BFPPG

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BFPPG Submission relating to
"Corporate & Financial Services Regulation Review" April 2006.

Corporate & Financial Services Regulations Review
Corporate & Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

19 May 2006

To whom it may concern

In it's bluntest terms, we see Chris Pearce's APRIL 2006 call for submissions on FSR refinements version 2 as looking for recommendations on how the regulatory environment can achieve the government's visions of a "principle-based system of disclosure, supervision and education" (Money Management 11/5/06 Page 3).

In this package, we provide:

- Our **cover-letter** with a summary of the key issues and a set of key recommendations. However, given the magnitude of the task to properly review, assess and provide feedback on all aspects of FSR regulation, we provide some specific recommendations plus some philosophical approaches that we believe need to be applied across the board to the current FSR regulatory regime.
- Our **submission** itself, which argues the case for some of the specific regulatory issues which cause us concern. This submission follows the coverletter.

The task of pruning FSR compliance back to a manageable, optimally-focused regulatory regime is actually quite huge. These are the issues as we see them:

- **Compliance under FSR has turned into a monster for small dealers.**
  - ASIC policy statements by themselves are a forest of trees - and there is a wealth of other compliance obligations and compliance burdens.
  - Compliance has come to dominate the small dealer's business and is a huge cost of these small businesses.
  - This means that responding to Chris Pearce's request for submission on FSR V2, is like contemplating a forest and working out which few trees we might be able to chop down in the time available. This goes to the question of ***"just how serious is Chris Pearce in paring back the unreasonable level of compliance burden created by FSR?"***.
  - Because the regulatory regime under FSR is written on a forest of trees far bigger than any small dealer could ever really do justice to, it is clear that the only way to prune the regulatory under FSR back to manageable proportions, is with a team of people with chain-saws, taking FSR back to the underlying principles which have been obscured by layers of

check-boxes.

- **Form has become the requirement rather than substance** - AND this is bad for consumers whose objective is good advice - that is, consumers want substance and not form.
  - That form has become the requirement,
    - is very anti advice-focused advisors who tailor advice to individual clients
    - is very pro the product-distribution model of the big financial planning subsidiaries of the big product providers.
    - This is also bad for consumers because it does not support what Chris Pearce can clearly see consumer's are looking for when he said in March *" ... Australians are increasingly wanting professional, objective advice – not just product sales advice."*
  - There are many losers from the advent of FORM becoming more important than SUBSTANCE:
    - Consumers are loses because while they might be getting wonderfully compliant looking advice, there is no focus on policing of the quality of advice – and the advice is more expensive then it should be.
    - Small dealers are loses because this regulatory emphasis directs our energies and resources into labour which does not benefit consumers – just adds costs to them.
    - The only winners of FORM over SUBSTANCE are dealers who wish to hide the substance (or lack thereof) of their advice behind advice with compliant form.
  - **For the benefit of consumers, the solution to this problem needs to be a MASSIVE refocusing of the regulatory priorities from FORM to SUBSTANCE!**

- **The huge fundamental flaw in FSR compliance is that it is focused on PROCESS and not OUTPUT.**
  - FSR seeks to regulate for good advice - or at least regulate against bad advice - and as FSR is constructed, the regulator could use FSR to focus on that objective.
  - But instead it (or at least ASIC's focus) seeks to focus its regulatory activity on process - and fails to focus on policing advice output.
  - This is a very serious flaw because
    - High-quality highly-documented process (eg in a big dealer) can manufacture poor advice.
    - Informal processes in a small, one-location dealer can craft very high quality advice.
  - In summary this is a very very very serious problem - and why, without refocus of the regulatory environment:
    - FSR will FAIL to deliver significantly more that Corporations Law did before FSR, unless there is a change in emphasis and focus to OUTPUT rather than PROCESS
    - FSR will reduce consumer choice - as it is policed more tightly over time (because there is a grave risk ASIC's FSR regulation may eventually crush many small dealers)
    - FSR will simply add cost to consumer advice without producing better results.
    - But if it makes everyone feel better, under ASIC's approach to regulation it will be easy to hang dealers for not ticking boxes (which it seems is ASIC's measure of success of getting rid of bad dealers), but from a consumer benefit perspective it will probably be hanging many of the WRONG dealers – and thus give the consumers are poor result.
    - Further, such poor regulatory focus (lack of focus on the important issues) will over time, diminish consumer's confidence in the system – and thus FSR will not achieve the government's objectives without change.

SUMMARY

In summary then, let us define the philosophical approach that needs to be taken to refocus FSR to achieved the desired outcomes more effectively and with less undesirable side-effects:

- All regulatory measures (including in AFS licence conditions)
  - need to be re-focused onto SUBTANCE and not FORM
  - need to be re-focused onto OUTPUT not PROCESS
- Specific measures need to be put in place to cultivate and support the growth and development of the professional objective advice segment where there is no conflicting relationship that might bias the advice (eg dealer owned by product provider).
  - And since the provision of such advice is dominantly in the small dealer segment, specific provisions need to be provide to
    - ⇨ support experienced professional advisors obtaining their own AFS Licence where they wish to move away from the conflicted environment's of a dealer owned by a product provider
    - ⇨ continue to monitor the cost and compliance burden for small dealers – and the level of business uncertainty created by the excess regulatory complexity.

Specific actions we are recommending include (to provide examples of the changes that are needed):

- Remove the highly prescriptive ongoing training requirements defined in PS146 and replace this with
  - reliance on Corporations Law Section 912A(1)(f) that AFS licencees *"ensure that its representatives are adequately trained, and are competent, to provide those financial services"*
  - AND assessing the advice OUTPUT produced by licencees on the following legal requirements which need to be ENFORCED. These requirements are:
    - ❖ well established **common law** obligations in terms of negligence, duty of care; etc.
    - ❖ The **Corporations Act 2001** requirement that:
      - ☆ there was a reasonable basis for the advice and the advice was reasonable in the circumstances. Section 945A
      - ☆ a licencee must "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" s912A(1)(a)
    - ❖ The **ASIC Act 2001** provision for protection in respect of:
      - ☆ Misleading or deceptive conduct. Section 12DA.
      - ☆ False or misleading representations. Section 12DB.
      - ☆ Requirements to apply "due care and skill", and that advice is "fit for the purpose".Section 12ED

- Removal of PS166 and related provisions in the licence conditions – as discussed in our attached paper.
  - Failing removal of PS166 and related licence conditions, if PS166 is to remain that goodwill should be able to be counted for cash flow purposes, to the extent that a financial institutions are prepared to lend against the goodwill.

- That the word "independent" (currently effectively outlawed by ASICs' interpretation of the law) be reviewed to allow a much broader segment of advisors to use this term, so consumers could more readily recognised the a non-aligned advisors from a financial planning subsidiary of a product provider.

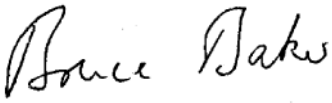
- Further, that the following practices be policed heavily:
  - Financial planning subsidiaries calling themselves independent – this abuse seems quiet common.
  - Corporate authorised representatives and authorised representatives (running their own businesses) grossly underplaying the fact that they operate under the licence of an AFS licencee which is a financial planning subsidiary of a product provider. There are a range of variations of this abuse which seems not to be policed currently.

- A variation of this is even the “find a planner” facility consumer's use on the FPA web site, which discloses the advisors business name rather than the name of the AFS licencee that they are authorised through.
- However, this issue clearly extends to business cards and business signs.

❒ That breach reporting be discarded. ASIC resources should be focused on policing advice-output using the tests in the law discussed above.

❒ That PS164 be reviewed with a view to reducing the compliance burden on small dealers. While the ideas expressed in PS164 are good, these ideas should have no more gravity than exactly that – guidance on a way that the law might be implemented. The focus should be on the broad intent captured in Corporations law itself.

Yours Sincerely



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Who is the Boutique Financial Planning Principals Group (BFPPG)?

The Boutique Financial Planning Principals Group Inc (BFPPG) was formed to give a voice to small, independently-owned financial planning businesses which in the main, are in the tailored-advice business rather than the product sales business. Since members of the BFPPG are not associated with any product vendors and are in the advice business rather than the product sales business, we believe that our goals are fairly closely aligned with the needs of consumers and the intent of the law. Most of the BFPPG membership consists of businesses comprising only 1, 2 or 3 advisers – being small family-owned businesses.

One of the key goals of the BFPPG is to give feedback to ASIC and the government about how best to achieve their goals for consumer protection while ensuring the law is practical and workable at the coal-face.

We believe that it is crucial to consumer choice that the legislation does not disadvantage or damage small dealers (small business AFS licensees), which is the sector of the financial advice market which is independent of the product providers. It is also the sector of the advice market that is a rich source of alternate and highly personalised styles of financial advice enabling consumers to find a style of advice which suits them.

Many of the most experienced financial planners work in boutique financial planning firms because they believe this provides an environment where they can best serve their clients. 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.

However, as FSRA regulation now stands, to the disadvantage of the consumer, FSRA creates a bias in favour of big product-distribution financial planning businesses which tend to be subsidiaries of the large product providers.

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Introduction.

We present below an assessment of FSR from the small independently-owned advice-focused segment of financial planning professionals. The impact of FSR has been disproportionately larger on small independently-owned advice-focused dealers compared with FSR's impact on the large highly-resourced product-distributor subsidiaries of the large product providers.

We note and appreciate Chris Pearce's comments at the May 2006 Canberra AIOFP conference where Chris was reported at saying *" ... Australians are increasingly wanting professional, objective advice – not just product sales advice."*

We, as representatives of the objective-advice providers of the financial planning profession, provide in this submission, an assessment of FSR's implementation and some pointers to how the government and ASIC can support, encourage and cultivate the objective-advice segment of financial planning, in the interests of all consumers.

Overall assessment of consumer protection under FSR – and summary of FSR.

The strength of the Financial Service Reform (FSR) Act is, as previous Federal Ministers have stated, that FSR is very largely principle-based law. The weakness of FSR is that much of the regulatory implementation of FSR is not principle-based.

Reference: In 8th March 2004 AFR, **Ross Cameron** was quoted as saying that the Financial Services Reform Act ***(FSRA) "was designed to be a 'light touch principles-based approach' to regulation."***

To put this into perspective, let us remind ourselves that FSR is there to help protect consumers. However, it must also create an environment where consumers can get affordable advice. Further in implementing FSR, ASIC needs to comply with the ASIC Act 2001 which says in Section 1 (2) (a) that ASIC must strive to provide *"commercial certainty"* and have a goal of *"reducing business costs". (Ref Appendix A for the specific words in the ASIC Act).* Pleasingly, all these objectives CAN be achieved under the **principles in FSR & Corporations Law** – but at the moment, the regulatory environment does not meet these standards.

So let us start at the most important place by reminding ourselves **under FSR, what are the most valuable consumer protection measures are.** We have always argued that the primary, most important and most valuable consumer protection necessarily must come from:

- well established **common law** obligations in terms of negligence, duty of care; etc.
- The **Corporations Act 2001** requirement that:
  - ⇨ there was a reasonable basis for the advice and the advice was reasonable in the circumstances. Section 945A
  - ⇨ a licencee must "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" s912A(1)(a)
- The **ASIC Act 2001** provision for protection in respect of:
  - ⇨ Misleading or deceptive conduct. Section 12DA.
  - ⇨ False or misleading representations. Section 12DB.
  - ⇨ Requirements to apply "due care and skill", and that advice is "fit for the purpose".Section 12ED

FSR's primary additional valuable contribution came from disclosure of factors which might influence.

The above consumer protection measures are very powerful tools. **Clearly the very biggest impact ASIC can have in consumer protection is to monitor advice and to ENFORCE the above measures of consumer protection – but this will require re-focus and re-prioritisation within ASIC.**

Problems with implementation of FSR.

ASIC Policy Statement issues.

Let us review ASIC's implementation of FSR Section 912A (see Appendix B) to see how well it does on the consumer-protection criteria defined above.

- Section 912A(1)(d)
  - *"unless the licensee is a body regulated by APRA—have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements"*
  - The main part of ASIC's response to this is **PS164**. Our assessment of PS164 is as follows:-
    - PS164 is a highly prescriptive, very detailed compliance regime which:
      - may define a very appropriate way for large dealers with many offices and hundreds of representatives to comply with Section 912A(1)(d).
      - However, PS164 imposes a very major and disproportionate cost impost on the small independently-owned advice-focused sector. Generally these small dealers have less than 5 representatives, they work from a single office and the principal is one of those representatives, enabling the principal to have a very close ongoing supervisory-relationship with his/her representatives. Further, these small dealers tend to have long-term regular-and-ongoing advice-relationships – whereas the large product distributors tend to more transaction driven.
      - This is a clear case where one-size-fits all policy is not appropriate. Small dealers can clearly see the intent in the words written in Section 912A(1)(d) and simply should be assessed on that.
  - A secondary part of ASIC's response to this is **PS166**.
    - **ASIC's policy statement PS166 is self-defeating** – and as such should simply be removed. The thinking behind PS166 was (according to ex-ASIC Pauline Vamos) that if a AFS licencee has a cash flow problem (i.e. is financially stressed), they are more likely to commit fraud on their clients. This may be so, but clearly an AFS licencee that is in the process of committing fraud on their clients is unlikely to report a PS166 breach to ASIC. So **PS166**, is self-defeating i.e. It is a compliance cost without consumer benefit – and yet it is a licence condition.
    - A specific PS166 issue. PS166 disallows counting goodwill as as asset under PS166 for purposes of cash flow calculations.
      - **Proposal** if PS166 is to remain:
        - **That goodwill should be able to be counted for cash flow purposes, to the extent that a financial institutions are prepared to lend against the goodwill.**
          - Please note that this proposal does not in any way defeat the intent of PS166. Rather, this proposal would simply iron out a problem in the implementation of PS166, a problem relating to an aspect of PS166 which does not seem to have been adequately thought through.
          - This proposal would help growth of independently-owned AFS licencees, which Chris Pearce seems to recognise the value of from a consumer-benefit perspective.
      - **Background:**
        - this situation is best illustrated by example. An existing small dealer (AFS licencee) wishes to extend their business by purchasing a life insurance practice. However, the goodwill of the life insurance practice cannot be used as part of cash flow calculations under PS166.
        - The impact of this is position is that smaller players have difficulty in competing for the purchase of existing practices. In turn this leaves some aligned advisers with little choice but to accept the Buyer of Last Resort option offered by their institution licenses when exiting the industry. Buyer-of-Last Resort facilities are seen to be undesirable conflicts of interests, yet this aspect of PS166 facilitates and supports such facilities.

- Section 912A(1)(e)
  - *"maintain the competence to provide those financial services"*
    - Covered in **PS164 & PS146**

❒ **Section 912A(1)(f)**

- *"ensure that its representatives are adequately trained, and are competent, to provide those financial services"*
- ASIC's response to this is PS146. Our assessment of **PS146** is as follows:-
  - ⇨ ASIC's policy statement PS146 seeks to excessively micromanage training and in particular ongoing training requirements.
- Refer to Appendix A of PS146 (and PS146.109) to see clearly (from a small dealer perspective) the excessive nature of ASIC's attempts to micromanage the ongoing training obligations. For small dealers operating in one location, a much more informal approach to meeting the principle outlined in Section 912A(1)(f) is appropriate.
  - ⇨ Appendix C of this document contains the summary component of Appendix A from PS146
  - ⇨ Appendix D of this document contains an appendix from a widely used commercially-available monthly education video.
  - ⇨ We note:
    - That while ASIC policy statements are meant to be just that – policy guidelines, PS 146 has taken on a greater gravity than this.
    - That
      - ❖ while this degree of ongoing education prescription might be suitable for a large product distributor with a representative force averaging very little experience in our industry – so as to ensure compliance with the letter and principles in the law,
      - ❖ this degree of prescription is not appropriate for small dealers who operate from a single location with generally less than 5 reps (more commonly 3 or less reps) and where the representatives and particularly the principals of the practice, usually have in excess of 10 years experience in giving advice.
        - ✰ Generic highly-prescriptive training regimes are far from the most appropriate ongoing training for these highly experienced professionals.
        - ✰ *In fact this forced generic ongoing training is anti-competitive because it simply imposes extra costs on these small dealers (disadvantaging small dealers in favour of the big product distributors)*
        - ✰ *AND these small dealers then still need to undergo the sort of APPROPRIATE ongoing education that they otherwise would, so as to continue to deliver high quality advice to their clients.*
- We are therefore identifying (from a **small dealer perspective**) **business uncertainty** because of excessive and un-necessary complexity being generated by PS146 here AND we are identifying excessive and un-necessary cost burden on the small dealers who tend to dominate the independently-owned (non-aligned) segment of financial planning advice.
- **Consumer impact** of PS146.
  - ⇨ There is no consumer benefit from the excessive prescription on ongoing education.
  - ⇨ There is potential consumer harm because it adds excessive cost to receiving advice from non-aligned service providers who are mainly small businesses.
  - ⇨ PS146 is anti-competitive against small independently-owned advice-focused highly-experienced dealers as discussed above because it seeks to impose an inappropriate ongoing education program on these small dealers in favour of the big product distributors. This is partly because PS146 has taken on a gravity in excess of the policy guideline that an ASIC policy statement should carry.
    - **Note:** ASIC has magnified the gravity of PS146 through the AFS licence condition titled ***"Training requirements for representatives"*** which also covers ongoing training requirements.

❒ **Section 912A(2)**

- "membership of one or more external dispute resolution schemes that is, or are, approved by ASIC in accordance with regulations made for the purposes of this subparagraph"
- ASIC response to this is PS139.
  - ⇨ FICS is the dominant external complaints resolution scheme and we understand that ASIC is reluctant to approve additional external complaints resolution schemes.
  - ⇨ As small dealers, our concerns with FICS are currently being formally documented and submitted to FICS for discussion. A copy of these complaints can be provided under a separate cover. However, our complaints with FICS stem from the fact that

- For the large product distributor financial planning firms, complaints through FICS are just a cost of doing business. In contrast, for small business AFS licencees, a complaint through FICS can be a devastating experience even where the AFS licencee is not at fault.
- Further
  - that FICS is increasingly seeking to extend its jurisdiction well beyond issues relevant to Corporations Law. FICS is using Corporations Law to lock members (including the majority of non-voting members) into membership, but then to extend its jurisdiction well beyond Corporations Law. This we would argue is abuse of the intent of the law. This is a bit like 3rd line forcing under Trades Practices Act.
  - that there is no independent appeals mechanism to allow a licencee to appeal a determination by FICS. This is problematic because:
    - there is a question of fairness and natural justice being in decisions brought down by FICS.
    - FICS has become a defacto law-maker in determining key principles of what is good advice – without adequate means for those decisions about these principles being properly tested. In this area we believe FICS has made some serious and important errors of judgement in it decisions.
  - that the FICS process is a complex process that imposes unreasonable costs on disenfranchised small licencees.
  - that small disenfranchised AFS licencees are charged excessive membership fees compared with large enfranchised members.

➢ **Note:** In Appendix G, we enclose some ideas for improvements in the complaints resolution environment.

⇨ For example, it is important that structural sources of consumer problems be identified, so as to improve the overall advice environment for consumers.

Summary of problems with other ASIC policy statements:

❒ PS 175 Licensing: Financial product advisers — Conduct and disclosure

➢ ASIC clearly acknowledge this document is now out of date, but at June 2005 had no plans of updating it. As such this document is now potentially misleading – and therefore problematic.

❒ Policy Statement 181 Licensing: Managing conflicts of interest

➢ No recommendations at this point.

❒ Policy Statement 182 Dollar Disclosure

➢ No recommendations at this point.

How has ASIC converted principles-based FSR into an excessively complex compliance-based regime?

There are two primary mechanisms that ASIC has used to achieve this result. These are:

- ASIC policy statements and
- AFS Licence conditions.

From a small dealer (small business) perspective, would like to suggest that the compliance burden and **the sheer volume of compliance has simply got out of hand.** *A few lines of FSR principles have turned into a forest of policy statement check boxes.* Just consider this:

➢ Section 912A(1)(f) - ASIC has turned 1 line of law has become 53 pages of PS146 policy statement

➢ Section 912A(1)(d) + Section 912A(1)(e). ASIC has turned 4 lines of law into 61 pages of PS164 policy statement plus 74 pages of PS166 policy statement.

➢ ***Running total:*** ***Please note the five lines of principles in FSR becomes 61+74+53 = 188 pages of policy statement being PS146, PS164, PS166.***

❒ **Breach reporting** – ref Section 792B, Section 912D.

IFA magazine 13/3/06 reports ASIC's Louise du Pre said *"We're more interested at the moment in who is not reporting breaches".* We understand that the logic behind this is:

➢ Point 1. That regulation under FSR is such that all licencees will be regularly not complying with

the law (i.e. Breaching) AND

- Point 2. So that any licencee not reporting breaches must be breach of the law, because they are not reporting breaches of the law that they ought to be reporting.
- Our view is that:-
  - if you have a regulatory environment where everyone must necessarily regularly be non-compliant with the regulations
    - THEN
  - the it is quite possible that the regulatory environment has the wrong focus and priority. The focus needs to:
    - be first and foremost on consumer protection WHILE
    - creating commercial uncertainty and without excessive business costs - particularly for and including for small independently-owned advice-focused AFS licencees.

Interim summary:
For small dealers (small businesses) providing financial advice, failure to translate principle-based law into an optimally-prioritised and optimally-focused principle-based regulatory environment has created commercial uncertainty and excessive business costs which threatens the very existence of small dealers AND in due course, for consumers this threatens the very availability of non-aligned independent financial planning advice, a style of advice which it seems Chris Pearce see the importance of.

Other issues.

- **The word "independent" and the clear consumer-friendly disclosure of conflicting relationships.** References:
  - Section 923A Corporation's Law. See Appendix E.
  - ASIC's Interpretation of the Law. See Appendix F.
- There are a number of elements of this point.
- First, ASIC have interpretted Section 923A so narrowly that in effect this word has been outlawed. This is an important issue because as Chris Pearce has recognised *" ... Australians are increasingly wanting professional, objective advice – not just product sales advice."* Unfortunately, the current definition of the word "independent" means that consumers have, in effect, no useful label (such as the word independent) by which to recognise an independent dealer over an aligned dealer.
  - **Proposal 1**:
    - That the word "independent" have a much more practical definition enabling a relatively wide usage of this word among the independently-owned, non-aligned AFS licencee segment.
- Second, we regularly see financial planning subsidiaries of product providers describing themselves as "independent" - as providing independent advice. This seems to be a clear contravention of the law – yet this does not seem to be policed. This behaviour by these large aligned groups seems specifically designed to confuse the distinction between their advice and independent advice, something which seems to be clearly against consumer interests.
    - Note: This issue often occurs where the name of the AFS licencee has no clear link with the name of their product-manufacturing parent.
  - **Proposal 2**.
    - That ASIC should police this rule, preventing aligned dealers from describing their business as being independent or promoting that they offer independent advice.
- Third, a related issue. It has come to our attention that a number of authorised representatives or corporate authorised representatives seem to be promoting the names of their financial planning business while not clearly disclosing the name of the AFS licence that they represent.
  - Clearly, such non-disclosure is against consumer interests.
  - Again, this is simply a policing matter.

- **The regulatory environment needs to encourage and facilitate more small businesses to create non-aligned ('independent") advisory businesses by getting their own licences, because clearly there is a great demand for such advice as Chris Pearce himself has identified.**
  - Reference: Money Management 29/3/06 reported that Chris Pearce told the the AIOFP conference, *" ... Australians are increasingly wanting professional, objective advice – not just*

product sales advice."

- To facilitate the creation of more non-aligned AFS licences, the regulatory environment needs to be pruned back to the key principles (see above) in the law – so that small businesses (and experienced advisors) do not find the process of getting a licence so formidable.
- Given ASIC's current approach to regulating the law, have extra AFS licences imposes relatively little load on ASIC. - mainly it is just processing an application for a licence.

❒ ASIC priorities & focus

- We understand and empathise with ASIC's position. ASIC has a tough and very demanding job – and consumers do need adequate protection in this important matter.
- We believe that the way ASIC have translated FSR into a regulatory environment which is from a consumer-outcomes perspective, very sub-optimal.
- Given ASIC has taken a tick-the-box compliance-and-process-focused emphasis in FSR implementation, ASIC has clearly de-emphasised the most critical aspect of FSR namely the advice-output tests identified above, which we believe are clearly the most important aspect of consumer protection under FSR. Instead of an advice-output focus, many of ASIC's (not FSR's) compliance requirements create no consumer protection but impose significant cost in time and money on small dealers dealers AND their clients.
  - ⇨ It is bad for small dealers because of the compliance cost and business risks in trying to maintain compliance – and the immense regulatory uncertainty for small dealers. This stems from the fact that ASIC is focused on PROCESS when it should be focused on ADVICE output.
  - ⇨ It is bad for consumers, because ASIC is not focusing on the most meaningful outcomes for consumers. To get the best outcome or consumers, ASIC needs to be focusing on ADVICE output.
  - ⇨ So there does seem to be an ASIC problem of incorrect priorities. AISC"s priority and focus is on ADVICE process – and yet it is very clear that there is no clear relationship between good advice-manufacturing process and good advice output. Clearly excellent process can create bad or damaging advice for consumers. Equally clearly, the less formal advice processes of small dealers can generate excellent advice output.

- Further ASIC seems to be adopting a strategy of:
  - ⇨ testing of tick-the-box compliance is easy to do by ASIC - and it is easy to be seen to be doing it
  - ⇨ But testing of the consumer protection tests below is much harder - even though it is of utmost importance.
  - ⇨ So summarise this second problem, ASIC is focusing on the simple "problem" and not the right problem.

- Let us be more specific about **what actions ASIC should take**, if it really is to be effective in consumer protection. ASIC could and should be doing the following:-
  - ⇨ **To be effective from a consumer perspective, ASIC needs to focus on output rather than process**. i.e. ASIC needs to check whether the advice manufactured by the dealer is good rather whether the advice manufacturing process is good. Good process does not equal good advice. Informal processes or simpler processes of small dealers does not equal bad advice. Process is not a good indicator of good advice. Testing advice is the only way to gauge whether a dealer is producing reasonable quality of advice. ASIC is currently obsessed with the advice process (an over-emphasis) – and places far too little focus on the most important thing which is advice quality.
  - ⇨ There are **two suggestions** about how advice might be tested:-
    - **First**, clearly ASIC needs to focus on consumer complaints about advice. While we understand that ASIC already does this, circumstantial evidence suggests that minimal resources go into following up consumer complaints. We have heard many stories of small dealers reporting issues and problems that they have seen to ASIC, with no apparent action being taken by ASIC. This is a serious source of concern.
    - **Second**, ASIC could regularly sample the type of advice from dealers to test advice whether it is negligent, that there is a reasonable basis etc etc as per parts of the laws we have identified above. This will flush out systemic problems with specific dealers.
  - ⇨ And for example with **Westpoint**, we suggest that ASIC looks at what other products that advisor who recommended Westpoint, has also recommended - because this may well point to other problems that need to be dealt with. We suspect so.

- ⇨ Clearly there is also consumer benefit in consumers being able to get information about the problems and complaints that have occurred in our industry. Specifically:
  - We understand that ASIC has recently announced that **ASIC intends to publish** (maybe on FIDO) **a list of actions against specific advisors**.
  - **ASIC could also publish a list of complaints against specific dealers** for example. This is somewhat akin to hospitals being required to publish success rates on different types of operations as we understand Queensland hospitals will be required to do.
  - As small independently-owned non-aligned dealers, we also have concerns with the occasional general broadside or sweeping statement ASIC officials (or shadow shop surveys) level at financial planners. We think that highly-ethical, highly professional small dealers are being unreasonably maligned by such general broadsides against financial planners. While problems might exist among financial planners, we find that many of these generalised criticisms are simply not justified (and ASIC has no data to the contrary). We believe that **ASIC would serve consumers better by being specific about disclosing where problems exist in our industry** (eg identifying specific problematic dealers and advisors – and identifying specific problematic types of practices). **Consumers would be better served if ASIC assisted consumers to find ethical professional advisors** rather than scaring consumers off all financial planners.
- ⇨ We also believe **ASIC should monitor complaints that go through FICS**, that ASIC ensures that FICS keeps sufficient level of detail about complaints on a database, to enable thorough analysis to look for systematic problems among AFS licencees.

- ➢ Further to the comments above about actions ASIC could take, we suggest that **ASIC needs to POLICE bad advice – and penalise the dealers and advisers at fault.** *It doesn't matter how good the law is if not policed.* And by this *we mean policing the important thing for consumers* – namely ***SUBSTANCE of advice not FORM of advice***. It actually seems to be quite difficult to get ASIC to act, when inappropriate behaviour is reported to ASIC. This goes to the very heart of the problem with FSRA - and that is:
  - ⇨ that it does not matter how good the law is if it is not policed .... and I think this is a very big issue AND
  - ⇨ that ASIC's interpretation of FSRA puts small business AFS licencees such as BFPPG members through massive compliance cost - and the vast bulk of this compliance obligation adds nothing to consumer protection - just adds cost i.e. it is FORM and NOT SUBSTANCE.

- ➢ So in summary, there is a lot more ASIC can and should be doing. ASIC is not being nearly as effective as it could be when it comes to consumer protection. This weakness seems to be an issue with priority on use ASIC resources, so ensure that ASIC resources are used to maximise the real goal is to be consumer benefit.

In summary:

We appreciate the opportunity to present this submission to you for your consideration and we would be happy to discuss this issue as required. Most of our specific recommendations are provided in the cover-letter.

Appendix A. Key words from the ASIC Act.

ASIC Act Section 1 (2) (a) that “In performing its functions and exercising its powers, 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.”

Appendix B

Division 3—Obligations of financial services licensees

912A General obligations

(1) A financial services licensee must:

(a) do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; and

(b) comply with the conditions on the licence; and

(c) comply with the financial services laws; and

(ca) take reasonable steps to ensure that its representatives comply with the financial services laws; and

(d) unless the licensee is a body regulated by APRA—have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and

(e) maintain the competence to provide those financial services; and

(f) ensure that its representatives are adequately trained, and are competent, to provide those financial services; and

(g) if those financial services are provided to persons as retail clients—have a dispute resolution system complying with subsection (2); and

(h) unless the licensee is a body regulated by APRA—have adequate risk management systems; and

(j) comply with any other obligations that are prescribed by regulations made for the purposes of this paragraph.

(2) To comply with this subsection, a dispute resolution system must consist of:

(a) an internal dispute resolution procedure that:

(i) complies with standards, and requirements, made or approved by ASIC in accordance with regulations made for the purposes of this subparagraph; and

(ii) covers complaints against the licensee made by retail clients in connection with the provision of all financial services covered by the licence; and

(b) membership of one or more external dispute resolution schemes that:

(i) is, or are, approved by ASIC in accordance with regulations made for the purposes of this subparagraph; and

(ii) covers, or together cover, complaints (other than complaints that may be dealt with by the Superannuation Complaints Tribunal established by section 6 of the *Superannuation (Resolution of Complaints) Act 1993*) against the licensee made by retail clients in connection with the provision of all financial services covered by the licence.

(3) Regulations made for the purposes of subparagraph (2)(a)(i) or (2)(b)(i) may also deal with the variation or revocation of:

(a) standards or requirements made by ASIC; or

(b) approvals given by ASIC.

Appendix C – PS146 Summary of requirements – from PS146 APPENDIX A.

Knowledge requirements

[PS 146.117] The following list of ASIC's knowledge requirements applies to a range of products and activities relevant to the financial services sectors regulated by ASIC.

The requirements are grouped under:

A1 Generic knowledge

A2 Specialist knowledge, covering

A2.1 Financial planning

A2.2 Securities

A2.3 Derivatives

A2.4 Managed investments

A2.5 Superannuation

A2.6 Insurance — general, life and broking

A2.7 Deposit products and non-cash payment products **A2.8** Foreign exchange

All advisers should demonstrate that they have met the generic knowledge requirements and specialist knowledge requirements relevant to their activities. We recognise that, depending on the nature of the activities undertaken, the extent and scope of the knowledge
requirements to be met may vary (and may not be listed above).

Licensees must first identify their advisers' tasks and functions. They must then determine which of ASIC's knowledge requirements should be covered in their training courses or individual assessments of advisers in relation to those tasks and functions.

Appendix D – An example of industry implementation of PS146 – from Tribeca edu videos

PS146 compliance information

March

ASIC PS 146 details minimum training standards for people who provide advice to retail clients, and give guidance on the continuing training required.

Tribeca has taken the ASIC knowledge areas and has delved deeper into the key competencies a planner or adviser will undertake in their day to day activities.

Each segment of the Tribeca PDsessions is categorised and a time allocation provided to assist in mapping the skills and knowledge addressed in the program. Our PS146 mapping is listed by story for the month.

Our knowledge areas for continuing education are:

Generic knowledge
Financial planning
Personal taxation issues Securities
Derivatives
Managed investments
Fixed interest
(incorporating deposit products)
Superannuation
Self managed superannuation funds
Retirement income streams Social security
General insurance
Life insurance
Estate planning
Skills

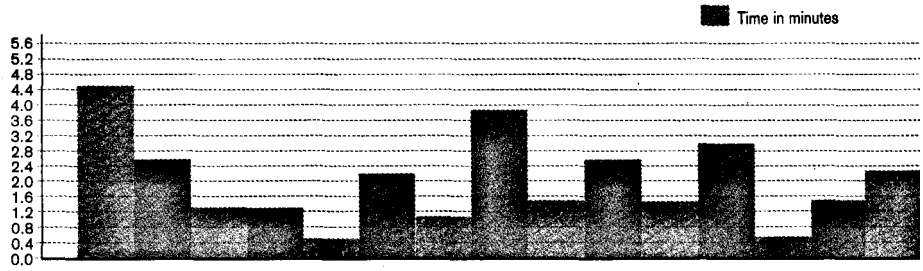
PD SESSIONS — MARCH PS 146

KNOWLEDGE AREA

	Gen.	Financial planning	Personal taxation issues	Securities	Derivatives	Managed investments	Fixed interest	Superannuation	Self managed superannuation funds	Retirement income streams	Social security	Life insurance	General insurance	Estate planning	Skills
March 2006															
News update	X							X							
Reversing income stream strategies											X				
Investing outside super		X													
SMSF trust deeds						X									
Comparing options and warrants														X	
TPD in super															

TIME ALLOCATIONS

Rolling totals of accumulated time in hours to March



Appendix E. Corporation's Law – the use of the word "Independent"

923A Restriction on use of certain words or expressions

(1) A person contravenes this subsection if:

(a) either:

(i) the person carries on a financial services business or provides a financial service (whether or not on behalf of another person); or

(ii) another person (the ***provider***) provides a financial service on behalf of the first person; and

(b) the first person assumes or uses, in this jurisdiction, a restricted word or expression in relation to that business or service.

Note 1: For the meanings of ***restricted word or expression*** and ***assume or use***, see subsection (5).

Note 2: A contravention of this subsection is an offence (see subsection 1311(1)).

(2) However, it is not a contravention of subsection (1) for a person to assume or use a restricted word or expression if:

(a) the person does not receive any of the following:

(i) commissions (apart from commissions that are rebated in full to the person's clients);

(ii) forms of remuneration calculated on the basis of the volume of business placed by the person with an issuer of a financial product;

(iii) other gifts or benefits from an issuer of a financial product which may reasonably be expected to influence the person; and

(b) none of the following persons receives any of the things covered by paragraph (a):

(i) the person's employer (if any);

(ii) if the person provides the financial service on behalf of another person (as mentioned in subparagraph (1)(a)(i))—that other person;

(iii) any other person identified (whether by reference to a class of person or otherwise) in regulations made for the purposes of this subparagraph; and

(c) if subparagraph (1)(a)(ii) applies in relation to a financial service—the provider mentioned in that subparagraph does not receive any of the things mentioned in paragraph (a) of this subsection in respect of the provision of that service; and

(d) in carrying on a financial services business, or providing financial services, the person operates free from direct or indirect restrictions relating to the financial products in respect of which they provide financial services; and

(e) in carrying on that business, or providing those services, the person operates without any conflicts of interest that might:

(i) arise from their associations or relationships with issuers of financial products; and

(ii) reasonably be expected to influence the person in carrying on the business or providing the services.

Note: A defendant bears an evidential burden in relation to the matters in subsection (2). See subsection 13.3(3) of the *Criminal Code*.

(3) The reference in paragraph (2)(d) to direct or indirect restrictions does not include a reference to restrictions imposed on a person by:

(a) the conditions on an Australian financial services licence; or

(b) this Chapter or regulations made for the purposes of this Chapter.

(4) If a person assumes or uses a word or expression in circumstances that give rise to the person committing an offence based on subsection (1) of this section, the person is guilty of such an offence in respect of:

(a) the first day on which the offence is committed; and

(b) each subsequent day (if any) on which the circumstances that gave rise to the person committing the offence continue (including the day of conviction for any such offence or any later day).

(5) In this section:

(a) a reference to a restricted word or expression is a reference to:

(i) the word ***independent***, ***impartial*** or ***unbiased***; or

(ii) any other word or expression specified in the regulations as a restricted word or expression for the purposes of this section; or

(iii) any other word or expression (whether or not in English) that is of like import to a word or expression covered by any of the previous subparagraphs; and

(b) a reference to a word or expression being assumed or used includes a reference to the word or expression being assumed or used:

(i) as part of another word or expression; or

(ii) in combination with other words, letters or other symbols.

Appendix F – ASIC's interpretation of the use of the word independent.

QFS 38
Can AFS licensees (including financial planners or advisers) call themselves 'independent' under s923A if they receive trail commissions?

No (unless all commissions are rebated in full to their clients, see following text). It is an offence for a person carrying on a financial services business or providing a financial service to assume or use a 'restricted word or expression' in relation to that business or service. A restricted word or expression includes the words 'independent', 'impartial' or 'unbiased': see s923A(5)(a)(i) of the *Corporations Act 2001* (the Act). Use of the restricted word or expression would include, for example, use of the word in any publication or advertisement produced or released by the financial services provider.

A person must not describe himself or herself as 'independent' if the person receives commissions (apart from commissions that are fully rebated (ie refunded) to the client: see s923A(2)(a)(i). To take advantage of this exception, the person must not receive any commissions, including trail (also known as trailing) commissions, unless they are rebated in full to the person's clients.

ASIC considers that the requirement that commissions are 'rebated in full' is satisfied if, as soon as the commission is received, it is rebated to the client without delay by:

- rebating an amount equivalent to the commission directly to the client by cash, cheque or other direct means (eg by direct credit to a bank account nominated by the client); or
- offsetting any debt owed by the client (ie a debt owed before the commission was received by the licensee) by an amount equivalent to the commission, except in circumstances where the amount of the debt is calculated by reference to commissions expected to be received by the licensee.

ASIC does **not** consider that the requirement that commissions are 'rebated in full' is satisfied if a client's account with the licensee is credited with the amount of commission received, where funds in the client's account may be used to meet future liabilities of the client to the licensee and the client does not have the right to demand payment to it. This is because the rebate is not immediately available to the client in these circumstances.

Appendix G. Improving Complaints Resolution – for a better consumer outcome – Some ideas.

We believe ASIC's Policy Statement 139 requires external complaints resolution schemes to collect information about the underlying cause(s) of complaints (refer PS 139.83), but that such information is not collected by the Financial Industry Complaints Service (FICS).

Data collected by FICS provided gives minimal information about the nature of the complaints and no indication of the factors associated with and contributing to complaints made to FICS. In particular the data provides no insight as to whether the complaints have resulted from:

- lack of experience or training;
- poor administrative procedures;
- poor supervision by the AFS Licencee;
- fraud;
- biased behaviour;
- poor disclosure of fees,
- poor disclosure of risks;
- false or misleading information;
- etc.

nor does it indicate whether the complaints tend to be associated with:

- one time advice or ongoing advice;
- small Licencees or large licencees;
- certain types of products;
- FPA members or non-FPA members;
- CFP's or non-CFP's;
- recently appointed authorised representatives or long term authorised representatives;
- licencees that are independent of product issuers or licencees that are associates of product issuers;
- licencees that are new to the industry or licencees with many years experience;
- licencees that have multiple offices or licencees with a single office;

nor does it indicate whether there are repeat offenders whose activities by their nature tend to lead to complaints.

The consequence of this data not being collected is that despite to date there having been a great deal of talk about "raising the bar" for the financial planning industry it is impossible to determine which bar(s)

need raising and whether the bars that have been raised have had any impact on complaints. A secondary consequence is that measures that have been introduced tend to be broad attempts to "raise the bar" rather than actions designed to achieve specific results. Not surprisingly the measures introduced appear to be largely inefficient and ineffective giving a very poor cost/benefit outcome for consumers.

In short we suggest that ASIC should enforce the collection of data in respect of the underlying cause(s) of complaints and that this data be made freely available by to Government, ASIC, FPA, etc. As an industry we would then have a better understanding of the real nature and magnitude of the problem we face, we could then introduce measures designed to overcome these problems and we could assess the effectiveness of these measures.

Following is an example of the data we suggest that should be collected. We suggest the cost of collecting such data would be small relative to its value.

Suggested fields for database
Profile of Dealer

- Name of dealer against whom the complaint has been made
- Date when dealer was first issued with a licence
- Number of authorised representatives at time of complaint being lodged
- Number of locations from which dealer opeated at time of complaint being lodged
- Ownership of dealer (publicly listed, fund manager, employees)
- Is the dealer a member of the FPA
  If the dealer is a member of the FPA, when did the dealer become a member of the FPA
- Number of complaints previously lodged with FICS against this dealer
- Number of FICS complaints previously upheld 100%
- Number of FICS complaints previously dismissed 100%
- Number of FICS complaints previously settled, but neither 100% for or against the dealer
- Number of previous FICS complaints still pending resolution

Profile of adviser

- Name of adviser
- Date when advisor became a representative
- Experience as a financial planner (years)
- Level of training (e.g. Meets PS 146 only, Tertiary qualified, Industry diploma)
- Is the adviser a member of the FPA
- If the adviser is a member of the FPA, when did the adviser become a member of the FPA
- If the adviser is a member of the FPA, is the adviser a CFP
- Number of complaints previously lodged with FICS against this adviser
- Number of FICS complaints previously upheld 100%
- Number of FICS complaints previously dismissed 100%
- Number of FICS complaints previously settled, but neither 100% for or against the adviser
- Number of previous FICS complaints still pending resolution

Details of complaint

- FICS case number
- Name of complainant
- Has the complainant ever lodged another complaint with FICS
- Date of complaint being lodged with FICS
- Date of event leading to complaint
- State
- City / Town
- Dollar Value claimed
- Nature of complaint
    - Professional negligence (e.g. error or mistatement of facts that reflects carelessness, lack of training, or irresponsible behaviour)

- Professional misjudgement (e.g. providing poor advice)
- Professional standards breach (e.g. failure to disclose fees/commissions appropriately, failure to provide a Financial Services Guide, failure to deliver service as promised, charging fees in excess of what was expected by the client.)
- Professional misconduct (e.g. unauthorised action, misappropriation of funds, misleading information)

- Brief description of the complaint (say 25 words or less)

Outcome

- Date complaint was resolved
- Extent to claim was upheld (0% = dismissed, 100% = fully upheld, in between = partially upheld
- Dollar value of any penalty.
- Any non monetary penalty imposed by FICS
- Reasons for decision by FICS
- Factors which FICS believed led to the complaint (e.g. lack of training, carelessness, self-interest and bias created by commissions and other benefits)
- Actions which could have avoided the complaint (e.g. better training, better supervision, better documentation, better screening of authorised representatives, systemic failure of the dealer)
- Cost to FICS of dealing with the complaint.

We also suggest that ASIC should enforce its Policy Statement 139 in respect of the fairness of FICS by requiring FICS to have "specific criteria upon which its decisions are based". (refer PS 139.151) Currently, FICS does not have such criteria and there is a feeling amongst many AFS Licencees that decisions by FICS are not fair.