Submission:-

Background:-

- I work in the financial planning industry and am concerned about the way the industry is regulated.
- Under current regulations the emphasis is on disclosure and discussion of risks.
- Many people do not have the financial knowledge to understand the risks or implications of their decisions. Hence they "trust" the adviser to manage this.
- The current regulations make the licensee responsible for ensuring advisers provide appropriate advice.
- Anecdotally most investments that have hurt people in major ways share many common features – such as
  - Large fee structures
  - Large investment amounts into single investments
  - The people have invested into the types of products being sold so they do not have a good understanding of the risks.

Discussions:-

- Most clients do not want 50 pages of risk information and discussion of alternatives. This particularly applies to those people who are likely to be "caught" in inappropriate investment strategies. So the current system of disclosure and education is not particularly effective. Think about your doctor. They diagnose the illness, give you a name you can not spell and a treatment. They don't give you 50 pages and attempt to educate you about the illness and treatment. Why should this industry pretend people are suddenly going to start reading and educating themselves. Our financial planning regulations attempts to educate people and turn them into investment and risk assessment experts. For a critical number of people this fails.

- The current investment risk discussions may be correct - but they are not understood by clients so they are also not particularly effective.

- The "professional and honest" advisers will act to ensure they have appropriate strategies and investments so the need for the disclosure is reduced. However the "less professional and honest" advisers use the above to hide behind. Both results reinforce my point that the disclosure and risk assessment discussions are <u>not appropriate in the current format</u>.

- Placing the licensee in charge of monitoring it's own advisers is not providing independent monitoring of advisers. Particularly when the adviser may also be the licensee. For " honest and professional" advisers and licensees this monitoring is just a cost that does not improve the quality of their work, because they were already working well. For “less professional and honest” advisers I do not believe that self monitoring will achieve any realistic customer protection.

- We need a system that identifies real potential concerns BEFORE they occur. The common elements of large fees/low diversification and clients who have never invested before making large investments should be used as a “RED FLAG” when auditing.

- In my experience most licensee compliance systems concentrate on “form” and “legal compliance” rather than client protection. This is a result of the current regulation system and laws which also concentrate on form/disclosure and legal compliance.

- Currently advice is not scalable. ASIC has not provided any advice or regulation that would differentiate between a $25,000 investment and a $1,500,000 investment. Hence the regulations have attempted to provide an average solution that suits every situation. This is wasteful of time and effort for small investors and leads to unneeded consumer costs while not providing adequate protection to larger clients.

- The current regulations do not differentiate between different client risks. Hence a $500,000 investment into a cash account is treated the same as a $500,000 into shares in some developing country using borrowed money. This seems foolish to everyone with common sense. However as advisers we must charge people to meet our compliance costs. Hence adviser cost structures are inefficient.

- The current regulations are complicated and confusing. Yet if you ring ASIC and ask for their advice on how to meet the current regulations and generally do the right thing they will quickly refuse to provide any advice. Yet if you do the wrong thing they are very quick to point this out (when it is all too late). Hence advisers are left with numerous documents that attempt to correctly interpret ASIC’s understanding of the regulations. Similarly ASIC has to produce discussion papers (with big disclaimers that state you can not rely on their advice) to explain the complicated system. I do not believe the regulations have reduced the occurrences of inappropriate advice or products. STORM has still occurred as has WESTPOINT a few years ago.

- In one hour in a large department store you can spend $20,000 on a big TV and surround sound system with no disclosure/paperwork or anything else. To invest the same amount currently you need to pay advisers to question you for an hour on your understanding of investments, your assets and liabilities and your spending habits all of which is rather invasive so you are forced to sign a privacy agreement. You then also pay for an report and then pay again for the paperwork to be processed. Image having to do all this to buy a TV? Most clients just want to know the “total costs to me” for the investment.

<u>Possible Solutions:-</u>

1. **Compliance should be more targeted to large investment amounts and large fee structures.**

    - This could be achieved by requiring full SOA's when clients have total investments over $500,000. The SOA must detail cash flows and have a risk strategy in place to deal with a once in 30 year market fall.

    - Clients paying over $20,000 in fees would require a compulsory audit.

2. **Compliance should be less cumbersome for lower risk investments.**

    - This could be achieved by recognizing that smaller investments have less risk. It is very unlikely that someone would loose their house if a $20,000 investment declined by 50% , or if the investment was in cash.

    - Investments in cash or highly rated bonds are secure and should not need an SOA. A single page general advice statement that states the investment name, and the total upfront and annual cost to the client should be sufficient.

    - Investments under $20,000 (that are not cash or highly rated bonds) could be completed after a verbal discussion and a single page general advice statement that states the investment name, and the total upfront and annual cost to the client.

    - Combining numerous super policies with the aggregate total of less than $20,000 should also be a single page general advice statement that states the investment name, and the total cost to the client. Most people agree combining super polices makes sense – why spend money needlessly producing a report to say "It makes sense"

    - Investments (that are not cash or highly rated bonds) over $20,000 and less than $200,000 are larger but realistically it is also unlikely that someone would lose their house if the investment fell by 50%. Hence these are basically medium risk for the client. A general advice document that outlines the fee structure, client costs, and the typical fall in investment value that might occur once every 5 years and once every 30 years would be appropriate.

    - Investments (that are not cash or highly rated bonds) over $200,000 are larger and should have appropriate discussions on cash flows and risk management. A personal advice document that outlines the strategy, cash flows, risk management strategy, fee structure, client costs, and the typical fall in investment value that might occur once every 5 years and once every 30 years would be appropriate. The risk strategy should address the actions that may be taken if the investment falls in value by the 5 year and 30 year amounts.

3. **Advisers need to be independently audited by someone not associated with their business or their licensee.**

    - Annual independent audit of recommendations is appropriate.

4. **Compliance should be more targeted to client risk assessment.**

    - Audits and regulations currently concentrate on form and education, however these do not eliminate “poor advice” or “unethical behavior”.

    - Audits should target client risks. Ie a review of recommendations made above.

    - Audits are costly and time consuming. Hence audits should be concentrated towards clients with larger risks and who have paid higher fees because historically these client are more likely to have concerns. Also larger investments generally require more work so tend to have larger fee structures and require more risk assessment. Hence 100% audit of clients paying over $20,000 in fees or commissions in any year. Then audit 3% of clients paying over $10,000 in fees or commissions. Audit 1% of clients paying lower fees.

5. **ASIC should have an adviser education role to assist people to meet their requirements.**