5 December 2014

Senate Standing Committees on Economics
PO BOX 6100
Parliament House
CANBERRA ACT 2600

Submission by email: economics.sen@aph.gov.au

Dear Secretariat,

SCRUTINY OF FINANCIAL ADVICE

The Financial Services Council (FSC) thanks the Committee for the opportunity to provide feedback to the inquiry into the Scrutiny of Financial Advice.

The Financial Services Council represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees.

The Council has over 125 members who are responsible for investing more than $2.2 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

This submission considers the regulatory regime that applies to financial advice, which has been subject to comprehensive reform under the recently introduced Future of Financial Advice reforms. The regulatory regime is considered in the context of recent, as well as current inquiries, and concludes by providing feedback to the terms of reference.

Should you have any questions in relation to the contents of this submission, we would welcome the opportunity to discuss this further.

Yours faithfully,

Bianca Richardson
Senior Policy Manager

SCRUTINY OF FINANCIAL ADVICE

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EXECUTIVE SUMMARY

Australia has a comprehensive and well developed regulatory system for financial services and for the protection of consumers.[1] The regulatory system includes a 'twin peaks' model of regulation, with the Australian Prudential Regulation Authority and the Australian Securities and Investment Commission as key regulators. It also includes a comprehensive conduct, disclosure and enforcement framework, together with enforceable legal obligations and a readily accessible ombudsman system for consumer redress.[2]

Recently implemented Future of Financial Advice reforms have also significantly changed the structure and operation of the financial advice industry to remove conflicts of interest arising from remuneration arrangements such as investment commissions, introduced a statutory best interest duty and increased ASIC powers to better align the interests of advisers and consumers. The reforms have involved over 4 years of consultation and address many of the issues raised by the 2009 Parliamentary Joint Committee Inquiry into financial products and services in Australia.

Given the breadth of the reforms it is essential that they be given the opportunity to demonstrate that they work. This is important for the stability of the industry and for consumer confidence.

Whilst the regulatory and legislative framework imposes extensive obligations and requirements on the financial advice industry, the regulatory framework is of little value if it is not appropriately enforced. This requires prompt and efficient action by ASIC to investigate and enforce breaches of law. This is critical for the prevention of misleading advice and prevention of breaches of law generally. ASIC's role is to enforce the law. There are numerous examples where the law has not been properly enforced.

It is vital that ASIC has the necessary resources to enable it to carry out its regulatory oversight functions. The FSC supports funding ASIC on a cost recovery basis with a refined focus on regulation of financial services companies and financial market integrity as outlined in Recommendation 1.

In considering the Terms of Reference of this inquiry, as well as the current level of consumer protections, this submission explores the breadth and robustness of the existing framework, the key inquiries which have taken place since the Financial Crisis, an international comparison of Australia's regulatory regime as well as the current inquiries under way and potential changes. Consideration of these issues demonstrates the comprehensiveness and breadth of Australia's regulatory regime and consumer protections.

This submission also considers each of the terms of reference and makes a number of key recommendations which are outlined below;

Recommendation 1: Further to FSC recommendations made to the Financial System Inquiry, ASIC should be funded on a cost recovery basis by the industry with a refined focus on regulation of financial services companies and financial market integrity.

Recommendation 2: The FSC does not support a statutory compensation scheme of last resort.

[1] Richard St John (2012) Compensation arrangements for consumers of financial services, page 138.
[2] Ibid, page 138.

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Recommendation 3: The FSC supports the enhanced register. We further support the disclosure of enforcement action such as bans, disqualifications or enforceable undertakings, however we do not support the inclusion of any breaches of law or professional standards being included in the enhanced adviser register.

Recommendation 4: The FSC supports the enhancement of licensee protections for sharing information for reference checking purposes.

Recommendation 5: The FSC supports increased competency standards for financial advisers and the establishment of a new and independent Advice Competency Standards Board (ACSB) to develop competency standards for the different advice segments.

1. Current framework

The current legal, statutory and regulatory framework under which financial planners operate is complex and broad ranging. The consumer protections are extensive. Advisers are subject to conduct obligations ranging from the general law (tort), equity (fiduciary duties) as well as legislative requirements (including the best interests duty under the Corporations Act 2001 (Cth) and regulatory oversight (ASIC). Some of these are considered in more detail below:

General law

Financial planners are recognised as owing a duty of care to their clients under the general law tort of negligence. Generally, if a financial planner breaches that duty of care, where the client has relied on the advice, and the client suffers a loss as a result of that breach, then the adviser will be liable for that loss.

Equity / fiduciary duty

While it will depend on the particular factual situation, in most cases it is likely that where a financial planner provides personal advice to a retail client, fiduciary obligations will arise. Being in a fiduciary role means that the adviser will owe an obligation of loyalty to the client, which must be observed by meeting two proscriptive obligations, as follows:

- a fiduciary must not put himself/herself in a position where a duty or interest of the fiduciary may conflict with duties owed to the other person in the relationship without receiving fully informed consent from the other person; and
- a fiduciary must not use their position to gain profit or advantage (for himself/herself or for a third party) without receiving fully informed consent from the other person.

Legislative Requirements

An adviser providing advice to a client is subject to many different obligations under a plethora of different legislation, including the Corporations Act, the Australian Securities and Investments Commission Act 2001 (Cth) (**ASIC Act**), the Competition and Consumer Act 2010 (Cth), the Privacy Act 1988 (Cth) and the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth). We have only considered below some of the main conduct obligations to which an adviser is subject under the Corporations Act and ASIC Act.

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Corporations Act – Best interest duty

The Future of Financial Advice (**FOFA**) reforms introduced a new duty on a provider of advice to act in the best interests of a retail client when providing the advice (s961B). This is a broad, undefined duty which is deemed to be met if the "safe harbour" steps in s961B(2) are met. This duty is intended to address the behaviour and conduct of an adviser in the process of providing advice.

Another important duty in this division is for advisers to give priority to clients' interests when giving advice (s961J). It governs all aspect of the role undertaken by the adviser in giving advice and has no limitation on its operation as to where it applies. It is therefore not permitted under the legislation for an adviser to prefer their own (or their licensee's) interests to the interests of their client when giving advice.

Another obligation is the requirement for an adviser to only provide advice to the client if it would be reasonable to conclude that the advice is appropriate to the client (s961G).

Corporations Act – disclosure requirements

Before an adviser provides any financial services to a retail client they are required in most circumstances to provide their client with a Financial Services Guide (FSG) which contains information relating to, amongst other things, remuneration and associations, and relationships that might reasonably be expected to influence the adviser or licensee in providing the advice.

When he or she provides personal advice to a retail client, the adviser is required in most circumstances to provide this advice in a "Statement of Advice" (SoA), which again contains information disclosing potential conflicts of interest such as remuneration, interests and associations and relationships that might reasonably be expected to be capable of influencing the adviser or licensee in providing the advice.

Corporations Act – prohibition on receipt of conflicted remuneration

Licensees and advisers are prohibited from receiving conflicted remuneration (subject to certain limited exceptions). This means when an adviser provides personal advice, and in many cases when they provide general advice, to a retail client an adviser cannot receive any monetary or non-monetary benefit that could reasonably be expected to influence either the choice of financial product recommended or the financial product advice provided to the retail client.

Corporations Act - Misleading and deceptive behaviour

The Corporations Act contains criminal offences including the prohibition from making false or misleading statements that are likely to induce clients to apply for or dispose of financial products in certain circumstances (s1041E), and also the prohibition of dishonest conduct in relation to a financial product or financial service (s1041G). Other civil penalty provisions include the prohibition of conduct that is misleading and deceptive or is likely to mislead or deceive (s1041H).

ASIC Act – Misleading and deceptive behaviour, false statements, unconscionable conduct

The ASIC Act contains extensive provisions aimed at protecting the consumer, to which an adviser is subject. For example, the ASIC Act prohibits a person from:

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- engaging in unconscionable conduct in relation to financial services (s12CA);
- engaging in misleading or deceptive conduct, or conduct that is likely to mislead or deceive (s12DA); and
- making false or misleading statements in connection with the supply of financial services in certain circumstances (s12DB).

ASIC powers

As the corporate regulator, the Australian Securities and Investment Commission has broad ranging powers and responsibilities to ensure financial services licensees and advisers meet their obligations under the Corporations Act 2001. This role includes;

- ensuring that licensees act honestly, efficiently, fairly, and with competence;
- monitoring and enforcing disclosure and conduct obligations;
- providing consumer protections by
    - ensuring that advice providers are competent to provide their services;
    - promoting transparency and ensuring there is appropriate disclosure;
    - requiring licensees to have fair, accessible and efficient dispute resolution processes in place including external dispute resolution; and
- ensuring that licensees and their representatives meet their legal obligations by enforcing compliance with the law.[3]

Where licensees or advisers fail to meet their obligations or breach financial services laws, ASIC has broad ranging powers, and a range of remedies it can utilise. These remedies are categorised as:

- criminal action;
- civil action (civil penalty proceedings, corrective or compensatory remedies); and
- administrative action (eg banning or disqualifying someone).

The administrative actions that may be available to ASIC include:

- suspending or cancelling an AFS licence;
- temporarily or permanently banning a person from providing financial services;
- varying the conditions of an AFS licence; and
- accepting an enforceable undertaking as an alternative to other remedies.

ASIC's powers were increased as part of the FOFA reforms, and included the ability to ban a licensee or an adviser who is likely to contravene the law. This is significantly broader than previous powers held by ASIC, and means ASIC should now be able to act pre-emptively rather than waiting for an actual breach of the financial services laws.

Obligations at Licensee level and adviser level

The licensing regime under the Corporations Act enables a licensee to operate through representatives, including employees and authorised representatives.

[3] ASIC FSI submission (2014) pages 61-62 & 67.

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Many of the legal obligations described in paragraphs (a) to (c) above sit at the individual (i.e. the adviser) level. For example, the common law and fiduciary obligations sit at the adviser level, as do the requirements to act in the best interests of the client under the Corporations Act. Some of these obligations under the legislation also sit at the licensee level, or the licensee is otherwise deemed to be liable where an adviser breaches an obligation.

The FOFA obligations increased the level of obligations that applied at the individual adviser level. Previously, some of the main conduct provisions (such as the "reasonable basis of advice" test under the old s945A) applied in relation to the "providing entity". The "providing entity" includes an authorised representative or a licensee, but does not include a representative (that is, an employed adviser). In an effort to increase accountability at the adviser level (including increasing the ability for ASIC to take enforcement action) the new best interest obligation and other similar obligations under FOFA apply now to the individual adviser as well as the licensee (where the licensee provides the advice).

Under the Corporations Act, the licensee is liable to a client in respect of any loss suffered by a client as a result of the representative's conduct (s917B and C).

Dispute resolution mechanisms

Licensees who provide services to retail clients are required to have in place a system for the resolution of disputes with those clients as well as arrangements to compensate their clients for loss or damage arising from breaches of obligations under Chapter 7 of the Corporations Act (s912B).

2. Robustness and breadth of existing obligations

Section 1 highlights the breadth and comprehensiveness of Australia's legal, statutory and regulatory framework under which financial planners operate. Extensive conduct and disclosure obligations, as well as enforcement of these obligations by ASIC, are designed to protect consumers and are considered in further detail below.

Conduct Obligations

As identified in section 1 on this submission, the regulatory regime imposes significant conduct and disclosure obligations which protect consumers. This includes the Best Interest Duty which requires the adviser to act in the best interests of the client (s961B(1) of the *Corporations Act 2001*), the advice to be appropriate for the client (*s961G Corporations Act 2001*) and to prioritise the client's interests in a situation of conflict (s 961J Corporations Act 2001). Failure by either the licensee or the adviser to meet these obligations amounts to a contravention of the Corporations Act and subjects the adviser or the licensee to a civil penalty.[4]

To further enhance consumer protection provisions, a further obligation is imposed on licensees to ensure that their representatives, such as financial advisers, comply with these obligations. A failure by the licensee to ensure that its representatives meet these obligations also amounts to a failure by the licensee to meet its obligations under s961L. This ensures that licensees have the appropriate compliance regimes in place to oversee their representatives.

[4] s96K and s961K and s961Q of the *Corporations Act 2001*.

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Disclosure Obligations

In addition to conduct obligations, the regulations also impose disclosure obligations on advice providers. This includes providing a financial services guide to retail clients clearly setting out the adviser's and the licensee's contact details, the kinds of financial services which can be provided, remuneration that the adviser or licensee will receive in relation to the advice and further information requirements. A statement of advice must also be given to retail clients for personal advice which encompasses comprehensive content requirements such as who is providing the advice, what the advice is, what it is based on and remuneration information including remuneration or benefits 'that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice.'[5]

These conduct and disclosure obligations are comprehensive and designed to ensure that the client understands the advice received, is aware of any remuneration and benefits that the advice provider will receive, including any benefits that could influence the advice provider, and ensure that the adviser acts in the client's best interest.

To add to this, the Future of Financial Advice reforms have also introduced prohibitions on conflicted remuneration to ensure that personal advice is not susceptible to influence by conflicted remuneration. This also acts as another layer of consumer protection.

Dispute Resolution and Compensation Arrangements

If a client is not satisfied with the advice received or has a dispute to raise, the client can raise a dispute with the adviser or the adviser's licensee. Licensees are required to have dispute resolution processes in place. Information on how consumers can raise disputes is clearly set out in the Financial Services Guide (which requires information to be included about the dispute resolution system and how the client may access that system[6]). If the client is not satisfied with how the complaint has been dealt with, the consumer can raise the dispute through an external dispute resolution regime such as the Financial Ombudsman Service. This provides the client with another avenue in which to raise their dispute at no or limited cost to the client.

In order to satisfy compensation requirements, licensees must have compensation arrangements in place. This requires a licensee to have arrangements in place for loss or damages arising from a breach of obligations by the licensee or its representatives.[7] For most licensees, the compensation arrangements in place consist of licensees holding professional indemnity insurance. There are also some licensees which are exempted from this requirement on the basis of 'their financial strength'.[8] These arrangements assist licensees to meet client claims.

ASIC Enforcement Action

In addition to internal and external dispute resolution mechanisms, ASIC's enforcement action is designed to protect consumers and ensure they have trust and confidence in Australia's financial services. In 2013-2014 ASIC's enforcement activities consisted of;

[5] s947C *Corporations Act 2001.*
[6] s942B *Corporations Act 2001.*
[7] s912B *Corporations Act 2001*.
[8] Richard St John (2012) Compensation arrangements for consumers of financial services, Section A7.

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- 113 investigations;
- 95 criminal and civil litigation and administrative actions completed including 15 criminal proceedings and 8 imprisonments;
- securing $172.6m in compensation or remediation for investors and financial consumers;
- including cancelling or suspending 23 AFS Licensees, with a further 6 AFS Licensees agreeing to have conditions imposed on their licenses;
- permanently banning 20 individuals from providing financial advice; and
- further 12 being banned or agreeing to stay out of the industry for a period of time.[9]

These extensive enforcement activities were undertaken in relation to investor and financial consumer trust and confidence, in addition to ASIC's other functions as a market regulator and registry and licensing functions.

The comprehensive regulatory environment and consumer protections currently in place in financial services are the result of a range of financial services inquiries, reviews and regulatory reforms. The most recent of these being the FOFA reforms which resulted in significant changes to the financial advice industry, and arose out a recommendation from the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and services in Australia 2009.

3. Key Financial Services Inquiries since the Financial Crisis

Parliamentary Joint Committee on Corporations and Financial Services (PJC) Ripoll Inquiry 2009

Following the collapse of financial products and services providers, such as Storm Financial and Opes Prime, and considerable consumer losses, the PJC undertook a comprehensive review into issues associated with financial product and service provider collapses in 2009. The Inquiry into financial products and services in Australia ('PJC Ripoll inquiry') considered extensive and broad ranging issues such as;

- 'the role of financial advisers;
- the general regulatory environment for these products and services;
- 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;
- the role played by marketing and advertising campaigns;
- the adequacy of licensing arrangements for those who sold the products and services;
- 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;
- consumer education and understanding of these financial products and services;
- the adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
- the need for any legislative or regulatory change.'[10]

[9] ASIC Annual Report 2013-2014, page 5 and 34-36.

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Following 398 formal submissions, 37 supplementary submissions and 9 public hearings, the PJC provided a comprehensive 217 page report in November 2009[11]. The PJC made 11 recommendations to help prevent the occurrence of similar collapses in the future and improve the quality of financial advice.[12]

Future of Financial Advice Reforms

In response to the PJC Ripoll inquiry, the FOFA reforms were initiated in 2011 to improve the quality of financial advice and expand the availability of more affordable financial advice. The government stated that its response to the PJC Inquiry was guided by two over-riding principles:

- "financial advice must be in the client's best interests – distortions to remuneration, which misalign the best interests of the client and the adviser, should be minimised; and
- in minimising these distortions, financial advice should not be put out of reach of those who would benefit from it."[13]

Following extensive consultation between 2011 to 2013, the following reforms have been implemented effective 1 July 2013 (and voluntary from 1 July 2012);

- a prospective ban on up-front and trailing commissions and like payments for group risk within superannuation;
- a prospective ban on up-front and trailing commissions for investment and superannuation products;
- a prospective ban on any form of conflicted remuneration payments relating to volume or sales targets from any financial services business to dealer groups, authorised representatives or advisers, including volume rebates from platform providers to dealer groups;
- a ban on soft dollar benefits, where a benefit is $300 or more (per benefit);
- introduction of a statutory best interests duty imposed on advisers;
- duty of priority in a situation of conflict placed on advisers;[14]
- fee disclosure statements; and
- ban on asset based fees on borrowed amounts.

These additional obligations have transformed the financial services industry, have banned commissions and introduced a best interest duty that places the consumer's interests first. These reforms have given effect to, and implemented, many of the recommendations made in the Ripoll report in order to improve the quality of financial advice consumers receive and protect against future collapses.

[10] Parliamentary Joint Committee on Corporations and Financial Services (2009) Inquiry into financial products and services in Australia, page 1.
[11] Ibid., page 3.
[12] Ibid., page 149.
[13] The Future of Financial Advice Information Pack 26 April 2010.
[14] Future of Financial Advice (2011) Information pack, page 5; Online source http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf

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Richard St John Report

Additionally, as part of the FOFA reforms, a comprehensive review into the costs and benefits as well as the need for a statutory compensation scheme was undertaken[15]. The Richard St John report was issued in April 2012. The report considered the compensation arrangements for consumers of financial services and considered the regulatory environment which requires licensees to hold professional indemnity insurance, other than those who are in well resourced categories such as APRA regulated banks and insurers.[16]

The report noted that generally retail clients are able to recover compensation for losses arising from licensee misconduct. Compensation arrangements consist of licensees holding professional indemnity insurance, as well as meeting claims from their own financial resources.

The report also noted however that clients are unable to obtain compensation in a limited number of cases. Reference was made to ASIC's and the Financial Ombudsman Service's (FOS) feedback on the limitations of professional indemnity insurance as a compensation mechanism where a licensee becomes insolvent.[17] A client's ability to recover compensation in those circumstances depends on a variety of factors including the timing of when a claim is notified, with early claimants having a better chance of obtaining compensation than later claimants, the involvement of the liquidator and when the insurance policy is cancelled. Whilst there are cases where compensation claims are unable to be met, the report referenced FOS feedback whereby 'in most cases consumers who are awarded compensation are able to recover it under current arrangements.'[18]

Following extensive assessment of the adequacy of current arrangements for providing consumer compensation arising from licensee misconduct, the report identified that consumers are generally able to recover losses that are attributable to licensee misconduct. The report concluded that it would be 'inappropriate and possibly counter-productive, to introduce a more comprehensive last resort compensation scheme'.[19] The report stated that;

> *'it would be inappropriate to require more responsible and financially secure licensees to underwrite the ability of other licensees to meet claims against them for compensation. There would also be an element of regulatory moral hazard should a last resort scheme be introduced…and would reduce the incentive for stringent regulation or rigorous administration of the compensation arrangements'*[20]

Following extensive inquiries into a range of issues, including the adequacy of compensation arrangements, significant financial services reform has been introduced through the FOFA reforms. These reforms have been four years in the making, are aimed at improving the quality of advice and expanding the availability of advice. The consumer benefits of these reforms are immediate. In terms of evidencing the benefit of these reforms more widely, this will naturally take time.

[15] http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/compensation_arrangements_report/default.htm
[16] Richard St John (2012) Compensation arrangements for consumers of financial services, page iii.
[17] Richard St John (2012) Compensation arrangements for consumers of financial services, page 34.
[18] Richard St John (2012) Compensation arrangements for consumers of financial services, page 37.
[19] Richard St John (2012) Compensation arrangements for consumers of financial services, page iii.
[20] Richard St John (2012) Compensation arrangements for consumers of financial services, page iii.

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Whilst significant changes have been brought into the financial services industry, it is important to note that these changes have also come at considerable cost. FOFA reforms have required widespread changes to systems, processes, training of staff and investment of considerable internal and external resources. These costs invariably flow through to consumers and increase the cost of services and advice. Given that one of FOFA's key objectives is to expand the availability of advice, it is not yet evident whether this has been or will be achieved.

Given the financial and non-financial benefits that financial advice delivers to those who receive it, it is imperative that regulatory reform does not drive financial advice out of the reach of Australian consumers. Research has shown that Australians obtaining financial advice save an extra $1,590 per year when compared to someone who does not receive advice[21] and that the benefits extend well beyond financial factors. Advised clients feel a stronger sense of control of their finances, have lower levels of stress and feel a greater sense of well being.[22]

To ensure that consumers not only continue to obtain advice however, and to achieve FOFA's objectives to expand the availability of advice across consumers, it is imperative that the FOFA reforms be given the opportunity to demonstrate the benefits prior to any further wholesale change of the regulatory regime.

4. International comparison of Australia's Regulatory Regime

Australia has a comprehensive and well developed regulatory regime for financial advice providers. The regulatory regime includes Licensing obligations imposed on financial advice providers in order to provider financial advice, conduct and statutory duties, disclosure requirements which include disclosure of any conflicts of interest, prohibitions against conflicted remuneration and duty to place a client's interests first in a situation of conflict.[23] An international review of some of these key obligations was considered in a 2014 Deloitte benchmark report prepared for the FSC, '*A comparison of financial advice regulations – personal advice for retail clients'* . The benchmark report reviewed the regulatory landscape for retail personal financial advice across Australia, United Kingdom ('UK'), United States of America ('USA'), Canada, Singapore and Hong Kong. The report reviewed;

- licensing requirements for providing financial advice;
- statutory duties imposed on advice providers;
- disclosure requirements when providing advice;
- conflicted remuneration provisions, if any; and
- requirements to manage conflicts of interest imposed on advice providers, if any.[24]

[21] KPMG Econtech, Value Proposition of Financial Advisory Networks Update and Extension, 2011.
[22] Irving, K., Gallery, G., Gallery, N., Newton, C., (2011). I can't get no satisfaction ... or can I? An exploratory study of satisfaction with financial planning and effects on client well-being, *JASSA The Finsia Journal of Applied Finance Issue 2,* p.40, 41 & 44;
[23] Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients,* pages 9-10.
[24] Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients*.

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The regulatory framework for the attributes above are outlined in Table 1 below.

Table 1: Summary – Country comparison of financial advice regulations[25]

AUSTRALIAN Requirement	Indicative comparisons				
	Canada	Hong Kong	Singapore	UK	USA
Licensing requirements					
Organisation requirements – Must hold Australian Financial Services Licence and meet obligations on governance, organisational competence, risk management, financial capital, technology, human resources, insurance and disclosure.	Comparable	Comparable	Comparable	Comparable	Less
Individual adviser requirements – Must hold Diploma Financial Services qualification, relevant accreditations and maintain annual Continuing Professional Development.	Comparable	Comparable	Comparable	Comparable	Less
Statutory duties					
Client centricity – Must demonstrate client's best interest and demonstrate compliance with safe harbour steps.	Less	Less	Less	Comparable	Less
Disclosure requirements					
Must provide Financial Services Guide to client prior to giving advice.	Comparable	Less	Comparable	Comparable	Comparable
Must document client objectives, financial circumstances, recommendations, alternatives considered, risks, fee and conflict disclosures (usually in a Statement of Advice).	None	None	None	Less	None
Must provide Fee Disclosure Statement on annual basis where ongoing services are provided to review clients.	None	Less	None	Less	None
Conflicted remuneration prohibitions					
Ban on remuneration and benefits that could reasonably be expected to influence the financial product advice given.	None	None	None	Comparable	None
Conflict of interest requirements					
Further to the statutory duty to prioritise client interests, required to manage conflicts of interest through either controlling and avoiding or disclosing.	Comparable	Less	Comparable	Comparable	Comparable

Table 1 demonstrates the comprehensiveness of Australia's licensing, conduct, disclosure and conflicted remuneration requirements. Whilst there are comparable licensing obligations across most of the jurisdictions, Australia overall has a "higher standard of regulation with more prescriptive requirements than the other countries studied."[26]

[25] Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients,* page 8.
[26] Ibid, p.g.3

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5. Current inquiries under way and upcoming changes

Financial System Inquiry

The Financial System Inquiry (FSI) is currently underway and examining how the financial system can be positioned to meet Australia's needs and support economic growth. The FSI released its interim report in July 2014. The interim report made a number of comments in relation to the significant benefits affordable and quality advice can bring consumers although noted that competence across advisers varies widely.[27] It has sought views on raising minimum education and competency standards for personal advice, introducing an enhanced public register of financial advisers and enhancing ASIC's powers to include banning an individual from managing a financial services business.[28]

The Financial Services Council provided a supplementary submission to the FSI and provided support for establishing an independent Advice Competency Standards Board which would review and set the competency standards for the different advice/information segments, together with the establishment of a comprehensive adviser competency framework which includes ethics training and an enhanced register of advisers. In addition to this we also supported ASIC having the power to prevent a person from managing financial services where judicial review of the decision was available.

Following extensive review, the FSI is expected to finalise its report in December 2014. It may make a number of further observations and recommendations in relation to the issues canvassed above.

The adequacy of adviser competency requirements has also been subject of further review and dedicated inquiry by the PJC Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry which is likely to make key observations and recommendations in relation to professional, ethical and education standards.

Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry

The PJC is reviewing the adequacy of current qualifications for financial advisers and reviewing proposals to improve professional, ethical and education standards.

The FSC reiterated comments made in our second FSI submission, and supported the establishment of the Advice Competency Standards Board, increasing competency standards for financial advisers and a competency framework which would consider;

- education requirements (including ethics training);
- continuing education (CPD) and/or a national exam;
- professional Standards or a Code of Conduct;
- experience requirements;
- enhanced register of advisers including employee representatives;

[27] FSI Interim Report 3-49-3-69
[28] 3-49-3-69

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- a training/course register to enable advisers, licensees and regulators to keep track of which courses meet ACSB requirements; and
- power to recognise professional associations.

When it reports, the PJC is likely to make observations or recommendations in relation to lifting adviser competency, professional, ethical and education standards.

Separately, a number of large financial services providers have already moved to increase the education requirements of their financial advisers, such as requiring new advisers to have a relevant degree or having a recognised professional association qualification and increased standards for existing advisers following appropriate transition periods.[29]

Enhanced Adviser Register

The establishment of an enhanced adviser register has been announced to improve transparency and provide consumer confidence. The enhanced adviser register will be up and running by March 2015 and will include information such as:

- adviser's name;
- registration number;
- experience;
- qualifications and professional association memberships;
- any bans, disqualifications or enforceable undertakings;
- ownership of the licensee and disclosure of ultimate parent company where applicable.[30]

The register is designed to assist investors, employers and the regulator ASIC to confirm an adviser's credentials and provide confidence that the adviser is appropriately qualified and experienced.

6. Terms of Reference - Comments

TOR 1 – the current level of consumer protections

Australia's regulatory framework consists of a comprehensive range of conduct and disclosure obligations imposed on advisers and licensees which have been discussed at length in Section 1 and Section 2 of this submission. These obligations are designed to ensure that clients understand the advice received, are aware of any remuneration and benefits relating to the advice, including any benefits that could influence the advice, and impose considerable conduct obligations on advisers and licensees.

Further the structure of the licensing and regulatory regime itself affords further consumer protection not only imposing obligations on both the licensee and the adviser to ensure that they are meeting their respective regulatory duties, however also adding an extra layer of oversight requiring Licensees to ensure that their representatives comply with their obligations.

[29] http://www.ifa.com.au/news/13456-commonwealth-bank-strikes-cfp-deal-with-fpal; http://riskinfo.com.au/news/2014/08/26/large-institutions-move-on-advice-education-standards/
[30] An Enhanced Public Register of Financial Advisers, 24 October 2014.

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In addition, the recently introduced FOFA reforms also incorporate a comprehensive range of new obligations, including a statutory best interest duty, and a duty to place the client's interests first in a situation of conflict. Importantly, the best interest duty and duty of priority have been imposed at the individual adviser level to enhance consumer protections. To add to this there are now also prohibitions on conflicted remuneration to ensure that advice is not susceptible to influence by conflicted remuneration and to better align the interests of consumers and advisers. These significant reforms have introduced further consumer protections.

It is our view that the existing regulatory regime, recently bolstered by increased ASIC powers and extensive FOFA reforms, provide appropriate protections to consumers.

TOR 2 - the role of, and oversight by, regulatory agencies in preventing the provision of unethical and misleading financial advice

To prevent the provision of unethical and misleading financial advice, an appropriate regulatory framework is required which imposes relevant obligations and behaviours at the outset, includes appropriate monitoring and enforcement and has effective regulatory oversight. Australia's regulatory framework consists of a comprehensive range of conduct and disclosure obligations imposed on advisers and licensees which have been discussed at length in Section 1 of this submission. The recently introduced Future of Financial Advice reforms also incorporate a comprehensive range of new obligations, including the best interest duty and removes conflicted remuneration to better align the interests of consumers and advisers. The introduction of these obligations, together with existing obligations, assists in the prevention of misleading and unethical advice.

ASIC Powers, Monitoring and Enforcement

In order to ensure participants in the advice industry meet their obligations, ASIC has a broad range of regulatory powers. ASIC's regulatory powers include;

- investigation and surveillance powers such as gathering information on specific or a range of entities, issues of concern or assessing compliance with the law;
- taking enforcement action such as disqualifying or banning someone from providing financial services;
- the ability to use:
    - administrative sanctions;
    - civil remedies (civil penalty proceedings, corrective or compensatory remedies); and
    - criminal remedies [31]
- increased powers to refuse an application or cancel a licence where there is reason to believe that the licensee is likely to contravene their obligations[32].

These broad ranging powers enable ASIC to undertake appropriate action for breach of financial services obligations. In addition to reactive responses, ASIC also engages in pro-active risk based

[31] ASIC FSI submission (2014) page 75.
[32] ASIC Annual Report 2012-2013 (2014).

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surveillance and takes action where it identifies breaches of the law. Misleading or unethical advice would be captured as part of ASIC's proactive and reactive surveillance as well as in its enforcement activities against those who have breached their obligations.

Whilst the regulatory and legislative framework imposes extensive obligations and requirements on the financial advice industry, the regulatory framework is of little value if it is not appropriately enforced. This requires prompt and efficient action by ASIC to investigate and enforce breaches of law. This is critical for the prevention of misleading advice and prevention of breaches of law.

Prompt and efficient enforcement action provides a clear signal to the broader industry and market that breaches of obligations will not be tolerated and will be pursued.

Regulatory Oversight

Under the licensing framework ASIC does not have complete visibility across financial advisers. ASIC has oversight of licensees and authorised representatives however it does not have oversight or transparency over employee adviser representatives.

The enhanced adviser register will include employee representatives and provide ASIC with the visibility it has not previously had. The register will also include relevant information such as experience, qualification, licensee ownership and whether the adviser has ever had any banning orders or enforceable undertakings. This is an important development for consumers, the industry and ASIC. Importantly it will also provide ASIC with visibility into employee representatives, which they have not previously had.

The Financial Services Council commends the establishment of the enhanced adviser register.

Adequacy of Funding

Aside from appropriate oversight, it is also important that ASIC has the necessary funding to enable it to carry out vital regulatory oversight functions. ASIC is under resourcing pressure and has a reduced operating budget of $44m or 12% in 2014-15. The effect of these cuts are to reduce staffing numbers as well as substantially reduce proactive surveillance.[33]

This will impact ASIC's ability to investigate and undertake enforcement activities.

We note the FSC's observations made in our second submission to the Financial System Inquiry (FSI) whereby recent inquiries paint a picture of an over-stretched, at times under performing watch dog. The widespread regulatory functions has been raised as a concern in the FSI's interim report and it may be argued that ASIC has too many regulatory functions and staff spread across too many responsibilities. Given that the FSI is a structural review, we noted that the FSI offers an opportunity to refocus ASIC on its core function as a securities and markets regulator. [34] In support of this, the FSC made a recommendation to support funding ASIC on a recovery basis by

[33] ASIC Annual Report 2013-2014 (2014) page 4.
[34] FSC (2014) Financial System Inquiry – Phase 2, Chapter 3 Regulatory Architecture submission, pages 78-79.

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industry, with a refined focus and targeted focus on regulation of financial services companies and financial market integrity.[35]

Recommendation 1: Further to FSC recommendations made to the Financial System Inquiry, ASIC should be funded on a cost recovery basis by the industry with a refined focus on regulation of financial services companies and financial market integrity.

TOR 3 – whether existing mechanisms are appropriate in any compensation process relating to unethical or misleading financial advice and instances where these mechanisms may have failed

Where consumers suffer loss arising from licensee or adviser misconduct, such as inappropriate advice, consumers have access to internal and external dispute resolution mechanisms. In order to satisfy compensation requirements, licensees must have compensation arrangements in place. This requires a licensee to have arrangements in place for loss or damages arising from a breach of obligations by the licensee or its representatives.[36] An extensive review into compensation arrangements for consumers of financial services was undertaken in 2012 by Richard St John, during the FOFA review.

As noted in Section 3 of this submission, Richard St John's report identified that consumers are generally able to recover losses that are attributable to licensee misconduct. It also noted that there are however some instances where consumers were unable to obtain compensation for their losses arising from licensee misconduct. Following extensive consideration of the consumer protections available in financial services, including the scope and nature of compensation arrangements as well as the limitations of professional indemnity insurance, the report concluded that it would be 'inappropriate and possibly counter-productive, to introduce a more comprehensive last resort compensation scheme'.[37]

Feedback on dispute resolution mechanisms has also been provided to the Financial System Inquiry, with the FSI interim report noting that 'overall, stakeholders have said that dispute resolution systems are working well.[38] Whilst the existing mechanisms largely address consumer losses arising from licensee and adviser misconduct, there are some cases that consumers are unable to obtain compensation such as where a licensee enters administration or liquidation or ceases to exist.

The Financial Ombudsman Services this year released figures on unpaid determinations in the investments, life insurance and superannuation area.[39] On a yearly basis the unpaid determinations range between $650,000 to a maximum of $3.2m over the last four years.[40] In 2013, $2.3m of determinations were unpaid. Importantly FOS notes that unpaid determinations relate only to a very small percentage of FOS members and only a very small number of financial planning firms that are members of FOS. [41]

[35] Ibid, pages 78-79.
[36] s912B of the *Corporations Act 2001*.
[37] Richard St John (2012) Compensation arrangements for consumers of financial services, page iii.
[38] FSI Interim Report, 3-85
[39] Financial Ombudsman Service (2014) Unpaid determinations by financial services providers, pages 1-4
[40] Ibid, pages 1-4.
[41] Ibid, pages 1-4.

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It is difficult to quantify what percentage of $2.3m of unpaid claims represents overall compared to the claims that are paid out through internal dispute resolution mechanisms (via professional indemnity insurance or a licensees own financial resources), external dispute resolution mechanisms and compensation awarded under court orders or compensation pursue by ASIC. In 2013-2014, ASIC alone secured $172.6m in compensation or remediation for investors and financial consumers.[42] In 2012-2013, ASIC secured $136m solely for clients who suffered losses arising from the collapse of Storm Financial. This was in addition to $132m already paid to investors via internal dispute resolution scheme of a major financial services provider. [43]These figures suggest that unpaid claims represent a small proportion of overall claims paid to consumers. This is consistent with Richard St John's observations that

> *'information provided by ASIC and FOS indicate that the value of compensation claims that cannot be recovered following the failure of licensees is significant, probably running into some millions of dollars each year, but not large when compared for example with the scale of losses suffered by consumers following the failure of financial products in which they have invested.'*[44]

Whilst the overall unpaid determinations may be small it is important to acknowledge the significant impact unpaid claims have on those who do not receive compensation to which they are entitled. In consideration of what measures can be incorporated to help prevent such losses, the benefits of any regulatory change must be weighed against the impact and costs of such change. There is considerable concern of increasing moral hazard and increased consumer costs arising from a statutory compensation scheme.

The FSI interim report makes reference to both the Wallis Inquiry and the Richard St John report which did not support a statutory compensation scheme.[45]

The FSC is not supportive of introducing a statutory compensation scheme of last resort for similar reasons outlined in the Richard St John report who noted that introducing such a scheme could be counter productive.

Recommendation 2: The FSC does not support a statutory compensation scheme of last resort.

Aside from compensation schemes of last resort Richard St John made a number of observations for other measures that can enhance current compensation arrangements in Chapter 4 of his report. This included placing a 'greater onus on licensees to verify they have adequate insurance cover, more attention by ASIC to the adequacy of licensees' financial resources as viewed in conjunction with their insurance cover; a more pro-active stance by ASIC in administering compliance by licensees with their obligation to hold adequate professional indemnity insurance or other financial resources and strengthening ASIC's ability to police the licensing system.'[46] There may be merit in providing further consideration to these proposals, including the benefits and risks associated with the respective propositions.

[42] ASIC Annual Report 2013-2014 (2014) page 5.
[43] ASIC Annual Report 2012-2013 (2014) page 33.
[44] Richard St John (2012) Compensation arrangements for consumers of financial services, page 43.
[45] FSI Interim Report, 3-86.
[46] Richard St John (2012) Compensation arrangements for consumers of financial services, page 70.

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TOR 4 – mechanisms, including a centralised register, that would ensure financial planners found to have breached any law or professional standards in their employment are transparent, for both the sector and consumers

The enhanced adviser register will be introduced in 2015 will provide greater transparency to the industry, ASIC and consumers, regarding important information such as an adviser's experience, their qualifications and whether they have had any bans, disqualifications or enforceable undertakings.

By including information such as bans, disqualifications or enforceable undertakings, accessible to consumers and the industry in a transparent manner through a single source of information, such as the adviser register, will assist the industry and consumers alike. Whilst regulatory action such as bans and enforceable undertakings will be included on the register, it will not include information for breaches of any law or professional standards.

There is the risk that including breaches of any law or professional standards on a register consisting of thousands of advisers, would neither be effective nor meaningful. For example, failure to provide a financial services guide to a client is a breach of the law. Whilst this requires remediation and appropriate action, it does not necessarily assist consumers, to be aware of a single instance of where a financial services guide may not have been provided to a client. Including information on whether an adviser has been subject to a ban or disqualification is arguably more important as well as meaningful to consumers and the broader industry. This equally applies to potential breaches of professional standards.

In order for disclosure, and information on the register to be meaningful, it should be concise and include relevant information. Given the breadth of information currently proposed to be included in the enhanced adviser register we do not support the inclusion of any breaches of law or professional standards being included in the enhanced adviser register.

Recommendation 3: The FSC supports the enhanced register. We further support the disclosure of enforcement action such as bans, disqualifications or enforceable undertakings, however we do not support the inclusion of any breaches of law or professional standards being included in the enhanced adviser register.

TOR 5 – how financial services providers and companies have responded to misconduct in the industry

Misconduct in the financial services industry adversely impacts the reputation of the entire industry as well as consumer confidence which is counterproductive to encouraging more consumers to obtain financial advice.

In an endeavor to raise quality of advice, many licensees impose higher education training standards than the legislated RG 146 requirements. It is common across the industry to require additional internal or external courses in the following advice areas prior to the provision of advice.

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- Direct Equities
- SMSF
- Derivatives
- Gearing
- Aged Care
- Structured products
- Estate Planning

Once an adviser becomes accredited they are generally subject to more stringent compliance requirements and procedures. Examples of frequently used compliance rules surrounding specialist advice areas across the industry include:

- Maximum Loan to Equity Ratios for gearing;
- Cash flow buffers to allow for interest rate rises;
- Minimum amount of funds available to set up an SMSF;
- Minimum number of direct equities in a portfolio or maximum percentage of a portfolio invested in any one share;
- Minimum level of risk tolerance needed for a more aggressive strategy;
- Additional audit or vetting requirements; and
- Maximum amount of a client's portfolio invested into any one product.

These increased education, training and compliance standards are aimed at improving the quality of advice, as well as having appropriate risk management processes in place to reduce risks and general misconduct.

Furthermore, many large licensees have recently announced that they are significantly increasing new adviser education and experience requirements, such as requiring new advisers to have a relevant degree or having a recognised professional association qualification and increased standards for existing advisers following appropriate transition periods.[47]

Furthermore there is broad support for increasing competency standards in the industry which the Financial Services Council also supports.

In addition to raising standards, we have received member feedback that reference checking of information relating to advisers has improved with greater sharing of information between licensees. Reference checking helps to strengthen the suitability of adviser appointments. Whilst reference checking has improved, barriers to sharing of information are still in place. There is the concern that licensees may be subject to potential liability or claims for sharing adverse or negative information relating to an adviser.

In order to enhance reference checking where an adviser is seeking to join a new licensee, and facilitate the sharing of vital information (provided that it is true and accurate) between licensees, it would be helpful if greater protections could be provided to licensees when engaging in reference checking.

[47] http://www.ifa.com.au/news/13456-commonwealth-bank-strikes-cfp-deal-with-fpal; http://riskinfo.com.au/news/2014/08/26/large-institutions-move-on-advice-education-standards/

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Recommendation 4: To enhance licensee protections for sharing information for reference checking purposes.

TOR 6 – other regulatory or legislative reforms that would prevent misconduct

An effective regulatory regime, requires appropriate safeguards upon entry into the industry, appropriate behaviours and obligations while practising in the industry, as well as effective monitoring and enforcement activities by a regulator.

FSC advocates that consideration should be given to ensuring that those who apply to be licensed to give financial advice and operate financial advice businesses are of good character, adequately skilled and have adequate financial resources. Rather than ASIC acting after the event to intervene, the FSC proposes that ASIC adopt a more stringent approach to new applicants to ensure that only those of good character, who are adequately skilled, have adequate financial resources and can effectively discharge their legal obligations are granted a license to operate.

TOR 7 – any related matters.

The FSC supports measures to increase the professionalism of financial advisers. Relevant and appropriate adviser education, including ongoing education requirements such as continuing professional development, are a key part of adviser competency and professionalism. We note the

Parliamentary Joint Committee on Corporations and Financial Services inquiry into proposals to lift professional, ethical and education standards in the financial services industry is likely to report in the coming months and may make recommendations on increasing competency standards for financial advisers.

The FSC reiterates its support for increasing competency standards for financial advice and the establishment of a new and independent Advice Competency Standards Board (ACSB) which develops competency standards for the different advice segments.

Recommendation 5: The FSC supports increased competency standards for financial advisers and the establishment of a new and independent Advice Competency Standards Board (ACSB) to develop competency standards for the different advice segments.

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