SUBMISSION

TO

PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA

BY

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I am an authorised representative with a large financial planning licensee, and the comments expressed herein are my personal views and not those of my dealer.

Terms of Reference No. 1
The role of financial advisers

RECOMMENDATION
It is recommended that ASIC fully investigates the actions of the financial advisers involved in the Storm debacle to ensure that the obvious breaches of the Act are suitably penalised.

The financial services industry has arisen from the desire of individual members of the community to improve their net worth, and markets have evolved as vehicles for this purpose.

Regulation of the markets is becoming increasingly complex as legislation is put into place to either provide a measure of protection for unsophisticated investors, or to satisfy a particular Government's ideology.

The role of the financial adviser is to be able to guide the client through the many legislative issues and demonstrate to the client the investment options that are available for their particular circumstances.

For example, margin lending is an option that has the potential to achieve a client's objective of increasing net worth.

However it is the role of the financial adviser to ensure that the client is fully aware of the inherent risks of borrowing to invest, be satisfied that the client has a strong tolerance to this risk, and has the resources available to meet repayment commitments or capital needs in market downturns as they occur.

From newspaper reports I have read, it appears that many Storm clients were inveigled into the margin lending strategy when clearly either this was not appropriate for them, or the extent of the strategy was beyond an acceptable level to their circumstances.

Although I am an authorised representative, my principal activity at this time in my life is to mentor other financial advisers, and to this end over the years I have had association with over 120 different advisers. To do this successfully I have to have a close insight into the way my advisers deal with their business and clients, and without any hesitation I can say that none of my people would do anything but put their clients first, often to their own detriment.

I am appalled at the reports of the actions of a few who clearly gave Storm clients inappropriate advice, and as a consequence have created a level of distrust against the thousands of careful, dependable and caring advisers who benefit their clients day in and day out.

In my opinion, those who created this distrust should be severely dealt with under the provisions of the Corporation Act and made examples of to the general community.

Terms of Reference No. 2
The general regulatory environment for these products and services

RECOMMENDATION
That it be accepted that there is sufficient legislative power available now for the regulator to ensure that the interests of the public are properly safeguarded.

As noted on the ASIC website, the Financial Services Reform Act commencing 11 March 2002 amended the Corporations Act to create a single licensing regime for financial sales, advice and dealings in relation to financial products.

The Corporations Act thus became a comprehensive and all-embracing statute to regulate the proper supervision of financial products and services, and in my experience this would be complied with by far the majority of financial advisers in Australia.

My own dealer, which has one of the largest number of authorised representatives has stringent compliance requirements in its processes to ensure that there is strict observance of the Act's requirements and I understand that this is present across the industry.

Until recently the mortgage broking industry was regulated by State Governments with often conflicting requirements under the respective State Acts, e.g. only Western Australia required mortgage brokers to be licensed, and even then it was doubtful whether there was sufficient legislative control available to ensure the full maintenance of rights of persons dealing with brokers.

Because mortgage brokers were under State Acts, there has been a readymade excuse for ASIC to abrogate its responsibilities under the Corporations Act, however the National Consumer Credit Protection Reform Package was introduced by the Minister for Financial Services, Superannuation and Corporate Law on the 25th June 2009 and hopefully will ensure the proper regulation of these brokers in the future.

Consequently there is or will be more than sufficient regulatory power available to ASIC to ensure that appropriate financial advice is provided to the public, and to severely censure the few who flagrantly ignore the provisions of the legislation.

However I believe that the regulator must take a more proactive approach to protect the public from unscrupulous dealers and advisers who do not comply with the law. In the industry there is constant reference to matters being referred to the regulator and not acted upon for often specious reasons, Westpoint and Storm are two that readily come to mind, both of which have resulted in distressed investors with no compensation that perhaps may have been available if these issues had been acted against earlier.

Terms of Reference No. 3
The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers.

RECOMMENDATION
That it be accepted that there is sufficient legislative power available now for the regulator to ensure that the client is fully informed as to the amount that is to be paid for financial advice.

No one can argue that much of the criticism of dealers/licensees and their financial advisers that has arisen through recent disastrous events has come from blatant commission chasing by a few who take advantage of high commissions offered by product providers for the sale of their products.

The role played by those providers should not be overlooked in creating the environment in which it can be tempting for a financial adviser to have more regard for himself than the client, because high commissions offered mean that the client pays more, either from his resources or by increased premiums for risk insurance.

However the Corporations Act and ASIC's Regulatory Guides clearly set out how the clients are to be informed of the costs they will be incurring to receive financial advice, and if advisers do not fully comply with the disclosure requirements they are in breach and I believe should be subject to the full penalty provisions of the Act.

In my experience, all advisers I have been connected with charge their client on an hourly basis calculated on the costs incurred in running their practice plus a profit margin, and avoid charging the full amount of the revenue available from providers. Unfortunately some providers pay a fixed commission that can't be rebated and there is no option other than to

accept it. Depending on their business model, some advisers will send it to their client, but invariably their dealer will have deducted an administrative charge and the adviser has to make this up to the client. There are instances when the acceptance of a fixed commission is all that is available to an adviser during the life of an investment and there is justification for retaining it.

There has been a great deal of media coverage on the so called disagreement in the industry over whether the costs incurred by clients for advice should be paid through direct invoicing or "fee for service", or from the investment as a commission based fee when an investment is recommended..

With every respect to members of my profession who strongly advocate one or the other process, their arguments are irrelevant while the opportunity to receive investment based commissions is retained by the product providers.

We are no longer in the early 1990's when entry commissions of up to 10% were common and it was deemed acceptable to claim the maximum commission. Today's competitive environment means that clients are generally cost conscious, and advisers must also be competitive with the level of their fees. If the reports that Storm clients were being charged substantially high commissions (10%?) are true then there is more reason why the dealer and its advisers should be pursued, because those commissions have to be disclosed and I find it difficult to accept that clients would be happy to be charged this amount if they were aware of its extent.

Because either alternative remains available, advisers should always give the client the choice of how they want to pay, but the important matter is that the client is fully informed of the process and is able to negotiate.

I have said that advisers connected to me assess their fee on the hours involved in a transaction. Where an investment is involved, most use the commission system, because this is simply the most tax effective method for their clients and therefore the cheaper option. For example for a directly invoiced fee of $2,000 there is GST of $200. By asking for this to be recouped through the investment as a commission based payment, the provider claims a reduced input tax credit which is passed back to the client, so the GST is reduced to $50 – a not inconsiderable benefit to the client.

Terms of Reference No. 4
The role played by marketing and advertising campaigns.

In principle I personally cannot see the difference between a marketing and advertising campaign in this industry and any other industry.

Terms of Reference No. 5
The adequacy of licensing arrangements for those who sold the products and services.

RECOMMENDATION
That the current dealer licensing arrangements be considered as sufficient for establishing a financial advice business, but RG146 should be rewritten to reflect a higher degree of knowledge as a minimum level for the provision of financial advice.

The application for a dealer's licence is comprehensive with ASIC providing three guidance papers totaling 140 pages in length. There must be a demonstration that there are sufficient financial, human and technological resources to provide financial services and supervision both at the beginning and in anticipation of growth. The prospective licensee or responsible manager has to prove that the appropriate skills are held, and has the relevant qualifications. Good fame and character is assessed as is the process for compliance with relevant industry codes. There is a strict requirement to have compliance measures in place and to have arrangements for managing conflicts of interest. All of this is directly assessed by ASIC.

The Licensee is able to appoint representatives such as Authorised Representatives but is responsible for their competence and training to ensure that they are complying with financial services law. It is generally accepted that the minimum qualification for an Authorised Representative is to meet the requirements of RG146.

RG146 is a very basic level and I believe is not adequate to prepare new Authorised Representatives to provide advice across the whole spectrum of products and services now available.

Clearly if an authorised representative is not acting in accordance with financial services law then the licensee must accept shared responsibility for the authorised representative's breaches.

Terms of Reference No. 6
The appropriateness of information and advice provided to customers considering investing in those products and services, and how the interests of consumers can best be served.

RG 175 comprehensively sets out what advice is considered appropriate for a client or different classes of clients. Essentially the Suitability Rule in RG175.106 requires personal advice to "Know your client" and "Know your product", and be appropriate, which if complied with will ensure that the client's interests are best served.

If information and advice is not given in accordance with these principles it is clear inappropriate advice is being given and should be subject to the penalty clauses in the Corporations Act.

Terms of Reference No. 7
Consumer education and understanding of these financial products and services.

Apart from the assistance which should be provided by the financial adviser, there is a wealth of education opportunities available to anybody who is interested in understanding any product or service. For example if knowledge is sought on the operation of direct shares, the ASX conducts courses on several types of securities and how they work.

Even an elementary search of the web will provide comprehensive discussions on all types of investment opportunities, so consumers have ample opportunity to fully brief themselves before making an investment decision, if they so desire.

A reputable financial adviser will assist the client in reaching an understanding of what is relevant to the circumstances.

Terms of Reference No. 8
The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers.

Financial advisers are required to have professional indemnity insurance basically to compensate clients for inappropriate or unlawful actions by the adviser.

To me the issue is not how adequate the insurance is, the issue is advisers should endeavor to follow practices that will ensure that any matter of compensation does not arise.

Competent advisers maintaining strict compliance with the provisions of the Corporation Act and the various Regulatory Guides should avoid any need to claim to satisfy an aggrieved client. Any claims made automatically increase the level of premiums we have to pay to maintain this insurance, both on a claims basis but also on a reputation basis where insurers load the premiums in a belief that the industry will incur more and more issues such as Storm where wrongdoing by a few financial advisers is clear.

Once again I can only say that early proactive intervention by ASIC will help rid the industry of these incompetent or careless individuals and help restore our reputation, and therefore any need for a broader insurance cover will be minimised.

Terms of Reference No. 9
The need for any legislative or regulatory change.

RECOMMENDATION
That it be accepted that the current legislation is more than adequate to regulate the industry and there is no need for any more rigorous legislative or regulatory change. Further that the current provisions be more vigorously utilised against those who recklessly disregard the law.

FSR in 2002 re-established the rules for giving advice in a strong and comprehensive manner.

Many said at the time that the Government had gone too far, but in retrospect the reputable members of our profession had not fully understood the extent of the number of uncaring or reckless participants within the industry whose actions were being detrimental to all.

Since 2002 the industry has adjusted its procedures to fit in with the principles and spirit of the legislation, and with the refinements that have been put into place since, I believe that we have an excellent framework in which we can work for the betterment of the public.

A large number of the participants who were dragging the reputation of the industry down have left knowing they could never comply with the new regime.

Nevertheless as in all professions events such as Storm has shown there are some still remaining, but just because that few choose to ignore the provisions of the legislation or simply pay it lip service, does not in my view justify further arbitrary amendments to the Act that will penalise the majority of the industry who are doing the right thing for their clients, constantly, day in day out.

I believe there is more than adequate powers available to ASIC under present legislation to be able to rid our profession of those who refuse to comply, and if more action is taken there will be a greater deterrent to these people.

Additional Term of Reference
The committee will investigate the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opres Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.

RECOMMENDATION
1. That the banking industry be publicly reprimanded by Parliament for poor lending practices and counseled into revising these practices and establishing lending criteria that are more conducive to the best interests of the borrowers.

2. That banks/lenders be directed to allow all borrowers with loans under the low doc no doc system provided through mortgage brokers to access their loan application form if they choose.

3. That where it can be shown that the loan application forms have been amended without the authority of the borrowers, the borrowers be given the opportunity to have the loans forgiven.

4. That where it can be shown that the loan application forms have been amended by the mortgage brokers without the authority of the borrowers, and the loan is forgiven, the broker be required to refund commissions paid and action be taken against them for fraud.

The Storm and Opres Prime debacles have clearly disclosed how the banking industry has generally little or no regard for its clients and are concerned primarily with profit to the exclusion of everything else.

This once proud sector of which I was a long term member is now only a shadow of its former self in matters of putting the client first.

Today the level of "service" given at the point of personal customer contact is pathetic. There can't be anybody who hasn't been annoyed by extended queuing for an inadequate number of tellers whilst other staff are obviously under-employed. To add insult to injury fees can be charged in your own branch on the grounds that ATMs are available.

Lending practice has changed dramatically since the 1970's when banks insisted that borrowers had to have a clear understanding of the risks they were taking, more than adequate security for the loan, and above all a demonstrated capacity to repay the money borrowed.

Since then these practices have been modified to the extent that loans are being willingly granted to people with no income, no job, and no assets, as evidenced by the NINJA loans in the USA which were the catalyst for the global financial mess we are in at present.

Being well aware of the paucity of security they were holding the banks then invented CDOs by parcelling up the loans and persuading investment banks who should have known better to accept them as a valid investment medium, thereby ridding themselves of the debt.

When the time came for borrowers to commence repayment they simply walked away, these mortgage-backed securities became worthless, and the current repercussions commenced as a direct result of the banks' thirst for profits.

We may wish to think that irresponsible lending did not happen in Australia, but regrettably I have to bring to your attention that the banks here have their low or no doc loans which effectively grant loans via mortgage brokers to those who are in no position to service them. As ASIC is aware there is currently a great deal of distress in the community as the result of fraudulent use of the low or no doc loan system.

There is a mortgage broker who was based in WA and is now subject to an investigation by the WA Police Major Fraud Squad into fraudulent activities used by the broker to obtain loan approvals and the consequent commission income.

The broker had affiliations with developers and persuaded clients to take "temporary" loans to purchase a development on the assurance that the property would be sold before settlement and the client would benefit from the expected capital gain. Loan application forms for several banks and lenders were completed by the clients and loans approved.

The predominance of clients are senior citizens with no income other than the age pension.

On realising that the promises of prior sale were not going to be met the borrowers sought the services of consumer advocate Ms Denise Brailey who suggested that the borrowers obtain a copy of the loan application forms lodged by the broker with the banks, and which was used by the banks for assessing the eligibility of the loans granted.

The outcome was to see that the loan application forms held by the banks had been flagrantly amended from the original loan application forms prepared by the borrowers, with no attempt at concealment, assumedly to ensure the application met the bank criteria. Details of assets and income and even occupations had been changed and no attempt had been made by the broker to have the changes authenticated.

What is distressing is how the banks processed these applications in their obviously fraudulent and in some cases forged form without querying the applicant beforehand.

Regrettably Ms Brailey's experience is that this practice is far from new and in fact she advises a cursory investigation by ASIC in 2005 disclosed about 800 instances in that year alone, however it appears nothing was ever done to put an end to it.

Banks were happy for the practice to continue because it meant more loans and more profit, but of course it means that the borrowers are the ones who have to sell their homes and live in a caravan for the rest of their lives, if they are lucky, and in accepting such poor documentation from their agent, the banks must take full responsibility, regardless of the broker's actions.

Like in the USA we have banks pushing their loans without regard to actual client circumstances, and to worsen the situation some of the affected borrowers are facing recovery action by the banks in the courts.

In principle we have similar circumstances to this careless lending in Storm and Opres, where we have the same disregard for the client in the actions taken by the banks to recover their loans which in the main came about through inappropriate lending based on careless advice, and then followed by swift action to penalise the borrowers who should never have been granted the loans in the first place.

Banks have to take responsibility for their actions or the actions of their agents, and I am pleased to note the Commonwealth Bank of Australia at least has raised the possibility of negotiation.

However I am also concerned at the minimal stance taken by the regulators both here and in the USA when matters of poor lending practices were brought to their attention.

In 23rd October 2008 the previous Chairman of the Federal Reserve was quoted by BBC News as saying that "he was partially wrong in thinking that relying on banks to use their self interest would be enough to protect shareholders and their equity".

As recently as 28th July 2009, it was published in the *West* Australian that Chairman of the Federal Reserve Mr. Ben Bernanke admitted "we were late in addressing the sub-prime lending problem".

Both statements are an admission of "fiddling while Rome burns" and I am concerned that our own regulator also has done little to rein in avaricious practices by the banks despite its reported investigation in 2005, and despite having been directly notified of the practices of the mortgage broker referred to above.

In fairness it must be said that the recent introduction of legislation for the creation of a National Consumer Credit Regime is a step in the right direction to ensure that there is statutory control over credit issuers including mortgage brokers, however ASIC's previous practice of condoning the actions of banks that are clearly based on poor lending practices resulting in severe losses to unaware clients is disappointing.

Thank you for the opportunity to comment.

Yours sincerely

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