



**10 March 2017**

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

**By email:** [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

**Consumer protection in the banking, insurance and financial sector**

The Financial Services Council (FSC) welcomes the opportunity to make a submission to the Senate Standing Committee on Economics' inquiry into consumer protections in the financial sector.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than \$2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

This submission focuses on the sectors in the financial services industry that we represent; life insurers, financial advice networks, superannuation funds, public and private trustees and investment managers. The FSC notes that, for the sectors we represent, there has been an extended period of unprecedented scrutiny stemming from the financial crisis.

As a result of the enhanced scrutiny of regulators and the Government there has been a range of inquiries, recommendations and reforms that have been completed, implemented, or are currently underway. The FSC is of the view that collectively, across these reviews, there is a robust regulatory framework proposed that would deal with the issues detailed in the inquiry's terms of reference.

Please contact me with any questions in relation to this submission on .

Yours sincerely,

Blake Briggs  
Senior Policy Manager

## Contents

|   |    |
|---|----|
| Introduction .....  | 3  |
| Financial Advice .....  | 4  |
| Professional Standards of Financial Advisers.....                               | 5  |
| Enshrinement of financial planner and financial adviser in law .....            | 5  |
| General consumer protection framework.....                                      | 5  |
| Obligations at Licensee level and adviser level.....                            | 7  |
| Fee for ‘no service’ .....  | 8  |
| International comparison of Australia’s financial advice regulatory regime..... | 8  |
| Life Insurance .....  | 10 |
| Life Insurance Code of Practice.....  | 10 |
| Key Code Promises.....  | 11 |
| Group Insurance WG.....   | 11 |
| Superannuation .....  | 11 |
| Compensation Scheme .....   | 12 |
| ASIC Powers and Resourcing.....   | 14 |
| Recent changes to ASIC resourcing.....  | 15 |
| Overview of previous financial services industry reviews and inquiries .....    | 16 |

## Introduction

Australia has a comprehensive and well developed regulatory system for financial services to enhance the protection of consumers. The regulatory system includes a 'twin peaks' model of regulation, with the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investment Commission (ASIC) as key regulators. Our financial system also includes a comprehensive conduct, disclosure and enforcement framework, together with enforceable legal obligations and a readily accessible ombudsman system for consumer redress.

Despite this well-established framework the financial services industry has been subject to extensive public, regulatory and political scrutiny in the decade since the financial crisis. This scrutiny has occurred through a range of reviews and inquiries, regulator investigations and industry self-review.

These reviews have occurred at the system level, such as the Financial System Inquiry in 2014 and the Superannuation System Review in 2009, or more targeted, such as the Trowbridge Review of Retail Life Insurance Advice in 2015, the Productivity Commission Review of the Competitiveness and Efficiency of the Superannuation System in 2016, or the Inquiry into Financial Products and Services in Australia in 2009.

Collectively, these reviews and inquiries are a legitimate response to public and political concerns that there were issues in the financial services industry that required reform. The industry has responded to these concerns and participated constructively with the inquiries and supported legislative and regulatory reform or implemented industry self-regulation.

There remains, however, a significant number of inquiries currently ongoing, as well as a plethora of recommendations from completed reviews that remain unimplemented. The FSC estimates that, for the sectors we represent, there has been over 15 reviews and inquiries in the past decade, with 8 major inquiries taking a detailed examination of consumer protections.

These major inquiries have made recommendations in at least 74 areas for thematic reform. As a result there has been significant reform of the financial services industry, particularly in relation to superannuation financial advice and life insurance. Further, there are at least 30 issues and recommendation for reform that are currently ongoing or are being implemented. Of greater concern, however, is that another 19 areas of reform show no evident progress from when the review was completed.

Two thirds, or at least 49 of 74, of the recommendations for reform to the financial services sector remain unimplemented or ignored by successive governments.<sup>1</sup> The FSC submits that these reviews collectively lay out a blueprint to deliver a regulatory regime that promotes the best interest of consumers of financial products. In some instances they have also considered, and recommended against, options for reform that are still being subject to debate.

Major progress has been made on key issues, including limiting commissions on financial advice products, implementing higher standards on financial advisors, banning commissions in superannuation, and implementing low cost, MySuper products.

There, however, remain barriers to other important consumer protections and improvements, such as requiring all superannuation funds to appoint independent directors and an independent chair,

---

<sup>1</sup> A detailed table of the major review considered for this analysis can be found at Attachment A.

allowing for rationalisation of legacy insurance products and relabelling forms advice to better reflect the service being provided.

The FSC has taken a proactive stance on developing and supporting reforms to ensure consumer confidence in the sustainability of the industries we represent. Examples of this include the Trowbridge Review of the retail life insurance sector and the implement of an FSC Standard that requires all our superannuation members to appoint a majority of independent directors and an independent chair to our trustee boards.

Unfortunately other sectors in the financial services industry have sought to oppose important reforms that promote consumer protections, such as legislation that would require all superannuation funds, including retail funds that are not members of the FSC, appoint independent directors. This opposition reflects the challenges face by parliament to implementing tangible measures that are intended to improve corporate culture within the financial services industry.

The FSC submits that it is in the best interest of consumers for the industry and parliament to focus on tangible actions that promote consumer protections. It would be a disservice to consumers if important reforms continued to be ignored or delayed as a result of ongoing parliamentary and industry reviews.

**Recommendation:** The Committee undertake a gap analysis to identify whether or not there are deficiencies in the consumer protection framework established through recent reviews and inquiries, including reviews and recommendations that remain uncompleted and unimplemented.

## Financial Advice

The Future of Financial Advice (FoFA) reforms have significantly changed the structure and operation of the financial advice industry to remove conflicts of interest arising from remuneration arrangements such as investment commissions, introduced a statutory best interest duty and increased ASIC powers to better align the interests of advisers and consumers. The reforms involved over 4 years of consultation and address many of the issues raised by the 2009 Parliamentary Joint Committee Inquiry into financial products and services in Australia.

Given the breadth of the reforms it is essential that they be given the opportunity to demonstrate that they work. This is important for the stability of the industry and for consumer confidence.

Whilst the regulatory and legislative framework imposes extensive obligations and requirements on the financial advice industry, the regulatory framework is of little value if it is not appropriately enforced. This requires prompt and efficient action by ASIC to investigate and enforce breaches of law. This is critical for the prevention of misleading advice and prevention of breaches of law generally.

It is vital that ASIC has the necessary resources to enable it to carry out its regulatory oversight functions. The FSC supports funding ASIC on a cost recovery basis with a refined focus on regulation of financial services companies and financial market integrity.

In considering the Terms of Reference of this inquiry, as well as the current level of consumer protections, this submission explores the breadth and robustness of the existing framework, the key inquiries which have taken place since the Financial Crisis, an international comparison of Australia's regulatory regime as well as the current inquiries under way and potential changes. Consideration of

these issues demonstrates the comprehensiveness and breadth of Australia's regulatory regime and consumer protections.

### Professional Standards of Financial Advisers

Recent financial advice laws raised professional and education standards for financial advisers, overseen by a new independent standards setting body.

These reforms include:

- compulsory education requirements for new and existing advisers;
- professional year requirements for new advisers;
- an exam; and
- obligations under a code of ethics for all advisers.

It is also important to note that the financial services industry has undertaken to fund the independent professional standards body for financial adviser standards.

The FSC was a strong advocate for these reforms throughout their development and is continuing to work with the Government and industry to ensure their implementation is effective.

Raising professional standards and education requirements, and establishing a dedicated standard setting body to set standard for advisers, brings financial advice in line with other professions.

### Enshrinement of financial planner and financial adviser in law

The recent advice reforms also includes the enshrinement of financial adviser and financial planner in law – such that you can only use those labels if you are on the ASIC register and have met the education/professional standards requirements.

This is an important consumer safeguard. It enables consumers to trust that any given advisor has met the minimum education requirements.

In order for these requirements to be effective the FSC is still working with other stakeholders to implement the following features of the new framework:

- Ongoing industry funding of the standards board;
- Education content requirements, including– degree, exam, professional year and CPD points, code of ethics; and
- The implementation timeframe, including by when new advisers must pass an exam, be degree qualified and supervised during their Professional year.

There remains significant detail to work through in order to effectively implement these reforms. As a result the ongoing support from industry and Government is critical to ensure that these new consumer protections are effective.

### General consumer protection framework

The current legal, statutory and regulatory framework under which financial planners operate is complex and broad ranging. The consumer protections are extensive. Advisers are subject to conduct obligations ranging from the general law (tort), equity (fiduciary duties) as well as legislative requirements (including the best interests duty under the Corporations Act 2001 (Cth) and regulatory oversight (ASIC). Some of these are considered in more detail below:

### *General law*

Financial planners are recognised as owing a duty of care to their clients under the general law tort of negligence. Generally, if a financial planner breaches that duty of care, where the client has relied on the advice, and the client suffers a loss as a result of that breach, then the adviser will be liable for that loss.

### *Equity / fiduciary duty*

While it will depend on the particular factual situation, in most cases it is likely that where a financial planner provides personal advice to a retail client, fiduciary obligations will arise. Being in a fiduciary role means that the adviser will owe an obligation of loyalty to the client, which must be observed by meeting two proscriptive obligations, as follows:

- a fiduciary must not put himself/herself in a position where a duty or interest of the fiduciary may conflict with duties owed to the other person in the relationship without receiving fully informed consent from the other person; and
- a fiduciary must not use their position to gain profit or advantage (for himself/herself or for a third party) without receiving fully informed consent from the other person.

### *Legislative Requirements*

An adviser providing advice to a client is subject to many different obligations under a plethora of different legislation, including the *Corporations Act*, the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act), the *Competition and Consumer Act 2010* (Cth), the *Privacy Act 1988* (Cth) and the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth). We have only considered below some of the main conduct obligations to which an adviser is subject under the Corporations Act and ASIC Act.

#### 1) Corporations Act – Best interest duty

The FoFA reforms introduced a new duty on a provider of advice to act in the best interests of a retail client when providing the advice (s961B). This is a broad, undefined duty which is deemed to be met if the “safe harbour” steps in s961B(2) are met. This duty is intended to address the behaviour and conduct of an adviser in the process of providing advice.

Another important duty in this division is for advisers to give priority to clients’ interests when giving advice (s961J). It governs all aspect of the role undertaken by the adviser in giving advice and has no limitation on its operation as to where it applies. It is therefore not permitted under the legislation for an adviser to prefer their own (or their licensee’s) interests to the interests of their client when giving advice.

Another obligation is the requirement for an adviser to only provide advice to the client if it would be reasonable to conclude that the advice is appropriate to the client (s961G).

Finally, there are additional safeguards from poor advice, including prioritising the interests of the client (s961J) and ensure that they warn the client if the advice is based on incomplete or inaccurate information (s961H).

#### 2) Corporations Act – disclosure requirements

Before an adviser provides any financial services to a retail client they are required in most circumstances to provide their client with a Financial Services Guide (FSG) which contains information relating to, amongst other things, remuneration and associations, and relationships that might reasonably be expected to influence the adviser or licensee in providing the advice.

When he or she provides personal advice to a retail client, the adviser is required in most circumstances to provide this advice in a “Statement of Advice” (SoA), which again contains information disclosing potential conflicts of interest such as remuneration, interests and associations and relationships that might reasonably be expected to be capable of influencing the adviser or licensee in providing the advice.

### 3) Corporations Act – prohibition on receipt of conflicted remuneration

Licensees and advisers are prohibited from receiving conflicted remuneration (subject to certain limited exceptions). This means when an adviser provides personal advice, and in many cases when they provide general advice, to a retail client an adviser cannot receive any monetary or non-monetary benefit that could reasonably be expected to influence either the choice of financial product recommended or the financial product advice provided to the retail client.

### 4) Corporations Act - Misleading and deceptive behaviour

The Corporations Act contains criminal offences including the prohibition from making false or misleading statements that are likely to induce clients to apply for or dispose of financial products in certain circumstances (s1041E), and also the prohibition of dishonest conduct in relation to a financial product or financial service (s1041G). Other civil penalty provisions include the prohibition of conduct that is misleading and deceptive or is likely to mislead or deceive (s1041H).

### 5) ASIC Act – Misleading and deceptive behaviour, false statements, unconscionable conduct

The ASIC Act contains extensive provisions aimed at protecting the consumer, to which an adviser is subject. For example, the ASIC Act prohibits a person from:

- engaging in unconscionable conduct in relation to financial services (s12CA);
- engaging in misleading or deceptive conduct, or conduct that is likely to mislead or deceive (s12DA); and
- making false or misleading statements in connection with the supply of financial services in certain circumstances (s12DB).

### Obligations at Licensee level and adviser level

The licensing regime under the Corporations Act enables a licensee to operate through representatives, including employees and authorised representatives.

Many of the legal obligations described in paragraphs (a) to (c) above sit at the individual (i.e. the adviser) level. For example, the common law and fiduciary obligations sit at the adviser level, as do the requirements to act in the best interests of the client under the Corporations Act. Some of these obligations under the legislation also sit at the licensee level, or the licensee is otherwise deemed to be liable where an adviser breaches an obligation.

The FOFA obligations increased the level of obligations that applied at the individual adviser level. Previously, some of the main conduct provisions (such as the “reasonable basis of advice” test under the old s945A) applied in relation to the “providing entity”. The “providing entity” includes an authorised representative or a licensee, but does not include a representative (that is, an employed adviser). In an effort to increase accountability at the adviser level (including increasing the ability for ASIC to take enforcement action) the new best interest obligation and other similar obligations under FOFA apply now to the individual adviser as well as the licensee (where the licensee provides the advice).

Under the Corporations Act, the licensee is liable to a client in respect of any loss suffered by a client as a result of the representative’s conduct (s917B and C).

Whilst there are a range of other obligations that a licensee is subject to, the Committee should also consider key obligations in ASIC's RG 36:

- The licensee must ensure that its licensees are adequately trained and comply with financial services law;
- The licensee must have compensatory arrangements in place in case of loss or damage suffered because of breaches of the relevant obligations;
- The licensee must have arrangements in place to ensure that they are complying with their obligations as an AFSL licensee; and
- Have adequate measures in place to ensure that the licensee is managing conflicts of interest.

#### Fee for 'no service'

Since the FOFA reforms the issue of 'fees for no service' have been comprehensively addressed. There are now extensive obligations for persons who provide personal advice to retail clients to provide a fee disclosure statement (FDS). The FDS outlines fees paid by the client and the corresponding services they have received for the incurred fees.

Further, the opt-in provisions, which require a client to confirm their willingness to continue with the service provider, are another safeguard to ensure that clients are not only aware of the fees and services they are receiving from the provider, but also their willingness to continue with this service. ASIC, in their *'Report 499: Fees for no service'* affirmed that FOFA reforms have had a positive impact in materially reducing instances of fees for no service.

#### International comparison of Australia's financial advice regulatory regime

Australia has a comprehensive and well developed regulatory regime for financial advice providers. The regulatory regime includes Licensing obligations imposed on financial advice providers in order to provider financial advice, conduct and statutory duties, disclosure requirements which include disclosure of any conflicts of interest, prohibitions against conflicted remuneration and duty to place a client's interests first in a situation of conflict.<sup>2</sup>

An international review of some of these key obligations was considered in a 2014 Deloitte benchmark report prepared for the FSC, *'A comparison of financial advice regulations – personal advice for retail clients'*. The benchmark report reviewed the regulatory landscape for retail personal financial advice across Australia, United Kingdom ('UK'), United States of America ('USA'), Canada, Singapore and Hong Kong. The report reviewed;

- licensing requirements for providing financial advice;
- statutory duties imposed on advice providers;
- disclosure requirements when providing advice;
- conflicted remuneration provisions, if any; and
- requirements to manage conflicts of interest imposed on advice providers, if any.<sup>3</sup>

The regulatory framework for the attributes above are outlined in Table 1 below.

---

<sup>2</sup> Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients*, pages 9-10.

<sup>3</sup> Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients*.



**Table 1: Summary – Country comparison of financial advice regulations<sup>4</sup>**

| AUSTRALIAN Requirement  | Indicative comparisons |              |              |              |              |
|---|------------------------|--------------|--------------|--------------|--------------|
|   | Canada                 | Hong Kong    | Singapore    | UK           | USA          |
| <b>Licensing requirements</b>   |                        |              |              |              |              |
| Organisation requirements – Must hold Australian Financial Services Licence and meet obligations on governance, organisational competence, risk management, financial capital, technology, human resources, insurance and disclosure. | ● Comparable           | ● Comparable | ● Comparable | ● Comparable | ● Less       |
| Individual adviser requirements – Must hold Diploma Financial Services qualification, relevant accreditations and maintain annual Continuing Professional Development.  | ● Comparable           | ● Comparable | ● Comparable | ● Comparable | ● Less       |
| <b>Statutory duties</b>   |                        |              |              |              |              |
| Client centricity – Must demonstrate client’s best interest and demonstrate compliance with safe harbour steps.   | ● Less                 | ● Less       | ● Less       | ● Comparable | ● Less       |
| <b>Disclosure requirements</b>  |                        |              |              |              |              |
| Must provide Financial Services Guide to client prior to giving advice.   | ● Comparable           | ● Less       | ● Comparable | ● Comparable | ● Comparable |
| Must document client objectives, financial circumstances, recommendations, alternatives considered, risks, fee and conflict disclosures (usually in a Statement of Advice).   | ● None                 | ● None       | ● None       | ● Less       | ● None       |
| Must provide Fee Disclosure Statement on annual basis where ongoing services are provided to review clients.  | ● None                 | ● Less       | ● None       | ● Less       | ● None       |
| <b>Conflicted remuneration prohibitions</b>   |                        |              |              |              |              |
| Ban on remuneration and benefits that could reasonably be expected to influence the financial product advice given.   | ● None                 | ● None       | ● None       | ● Comparable | ● None       |
| <b>Conflict of interest requirements</b>  |                        |              |              |              |              |
| Further to the statutory duty to prioritise client interests, required to manage conflicts of interest through either controlling and avoiding or disclosing.   | ● Comparable           | ● Less       | ● Comparable | ● Comparable | ● Comparable |

Table 1 demonstrates the comprehensiveness of Australia’s licensing, conduct, disclosure and conflicted remuneration requirements. Whilst there are comparable licensing obligations across most of the jurisdictions, Australia overall has a “higher standard of regulation with more prescriptive requirements than the other countries studied.”<sup>5</sup>

<sup>4</sup> Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients*, page 8.

<sup>5</sup> Ibid, p.g.3

## Life Insurance

The recent passage of reforms to life insurance remuneration, to limit the payment of commissions on life insurance products, is an important step forward in improving consumer protections in the life insurance industry. It has received broad based support from the industry and consumer advocates.

The reforms are the product of the FSC taking proactive steps to determine the scope of the issues facing the industry and develop credible options for reform that put the industry on a more sustainable footing. The Trowbridge Review of retail life insurance, which was commissioned by the FSC, is the gold standard of policy development that demonstrates what can be achieved when an industry recognises there is a need to change and takes steps to achieve serious reform.

The FSC has subsequently supported reforms that have come from the Trowbridge Review, including removing the exemption from the ban on conflicted remuneration for benefits paid in relation to certain life risk insurance products and the development of the FSC's Life Insurance Code of Practice.

The reforms will also ensure that benefits paid will need to meet criteria set out in the ASIC Instrument which will set:

- Maximum level of upfront and ongoing commission; and
- Provide a three year transition period to allow industry to adapt to new requirements, transitioning upfront commission maximums from 80%- 60%, with a maximum of 20% ongoing commission.

There has also been a responsibility period (clawback of adviser payments) of 2 years introduced.

### Life Insurance Code of Practice

The FSC recently published a Life insurance Code of Practice that is binding on the FSC's life insurance members. The Code is an important example of industry self-regulation that goes above what is required in law and is enforceable through an independent Code compliance review body.

The Code is the life insurance industry's commitment to mandatory customer service standards and will:

- Promote high standards of service to consumers
- Provide a benchmark of consistency within the industry
- Establish a framework for professional behaviour and responsibilities

The Code sets out the life insurance industry's key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their life insurance services, such as being open, fair and honest.

It also sets out timeframes for insurers to respond to claims, complaints and requests for information from customers.

The Code covers many aspects of a customer's relationship with their insurer, from buying insurance to making a claim, to providing options to those experiencing financial hardship or requiring additional support.

The Code is binding on life insurance companies; in its first iteration it is not intended to put obligations on financial advisers or planners or superannuation trustees. A list of the companies bound by the Code can be found on the FSC website.

The Code is monitored by an independent committee, to ensure effective compliance by life insurers. Insurers can be sanctioned if they do not correct breaches of the Code.

### Key Code Promises

1. We will be honest, fair, respectful, transparent, timely, and where possible we will use plain language in our communications with you.
2. We will monitor sales by our staff and our authorised representatives to ensure sales are appropriate.
3. If we discover that an inappropriate sale has occurred, we will discuss a remedy with you, such as a refund or a replacement policy.
4. We will provide additional support if you have difficulty with the process of buying insurance or making a claim.
5. When you make a claim, we will explain the claim process to you and keep you informed about our progress in making a decision on your claim.
6. We will make a decision on your claim within the timeframes defined in the Code, and if we cannot meet these timeframes you can access our complaints process.
7. If we deny your claim, we will explain the reasons in writing and let you know the next steps if you disagree with our decision.
8. We will restrict the use of investigators and surveillance, to ensure your legitimate right to privacy.
9. The independent Code Compliance Committee will monitor our compliance with the Code.
10. If we do not correct Code breaches, sanctions can be imposed on us.

The Code is currently being implemented by the life insurance industry and will formally commence on 1 July 2017. The benefits to consumers of introducing the code are expected to appear over time.

### Group Insurance WG

The FSC is also working with super trustee associations including ASFA, AIST Industry Funds Forum (IFF) and Industry Super Australia (ISA) to examine options for reform to group insurance arrangements in superannuation.

The working group is looking at showing the value and benefit of group insurance and dealing with issues of concern arounds claims handling, member erosion and communication. Its work will lead to further enhancements to the Life Insurance Code of Practice.

The FSC expects that the working group will look to release a series of consultation papers over the coming months that focus on a range of issues that consumers and the industry have identified.

## **Superannuation**

The superannuation industry has been subject to substantial reform over the past decade, stemming from both the Super System Review and the Financial System Inquiry, in conjunction with subsequent reviews and inquiries into specific issues.

Whilst too broad to consider in detail in this submission, the Committee should have regard to developments such as MySuper, SuperStream, enhanced APRA data collection powers and enhanced APRA prudential standard making powers when assessing the extent of consumer protections in the superannuation sector.

Collectively these reforms have resulted in the protection of consumers in low cost default superannuation products with a high degree of prudential oversight.

The FSC notes that it is unfortunate that the common recommendation of both the Super System Review and the Financial System Inquiry, that all superannuation funds appoint independent directors to ensure that funds are more accountable to consumers, remains unimplemented. There benefit to consumers of appointing directors who are unconflicted by relationships to third parties, and who have an undivided loyalty to the consumer.

The FSC also notes the existence of the prohibition under s68A of the SIS Act against inducements being offered by a superannuation fund to an employer in return for the selection of a particular fund as the default superannuation fund for a workplace. There has been significant public commentary, unsupported by evidence, that inducements are offered by the superannuation sector. This is simply not true. A recent, comprehensive review by ASIC and APRA confirmed that there was no evidence of inducements being offered.

The FSC submits, however, that the operation of s68 of the SIS Act is limited to individual effected consumers taking action. The FSC would support the strengthening of s68A to enable to regulator to take action when a breach occurs to ensure that the offering of inducements never becomes a feature of the superannuation industry.

## **Compensation Scheme**

For the reasons set out below, addressing the regulatory framework, including capital adequacy of licensees, appropriate professional indemnity insurance and increased professionalism for the advice industry, should be prerequisites to the contemplation of the introduction of a CSLR.

Any proposal to establish a CSLR necessarily should be approached with a very high degree of caution and extensive review, consultation and research must take place.

By their nature compensation schemes of last resort, (CSLR) represent poor public policy because of, at least, the following material outcomes and risks which would severely erode any perceived consumer benefits:

1. CSLR inherently promote moral hazard – for instance smaller, less-capitalised licensees could adopt less risk-adverse approaches and behaviours in the expectation that if something goes wrong, the scheme will “pick up the tab”;
2. CSLR generally are suggested as having a coverage that is wider than financial advice failures and include product failures-this gives rise to significant on-going liabilities for the scheme;
3. CSLR have the very real potential to be retrospective in nature. This raises the prospect of the scheme having to address not only current FOS unpaid determinations but also future determinations relating to events that may date back a number of years. No modelling has

been undertaken to determine the size of the liabilities relating to this 'tail'. There also is an issue as to whether unpaid determinations or judgments of other tribunals and courts would fall within this process;

4. CSLR will be costly for those entities which are well-capitalised;
5. CSLR require funding and the precise parameters and scope of that funding is unclear;
6. CSLR, ultimately, will be an additional cost to industry which is passed on to the consumer, either directly or indirectly.

The concept of a CSLR was last formally considered at a governmental level by Mr Richard St John in 2012. Mr St John concluded then that it would be inappropriate, and possibly counter-productive, to introduce a last resort compensation scheme at this stage.

In order to test whether the reasons given by Mr. St. John in his report remain relevant and if the regulatory and commercial matrix has not altered so as to arrive at a different conclusion, the FSC engaged Professor Pamela Hanrahan to provide a review of the St John research and to provide a commentary based on the current regulatory landscape.

Professor Hanrahan arrived at the following conclusions:

- the public interest case for introducing such a scheme has not yet been made;
- as with Mr. St John, Professor Hanrahan thought that a CSLR, could well introduce an element of regulatory moral hazard by reducing incentive for stringent regulation or rigorous administration of the compensation arrangements;
- the interests of Australian consumers at this stage would best be served by more effective regulation directed at both institutional and compliance risk in the financial services sector;
- CSLR face challenges in building and maintaining sustainable funding bases-there are potentially difficulties in anticipating and planning for likely claims and thus losses, and if a CSLR is post-funded, levies are likely to increase in circumstances where the financial sector as a whole is under pressure- this may impact disproportionately on smaller organisations;
- Notwithstanding the findings in the St. John report, ASIC has not changed its practices on "first-tier protections" for consumers under the Corporations Act. For example, ASIC has not amended its Regulatory Guide 126 Compensation and insurance arrangements for AFS licensees (December 2010) or Regulatory Guide 210 Compensation and insurance arrangements for credit licensees (March 2010) were not updated to reflect the recommendations in the St John Report.
- Licensees should be required to hold insurance cover that reflects the guidelines required by the Professional Standards Council, including in relation to run-off cover.

Based on the St John report and the Hanrahan research, more appropriate and effective policy outcomes, are likely to include at least the following approaches:

- (i) a detailed review and consideration of capital adequacy for AFSL licensees (as is currently the case with REs and RSEs) to "cover" potential liabilities;
- (ii) the raising of the level of professional indemnity insurance, with the support of ASIC and the general insurance industry;
- (iii) at least three other steps should be taken to strengthen the regulatory framework before consideration is given to a CSLR. These are:

- 1) the reforms to improve the competence and professionalism of advisers announced by the Government, but not currently due to be fully implemented until 2024, should be finalised;
- 2) changes to the legislative breach reporting framework should be made to encourage and assist licensees to report 'bad apple' representatives to ASIC and have those representatives dealt with;
- 3) the problems created by conflicted remuneration where it remains in the sector should be addressed.

## ASIC Powers and Resourcing

The Government can implement extensive consumer protections in law, however if the laws are not enforced by the corporate regulator they will have reduced impact on the industry.

As the corporate regulator, the Australian Securities and Investment Commission (ASIC) has broad ranging powers and responsibilities to ensure financial services licensees and advisers meet their obligations under the *Corporations Act 2001*. This role includes;

- ensuring that licensees act honestly, efficiently, fairly, and with competence;
- monitoring and enforcing disclosure and conduct obligations;
- providing consumer protections by
  - ensuring that advice providers are competent to provide their services;
  - promoting transparency and ensuring there is appropriate disclosure;
  - requiring licensees to have fair, accessible and efficient dispute resolution processes in place including external dispute resolution; and
- ensuring that licensees and their representatives meet their legal obligations by enforcing compliance with the law.<sup>6</sup>

Where licensees or advisers fail to meet their obligations or breach financial services laws, ASIC has broad ranging powers, and a range of remedies it can utilise. These remedies are categorised as:

- criminal action;
- civil action (civil penalty proceedings, corrective or compensatory remedies); and
- administrative action (eg banning or disqualifying someone).

The administrative actions that may be available to ASIC include:

- suspending or cancelling an AFS licence;
- temporarily or permanently banning a person from providing financial services;
- varying the conditions of an AFS licence; and
- accepting an enforceable undertaking as an alternative to other remedies.

ASIC's powers were increased as part of the FOFA reforms, and included the ability to ban a licensee or an adviser who is likely to contravene the law. This is significantly broader than previous powers held by ASIC, and means ASIC should now be able to act pre-emptively rather than waiting for an actual breach of the financial services laws.

---

<sup>6</sup> ASIC FSI submission (2014) pages 61-62 & 67.

### Recent changes to ASIC resourcing

The FSC notes that, with industry support, the Government has recently reformed the operations and resourcing of ASIC to enforce financial services regulation, and is currently consulting on whether any additional powers are necessary.

The changes included a \$127.2 million reform package to better protect Australian consumers by enabling ASIC to improve governance, recruitment, annual performance discussions with the Minister and remove ASIC from the Public Service Act.

The Government has also invested \$61.1 million to enhance ASIC's data analytics capabilities as well as modernise ASIC's data management systems, and a further \$57 million to enable increased surveillance and enforcement on an ongoing basis in the areas of financial advice, responsible lending, life insurance and breach reporting.

Another significant reform is the move towards a 'user-pays' model, which the FSC supports, which is scheduled to commence later in 2017. Appropriately, this ensures that the costs of regulation are borne by those entities that have created the need for it, rather than the public.

Finally, the Government has decided to appoint an additional ASIC Commissioner with experience in the prosecution of crimes in the financial services industry.

The FSC maintains that new laws and regulation are only ever as effective as the corporate regulator that is responsible for enforcing the law. For this reason we support a strong and well-resourced ASIC.

## Overview of previous financial services industry reviews and inquiries

74 total recommendations or thematic reforms. Of which 22 are currently ongoing and not completed and 19 have no evident progress.

|   | Legislated/ Enacted   | Under Consultation/ Ongoing  | No progress evident  |
|---|---|--|--|
| <p><b>Financial System Inquiry</b><br/> <a href="http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf">http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf</a></p> | <ul style="list-style-type: none"> <li>• <b>Rec 41</b> – Unclaimed Monies</li> <li>• <b>Rec 14</b> – Innovation Collaboration Committee</li> <li>• <b>Rec 23</b> – Facilitate innovative disclosure (ASIC guidance)</li> <li>• <b>Rec 24</b> – Life Insurance Reforms</li> <li>• <b>Rec 25</b> – Adviser Standards</li> </ul> | <ul style="list-style-type: none"> <li>• <b>Rec 9</b> – Objective of Super</li> <li>• <b>Rec 10</b> – PC Reviews on indicators of assessment and alternative default models</li> <li>• <b>Rec 11</b> – Comprehensive Income Products for Retirement (TSY consultation)</li> <li>• <b>Rec 15</b> – Digital Identity PC Review</li> <li>• <b>Rec 19</b> Data access and use – DTO funding</li> <li>• <b>Rec 21</b> – Product design and distribution obligation (TSY consultation paper)</li> <li>• <b>Rec 22</b> – Product intervention power (TSY consultation paper)</li> <li>• <b>Rec 28</b> – 3 year funding model for ASIC (TSY consultation paper)</li> <li>• <b>Rec 29</b> – ASIC enforcement review taskforce + government increased funding to ASIC</li> <li>• <b>Rec 37</b>- ASIC-ATO information sharing for retirement projections</li> <li>• <b>Rec 39</b> – Technological Neutrality</li> <li>• <b>Rec 40</b> – ARFP readiness in regulatory architecture – Collective Investment Vehicles</li> </ul> | <ul style="list-style-type: none"> <li>• <b>Rec 12</b> – Choice of Fund</li> <li>• <b>Rec 13</b> – Governance of Super Funds</li> <li>• <b>Rec 27</b> – Clearer Statements of Expectations for Regulators</li> <li>• <b>Rec 30</b> – Review competition of financial services and include competition in ASICs mandate</li> <li>• <b>Rec 31</b> – Increase time available for industry to complete regulatory change + post implementation reviews</li> <li>• <b>Rec 32</b> – Impact Investing</li> <li>• <b>Rec 40</b> – rename general advice</li> <li>• <b>Rec 43</b> – Product Rationalisation for life insurance and managed funds</li> </ul> |
| <p><b>Cooper Review</b><br/> <a href="https://strongersuper.trea">https://strongersuper.trea</a></p>  | <ul style="list-style-type: none"> <li>• <b>Chapter 1</b> – MySuper and financial advice reforms</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Chapter 4</b> - Outcomes Transparency</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Chapter 2</b> – independent directors and governance</li> </ul>  |



|   |   |   |  |
|---|---|---|--|
| <p><a href="http://sury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf">sury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf</a></p>   | <ul style="list-style-type: none"> <li>• <b>Chapter 6</b> – Integrity of the system</li> <li>• <b>Chapter 9</b> – SuperStream</li> <li>• <b>Chapter 10</b> – Regulatory settings</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Chapter 5</b> - Insurance in superannuation</li> <li>• <b>Chapter 7</b> - Retirement</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Chapter 3</b> – investment governance</li> <li>• <b>Chapter 8</b> – SMSFs</li> </ul>   |
| <p><b>Ripoll Inquiry</b><br/><a href="http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf">http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf</a></p>  | <ul style="list-style-type: none"> <li>• <b>Rec 1</b> – Advisor duty</li> <li>• <b>Rec 2</b> – ASIC resourcing</li> <li>• <b>Rec 3</b> – disclosure obligations</li> <li>• <b>Rec 4</b> – Conflicted remuneration</li> <li>• <b>Rec 6</b> – ASIC enforcement powers</li> <li>• <b>Rec 8</b> – Enforcement for non-compliance</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Rec 9</b> – Independent financial advisor standards body</li> <li>• <b>Rec 10</b> – Statutory compensation scheme</li> <li>• <b>Rec 11</b> – Consumer financial literacy</li> </ul> | <ul style="list-style-type: none"> <li>• <b>Rec 5</b> – Tax deductible financial advice</li> </ul>   |
| <p><b>Richard St John Report</b><br/><a href="https://futureofadvice.treasury.gov.au/content/consultation/compensation_arrangements_report/downloads/Final_Report_CACFS.pdf">https://futureofadvice.treasury.gov.au/content/consultation/compensation_arrangements_report/downloads/Final_Report_CACFS.pdf</a></p>  |   | <p><b>Rec 3</b> – Review regulators’ approach to enforcement and EDR schemes</p>  | <ul style="list-style-type: none"> <li>• <b>Rec 1</b> – Not proceed with compensation scheme</li> <li>• <b>Rec 2</b> – Strengthen existing licencing scheme</li> </ul>   |
| <p><b>PJC Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry</b><br/><a href="http://www.aph.gov.au/~media/Committees/Senate/committee/corporations_ctte/financial_services_industry/report.pdf?la=en">http://www.aph.gov.au/~media/Committees/Senate/committee/corporations_ctte/financial_services_industry/report.pdf?la=en</a></p> | <ul style="list-style-type: none"> <li>• <b>Rec 3</b> - Requirement to be registered as adviser</li> <li>• <b>Rec 4</b> – Restrict use of labels financial advice and planner</li> <li>• <b>Rec 5</b> – Register of financial advisers</li> <li>• <b>Rec 7</b> – Increase adviser education requirements</li> <li>• <b>Rec 8</b> – Adviser on register once education, professional year and exam requirements met</li> <li>• <b>Rec 9</b> - Mandatory ongoing professional development</li> <li>• <b>Rec 10</b> – Code of Ethics requirements</li> </ul> | <ul style="list-style-type: none"> <li>• <b>Rec 6</b> – Review of financial advice licensees fees</li> <li>• <b>Rec 10</b> – Independent standards setting body</li> </ul>  | <ul style="list-style-type: none"> <li>• <b>Rec 1</b> – Rename general advice to product sales information</li> <li>• <b>Rec 2</b> – Relabel personal advice' to 'financial advice'</li> <li>• <b>Rec 11</b> – Associations develop professional approved standards schemes</li> </ul> |
| <p><b>Trowbridge Review into Life Insurance</b><br/><a href="http://www.fsc.org.au/downloads/file/MediaReleaseFile/Fi">www.fsc.org.au/downloads/file/MediaReleaseFile/Fi</a></p>  | <ul style="list-style-type: none"> <li>• <b>Rec 1</b> - Life insurance advisor remuneration</li> <li>• <b>Rec 2</b> – Advisor remuneration transition plan</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Rec 4</b> – Insurer choice in APLs</li> <li>• <b>Rec 5</b> – Statements of advice</li> </ul>  |  |

|  |  |   |   |
|--|--|---|---|
| <p><a href="#">nalReport-ReviewofRetailLifeInsuranceAdvice-FinalCopy(CLEAN).pdf</a></p>  | <ul style="list-style-type: none"> <li>• <b>Rec 3</b> – Licensee remuneration</li> <li>• <b>Rec 6</b> – Industry code of practice for retail life insurance</li> </ul> |   |   |
| <p><b>Productivity Commission Review into the competitiveness and efficiency of superannuation</b><br/><a href="http://www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency#report">http://www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency#report</a></p> | <ul style="list-style-type: none"> <li>• <b>Stage 1</b> – Measures of efficiency</li> </ul>  | <ul style="list-style-type: none"> <li>• <b>Stage 2</b> – Competitive models for the default market</li> </ul>  | <ul style="list-style-type: none"> <li>• <b>Stage 3</b> – Measuring competitiveness and efficiency</li> </ul> |
| <p><b>Cross industry working group on insurance inside superannuation</b></p>  |  | <ul style="list-style-type: none"> <li>• A collection of issues papers (likely 5) addressing issues such as: <ul style="list-style-type: none"> <li>○ Benefit erosion on super account balances for members, including default cover for young people.</li> <li>○ Multiple default insurance policies.</li> <li>○ Claims assistance.</li> <li>○ Fund member communications.</li> <li>○ Data standards and member services.</li> <li>○ Costs and benefits of group insurance within superannuation.</li> </ul> </li> </ul> |   |