Q Invest

PO Box 15318
City East
Queensland 4002
> T 07 3008 8100
F 07 3008 8111
Toll Free 1800 643 893
qinvest.info@qinvest.com.au
www.qinvest.com.au

31 July 2009

Committee Secretary, Parliamentary Joint Committee on
Corporations and Financial Services
Department of the Senate
PO Box 6100 Parliament House
CANBERRA ACT 2600

Dear Sir/Madam

SUBMISSIONS TO PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA

Thank you for allowing us the opportunity to present the following submissions in relation to the Parliamentary Joint Committee's Inquiry into Financial Products and Services in Australia.

About Q Invest

Q Invest is jointly owned by the Board of Trustees of QSuper and QIC.

Established in 1994, our business provides cost-effective and accessible financial planning advice to the members of Queensland's public sector superannuation fund (QSuper). We also provide advice to members of First State Super in New South Wales, operating under the trading name *FSS Financial Planning*.

We hold an Australian Financial Services License in our own right and are responsible for training and supervising our advisers.

We operate under a fee for service model and rebate product commissions to our clients wherever the product makes this is possible.

In the financial year ended 30 June 2009, Q Invest assisted more than 10,000 clients make significant financial decisions about personal assets valued at more than $3 billion.

Our advisers assist clients with financial planning strategies that cover superannuation and retirement incomes, managed investments, managed accounts, margin loans and personal insurance. In addition to information and education, our advice capabilities extend from single issue, telephone-based limited advice to comprehensive, private client services.

Between March 2002 and March 2009, we were the responsible entity for a suite of managed investment schemes collectively known as the *Investment Access Funds*.

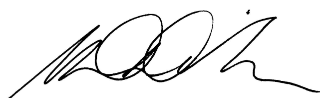
The table below summarises our recommendations to the inquiry:

Recommendation #1:	Government should resist the temptation to introduce further regulation, which will only serve to ultimately disadvantage consumers of advice.
Recommendation #2:	ASIC should strive for a primarily preventive function, through greater monitoring, supervision and enforcement of obligations imposed on AFS licensees and others falling within its jurisdiction.
Recommendation #3:	ASIC should review Regulatory Guide 126 with a view to imposing less prescriptive requirements for professional indemnity insurance.
Recommendation #4:	Industry bodies such as the Financial Planning Association should be encouraged to similarly increase greater monitoring and supervision of their members, and impose heavy sanctions for serious non-compliances. In this way, the industry body should behave more like a professional standards council.
Recommendation #5:	Financial advisers should embrace the idea of being fiduciaries for their clients in order to justify their status as true professionals.
Recommendation #6:	Government should make fees for financial planning advice tax deductible for individuals and/or employers who may pay them on behalf of their employees.

More information

Our detailed submission is enclosed, however if you should require further information or clarification of any matter, please do not hesitate to contact our office.

Yours faithfully



Bill Danaher
General Manager

PO Box 15318
City East
Queensland 4002
> **T** 07 3008 8100
F 07 3008 8111
Toll Free 1800 643 893
qinvest.info@qinvest.com.au
www.qinvest.com.au

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TERMS OF REFERENCE

We provide our comments in relation to the various terms of reference in the sections that follow.

1. The Role of Financial Advisers

We believe financial advice can play a pivotal role in helping ordinary consumers make important decisions about their financial assets. Skilled financial advisers should be recognised as being among those best placed to effectively guide consumers through the opportunities, risks and obligations inherent in managing financial strategies.

There can be no doubt that financial advisers have played a key role in recent financial product and services provider collapses, such as Westpoint, Storm Financial and Opes Prime.

The financial planning industry, in particular, should be beyond debating whether or not financial advisers are fiduciaries. In order to be recognised as professionals, financial advisers need to embrace unconditionally the notion that they should be held to a higher standard of care in their dealings with their clients. Those who fail to do so are not only ignoring reality, but are inadvertently perpetuating the belief among large cross-sections of the community that financial advisers are merely product salespeople.

In our view, most participants in the financial services sector willingly comply and apply their best endeavours to meeting their obligations.

We question whether additional disclosure obligations would have saved investors from the collapses we have witnessed.

In our opinion, enforcement and appropriate action in terms of the spirit of those obligations is what was missing.

Our assessment from the information made public suggests those advisers associated with the corporate collapses operated largely as intermediaries, being rewarded for their sales skills rather than their professional counsel.

It is trite to state that financial advisers *must* place their clients' interests ahead of their own or their employer's, which is the essence of being a fiduciary.

2. The general regulatory environment for products and services

It is well recognised that the financial services is a heavily regulated industry. In fact, the Federal Government's Taskforce on Reducing Regulatory Burden on Business had previously expressed concerns in relation to over-regulation and the high compliance costs introduced by the *Financial Services Reform Act* 2001 (*Rethinking Regulation*, January 2006).

The number and spectacular nature of the collapses of financial services institutions since the introduction the Financial Services Reforms only serves to highlight the fact that increased regulation is not the answer to our current problems.

There following references illustrate the point.

> St James Ethics Centre director Simon Longstaff: "The root cause of the problem is not a failure of regulation, but of ethics." ("A return to ethics", Investor Daily, 23 April 2009).

> Hyperion managing director Manny Pohl: "More regulation will just add to the heavy burden carried by the good guys, while the bad guys will continue to obfuscate the truth." ("A return to ethics", Investor Daily, 23 April 2009).

> Former ASX chairman, Maurice Newman: "I think the moral hazards, which are being created in the United States right now – the idea that more oversight, more regulation, the automatic default whenever there's problem will get you out of trouble – is only going to make the problem worse." ("Former ASX boss says regulation not the answer", *Business Spectator*, 28 September 2008).

In our opinion, the answer lies in greater preventative action in the form of:

1. Elevation of entry standards and qualifications required for financial advisers by the financial planning industry;
2. Greater levels of monitoring, supervision and enforcement by ASIC; and
3. Greater levels of monitoring and supervision of their members by the relevant financial planning industry bodies, and increasing visibility in imposing sanctions to those who contravene rules.

The world's best regulatory and disclosure regime will not, in itself prevent inappropriate conduct or individual operators taking advantage of a consumer's dreams or naïve trust.

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

There is nothing inherently wrong with commission-based remuneration provided that there has been full and frank disclosure to clients. The practical reality, evidenced by the matters under the inquiry's terms of reference, is that such arrangements create a conflict of interest for financial advisers. In practice and regardless of the success of those who have managed them, they have proven to be very difficult for many to effectively (and honestly) manage.

It is indeed a truism that "No man can serve two masters" – and this is more so in the financial planning industry. As an industry, financial advisers are at a crossroad and each of us needs to honestly decide: Who is our master – the client or the product issuer? Experience has shown us that attempting to serve both places the financial planner in an untenable position. It is only by fully embracing the fiduciary obligation of placing the client's interests first – which is the very essence of being a professional – that financial planners will be recognised as true professionals.

ASIC's recent decision to place adviser remuneration under the microscope would be a step in the wrong direction if it simply examines remuneration structures without considering the fundamental issue of conflicts of interest.

We do not consider it appropriate for financial planners to base their remuneration on a percentage of assets as this necessarily results in different clients being charged differently for substantially the same level of service. This inequitable practice dilutes the value of advice by perpetuating the notion that financial planners are product distributors and it should be avoided.

4. The role played by marketing and advertising campaigns

We have no difficulties with product and service providers promoting their wares. This is a fundamental principle of a free market. It becomes problematic when conduct becomes misleading and deceptive or is rewarded by short term sales incentives.

We believe this is an area where ASIC should increase its intervention – perhaps not by dictating the specifics of what must be disclosed but rather by illustrating and offering guidance on those elements of disclosure which it will prosecute. The regulator's attention must go the substance of what is being said about performance, for example, rather than the form of disclosure.

While most financial advisers' intentions are well-meaning, the current inquiry is looking at behaviour driven by an undeniable side of human nature: that financial incentives such as marketing allowances and high commissions can, and too often do, drive advisory behaviour. We need not look further than the Westpoint debacle and the Storm Financial collapse to see that.

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

Licensing arrangements are not the panacea. Failed operators have been able to easily satisfy the AFS licensing obligations by entering into Authorised Representative agreements with AFSL holders and continuing to operate with a great degree of autonomy.

Increased licensing obligations also create a false impression in the mind of consumers that the licensees are "ASIC-approved" or that they will necessarily be honest and competent because they are appropriately "licensed".

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

While advisory deficiencies (discussed above) have been a major contributor to the recent collapses, affected consumers, too, must accept some level of personal responsibility for the failure of their investment decisions.

At every point investors should take account of their own responsibilities when they make decisions. As Maurice Newman is quoted "there is no magic pudding, the government

can't bail you out of everything." ("Former ASX boss says more regulation not the answer", *Business Spectator*, 28 September 2008).

There as been much written about whether the current regulatory regime has delivered effective disclosure. Given the extent to which the dialogue continues, it could be argued that the answer is "no". To this point, it is not outside the realm of possibility that a less enlightened operator might rely on disclosure in strict accordance with the letter of the law simply with a view to obfuscating the inherent flaws in the actual recommendations being made.

In our opinion, the key issue is conflict of interest.

We have enjoyed a climate of mandated continuous disclosure since the Financial Services Reform Act in 2004, yet the behaviour of some participants brings the entire financial services sector into disrepute. Financial advisers seem to have borne the brunt for many of the recent failings.

We suggest the most effective solution is to avoid conflicts of interest in the first instance. Of course, there will be occasions where conflicts cannot be avoided. In these cases, they must be clearly and simply disclosed. However, if a business practice cannot be understood and accepted by a reasonably informed consumer, one would have to question the purpose for which it exists.

Perhaps it is appropriate to mention that the dilemma we currently face is not one confined to financial planners alone. In the past, other professions have struggled to manage similar financial incentives - such as doctors with pharmaceutical companies, lawyers with referral partners and auditors with non-audit clients. The difference, however, lies in the fact that each of these professions have elected to adopt the high moral ground as the only means of ensuring that their reputation as a group remained intact. The reputation of the sector and those operating in it is something that we cannot allow to be (further) compromised given its increasing importance to the long term retirement adequacy of most Australians.

7. Consumer education and understanding of these financial products and services

There is now an abundance of informational and educational material available for consumers for free – whether through the internet, government agencies, industry bodies and financial services firms.

The key issue lies, however, in the ability of consumers to process this information in the context of their personal circumstances. That Government commits resources to consumer financial literacy projects such as *Understanding Money* and *FIDO* is good policy. That Government also feels obliged to do this so that consumers might come to recognise what they do not know, says just as much.

While ASIC has done much with its consumer education, in our view, consumers simply do not know what to look for. The financial services sector is layers of legislation, participants and products with multiple fee structures. Its inherent complexity makes it difficult and unattractive for consumers to access, and licensees to provide convenient advice solutions to simple problems.

Simply adding more regulation will not solve this challenge however better application and simplification of regulation might.

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

Most financial advisers are currently experiencing significant increases in their professional indemnity insurance premiums, which is predicted to force many of them out of business even when their services provide genuine value for clients.

In our view, ASIC needs to impose less specific and prescriptive requirements for professional indemnity insurance in Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees (RG 126).

Section 912B of the Corporations Act 2001, when combined with Regulation 7.6.02AAA of the Corporations Regulations 2001, makes it clear that it is entirely for the AFSL holders themselves to determine appropriate insurance coverage for their business provided it is "adequate".

Current ASIC guidelines, however, are too prescriptive and make it virtually impossible for licensees to negotiate terms with their PI insurers, paving the way to increased insurance premiums being charged by the insurers.

Unreasonably high insurance expenses decreases competition in the market place which, while beneficial to larger firms, only serves to disadvantage consumers in the long run as fewer options become available and higher fees are charged in a less competitive environment.

The ACCC's Public liability and professional indemnity insurance – Fifth monitoring report (July 2005) has revealed that the average size of professional indemnity claims has been increasing continually since 1997 despite greater levels of regulation being introduced over that period of time. To believe that imposing higher insurance limits would benefit consumers would be misguided. The limit of liability that would have been required to fully satisfy the catastrophic losses recently incurred by a handful of licensees would have imposed an unreasonably heavy burden on the rest of the industry if such a limit was imposed universally.

9. The need for any legislative or regulatory change

There is no need for further legislative or regulatory change at this point in time. Both common law and statute law already offer a plethora of possible causes of action for consumers who have been adversely affected by poor advice or service from financial advisers. These include, for instance:

- Misleading and deceptive conduct (s1041H *Corporations Act*);
- Dishonest conduct (s1041G *Corporations Act*);
- False and misleading statements (s1041E *Corporations Act*);
- Common law negligence (breach of duty of care);
- Breach of fiduciary obligations (including disclosure of conflicts); and

- Breach of contract (including breach of certain conditions implied by statute).

The decision in *Newman v Financial Wisdom Limited* [2004] VSC 216 has served to reinforce the high degree of care that financial advisers must exercise in serving their clients' interests. Note also the Queensland District Court decision in *Evans v Brannelly* [2008] QDC 269.

The situation is well understood within the legal profession, which is why experienced financial services lawyers have argued strongly against introducing further regulation – in the context of whether specific definitions around salespeople and advisers were required.

What is required is greater exercise of powers by regulator and industry bodies.

Excessive regulation has a number of significant negative side effects:

1. It creates a 'tick box' mindset on the part of many licensees who get lost in the detail and fail to see the bigger picture;
2. It creates a false impression on the part of consumers that all licensed operators must be honest and competent; and
3. It increases compliance costs which are ultimately borne by the consumer.

The increase in compliance costs also militates against the Government's policy of making advice affordable for all consumers.

SUMMARY

In summarising our position we make the point that the heads and staff of businesses make choices about the way those businesses will operate. These choices will range from the target market, sales processes, the products approved for advisers' use to the skills and training delivered to advisers.

Putting aside remuneration issues, the tradition has been to focus financial products and services on clients of net worth. Choices have been made that see individuals with high incomes and those with lump sums at, or approaching, retirement being given particular emphasis.

In the process of making the choices mentioned above, the reality has been that the cost of regulation through prescriptions of disclosure, insurance and general compliance has compounded the focus on clients with better than average net worth. The expense incurred in dealing with clients with limited assets has been uneconomic for businesses striving to meet rational business goals that include delivering shareholders a return on their investment.

In our view, most licensees when given the opportunity have, and will, choose a high balance client over a low balance client. In doing this, the traditional financial advice business model has seen services designed, priced and delivered to maximise the business potential of those clients with greatest perceived capacity to pay.

Q Invest counters this by advocating the delivery of quality advice in ways that make it affordable and accessible to those who need it. The growing importance of individual ownership of

retirement planning outcomes is entrenched in public policy. This suggests that good financial advice approaches the status of a public good, in a similar vein to healthcare. The value and opportunity for consumers (regardless of their income, asset base or occupation) from relevant, effective personal financial advice should not be underestimated.

The relief contained in ASIC Class Order [CO 09/210] Intra funds superannuation advice serves as a simple illustration of the effects of regulation. It is somewhat paradoxical that the regulator had to make an *exception* to the law to allow (some) licensees to meet some consumers' reasonable needs in a compliant manner.

It is Q Invest's submission that licensees should be encouraged to pursue flexible, cost-effective service delivery because these things are right for consumers. Meeting consumers' reasonable needs should foster innovation. This will not be served by greater and more prescriptive regulation.

Our recommendations to the Committee follow.

OUR RECOMMENDATIONS

Recommendation #1: Government should resist the temptation to introduce further regulation, which experience has demonstrated only serves to disadvantage the consumers who must ultimately bear the additional compliance costs incurred by licensees. The fact that ASIC recently considered it necessary to issue class order relief to superannuation fund trustees from complying with section 945A of the Corporations Act in the provision of intra-fund advice – in the interest of making advice more accessible to members - only serves to highlight the practical difficulties that had been caused by the legislation in the first place.

Recommendation #2: ASIC should strive for a primarily preventive function, through greater monitoring, supervision and enforcement of obligations imposed on AFS licensees and other entities falling within its jurisdiction. The reality is that there are enough laws in existence to cover every conceivable instance of misconduct within the financial services industry today. It needs to be recognised, therefore, that what we need now is a regulatory body who will be ready, willing and able to take the necessary steps to ensure that all the participants in the industry are complying with those laws.

Recommendation #3: ASIC should review Regulatory Guide 126: *Compensation and insurance arrangements for AFS licensees* with a view to imposing less prescriptive requirements for insurance. The current requirements, whilst innocuous at first glance, overlook certain commercial side effects which have a deleterious effect on competition, affordability and, ultimately, the cost of advice borne by consumers.

Recommendation #4: Industry bodies should be strongly encouraged to similarly increase greater monitoring and supervision its members, and be highly visible in the imposition of heavy sanctions for serious non-compliances and

repeat offenders. In this way, the industry body should behave more like a professional standards council.

Recommendation #5: Financial advisers should embrace the idea of being fiduciaries for their clients in order to justifiably be recognised as true 'professionals' in today's society. Those who eschew the burden of fiduciary duties will risk being perceived by members of the public as nothing more than "product floggers".

In the ICAA's 2007 paper "Reinventing financial planning", Robert M.C. Brown noted a strong ethical base, credibility and trust are key in defining a profession. We suggest that where any one of these is compromised, particularly at a systemic level, the participants can never hope to be recognised as professional, despite their best intentions.

Recommendation #6: Government should make fees for financial planning advice tax deductible for individuals and/or employers who may pay them on behalf of their employees.

There is a clear public policy benefit to be gained by encouraging consumers to seek professional advice to prudently plan their financial future – and financial independence. Secondly, many remuneration structures which operate on a commission model effectively enable a tax deduction to be claimed for the commission payment, thereby providing an incentive to pursue the type of remuneration model associated with some of the recent collapses.

Government may also consider providing a mechanism for advice to be subsidised to low income earners, as a means to make professional advice available to those with the greatest need, but the least ability to afford it.