional body mandatory for financial planners (see **sections 4 and 5.3**).

The FPA therefore recommends that ASIC recognise that minimum competency requirements for financial planning advice should be strengthened and raised through the mechanism of professional obligations and mandatory professional membership requirements.

5.5 Complexity of disclosure

The disclosure regime, due to its complexity, is a significant barrier to the delivery of quality advice and consumer understanding. The aim of a proper disclosure regime should be to ensure information provided to advice consumers allows a clear understanding of the conflicts of interest, risks, costs and fee structures, ownership links, and the advice provided. To facilitate consumer understanding, it must be a consumer focused disclosure regime, and one that is inexpensive to produce, to keep costs low for clients.

The FPA has worked effectively with ASIC to develop a short form Statement of Advice which runs to around 10 pages, even for a relatively complex example. The FPA is looking forward to a shortened Product Disclosure Statement (PDS) as well which adopts the same clear and consumer tested language. Further disclosure rationalisation would be welcome by both Financial Planners and their clients.
We need a disclosure regime which:

- Provides for a simplified disclosure documentation and requires:
    - One upfront client-focused disclosure document detailing the 5 important things a client must know about the advice;
    - One short form SOA that is flexible and focuses on advice, and the client; and
    - A file note to be retained and made available to the client on request, for informational purposes and not to meet legal disclosure requirements.
- Requires that licensees, supported by ASIC, ensure disclosure is client focused (not compliance focused).

A short document could highlight to consumers the key elements. The SOA should focus on the advice provided and not on compliance based material. Rethinking disclosure from the beginning, a useful approach would be to cover the 'five R's' which would include:

- Risk profile of the client – appetite to risk and implications
- Relationship with client – expectations and services to be provided
- Remuneration – what the client will be charged for the agreed services
- Related parties – including ownership links and relevant conflicts of interest
- Returns – over the longer term, along with impact of market cycles and other relevant issues

5.6 Clarifying the legal requirements for disclosure

A significant barrier to the provision of affordable and quality advice is the cost of undertaking a full fact find and 'know your client' process, the research and analysis of the subject matter, and the resulting production of an SOA, even if only responding to general requests or giving limited advice. These requirements are set out in Section 945A.

This is exacerbated by inconsistencies in the Regulator's approach around the requirements of 'relevant personal circumstances' in s945A(1)(a) of the Corporations Act 2001. Legislative change in s945A is required and appropriate as it relates to the basis, subject matter, and circumstances of the advice. Section 945A should explicitly describe the ability to provide advice based on the particular circumstances of the consumer and the advice sought. If this legislative certainty were provided, an environment could be fostered where concise and effective disclosure documents were developed and would allow for rationalisation of the disclosure documentation regime.

Amending s945A would allow for substantial time savings in regards to the inputs required prior to the development of the SOA. In turn, this would enable Statements of Advice to be tailored to client needs with greater regulatory comfort and improve the understanding of the advice for consumers.

These measures would:

- Ensure consistency and readability of the type of documentation the consumer would receive;
- Allow firms to standardise processes;
- Reduce the cost of advice for consumers; and

This approach would maintain appropriate consumer protections while increasing the accessibility of advice.

5.7 Licensee responsibilities and Approved Product Lists

ASIC has a mandate to ensure that licensees and their representatives giving financial advice meet the standards required by the law. These standards have two important elements – knowing your client and knowing your product. Due to the wide range of products available in the retail market and the complexity and risk associated with some of them, ASIC's focus is on the compliance arrangements licensees have in place to support obligations to 'know your product'.

As noted above, the legal structure for advice provision in Australia requires that limitations are placed on the planning process. By law, licensees must know enough about the products they recommend to be satisfied that they are suitable for their clients. They must undertake research on the products to the extent that it is warranted in the circumstances and, if necessary, carry out their own enquiries. Many licensees manage this responsibility by establishing an 'approved product list' (APL), which involves doing due diligence on products before approving them for clients. Some licensees only permit their representatives to recommend products that are on the approved product list. Others require sign-off from management if a representative wishes to recommend a product that is outside the approved product list.

The law requires licensees to conduct due diligence on financial products to the extent that it is reasonable in the circumstances. This means that the research can be tailored to the product. For example, if a licensee is recommending a simple deposit product from a financial institution, the research might be limited to the product terms and the interest rate. At the other end of the spectrum, due diligence on a complex financial product, like an interest in a mortgage fund or a derivative, may require a licensee to carry out a detailed analysis of product features and the institution standing behind the product.

With over 16,000 products in the market, the licensee's APL offers a significant first step for planners in assessing the risks, stability, validity, returns, management, governance and relationships associated with the product, in filtering suitable products for clients. However, FPA's professional obligations ensure that planners do not solely rely on the APL.

FPA's Conflict of Interest Principles require "all FPA members to undertake due diligence necessary to offer products which suit the needs of the client". The draft Code of Professional Practice goes further - "a member must not recommend a product or service unless the member understands its characteristics, risks and key features". ASIC also requires the SOA to clearly disclose if a planner's recommendations are restricted to products from an approved product list.

The FPA is concerned that many of the 16,000 products in the market are not subject to adequate oversight before issuance. The responsibilities placed on licensees and planners under the Corporations Act and the Regulator's approach to consumer protection against poor products clearly misplaces the regulatory burden of ensuring the validity of all products on the individual planner.

Financial planners should and do have responsibility for ensuring the understanding and suitability of products for clients. However, the FPA suggests a more proactive environment of legal and regulatory requirements on products would provide greater prevention of product failures than the regime allows.

5.8 Availability, advertising and promotion of poor products

Of high significance is the vulnerability of Australians with low levels of financial literacy to be influenced by advertising and promotion of financial products promising extravagantly high returns. Following the collapse of Westpoint in 2007, changes were made to the law to restrict the use of advertising and promotion of debentures and mortgage products. This was a welcome and necessary policy change. While the failure of Storm Financial involved margin lending products which will be regulated under the Corporations Act from November 2009, consumers have already suffered losses due to collapses involving other financial products which have minimal regulatory oversight.

In a recent speech, ASIC's then Deputy Chairman, Jeremy Cooper highlighted ASIC's approach to changing consumer behaviour towards investing by translating financial services language to visual imagery that would be well known to all Australians:

"ASIC has decided to use the image of 'swimming between the flags': a metaphor suggesting a type of investment behaviour that should keep most people out of trouble, most of the time. All investing involves some risk, so investing between the flags, just like at the beach, is never risk-free. At its simplest, swimming between the flags is investing in a diversified way between bank deposits, your super, blue-chip shares, vanilla managed funds (and other investments with relatively low risks) or with

independent, professional advice. Swimming outside the flags is investing in more complex, illiquid, undiversified investments or leveraged products; all the way along the spectrum to outright scams. Each person's flags might be a slightly different width apart and some people are better swimmers than others, but the point is not to split hairs about what is inside and what is outside the flags; it detracts from the simplicity of the message and the force of the metaphor."[11]

Though it was also noted that at least some of the solutions to the global financial crisis should come from better design of financial products, there was no description of how and by whom ratings would be determined as to which products fall between the flags and outside the flags. Many products are sold directly to consumers who may not have the capacity to clearly identify and assess the complex elements that would go into making such a determination. It should be noted that a significant proportion of Westpoint investors invested directly with the product provider. Though such investments may be appropriate for some investors, a degree of protection is needed for those who are vulnerable. Product regulation should identify which products are 'inside or outside the flags' to enable a consideration to be made as to whether a product is appropriate. A well thought out system of warnings and disclosures at points of direct sale would be an improvement, in this regard.

There is a plethora of financial products available to consumers, both directly and via an intermediary. FPA members are troubled by the lack of accountability of product providers and research houses when products do not live up to the claims of their promotions. The financial planning profession is often targeted with all the blame for product failures, which are wholly outside their control. Planners are attractive targets because of the ease of access to their professional indemnity insurance cover for consumer compensation. However, the source of most complaints is failed products.

Australian consumers rely on information from credit rating agencies and research houses to make investment decisions, so they play an important gate-keeping role in the financial system. The role of such organisations is to provide specialist assessments and detailed due diligence research on financial products for consumers and intermediaries. It is a specialised service which comes at considerable expense. While the FPA acknowledges recent changes by the International Organisation of Securities Commissions (IOSCO) and ASIC to the regulation of Credit Rating Agencies (CRAs) and research houses, CRAs and research houses should also be held accountable for their roles in product failures.

[11] Jeremy Cooper, ASIC Deputy Chairman to the Financial Ombudsman Service, National Conference, 11 June 2009, Melbourne

Problems with products should be addressed through product regulation, rather than advice regulation. Product providers should be held accountable for failing to deliver on product benefits or if there are fundamental flaws in products.

The FPA recommends:

- A more robust risk assessment process from product providers, which would include:
    - Identifying specific categories or classes of risk;
    - Stipulating disclosure requirements and specific risk warnings for each category;
    - Carrying out stress testing of products and disclosure of possible outcomes;
    - Stipulating the level of professional support needed to utilise products;
    - Establishing requirements for different documentation for different classes of products; and
    - Establishing requirement for different compensation regimes to be applied or proportionately funded, on the basis of product risk or complexity.
- Products sold directly to consumers should include point of sale warnings identifying the risk level and need for appropriate advice to assess compatibility with client's objectives.
- Stronger advertising controls should be adopted to ensure truth in advertising.
- The requirements of IFSA's Superannuation Charter, which calls for better controls relating to promotion of superannuation investment performance, should be extended across the industry to all products.

6. Consumers' financial capability

Consumer financial capability and understanding is fundamental to the ability to make informed judgements and effective decisions about the use and management of money. This challenge requires the combined efforts of all stakeholders, in both the public and private sector. For the financial planning sector it is a joint challenge of planners, the FPA, and the Government. The profession embraces its role in this regard.

Indeed, financial planners and the profession already play a significant role in educating consumers through the provision of quality advice. Access to affordable advice for consumers will assist the Government in addressing financial capability.

Through our investigative work on Storm Financial, we identified that there were clear lessons for consumers in protecting their finances, with simple messages such as:

- If it sounds too good to be true, it probably is.
- There are no shortcuts to wealth. Good advice requires patient adherence and a long term strategy.
- Diversification is important.
- Ask whether the advisor is a member of a professional body, and how complaints are handled.
- One should not sign documents one does not understand.
- Clients should learn about the risks associated with their strategies and consider the worst possible outcome if something goes wrong.

6.1 Understanding the role of financial capability in protecting consumers

Financial capability enables consumers to make informed judgements and effective decisions about the use and management of money. It's an essential skill for functioning in modern society and is becoming increasingly important to the long-term wellbeing of individuals and the community.

Approximately 8 million Australians or 53 per cent of the adult population have been assessed as having low levels of the knowledge and skills required to effectively manage and respond to situations requiring financial decisions[12]; and 44 per cent of

[12] Organisation for Economic Cooperation and Development (OECD), published by the Australian Bureau of Statistics

households on incomes of less than $50,000 per annum do not have the ability to make sound financial decisions[13]. There are also certain groups who face particular challenges as well as certain areas of money management and products that are not as well understood as they should be. Financial capability is strongly associated with a person's age, gender, education, and socioeconomic characteristics.

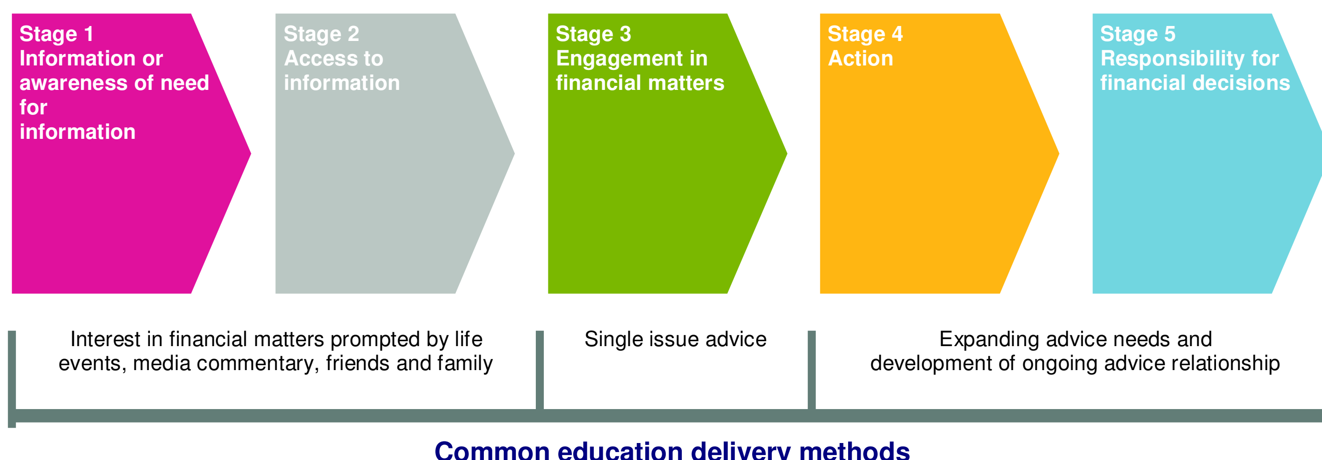
The core issues identified as causing financial difficulty include:

- 'Unhealthy' ways of thinking about finances including 'living for today', 'financial disengagement' and 'aspirational' spending;
- Circumstances or events outside their control such as job loss, poor health and relationship breakdown; and
- Very low financial skills and knowledge which disproportionately impacts many of the most vulnerable in the community including those with lower education levels, those not employed, people with lower incomes, low savings and people at both extremes of the age profile – 18-24 year olds and those aged 70 years and over[14].

The regulatory regime does not differentiate between those who have financial capability and those who do not, instead drawing a blunt and seemingly arbitrary line at $500,000. The definitions of 'retail' and 'non-retail' allow some persons with a portfolio over $500,000 to be considered as wholesale and accordingly carved out of the retail client protections and disclosures (i.e. FSG, PDS, SOA, and SOAA). The definitions do not recognise the level of knowledge or sophistication of the investor. In addressing consumer financial capability, it would be appropriate to reconsider such definitions, in respect of delivery of financial services.

As detailed in the following spectrum of financial capability, quality financial advice from a professional financial planner has a key role to play in addressing financial capability issues in Australia.

[13] The Smith Family
[14] ANZ Report: *Understanding personal debt & financial difficulty in Australia*, November 2005



6.2 Increasing financial capability through the principles of financial planning

The principles upon which financial planning is based provide an effective approach for making appropriate and beneficial long term investment decisions. These principles can be used by all and many non-advised investors would benefit from their application:

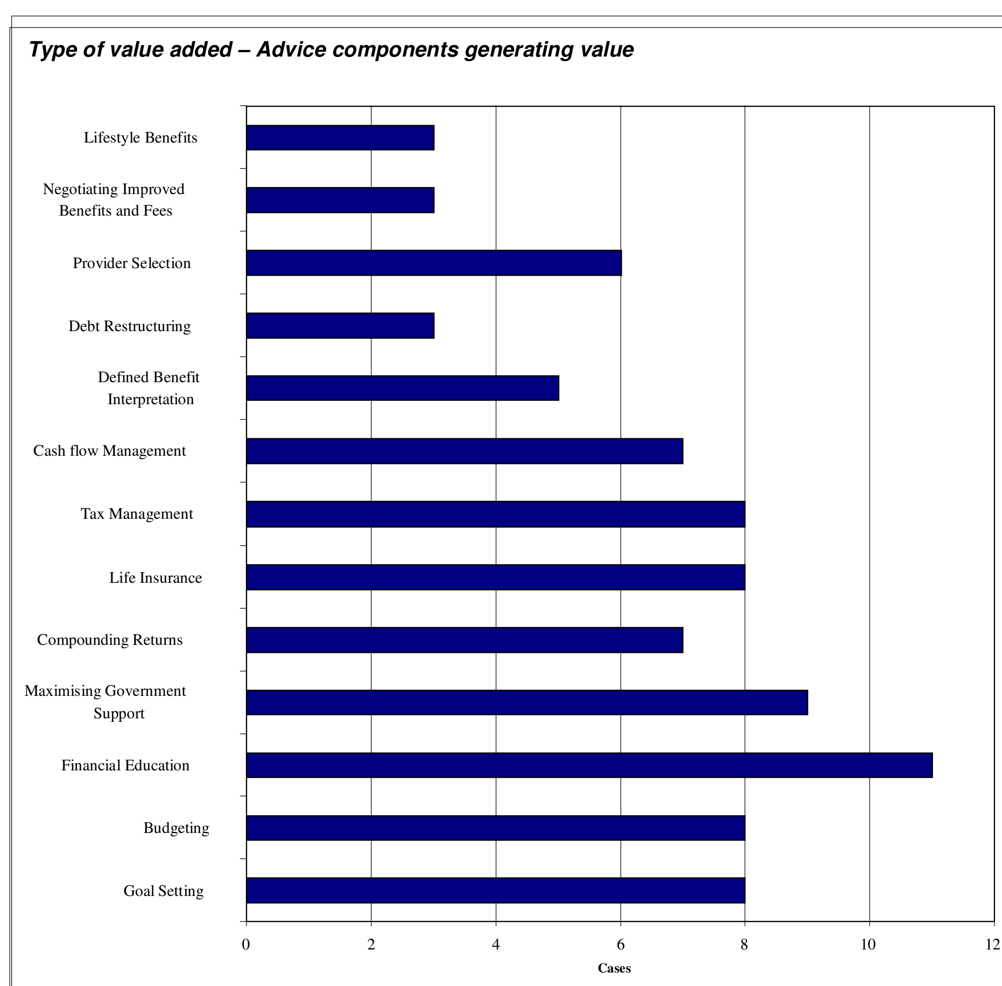
- Liquidity - the need to maintain access to funds
- Understanding the basic saving and debt principles
- Saving - spend less than you earn – start early
- Planning- fail to plan, plan to fail
- Investing – only invest in what you understand – if its too good to be true then it usually is
- Advice – good advice is money well spent
- Diversification – don't put all your eggs into one basket
- Borrowing to invest – only borrow what you can afford to lose
- Superannuation – the most tax effective way to save for retirement

These principles can be used by all consumers as a thorough and reliable basis for managing household finances and making every day financial decisions. As financial

matters become more complex, specialist assistance may be sought from a professional financial planner.

6.3 Financial planners' role in consumer capability

Financial advice from a qualified professional can help Australians understand financial matters. Along with financial education, other valued consumer benefits include effective cash and debt management and assisting consumers to reduce lifestyle instability[15].



Feedback from FPA members on changes in client behaviour resulting from the advice received includes greater engagement financial matters and consequently improved decisions which result in:

- Greater self reliance and reduced reliance on government provided benefits;
- Better usage of individuals' economic resources; and

[15] *FPA Value of Advice Research*, by Rice Warner Actuaries, February 2008

- Positive influence on the financial behaviour of family and friends through educational 'flow-ons'.

6.4 Personal responsibility for financial decisions

Anecdotal evidence shows consumers' attitudes and levels of comfort with an investment decision have been seen to change depending on product performance. A consumer may be comfortable with a product when advice is given, even if aware that the investment may be in a high risk category. This attitude often changes if product performance becomes unsatisfactory.

The FPA continually tries to make important information easily available to clients, such as via our brochure on selecting and managing the relationship with your financial planner. Such measures serve to empower clients and inform them about the complaints process.

Going further, financial capability programs should not be based on the 'how to' of financial management alone. Programs should incorporate consumer rights and responsibilities for ensuring they are informed, that they fully understand and are comfortable with investment options prior to making their decision, whether or not a consumer seeks professional advice.

6.5 Consumer access to affordable advice

Tax concessional treatment of expenditure is an efficient Government incentive to influence consumer behaviour. The educational value unlocked for consumers by the provision of advice is well documented and demonstrates that access to affordable financial advice is a critical element of Australia's economic environment. However, research also shows that the cost of delivering advice in Australia is relatively high due in part to the strict regulatory regime, limiting the ability for many Australians to access affordable advice[16]. Many consumers, particularly lower income earners do not seek professional financial planning advice because of the cost involved and their ability to pay for advice.

Consumers are paying for personal financial advice in varying ways that result in disparate tax treatment that does not correspond to any public policy objective. A fee for service arrangement for the preparation of an initial financial plan recommending investments is not tax deductible under section 8-1 of the Income Tax Assessment Act 1997. This is because the ATO does not view it as an expense incurred in

[16] *FPA Value of Advice Research*, Rice Warner Actuaries, November 2007

producing assessable income. However, when a financial planner arranges for the issue of financial products as a result of providing an initial financial plan, the adviser could opt to be paid by commissions from the product issuer, rather than charging a fee for service to the client. The payment by commission for the implementation of the plan is effectively tax deductible for the client. The tax system therefore encourages commission based remuneration, but not fee for service.

In the larger picture, public policy initiatives are needed to assist in creating a more affordable advice framework and to ensure consistency in the tax treatment of advice fees for consumers. There are many societal benefits to providing a tax incentive to help consumers pay for financial planning advice. These include the following:

- Facilitating the greater education of investors about money issues including savings, retirement planning, social security, tax responsibilities, budgeting and debt management;
- Encouraging more investors to seek professional assistance with their overall savings objectives;
- Planners charging fee for service instead of commission (by extending the tax incentive to include the initial financial plan, irrespective of payment method);
- Greater transparency of advice and financial product costs;
- Expanding retirement savings beyond mere reliance upon superannuation and Government benefits;
- Engaging consumers on the need for retirement savings; and
- Encouraging competitive pricing of financial advice through fee based charges.

The FPA would like to see policy in relation to the deductibility of advice fees become a priority and the income tax deduction should not to be limited to the extent that the advice is in respect of assessable income, it should be recognised as a deduction by reference to the person charging the fee, so long as the person charging the fee is a professional, licensed financial planner who is a member of a recognized professional services body.

The FPA Recommends that fees for advice should become an income tax deduction, including fees for initial advice. Alternatively, consideration could be given to a tax rebate to allow an income tax rebate of 30 percent to a maximum of a $2,000 fee. This would especially assist those persons earning an income of less than $80,000 per annum to pay for financial advice.

7. Retail consumer compensation

7.1 Existing consumer compensation mechanisms

Aside from internal dispute resolution mechanisms, the consumer compensation system in Australia encompasses four main components. Some of these components have yet to be thoroughly tested:

External Dispute Resolution (EDR) – The Financial Ombudsman Service (FOS) is still in its infancy and has yet to be tested as to its effectiveness under its new Constitution, harmonised Terms of Reference, and new monetary limits.

RG126 Professional Indemnity Insurance (PII) run-off cover – from 2010 all AFSLs will be required to hold run-off cover for a period of 2 years following the closure of the company to cover consumer claims that may arise (now in transition period).

ASIC action - Section 50 of the ASIC Act allows ASIC to begin proceedings to recover damages or property against a company or person for fraud, negligence, default, breach of duty, or other misconduct. Most recently ASIC has used such powers to launch a class action against companies involved in the Westpoint collapse, to recover investor losses.

Independent class actions and the courts are always avenues open to consumers seeking compensation, where the above arrangements do not apply or have failed, or are seen as less effective.

7.2 Issues in current consumer compensation system

One of the major failings of the regime for licensees is the reliance on PII as the primary method of financial services compensation. As a mechanism to deliver financial redress to consumers, it is inadequate and can be avoided by unscrupulous operators. From an industry perspective, it places asymmetric burdens on financial services licensees.

An illustrative example emerges from Westpoint, where consumers who rightly deserved maximum compensation for a corporate collapse in which they were defrauded, were met with relying on the PII of their financial advisers to recoup their losses. Notwithstanding that recipients of poor advice deserve to be compensated, inevitably the compensation available through this channel is less than the loss incurred, and it is limited by the proportionate role of advice in a corporate fraud that was enacted many layers higher in the product provider. Further, because

requirements to have PII and be a member of an EDR are applied via licensing obligations, clients who engaged in Westpoint via an unlicensed adviser are unlikely to be able to avail themselves of compensation via PII or FOS. Compensation via these mechanisms would be unavailable to those who had directly engaged in Westpoint. Thus, model of resolution and compensation punishes the regulated, fails the consumer, and does not address underlying structural problems inherent to the compensation system.

If a product were to fail through an event outside of the planner's control, the planner is often held responsible, anyway, and the professional indemnity insurance is met with compensating the full loss of the product failure. It does not make sense to hold planners responsible events outside their control or losses caused by other parties. Rather, compensation should be based on the materiality of any breach instigated by the planner, perhaps in a concept similar to proportionate liability in tort law.

The consumer compensation system requires substantial breadth and depth in its consideration of disputes to ensure consumers are protected and compensated in cases of clear and extreme negligence or inappropriate advice, while providing a fair outcome in disputes of less significant wrongdoing. However, many consumers hold their planners responsible for any financial loss suffered, even if the loss is based on market movements and the advice provided was sound.

ASIC acknowledges the scope for proportionate liability as demonstrated by its actions in response to the Westpoint collapse. ASIC has pursued charges and sought consumer compensation from Westpoint directors, the CEO and founder, and even the auditors of Westpoint for their role in the loss incurred by investors from the collapse.

However, the consumer compensation system does not explicitly support the principle of proportionate liability as only the planning profession is required to hold professional indemnity insurance to cover compensation claims.

7.3 Availability of professional indemnity insurance

A major impediment to industry confidence and even potential survival is the ability of financial services providers to obtain appropriate PII cover at affordable premiums. This is particularly a problem for individual licensees and small firms. Inability to access affordable professional indemnity insurance may impact on a firm's ability to meet its licence conditions and continue to stay in business as well as impacting on the availability of funds to pay compensation to consumers.

As a consequence of regulation, professional indemnity insurance now underpins the consumer compensation mechanisms in Australia. If professional indemnity insurance is not available to financial services providers there will be no or limited funds available to compensate consumers.

If appropriate professional indemnity insurance cover is not available at reasonable premiums, financial services providers are at risk of being forced into breaching their licensing requirements. FPA member experience shows significant premium increases over the past year. Such premiums represent a sizable proportion of a small firm's operational costs. This could result in many smaller firms exiting the industry and larger firms restricting service offerings, substantially reducing choice for consumers. Feedback from the insurance industry indicates that insurance provides are not enamoured of the new Terms of Reference and will respond with further reductions in the availability of professional indemnity insurance.

The professional indemnity insurance system is problematic because of difficulties in meeting obligations under Regulatory Guide 126: *Compensation and insurance arrangements for AFS licensees* and ongoing concerns about the availability of appropriate cover. In addition, the focus on compensation from planners, simply because they have professional indemnity insurance available to pay claims, puts additional upward pressure on premiums.

7.4 Potential gaps in coverage of consumer compensation

The system creates the following potential gaps in the consumer compensation mechanisms available:

- Not all providers are required to have professional indemnity insurance which leads to consumers making claims only against those who do, while other parties, often who play a significant role in the collapse and loss to consumers are less accountable for their actions.

- The FOS Rules stipulate that companies that are insolvent or under administration are immediately expelled from FOS and the EDR scheme cannot accept any complaints relating to that company.

- ASIC Section 50 class action takes time to recover losses. In the meantime consumers may be exposed to hardship. While ASIC class actions have been more common of late, they are undertaken at the discretion of the regulator based on the requirements of Section 50, and not undertaken in response to all

corporate collapses. In addition, the ability of ASIC to recover funds for consumers is dependent on the amount of monies recoverable from those involved in the class action.

- Consumers with valid claims against insolvent companies may find themselves low on the list of creditors and, as a result, ultimately receive little or no compensation.

While recognising there have been a number of attempts to resolve these issues over the last decade, the outcomes of inquiries have been unsatisfactory and have not delivered needed changes for consumers or industry. The consumer compensation system should be simple, clear, accessible, affordable, and robust, for both consumers and participants. It is necessary to review the entire consumer compensation system to address these fundamental flaws.

The FPA recommends that, as a matter of urgency, Treasury should undertake a review of the Retail Consumer Compensation system and hold extensive non-confidential consultation with industry, consumers, and other stakeholders.