Parliamentary Joint Committee on Corporations and Financial Services Inquiry

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1. Introduction

The 'Global Financial Crisis' and range of financial product and service provider collapses in recent years, such as Storm Financial, Opes Prime and other such collapses, has placed a great strain on the consumer confidence in the financial services industry, and raised extensive questions as to the suitability and effectiveness of current policies, business practices and the broader regulatory environment.

As a financial services Licensee and Australia's largest financial services dealer group (by Adviser network numbers), Professional Investment Services ('PIS') directly operates within the existing regulatory environment, adhering to industry standards and procedures. As a Licensee we are directly impacted by both the successes and shortcomings of this industry. Furthermore, with one in twenty adult Australian's being clients of PIS we directly experience the successes and shortcomings of this industry from a client perspective as well. Collectively, these experiences provide us with a practical understanding of what we believe to be the issues, shortcomings and areas for improvement in the regulatory system and within this industry.

We welcome the opportunity to submit our views in the Parliamentary Joint Committee on Corporations and Financial Services to provide our understanding and feedback on the issues associated with the recent financial product and service provider collapses.

This submission identifies that there have been a number of factors which have contributed to the recent financial product and service provider collapses. These factors include advice based failures, product based failures, insufficient consumer understanding and overall greed of all parties involved in the value chain. Many of the key issues identified in this submission are also the result of practices extending beyond industry norms and acceptable conduct, involving fringe players, rather than being reflective of systemic issues or a failure of the existing regulatory system.

In fact this paper serves to highlight that investor confidence and client satisfaction remains in spite of the recent collapses, whilst also recognizing that the current system can also benefit from clearer disclosure, improved educational and training competencies of financial advisers as well as greater monitoring and supervision which enhances early waning capabilities.

To this extent, this paper commences by providing insight into the value of advice and investor sentiment, followed by identification of the key issues, how (if at all) the Terms of Reference relate to the core issues, and concludes by proposing possible solutions for bridging the gap.

2. The Value of Advice and Investor Sentiment

The vast majority of financial advisers work hard to provide quality advice that is both appropriate and suited to the individual client's needs. This not only involves understanding a client's whole financial situation and helping clients achieve their outcomes but also includes helping clients understand investment risks and the nature of investment cycles. When done properly, this ensures that clients understand the potential for market downturns and the importance of long-term investing (which allows for market recovery and the benefit of market upsides). This is particularly important during difficult economic periods. Advisers have the important function of helping clients through a market downturn and maintaining investor confidence.

The findings of a survey completed by PIS (July 2009) into client insights indicate that clients understand the nature of investment cycles and that lower investment returns are to be expected in the current economic climate. More specifically, three out of four participants believed the lower investment returns were to be expected and were not the fault of their respective planner.[1] Furthermore, the majority of respondents believe that the economic downturn has not affected their attitude towards financial advice and in fact one third of respondents are even more inclined to seek financial advice in the future. This survey demonstrates that clients understand the risks involved with investing and perceive the value of advice.

A trusted relationship is crucial to this and the findings of the client insights survey indicate that the trusted relationship is the most valued aspect of having a financial adviser, whilst development of investment strategies that consider the client's whole financial situation, reassurance that someone is monitoring their investments and the convenience of having someone manage their investments being the three next most important reasons for using financial advisers.[2]

[1] PIS (2009) Client Insights Survey.
[2] PIS (2009) Client Insights Survey.

The importance of this, and the function which financial advisers serve, can be understood in light of the recent findings on investor and consumer confidence, prepared by brandmanagement in May 2009, which found that Australians who have never used a financial adviser are twice as likely to be financially insecure, additionally those who have never used a planner or those which used to have a planner are apathetic to having enough money in retirement.[3]

Collectively these findings illustrate that clients who receive advice are more inclined to be financially secure, that clients have confidence in their advisers and will continue to obtain financial advice irrespective of the market downturn. This is an important point worthy of bearing in mind when considering the recent financial services and product collapses, with this submission highlighting that in spite of the recent financial services and product provider collapses consumer confidence and client satisfaction remains and the value of advice continues to be perceived by clients.

3. Causes for collapse

In addressing the issues associated with recent financial product and services provider collapses a distinction has been made between product and advice based failures which are driven by a range of different factors. Particular regard has been given to these issues from the financial adviser's perspective and the degree to which adviser's are related to these issues (Term of Reference 1), if at all. Some of these factors are not related to the provision of advice and fall outside the scope of financial adviser's role.

This is an important point worth highlighting given that there has been great media scrutiny unduly apportioning responsibility to financial advisers or Licensees for financial product provider collapses. Generally speaking, advice based failures relate to the provision of inappropriate advice, which falls within the scope of a financial adviser's function and can be mitigated, whereas product or institutional failure relates to the failure of properly managing a corporation which can not be mitigated or controlled by financial advisers. The responsibility for proper corporate management rests with the management of a corporation and the board of directors and where the losses represent a market failure this is an issue which should be addressed by the broader regulatory framework.[4]

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[3] Financial Planning Affection Study, May 2009.
[4] D'Aloisio, T (2009) *Proof Committee Hansard,* p6.

3.1 Advice Based Failure

Advice based failures have been influenced by the provision of inappropriate advice which are not suitable for the client. The Storm example appears to represent advice based failure in which a 'cookie cutter,' pre-packaged advice model, approach was allegedly employed. The reports indicate that a pre-packed advice model, employing heavy gearing and in many cases double gearing (using client's homes and other assets to gear into further investments) was utilised widely within the client spectrum. The strategy did not seem to discriminate and take into account individual's personal circumstance which varied greatly in age, income levels, and the ability to meet margin calls if at all.

The 'pre-packaged advice' model does not reflect industry norms, whereby advice is tailored to the individual in accordance with the client's individual circumstances and needs. The use of margin lending is also not widespread but instead used as part of an overall investment strategy when appropriate. From a PIS perspective margin lending constitutes a nominal level of overall business, ranging between .66% and 1.67% of overall business in the last three years. These minor relative figures illustrate the selective use of margin lending when compared with overall level of advice.

Being the largest Licensee and the fact that PIS has an open architecture which doesn't prescribe the type of advice or strategy to be provided, we believe our statistics above are representative of the industry.

Essential to the use of margin lending and gearing as part of an overall strategy, is that it is used appropriately. With respect to Storm gearing of itself is not an issue, it seems, it was the alleged provision of inappropriate advice. In many cases the excessive leverage employed and advice provided did not reflect industry norms or practices regarding acceptable levels of risk taking into client's risk profiles and personal circumstances, for example double gearing recommended to retirees who did not seem to have the time horizon to recover potential losses nor have sufficient capital to meet margin calls.[5] It could be argued the advice in many cases was clearly inappropriate.

The provision of inappropriate advice appears could well have been driven by aggressive sales approach to generate excessive fees. If so, there was a clear conflict of interest

[5] Submission 9 into the PJC inquiry.
http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sub09.pdf & Submission 12 Old R & J (2009) Inquiry into Financial Products and Services in Australia.
http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sub12.pdf

between excessive financial gain and the provision of advice. We believe this will be clarified in the fullness of time.

3.2 Remuneration Model

Given the extensive media attention that the commissions based remuneration system has received, as well as being addressed under the third term of reference (ToR3) by the inquiry, it is important to note that the advice based failure in the Storm circumstance was allegedly driven by an excessive fee generation model, predominantly using a fee based system, as well as commissions received from margin lending products. The key issue was not the remuneration model employed, as the method of remuneration (whether fee based, hourly based or commission) does not of itself lead planners to advise clients to engage in high risk and inappropriate strategies. Arguably, It appears it was excessive remuneration amounting to greed.

3.3 Product Based Failure

Aside from advised based failures, a number of product based failures have been the result of flawed institutional business models and poor management resulting in corporate collapse. The responsibility for such institutional failure rests with the management and the board of a company, to manage a business appropriately.[6] Effective business management and protection against institutional failures extends beyond the scope of the current regulatory regime and is not something which financial advisers are in a position, nor have the capacity, to prevent. This responsibility resides with the regulator in discharging its duty to ensure that the market operates efficiently and in mitigating risks where there appear to be systemic problems.

It is difficult to say whether the extensive product based failures represent systemic problems and this is something for the Committee to determine as part of the inquiry. What has however become apparent, with the number of corporate collapses in recent times, is the existence of a gap in the current regime, somewhere along the lines between good corporate governance, monitoring and enforcement, the Corporations Act, accounting standards and audit requirements which warrants further review. When reviewing this issue particular regard should be given to the proper financial management of a company which includes cash flow and liquidity management, as well as the use of gearing across the business. Excessive leverage appears to have been a common thread amongst some of the

[6] D'Aloisio, T (2009) *Proof Committee Hansard,* p5.

recent collapses which may indicate that greater monitoring and supervision may be required.

4. Contributing factors

Whilst this submission has separated the causes for collapse into two clear areas being advice based failures (falling within the scope of financial advice and financial adviser's role) and product based failures, there are a number of other contributing factors such as insufficient or inadequate disclosure of risks by product providers, insufficient consumer understanding of financial products and risks, and excessive fees which have also played a part in recent financial product and services provider collapse.

4.1 Insufficient disclosure of risks; Product Providers

[addressing ToR4]

Lack of or insufficient disclosure of key risks by product providers in disclosure documentation and marketing material has also contributed to product failures. For instance the failed Rubicon International Leaders Fund (Capital Protected Series 1) was understood to be a capital guaranteed product. Whilst disclosure documentation stated that the capital guarantee only applied at maturity (2015),[7] what was not so clear was that the guarantee would lapse if the underlying fund collapsed, as was the case with Rubicon. When Rubicon collapsed, UBS removed the capital guarantee which was contrary to the generally held understanding that capital guaranteed products were 'guaranteed in all market circumstances.'[8] The disclosure of the limited operation of the guarantee was unclear from disclosure documentation.[9]

Another example in which it appears there was insufficient disclosure of downside risk, including the practical operation of a product, was in the case of Opes Prime. Many clients utilised margin lending to purchase shares and were not aware of the collateralised arrangement in which the legal title to the shares was transferred to the lender as the secured creditor in exchange for the margin loan. [10] It also seems many clients were not aware that the lender had the right to sell their shares without making prior contact.[11] Storm

[7] Egan, L (2009).
[8] Moran, cited in Egan, L (2009).
[9] Moran, cited in Egan, L (2009).
[10] Case, T (2008).
[11] Case, T (2008).

clients also faced similar issues, unaware of the lenders capacity to sell their shares without prior contact to the client.[12]

Whilst this reflects a failure in the advice process, what it also demonstrates is a failure on behalf of disclosure documents, namely failure to transparently disclose how a product operates and clearly present downside risks. Presenting risks or product limitations as fine print, as part of footnotes, or in a manner which easily promotes oversight (such as towards the end of disclosure documents) is clearly inadequate. This downplays the severity or degree of risk involved and does not facilitate a consumer's capacity to understand the complexities of the product. Where the risk relates to a fundamental aspect of the product, such as the extent to which a capital guarantee either operates or ceases to operate within a capital guaranteed product or the risk that a portfolio can be sold without prior notice to the client, there should be greater obligation of clear and transparent disclosure. This includes disclosure documents and marketing and advertising campaigns which will promote consumer understanding and awareness.

One important point which this submission would like to raise, as part of the reform, is the important function and duty which financial services product providers have in facilitating clear and transparent disclosure of the risks involved with an investment or product such as a margin loan, particularly with respect to the way in which a product operates.

4.2 Lack of consumer understanding

Insufficient consumer understanding of investment risks, including the operation of margin lending and the high risk gearing, demonstrates that there was a failure in the advice process. This includes a failure on behalf of advisers to adequately communicate the risks and also includes inadequate consumer financial literacy.

PIS provided 1,483 client education events in the last twelve months. For most people education is a valued aspect of the services received from financial planners. The majority of participants in the PIS client insights survey indicated that the education seminars received were just right (78%), whilst close to 20% indicated that they would like to receive further education seminars. This illustrates that whilst PIS clients have access to a great deal of education seminars (1,483 education seminars amounts to an average of 4 seminars per day), investors could still benefit from further education.

[12] See submissions into the PJC inquiry. http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sublist.htm.

Anecdotally investors seek information from newspapers, magazines, television and other forms of media, family, the guy next door and financial advisers. The Committee can see the obvious challenges facing the average investor in understanding the complexities of the financial services market. This links in with the Consumer and Financial Literacy Taskforce chaired by Paul Clitheroe in 2004 and the recommendation for the establishment of a central body to assist with financial literacy.[13] This resulted in the establishment of the Financial Literacy Foundation in June 2005, whose function was transferred to ASIC on 1 July 2008.

We support consumer education initiatives aimed at increasing financial literacy of Australians. In particular, PIS supports the incorporation of financial literacy education as part of the core curriculum for students from kindergarten through to year 12. Given the importance of financial literacy education, we support core curriculum education in the form of a separate core subject, rather than the integration amongst existing subjects (such as maths and english). This could consist of an extension to the existing 'Professional Learning Package' aimed at supporting teachers in integrating consumer and financial literacy of students.[14]

4.3 Excessive Fees and conflicts of interest.

[addressing ToR3]

Another contributing factor to the recent failures, was the provision of inappropriate advice which appears to have been driven by predatory behaviour incorporating excessive lending practices and charging unreasonable fees. As previously noted, it appears the Storm business model was driven by an aggressive sales approach in pursuit of excessive fees. In many cases the fees did not seem to correlate with the services rendered nor reflect the value of advice provided. It can be argued that the conflict in this case was clearly excessive financial gain with fees charged of up to $140,000[15] in some instances, arguably being both unreasonable and representing a clear departure from industry norms and charging practices. The remuneration model employed was essentially fee based, although commission was also received for margin lending. What is important to note is that the conflict which was of crucial importance was not the remuneration structure but rather the conflict of excessive financial gain and possibly greed. This conflict exists irrespective of which remuneration model is utilised.

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[13] Financial Literacy Foundation, sourced 30 July 2009 at http://www.understandingmoney.gov.au/content/media/members/clitheroe.aspx.
[14] Consumer Financial Literacy Program viewed at http://www.financialliteracy.edu.au/about/the_program.html.
[15] Submission 9 (2009) Inquiry into Financial Products and Services in Australia.

The issue of remuneration models and conflicts of interest is an important one which has been the subject of considerable media scrutiny and is specifically encapsulated within ToR3. This issue requires further elaboration and is addressed below.

5. The role, if any, which the following had in the collapse;

5.1 Commission arrangements (ToF3) and remuneration models

In addressing conflicts of interests and clarifying the misconceptions created by the commission debate, this paper raises the important point that conflicts of interest are inherent in all remuneration models, irrespective of whether a commission or a fee based model is utilised. A real or potential conflict exists any time there is a potential for personal or professional judgment to be influenced by personal or financial benefit. The client adviser relationship is one in which the adviser profits from the advice and services provided to the client, this conflict is inherent in the financial advisory process as it is with every other business relationship or transaction in which there is monetary gain for services rendered.

From a remuneration perspective, the conflict can be direct through commissions received for product or platform placement or may be indirect. Indirect conflicts relate to those in which the Licensee, subsidiary of the Licensee, or a related party gains (rather than the adviser directly) through placement of aligned products or platforms, this is particularly the case where the advice is provided by an employee of a product provider or institution.

Within the financial planning industry the potential for remuneration conflicts can include;

Remuneration conflicts	**Commission Based System**	**Fee Based system,**	**Free advice provided by product providers**
Payment for product placement	yes	Potentially	Potentially
Comments		Potential for indirect conflict, where the product provider is the Licensee, or related party, of the adviser providing the advice.	There is an indirect conflict. The Licensee or related party gains (rather than the adviser) through placement of aligned products either owned by the institution or a related party or subsidiary

Payment for volume	Yes	Potentially	Potentially
Comment		Potential for indirect conflict where the Licensee benefits from volume, or where the product provider is the Licensee, or related party, of the adviser providing the advice.	There is an indirect conflict. The Licensee or related party gains (rather than the adviser) through placement of aligned products which are owned by the institution or a related party or subsidiary
Employment situation	Yes	Potentially	Yes
Comment		Potential for conflicts where KPI's or bonuses incorporate specific product placement/or product volume	Potential for conflicts where KPI's or bonuses incorporate specific product placement/or product volume
Payment for platform placement	Yes	Potentially	Potentially
Comment		Potential for indirect conflict where the Licensee benefits from volume, or where the product provider is the Licensee, or related party, of the adviser providing the advice.	There is an indirect conflict. The Licensee or related party gains (rather than the adviser) through platform placement which are owned by the institution or a related party or subsidiary

As can be seen from the table above, the current system and structure of the industry inherently includes the potential for remuneration conflicts in a range of ways. The adviser may have a direct conflict in receiving commissions, or it may also have an indirect conflict in which the Licensee or its subsidiary may receive financial gain by product or platform placement. This conflict is even more apparent in an employee situation where the adviser is gainfully employed by an institution, industry fund, or product provider and may have a vested interest in selecting particular products or platforms. To this extent the issue is not the existence of conflicts in itself, or which remuneration model is utilised, but to ensure that the conflict is managed appropriately through transparent disclosure, informed consent and through the provision of advice which is both suitable to the client and which meets their needs.

This is the key issue which must be addressed. From a financial planning perspective this relates to the provision of quality advice, including disclosure and informed consent, which is in the best interests of the client.

5.2 Conflict within commission models

[addressing ToR3]

In specifically addressing commissions based system, it is evident that direct conflict exist which may or may not be inherent in other models. Anti commission proponents would argue that the conflict included in the commission system is either undesirable or not appropriate for the client. Furthermore, that the conflict inherent in commissions arrangement is not in the best interest for the client. In order for such an argument to have any merit, the conflict inherent in a commission based system would have to **unduly influence** the adviser's capacity to exercise their professional duty to the client (in providing appropriate advice which meets the client's needs) than when compared with other remuneration models.

This paper asserts that the conflict inherent in commissions system does not unduly influence the adviser's capacity to exercise their professional duty any more than other remuneration models. For example, there is the concern that product selection may be based on the potential to generate commissions and not based on client suitability. This conflict also exists where advice is provided 'free' with no direct cost to the client, such as through a product provider, institution or industry fund. In these instances the cost of advice is subsidised by the product provider, institution or industry fund, which generates fees through the distribution of aligned products, or within the management fee for institutionally owned products. The conflict is not direct payment by the product provider, but indirect through employee remuneration (wage or bonuses) or through product placement restrictions, whereby the adviser can only recommend products included in the APL which may be restricted to institutionally aligned products. This indirect conflict operates in a similar fashion to those inherent in commission arrangements.

A further consideration regarding conflicts of interest for product or platform placement relates to industry trends and the level of commission payments. The financial planning industry and product providers recognise the need to manage conflict of interests and have moved to standardise the level of commission payments provided through products. In many cases the level of commission paid is capped at 4% for upfront payments and 2% for ongoing advice for investment products which standardises commission payments. This serves to manage conflicts whereby there is no incentive to nominate one product over another on the basis that the fee generated is standardised.[16]

When determining the level of commissions charged, industry practice is to charge a commission or fee commensurate to the advice and services rendered. To this extent many advisers within the PIS network charge well below the nominated amount (often under 2% upfront and below 1% ongoing). In fact over the last twelve months the PIS average upfront fee was 1.34%. We again view this to be reflective of the industry as we do not prescribe methods or levels of fees charged. In many instances advisers also rebate commissions to clients. PIS addressed the issue of remuneration with greater depth in the FPA submission to the FPA Consultation Paper on Financial Planner Remuneration (see Appendix 1), making a number of recommendations for positive reform in this regard.

In the submission PIS highlights the existence of conflicts of interest across all remuneration methodologies and note that remuneration methodology merely reflects a mechanism of payment for the services rendered. Clients are often provided with the option of nominating the preferred payment methodology, whether it be fee for services (hourly based fees, fees taken as a proportion of the investment made, or flat or tiered fee structure) or commission based. To this extent the client has the freedom to choose payment for the provision of services and the capacity to select an alternative adviser where that choice is not provided or level of remuneration charged is not in line with the client's expectations.

Where the remuneration charged is excessive, which does not reflect the value of advice and services rendered, and is driven by predatory behaviour, it is difficult to prevent. Unreasonably high fees can be generated by any remuneration model. With respect to Storm, a fee based system was largely utilised, whilst also incorporating commissions through lending practices. It is important to note that the remuneration model itself did appear to be the basis underlying the provision of seemingly inappropriate advice, but rather

[16] It is recognised that there are a number of exceptions to standardised commission payments with a ceiling of 4% for upfront commissions and 2% for ongoing commissions, particularly with respect to MIS investments such as trees and olives, or for insurance products. This paper does not address the issue of commission as they relate to insurance products. With respect to MIS and other tax effective investments, we are working with product providers should seek to bring these in line with current industry practices and incorporate a ceiling of 4% on all upfront commission payments and 2% on ongoing commission payments.

the pursuit for excessive financial gain. This behaviour is a departure from standard industry practice by fringe players.

5.3. Managing Conflicts - Platforms

Conflicts of interest are mitigated to a great extent through the use of Platforms. A platform in terms of financial services is an administration system which manages, transacts, records and reports on a range of investments chosen from a generally wide range of investment products which are generally lower cost than ordinary retail products and in which no commission element exists. Generally speaking the client and the adviser agree an adviser service fee which is deducted regularly from the client's account.

Platforms are widely used and it is estimated that some 80% of all investment transactions take place through platforms. This is important in determining any conflict of interest as only the platform provides a potential conflict as no investments actually pay a commission to the adviser. To this extent platforms serve to mitigate and reduce remuneration conflicts of interest.

We understand that IFSA will be addressing the role of investment platforms and the range of benefit platforms provide to investors in its submission to the inquiry. To this extent we further support the view that platforms benefit consumers in a number of ways and serve to reduce remuneration conflicts.

6. Additional Contributory factors

6.1 Gearing for Gains and Gearing for Losses – Client responsibility.

What is also important to note is that it would have been difficult to challenge the advice, the business model and the suitability of fees while Storm clients were receiving exceptional investment returns and benefiting greatly from the high risk and highly leveraged strategies during periods of positive economic growth preceding the market downturn and the global financial crisis. All the members involved in the value chain, Storm, the advisers, the banking institutions and the clients all benefited greatly from the Storm model during the preceding period of economic growth. It is unclear whether Storm clients made any, or what the extent was, of complaints to the regulator against Storm, the advice provided, or the business practices during the period of economic growth. This is worthy of further exploration. It is highly likely that the nature and proportion of complaints is limited in number than when compared with complaints made once the market moved towards a downward spiral. Where further review uncovers limited complaints, it may indicate that many clients felt the advice, and the risk taken was appropriate and the excessive gains obtained through leverage were in fact welcome during the periods of economic growth.

Whilst this does not serve to abdicate either Storm's or the financial adviser's responsibility to provide appropriate advice which was suitable to the client, what it does highlight is that the clients also benefited greatly from a advice/business model which provided returns which were beyond those offered under general industry practices. To this extent they sought gains that were beyond normalised returns and it is likely that a number of clients were drawn to the Storm model as a consequence of the higher than normal potential for returns. Where this is the case, a certain level of client responsibility must also be taken. The potential upsides must also be taken together with the potential downsides because when you gear for profit you also gear for losses.

It can be difficult at times to help protect clients from themselves and to this degree it is noted that neither the system nor regulation has the capacity to legislate away greed. This is true for everyone involved in the value chain, the Licensee, its advisers, the banks (in their lending practices) and clients. However it is important to note that it is incumbent **on all 'educated' parties within the value chain** to take a fiduciary responsibility to act in the client's interest with the generally financially uneducated investor.

6.2 Business Practices by Financial Services Product Providers: Responsible Lending

[addressing ToR2]

The businesses and lending practices of the product providers also served to benefit greatly from the revenue generated by the extensive number of margin loans and refinancing of home loans, permitting double gearing. These product providers also have a degree of responsibility to ensure appropriate lending practices are adhered to, as well as a responsibility to ensure the appropriate communication of margin calls directly to the client.

The government has recognised the importance of this and placed greater regulation on margin lending, as a financial product pursuant to the Corporations Act. The *Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009* (Bill) was introduced into Parliament on 25 June 2009. Under the Bill, a margin lending facility will be regulated as a financial product under Chapter 7 of the *Corporations Act 2001*. This ensures that firms that offer or advise on margin lending facilities will be subject to the conduct obligations in Chapter 7, including the obligation to have adequate financial resources and ensure that its representatives are adequately trained and are competent to provide the financial services.[17]

[17] Media Release AD 09-122 (2009).

This will serve to safeguard consumers against some of the issues experienced by Storm clients. PIS supports the regulatory change, which it understands will impose tougher lending obligations on margin lenders, enhance consumer protection and options for redress.[18]

6.3 Financial Responsibility of Product Providers

Under the current system the financial responsibility for the provision of inappropriate advice rests with the Licensee however the financial responsibility for product provider collapses does not seem to be apportioned to failed product providers in a similar fashion. Whilst consumers have the capacity to seek redress against Licensees and financial services product providers by lodging complaints with FOS, the practical operation of the current system often holds Licensees financially responsible for the failures of financial services product providers.

For example, where client loss is suffered as a consequence of a product failure, and investment loss, the advice under which the product was recommended is placed under scrutiny, and where the advice (which includes the selection of the failed product) was deemed to be inappropriate for the client, the adviser and therefore Licensee is responsible. The Licensee has no legal capacity to initiate legal action on behalf of clients but must sit and wait to be 'sued' by a client before it can 'join' the product provider in an action.

Where the advice is inappropriate the client has the opportunity to seek redress against the Licensee for losses sustained, and rightly so. This however is only one part of the equation. The second part of the equation amounts to the financial loss suffered by the client, and redress sought against the Licensee, as a direct result of the product failure. In this instance, the Licensee is often held financially responsible for this loss under the umbrella of failing to provide appropriate advice, which in effect results in the Licensee underwriting the failures of financial services product providers.

Licensees should have the ability to take action on behalf of the client against the failed product provider to the extent that the financial loss relates to product failure. This could be achieved by conferring rights on the Licensee similar to those which ASIC is granted under section 50 of the ASIC Act (2001) which enables ASIC to undertake civil proceedings for the recovery of damages for corporate misconduct by placing itself in the position of the client.

6.4 Variability around Adviser skill set – Education and Training

[18] Media Release 17, (2009).

[addressing ToR1 and ToR6]

Whilst it is unclear whether or not adviser's skill set was inadequate and a contributing factor in any of the current issues, what is however evident is that there is a great deal of variability around adviser skill set overall within this industry. The current regime enables individuals to obtain minimum competencies, satisfying RG146 requirements, and provide advice in a matter of months.

Given the breadth and depth of advice which financial advisers can provide, ranging from wealth accumulation to retirement planning, superannuation and through to estate planning (amongst other things), adequate training and education is an important function of providing quality advice.

PIS recognises the importance of training and education, acknowledging the excellence of Australian university courses and the high standard of students currently undertaking financial planning as their major stream of study as part of their bachelor or masters program. PIS serves to facilitate the link between university graduates and those entering the financial services industry. Through the Professional Investment Services Network Education Program (Network Education Program) PIS has developed relationships and links with over twenty tertiary institutions around Australia to source quality candidates for entry into the PIS adviser network.

The Network Education Program consists of three programs which engage university students directly. Insight is a one day program held in all states, whereby current students are invited to attend and become exposed to an industry perspective of the profession. The prime message is one of fiduciary responsibility to the client and performance excellence. The second program, Hotspot, provides individuals with the opportunity to directly engage with prospective employers through networking exercises and interview processes. The third program, Partners, involves a six week program whereby participants partake in training across a number of areas of the profession, whilst collectively working with PIS advisers who act as mentors. Through this contact, PIS advisers have the option of employing participating mentees.

PIS Network education also offers ongoing training for new recruits through the 'Launch program' and the Paraplanner School.' Education and training is an ongoing process and highly regarded by the group, with the overwhelming majority of entry level recruits into the PIS network over the past two financial years have emerged from university programs.

6.5 Support for Increased Education Qualifications

[addressing ToR1 and ToR6]

PIS is a strong supporter of excellence in education and supports increasing competency standards which will enhance the delivery of quality advice and provide greater consumer confidence and protection. From an entry, and minimum education qualification, perspective, PIS supports increasing the minimum training and qualification requirements of those providing advice to include an undergraduate or postgraduate degree in a financial services related field, such as a Bachelor of Commerce or Business (financial planning) or Master of Financial Planning through tertiary education. Furthermore, a practical training and development year (akin to the practical legal training year completed by the legal profession or the professional year completed by chartered accountants) following tertiary education, involving continued training, mentoring and reflective supervision, during the first year of advising would also serve to increase professional competence and promote consumer confidence in the financial services industry.

In supporting increased training and qualifications of those which provide advice, these objectives must be balanced against the existing regime. Where the committee supports further education, it is recommended that the committee consult with the industry and industry bodies to assess the barriers, overall impact and benefit of increasing education requirements. This may require allowing for a 'grandfathering' process to promote smooth transition from the existing to the new regime.

7. Recommendations

When looking at any change within the regulatory or broader system there are two key requirements which need to be taken into account. First and foremost, any reform should be consistent with the overall objective of the regulatory system which is to promote market integrity, which is both efficient and flexible, and provides access to advice and a wide range of products, whilst also promoting consumer confidence that includes necessary safeguards.[19] The second requirement is one of balance. Where regulatory or system reform is required it must be balanced against the impact of change to the consumer and the industry.[20] Without these two factors, system reform runs the risk of making advice too costly and too restrictive which may price the consumer out of the market all together, leaving them without advice.

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[19] D'Aloisio, T (2009) *Proof Committee Hansard,* p5.
[20] D'Aloisio, T (2009) *Proof Committee Hansard,* p6.

7.1 Recommendations;

1. Advice based failure - greater monitoring and supervision, as well as the development of early detection of warning signs for business or advice practices which extend beyond industry norms to ensure that the provision of advice is appropriate. For example, where the regulator is alerted to the fact of exceptionally high risk business models or high risk advice strategies, similarly applied across an entire client base, greater monitoring could be undertaken to ensure that the advice provided is appropriate for the client(s). It is important to note that the business model or high risk strategy is not of itself the key concern but rather whether or not the advice provided to the client(s) is appropriate.

2. Product based failure – review the current system to ensure good corporate governance and whether there is a need to move back in part to the old trustee system in place of the responsible entity.

3. Insufficient disclosure of risks by financial services product providers – greater transparency and clarity of risks and the operation of a product. This could include presenting risks in a key summary at the start of disclosure documents and with minimum font requirements.

4. Lack of consumer understanding – increase minimum education and training qualifications of those providing advice and incorporate financial literacy education programs as a separate core subject within the education curriculum.

5. Responsible business practices and responsible lending – PIS supports the regulation of margin lending under the Corporations Act and the introduction of lending obligations to enhance consumer protection.

6. Financial responsibility of Financial Services Product Providers – enable Licensees to act on behalf of clients and investors to undertake proceedings against financial services product providers for the recovery of damages for corporate misconduct and product failure.

7. Variability around adviser skill set – increase the minimum education and competency requirements for those providing advice. PIS supports undergraduate or postgraduate qualifications in a related field, as well as a practical training and development year for those new to providing advice.

8. Conflict of interest and Commissions – Industry and key stakeholders to work together to consider commission arrangement ceilings, standardising commission payments across all investment products for upfront and ongoing commission. This will serve to remove product bias selection and restrict excessive remuneration generation.

8. Conclusion

Financial advisers and the various market participants involved in the financial services industry, on the whole, strive to operate with integrity and provide quality advice and quality financial products and services. There will however be instances where fringe participants engage in high risk or inappropriate practices, both at the corporate and advice level, which extend beyond industry norms and outside the bounds of regulatory requirements. This is also the case for many of the recent corporate collapses and issues surrounding financial services industry in recent times. To this extent it is important to note that the regulatory system cannot guarantee against corporate failures or prevent poor business or advice models that systemically lead to losses. The system also does not have the capacity to legislate away greed. What it can however do is work together with key stakeholders and market participants to promote market integrity, good corporate governance and facilitate consumer understanding through improving system safeguards and increasing the professionalism of those providing advice. This can best be achieved through consultation and greater interaction between key stakeholders such as ASIC, IFSA, FPA, Licensees and financial product providers who collectively have an interest in and also a responsibility to maintain integrity and confidence in the financial services industry.

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Appendix 1.

PIS submission to the FPA Consultation Paper on Financial Planner Remuneration, included as a separate attachment.