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31 MAY 2002

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Kathleen Dermody FAX: 02-6277 5719
Secretariat, Joint Parliamentary Committee on Corporations & Financial Services
Parliament House
Canberra ACT 2600

Re: The Committee's Inquiry into FSRA and ASIC's policy statements

Dear Kathleen

Primary submission by Boutique Financial Planning Principals Group Inc

The primary submission we wish to make relates to **compliance burden** and **business uncertainty** for **small and micro businesses** who are licensees under FSRA.

Our member businesses hold security dealers licences under Corporation Law. We are each contemplating the transition to FSRA which we are required to make over the next 2 years - no small effort for small business - even simply to read & then understand all the relevant material - but then to prepare a raft of new compliance documents and procedures. In many cases with our members, it is the primary income generator of these businesses (the principal) who will be required to undertake a number of man-weeks of effort to complete this transition - time which will be unavailable to be spent earning income. Of course, we then have what seems to be a very significant ongoing compliance burden as well.

However, **our primary initial concern** is the significant **business uncertainty** caused by FSRA - because of the way in which the rules are written. For example, in PS164 Section F - Risk Management. it says "**The nature and scope of a licensee's risk management systems are dictated by the nature, scale and complexity of its business and its risk profile.**" *For a small licensee, when is a risk strategy deemed to be sufficient and complete enough to be deemed to be complying?* With this current vagueness for small businesses, there seems ample scope for arbitrary interpretation of the rules, arbitrarily deeming one of our members to be non-complying - probably putting them out of business. This of course would not be fair or just. We are therefore seeking **business certainty**, so that if we have reasonably endeavoured to comply, we can be confident that the rules cannot be arbitrarily applied to put us out of business.

Our members all wish to comply with the rules. However, as a small dealer, **we need to be able to find a practical way of complying where we can be confident that the measures that we put in place are sufficient.** It is clear that ASIC do not expect compliance manuals, procedures and strategies to be as voluminous for small dealers as it does for big dealers. However, how much is enough? To ensure we comply with the rules, we need to understand where the boundaries are. At the moment, quite a few of these boundaries seem fairly hazy.

The solution we have suggested to ASIC is to come up with some acceptable templates (for the various new compliance documents required under FSRA, regulations and related Policy Statements) for a 1-adviser practice and a 5-adviser practice, so that small licensees can see some examples of what might be regarded as acceptable documents.

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To date, we have had no response to this suggestion.

We are seeking to comply. We need the rules to be clear.

Note: It has been pointed out to us, that under **AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION ACT** 2001 SECT 1 - 2 (a) that *"**ASIC must strive to maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy**".*

It strikes us that the at the moment that:-

- The current implementation of FSRA fails the "**commercial-certainty**" test because as indicated above, we are having difficulty obtaining adequate definition of what (as small licensees) we are required to do to comply.
- By sheer weight of new rules and practice standards, there very clearly is a **major increase in business cost** - whereas the Act requires focus on reducing costs.

Background - consumer choice

Small dealers are an important alternative for consumers seeking financial planning advice - an important part of **consumer choice**.

Indeed, small dealers were a major driving force towards professionalism in financial planning. Over the last 15 years, many small dealers have contributed a lot of their time (particularly through the Financial Planning Association), to furthering the cause of professionalism. *Many of the most experienced financial planners often work in small dealerships.* And other than the historical reasons, many of these experienced small dealers choose to work in small dealerships because *they believe this provides an environment where they can best serve their clients.* [Eg In a small business, financial planners are less likely to find themselves under an obligation to "sell a quota of product". Rather, the financial planner can focus on doing the best for their client.]

Clearly small dealerships have an important place in the future of financial planning. **Clearly small dealers are also an important part of consumer choice.**

Note: Small independently-owned firms do not face the same **conflict of interest** as:-

- The large Wall Street brokerage houses who for example were recommending stocks in companies on one hand while they were receiving big investment banking fees from the same companies (eg relating to floats, or mergers and acquisitions). We have all seen the scandal that has erupted over this since the bursting of the tech bubble. In case you are not aware of the press discussion of these issues, we attach an example of the stories relating to this (AFR 23/5/2002 Page 13.) For an Australian angle on this story, you might reference Australian Financial Review 25/5/02 Page 20.
- There are also conflicts of interest where a large fund managers has a securities dealers licensee (or AFS Licensee) as a subsidiary or related party. Again, the issues are widely known and understood. Perhaps recommendations of a related parties product need to be explicitly identified as such, to ensure the consuming public is adequately informed.

With these points, we are not claiming small dealers (AFS Licensees) are "holier that thou". Unethical small financial planning businesses exist as do unethical large financial planning businesses. This is why compliance does have an important place. With these points about conflicts of interests, **we are identifying that many small dealers do not have the above specific conflicts of interest - and as such, this is another reason why small financial planning businesses do have a very important place in consumer choice** - and in providing competition in this sector.

Of course, the other place where discussions take place regarding **conflict of interest** - is the fees vs commission debate. For those who believe that fees independent of advice, reduces this conflict of interest - please observe that

a greater predominance of fee-based advice occurs in small to medium-sized financial planning businesses. Again, **this is further reason why the government and regulators should be encouraging and supporting the development of small financial planning businesses.** *Clearly the consumers lose, if these small financial planning businesses are regulated out of existence.*

Background - Un-acknowledged public safeguards offered by small business licensees.

The rules may seem appropriate for large organisations - not suited, tailored or designed for small businesses. For example:-

- **Larger financial planning businesses tend to have multiple locations - often widely spread geographically.** It is widely recognised that supervision of compliance requirements (even as they have stood pre-FSRA) was far more problematic in these scenarios. We agree that clearly in such cases, tighter compliance procedures are required. However, our membership mainly operate from one location where it is much easier to supervise compliance.

- **Management in larger financial planning businesses are employees.** If they behave inappropriately, they may lose their job. By contrast, **management in smaller practices are owners.** If they behave inappropriately, they may lose their job and their house - and other assets. Under such circumstances, you would expect the management of smaller practice to be more diligent in ensuring they comply. This extra public safety factor does not seem to be acknowledged.

- **Many of the most experienced financial planners often work in small dealerships** - see comments above. We believe this experience results in a better, more appropriate service - something which has not adequately been recognised in PS146.

- **Small financial planning practices are generally more advice-focused** - see comments above. In small practices, financial planners are less likely to find themselves under an obligation to "sell a quota of product". This can result in smaller financial planning practices being "safer" places to be serviced.

- **In small practices, the business owner generally has a personal relationship with his clients.** We believe this reduces the chance of unethical behaviour. In a large dealer, the business owner generally has no personal relationships with the clients of the business.

- **Generally, in smaller practices there are less clients per advisor.** This relates to the fact the businesses tend to be more advice-focused, rather than product sales focused. Again this leads to multiple benefits from a public protection angle because:-
  - the advisor tends to get to "know their clients" (as required) much better, increasing the chance of well-tailored, appropriate advice.
  - the advisor has a much better chance to educate his/her client (eg more fully be able to discharge obligation to ensure clients understand the relevant investment risks of the investment strategy.)
  - Again, the closer bond between client and advisor, the less likely the trust will be abused. The clients are more than simply a name on a register.

Bottom line: We believe that rather than disadvantaging small business financial licensees under the FSRA, related regulations and Policy Statements, the government would serve the public interest by creating positive incentives for experienced financial planners to take up their own Australian Financial Service Licence.

Background - who are the Boutique Financial Planning Principals Group Inc

We are an association of small security dealers, incorporated on 26th April 2002. We are all Principal members of the Financial Planning Association. We are a self-help association of small dealers, helping each other find practical

day-to-day solutions to issues faced by its membership.

We have felt that in recent times, the needs of **small independently-owned dealers** have not been heard, as **the financial planning industry has become increasingly dominated by large organisations who both manufacture and sell investment product.** While the needs of big dealers may have been adequately catered for in FSRA and related regulations, we have felt that without a voice, the FSRA issues which were damaging (or had potential to damage) small dealers were not being heard.

Working collectively on ***surviving*** the FSRA transition is a key catalyst for our association coming into existence and **assistance of our membership in this FSRA transition and ongoing compliance is the primary focus for our association over the next 2 years.**

Conclusion:

The above issue is the most burning issue for our association of small security dealers. In the interest of time, we are forwarding this submission now. We will follow this submission up, with a range of other issues in the next few days.

We trust the above points, will help the committee understand why greater business certainty should be available to small security dealers/small AFS licensees, and why focus is required to minimise the ongoing compliance cost for these businesses. **It is in the public interest, that there are healthy, thriving independently-owned, small financial planning businesses - providing quality service and choice to the public.**

Yours Sincerely

Bruce Baker

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Appendix A Higher & higher compliance burden does not necessarily lead to better outcomes for consumers.

Clearly compliance has a role to play to protect the consumer by minimising unethical, unscrupulous and incompetent practises. The key is finding the right balance. The key also probably depends on finding the right balance between regulation/compliance and investigation of consumer complaints.

At some point the extra compliance burden is counter productive - as it drives small businesses to the wall - reducing choice for consumers - and also increasing costs to those consumers. If the costs are going to be higher for consumers, we need to ensure have some reason to believe there is sufficient compensatory benefit.

We do not believe the government is trying to drive small dealers out of business. In fact, we have been led to believe that this government seeks to be supportive of small business. However, the government needs to ensure that when it drafts legislation, that the legislation is sensitive and supportive of small businesses who happen to be security dealers (Australian Financial Service Licensees under FSRA).

Regardless of how much compliance burden is created, there will always be some unscrupulous players. This is a simple fact of life.

Regardless of how heavy the compliance burden, unscrupulous players with good legal advice will always be able to design a complying business flogging product unethically. Unfortunately, the cost for this compliance burden is borne by the ethical advice-oriented advisors - and their clients.

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Merrill Lynch puts out peace proposals

Merrill Lynch has put the finishing touches on a formal proposal that it hopes will persuade New York Attorney-General Eliot Spitzer to not bring formal charges as a result of his 10-month inquiry into the firm's research practices, according to people close to the investigation.

The proposal, these people said, included the creation of an ombudsman and a separate committee to monitor Merrill's research, payment of a fine totalling tens of millions of dollars and an expression of some contrition.

Restitution for aggrieved investors who lost money on stocks Merrill analysts recommended, however, would be left to civil litigation on their behalf.

Another key element to the deal: Merrill would attempt to get other Wall Street firms to go along with similar plans as a way of attempting to restore investor confidence in the research process.

Ratings agency Standard & Poor's was later reported as saying that with a settlement imminent, it did not believe Merrill's credit quality would be affected.

The move comes only days after the two sides agreed on a "framework" for a possible settlement of allegations by Mr Spitzer that the big Wall Street firm misled small investors with overly optimistic research on stocks of companies that were also investment-banking clients, paying big fees to Merrill.

When the shares plummeted, investors lost large sums.

Merrill has denied the charges, but after Mr Spitzer released emails from analysts showing that they privately harboured doubts about companies that received higher ratings from the firm, shares of Merrill dropped nearly 20 per cent over the next few weeks.

The firm planned to present the proposal to Mr Spitzer's office before the weekend.

If he agrees to its terms, a final settlement could be reached in a matter of days.

Under the proposal, Merrill would agree to appoint an ombudsman to monitor its research department, as well as create a separate committee to keep tabs on the relationship between research and investment banking.

Analysts no longer would be paid based on how many investment banking deals they helped the firm generate; in fact, such deals would be specifically barred from being taken into account when the firm develops its end-of-year bonuses for researchers.

Analysts would still be able to accompany the firm's bankers when they meet potential investment-banking clients, as long as they were monitored by the new committee.

Merrill also agreed to make more disclosures about investment-banking relationships, so that investors would know of motives for a broker to be pushing a certain stock.

Merrill has also made it clear that it is willing to pay a significant fine as part of the process.

The Wall Street Journal

Andersen partner not told to shred

An Arthur Andersen partner testified on Friday that he did not consider another partner's presentation of the firm's document retention policy last October as "an instruction to shred Enron Corp-related documents."

Carl Bass, a Houston-based Andersen partner whose criticism of Enron's accounting prompted Enron officials to push to get him barred from consulting with Enron auditors earlier last year, said another local Andersen partner, Mike Odom, discussed the policy at an October 10 continuing education meeting for the firm's workers.

That was two days before in-house Andersen lawyer Nancy Temple sent Mr Odom an email from the firm's Chicago headquarters reminding workers of the policy.

"He did talk about emails and stuff like that, but I don't recall the entire presentation," Mr Bass said. He said no one ever suggested that he get rid of emails and other documentation of his disapproval of some accounting approaches that fuelled Enron's descent into bankruptcy last year.