FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

7 March 2017

Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Sir / Madam

Consumer protection in the banking, insurance and financial sector

The Financial Planning Association of Australia welcomes the opportunity to provide input into the Senate References Committee on Economics inquiry into consumer protection in the banking, insurance and financial sector.

In recent years there has been numerous Parliamentary inquiries relating to the financial services industry and financial advice providers including:

- Inquiry into the performance of ASIC
- Inquiry into education, professional and ethical standards for financial advisers
- Two inquiries into the Future of Financial Advice (FoFA) Amendment Bill
- Financial Systems Inquiry
- PJC Inquiry into Trio
- Inquiry into the Scrutiny of financial advice
- Richard St John review of compensation arrangements for consumers of financial services
- PJC Inquiry into financial products and services in Australia

Many of these inquiries had Terms of Reference and have made clear recommendations addressing many of the issues which are to be considered by the Committee's current Inquiry into consumer protection in the banking, insurance and financial sector. The recommendations made by these inquiries are still being appropriately implemented by the relevant parties and/or are yet to be tested.

However, the FPA believes that the following changes are vital for the protection of consumers:

- Effective product regulation and oversight of gatekeepers including research houses
- Changing the definition of 'general advice',
- Reviewing the retail, wholesale and sophisticated investor definitions in the Corporations Act, and
- Facilitative arrangements for regulators and professional bodies to work together

We would welcome the opportunity to discuss the matters raised in our submission with you further. If you have any queries, please do not hesitate to contact me on or .

Yours sincerely

Heather McEvoy
Policy Manager
Financial Planning Association of Australia[1]

[1] The Financial Planning Association (FPA) has more than 12,000 members and affiliates of whom 10,000 are practising financial planners and 5,600 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and super for our members – years ahead of FOFA.
- An independent conduct review panel, Chaired by Mark Vincent, deals with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules required of professional financial planning practices. This is being exported to 24 member countries and 150,000 CFP practitioners of the FPSB.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. Since 1st July 2013 all new members of the FPA have been required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional designations, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board

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Consumer protection in the banking, insurance and financial sector

FPA submission to

Senate References Committee on Economics

7 March 2017

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Terms of Reference

The regulatory framework for the protection of consumers, including small businesses, in the banking, insurance and financial services sector (including Managed Investment Schemes), with particular reference to:

a. any failures that are evident in the:

   i. current laws and regulatory framework, and

   ii. enforcement of the current laws and regulatory framework, including those arising from resourcing and administration;

b. the impact of misconduct in the sector on victims and on consumers;

c. the impact on consumer outcomes of:

   i. executive and non-executive remuneration,

   ii. incentive-based commission structures, and

   iii. fee-for-no-service or recurring fee structures;

d. the culture and chain of responsibility in relation to misconduct within entities within the sector;

e. the availability and adequacy of:

   i. redress and compensation to victims of misconduct, including options for a retrospective compensation scheme of last resort, and

   ii. legal advice and representation for consumers and victims of misconduct, including their standing in the conduct of bankruptcy and insolvency processes;

f. the social impacts of consumer protection failures in the sector, including through increased reliance of victims on community and government services;

g. options to support the prioritisation of consumer protection and associated practices within the sector; and

h. any related matters.

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Introduction

The FPA supports the goal of enhancing consumer protection in the banking, insurance and financial services sectors. However, we believe that the best way to achieve this goal is through appropriate proactive regulation, rather than band aid consumer redress.

There have been nearly ten parliamentary inquiries into the financial services sector over recent years which have resulted in significant regulatory changes particularly for providers of financial advice. The recommendations made by these inquiries are still being appropriately implemented by the relevant parties and/or are yet to be tested.

Many of these inquiries had Terms of Reference and have made clear recommendations addressing many of the issues which are to be considered by the Committee's current Inquiry into the consumer protection in the banking, insurance and financial sector.

Hence, our submission focuses on the gaps in the current proactive regulation of the financial services sector, and effective and appropriate mechanisms to minimise consumer risk and ensure compensation is available for consumer who suffer loss due to the dishonest or fraudulent behaviour of providers.

We also note the Government's Ramsay Review into the external dispute resolution framework and consumer compensation which is being conducted concurrently to this Inquiry.

Current laws and regulatory framework

Consumers deserve appropriate and effective protection measures when receiving services and products from financial services providers in Australia. This is best achieved by a regime that protects consumers from poor products and poor advice in the first instance, supported by a system that delivers justice and compensation to consumers who suffer loss resulting from dishonest or fraudulent behaviour.

That is why the FPA:

- supported in the introduction of the Future of Financial Advice (FOFA) reforms and the establishment of the ASIC Financial Advice Register
- called for improved professional and education standards for individuals providing personal financial advice to retail clients
- for over a decade championed the use of the terms financial planner and financial adviser to be restricted within the law to those authorised to provide financial advice
- backed the new Life Insurance Framework setting regulatory obligations around remuneration when recommending life insurance solutions to consumers
- introduced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members in 2009 – years ahead of FOFA, and

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- since 1 July 2013, has required all new members of the FPA to hold, as a minimum, an approved undergraduate degree.

The reform agenda of multiple governments over the past five years has been substantial and has changed the regulatory landscape for the provision of financial advice to improve consumer outcomes.

Year	Reforms	Description
2012 with many requirements commencing in 2013, 2014 and 2015	Future of Financial Advice (FOFA) Reforms	• Banned adviser commissions on superannuation and investment products • Introduced a best interest duty for providing financial advice • A requirement to send a renewal notice every two years to new clients that have signed an ongoing fee arrangement, and • an annual fee disclosure statement to all clients under an ongoing fee arrangement
March 2015	ASIC Financial Adviser Register (FAR)	Requires an individual to be authorised, and be registered on the Register to be able to provide financial advice to consumers On commencement of the new professional and education standards, advisers must meet the new education and experience standards, pass an exam, maintain CPD, adhere to a Code of Conduct to be listed on the Register
February 2017 - Bill passed by parliament	Professional and education standards for financial advisers	• A degree requirement and a professional year obligation for new financial planners • both new and existing financial planners required to undertake Continuing Professional Development (CPD), be subject to a code of ethics and pass an exam; • the establishment of an independent Standards Setting body.
	Enshrinement of terms	Restricts the use of the terms financial planner and financial adviser within the law to those authorised to provide financial advice and listed on the ASIC register.
February 2017 - Bill passed by parliament	Life Insurance Framework	Restrictions around remuneration when recommending life insurance solutions to consumers

There have been some significant instances of poor products and financial advice resulting in unacceptable consumer detriment and suffering over the past five years while these reforms were being established. However these reforms are a major leap forward for consumer protection and therefore need time to be embedded in the financial services sector and their effectiveness tested.

For example, the FoFA reforms introduced a Best Interest Duty for the provision of financial advice. The first cases that ASIC have identified as suspected breaches of the new best interest obligations are only just now before the courts.

It would be inappropriate and pre-emptive to consider any potential or suggested failures in the laws and regulatory framework, or enforcement of those laws, without accepting that the reforms described above are still in progress.

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Recommendation:

Recent regulatory reforms in the financial advice framework must be given time to take effect and their effectiveness in improving consumer protections tested.

Product and gatekeeper regulation'

In December 2016, the Government released a consultation paper on two key proposals from the Financial System Inquiry:

- design and distribution obligations for financial product issuers and distributors, and
- product intervention powers for ASIC to enable the regulator to intervene where a product is identified as creating a risk of significant consumer detriment.[2]

The FPA has strongly advocated for greater oversight of financial products for many years. The introduction of product regulation is vital to enhancing consumer protections across the breadth of the financial services sector.

There are multiple participants who offer financial products or services who influence consumers' decisions on financial matters, including:

- Product manufacturers and fund managers
- Platforms
- Property schemes
- Ratings agencies and research houses
- Investment banks (funding the development of financial products sold to consumers)
- Auditors (of products and product manufacturers)
- Accountants (of product manufacturers)
- Accountants (of consumer) operating under a limited licence
- Stockbroker / share broker
- Futures broker
- Australian Deposit Institutes (banks, building societies, credit unions)
- Insurance brokers and companies
- Unregulated participants (including some Accountants) acting as financial planners
- Regulatory agencies including ASIC and the ACCC
- Professional Indemnity Insurers

Each of these participants play some part, either directly or indirectly, in influencing a consumers' decision to invest in a financial product and the ongoing stability of that product. However, currently many of these entities or their products or services are not appropriately regulated. Meaning they are not held accountable for their actions and do not have a legal responsibility to the end consumer for their role and influence in getting consumers to buy financial products and services.

Product providers should be held accountable for failing to deliver on product benefits due to dishonest conduct, fraud or insolvency, or if there are fundamental flaws in products.

These gaps in the law create significant risks for consumers and significantly undermine the role and powers of ASIC and the value of legislation which serves to protect consumers.

[2] Increasing the accountability of financial product issuers and distributors, Media release, Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, 13 December 2016

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Currently ASIC does not have legislative obligations to regulate financial products. ASIC's oversight of product providers is limited to matters of corporate governance and disclosure, and in the main not on the design and other issues related to the products they sell to consumers.

Complex products are particularly problematic for the following reasons:

- complex products require a high degree of financial capability to understand
- where a complex product would be in the best interests of a retail investor, that investor will almost always require a financial intermediary to engage with the product on their behalf
- behavioural economics indicates that product complexity encourages irrational decisions with respect to the product or advice in relation to that product
- issuing and distributing complex products involve the arms-length collaboration of several financial intermediaries, of whom few owe any gatekeeper obligations to the end users or the financial system itself, and
- Australia's regulators are not sufficiently empowered to address product regulation, either collaboratively or on a command-and-control basis.

Legislation must enable ASIC to effectively and proactively regulate product providers and the products they develop and sell to consumers.

Recommendation

That bipartisan support be given to appropriate and effective product regulation and oversight.

Research Houses

Australian consumers rely on information from credit rating agencies and research houses to make investment decisions, so they play an important gatekeeping role in the financial system. The role of such organisations is to provide specialist assessments and detailed due diligence research on financial products for consumers and intermediaries. It is a specialised service which comes at considerable expense. Credit rating agencies (CRAs) and research houses should also be held accountable for their role in product failures and the influence their services have on the end consumer.

Biases and methodological errors by CRAs and research houses can distort investment decisions and have a profoundly negative effect on financial markets, financial institutions, and the broader economy. For example, when research houses award overly high ratings to any class of product, financial institutions and other investors purchase more of these products for their investment portfolios. At the same time, systemic biases and errors in ratings encourage issuers to supply more of these overly rated products to financial markets. Thus, systemic biases and errors in ratings erroneously stimulate the flow of credit to economic sectors that are receiving funds through these overly rated products.

Further, the "issuer pays" business model of CRAs and research houses make them financially dependent upon the providers of the products they assess. Often analysts are pressed to give favourable ratings to maintain or increase market share with product providers.

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The current system creates systemic biases, conflicts of interest, and potential for errors in assessment and ratings of products, which put Australian consumers at risk.[3]

The FPA acknowledges the current licensing and regulatory requirements placed on research houses, including the requirement to hold an Australian Financial Services License (AFSL), meet general advice obligations, disclosure of conflicts of interest, and dispute resolution membership. However, the FPA believes the current requirements are not effective in protecting consumers given the influence research houses have, either directly or indirectly, on consumers' investment decision. ASIC's legislative requirements in this regard should be bolstered.

The licensing requirements for research houses are dependent on the services the entity provides. If they provide services to wholesale clients only, they are not required to be licensed; if they provide services to retail clients, they are. We note that ASIC changed its requirements regarding product manufacturers including in their PDS information sourced from research houses. Now product manufacturers must gain consent from the research house to include any information they provide to the product manufacturer (the wholesale client) in the PDS. In giving consent the research house is in effect agreeing to the provision of its information (via the product manufacturer) to retail clients, and as a result must have professional indemnity (PI) insurance and be a member of an external dispute resolution (EDR) scheme to support the provision of information to retail clients.

However, the FPA questions the benefits of EDR, compensation arrangements and PI for research houses as, in the main, their clients are wholesale clients (usually other licensees who are prohibited under the Corporations Act from making a claim through these EDR mechanisms) even though the service provided by research houses influences the retail clients' decision. It is also very difficult, near impossible, for a retail client to provide causal link evidence of the failings of the research house to the event at the cause of their loss. This is exacerbated by the exclusion from PI cover (RG126.23) and EDR (RG139 and FOS Terms of Reference) of product failures and claims for loss solely as a result of the failure (e.g. through insolvency) of a product issuer, such as Trio Capital, Westpoint and Basis Capital.

CRAs and research houses who provide research and analysis of financial products and the market, should be regulated as financial intermediaries. Australian consumers rely on information from CRAs and research houses to make investment decisions. This is particularly the case where consumers are unable to evaluate either the products which are covered by research[4] or the research methodology CRAs and research houses use to form an opinion.

ASIC has recognised that there are significant risks if CRAs and research houses fail to fulfil this role, as they state in Regulatory Guide 79:

> *"Poor quality research or research that is not reliable, credible or current, damages confidence in the research sector itself and in the financial services industry more broadly. Risks for the investment community are amplified where there is undue reliance on research reports and a lack of awareness of real and potential conflicts of interest*

[3] For example, Basis Capital - received glowing reports and high ratings from several research houses. This influenced financial planners' views of the product and consumers decision to invest in the product. Westpoint - some reputable research houses continued to give the product a highly positive rating. Many consumers impacted by the Westpoint failure invested directly with the product provider or through a broker. Trio Capital - research houses relied on information provided by the product provider and failed to conduct independent investigations even though the information released by the product provider was restricted based on 'private investment contracts' and was inconsistent.
[4] Bathurst Regional Council v Local Government Financial Services Pty Ltd (No 5) [2012] FCA 1200 at [2459].

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which may adversely impact on the independence and therefore the reliability of those reports."[5]

Although Regulatory Guide 79 does provide guidance on the obligations of CRAs and research houses through their licensing conditions, there are few forms of Australian regulation which directly affect the conduct of these financial intermediaries. This again highlights a gap in ASIC's regulatory responsibilities that significantly impacts on consumer protection.

A better solution exists for three of Australia's major CRAs, who have been granted relief from the AFS licensing regime[6] provided that they comply with IOSCO's *Code Of Conduct Fundamentals For Credit Rating Agencies*. That Code of Conduct includes several financial intermediary obligations regarding conflicts of interest, transparency of reports, and the integrity of employees. The European Union has also introduced key regulations of CRAs which impose many similar standards of conduct for these agencies.

Research houses should be held accountable for their ratings. Rating a particular product as '5 star' is their opinion. However it should be made clear in what context this rating is given. For example, 'a 5 star rating only in the context of highly aggressive hedge funds'. The rating should also clearly disclose any potential downside risks of the products for consumer.

Recommendation

The Committee should consider how best to regulate research houses and credit rating agencies as financial services intermediaries so that they have accountability to the end consumer.

General advice definition

Fundamental to proactive consumer protection is the separation of advice from product selling and the need for a change to the definition of 'general advice' in the Corporations Act.

There is a high level of confusion in the market, within industry, media, Government and consumers about the definitions and roles of financial advisers and financial planners, and those that sell financial products.

Some consumers incorrectly mistake the use of the word 'advice' to have the standard dictionary meaning when in fact there is a significant legal and technical difference between 'general' and 'personal' advice. The Law defines the act of providing 'financial product advice', specified as general advice and personal advice:

- Personal advice (s766B) is given when the provider of the "financial product advice" has considered one or more of the consumer's objectives, financial situation and needs.
- General advice is financial product advice that is not personal advice.

We are concerned that defining financial product advice on this basis makes it more difficult for consumers to distinguish personal financial advice from marketing material or product sales. Most of

[5] ASIC, *Regulatory Guide 79: Research report providers: Improving the quality of investment research*, 5.
[6] ASIC [CO 05/1230].

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the documents provided to consumers under the guise of advice are clear sales and marketing tools. This risk is confirmed by ASIC's *Report 384 – Regulating Complex Products*, where the Report states;

> *"Our research has indicated that marketing information plays a particularly strong role in product distribution and may influence investors' decision making more than other product disclosure. In particular, when investors approach product issuers or other intermediaries responsible for selling products directly, rather than going through advisers, the information contained or implied in product issuers' marketing information is often the first, and may be the only, information that investors use to decide whether or not to invest in that product."*[7]

Framing 'general advice' as advice plays into the behavioural aspects of financial decision-making by giving the impression that the advice has a reasonable basis or is appropriate for the client, and thereby exposes retail investors to decisions made under uncertainty about the regulatory framework for that advice. Anecdotal evidence shows that it is common for individuals to interpret general advice as personal advice because it is relevant to their circumstances at the time it is provided.

Recommendation:

The Committee support additional consumer protection measures by recommending:

- General Advice be re-termed 'general or product information' and be limited to the provision of 'factual information and/or explanations' relating to financial products.
- Personal Advice be re-termed 'Financial Advice' and have the following meaning:

  Any recommendation made personally to a consumer on which that consumer could reasonably be expected to act in relation to an investment or financial decision, including but not limited to, any recommendations relating to shares, debentures, collective investments, futures or options contracts, life insurance, superannuation, property or other financial instruments, transactions or investments.

The provision of 'financial advice' should only be permitted by those who meet the legal requirements for using the terms financial planner and financial adviser, and are listed on the ASIC Financial Adviser Register (and meet the "relevant service provider" requirements from 1 July 2019).

Commissions and General Advice

The original Future of Financial Advice (FoFA) reforms banned conflicted remuneration in connection to both personal and general financial product advice on superannuation and investments. However, the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014*, removed the ban on conflicted remuneration on general advice, reintroducing commissions into the advice space, especially in connection to superannuation and investment products.

[7] ASIC, "*Report 384 – Regulating Complex Products*" (January 2014), at [46]

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Commissions must not be permitted to be paid under general advice. The ban of commissions on investments (including upfront or trail commissions), or in superannuation, should be reinstated.

It is undeniable that conflicted remuneration has eroded public confidence in our financial system. The impact of commissions on consumers and the operations of the financial system has be well examined by numerous parliamentary and industry inquiries.

Australians have right to expect that the financial services which they use to ensure their financial security should not also be motivated to sell potentially inappropriate products in order to generate commissions and other forms of conflicted remuneration.

General advice is most commonly provided by product manufacturer employees (such as banks and superannuation funds), and is arguably more conflicted than personal advice. There is an inherent lack of accountability for general advice, as there is no paper trail –there are very limited disclosure requirements for providing general advice to consumers.

To facilitate this legislative approach, the FPA recommends the Government clearly define the term 'commissions' in relation to conflicted remuneration and ban commissions from all superannuation and investment products. In our Remuneration Policy, the FPA defines commissions as:

> *"An amount calculated as a percentage value of the consumer's asset or insurance premium payable by the product provider to the financial planner's licensee for recommending the product to the consumer. Commissions are not paid directly by the consumer but are paid by the product provider.*
>
> *A commission cannot be switched off and will be paid until such time as the client withdraws their funds or ceases life insurance cover."*

Recommendation

The term 'Commission' to be defined and then banned under the General Advice exemption in the Corporations Act.

Retail, wholesale and sophisticated investor definitions

The FPA strongly supports a review into the definitions of retail, sophisticated, and wholesale investors. The current definitions:

- are based on the wealth of the investor, rather than a qualitative and/or quantitative measure of their financial literacy
- do not incorporate behavioural elements into the categorisation or basic understanding of how consumers make decisions or engage with financial products and services
- assume (wrongly, in our view) that client wealth is a good proxy for financial literacy

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- removes judgement and discretion from financial intermediaries regarding their conduct towards clients with differing degrees of financial capability, and

- when paired with a disclosure-based system of regulation, the definition encourages documentary compliance with little consumer protection benefit or improvement in financial capability or opportunity.

Recommendation

The Committee recommend a review of the effectiveness and value of the retail, sophisticated, and wholesale investor definitions in the Corporations Act, including the development of a definition based on consumer financial literacy.

Co-regulation - Regulators and professional bodies working together

The FPA suggest there is a fundamental need to recognise the role professional bodies can play in assisting ASIC to achieve its mandate under the ASIC Act, in order to improve overall consumer protection.

Industry specific obligations set and enforced by professional bodies, greatly complement the requirements of Corporations Law regulated by ASIC. Corporations Law requirements are over-arching and do not speak to the specific roles, services, and interactions provided to consumers by the various industries within the Australian financial services sector. Professional obligations are industry specific and provide a vital contribution to protecting consumers.

The FPA's professional obligations and activity are focused on the part of the financial services sector to which the FPA belongs, that is the financial planning profession. Our obligations and activity are specifically designed to govern the conduct of our members in the provision of financial planning services to consumers, and in turn the needs of the consumers seeking the services of our members. Therefore, they have a significant impact on the conduct of our members and the consumers they serve.

Co-regulation based on a collaborative two-way partnership between the Regulator and professional bodies is a cost-effective way to enhance consumer protection.

Currently ASIC's work with professional bodies is based on limited ad hoc issues. Formal arrangements should be established between ASIC and professional bodies, through a Memorandum of Understanding (MOU), that ensures a focused and ongoing partnership that enables parties to work openly together to deliver a stronger and more effective regulatory environment for all stakeholders.

The current system does not always allow or facilitate such arrangements creating significant inefficiencies and duplication of costs to the detriment of consumers, industry and government.

For example, recently ASIC and the FPA simultaneously banned a financial planner, Darren Tindall. This means, the FPA and ASIC conducted the same investigations and came to the same conclusions at the same time. This highlights the unnecessary duplication of effort and resources that could be avoided were a collaborative approach permitted.

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We note the current work of the Committee and the Government regarding whistleblower protections and highlight the need for appropriate mechanisms to protect individuals and entities who disclose information to ASIC and professional bodies to be included in MoUs and collaborative investigative processes.

Recommendation:

Amend Regulation 8AA of the ASIC Regulations to include other financial services professional bodies, including the Financial Planning Association, and permit collaborative and confidential information sharing between ASIC and professional bodies to enhance consumer protection.

Permit the establishment of Memorandum of Understandings between ASIC and professional bodies that facilitates and permits a more collaborative and cooperative two-way working relationship, or co-regulatory partnership.

Retrospective compensation scheme of last resort (CSLR)

Consumer protection and appropriate consumer compensation is the responsibility of all participants who have a role in causing, or an influence in allowing, consumer detriment. Until the regulatory and compensation framework is able to ensure that each provider has responsibility and financial accountability to the end consumer for their role in ensuring the effective and ethical delivery of financial products and services, the FPA is unable to support the introduction of a Compensation Scheme of Last Resort.

Though the FPA understands the reasons for stakeholders wanting to introduce a last resort compensation scheme, we recommend that further analysis or inquiry is conducted as to why there are unpaid Financial Services Ombudsman (FOS) determinations, before bolting on a costly scheme that does not actually resolve the underlying reasons as to why there are unpaid determinations.

In 2011, the Government appointed Mr Richard St John to undertake an extensive independent review of the consumer compensation system. This Review examined the need for, and costs and benefits of, a statutory compensation scheme for clients who suffer damage or incur loss as a result of misconduct by persons with whom they have dealt with in the financial services sector.

In his final Report, Mr St John concluded that it would be inappropriate and possibly counter-productive to introduce a 'last resort' compensation scheme without first strengthening the existing compensation arrangements.

> *"There would also be an element of regulatory moral hazard should a last resort scheme be introduced without a greater effort first to put licensees in a position where they can meet compensation claims from retail clients. It would reduce the incentive for stringent regulation or rigorous administration of the compensation arrangements."*[8]

[8] Compensation arrangements for consumers of financial services, Report by Richard St. John, April 2012, p. iii

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While the FoFA and other reforms detailed above have significantly improved proactive consumer protections in the last five years, few of Mr St John's recommendations in relation to the consumer compensation system have progressed in this time.

The FPA does not support the establishment of a CSLR for the following reasons:

- Proportionate liability - Gaps in the regulation of product providers, research houses and other financial service gatekeepers mean there is no ability of a scheme to proportion liability of loss based on causal link. This is vital in cases of fraud and dishonest conduct that may have involved multiple providers (such as the collapse of Trio which involved fraud by the product provider, was signed off by the auditor, and given an A rating by research houses, prior to inappropriate advice by the adviser).

- Access to the CSLR – It is unclear how consumers will be permitted to access a Scheme. Previous CSLR proposals have been reliant on a complaint determination by an EDR scheme, a court or tribunal, or a trustee regarding bankruptcy. EDR schemes have a strong history of blaming the adviser for the entire loss incurred by the consumer and do not take into account the role of other parties. Some parties responsible for consumer loss in the case of fraud (as evidence in the Westpoint and Basis Capital cases) have no standing for a retail client to bring a complaint against them in existing mechanisms without incurring extreme cost and would therefore not be considered as a claim under the such proposals. This is an unfair and inequitable process as it does not hold all parties to account for the consumer detriment caused by their actions.

- Disproportionate impact on small business – The introduction of such a scheme would have a significant impact on small licensees and could result in the closure of many small advice businesses. It creates a moral hazard as licensees would have to seek PI cover to insure against the risk of incurring a levy for someone else's mistake/action, even though their business may have a 'clean sheet'. Larger licensees and large dealer groups who are APRA regulated or self-insured would be the only businesses able to afford to maintain their business, forcing advisers to tie themselves to large dealer groups. This will impact on market competition as it would create a barrier to entry for small licensees.

- Double paying – AFSL holders have an obligation under the Corporations Act to hold professional indemnity insurance to cover the cost of consumer claims against them, and to pay the fees for EDR scheme membership. If they were also required to fund a CSLR, it would create a situation where they would be double paying to cover the same potential claims.

- Regulatory moral hazard – Regulatory moral hazard is created if the Regulator is aware that in a particular area there is a compensation scheme and therefore may be less diligent in making sure that it is active in that area so that the scheme is not required to be used by consumers.

- Consumer moral hazard – consumers may not give appropriate consideration to the true risk of an investment as they have a misplaced sense of security that the CSLR will compensate them should an investment fail or deliver poor returns.

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- Scope of scheme — there appears to be no stakeholder consensus as to coverage of a CSLR. Many consumers invest in financial products directly from product providers. For example, a consumer may decide to invest in a financial product after hearing it promoted on the radio, and the product manufacturer becomes insolvent due to fraudulent activity by the directors. This highlights the need to ensure appropriate proactive regulation and access to redress and compensation for loss resulting from fraud or misconduct by product manufacturers or any provider in the financial services value chain, including:

  - Product manufacturers
  - Research houses / Credit Rating Agencies
  - Auditors (who may sign off on fraudulent company accounts)
  - Accountants
  - Accountants operating as Authorised Representatives
  - Stockbroker / share broker / Futures broker
  - Investment banks (funding the development of financial products sold to consumers)
  - Auditors (of products and product manufacturers)
  - Platforms
  - MIS and property schemes
  - Margin lenders
  - Hedge funds
  - Credit providers

- Class actions – The establishment of a CSLR would potentially result in the financial services industry funding lawyers representing consumer class actions.

Given the current regulatory environment there is a high risk that a sub-standard scheme will result if a CSLR is introduced. Alternatives must be considered such as:

- St John review into consumer compensation – Review the recommendations made by Mr St John to improve the professional indemnity insurance arrangements and the existing consumer compensation regime.

- Expand regulatory reach - Proactive regulation of product providers, research houses and other gatekeepers is key to improving consumer protection. Most financial products have a degree of complexity and there is an expectation in the community that product providers will provide a basic level of assistance to consumers deciding whether the product is suitable for them.

- Limited Liability Schemes - Professional Standards Legislation limits a professional's civil liability in return for improved risk management at the practice level and improved standards of conduct of providers. Such schemes provide multiple consumer protection benefits as they require the highest professional standards and conduct to be maintained by its members creating a proactive measure of quality consumer service and protection, minimising the risks leading to a claim. It may also make the PI insurance market more competitive driving improvements in the quality and price of PI cover, and, in turn, reduce the occurrence of uncompensated consumer losses at the EDR level.

- Professional indemnity (PI) insurance - Make professional indemnity insurance work to ensure that all financial service providers are bearing the costs of their own business activities and not compensating others – that is a risk-based system based on the risks associated with that business' activities. Existing arrangements with PI insurance should be reviewed and

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considered before jumping to the establishment of a last resort scheme. In particular, we recommend investigating how competition in the PI insurance market could be enhanced to improve cost and quality of cover.

- Continuing PI cover – When a company goes into liquidation insurance premiums are not paid and the PI policy is cancelled so all cover is stopped. An administrator should be required to keep paying PI premiums once a company goes into liquidation to keep the PI cover going so EDR claims can be paid.

- Improve transparency of PI cover – Include information about the licensee's insurer on the ASIC Financial Adviser Registry.

Recommendation

The Committee should consider appropriate alternative solutions to a CSLR (as suggested) and preventative regulatory measures for protecting consumers.

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