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14th July 2009

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

Attention: Dr Shona Batge – Committee Secretary

Dear Dr Batge,

Submission to Parliamentary Joint Committee on Corporations and Financial Services
Inquiry into Financial products and Services

The Boutique Financial Planning Principals Group (BFPPG) is pleased to make our submission to your committee's Inquiry into Financial Products and Services.

Our submission is firmly based on the nationally worthwhile objectives of:

- Encouraging all Australians to achieve financial independence in retirement by seeking the level of financial planning advice they need when and where appropriate.
- Firmly establishing a high degree of consumer trust and confidence in the financial planning industry.
- Improving the industry as it transitions to a profession by encouraging, requiring and enforcing higher competency and standards at the financial planner level as well as improved consumer education.

We believe that the recommendations made in our submission will be to the benefit of all Australians and will address the issues facing the industry that have dented its integrity.

The opportunity to make significant improvements that move our industry, internally, to a new level of professionalism and, externally, to a new level of consumer confidence is exciting and one to which the BFPPG is committed.

We are prepared to assist you and your committee in whatever capacity you deem appropriate.

Yours sincerely,

Claude Santucci
President

BFPPG

Boutique Financial Planning Principals Group Inc.

Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Financial Products and Services

BFPPG

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Executive Summary

Key Objectives

The recommendations provided by the Boutique Financial Planning Principals Group in this submission start from the very clear and nationally worthwhile objectives of:

- Encouraging all Australians to achieve financial independence in retirement by seeking the level of financial planning advice they need when and where appropriate.
- Firmly establishing a high degree of consumer trust and confidence in the financial planning industry.
- Improving the industry as it transitions to a profession by encouraging, requiring and enforcing higher competency and standards at the financial planner level as well as improved consumer education.

Recommendations

Recommendation 1

Government should encourage all stakeholders to help Australians achieve financial independence in their retirement by ensuring a level playing field in which the consumer benefits from competition, choice, and value for money.

Recommendation 2

Regulations / legislation should be introduced or changed to ensure that consumers can distinguish between financial planners providing independent, strategy–driven advice and those providing product sales–driven advice.

Recommendation 3

A Professional Standards Board (PSB) should be established to set the standards of behaviour, ethics and conduct of the profession. Financial planners would be registered to the PSB and be required to adhere to its standards. Education and competency standards would be transferred from the control of licensees to the PSB.

Recommendation 4

The use of the term "financial planner" would be restricted to those who are registered to the Professional Standards Board. This restriction would be expanded to include other terms that suggest a professional obligation.

Recommendation 5

The rules regarding disclosure should be reviewed and enforced to ensure the compulsory, clear and comprehensive disclosure of all relationships between AFSLs, financial planners and product providers. Compulsory product control by licensees should be removed from the licensing regime.

BFPPG

The Boutique Financial Planning Practitioners Group

The Boutique Financial Planning Practitioners Group Inc (BFPPG) is a national, non profit association of like–minded, independently owned financial planning practices. The BFPPG was incorporated on 26th April 2002 which formalised a monthly study meeting of boutique financial planners going back to 1996. The BFPPG now has around 75 principal members, with members in every state.

Ordinary Members of the BFPPG must:

- Be licensed to deal and/or advise in securities;
- Be providing ethical and professional financial planning advice i.e. advice which puts the client's interests first;
- Be independent and independently-owned, as defined in the BFPPG Constitution;
- Hold either principal membership, or the principal(s) must be individual members of the Financial Planning Association of Australia (FPA); and
- Have 15 or less Authorised Representatives.

The Mission of the BFPPG is to use our collective strength to improve the financial planning environment for clients and financial planners by:

1. Sharing ideas and information between members — helping members in all areas of financial planning with emphasis on the particular vulnerabilities of small businesses in an industry where the majority are large businesses.
2. Fostering friendship between members and providing support — supporting members and providing assistance to representatives seeking their own licence.
3. Communicating with the FPA — providing a united and strong boutique voice to the FPA and working with the FPA to promote the specific interests of boutique financial planners.
4. Communicating with regulators and government — providing a united and strong voice to regulators and government about matters that are consistent with the provision of client–focused as distinct from product–focused financial planning advice to the Australian public.
5. Promoting awareness and recognition — promoting the significant differences between boutique financial planners and institutionally owned financial planners and the differences between "advice businesses" and "product sales businesses" to regulators, politicians and to the public.

Working with Consumers and Stakeholders

Financial planning practitioners are in the privileged position of looking after their clients' wealth — a matter second in importance only to their health. In fact, financial planners can provide advice that benefits several generations of the same family and not just the current client. With that privilege comes the responsibility to put the client's interests first and to act in a thoroughly professional manner at all times.

Since its establishment in 2002, the BFPPG has sought to improve the financial planning industry directly through its peer-driven internal education and practice management processes and indirectly through active participation in the Financial Planning Association (FPA) and through direct contact with ASIC, Treasury, Government and the media.

Industry Overview

The BFPPG recognises that the Australian financial planning industry has had a short history starting in insurance sales and built on by accountants adding advice to their compliance roles. Over the past 25 years or so, development has moved the industry into providing choice, competition and improved financial outcomes for its clients. Development continues strongly and it can be argued that Australia's financial services regime is well advanced of both the United States and the United Kingdom.

The pace of that development and its direction, however, have now been brought into focus by a combination of:

- Recent and significant product failures such as Timbercorp, Great Southern and Westpoint;
- The collapse of the Storm Group;
- The global financial crisis; and
- An increasing focus on the question of commission v fees.

Australian Financial Services Licensing

The current licensing regime is problematic for financial planners because to control the products that are recommended and the fees the client pays, the financial planner has to be licensed. Many financial planners enter into remuneration contracts with the licensee which details fees and commissions between the client and the licensee but the financial planner has no direct control over the products nor commissions / fee arrangements between product provider and the licensee. The licensee has complete control over the availability of products to clients and the commission / fee arrangements.

The only way that a financial planner can enter into agreements with product providers on behalf of the client is to become a licensee. We believe that this is an unintended consequence of the licensing regime which commenced in 2001.

One of the key purposes of the licensing regime is the supervisory role of the estimated 16,000 financial planners. The licensee has control of the level of competency and training of its Authorised Representatives as prescribed in RG146. This is a minimum standard of financial planning education which, in our experience, is more suitable for product distribution than for financial planning that meets the needs of the client. This is one of the main reasons that financial planners who focus on providing advice rather than selling a product seek their own licence.

Competition and Choice in Financial Planning

In the financial planning industry's relatively short history it has broadly developed into two distinctly different financial planning practice models:

- Investment product provider owned (or partly-owned) practices (we will call them "institutionally owned").
- Independently owned financial planning practices.

Institutionally Owned Financial Planning Practices

Institutionally owned (or partly owned firms) such as Garvan, owned by National Australia Bank; Hillross, owned by AMP; BT, owned by Westpac; Ipac, owned by AXA etc, form the major portion of the industry. These firms serve as the distribution arm for their owners' products. Where the firm is not wholly owned by an institution there are usually financial arrangements in place that favour the distribution of the institution(s)' products. A key objective for the relevant institutions is to generate funds under management.

In a 2003 presentation to the Australian Investors Association, ASIC Commissioner, Berna Collier, said:

> *"The perception at present in many circles however is that fund managers do not own financial planning groups because they want to be in the advice business. They want to be in the distribution business."*

Berna Collier's view can also be evidenced in AXA's briefing to brokers in London in December 2008 where AXA described a number of "distributors" in Australia as 16,000 of which 8,000 were identfied as supporters of AXA products. By 2012 AXA believe that 10,000 will distribute AXA products. *(Penn & Roberts, AXA presentation, December 2008 page 12)*

The reference to distribution is not peculiar to AXA. A presentation by the CEO of AMP on 18 September 2008, referred to AMP's financial planners as "distribution channels".

http://library.corporate-ir.net/library/14/142/142072/items/308113/pres.pdf

ASIC's enforceable undertaking on AMP relating to super switching also adds significant weight to the BFPPG argument that the focus of institutionally owned practices is on product sales:

http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/AMP_enforceable_undertaking.pdf/$file/AMP_enforceable_undertaking.pdf

> *"Between January 2005 and October 2005, ninety three (93) percent of all new investment or superannuation business resulting from the advice of AMPFP Planners was invested in AMP products. This is not atypical of dealers"*

This is not to argue that the advice provided to clients of institutionally owned, or part owned, financial planning practices is inherently flawed. We have used these examples to make our case, not to assert that they are generally providing flawed advice. The ownership issue, however, clearly introduces a bias into the provision of the advice. This is particularly so where the owning institution's products provide a benefit to the financial planner either directly or indirectly that may not be a meaningful benefit to the client.

Independently Owned Financial Planners and the BFPPG

It is estimated that there are over 400 smaller, independently owned financial planning licensees in Australia. The BFPPG represents 75 of those firms and actively seeks to recruit additional suitably qualified members whose common characteristics can be described as:

- No institutional ownership – usually family or individually owned businesses;
- Experienced financial planners who are well regarded by their peers;
- Focused on providing quality advice with a first emphasis on strategy rather than product sales;
- Established long term relationships with loyal clients; and
- Embedded in their local communities.

Many BFPPG financial planners started their careers with institutionally owned practices and then either joined independently owned firms or took a license in their own right because:

a. They valued the ability to put their client first, without institutional interference and free from product bias; and
b. They valued the professional environment fostered by a strategic advice focus rather than a product focus.

The clients of BFPPG member firms value the experienced, advice focused, independent approach of our members. Like their financial planners, many clients also started out with institutionally owned financial planners and became disillusioned with the "one size fits many" product sales focused approach. They sought advice and they were sold a product.

BFPPG financial planners work hard to ensure that the advice they provide is of the highest quality because they build the value of their businesses on establishing and maintaining long-term relationships with their clients. Our members believe that the client's interest must come first so the advice they provide must:

- Meet the client's needs and objectives;
- Be supported by a clear and reasonable strategic rationale;
- Clearly set out the present and future benefits of the advice as well as what can go wrong;
- Put the client in a fully informed position from which the decision whether or not to accept the advice can be made;
- Clearly and fully disclose any influences on the advice, either positive or negative;
- Clearly set out the risks to meeting the client's objectives and how those risks are to be managed;
- Clearly and fully disclose all fees, charges and remuneration; and
- Clearly and fully disclose all and every ownership factor that could have an impact on the advice.

Our members hold the view that financial planners need to follow such a framework if they are to put the client's interest first and if the advice they provide is to have integrity. From a business perspective our members understand the value of an on–going client relationship as opposed to a sales transaction.

The value of that approach is evidenced by the facts that no member of the BFPPG recommended investment in Westpoint and the level of investment in Timbercorp and Great Southern was very small and, in most cases, the result of inheriting the investments when the BFPPG members took on new clients.

Remuneration Issues

The BFPPG supports the elimination of incentive based commission payments received by financial planner licensees from product providers on a gradual but definite timetable. The BFPPG supports the principles that:

- The manner in which fees are calculated and the amount of the fees should be agreed directly between the financial planner and the client, and that the licensee should agree to collect those fees;
- The role of the licensee should be flexible and negotiated with the financial planner, especially in the area of product mandates / approved product lists;
- All costs should be clearly and fully disclosed;
- The cost of advice should be separately identifiable from payments for products, administration and platforms;
- Payment for advice should come from the client not the product provider. It should be agreed between the financial planner and the client and the method and source of the payment should also be agreed between the financial planner and the client;
- Payments made between licensees and product providers or administrators for marketing, business volumes and listing on approved product lists should be disclosed in percentage and dollar terms in the licensee's Financial Services Guide; and
- Payments to related parties should be clearly and fully disclosed.

The collection of the payment by a platform or product manager is consistent with this approach where this is an administrative efficiency quite different from the payment of a commission directly to the financial planner that comes out of the product and directly impacts the client's overall return.

BFPPG accepts that making a rapid change from a commission–based model to a fee–basis model could be detrimental to clients and the process should be managed over a short but definite time and, with all stakeholders involved, through the development of improved fee and remuneration models that drive down costs and improve transparency.

There has been recent argument that commissions should be banned immediately rather than eliminated over a period. There are still many financial practices that rely on commissions for their income. It is reasonable to accept that banning commissions within a short time frame would jeopardise the continued viability of those businesses. The real risk, however, is that the clients of those practices would suffer as their financial planners struggled to replace their remunerations models.

The BFPPG believes that, as long as the industry is committed to moving to a fee basis in an orderly manner, the change from the commission based–model to fee–based models will be to the advantage of all stakeholders.

The bigger, and more subtle problem that will not be eliminated by the removal of commissions, is the difficulty that the public has in recognising who is providing independent advice, i.e. advice free from ownership or remuneration bias and who is providing advice based on the sale of a product.

For example: A Garvan financial planner (Garvan being ultimately owned by the NAB) may recommend that a client invest in a portfolio of, say, five investments, two of which are provided by external providers and three are internal, i.e. MLC product. The financial planner could well argue that the portfolio is well constructed and diversified. He could make the point that there are no commissions involved as he and the client have negotiated fees. What is not apparent, however, is that, because the portfolio is administered through the MLC platform, there is an inherent direct remuneration bias in the recommendation of the MLC products and an indirect remuneration bias in the use of the other product through the MLC platform. It is easy to reduce the argument to fees versus commissions; the real test is to clearly, and in a simple manner disclose all the ownership links and remuneration bias. Consumers are entitled to all the relevant information that could influence their decisions.

It is also unreasonable to expect that commission arrangements that have been in existence for decades can be eliminated quickly. With good will from all stakeholders, however, the changes can be implemented and the problems that may seem unsurmountable now will be overcome.

Recommendations Explained

Recommendation 1

Government should encourage all stakeholders to help Australians achieve financial independence in their retirement by ensuring a level playing field in which the consumer benefits from competition, choice, and value for money.

How can government provide this encouragement?

1. **Recognise and continue to promote the benefit for the consuming public of a broad range of financial planner choice for the consumer.**
2. **Work with the industry to improve:**
   a. **The financial literacy of Australians.**
   b. **Product risk assessment and consumer product warnings.**
   c. **Practice standards and increased accountability for research firms and auditors.**
   d. **Consumer access to affordable advice.**
   e. **Advice disclosure requirements.**
3. **Ease the compliance burden which is currently focussed on form rather than substance.**
4. **Introduce legislation / regulation to ensure that clients can move from one platform to another without incurring significant expense or a tax liability.**
5. **Allow a tax deduction for financial planning fees.**

1. **Recognise and continue to promote the benefit for the consuming public of a broad range of financial planner choice for the consumer.**

The distribution channels of the major fund managers are conflicted. There is a dichotomy between being providers of advice and sellers of product. This was acknowledged by ASIC in the first public hearing of the PJC Inquiry. ASIC in effect acknowledge that the product distribution channels are there to sell product rather than advice and as Bernie Ripoll pointed out "the conflict that exists is that the responsibility of anyone selling any product is to the person who pays them not to the person they sold the product to necessarily."

Consumers are entitled to and looking for unconflicted advice, where the advisor puts the needs of the client first and above all other interests. This is often referred to as professionally disinterested advice. It means that:

- Consumers would not be a sold a product which does not put their interest first.
- Products recommended would only be those that are appropriate for the client and client's objectives;
- If the consumer would be better off without being sold a product, the consumer would not be sold a product.

- If the consumer would be better off without a particular investment strategy, that strategy would not be recommended.

Currently in the Australian financial planning industry there is only one source of unconflicted advice – the independently-owned sector, where there is no ownership or other relationship with product providers.

It should be noted, however, that, right now, it is unusual to find completely unconflicted advice because of the gradual development of the industry and the time it takes to replace legacy products, and remuneration arrangements. It is, however, in the independently–owned sector that the greatest and fastest changes towards completely unconflicted advice is proceeding. With no product to sell or ownership restrictions to consider the independently owned sector is free to choose the path of advice that puts the client first.

Consumers want choice of styles of advice.

Many clients want simple, one-off advice or advice that is limited to a particular issue. The independently-owned sector is well suited for providing quality advice from the simplest to the most complex. It is this sector of the industry that provides the widest diversity of styles of advice, enabling consumers to find a style of advice and working with their financial planner that suits them. Clients with investment experience tend to seek far more sophisticated advice tailored to their needs. This need is well catered for in the independent advice sector. By contrast, and because of size and the need for efficiency across a network, larger institutionally–owned financial planners tend to focus on a set process of advice and a limited range of investment product, often with an inbuilt bias.

Consumers with more complex needs value continuity of advice.

All consumers prefer to deal with someone they know. We all feel comfortable dealing with the same person with whom we have built a relationship. Consumers who want and need advice on a continuing basis value a long-term relationship with an individual advisor similar to the long-term relationship they have with their doctor which ensures the continuation of good advice built on a base of preceding good advice. Financial planners often come and go within major institutions. In fact, the better planners usually leave to work under their own licence or as part of an independently owned practice. Consumers do not like changing advisors, particularly where this occurs without their input and where often the next advisor may offer a different strategy using different products from the previous advisor. In a small financial planning AFSL, the principal is usually a practising financial planner, the group of planners in the practice tends to be stable over the long-term and the practice has a planning culture that ensures continuity of advice when a planner is on leave or leaves the practice.

It has been argued that there is an inherent weakness in small independent AFSLs because of a lower level of capital adequacy. In fact the most often quoted reason for using a small independent AFSL is the advantage of advisor independence, and typically the experience and personal service that goes with being small. Consumers see these important factors as being greater than the disadvantage that these businesses are less highly resourced and less capitalized. In the PJC hearings Mr D'Aloisio of ASIC said:

> *"when you look at these product lists and how they work and you look at the reputation of the brand that might be behind them and the organization that is doing it, there is also a lot of comfort to be drawn from the fact that those organizations, given their reputation, have put those products on a product list, have developed them and will stand behind them. It means that the financial planner or adviser who is recommending those products is probably in a reasonably good position from the consumer's point of view."*

In other words, larger institutionally owned, and partially institutionally owned, AFSLs are discouraged from poor behaviour because of the fear of loss of good reputation; the implication being that the small independently owned AFSL does not have that discouragement.

This is obviously contrary to the reality of the industry today:

- ASIC forced AMP to give an enforceable undertaking which related to many of their financial planners providing many of their clients with an inadequate basis for advice;
- Suncorp problems required their financial planners to undergo additional educational requirements;
- Storm Financial, Great Southern, Timbercorp all had reputations to protect;
- The Commonwealth Bank has moved, after many months, to limit the damage to its reputation as a result of their loan practices to Storm clients; and
- Professional Investment Services, which is 24% owned by Aviva, has had problems with Westpoint and with agribusiness schemes such as Timbercorp and Great Southern.

The small AFSL often has family assets supporting the business, works longer hours, takes a lower level of income to build the business and has a closer and more personal relationship with clients. Reputation is even more important for the small AFSL because of the positive impact of referrals to the business from client advocates and the negative impact of one mistake that can put them out of business.

Clearly, size is not an important issue when it comes to the quality of advice. Despite this there are significant threats to consumers' choice and competition because of increased or poorly considered regulation which impacts directly on the small licensee, including:

- Compulsory Professional Indemnity (PI) insurance at an unrealistically high level which could force small financial planning practices to close, as has happened in the UK recently;
- Financial Ombudsman Service (FOS) jurisdiction limits being increased to $300,000 with the expectation that the limit will be increased further to $500,000; and
- Calls for increased capital adequacy.

The argument put forward for the measures above is the protection of the consumer despite clear evidence that the majority of smaller independently owned financial planning practices provide quality advice at a reasonable price and within a strong financial planner–client relationship.

PI cover offers little protection for anyone in the chain of advice and even less for the financial planner and, consequently, the client. Under the current arrangements, a product provider can misrepresent a poorly designed investment product, a research house can rate the product well, and a financial planner can recommend the product to a client based on the manufacturer's misrepresentation and the research houses' ratings. Only the financial planner stands unprotected when the product falls over and the client seeks redress.

The product provider hides behind the complexity of a product disclosure statement that was designed to obfuscate. The research house hides behind the protection of a rating that is full of "ifs", "buts", "maybes" and "coulds". The financial planner's reliance on the matter and nature of the advice he provided may not be enough and a successful claim against a small financial planner, whether deserved or not, can effectively put that financial planner out of business.

The BFPPG strongly recommends that PI cover limits be kept at the reasonable level required to meet its main objective – the protection of the business - and that the principle of proportionality be applied so that redress can be sought from all relevant parties in proportion to their blame when something goes wrong.

FOS jurisdiction limits are sufficiently high to meet the majority of claims and there is no need to increase them further. Most claims against financial planners are quite small and are adequately covered by current PI cover levels.

The BFPPG is also concerned that FOS operates in a way that severely limits the rights of financial planners in a manner quite contrary to our principles of law.

Calls for **increased capital adequacy** are based on the idea that the bigger you are the more protection you offer the client. This is also contrary to reality. When the requirement for stockbroking firms was raised to $5 million it effectively removed smaller stockbroking firms from the industry.

Storm had adequate capital as did Lehmann Bros and Bear Stearns.

The way capital is employed is far more important than the size of the capital and we all know from experience that those with lesser capital tend to be better at managing their capital and spending their money. There is not much point in having sufficient capital to take clients on a Mediterranean cruise when, a short time later, the business collapses and those clients lose their wealth.

It is important to understand that one advice firm collapsing involves hundreds, possibly thousands of clients also suffering; and each poor experience destroys the incentive for that client, family friends and colleagues to seek professional advice in the future.

The BFPPG believes that the best protection for the consumer is the continued encouragement and development of the independently owned smaller financial planning practice and the continuation of a competitive, level playing field that offers genuine choice across a broad range of advice models. Those clients who prefer to deal with institutions can continue to do so and those that prefer independent advice can also have their needs met.

The current retail duopoly between Woolworth and Coles is a good example of what can happen when smaller players are removed from the market. The Australian consumer now has to contend with limited choice, an almost identical range of product, a decreasing variety of product and a similarity of pricing that borders on price fixing. This is not the open, competitve, wide ranging market in which financial services should operate.

The BFPPG does not want to see the Australians saving for their first home, saving for their children's education or planning their retirement have to deal with similar limitations
and restrictions.

2. **Work with the industry to improve:**

   a. **The financial literacy of Australians.**

   The investing public must understand that there is always some level of risk in investing and a level of personal responsibility that goes with accepting that risk.

   b. **Product risk assessment and consumer product warnings.**

   Investment products sold without advice should carry a clear, unambiguous and up-front "warning label". It is inappropriate for product providers to advertise their product to the public at large and meet their responsibilities by providing an ambiguous warning in complex legalese buried somewhere within a multi-page product disclosure statement.

   c. **Practice standards for research firms and auditors.**

   Research houses need to be held more accountable for product failure. ASIC should also hold auditors more accountable.

   d. **Consumer access to affordable advice.**

   If most Australians will require limited advice, the compliance regime should reflect that. Someone who simply wants advice on which is the best superannuation investment option for them within their company's fund should not have to receive a multi-page statement of advice (SOA). A simple written advice disclosing costs, ownership and risk should suffice.

   e. **Advice disclosure requirements.**

   This is a fundamental issue that goes to the heart of unbiased advice. The consumer has to know who stands behind the advice and, more importantly, what do they stand to gain when the consumer acts on that advice.

3. **Ease the compliance burden which is currently focussed on form rather than substance**

The reforms introduced under FSRA have not achieved what they set out to do in the area of compliance, particularly with SOAs. A compliance regime designed to protect the public has been established that starts with a focus on the sale of product and then relies on form rather than substance. The focus should be on the provision of well thought out advice.

The requirements relating to SOAs have skewed advice so that emphasis is now on the protection of the financial planner against all possible future problems and then the production of those long, complicated SOAs in the most efficient manner. In other words, if in doubt, put it in the SOA – the result has been over complicated and extremely long SOAs that are of little value to the client. In addition, the cost of producing them in an efficient manner has put an unnecessary financial strain on financial planners and made the provision of simple one–off advice more costly.

Corporations law says that an SOA must contain:

- "information about the basis on which the advice is or was given" Section 947B(2)(b)
- "the level of detail about a matter that is required is such as a person would reasonably require for the purpose of deciding whether to act on the advice as a retail client." Section 947B(3)

Section 945A says the advisor must "have a reasonable basis for the advice".

Superficially, these requirements seem reasonable and good for consumers. Unfortunately for other than the most simple advice, the basis for any advice can often be complex and comprehensive resulting in SOAs that are exceptionally long and an inability for financial planners to provide simple advice in a cost–effective manner.

It is becoming increasingly accepted that long SOAs are not in the consumers' interest:

- Long SOAs are not read completely by most consumers and fewer understand them.
- Often the best place to hide something is to disclose it within a complex and comprehensive document. Sir Anthony Mason said: *"Detailed and dense disclosure is often the most effective form of concealment"*.

There is a simpler approach that will provide the consumer with a better outcome:

- Replace the requirement for full disclosure of the basis of advice with the requirement that the advice **must be defensible**. There must be a reasonable basis for the advice, and the financial planner must be able to defend the advice if required by the client, ASIC or FOS.
- The advisor can then provide the consumer with documentation on the basis for the advice at a level that is suitable to the client's needs.

This approach will work well for both simple advice and for more complicated advice that is built up over time as part of an ongoing relationship of advice.

The benefits of implementing this recommendation include:

- Shorter consumer–friendly clearly understandable Statements of Advice.
- Poor advice will be more easily exposed if SOAs are short, standardised documents. Poor quality advice will not be able to hide behind good quality form and the onus will be on the individual financial planner and the AFSL to defend the substance (and basis) of their recommendations.
- Conflicts of interests are harder to hide in short disclosure documents.

If we have short, preferably standardised SOAs the disclosure of important factors which might influence the advice (including commissions, relationships and other conflicts of interest) would no longer be able to be hidden.

The BFPPG is not recommending a lower level of protection for the consumer. Consumers will be better protected if:

1. They can start with simple, understandable SOAs; and
2. ASIC adequately enforces the well established common law obligations in terms of negligence, duty of care; including:

(a) 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)

(b) 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
- The requirement to disclose all factors which might taint the advice. Section 947 2(d) & 947 2(e)

Currently there is a high level of non-compliance with these sections that is either unpoliced or inadequately policed. If the requirements around disclosure were standardised the problems with disclosure, and related conflicts, would be addressed. Consumers would be better informed and it would be almost impossible to hide a conflict or not make an appropriate disclosure in a short, simple, clearly laid out standardised format.

It must be alarming to ASIC, as it is to the financial planning industry at large, that Storm apparently met all their compliance requirements and yet the clients were left unprotected. This is a perfect example of form over substance.

The recent change to superannuation advice highlights and supports this recommendation to ease the compliance burden for all financial planners. The current compliance regime's complexity makes it very difficult to provide simple, one–off advice in a cost effective manner. Now superannuation trustees can provide that simple, albeit limited, advice to their members free from that compliance burden.

The BFPPG sees this as a positive step in helping Australians get the advice they need. The class order relief unfortunately creates differences in the protection available to consumers and an uneven playing field with the retention of the compliance obligations for some financial planners and not for others. Extending this change to all financial planners when they provide simple, limited one–off advice would make that advice available to all consumers, not just those within superannuation funds that elect to provide advice, and it would bring down the overall cost of advice significantly.

4. **Introduce legislation / regulation to ensure that clients can move from one platform to another without incurring significant expense or a tax liability.**

Increasingly, financial planners and their clients are taking advantage of the benefits offered by administration platforms, wraps etc.

There are, however, significant problems in this area:

- Platforms can lock in a client making it difficult and potentially expensive for the client to move to another platform provider. This can often discourage a financial planner from advising the client to make the move; in turn this removes some of the independence that the client should have. It is relatively easy to leave a financial planner but much harder to leave a platform.

- Platforms provide overrides and volume bonuses to AFSLs as an incentive to keep funds under administration. This introduces an unnecessary conflict. Even when these incentives are clearly and fully disclosed they leave the client at a disadvantage because the platform providers do not have to compete on service and product differentiation; they can simply manipulate the incentives to ensure that funds stay under their administration. If there was genuine competition the client would benefit from a better level of service and innovation.

The BFPPG understands the difficulties this would involve. Moving superannuation from one platform to another involves a change of Trustee. Investments have to be sold down to cash, the cash transferred and then reinvested in the new platform. This can be expensive and time consuming for the consumer and often results in the maintenance of a sub-standard arrangement rather than incur costs.Capital gains tax would be foregone by Government and this may be substantial. The trade-off is the empowerment of the consumer. The pricing power of platforms would be reduced significantly; platforms would not be content to all "charge around the same level of fees" as they would have to compete on service, and administrative efficiency. As well, the volume overrides and bonuses paid by the platforms would quickly disappear under pricing competition.

The consumer would directly benefit from:

(1) Lower fees;

(2) Improved service and administrative efficiency; and

(3) Transparency.

5. Allow a tax deduction for financial planning fees.

The Commissioner's determination that financial planning fees are not tax deductable arises from section 8(1) of the *Income Tax Assessment Act 1997*. This section provides a tax deduction for all "losses and outgoings" (expenses) to the extent that they are incurred in gaining or producing assessable income or incurred in carrying on business for the purpose of gaining or producing assessable income.

Expenses, however, are not tax deductible under section 8(1) if they are of a capital, private or domestic nature. Out of that seeming contradiction, the Taxation Office issued Taxation Determination 95/60 (2006) which declined to allow a tax deduction for financial planning fees on the basis that the advice was too far removed from the actual investments and subsequent income.

The BFPPG believes that the Commissioner should review this ruling or the law should be changed to allow a deduction.

In the continuing argument about commissions v fees it makes little sense for an upfront commission paid to a financial planner to be tax deductible to the product manufacturer but an upfront fee paid to a financial planner not to be tax deductible to the client.

As the financial planning industry moves forward to eliminate commissions, Government can lend its support by allowing a tax deduction for the fees. The precedent exists: for example, expenditure incurred in the management of a person's taxation affairs are tax deductible, even though section 8(1) does not make this clearly so.

Recommendation 2

Regulations / legislation should be introduced or changed to ensure that consumers can distinguish between financial planners providing independent, strategy–driven ongoing advice and those providing product sales–driven advice.

The BFPPG believes that the consumer will be better served when there are clear, legal definitions that make the distinction between institutionally owned, product sales driven, advice and independently owned, strategically focussed advice.

Currently, it is very difficult for consumers to identify whether they are dealing with a financial product salesperson or an independent financial planner committed to putting their interests first. There is ample evidence that financial product salespeople hold themselves out to be independent in a misleading manner so as to make it easier to make a sale.

In the interests of consumer transparency there should be a clear distinction made between independent financial planners and financial product salespeople.

The BFPPG accepts that the sale of financial product is not, of itself, a problem. It is the sale of the product under the guise of independent advice by a salesperson with a vested interest in the sale itself that is the problem. Consumers should be able to ask the question 'Why am I being sold these products – Is it because the financial planner is putting me first or is he putting himself first?" and the answers should be clear and obvious.

The objective is clear but achieving it will require a commitment on the part of all stakeholders, or failing that, direction from Government. Clearly there are financial planning practices that are independently owned at one end of the spectrum and there are those practices wholly owned by institutions at the other end. There is a very large part of the industry, however, that falls between the two where there is part ownership by institutions and an in-built bias to recommend the institution's products or where there are financial incentives in place to recommend one product over another such as volume overrides or a combination of both. This group has to work out if they are in the advice business and should be remunerated for providing advice or if they are in the product sales business and should be remunerated on that basis.

The BFPPG accepts that there are different business models but consumers should have confidence in their decision to go with one model over another. A client may prefer to deal with an institutionally owned practice because he values the corporate strength behind the practice and because he is prepared to accept some level of product bias for that corporate strength. Another client may prefer to deal with an independent financial planner because he considers product bias to be more of a problem. Both types of client ought to be able to make their decisions on the basis of a fully informed position about ownership and product and remuneration relationships.

Recommendation 3

A Professional Standards Board should be established to set the standards of behaviour, ethics and conduct of the profession. Financial planners would be registered to the Board and be required to adhere to its standards. Education and competency standards would be tranferred from the licensees to the control of the Proffesional Standards Board.

Industry standards will be improved by the establishment of a Professional Standards Board (PSB) and the registration of financial planners to that Board. This will lift the minimum competency requirements for financial planning advice through professional obligations and mandatory professional membership requirements.

The Professional Standards Board is one side of the equation – the other side is the professionalism of the individual financial planners.

Unfortunately, at present anyone can call themselves a financial planner. Anyone with one or more RG146 qualifications, which can be obtained with a minimum of effort and in a very short time, can give advice to retail clients.

The regulations covering entry should be reviewed so that those entering the profession with the minimum education requirements (i.e. RG 146) could only work within an established financial planning business and those businesses that were content to employ minimally educated financial planners would be held fully responsible for the advice given by the people they employ.

The PSB would have the power to admit members, restrict membership and expel members. Only those admitted to the profession could call themselves "financial planners". They could choose to work as individuals, or in partnerships, or other arrangements, but they would each be held accountable for their advice.

The big difference between this and the current system is what is at stake for the financial planner. Currently, an RG 146 educated financial planner has little to lose. If, however, it took a serious level of education over a few years and the establishment of professional qualifications to be admitted as a professional the role would be seen as a serious career and being barred would be a serious consequence of unprofessional conduct.

The PSB would be more capable of managing the quality of advice and the standards of the profession than ASIC or such other organisation that can only administer the law. A professional body is not restricted to enforcing the law but can act in advance of problems whether they involve "legal" behaviour or not. A PSB can also receive intelligence from its members, develop meaningful standards, counsel members and use the threat of expulsion if members are in a position where they may bring the profession into disrepute.

By contrast ASIC is so restricted by law they were, and still seem, unable to determine if Storm Financial did anything wrong. Similarly, some of the determinations by FOS, and formerly FICS, have been dragged out and based on legal arguments. A PSB is ideally placed to determine if things are not as they should be before things go too far and to continually improve the profession for the benefit of all stakeholders but particularly consumers.

Interestingly, ASIC informed the BFPPG that they had not received any formal request to look into Storm Financial. The Financial Planning Association (FPA) told the BFPPG that, although rumours were rife, they also had not received a formal complaint. So nobody did anything and Storm continued to provide questionable advice. When Storm fell over the blame game started and with so much mud flying around it was inevitable that the whole financial planning industry would be blamed for the behaviour of one group.

Yet many members of the BFPPG had expressed concerns about Storm (and others) well before the issue became public. Concerns and rumours, however, were insufficient for anyone to take action until it was too late. There was no mechanism for handling those concerns. A PSB would address this problem and make a vast improvement to the entire financial planning industry to the benefit of all stakeholders and especially consumers.

Recommendation 4

The use of the term “financial planner” would be restricted to those who are registered to the Professional Standards Board. This restriction should be expanded to include other terms that suggest a professional obligation.

As the industry moves to a profession it becomes more important that the investing public can distinguish between those who have the qualifications, experience, and commitment to looking after them financially over the long term from those who see an opportunity to place a one-off investment.

Currently anyone can call themselves a financial planner. Anyone with one or more RG146 qualifications, (which can be obtained with a minimum of effort and in a very short time) can give advice to retail clients.

The BFPPG believes that this minimum requirement is insufficient for financial planners to be taken seriously as professionals.

The public can readily identify other professions: doctors, lawyers etc by their title. There are, however, thousands of individuals holding themselves out to be financial planners who meet the barest minimum training or ethical requirements. In most cases these people are associated with single product areas of advice or advice that is focussed strongly into one type of asset class or investment type. There are real estate agents who call themselves financial planners so that they can offer advice on the investment of excess funds after the purchase or sale of a property. There are property developers who call themselves financial planners so that they can package the sale of their property development into superannuation funds. There are many other examples.

It may be that the term “financial planner” is insufficient to describe the activities of strategy driven financial planners. It may be that there are a number of terms that can cover different areas of the financial services industry. All stakeholders in the industry have an interest in seeing that people are properly identified. The BFPPG, however, is committed to the principle that the public should be able to readily identify who is and who is not a genuine financial planner.

Recommendation 5

The rules regarding disclosure should be reviewed and enforced to ensure the compulsory, clear and comprehensive disclosure of all relationships between AFSLs, financial planners and product providers. Compulsory product control by licensees should be removed from the licensing regime.

The BFPPG believes that ASIC should rigorously enforce the regulations and prosecute where necessary. This has happened in some cases:

- AMP Financial Planning – enforceable undertaking
- The Brannelly Group – financial planners banned

The BFPPG believes, however, that ASIC has not been rigorously enforcing the regulations in the key area of ownership. The regulations are clear: all financial planners must disclose their ultimate licensee ownership. It follows that the disclosure must be made in a manner that is meaningful for the client. The reality, however, is quite different. The majority of clients have no idea who the ultimate licensee is. In many cases they believe they are dealing with independently owned firms when in fact they are dealing with institutionally owned firms.

This belief is supported by the report prepared by Roy Morgan Research in July 2007 entitled:

> *Superannuation Choice - A Tracking Study into Consumer Behaviour and Fund Performance in Australia*

which states on page 23:

> *"Table 19 shows that for at least a few financial planner brands such as Hillross (52%), Garvan (58%) and RetireInvest (58%), the majority of products obtained appear to be owned by respondents perceiving that planner to be an independent adviser.*
>
> *Overall it would appear that there is still a great deal of confusion amongst consumers over the term "Independent Adviser" particularly when a brand other than the parent or group name is used. Consumers using advisers from ANZ Westpac, CBA and NAB are generally aware that they are dealing with a tied planner but there is a lot of uncertainty as to the status of most other brands"*

Clients coming across to BFPPG members from institutionally owned financial planners provide confirmation of this confusion.

ASIC advised the BFPPG that ownership is not an issue unless a client is harmed. Unfortunately, if and when ASIC are alerted to and acknowledge that harm has been caused to a consumer it is often too late to protect the consumer.

Our recommendation regarding disclosure is, however, not solely based on a potential harm. It fits tightly with our previous recommendations (2) and (4):

> **Regulations / legislation should be introduced or changed to ensure that consumers can distinguish between financial planners providing independent, strategy–driven advice and those providing product sales–driven advice.**
>
> **The use of the term "financial planner" would be restricted to those who are registered to the Professional Standards Board. This restriction would be expanded to include other terms that suggest a professional obligation.**

All three are designed to give the consumer the fully informed basis from which to make and accept important financial decisions. The three recommendations are essential to empower the consumer, improve the consumer's financial literacy, enable the consumer to accept responsibility and improve the overall confidence the Australian public has in their financial services industry.Further, ASIC has maintained that its role is to enforce the legislation and there are adequate regulations about ownership disclosure. Clearly, however, either the regulations are inadequate or ASIC is not enforcing them adequately.

The BFPPG believes that ownership is a key issue for a client making a decision whether or not to proceed with a financial planner. Ownership goes to the heart of bias and influence in the provision of product advice. Clients must have the confidence that the advice being provided is free from the bias generated from a favourable remuneration arrangement such as a volume override or other product provided incentive.

Another example of the blurring of ownership and the distinction between advice and product sales can be seen in the large dealer groups that employ product representation under the guise of financial planning advice. The two largest providers of agricultural based investments, Great Southern and Timbercorp, both now in administration, sold a large percentage of their products through direct product representatives, many of whom worked in private practice accountancy firms.

The BFPPG accepts that quality advice can be provided even when the advice is limited or when bias exists but it is the full and clear disclosure of that limitation, bias or conflict that separates quality advice from dishonest advice and that empowers the consumer.

The BFPPG believes that if ASIC's responsibility is limited to enforcing the law, then the need to educate the consumer and guide as well as enforce the spirit of the disclosure will have to be undertaken by another organisation and a Professional Standards Board is the ideal vehicle.

The consumer must be able to make the decision to proceed with a financial planner from a fully informed basis. ASIC must ensure that any relationship with a product provider which might reasonably be capable of influencing the advice, must be disclosed in an unavoidable and unambiguous way and must include the names of all entities up the chain to the ultimate owner.

The Author

This submission was prepared by Claude Santucci, President of the BFPPG and the executive with input from, and on behalf of, the members and represents the collective view of the BFPPG.

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