

Chapter 1

Introduction

1.1 This inquiry has been undertaken by the Parliamentary Joint Committee on Corporations and Financial Services during a period of significant change and scrutiny related to the provision of financial advice. Increasing the professional, ethical and education standards applied to financial advisers is not intended to be a silver bullet or a single solution to all of the issues that may arise in this policy area, but rather is seen by the committee as one of a range of measures intended to improve the quality of advice and outcomes for investors.

Duties of the committee

1.2 The Parliamentary Joint Committee on Corporations and Financial Services (the committee) is established by Part 14 of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act). Section 243 of the ASIC Act sets out the committee's duties as follows:

- (a) to inquire into, and report to both Houses on:
 - (i) activities of ASIC or the [Takeovers] Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or
 - (ii) the operation of the corporations legislation (other than the excluded provisions); or
 - (iii) the operation of any other law of the Commonwealth, or any law of a State or Territory, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); or
 - (iv) the operation of any foreign business law, or of any other law of a foreign country, that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and
- (b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and
- (c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.¹

1 *ASIC Act 2001*, s. 243.

Referral of the inquiry and terms of reference

1.3 Following a recommendation by the Senate Economics References Committee inquiry into the performance of ASIC, the committee resolved on 14 July 2014, to inquire into proposals to lift the professional, ethical and education standards in the financial services industry with the terms of reference set out below.

Pursuant to the committee's duties set out in section 243 of the *Australian Securities and Investments Commission Act 2001*, the committee will examine proposals to lift the professional, ethical and education standards in the financial services industry, including:

1. the adequacy of current qualifications required by financial advisers;
2. the implications, including implications for competition and the cost of regulation for industry participants of the financial advice sector being required to adopt:
 - a. professional standards or rules of professional conduct which would govern the professional and ethical behaviour of financial advisers; and
 - b. professional regulation of such standards or rules; and
3. the recognition of professional bodies by ASIC.

Conduct of the inquiry

1.4 The committee advertised the inquiry on its webpage and invited submissions from a range of relevant stakeholders. The committee received 39 submissions which were published on the committee's website and are listed at Appendix 1. The committee held public hearings in Melbourne on 13 October 2014, in Sydney on 14 October 2014 and in Canberra on 26 November 2014. Appendix 2 lists the names and organisations of those who appeared at public hearings. Details of the inquiry and associated documents including the Hansard transcripts of evidence may be accessed through the committee webpage.

1.5 The committee thanks organisations and individuals who made submissions and gave evidence at public hearings.

1.6 References to the Committee Hansard include references to the proof Hansard. Page numbers may vary between the proof and the official Hansard.

Report Structure

1.7 This report is structured as follows:

- the rest of Chapter 1 provides some background to the inquiry, and a discussion of other relevant inquiries;
- Chapter 2 discusses relevant terminology affecting the financial advice industry, including 'general advice' and who is able to use the terms 'financial adviser' and 'financial planner';
- Chapter 3 discusses professionalism and co-regulation of financial advisers;

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- Chapter 4 discusses the first term of reference on the adequacy of qualification requirements for financial advisers; and
 - Chapter 5 discusses the second and third terms of reference including professional standards, codes of conduct and recognition of professional bodies and codes of conduct.

Background

1.8 The issues relating to financial advisers considered by this inquiry have been the subject of previous inquiries by parliamentary committees and the government. This section provides a summary of some of the relevant inquiries and the recommendations made by those inquiries. In addition to demonstrating that a number of the issues considered by this inquiry are long standing, the committee considers that it is useful to be aware of the way previous inquiries have shaped current regulatory arrangements.

The Campbell inquiry

1.9 In 1979 the government established a *Committee of Inquiry into the Australian Financial System* (the Campbell Inquiry), which examined the structure and methods of operation of the Australian financial system. The inquiry, which was finalised in 1981, advocated substantial financial deregulation and was a catalyst for major economic reforms including financial deregulation in Australia.²

1.10 In 1991 the impact of financial deregulation was reviewed by the House of Representatives Standing Committee on Finance and Public Administration (the Martin committee). The Martin committee concluded that:

...much of what was envisaged of deregulation has occurred...Finance has become more widely available, though customers have had to pay a market price for it, including a component to reflect risk...However deregulation has not delivered some of the benefits envisaged...The failure of the market to deliver better information to consumers...The relationship between banks and customers remains an area requiring major improvement.³

The Wallis inquiry

1.11 The 1997 *Financial System Inquiry*, known as the Wallis inquiry, provided a stocktake of outcomes from financial deregulation of the Australian financial system from the early 1980s. The Wallis inquiry considered a broad range of reforms aimed at improving financial system efficiency and presented recommendations for financial regulation, including arrangements for market integrity, consumer protection, safety, stability and competition.⁴

2 Financial System Inquiry, <http://fsi.gov.au/>, (accessed 7 November 2014).

3 House of Representatives Standing Committee on Finance and Public Administration, *A Pocket Full of Change: Banking and Deregulation*, 1991, p. 457.

4 Financial System Inquiry, *Final Report*, March 1997, Overview pp 1–11, 28–29.

1.12 The fundamental policy settings for financial services in Australia were developed following the principles set out in the Campbell and Wallis inquiries. Those principles were based on the ‘efficient markets theory’, a belief that markets drive efficiency and that regulatory intervention should be kept to a minimum to allow markets to achieve maximum efficiency. As a result, consecutive governments have established that ASIC's role is largely to ‘oversee and enforce compliance’.⁵

1.13 The Wallis inquiry considered the regulatory arrangements for financial advice and financial advisers. The inquiry concluded that consumers need information about fees, commissions (including trailing commissions) and the remuneration paid to their financial advisers or brokers so that they can determine whether a recommendation is skewed in favour of a particular product. Regulations at the time covered disclosure of fees and commissions by investment advisers, life agents and brokers, but not bank staff. The inquiry recommended enhancements to disclosure requirements and regular monitoring of those requirements.⁶ The Wallis inquiry made a number of other significant recommendations relating to financial advisers and financial advice, as set out below.

1.14 In recommendation two the Wallis inquiry recommended that the body, which is now ASIC, should be responsible for a wide range of regulatory functions, including the following functions that relate to financial advice:

- regulating disclosure for securities and retail investment products;
- regulating investment and insurance sales and advice and financial market dealers and participants;
- regulating the conduct of dealings with consumers and the prevention of fraud;
- delegating accreditation and disciplinary functions to self-regulatory bodies where appropriate; and
- setting benchmarks for and monitoring the performance of those self-regulating bodies.⁷

1.15 In recommendation 13 the Wallis inquiry recommended that a single licensing regime should be introduced for financial sales, advice and dealing, with separate categories for investment advice and product sales, general insurance brokers, financial market dealers, and financial market participants.⁸

5 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 7; Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. 40.

6 Recommendation 8, Financial System Inquiry, *Final Report*, March 1997, pp 263–264.

7 Financial System Inquiry, *Final Report*, March 1997, pp 1–2.

8 Financial System Inquiry, *Final Report*, March 1997, p. 6.

1.16 In recommendation 14 the Wallis inquiry recommended devolving responsibility for competency training and testing to industry bodies and giving the body that would become ASIC the option to require that licence holders commit to codes of conduct or dispute schemes that meet minimum standards.⁹

1.17 In recommendation 15 the Wallis inquiry recommended that the body that would become ASIC should develop a single set of requirements for investment sales and advice including:

- minimum standards of competency and ethical behaviour;
- requirements for the disclosure of fees and adviser's capacity;
- rules on handling client property and money;
- financial resources or insurance available in cases of fraud or incompetence; and
- responsibilities for agents and employees.¹⁰

1.18 In recommendation 16 the Wallis inquiry recommended that the existing regulation of real estate agents should be reviewed. It was recommended that real estate agents providing investment advice be required to hold a financial advisory licence unless the review clearly established the adequacy of existing regulation.¹¹

1.19 In recommendation 17 the Wallis inquiry recommended that professional advisers, such as lawyers and accountants, should not be required to hold a financial advisory licence if they provide investment advice that is only incidental to their other business and that they rebate any commissions to clients.¹²

1.20 Many aspects of Wallis recommendations 2, 13, 14, 15, 16, and 17 were implemented in subsequent reforms. The *Financial Services Reform Act 2001* (FSR Act) introduced a single licensing regime for financial products, a single regime for regulating financial services (investment advice), imposed requirements for disclosure of fees and introduced a national dispute resolution system. The FSR Act also required licensing of financial advisers.¹³ The FSR Act allowed for authorised representatives of the licensee to give advice¹⁴ consistent with the views put forward by the Wallis inquiry which suggested that licences should be issued to financial institutions (where the provider of sales and advice acts on behalf of an institution) or to independent advisers.¹⁵

9 Financial System Inquiry, *Final Report*, March 1997, p. 6.

10 Financial System Inquiry, *Final Report*, March 1997, p. 6.

11 Financial System Inquiry, *Final Report*, March 1997, p. 7.

12 Financial System Inquiry, *Final Report*, March 1997, p. 7.

13 Kevin Davis, *The Australian Financial System in the 2000s: Dodging the Bullet*, in *The Australian Economy in the 2000s*, Reserve Bank Conference 2011, pp 313–314.

14 *Financial Services Reform Act 2001*. s. 911A.

15 Financial System Inquiry, *Final Report*, March 1997, p. 273.

1.21 In 2007 changes to the corporations legislation led to requirements for financial advisers to take out adequate professional indemnity insurance. In addition a single Financial Ombudsman Service (FOS) was created in 2008 out of a number of separate financial sector ombudsman schemes.¹⁶ The FOS provides an independent dispute resolution process which covers financial services disputes, including banking, credit, loans, general insurance, life insurance, financial planning, investments, stock broking, managed funds and pooled superannuation trusts.¹⁷

1.22 Towards the end of the 2000s, there was substantial disquiet about incentive structures within that industry and conflicts of interest.¹⁸ Mr Kevin Davis noted that:

While AFS (Australian Financial Services) license holders were required to be members of an external dispute resolution scheme...the ability of individuals to afford to pursue legal action for claims above the \$100 000 cap involved in that scheme left investors exposed. Over the decade, the role of class actions and litigation funders of such actions also increased dramatically, including actions against financial advisers.¹⁹

2009 inquiry into financial products and services

1.23 In 2009, this committee conducted an *Inquiry into financial products and services in Australia*²⁰ to examine issues associated with collapse of financial products and services, such as those provided by Storm Financial and Opes Prime. The inquiry included a significant focus on the role and regulation of financial advisers, the role of commissions, and the adequacy of licensing arrangements.²¹ In its report the committee found that the historical emergence of financial advisers as a sales force for product manufacturers was inconsistent with expectations that financial advisers provide a professional service that meets their clients' best interests.²²

16 Kevin Davis, *The Australian Financial System in the 2000s: Dodging the Bullet*, in *The Australian Economy in the 2000s*, Reserve Bank Conference 2011, pp 313–314.

17 Financial Ombudsman Service, *What we do*, <http://www.fos.org.au/about-us/what-we-do/>, (accessed 23 November 2014).

18 Kevin Davis, *The Australian Financial System in the 2000s: Dodging the Bullet*, in *The Australian Economy in the 2000s*, Reserve Bank Conference 2011, pp 313–314.

19 Kevin Davis, *The Australian Financial System in the 2000s: Dodging the Bullet*, in *The Australian Economy in the 2000s*, Reserve Bank Conference 2011, p. 314.

20 Often referred to as the Ripoll inquiry

21 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. vii.

22 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 69.

1.24 The following recommendations made by the inquiry are relevant to the committee's current inquiry:

Recommendation 1

The committee recommends that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.

Recommendation 2

The committee recommends that the government ensure ASIC is appropriately resourced to perform effective risk-based surveillance of the advice provided by licensees and their authorised representatives. ASIC should also conduct financial advice shadow shopping exercises annually.

Recommendation 3

The committee recommends that the Corporations Act be amended to require advisers to disclose prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest.

Recommendation 4

The committee recommends that government consult with and support industry in developing the most appropriate mechanism by which to cease payments from financial product manufacturers to financial advisers.

Recommendation 6

The committee recommends that section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry.

Recommendation 7

The committee recommends that, as part of their licence conditions, ASIC require agribusiness MIS licensees to demonstrate they have sufficient working capital to meet current obligations.²³

FOFA

1.25 In April 2010 the government responded to the committee's report with a package of reforms called *Future of Financial Advice* (FOFA). The FOFA reforms were designed to tackle conflicts of interest that threatened the quality of financial advice provided to Australian investors, and the inappropriate selling of financial products that culminated in high profile corporate collapses such as Storm Financial, Opes Prime, and Westpoint.²⁴

23 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 150–151.

24 The Hon Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, Media Release No.036, *Overhaul of Financial Advice*, 26 April 2010.

1.26 In June 2012, FOFA reforms (which were voluntary from 1 July 2012 and mandatory from 1 July 2013) were passed by the Parliament that included:

- A prospective ban on conflicted remuneration structures including commissions and volume based payments, in relation to the distribution of and advice about a range of retail investment products.
- A duty for financial advisers to act in the best interests of their clients, subject to a 'reasonable steps' qualification, and place the best interests of their clients ahead of their own when providing personal advice to retail clients. There is a safe harbour which advice providers can rely on to show they have met the best interests duty.
- An opt-in obligation that requires advice providers to renew their clients' agreement to ongoing fees every two years.
- An annual fee disclosure statement requirement.
- Enhanced powers for ASIC.²⁵

1.27 Following a change in government, on 1 July 2014, new regulations commenced, which reduce compliance costs and regulatory burden on the financial services sector arising from the earlier FOFA reforms. The regulations changed fee disclosure, the best interests duty, grandfathering provisions and the 'opt-in' requirements for continuing adviser services. The new regulations also allowed for the provision of scaled advice and exempted general advice²⁶ from conflicted remuneration provisions.²⁷

1.28 The government's amendments were implemented through the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014*. The regulation commenced on 1 July 2014. The Government introduced the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014*, to bring some of the above amendments into legislation. The Bill including parliamentary amendments made by the government, was passed by the House of Representatives on 28 August 2014. The Bill is currently before the Senate. The government indicated that the interim regulations (those replicated in the Bill) will be repealed once the Bill passes the Parliament.²⁸

1.29 On 19 November 2014 the Senate disallowed the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014*. Following negotiations

25 ASIC, *FOFA Background and Implementation*, <http://www.asic.gov.au/regulatory-resources/financial-services/future-of-financial-advice-reforms/fofa-background-and-implementation/>, (accessed 18 December 2014).

26 General advice is defined and discussed at the beginning of Chapter 2.

27 Senator the Hon Arthur Sinodinos, Assistant Treasurer, Media Release, *Delivering affordable and accessible financial advice*, 20 December 2013.

28 Treasury, *Future of Financial Advice*, <http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=home.htm>, (accessed 18 December 2014).

between the government and the opposition, on 27 November 2014 the Senate passed the following motion which re-instated five aspects of the regulations:

That, for the purposes of paragraph 48(1)(a) of the *Legislative Instruments Act 2003*, the Senate:

- (a) supports the making of regulations re-instating provisions the same in substance as the following provisions of Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014, as contained in Select Legislative Instrument 2014 No. 102: Schedule 1 Items 5 (Accountants' certificate renewal period); 11 (Stamping fee provision); 12 to 17 (ASX24-related provisions); 27 (non-monetary education or training benefit not conflicted remuneration); and 28, 29 and 31 to 35 (Grandfathering arrangements); and
- (b) rescinds its disallowance resolution of 19 November 2014 relating to the above regulation, to the extent necessary to permit the re-making of the aforementioned provisions in the regulations.²⁹

1.30 The government also made other changes to FOFA in the additional *Corporations Amendment (Statements of Advice) Regulation 2014*, which will commence on 1 January 2015. The changes include additional disclosure requirements in the Statement of Advice, requiring a financial adviser to disclose existing obligations. The amendments also provide requirements for the financial adviser and the client to sign the Statement of Advice.³⁰

The Trio inquiry

1.31 In May 2012, this committee concluded its *Inquiry into the collapse of Trio Capital*. The collapse of Trio Capital involved the largest superannuation fraud in Australian history. Roughly \$176 million in Australians' superannuation funds were lost or missing from two fraudulently managed investment schemes. The committee considered that the Trio collapse raised distinct, and in some ways more troubling issues than those raised by the collapse of Storm Financial and Westpoint. Trio involved a fraud and therefore went beyond Australian investors being persuaded to put their money into inappropriate investment vehicles. The committee noted that:

Some of the financial advice given to Trio clients may have been in contravention of the 'best interests' test and conflicted remuneration provisions of the FOFA legislation.

However, these provisions would not protect against a circumstance where an adviser 'turns bad' and sets out to either defraud...clients or at the very least to concentrate on enriching [them]self while wilfully disregarding the evidence that the investment scheme...was fraudulent.³¹

29 The Senate, *Journals of the Senate*, 27 November 2014, p. 1893.

30 Explanatory Statement, *Corporations Amendment (Statements of Advice) Regulation 2014*, 22 September 2014.

31 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, pp xvii, xxii.

1.32 In its report on the Trio inquiry, the committee made 14 recommendations aimed at protecting Australian's superannuation savings through better compensation schemes, enforcement, education of investors, investigations by ASIC, oversight of license holders, and disclosure by responsible entities.³²

The Economics committee inquiry

1.33 In June 2014 the Senate Economics References Committee tabled a report on its inquiry into the performance of ASIC (Economics committee inquiry). The inquiry ran over many months, received 474 submissions and examined many areas of ASIC's performance, including regulation of financial advisers.³³ The inquiry identified significant areas for ASIC's improvement, while also recognising the good work that ASIC has done in a challenging environment.³⁴ The report made 61 recommendations, including the following recommendation to the committee:

Recommendation 54

The committee recommends that the Parliamentary Joint Committee on Corporations and Financial Services inquire into the various proposals which call for a lifting of professional, ethical and educational standards in the financial services industry.³⁵

1.34 On 14 July 2014, the committee accepted recommendation 54 and established an inquiry into proposals to lift the professional, ethical and education standards in the financial services industry.

1.35 The committee notes that the Economics committee made a number of other recommendations in relation to financial advisers which are not within the terms of reference for this inquiry. Some of these do however intersect with recommendations of this report:

Recommendation 42

The committee recommends that financial advisers and planners be required to:

- successfully pass a national examination developed and conducted by relevant industry associations before being able to give personal advice on Tier 1 products;
- hold minimum education standards of a relevant university degree, and three years' experience over a five year period; and
- meet minimum continuing professional development requirements.

32 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital*, May 2012, pp xxvii–xxix.

33 Senate Economics Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, pp xvii–xxii, 485.

34 Senate Economics Reference Committee, *Media Release*, 26 June 2014.

35 Senate Economics Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, p. xxxiii.

Recommendation 43

The committee recommends that a requirement for mandatory reference checking procedures in the financial advice/planning industry be introduced.

Recommendation 44

The committee recommends that a register of employee representatives providing personal advice on Tier 1 products be established.

Recommendation 45

The committee recommends that the *Corporations Act 2001* be amended to require:

- that a person must not use the terms 'financial adviser', 'financial planner' or terms of like import, in relation to a financial services business or a financial service, unless the person is able under the licence regime to provide personal financial advice on designated financial products; and
- financial advisers and financial planners to adhere to professional obligations by requiring financial advisers and financial planners to be members of a regulator-prescribed professional association.

Recommendation 47

The committee recommends that the government consider the banning provisions in the licence regimes with a view to ensuring that a banned person cannot be a director, manager or hold a position of influence in a company providing a financial service or credit business.

Recommendation 48

The committee recommends that the government consider legislative amendments that would give ASIC the power to immediately suspend a financial adviser or planner when ASIC suspects that the adviser or planner has engaged in egregious misconduct causing widespread harm to clients, subject to the principles of natural justice.

Recommendation 60

The committee recommends that the government consider measures that would ensure investors are informed of their assessment as a retail or wholesale investor and the consumer protections that accompany the classification. This would require financial advisers to ensure that such information is displayed prominently, initialled by the client and retained on file.³⁶

1.36 On 24 October 2014, the government responded to the Economics committee inquiry into the performance of ASIC. This response identified areas in which ASIC had already taken action to implement some of the recommendations, including an

36 Senate Economics Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, pp xxi–xxxiv.

industry working group on standards, a register of financial advisers, use of the terms financial adviser and financial planner. The response also indicated that the recommendations relating to recommendations 47, 48 and 60 would be considered as part of its response to the Financial System Inquiry.³⁷ Progress on the register of financial advisers has been announced by the government and is discussed further in Chapter 2. A recent media article reported that the working group had failed to reach a consensus about how to move forward in the area of advisor education.³⁸

Committee view

1.37 The Economics committee inquiry considered a large volume of evidence on the hardship suffered by many people as a result of corporate collapses and problems in the financial advice industry. The Economics committee inquiry also undertook a detailed case study of the problems that occurred at Commonwealth Financial Planning Limited.

1.38 The committee recognises the significant hardship suffered by many individual investors that have been brought to light during the Economics committee inquiry. However, in order to focus on specific proposals to lift standards for financial advisers, the committee has chosen not to seek further evidence on consumer specific cases as part of this inquiry.

The Financial System Inquiry

1.39 The Financial System Inquiry (FSI), announced by the Treasurer in December 2013 examined how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth. The FSI was required to submit a final report to the Treasurer in November 2014.³⁹

1.40 The committee received private briefings on the FSI from an industry expert and the secretariat of the FSI. The committee considered the interim report of the Financial System Inquiry which noted that:

Studies suggest there are significant issues with the quality of financial advice, due in part to varying standards of adviser competence and the impact of conflicted remuneration structures. Some submissions suggest aligned or vertically integrated structures may also reduce the quality of advice consumers receive.

At times, consumers also lack access to affordable advice. In addition, some submissions question whether general advice is properly labelled and

37 Senator the Hon Mathias Cormann, Minister for Finance, Acting Assistant Treasurer, *Government response to the Senate inquiry into the performance of ASIC*, media release, 24 October 2014, pp xxv, xxviii, xxxi, 21–28.

38 Adele Fergusson, *The Age*, *Planner education a new test for Cormann*, 21 November 2014.

39 Financial System Inquiry, <http://fsi.gov.au/terms-of-reference/>, (accessed 22 October 2014).

whether consumers understand its nature, given general advice often includes sales and advertising information.⁴⁰

1.41 The FSI interim report also noted evidence from the ASIC shadow shopping study on the quality of retirement advice, including that while 58 per cent of advice examples were adequate, 39 per cent of advice examples were poor in quality, and only 3 per cent of advice examples were good quality.⁴¹

1.42 The FSI interim report sought views on the costs, benefits and trade-offs of the following policy options:

- No change to current arrangements.
- Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures such as Self-managed Superannuation Funds), and introduce a national examination for financial advisers providing personal advice.
- Introduce an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.
- Enhance the Australian Securities and Investments Commission's power to include banning individuals from managing a financial services business.
- Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice.⁴²

1.43 The Financial System Inquiry reported to government in November 2014 and the final report was publicly released on 7 December 2014. The report made 44 recommendations.

1.44 The final FSI Report identified two general themes designed to improve the financial system:

1. Funding the Australian economy; and
2. Competition.⁴³

1.45 It also reported under five more specific themes

1. Resilience;
2. Superannuation and Retirement Incomes;
3. Innovation;
4. Consumer Outcomes; and
5. Regulatory System.⁴⁴

40 Financial System Inquiry, *Interim Report*, July 2014, p. xxxii.

41 Financial System Inquiry, *Interim Report*, July 2014, p. 1-21.

42 Financial System Inquiry, *Interim Report*, July 2014, p. xxxii.

43 Financial System Inquiry, *Final Report*, November 2014, p. 13.

1.46 The theme of 'consumer outcomes', discussed in Chapter 4 of the final FSI Report, focuses on the fair treatment of consumers. Relevantly, the report noted that issues related to the competence of financial advisers are unresolved:

To build confidence and trust, and avoid over-regulation, the financial system should be characterised by fair treatment.

In terms of fair treatment for consumers, the current framework is not sufficient. The GFC brought to light significant numbers of Australian consumers holding financial products that did not suit their needs and circumstances — in some cases resulting in severe financial loss. The most significant problems related to shortcomings in disclosure and financial advice, and over-reliance on financial literacy. The changes introduced under the Future of Financial Advice (FOFA) reforms are likely to address some of these shortcomings; however, many products are directly distributed, and issues of adviser competency remain.⁴⁵

Relevant FSI recommendations

1.47 As noted above at paragraph 1.41, the Interim Report of the FSI considered a range of options to improve financial advice provided to consumers. The committee notes that the final FSI report has made a number of recommendations in relation to these issues.

1.48 The final FSI Report recommends, at Recommendation 25,⁴⁶ raising the competency of financial advice providers and the introduction of an enhanced register of advisers. It also recommends at Recommendation 22,⁴⁷ a proactive power for ASIC to intervene in relation to financial products, their marketing and disclosure materials, consumer warnings and distribution, and the power to ban products.

1.49 The final FSI report does not recommend a national exam for advisers although notes that '...this could be considered if issues in adviser competency persist.'⁴⁸

1.50 Removing regulatory impediments to innovative product disclosure and communication with consumers is recommended at Recommendation 23 as a way of reducing the risk that consumers buy products unsuitable to their needs and to allow for more effective communication with consumers.⁴⁹

1.51 Recommendation 24 recommended better alignment of the interests of financial firms with those of consumers by raising industry standards, enhancing the

44 Financial System Inquiry, *Final Report*, November 2014, p. 13.

45 Financial System Inquiry, *Final Report*, November 2014, p. 27.

46 Financial System Inquiry, *Final Report*, November 2014, p. 222.

47 Financial System Inquiry, *Final Report*, November 2014, p. 206.

48 Financial System Inquiry, *Final Report*, November 2014, p. 225.

49 Financial System Inquiry, *Final Report*, November 2014, p. 213.

power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.⁵⁰

1.52 The FSI final report made a number of recommendations to address what it termed 'significant matters', including Recommendation 40: renaming 'general advice' and requiring advisers and mortgage brokers to disclose ownership structures.⁵¹ The committee will consider these recommendations in more detail throughout this report.

Lifting adviser qualifications as part of a system to improve advice

1.53 While the committee notes the important role that individual advisers can play in ensuring that consumers and investors receive good quality advice that is relevant to their individual circumstances, the committee recognises that lifting the qualifications of advisers and the standards they are required to meet is only one part of a more complex system. All parts of the system need to be operating effectively to provide appropriate safeguards for consumers and investors while allowing efficiency, innovation and growth within the industry.

1.54 The committee considers that Professor James Reason's model of accident causation in the aviation industry provides a useful frame of reference for understanding the role of individuals and organisations within a greater system; in this case the financial services industry. Reason argues that in order to provide appropriate risk management within a system, appropriate defences need to be created. Rarely can a system be appropriately protected by individual safeguards alone; there also needs to be appropriate organisational or system-wide defences to reduce risk. Many layers of defence provide protection against single failures but for an entire system to be adversely effected, it requires 'the unlikely combination of several different factors to penetrate the many protective layers...'.⁵²

1.55 Using this analogy, lifting the qualifications of financial advisers and the standards of advice provided to consumers and investors becomes just one important defence mechanism to help reduce the risk of failure in the broader system. Other defences must also be in place, such as the Register of Advisers, ASIC having banning powers over management as well as advisers, an enforceable code of professional ethics and professional conduct which detail ethical dispositions and behaviours that prioritise the best interests of clients. While outside of its current terms of reference, the committee notes that product design and the design of remuneration structures in both vertically integrated and independent settings has the potential to adversely affect the cultural realities of the respective workplace within the financial services industry.

50 Financial System Inquiry, *Final Report*, November 2014, p. 217.

51 Financial System Inquiry, *Final Report*, November 2014, p. 271.

52 Professor James Reason, 'Achieving a safe culture: theory and practice', *Work and Stress*, vol. 12, No. 3, 293–306, 1998, p. 295.