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Submission to the Parliamentary Joint Committee on Corporations and Financial Services

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About the Author:

This submission was prepared by **Julie Matheson** who has been a Director and Responsible Manager (RM) of a Dealer's Licence/Australian Financial Services Licence since 1999, and has more than 20 years' experience in financial services since 1987.

Julie completed the Diploma of Financial Planning (Deacon University) in 1991, and was one of the first 200 members of the Financial Planning Association's Certified Financial Planner (CFP) in 1992. She is a current Board Member of the Financial Planning Association (FPA), and has served on a number of FPA committees including Regulations, FSR Refinements, Professional Indemnity Insurance, and DFP8 Unit development.

This submission addresses Point 9 of the Inquiry and identifies the structural defects of the AFSL regime and the need for legislative and regulatory change.

Introduction

Today's consumer expects representation by well trained professional representatives negotiating where and with whom their money is invested. They expect to receive impartial research and comparisons in respect of investments in cash, shares and property, three essential assets that underpin financial security for all Australians.

The Corporations Act requires change as there is little consumer advocacy and representation in the current licensing regime regarding product negotiations and fee/commission arrangements. The power rests with the Australian Financial Services Licensee (AFSL) who either controls the delivery of products or manufactures products, relegating most Authorised Representatives to the role of explaining "the value of investing" in a narrow suite of products promoted by their AFSL.

This submission addresses the power and controls that AFSL's have over Authorised Representatives (commonly known as Financial Advisers) and whether those controls have benefited consumers. It specifically focuses on education and training, and the control of product delivery. Many banned Authorised Representatives have found themselves hopelessly lacking the necessary education and training to determine faulty and deceptive products. The control of education and training by AFSL's is an unacceptable influence over Authorised Representatives. Most Authorised Representatives are unaware of the necessary research skills to select products because they believe that responsibility rests with the AFSL.

Key recommendations of this submission

The key changes recommended for the Corporations Act and regulations are:

1. That the term Authorised Representative be replaced with "Financial Planner" who is defined by their education and training standards, and their role as representative of consumers. The term "AFSL Representative" be introduced to cover those who represent product manufacturers and product distribution business models.
2. That education and training standards of financial planners be placed with an independent professional body and that body has the power of the Corporations Act to make reasonable enquiries into products and can demand documents from product manufacturers to support disclosure.
3. That control over product negotiations including payment of fees and commissions be removed from AFSL's and placed in the hands of financial planners who meet the education and training standards set by an independent professional body.
4. Losses from product failure should rest with the product manufacturer. A suitable compensation fund should be set up and funded by all product manufacturers.
5. That research is regulated and accountability standards are set.

Background

A person must be a representative of an AFSL if they provide a financial service as described in Section 766A of the Corporations Act 2001. Since 2001, that person providing a financial service must also meet education standards prescribed by the AFSL and is paid by the same AFSL to provide a financial service. The AFSL also controls negotiations in relation to products and services to be provided by the representative, and how they are to be ultimately delivered to end user (the consumer). Control by AFSL's over products, education and training as prescribed RG146 appears to have caused defects in the delivery and the quality of the advice which unravels spectacularly in the event of a financial collapse such as the one being experience since September 2008.

Pre-FSR 2001

Prior to the changes to the Corporations Act in 2001, products and services were separate and "unbundled". From a consumer's perspective, they avoided lengthy research required to identify the product or service on offer. Labelling made it reasonably clear what financial services were on offer and the limitations. A consumer could easily identify the service they required and who could provide it as summarised in the table below:

Service	**Products**	**Provided by**
Banking	Loans and deposits	Bankers and tellers
Insurance	Life and General	Agents
Stockbroking	Shares	Stockbrokers
Securities	Unit Trusts (managed funds)	Licensed Dealers

After the Act was passed in 2001, products and services were bundled up with the aim to increase the level of compliance and competency in the financial services industry. These changes aimed to achieve the following:

- a single licensing regime for financial sales, advice and dealings in relation to financial products;
- consistent and comparable financial product disclosure; and
- A single authorisation procedure for financial exchanges and clearing and settlement facilities.

In most cases, the providers of these services were also bundled up and required to act as Authorised Representatives (Advisers) or as Licensees. The single licensing regime now requires much more research by consumers and only suits those who are inclined to do it.

One of the aims FSR 2001 was to increase the level of education and supervision of representatives for consumer protection across the financial services industry (Beardsley & O'Brien, 2005, p. 3). The change also placed the responsibility for education and ongoing training in the hands of the Licensee who were charged with "*ensuring they and their representatives are adequately trained and competent to provide services covered by their AFS Licence*" (ASIC, 2008, p. 4) and as defined in s912A of the Corporations Act 2001 (ASIC, 2005). The education courses set by Licensees are required to be appropriate considering the complexity of the representative activities and the needs of the clients. The courses must also be approved by ASIC to achieve a minimum standard.

After completing a complying RG146 education course, a person qualifies to be an Authorised Representative of an AFSL. There are no other education requirements other than the supervision by the AFSL to deliver a financial service to the consumer.

Section 766A of the Corporations Act 2001 identifies when a person provides a financial service:

1. ... a person provides a ***financial service*** if they:
    a. provide financial product advice...; or
    b. deal in a financial product...; or
    c. make a market for a financial product ...; or
    d. operate a registered scheme; or
    e. provide a custodial or depository service...; or
    f. engage in conduct of a kind prescribed by regulations made for the purposes of this paragraph.

It would be unreasonable to expect a representative with RG146 education program to be able to carry out the financial services listed above without supervision and ongoing training. However the level of supervision and training is highly dependent on the business model of the AFSL.

Reliance on RG146 is problematic for Authorised Representatives who must follow the systems and processes set by the AFSL that may have one or more products to sell. The structure of the Corporations Act creates very powerful incentives for AFSL's to control product delivery through education and training levels of the more than 16,000 representatives across Australia (AXA Pacific, 2008, p. 12).

The Authorised Representative – Captured or banned through RG146

To demonstrate just how much the AFSL's rely on capturing a large number of Authorised Representatives, a report by AXA Pacific in 2008 detailed who their competitors were, how much "distribution" they had, and how AXA had broaden their "distribution footprint" by acquisition of AFSL's and their brands (AXA Pacific, 2008, p. 13).

Since 2003, AXA have purchased 204 Authorised Representatives under the AFSL brand of IPAC, 366 Authorised Representatives under the AFSL brand of Genesys, and has more than 800 Authorised Representatives in their own direct brands of AXA and Charter.

AXA also claim that of the 16,000 Authorised Representatives across Australia, currently 50% sell one or more of AXA's products and they aim to increase this to 60% by 2012 (AXA Pacific, 2008, p. 16). A shareholder of companies such as AXA, AMP and other big product manufacturers could be quietly confident that product distribution targets can be reached because of the control the AFSL has over product negotiations and training required to meet RG146. They can also be confident that Authorised Representatives do not have the necessary training or **independence** from an AFSL to avoid the dominance of the product push as the majority are captured by product distribution businesses.

One of the unfortunate consequences of placing the education and training in the hands of the product owned AFSL is that Authorised Representatives gain little or no experience in researching and comparing products especially in their early formative years. Product-owned AFSL's use ongoing training responsibilities to dominate and limit the Authorised Representative's research and product selection skills. **This area of the Corporations Act is failing the advancement of the financial planner as a professional and failing the consumer who expects the research and product selection to be carried out on their behalf.**

The Corporations Act gives the Authorised Representative no powers to interrogate executives or the power to demand documents which may be crucial in researching potential products for consumers to invest in. They normally do not have resources to employ teams of auditors to crosscheck information but must heavily rely on the AFSL and the regulator, ASIC, to do so.

It is not until an investment product fails that an Authorised Representative realises how poor their education and training has been. Just look at the numbers that have been banned because they recommended Westpoint. They were ill-equipped under the RG146 standard to discover the necessary information that caused the failure of Westpoint, and the failure of other more recent companies. Not even the power and the resources of ASIC could uncover the financial mess of companies such as Westpoint before they spectacularly collapsed.

In banning Authorised Representatives who recommended Westpoint under the supervision of their AFSL, ASIC seems to ignore RG146 and the minimum standards (ASIC, 2008). ASIC also seems to ignore the supervisory responsibilities of the AFSL and placed the responsibility of research and product negotiations squarely with the Authorised Representative using the following reasons for banning them:

- *engaged in misleading and deceptive conduct in describing Westpoint investments to clients as 'safe' and 'sound';*

- *distributed outdated product research which implied that the risk rating of Westpoint products had not changed over time;*
- *incorrectly described to clients the nature and effect of the Westpoint guarantee; and*
- *provided inappropriate advice in relation to Westpoint products thereby breaching his duty to ensure that investments were appropriate for his clients.*

Ref: 08-125 ASIC Media Centre 2008

The "appropriateness" of an investment currently rests with the AFSL who provides the "financial service". It seems to be a loophole in the design of the Corporations Act and unreasonable to expect an Authorised Representative with limited powers to make their own enquiries about investments. The minimum education standards are not sufficient to conduct such research enquiries leaving Authorised Representatives vulnerable to the inadequacies of their AFSL, who in turn rely on the product manufacturer to qualify any disclosure statements in relation to the prospects of the investment.

The AFSL is also responsible for the content of a Statement of Advice under the Corporations Act including the research and suitability of a product. This unfairly transfers the disclosure responsibilities from the product manufacturer to the AFSL who relies on product disclosure.

It is not until a product fails that AFSL's are found to be relying on poor disclosure, and that an Authorised Representative finds themselves hopelessly lacking in appropriate education and training to determine faulty and deceptive products.

The Corporations Act and regulations must be changed so that education and the training of financial planners in product and strategy research be placed with an independent professional body, and one that has the resources and the power of the Corporations Act to make reasonable enquiries of product executives and can demand documents that support disclosure if required.

Product manufacturers should be ultimately responsible for the failure of their products to deliver the service they disclosed. Consumer recourse on faulty and deceptive products should rest with the product manufacturer and a suitable compensation fund be set up and funded by all product manufacturers.

AFSL's control the advice by controlling fees

Authorised Representatives are also captive to AFSL's by control over commissions and fees. Without an AFSL in the middle negotiating products and collecting fees and commissions, Authorised Representatives cannot be paid for the advice they give. They must enter into a "Remuneration Contract" with an AFSL to get paid. This seems reasonable if an Authorised Representative is employed by the AFSL, but there are many experienced Authorised Representatives who run and market their own businesses, yet are unable to be paid

directly by the consumer for the services they provide under RG 36 (ASIC, 2007). Many of these businesses are located thousands of kilometres away from the AFSL, and most consumers would not know that the AFSL existed.

Much is written and advertised in the media about consumers and "advisers" controlling fees or commission that are paid. Industry Super Funds run advertisements using member's funds claiming that their funds do not pay commissions to "advisers". According to ASIC's RG 36 only AFSL's can receive fees or commissions, not Authorised Representatives (ASIC, 2007, p. 23). If they do they must be licensed.

These types of regulations give even more power to product manufacturers and the AFSL to negotiate products and fees/commissions. The Authorised Representative must accept what is negotiated and try to work with the consumer to show that it is value for money or reduce their remuneration payable to them by their AFSL as a form of fee negotiation.

The Corporations Act fails to allow consumer direct representation without conflicts, and fails to equip representatives with powers to negotiate products, fees and commissions. It seems that it is an unintended consequence of the Act to place an AFSL between the consumer and the product manufacturer, and that the AFSL could be negotiating with itself because it is owned by the product manufacturer. This is unacceptable for today's consumer in a volatile economic environment.

Shifting the power of product negotiations

A small number of experienced Authorised Representatives have resorted to getting their own AFS Licence just so that they can provide consumer representation and control product negotiations on behalf of consumers, including fees and commissions. Having an Australian Financial Services Licence without a product to manufacture is an unnecessary burden and cost to the representative and ultimately the consumer. AFS Licence should be the domain of product manufacturers and their representatives. Consumer representatives (Financial Planners) need to be recognised through their education, training and experience and given separate powers under the Corporations Act to be referred to as Financial Planners. Those powers should also include research.

There are obvious failings in the area of research because it is unregulated, and existing research houses that claim to offer independent research are often paid by the product manufacturer. Licensees often rely on market research as they do not have powers under the Corporations Act to demand documents or interrogate product executives. Many Licensees have fallen victim to faulty products and poor or deceptive disclosure, yet the research houses who provided market research on the same faulty products continue to flourish without recourse.

Researchers give legitimacy to large product-owned AFSL's to ensure their products are on a "recommended" list. An article in Asset Magazine claimed that AXA used external researchers to fast track AXA's funds to gain a "recommended" status at IPAC and Genesys, both are AFSL's and both owned by AXA (Yeow, 2009, p. 11). The Authorised Representative has no power to check those negotiations, and may not have the level of education and training required to make reasonable enquiries and comparisons with other products not on the "recommended" list. The option of fee and commission negotiations with product manufacturers are also absent from the tools available to Authorised Representative. For most, their role is one of working with the consumer to show that the AFSL has negotiated value for money in a "recommended" product.

Not all Authorised Representatives want the power to negotiate product terms and research product comparisons. Most seem to be happy to transfer those responsibilities to a large AFSL's. There are also a few who do not wish for the public to easily identify with their AFSL and use an operating business name as a point of difference and independence. They may even have an AFS Licence owned by a product manufacturer but they are branded differently like IPAC Securities Limited who is owned by AXA (Ipac, 2008, p. 2). The consumer would need to conduct research to find this out but most avoid it due to a lack of interest or skills in this area.

A product manufacturer owning many AFS Licenses in different names does not achieve "*a single licensing regime for financial sales, advice and dealings in relation to financial products*" (Chartered Accountants, 2004). It seems to be an unintended consequence of the Corporations Act.

The Corporations Act and regulations need to be changed to accommodate professional financial planners who wish to represent the consumer in product and commission negotiations. They need to be paid directly for those negotiations and not be required to use an AFSL to collect fees or commissions on their behalf. This will have an immediate impact on costs associated with product delivery because the "middle man" (AFSL) has been taken out.

Those Authorised Representatives who wish to continue using an AFSL to negotiate products and research on their behalf should do so. They may choose to do this because they lack the education and training to carry out extensive product research, or they continue to demonstrate the value of the AFSL negotiations to the consumer.

In summary

The spectacular collapse of faulty and defective products such as Westpoint could not have been foreseen by Authorised Representatives who have the minimum education and competency standards set out in RG146. Authorised Representatives have found

themselves hopelessly lacking in the necessary research skills and investigative powers to deal with misleading statements by product manufacturers yet they carry all the risks if they select the wrong investment for their clients, the consumer.

It seems to be an unintended consequence of the Corporations Act that Authorised Representatives cannot negotiate products including fees and commissions on behalf of their client nor get paid directly to do so. There is little consumer advocacy in the current licensing regime. The Corporations Act must be changed so that there is consumer representation by financial planners, and that financial planners are adequately educated and competent to do so including receiving direct payment for such a role.

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