

Hon Dr Bob Such MP  
Member for Fisher

30 July 2009

Committee Secretary  
Parliamentary Joint Committee on Corporations  
and Financial Services  
Department of the Senate  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

Dear Committee Secretary

### **Inquiry into Financial Products and Services in Australia**

I respond to the invitation to provide a submission to the Inquiry which I very much welcome and offer the following comments in relation to the Terms of Reference.

My observations are that the financial services industry is in transition, evolving into a multi-disciplinary sphere where a broad range of financial advice is offered to clients. Whether all who provide that advice are fully compliant under the current regulations is an issue that needs to be addressed.

Concomitant with changes in the industry, consumers too face an increased expectation to assume responsibility for their own financial security, even into retirement. This is despite many people lacking the expertise and experience to make informed decisions on investment options or strategies.

#### **1. The role of financial advisers**

- I am aware that the Australian Securities and Investment Commission (ASIC) provides, for licensing purposes, extensive definitions of a 'person who provides a financial service'.
- It would be beneficial for consumers and the industry to clarify the definition of the term 'financial planner' and set down precisely what the role does or might encompass.
- Although subsequent investigations have revealed interconnecting reasons for various financial collapses, including lending practices by credit providers, audit processes, flawed management structures and the quality of research provided to advisers, it is also relevant that many clients are not well versed in investment options and strategies.
- Research indicates that only 25 per cent of respondents nominated financial advisers as their main source of financial advice/information. Conversely 45 per cent relied on their own ability to manage

investments and retirement<sup>1</sup>. The Financial Planning Association places the number of people who seek financial advice at 30 per cent<sup>2</sup>.

- For these clients, however, their financial adviser is the primary source of information they rely upon when entrusting their major assets within an adviser-client relationship. Integrity, independence, impartiality and a sound knowledge base should therefore be intrinsic to the role of adviser.
- Although the Financial Planning Association sets down its *Code of Ethics and Rules of Professional Conduct*, in light of the level of responsibility, consideration should be given to higher entry standards and defined qualifications for the profession, and inculcating a culture of ethical practice and an enforceable code of conduct among members, with the ultimate threat of delicensing.
- Consideration should be given to financial advisers/planners lodging a bond or there being a small percentage levy on transactions to help compensate clients who are misled or poorly advised.
- It is important that financial advisers and their industry are not only trustworthy, responsible and informed, but also that they are seen to be so by the wider community.

## **2. The general regulatory environment for these products and services**

- Although ASIC has broad oversight in this regard, the government might allocate additional resources or increased funding via licensing fees to enable the Commission to investigate and to enforce higher levels of review and forensic auditing of financial services providers.
- Standards might also be improved via a strong, unified professional peak body that sets down for its membership, and enforces, a mandatory code of practice.
- Financial planners should also be required to join a professional association and abide by its standards. There must be adequate and appropriate penalties for misconduct.
- Given that clients' lives can be ruined as a result of poor advice and practice, the fiduciary duty of financial planners should be aligned with that of other professions.
- Legislation to establish a professional ethical culture within the industry and enforce attendant standards should be a primary goal.

## **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**

- Commission-based remuneration and other financial incentives in relation to clients' investment options raise significant concerns about a conflict of interest for financial planners.

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<sup>1</sup> CoreData/brandmanagement survey in John Collett, 'Capital punishment', *The Age*, 7 May 2008.

<sup>2</sup> The Financial Planning Association, 'Members' remuneration concerns addressed: FPA', 20 May 2009.

- Indeed, Choice deems the financial planning industry to be ‘structurally corrupt’ because of the bias inherent in promoting and selling products under the guise of unprejudiced investment strategies<sup>3</sup>.
  - While clients should be able to assume that their adviser is an independent professional proffering objective recommendations with their interests at the forefront, some claim that advisers, in seeking to meet sales revenue targets and maximise commissions, act more like agents for fund managers.
  - Clients should receive impartial advice on the basis of a transparent fee-based service.
  - Accordingly, I would endorse a move towards a client-directed payment of fixed fees that could include asset-based fees, service-based fees negotiated with the client, as well as hourly rate fees.
  - Any commissions to be received by the financial planner should be spelt out clearly and prominently and the client advised in writing.
- 4. The role played by marketing and advertising campaigns**
- There is an indication that some of the failed corporations have utilised aggressive marketing techniques, targeting people in shopping centres and cold-calling people on the telephone, as well as excessive commissions to financial advisers.
  - I recommend that the financial services industry disassociates itself from a ‘sales’ culture that, in effect, harks back to an earlier era more akin to sales of life insurance.
  - I would also support additional resources to afford ASIC the authority to research and investigate new investment schemes as they enter the financial services market in order to assess levels of legal compliance and sound business principles.
- 5. The adequacy of licensing arrangements for those who have sold or sell the products and services**
- While I recognise that people who provide financial services are required by ASIC, under the *Corporations Act 2001*, to hold an Australian Financial Services Licence (RG 146 compliance), I am also aware of the call from a number of quarters for educational and professional standards to be raised.
  - RG 146 compliance equates to a Diploma of Financial Services (Financial Planning) which provides an introduction to the fundamentals of financial planning and the competencies necessary to begin employment at as a financial planner.
  - Again, given the implications of poor financial advice, consideration should be given to increasing the minimum requirement for financial planners to provide financial advice beyond RG 146/Diploma level.
- 6. The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be serviced**

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<sup>3</sup> Choice Online, 04/03, ‘The financial planning industry, 2002-2003, p 2; Choice, Letter to Financial Planning Association, 1 June 2009.

- I have concerns about the soundness of investment advice provided to consumers where there is any connection to the levels of commissions paid to financial advisers.
- Some of the failed companies paid commissions far above the average rate of 2 per cent; some sources cite payments between 4 and 10 per cent. Other inducements include trailing commissions and sponsored travel.
- Such inflated commissions must surely distort the objectivity of advice provided to consumers as to the reliability and security of any proposed investment.
- I therefore reiterate the need to divorce financial advice from the payment of commissions.

## **7. Consumer education and understanding of these financial products and services**

- Given the great diversity and complexity of financial products and investment vehicles, many consumers lack the knowledge and understanding to make informed decisions on investment options and retirement strategies.
- Accordingly, I commend the Government's goal of achieving greater levels of financial literacy to improve people's capacity to make better, more educated decisions about money and investments.
- Further to this, I would add that schools should teach the basics of prudent financial management and the need, and ability, to weigh up advice.
- Educational programs, however, are long-term strategies to address an immediate problem.
- The sophisticated knowledge necessary in today's investment market is not easily or quickly acquired. Consumers will still be reliant upon the independence and integrity of a financial adviser which imposes significant responsibilities on that role.
- Affording ASIC the authority to oversee the veracity of new investment schemes/proposal will also go some way towards shielding consumers.

## **8. The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers**

- I note that the Financial Planning Association called tenders for a group professional indemnity insurance policy for FPA members (June 2008). Underlying reasons were that in recent years the number of insurers offering PI cover to financial planners had declined. There were also concerns regarding the variety of terms, conditions and limitations in commercial arrangements<sup>4</sup>.
- If higher levels of professional indemnity insurance are introduced to protect consumers, my concern is whether smaller financial planning organisations – those that may be more in need of greater coverage

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<sup>4</sup> The Financial Planning Association, 'FPA calls for professional indemnity insurance tender submissions', March 2008.

given their limited research capacity - will be able to afford the additional premiums.

**9. The need for any legislative or regulatory change**

- Legislation should reflect the issues and concerns raised above and should have protection of consumers as the principal objective.

**Mortgage Brokers: Concerns**

While the role and responsibilities of mortgage brokers may fall outside the ambit of this inquiry, since they are not deemed to be financial planners, in the current climate I would also raise my concerns about the lack of regulation in that industry.

Given the rapid expansion of consumers' use of brokers and the level of debt they may incur, the few barriers to entry into the industry and the lack of any minimum competency or training regime should give cause for alarm. Standards should be raised and monitored to reduce the risk of poor advice, inadequate documentation and incomplete disclosure of fees to consumers who may not be fully aware of the level of commissions and other ongoing benefits brokers receive from the lender.

The lack of clarity as to whether brokers are really agents for lenders rather than consumers should also be addressed. The industry should aspire to levels of professionalism and fairness that would see brokers obligated to recommend to a client the best and most suitable loan arrangements available.

Given the scale of, and publicity surrounding, recent corporate collapses, along with financial ruin for many their clients, I believe that reforms are essential. I trust this inquiry will improve confidence in the impartiality and trustworthiness of the financial planning industry and offer better protection for those using the services of financial planners and advisers.

Yours sincerely

Bob Such MP JP  
**Member for Fisher**