

BFPFG

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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

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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 than 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 than 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 a 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 SUBSTANCE 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 licensee 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 licensee 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 licensee 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.