Chapter 20

Community expectations and financial literacy

20.1 Many submitters who expressed disappointment with ASIC's performance assumed that ASIC had the authority and the resources to act on their behalf. In this chapter, the committee examines the expectations that investors and other consumers of financial services hold when it comes to what ASIC can and cannot do. It seeks to establish whether there are gaps between community expectations of what ASIC can or should do and ASIC's actual statutory functions and powers.

20.2 The committee also takes the opportunity to consider financial literacy in Australia and the way in which ASIC disseminates information.

Expectation gap

20.3 A number of major institutions and academics expressed their concerns about the extent to which investors believe that ASIC is able to protect their interests. For example, the Financial Planning Association of Australia was concerned about the 'misalignment between consumer perception of the role ASIC should play in assisting them when things go wrong versus what ASIC can actually deliver'.[1] The Association of Financial Advisers shared this view, maintaining that only a limited proportion of consumers appreciated ASIC's role.[2] Along similar lines, the Corporations Committee of the Law Council of Australia's Business Law Section wrote:

> It is possible that some financial consumers misunderstand the difference between a prudential regulator such as APRA and a conduct regulator such as ASIC. In other words, people may think that ASIC can give comfort to financial consumers in the same way APRA may be taken to protect the interests of depositors or policy holders.[3]

20.4 The Corporations Committee recognised that ASIC has 'neither the mandate nor the resources to perform such a role', and suggested that 'perhaps more needs to be done to ensure that an "expectation gap" does not exist in this regard'.[4] Likewise, the Australian Institute of Company Directors stated:

> …ASIC is often placed in a difficult position due to the unrealistic expectations of the government, media and general public. There seems to

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1 Financial Planning Association of Australia, *Submission 234*, p. 6.

2 Association of Financial Advisers, *Submission 117*, p. 3. See also Mr Jason Harris, *Submission 116*.

3 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4.

4 *Submission 150*, p. 4.

> be a general misunderstanding as to what ASIC can reasonably achieve as a regulator.[5]

20.5 With regard to unrealistic expectations, the Governance Institute referred to 'a strong public perception that the regulator should be proactive in stopping…corporate misconduct from occurring in the first place'. Mr Jason Harris from the University of Technology, Sydney (UTS) Faculty of Law, explained:

> Criticisms based on a failure to prevent corporate scandals or collapses represent a misunderstanding of the focus of corporate regulation in Australia. Australia's corporate regulatory framework is based largely on the disclosure paradigm. Rather than vetting documents (such as prospectus documents and annual reports) ASIC is merely the body that receives copies of those documents. It is up to investors to read the information and make a complaint if they discover a problem. I'm sure ASIC does act proactively where it has reason to do so, but with over 2 million companies to deal with ASIC cannot read and assess every document.[6]

20.6 This expectation gap is evident in complaints lodged with the Commonwealth Ombudsman. Of the complaints he receives about ASIC, 'a frequent point of dispute appears to be the reporter's perception of ASIC's role as regulator and the expectation of a specific outcome from making a report, compared with ASIC's stated broader public benefit purpose'. The Ombudsman quoted from ASIC's published guidance on how it deals with complaints of misconduct, where ASIC advises that:

> All reports of misconduct that we receive provide us with valuable information, but not every matter brought to our attention requires us to take action. Under the laws we administer, we have the discretion to decide whether to take further action on reports of misconduct that we receive. Generally we do not act for individuals and we will seek to take action only on those reports of misconduct where our action will result in a greater impact in the market and benefit the general public more broadly.[7]

20.7 As shown in previous chapters, a significant number of submitters held the expectation that ASIC should have investigated their complaint. The Ombudsman was of the view that 'early management of expectations about what ASIC can or will do and the provision of better explanations of decisions to complainants should lead to a decrease in the number of complainants seeking an internal review of decisions by ASIC, as well as the number of complaints to the Ombudsman about ASIC'.[8]

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5 Australian Institute of Company Directors, *Submission 119*, p. 3. See also *Submission 150*.

6 Mr Jason Harris, *Submission 116*, pp. 1–2.

7 ASIC, *How ASIC deals with complaints of misconduct*, Information Sheet 153; cited in Commonwealth Ombudsman, *Submission 188*, p. 8.

8 Commonwealth Ombudsman, *Submission 188*, p. 16.

Licensed financial services providers, credit providers and registered companies

20.8 ASIC's licensing regime was one particular area where many people held a false notion about the extent of ASIC's power. Professor Dimity Kingsford Smith noted that:

> Assessments of ASIC's performance are sometimes subject to misconceptions: perhaps the most common is that ASIC closely supervises the Australian Financial Services License (AFSL) holders it regulates.[9]

20.9 She noted that ASIC does a certain amount of surveillance of AFS licence holders when it is alerted to problems but observed further:

> There is an expectation that licensing means that ASIC has some control over licensees' businesses. Likewise Australian investors expect that ASIC supervises licensees regularly. When losses occur there is anger and bewilderment that except in the limited area of market operators, participants and securities dealers ASIC does not have the power or the resources for ongoing supervision.[10]

20.10 In Professor Kingsford Smith's view, such expectations demonstrate that Australians mistakenly assume that ASIC has a regulatory toolkit with the types of tools that APRA has at its disposal.[11] Similarly, Ms Anne Lampe, a journalist and former employee of ASIC's media unit, referred to clients who often believe that, because advisers are licensed, they have passed some kind of integrity and competence screening process and that ASIC has provided a stamp of approval. She stated:

> They couldn't be more wrong. The licensing process is simply a tick all boxes procedure and regulation of financial advisors and fund managers who invest the money appears to be ineffective.[12]

20.11 Indeed, ASIC argued that the relatively low threshold for obtaining an AFS licence and the relatively high threshold for removing a licence was not well understood by retail investors. It stated:

> Licensing, therefore, may give retail investors a sense of security which is inconsistent with the settings of the regime. There is a perception amongst some consumers that an AFS licence means that the licensee has been approved by ASIC or that it signifies the high quality of the financial services provided by the licensee. For example, in submissions to the

9 Professor Dimity Kingsford Smith, *Submission 153*, p. 3.

10 Professor Dimity Kingsford Smith, *Submission 153*, p. 4.

11 Professor Dimity Kingsford Smith, *Submission 153*, p. 4.

12 Ms Anne Lampe, *Submission 106*, p. 1.

> Inquiry, some former Storm clients have stated that 'Storm was approved by ASIC'.[13]

20.12 The matter of ASIC's licensing powers, including the effectiveness of ASIC's screening processes for licence applicants and its ability to cancel licences, is examined in chapter 24.

20.13 The committee took first hand evidence from people who thought that ASIC was in a position to provide sound advice and guidance about the integrity or competence of a financial service provider or the viability of a business. Many drew on their experiences of the Storm Financial collapse. For example, Mr Spencer Murray was of the belief that ASIC was appointed by the Australian government to prevent Australian citizens from fraud by financial institutions.[14] Another submitter claimed that ASIC was the regulator who gave Storm Financial approval to run its business.

20.14 Mr Sean Mcardle stated that in 2006–07 and prior to becoming a signatory to the Storm Financial scheme, he sought ASIC's advice about any 'concerns it may have about this financial planning company'. He stated that he specifically sought 'to find out if there was anything that, as a retail investor, he should be aware of regarding Storm Financial'. This information included 'the strategy they were selling, or its director Emmanuel Cassimatis by way of complaints or anything else that as the regulator they knew and could warn me about in regards to investing with them'. Mr Mcardle informed the committee that he phoned ASIC twice and both times was advised that 'ASIC were unable to say anything about any company, its directors or the product, stating that if they did, they may get sued'.[15]

20.15 Mr Ron Jelich was also under the impression that ASIC had given its stamp of approval to the Storm Financial model:

> Chief among the reasons for finally deciding to join Storm were (a) ASIC's 'green light' report into the operations of Storm and ASIC's endorsement of Storm's investment model; and (b) the fact that Storm's investment home loans, margin loans and the creation of exclusive Storm-badged funds were overseen by the Commonwealth Bank of Australia, the country's biggest and most highly respected bank.[16]

20.16 Mr Peter Rigby, who invested in Trio Capital on the basis that it was a 'Fund of Hedge Funds' and hence under the impression that it one of the safest and most diverse ways of investing, clearly thought ASIC should have prevented investor losses. He stated:

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13 ASIC *Submission 378* to the PJCCFS Inquiry into Financial Products and Services in Australia, August 2009, p. 26.

14 Mr Spencer Murray, *Submission 23*, p. 1.

15 Mr Sean Mcardle, *Submission 87*, p. 1.

16 *Submission 172* and see also *Submission 18* (name withheld).

> …these funds were regulated by the government watchdog ASIC, so it was reasonable to consider that the funds were being run and administered properly. If this is not the role of ASIC, what is it?[17]

20.17 There were also misunderstandings regarding managed investment schemes approved in principle as 'tax effective' schemes by the ATO and Treasury.[18]

20.18 The Australian Institute of Company Directors observed that, unlike some overseas jurisdictions, in particular the US, there was a pervading cultural bias in Australia against failure. It explained:

> This bias has led to an expectation that the government can prevent corporate failures through greater regulation and that, where companies do fail, it is necessarily due to the fault of the company and/ or its directors and executives. This will inevitably impact negatively on ASIC's ability to properly prioritise its enforcement actions, as it is being constantly called on to investigate any and all corporate failures, notwithstanding the actual risks that they present or whether a breach of law is involved.[19]

20.19 ASIC informed the committee that its regulatory role 'does not involve preventing all consumer losses or ensuring full compensation for consumers in all instances where losses arise'. It stated:

> Our underpinning statutory objectives, regulatory tools, and resources are not intended to prevent many of the losses that investors and consumers will experience. This is true of every financial market regulator.
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> This is a very important issue that goes to the heart of what financial market regulation is intended to achieve, and thus to expectations about ASIC's performance. Unlike prudential regulators, market conduct regulators such as ASIC do not have the same focus on preventing institutional collapse and the losses this may bring. In addition, our market-based system for investment and for capital raising, which has served Australia's development well, inevitably involves investors assuming an amount of risk in order to make a return.[20]

20.20 Professor Justin O'Brien and Dr George Gilligan cited an interview related to ASIC's 2012 enforcement report during which Mr Medcraft, emphasised that 'you get what you pay for'. Mr Medcraft went on to stress that:

> ASIC had only 26 staff to cover 25 investment banks; the 135 insurers are reviewed only once every seven years; although the big four audit firms are reviewed once every 1.5 years the remaining 72 audit firms are reviewed less than once a decade; and that although the top 20 financial planners are reviewed once every 1.7 years, for the next 30 largest it is only once every

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17 Mr Peter Rigby, *Submission 364*, p. 1.

18 Burke Bond Financial Pty Ltd, *Submission 98*, p. 1.

19 Australian Institute of Company Directors, *Submission 119*, p. 3.

20 ASIC, *Submission 45.2*, p. 17.

> 3.8 years. This is the actuarial reality of contemporary Australian regulation.[21]

20.21 Mr Medcraft told the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS) that Australia has a system that is 'based on self-execution and relies on people to do the right and it was about time people 'were realistic about what we do and what we cannot do'.[22] In his view, it was important for ASIC to be 'transparent, to show Australians what we do in terms of engagement, surveillance, guidance and enforcement'.[23] As another example of ASIC's limited capacity, Mr Kell told the committee that ASIC simply cannot visit all financial advisers. A complete set of figures on the number of years it would theoretically take ASIC to cover the entire regulated population through 'high intensity' surveillances (those lasting more than two days), based on the number of surveillances conducted during 2012–2013, were outlined in Chapter 4.

20.22 This evidence clearly shows the limitations placed on ASIC's capacity to monitor and survey the people its licenses and regulates. But this message does not appear to be reflected in public expectations of ASIC's role. For example, a submitter advised that before subscribing to a trading information service he 'verified that the company is registered with ASIC in order to make sure if something goes wrong I have an official authority to protect my rights as a consumer/customer'. After further investigation, he alleged that the company was engaging in fraudulent phoenix activity. The submitter expressed concern that before a company registration occurs, ASIC does not check what products the company offers and whether these products are regulated by ASIC or not.[24]

Financial literacy

20.23 The perception that ASIC is able to provide a guarantee about the soundness and integrity of a financial service provider, a company or a product is further complicated by the level of literacy and numeracy skills in Australia. Australia's National Financial Literacy Strategy defines financial literacy as:

> …a combination of financial knowledge, skills, attitudes and behaviours necessary to make sound financial decisions, based on personal circumstances, to improve personal financial wellbeing.[25]

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21 Professor Justin O'Brien and Dr George Gilligan, *Submission 121*, p. 15.

22 Mr Greg Medcraft, Chairman, ASIC, *PJCCFS Hansard*, Oversight of ASIC, 12 September 2012, pp. 14–15.

23 Mr Greg Medcraft, *PJCCFS Hansard*, Oversight of ASIC, 12 September 2012, p. 15.

24 Mr Mustaffa Abu Sedira, *Submission 427*, pp. 1–2.

25 Financial Literacy Board, submission to the Financial System Inquiry, 28 March 2014, http://fsi.gov.au/files/2014/04/Financial_Literacy_Board.pdf.

20.24 According to the Financial Literacy Board, financially literate consumers are 'more likely to make informed financial decisions and less likely to choose unsuitable products, thus potentially reducing the degree of regulatory intervention required'.[26] Many organisations in the industry, however, cited the growing complexity of financial products over the past decade. For example, an OECD policy brief noted that the growing sophistication of financial markets means that:

> …consumers are not just choosing between interest rates on two different bank loans or savings plans, but are rather being offered a variety of complex financial instruments for borrowing and saving, with a large range of options. At the same time, the responsibility and risk for financial decisions that will have a major impact on an individual's future life, notably pensions, are being shifted increasingly to workers and away from government and employers. As life expectancy is increasing, the pension question is particularly important as individuals will be enjoying longer periods of retirement.[27]

20.25 The Consumer Action Law Centre referred to the current disclosure-based regulatory approach in Australia, which, in its view, 'fails to address many of the consumer problems in credit and financial services'. It suggested that more disclosure is often a bad thing and noted also that:

- credit and financial products are extremely complex and non-experts will frequently misunderstand even the most important elements;
- people do not necessarily choose between products 'rationally', they make quick decisions using mental shortcuts when dealing with unfamiliar topics or when limited by time; and
- people typically have trouble calculating costs and risks, especially when the cost or risk is temporally remote.[28]

20.26 Professor Dimity Kingsford Smith also drew the committee's attention to research showing there were 'serious reasons to doubt the regulatory efficacy of disclosure when as much reliance is placed on it'. She maintained:

> In essence the literacy and numeracy skills of the majority of Australians are not adequate for reading and analysing disclosure material for common retail financial products including superannuation. There are also indelible behavioural biases in financial decision making which can lead to unwise

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26 Financial Literacy Board, submission to the Financial System Inquiry, 28 March 2014, http://fsi.gov.au/files/2014/04/Financial_Literacy_Board.pdf.

27 OECD, 'The Importance of Financial Education', *Policy Brief*, 2006, www.oecd.org/finance/financial-education/37087833.pdf. See also OECD, *Financial Literacy and Consumer Protection: Overlooked Aspects of the Crisis, OECD Recommendation on good practices on financial education and awareness relating to credit*, June 2009, www.oecd.org/finance/financial-markets/43138294.pdf.

28 Consumer Action Law Centre, *Submission 120*, p. 7.

> decisions. Often disclosure documents seem more apt to protect the issuer or adviser than to inform the investor.[29]

20.27 She underscored the important link between consumer behaviour and financial literacy:

> The low level of financial literacy in Australia leads to an investor propensity to assess advice on 'the advisor's confidence, approachability, friendliness or professional manner' without looking too critically at the technical aspects or content of the statement of advice. This is one of the behavioural biases that can lead to unwise investment decision-making …Senior citizens are seen as more vulnerable consumers, and account for up to 30% of investment fraud victims.[30]

20.28 Many of the personal accounts before the committee, especially those drawn from the two case studies, demonstrate the harm that can result from investors or consumers placing too much trust in their adviser and in not asking questions or seeking second opinions. A former ASIC enforcement adviser, Mr Niall Coburn, suggested that ASIC needs to review how it responds to individuals and their expectations. In his view ASIC 'needs to get out into the community a lot more than it does and explain', before people invest, that they 'do not put 100 per cent in a managed investment scheme': they do not put all their 'eggs in one basket'.[31] The Consumer Credit Legal Centre strongly recommended that:

> …ASIC consider adopting a 'campaign approach' to enforcement like that used by the ACCC. In this approach, the regulator takes a multi-pronged approach to the issue by issuing media releases about concerns, guides about best practice conduct, investigations, negotiations with affected businesses and enforcement. We are aware that ASIC conducts all of these activities but suggest they could do more to coordinate them in a strategic and publicly overt manner to maximise the combined effect.[32]

20.29 The Governance Institute of Australia observed that there was a wealth of useful information on the ASIC and MoneySmart websites, yet the messages were 'usually only understood by those who operate in corporate circles'. It noted that 'the expansion in the number of incorporated entities over the past 20–30 years, with which retail investors and consumers are involved through superannuation, securities trading, and employment, for example, means that ASIC is now just as relevant to them as the ATO is'.[33] It noted further that many in the broader community do not know what ASIC does because it does not widely advertise its functions. It therefore recommended that ASIC:

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29 Professor Dimity Kingsford Smith, *Submission 153*, pp. 7–8.

30 Professor Dimity Kingsford Smith, *Submission 153*, p. 24 (footnotes omitted).

31 Mr Niall Coburn, *Proof Committee Hansard*, 21 February 2014, p. 7.

32 Consumer Credit Legal Centre (NSW) Inc, *Submission 194*, p. 13.

33 Governance Institute of Australia, *Submission 137*, p. 8.

> …should consider engaging in a broader and more prominent marketing and advertising campaign to promote the regulatory framework which it oversees, the intellectual property which it creates to guide those who are regulated, retail investors, and consumers, and the other various services it provides in administering the regulatory framework.
>
> ASIC's role as an educator for the private and corporate sector is pivotal to its ongoing functions and the effective regulation of the sector.[34]

20.30 The Law Council suggested more should be done to correct the public belief that ASIC, by licencing financial services providers, is like APRA and can act to protect the interests of individuals.[35]

Committee view

20.31 In Chapter 5, the committee recommended that ASIC consider adopting a multi-pronged campaign to educate retail customers about the care they need to take when entering into a financial transaction and where they can find assistance and affordable and independent advice when they find themselves in difficulties because of that transaction. The committee's findings in this chapter further underline the importance of ASIC's role in financial education, especially when considering the unrealistic expectations that many consumers have of ASIC's main functions. ASIC may licence persons, but it cannot endorse their business model nor their trustworthiness.

20.32 The committee has also recommended that ASIC review the information provided on the search results and extracts from its registers. To help avoid any misunderstanding about ASIC's role in approving the operations of various entities, on these documents ASIC should more clearly explain its role and what the extracts mean.

Recommendation 35

20.33 The committee recommends that ASIC include on all registry search results and extracts a prominent statement explaining ASIC's role and advising that ASIC does not approve particular business models.

Recommendation 36

20.34 The committee recommends that in bringing together the multi-pronged campaign to educate retail customers outlined in Recommendation 1, ASIC have regard to the fact that:

- **many retail investors and consumers have unrealistic expectations of ASIC's role in protecting their interests; and**

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34 Governance Institute of Australia, *Submission 137*, p. 8.

35 Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4.

- **financial literacy is more than financial knowledge but also incorporates the skills, attitudes and behaviours necessary to make sound financial decisions.**

20.35 Before concluding this chapter on expectations and financial literacy, the committee considers the role of the Consumer Advisory Panel (CAP).

Consumer Advisory Panel

20.36 Established in 1999, CAP's role is to advise ASIC on current consumer protection issues and give feedback on ASIC policies and activities. It also advises ASIC on key consumer research and education projects. The Consumer Credit Legal Centre informed the committee that it has an open and constructive working relationship with ASIC through its participation on the CAP.

20.37 The Consumer Action Law Centre was also pleased with ASIC's collaboration with consumer advocates, particularly through the CAP. It noted that the recent introduction of a CAP 'matters register' would enable progress of matters referred to ASIC from CAP members to be tracked at each meeting. Nonetheless, it suggested that consideration could be given to whether:

- ASIC could do more to prioritise the needs of vulnerable and disadvantaged consumers; and
- ASIC's consumer protection outcomes may be improved by enhancing the responsibilities of the CAP to more closely resemble the UK's Financial Services Consumer Panel.[36]

20.38 Established under the Financial Services and Markets Act 2000 (UK), the Financial Services Consumer Panel (FSCP) is an independent statutory body set up to represent the interests of all groups of financial services consumers in the development of policy for the regulation of financial services. Its membership must be such 'as to give a fair degree of representation to those who are using, or are or may be contemplating using, services other than in connection with business carried on by them'. According to the FSCP, it works 'to advise and challenge' the Financial Conduct Authority (FCA) from 'the earliest stages of its policy development' to ensure it takes into account the consumer interest. It also takes a keen interest in broader issues for consumers in financial services where it believes it can help achieve beneficial change/outcomes for consumers'. Its duties include:

- meeting regularly with the FCA and being available for consultation on specific high-level issues;
- actively bringing to the attention of the FCA issues which are likely to be of significance to consumers;

36 Consumer Action Law Centre, *Submission 120*, p. 12.

- commissioning such research as it considers necessary in order to help it to fulfil its duties under these terms of reference;
- requesting access to information from the FCA which it reasonably requires to carry out its work; and
- requesting regular access to the FCA chairman, board, chief executive and senior executives of the FCA.[37]

20.39 In its submission, the Consumer Action Law Centre noted that the FSCP describes its role as:

> …bringing a 'consumer perspective to aid effective regulation', supporting or challenging the FCA where required and acting 'as an independent counter balance' to parallel boards which represent the interests of industry.[38]

Committee view

20.40 The committee is of the view that ASIC could do more to prioritise the needs of consumer interests and should consider whether it could improve the work of the CAP by introducing some of the features of the Financial Services Consumer Panel.

Recommendation 37

20.41 Recognising the importance of giving priority to the needs of consumers when ASIC develops regulatory guidance and provides advice to government, the committee recommends that ASIC should consider whether its Consumer Advisory Panel could be enhanced by the introduction of some of the features of the United Kingdom's Financial Services Consumer Panel.

20.42 In this chapter, the committee considered public expectations and financial literacy with an emphasis on educating people so that they are in a stronger position to protect their interests. The committee also recognised the importance of ASIC giving priority to consumer protection and suggested a more involved CAP could help achieve this objective.

20.43 In the next chapter, the committee continues its examination of ASIC's engagement and relationship with retail investors and consumers by considering how ASIC converses with those who are making a complaint or seeking ASIC's assistance.

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37 UK Financial Services Consumer Panel, www.fs-cp.org.uk/about_us/what_is_the_panel.shtml (accessed 12 May 2014).

38 Consumer Action Law Centre, *Submission 120*, p. 12.