ASSOCIATION OF FINANCIAL ADVISERS LTD

AFA submission to the Parliamentary Joint Inquiry into Financial Products and Services

July 2009

This submission has been prepared by the Member's of the AFA

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Executive Summary

The Association of Financial Advisers (AFA) welcomes the Parliamentary Joint Committee (PJC) into the Inquiry into Financial Products and Services.

The operating landscape in the wake of the global financial crisis has created stress points across the economy and across all parts of the value chain in financial services.

Businesses that appeared sound at the peak of the boom, that had strong operating models, no longer exist. Big brand names and big reputations across the business community have been stretched to breaking point. These failures, which range from Storm Financial to Babcock & Brown, Centro, Opes Prime and many in between, give rise to a number of key issues and key learning's:

1. The nature of risk has come back into stark focus - market risk, product risk, company risk, asset risk as well as consumer risk.
2. Consumers have incurred significant losses & how much of it was preventable?
3. The role of the regulator in regulating the market, the companies and the Financial advisory profession.
4. The role of the Financial adviser in a post FSRA environment and the benefits of financial advice.
5. The role of Government in setting an operating environment for a profession.

The AFA view is that Financial Services Reform (FSR) has generally served the community well. As Ken Henry said recently " Our particular regulatory framework for the financial sector is widely regarded as close to if not at worlds best practice." (Australian Financial Review, 3/7/09, page 56)

Of course, to the investors in companies that are the focus of this enquiry, these recent failures have had a shocking impact on their lives and livelihoods.

The key question that arises is, were these failures as a result of poor regulation/ law or did these models operate at the margins in which during the raging bull market all "sins were covered", but as the GFC took hold and markets fell these models were exposed as unsustainable.

Unfortunately for AFA members and most hard working Australian Financial Advisers / Financial Planner, (who are part of the backbone of small business Australia), the failure of Storm in particular, has called into question the role & reputation of all advisers.

This is unfair and unjust and the sins of the few are been used to malign an entire profession.

It is the view of the AFA that the Storm model was one that operated " at the fringes". It was a "business model" of the bull market of the past 15 years which was clearly unsustainable for clients. The AFA is horrified at the impact these failures have had on peoples lives.

This submission provides comments and recommendations on the following:

1. The role of the financial adviser and the need to restrict the use of the term 'Financial Adviser"
2. Fees and commissions
3. Advice disclosure documents and legislative change
4. Consumer education and financial literacy
5. Financial Adviser Education
6. Adequacy of professional indemnity insurance

The AFA looks forward to discussing these issues and our recommendations and insights with the Committee.

If you have any questions please contact the AFA on (02) 9267 4003 or by email at richard.klipin@afa.asn.au

Yours sincerely,

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Key Recommendations

This submission provides the following recommendations:

Recommendation 1 – Restriction of the use the term 'Financial Adviser / Financial Planner'

1.1 The AFA recommends that a review of the use of the term 'Financial Adviser' be undertaken. The term 'Financial Adviser / Financial Planner' should be restricted to those persons who:

(a) Are regulated by the ASIC and

(b) Are duly authorised to provide personal advice by an Australian Financial Services Licensee (AFSL) and

(c) Recommend financial products, as defined by the Corporations Act; and

(d) Provide appropriate 'personal' advice following consideration of a person's personal circumstances, needs and objectives, and

(e) Required to adhere to the Corporations Act 2001 disclosure, training and supervision requirements

(f) Is a member of a Professional Adviser Association

Recommendation 2 – Choice of Payment Structures

2.1 The key to appropriate fees and charges is competition, not regulation. Regulatory reforms should be directed towards promoting competitive market outcomes and allowing consumers to choose what payment options they prefer when they choose to obtain financial advice.

2.2 In the interests of transparency and the consumer's right to know, the AFA recommends that the financial advising industry clearly define what a 'fee for service' is and what a 'commission' is. This will allow consumers to be in a position to make an informed decision and compare the costs of alternative products and advice services.

Recommendation 3 – Simplify Advice Disclosure Documents

3.1 That the Government's Financial Services Working Group liaise with relevant industry participants to develop more effective and concise disclosure documents, including Statements of Advice

3.2 Amend s945A to make it clear that advice can be provided on a limited basis, provided that it is agreed to by the adviser and the client and that it is clearly disclosed.

Recommendation 4 – Build, develop and enhance the current Financial Literacy Campaign.

4.1 The AFA recommends that the Government ensures that a financial literacy campaign continues for all Australians. This includes school based learning as well as an adult based curriculum. This needs to be well resourced, professionally managed and involve all Industry participants.

Recommendation 5 - Review Financial Adviser Education levels

5.1 The AFA recommends that the Government and industry review education levels and requirements for advisers. This is based on improving skill and knowledge levels within the profession. This will require skill assessment of competent advisers so that curriculum development reflects best practice within the advice community.

Recommendation 6 – Professional Indemnity Insurance - RG 126 reforms

6.1 That the industry and the regulator work together to address some of the issues identified above, with a view to reform the current RG 126 requirements. The two main options for considerations are as follows:

i. Ability for an AFSL holder to meet RG 126 requirement at licensee level by meeting the current minimum standards as well as accepting Advisers with own PI cover based on individual income level and service offering(that is, risk-only financial adviser)

ii. Provide more clarity in the definition of a failure of a company/product issuer and general investment losses as apposed to Financial Advisers / Financial Planner not meeting their obligations under chapter 7 of the Corporation Act. This will ensure that company failures caused by issues outside the Financial Advisers / Financial Planner control are not automatically deemed as breach of chapter 7 of the Corporations Act.

AFA Background

The AFA is Australia's oldest financial adviser association, coming into existence in 1946 as the Life Underwriters Association (LUA). Today's 1300 members represent large, medium and small practices across the country and provide advice to Australian communities in both regional and metropolitan areas.

Collectively our diverse membership base provides advice to over three million Australians each year, employs over 300,000 people and provides over $40 billion worth of services to consumers and other sectors of the community.

About the AFA

- An association of, by and for advisers
- National membership, with chapters in all major cities
- Central to the focus of the AFA is "helping Australians secure their financial futures"
- Although our members have a strong insurance heritage, today they provide broad and holistic advice to all Australians

Professionalism & Education

- The AFA has always stood for professionalism, believing that adviser learning and education helps clients enjoy better outcomes

Financial advice addresses three key issues

- Living too long (creating wealth, superannuation planning, retirement planning)
- Dying too young (comprehensive risk management and insurance)
- Becoming sick or becoming incapacitated by accident (managing risks in daily life)

Our members work with families, small and large businesses, in fact with all Australians to address the above issues. The advice they give is needs based and client focussed.

Ongoing advice is critical because:

- People change
- Circumstances change
- Needs change
- Markets and products change

On a broader scale

- Australia's superannuation assets stand at $1 trillion and growing
- Australians are chronically underinsured
- Australia's demographics are changing – the population ageing

The need for advice has therefore never been more important.

Key lessons we have learnt over recent years:

1. Serving the consumer well, honestly and diligently is always the most important outcome
2. Consumers need to make informed decisions - education is vital
3. Advice is the key - but it needs to be easy to understand and easy to implement

Key messages from our Committee members:

1. Advice is a critical part of the process: When we build our house we use an architect, when we need medical help we call a doctor. It follows that when we need to plan our futures and protect our families we should use a financial adviser
2. Financial Services Reform (FSR): FSR principles have been good for the industry, however implementation has been very difficult. FSR has increased the compliance load and over-burdened the adviser community, which has led to increased costs for the consumer

We look forward to further discussion with you on various aspects of a technical nature in relation to the project.

Introduction

This submission has been prepared by the Association of Financial Advisers Limited (AFA) on behalf of its members and in response to the Parliamentary Inquiry into Financial Products and Services in Australia. This submission provides comments and recommendations on the following:

- The role of the Financial Adviser and the need to restrict the use of the term 'Financial Adviser / Financial Planner'
- Fees and commissions
- Advice disclosure documents and legislative change
- Consumer education and financial literacy
- Financial Adviser Education
- Adequacy of professional indemnity insurance

The AFA is a professional organisation that has been serving the financial advising industry for over 60 years. Its aim is to provide members with a robust united voice, continually improve practices and focus firmly on the exciting, dynamic future of the financial advising industry.

With six decades of success behind it, the AFA attributes its ongoing relevance to being an association of advisers run by and for advisers. This means advisers set the agenda, decide which issues to tackle and shape the organisation's strategic plan.

The AFA's key strategic priorities are as follows:

1. Clearly define and position the role of the financial adviser
2. Significantly increase consumer literacy and education
3. Continue to improve education requirements for advisers
4. Ensure that disclosure documents meet the "clear, concise and effective mantra" of financial services reform (FSR)
5. Significantly address the under insurance problem in Australia
6. Increase the Superannuation Guarantee (SG) levy beyond 9% to 15% via a range of strategies
7. Ensure that the market place remains robust for all participants in the financial services sector

1 The Role of Financial Advisers / Financial Planner and the Need to Restrict the Use of the Term 'Financial Adviser'

The current legislative regime neither defines nor restricts the use of the term 'Financial Adviser'. Rather, the Corporations Act 2001 (the Act) sets to, among other things, define the conduct of those who provide a financial service and distinguish between those who provide 'personal' and 'general' advice. The distinction is important in determining the level of disclosure that will be required when providing personal or general advice.

The problem at the moment is that anyone offering 'advice' in financial services (or other industries) can hold themselves out to be a 'Financial Adviser' and can actively promote and market themselves to consumers as advisers or Financial Advisers / Financial Planner. Mortgage brokers and real estate agents, for example, often market themselves as Financial Advisers / Financial Planner.

This confusion is further exacerbated by the fact that the regulator, the Australian Securities and Investment Commission (ASIC), also uses the terms in an ad hoc manner.

It is not uncommon for ASIC in their media releases to refer to a banned 'adviser' even though the person in question was never licensed to provide 'personal' or 'general' advice. We refer to recent 2009 media releases:

Media Release 1: AD09-64 Unlicensed Westpoint adviser convicted, Friday 17 April 2009.

….. Mr Rowntree had previously pleaded guilty on 2 December 2008 to the charge of providing financial advice without holding an Australian financial services licence (AFSL) as required under the Corporations Act.

ASIC alleged that between July and December 2003, Mr Rowntree carried on a financial services business, Solutions One Finance Group in North Sydney….

Media Release 2: AD09-09 ASIC bans NSW advisers from providing financial services, Tuesday 3 February 2009

……ASIC found that at various times between December 2004 and December 2007, Mr Dryer and Mr Littlemore carried on a financial services business without holding an Australian Financial Services licence (AFSL) or being an authorised representative of a holder of an AFSL.

ASIC found that despite having a full understanding of the legal requirement to hold an AFSL, or to be an authorised representative of a holder of an AFSL, Mr Dryer chose to disregard the requirements and provide financial services…...

These interpretations mislead the general public and bring the financial advising profession into disrepute.

The AFA defines the role of a financial adviser as one that;:

- builds wealth
- manages wealth and
- protects wealth

Key Strategic Priorities

- Define and position the role of Financial Adviser
- Increase consumer literacy and education
- Improve education requirements for advisers
- Ensure that disclosure documents meet the "clear, concise and effective mantra" of Financial Services Reform (FSR)
- Address the "under insurance" problem in Australia
- Increase the Superannuation Guarantee (SG) to 15% via a range of strategies
- Ensure that the market place remains robust for all participants in the financial services sector

The Role of Financial Advisers

- To provide appropriate advice (that helps clients meet their financial needs and objectives)
- To build sustainable businesses

Understandably, the constant misuse of the term ‘Financial Adviser’ is very confusing to the consumer. Anyone using the term or who purports to offer any kind of financial advice should have to adhere to the same strict regulatory requirements as those persons authorised to provide financial product advice under the Corporations Act.

Recommendation 1 – Restriction of the use the term ‘Financial Adviser’

1.1 The AFA recommends that a review of the use of the term ‘Financial Adviser’ be undertaken. The term ‘Financial Adviser’ should be restricted to those persons who:

(a) Are regulated by the ASIC and

(b) Are duly authorised to provide personal advice by an Australian Financial Services Licensee (AFSL) and

(c) Recommend financial products, as defined by the Corporations Act; and

(d) Provide appropriate ‘personal’ advice following consideration of a person’s personal circumstances, needs and objectives, and

(e) Required to adhere to the Corporations Act 2001 disclosure, training and supervision requirements

(f) Is a member of a Professional Adviser Association

2 Fees and Commissions

Adviser remuneration and payment structures in financial services have received considerable press recently. It is a complex issue that reflects the complexity of the Financial Services value chain and ownership structures. It is also seen as a "silver bullet " issue, one that if resolved will somehow address all ills in the system.

The AFA observes that there is far more depth to this issue than just fees. The key issue's include marrying up:

- Value of advice (benefits to clients)
- The price they pay.
- The method of payment.
  - Fees ($per hour, job lot,% of FUM) or
  - Commission (% paid of funds invested, ongoing trails etc)

Of course at law all remuneration must be disclosed , signed off and agreed by all parties

The AFA has a clear position in regards to remuneration models. That is, that choice should exist for both consumers and advisers.

AFA members deal with clients in all segments of the market from wealthy high net worth individuals and families, to retirees, young families and people struggling to make their way in life financially.

Many AFA members are exponents of a fee based model, many of a commission based model, and many run hybrid models. There are compelling business/ commercial reasons for all models, and it depends on the service offer, the client type, the firms area of specialization, as to which model is most appropriate.

What is more important that simply the price of advice is:

- the quality/appropriateness of the advice given,
- the knowledge ,skills, education and experience of the adviser ,
- the breadth and depth of the recommended list .
- the training of the practice staff.
- The overall client experience.

It is with this experience and view that the AFA believes in choice, and further that banning commissions will take away a consumer's fundamental right to choose.

The AFA has a view that the role of Government should to set policy frameworks/ policy guidelines, and then let the "market run the market." Of course this needs to be done with diligence and due regard for all market participants and clearly ASIC regulates the law end enforces the guidelines.

The AFA is also concerned that banning commissions may make comprehensive financial advice unaffordable for consumers at the very time they need it most, and that the fees versus commissions debate is fixated on price when it should be focussed on value and the quality of the advice provided. It is important that in considering the remuneration structures of advisers, recognition is given to the contribution the existing structures have made to facilitating access to advice. It is critical that the focus of the Government remains on ensuring that the Australian community has access to affordable, high quality financial product advice.

The AFA agrees that effective disclosure is essential for ensuring that consumers understand the costs associated with the financial products and advice services they acquire. The financial services industry has spent many years building transparency into the system and Financial Advisers / Financial Planner have been legally required to disclose how and how much they are paid, in dollar terms, in a myriad of advice documents, for many years.

Commission and brokerage models exist in many industries and sectors, including the stockbroking, property, and investment banking industries.

There is no evidence to suggest that the way Financial Advisers / Financial Planner charge for their services makes them better or worse advisers and simply being fee-based will not guarantee consumers receive better quality advice or that advisers will build better businesses.

Life Insurance

The AFA recommends that Life Insurance remains out of scope for this inquiry. There are a number of key reasons to exclude Life Insurance. These include:

1. Australians are chronically underinsured with very low coverage rates.
2. The consumer protection need is very specific for Life Insurance.
3. Financial advisers are vital to Australians taking action to protect themselves, their businesses and their family.
4. Insurance serves a social good.
5. Australian's with appropriate insurance cover are much more financially self efficient when illness, accident or death strikes.

One of the unique aspect's of Life Insurance is that it is not guaranteed that every person will be offered cover under the policy of their choice, if at all. Under non-commission based arrangements, the customer would be required to pay a significant upfront fee to the adviser for advice on their insurance. If the customer was subsequently declined cover by the insurance company, they would have incurred significant expense and arguably received no benefit in that they were declined cover. This is clearly an undesirable outcome for both the consumer and for the advice industry.

The substantial increase in up-front costs that would result if commissions were prohibited will result in considerably less insurance being sold through advisers and a significant reduction in the number of people receiving advice on their insurance needs. The result will be a widening of the already significant protection gap in Australia.

Financial planners and advisers who advise on risk insurance products add significant value to the process for both the insured and the insurer. Advisers assist with the underwriting process and also follow up with the insured with respect to medical examinations and blood tests. The commission payments made by the product manufacturer to the adviser reflect the significant value that advisers add to the new business process.

Managing Conflicts of Interest

Any potential conflict of interest or lack of transparency that may arise due to commission arrangements are adequately addressed and managed through disclosure requirements and the obligation to have a reasonable basis for advice. In addition, in relation to life insurance, insurers closely monitor lapse rates and have in place 'claw-back' provisions which operate as disincentives for inappropriate behaviour.

The overarching principle therefore should be transparency and choice for the consumer in relation to how they pay for advice on insurance and the products that they purchase as a result of that advice.

Perceived 'conflicts of interest' are evident in both remuneration structures. For commission structures, there is a perception that the adviser will choose a financial product which offers a higher commission payment than a similar product, which offers a lower commission payment. Similarly, with a fee for service model, those who adopt an hourly billing structure have no financial incentive to provide the advice in an efficient manner. Those who charge a percentage of funds under advice as a fee model cannot accurately reflect the time spent on providing and managing the advice. We can learn from other professions (such as lawyers) who charge an hourly fee for their services.

Learning from other Professions

Speaking at the Law Society dinner at Parliament House on 3 February 2004, (to mark the beginning of the law term), Chief Justice Spigelman spoke out strongly against the "tyranny of the billable hour" - claiming the method of charging meant there was "no financial incentive to do the service as quickly as possible".

In fact, Chief Justice Spigelman argued that the practice "rewards inefficiency", inducing a small number of lawyers to provide services that were not required, or to offer them in a more extravagant manner than was appropriate.

The Real Issue

Rather than focusing on remuneration, the current debate should focus on:

- Insuring that consumers get consistently good advice outcomes
- Whether disclosure is still an appropriate system to manage conflicts
- What is good, professional advice, and how do consumers get the best outcomes from the advice relationship?
- What does professional really mean?
- Is there a 'best' compensation model for consumers and advisers?
- Enable broader access to affordable, quality advice

Recommendation 2 – Choice of Payment Structures

2.1 The key to appropriate fees and charges is competition, not regulation. Regulatory reforms should be directed towards promoting competitive market outcomes and allowing consumers to choose what payment options they prefer when they choose to obtain financial advice.

2.2 In the interests of transparency and the consumer's right to know, the AFA recommends that the financial advising industry clearly define what a 'fee for service' is and what a 'commission' is. This will allow consumers to be in a position to make an informed decision and compare the costs of alternative products and advice services.

3 Advice Disclosure Documents and Legislative Change

The Financial Services Reform Act (FSR) has, at its heart, consumer protection. FSR has improved the comparability and consistency of information available to consumers about financial products.

Consumers are provided with relevant information throughout the financial advice process, including the following disclosure documents:

Financial Services Guide - Provided to a consumer before advice is provided and explains the nature of financial services being offered, the fees charged and how the person providing the service deals with customer complaints

Product Disclosure Statement - Provided to consumers by the issuer of a financial product and provides information about the issuer, benefits, risks and costs of the product and certain other information

Statement of Advice - Provided to a consumer whenever advice is provided to a retail consumer (ongoing disclosure of material matters and periodic reviews are provided to consumers and documented in the Statement of Additional Advice and/or Records of Advice).

Making Disclosure Effective

The issue for some time now has been that the advice documents produced and provided to consumers have been written to comply with the law at large rather than to facilitate consumer understanding. Attempts to reduce documentation have been countered by concerns around satisfying existing disclosure requirements.

The AFA is aware, for example, of certain Financial Advisers / Financial Planner providing 100+ page Statements of Advice. We have seen some advisers requiring clients to sign each and every page of a Statement of Advice to confirm that they have read it. This practice is clearly about protecting the financial adviser, rather than the client.

We believe that measures need to be implemented to allow Financial Advisers / Financial Planner to provide more concise advice, which will be better understood by clients and, as a result, be more effective.

Guidance received from ASIC in relation to Statement of Advice content has been mixed, but has extended to the provision of an example Statement of Advice.

The AFA is aware of work being undertaken by the Government's Financial Services Working Group in relation to the development of more concise Product Disclosure Statements, involving Government and industry in this process. We believe that a similar process should be commenced in relation to Statements of Advice.

An opportunity for "limited advice"

There is a need for regulatory change to remove the confusion for the financial services industry as to what should and should not be included in advice documents. For example it is unclear whether "scalable advice" as outlined in ASIC Regulatory Guide 175 Licensing: Financial product advisers — conduct and disclosure (RG 175) can be achieved, as Financial Advisers / Financial Planner are confused on how to limit client enquiries or the extent of client investigations and still satisfy their Corporations Act responsibilities and duties.

This has resulted in Financial Advisers / Financial Planner opting out of providing limited and concise advice and providing safer and less liability stricken, all-encompassing holistic advice. Not only is this approach to advice more costly and time consuming to the financial adviser but it also discourages consumers to read and comprehend the advice.

ASIC has recently released guidance and class order relief for superannuation fund trustees from the personal advice requirements of s945A of the Corporations Act. The AFA believes that similar relief should be extended beyond the confines of an existing superannuation arrangement to allow 'limited advice' to be provided in relation to a broader range of financial services and products by appropriately licensed Financial Advisers / Financial Planner.

Recommendation 3 – Simplify Advice Disclosure Documents

3.1 That the Government's Financial Services Working Group liaise with relevant industry participants to develop more effective and concise disclosure documents, including Statements of Advice

3.2 Amend s945A to make it clear that advice can be provided on a limited basis, provided that it is agreed to by the adviser and the client and that it is clearly disclosed.

4 Consumer Education and Financial Literacy

As mentioned above, although FSR has improved the comparability and consistency of information available to consumers about financial products, the current legislative system not only requires a multiple of advice documents to be produced and provided to the retail consumer, but the length and content contained in the advice disclosure documents are not being read or understood by the retail consumer.

As such it is imperative that the issue of consumer education and financial literacy is addressed, along with the issue of multiple advice documents.

As noted by Keith Hall, Assistant Governor (Banking and Payments) Address to the Conference on Deepening Financial Capacity in the Pacific Region Sydney - 25 August 2008,

…. Financial literacy matters on many levels. It helps people manage their financial affairs and improve their standard of living. But it also makes an important contribution to the soundness and efficiency of the financial system and to the performance of the economy.

When we talk about financial literacy we are usually referring to a set of skills that allow people to manage their money wisely. As a minimum, these skills include the attainment of basic numeracy so that rates of return on savings and borrowings can be readily calculated and compared. They also extend to some understanding of essential financial concepts, not least an appreciation of the trade-off between risk and return. And not to be overlooked is the capacity to understand when the time may have come to seek professional financial advice and where you need to go to find it. Broader concepts of financial literacy also assume that people will make better judgments about their financial affairs if they understand the relationship between their own finances and the wider economy.

One of the biggest challenges after consumer education and financial literacy is getting consumers to understand when they require assistance with their financial affairs and seek financial advice from a financial adviser.

Recommendation 4 – Build, develop and enhance the current Financial Literacy Campaign.

4.1 The AFA recommends that the Government ensures that a financial literacy campaign continues for all Australians. This includes school based learning as well as an adult based curriculum. This needs to be well resourced ,professionally managed and involve all Industry participants

5 Financial Adviser / Financial Planner Education

Since 1946 the AFA has been representing the professional financial adviser. One of the key components to providing quality outcomes for clients is ongoing education and professional development. The AFA vision for it's members is a commitment to life long learning and education.

Whilst the failures of the companies in question don't point to a lack of education the AFA view is that the "education bar" needs to rise. The nature of the profession has evolved over many years and the state of regulation continually changes, as a result knowledge and information changes and professional Financial Advisers / Financial Planner need to commit to further education.

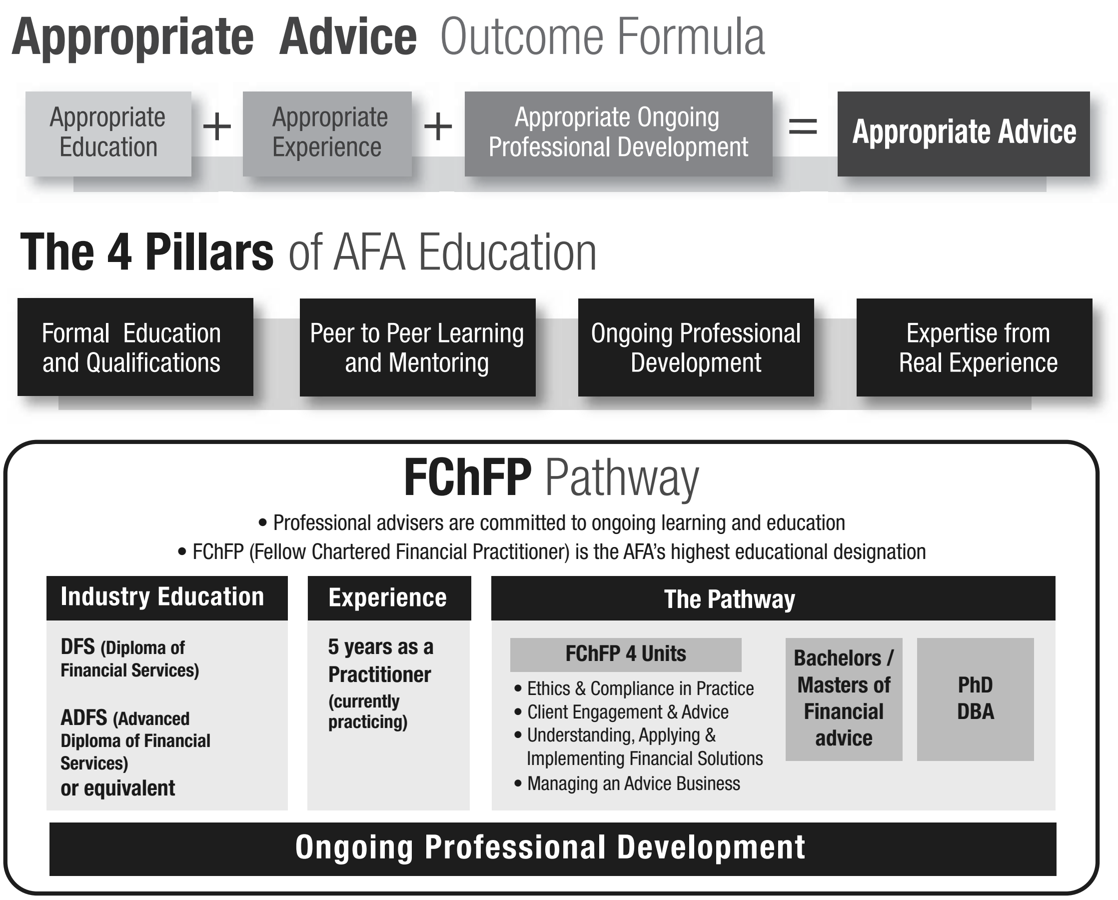
An assessment needs to be completed involving many parts of the profession but the AFA view is that there are a range of skills/ knowledge that are required to become a competent Financial adviser. They are blend of both " hard and soft skills. They (but are not exhaustive)

- Sustainable advice skills
- Strong client empathy skills
- Strong business management skills
- Strong numeracy skills
- Strong technical skills in area of speciality
- Coaching and mentoring skills
- Clear understanding of markets and products
- Client engagement skills
- Risk insurance skills
- Superannuation Advice
- Retirement Planning Advice
- Investment

AFA Educational Philosophy

Ongoing education and professional development is the corner stone to ensuring improving standards in the Financial Adviser community. There are a number of components to education, these include formal education, peer to peer learning and 'on the job' training.

The AFA has recently launched it's education pathway and the FChFP (Fellow Chartered Financial Practitioner). The FChFP seeks to raise the bar for AFA members, focussing on a balance of skills designed to lead to better client outcomes.



Recommendation 5 - Review Financial Adviser Education levels

5.1 The AFA recommends that the Government and industry review education levels and requirements for advisers. This is based on improving skill and knowledge levels within the profession. This will require skill assessment of competent advisers so that curriculum development reflects best practice within the advice community.

6 Adequacy of Professional Indemnity Insurance

Since the introduction of ASIC Regulatory Guide 126 (RG 126) in March 2008 covering the guidelines for Compensation and Insurance arrangements for AFS licensees, the industry has undergone one of the toughest times in living history. The failures of a number of high profile product issuers and service providers are testing the current guidelines and processes to the limit.

Given the current market environment, it is critical that the objective of RG 126 is reviewed to determine if it is meeting, and will continued to meet, its desired outcome. In introducing RG 126, ASIC's aim was to raise the standard of available professional indemnity (PI) insurance to cover licensees and their authorised representatives resulting from a breach of their obligations under Chapter 7 of the Corporations Act.

The purpose of the two-year staged approach was twofold:

1. Timeline to cater for both new licensees and existing licensees to comply
2. To allow the industry time to develop appropriate insurance products to cover the needs

Following the introduction of RG 126, the largest insurer in the market, QBE, ceased offering cover to Financial Advisers / Financial Planner. Currently, there are only five insurers still offering coverage which incorporates RG 126 wording in their products for Financial Advisers / Financial Planner.

The remaining five insurers in the market (down from seven in 2008) include AIA, VERO, DUAL, Dexta and CGU. With the increase in potential liabilities from recent high profile failures, it is now questionable whether all five insurers will continue to be in operation. Clearly, a further reduction in the number of insurers will result in further restrictions on the terms and conditions of the policies. This will undoubtedly make what is already a very expensive premium even more expensive. It also defeats ASIC's intention, as outlined in point 2 above.

There are many changes and issues confronting insurers, Financial Advisers / Financial Planner and clients alike. These have been brought about by:

- RG126 legislation requirements - fidelity requirements and increases in compensation limits have had a negative impact on insurance capacity
- The increase in the claim limits for external dispute resolution schemes such as the Financial Ombudsman Service (FOS) has resulted in higher claims being paid, resulting in a less profitable industry
- The Global Financial Crisis has affected insurance capacity in the market - for example, larger financial advisory groups have been unable to purchase the cover they require as the insurer is not comfortable with the level of exposure. Not having the insurance capacity renders AFSL unable to comply with RG 126 requirements.
- Contrary to the RG 126 claim that:

… Professional Indemnity insurance is not intended to cover product failure or general investment losses, claims for loss solely as a result of the failure (e.g. insolvency) of a product issuer or where a return on a financial product that has not met expectations. Nor is it intended to underwrite the products of a product issuer…

The AFA notes that there has been a major increase in the number of claims being made due to failed products such as Westpoint and most recently Great Southern and Timbercorp. Insurers are expecting over $300 million worth of claims in the next two-three years.

- For AFSL holders, minimum premiums have increased to a minimum of $5,000, regardless of whether the AFSL holders earn $1.00 per annum or $500,000.00 per annum
- There is no dedicated cover available for individual Financial Advisers / Financial Planner in the PI insurance market, which makes it difficult for some financial advisers to leave an AFS licensee and join another as the new AFS licensee seeks personal indemnities from the newly appointed financial adviser
- We are also beginning to see restrictions in coverage and increases in excesses with respect to specific strategies, with some insurers restricting their margin lending coverage to 50% loan to valuation ratio (LVR) and only into managed funds. Any claims arising from margin lending may also attract a higher excess

Should the current issues continue, then smaller AFS licensees will not be able to afford the PI insurance cover required and the large financial advice institutions will push liability down to advisers and have no liability themselves.

Recommendation 6 – RG 126 reforms

6.1 That the industry and the regulator work together to address some of the issues identified above, with a view to reform the current RG 126 requirements. The two main options for considerations are as follows:

iii. Ability for an AFSL holder to meet RG 126 requirement at licensee level by meeting the current minimum standards as well as accepting Advisers with own PI cover based on individual income level and service offering(that is, risk-only financial adviser)

iv. Provide more clarity in the definition of a failure of a company/product issuer and general investment losses as apposed to Financial Advisers / Financial Planner not meeting their obligations under chapter 7 of the Corporation Act. This will ensure that company failures caused by issues outside the Financial Advisers / Financial Planner control are not automatically deemed as breach of chapter 7 of the Corporations Act.

Summary and Conclusion

There has been much fallout from the Global Financial Crisis over the past 18 months. The Financial Services Industry has been at the frontline of this crisis worldwide. The majority of the 16000 Financial Advisers / Financial Planner in Australia have been in the trenches working with their clients, "holding their hands" and helping their clients stay on track.

Sadly failures like Storm, Opes Prime, Westpoint etc, and the shocking aftermath for their investors/shareholders and clients, focus the attention on the minority who do the "wrong thing"

This is why the AFA welcomes this enquiry. It is to articulate and demonstrate the value of advice and advisers for Australians when they are:

- setting up a business,
- buying a house,
- having children,
- retiring,
- changing job's,
- setting up a super fund.
- getting insured for life's uncertainties.

We have tried to address the key issues for AFA members, and to give the committee clear insight into our position via our key recommendations.

We look forward to discussing this further with the Committee.

Should you wish to discuss any aspects of this submission, please do not hesitate to contact the Association of Financial Advisers / Financial Planner Limited on (02) 9267 4003 or by email at richard.klipin@afa.asn.au

Yours sincerely

Richard Klipin

Chief Executive Officer

Association of Financial Advisers

Appendix 1: AFA Corporate Profile.

AFA
ASSOCIATION OF FINANCIAL ADVISERS LTD

Focusing on the exciting and dynamic future of the Financial Advising Industry

GenXt
bridging the gap...

CORPORATE PROFILE

Helping Australians secure their financial future

ASSOCIATION OF FINANCIAL ADVISERS LTD

The Association of Financial Advisers has been serving the financial advising industry for sixty years. Today the focus of the AFA is firmly on the exciting, dynamic future of the financial advising industry.

With six decades of success behind it, the association's ongoing relevance is due to its philosophy of being an association of advisers run by advisers. This means advisers set the agenda, decide which issues to tackle and shape the organisation's strategic plan.

AFA Purpose & Mission

- to maintain the ethical standards of financial advisers in the interest of the public, the financial adviser and the financial services industry in general
- to improve the educational standards of the financial adviser for the benefit of the public, the financial adviser and the industry
- to represent generally the views and interests of financial advisers
- to promote a knowledge of the value and importance in the community of the services of qualified financial advisers
- to cooperate with other financial services stakeholders in the best interests of the public and the financial services industry
- to promote a spirit of adviser good fellowship

AFA National Board

Absent from photo:

Michael Murphy

Anthony Smith

Brad Fox

AFA Member Benefits

- ✔ Adviser focussed - run by Advisers for Advisers
- ✔ Access to AFA Education program FChFP
- ✔ Concessionally priced Professional Indemnity Insurance
- ✔ Online members' forum
- ✔ Discounted rates to all AFA Events
- ✔ AFA ideas centre
- ✔ E-News bulletins containing up to the minute industry information
- ✔ The Financial Adviser quarterly magazine
- ✔ Online access to financial industry research papers
- ✔ Specialised networking groups including:
  - GenXt
  - SOS Mentoring Program
- ✔ NATIONAL and Regional Roadshows in all major cities and country centres
- ✔ Recognition of Adviser excellence through
  - AFA Adviser of the Year
  - AFA Rising Star of the Year
  - AFA Student of the Year

Who belongs to the AFA

The AFA currently has 1,300 members. With a growth rate of 20 per cent it is clearly a strong and highly valued organisation.

AFA members come from all sectors of the industry ranging from small business people to large corporate giants as well as some of Australia's largest licensees. Collectively they provide advice to over 3 million Australians each year, employ over 300,000 people and offer over $40 billion worth of services.

MEMBERSHIP PROFILE

Australian Financial Services Licence

- 26 per cent of members have their own AFSL
- 74 per cent of members are part of a larger AFSL

PRIMARY PROFILE

- 59 per cent write risk insurance
- 28 per cent write platforms/wraps/masterfunds
- 13 per cent write superannuation
- Less commonly members used insurance bonds, margin lending and tax effective products

PRACTICE STAFF NUMBERS

- 55 per cent have practices with three staff or less
- 45 per cent have practices with four or more staff

AFA Board 2008/2010

PRESIDENT Jim Taggart
VICE PRESIDENT Kerry Sharp
TREASURER Dennis Bateman
CEO Richard Klipin
WA DIRECTOR Stephen Knight
GENXT CHAIR Brad Fox
TAS DIRECTOR Anthony Smith
QLD DIRECTOR Troy Edmondson
VIC DIRECTOR Esther Althaus
SA/NT DIRECTOR Michael Murphy
NSW/ACT DIRECTOR Marc Bineham

The AFA Board Strategic Priorities 2009/2010

- Voice of advice to Government and the regulator
- Build AFA education – FChFP
- Build member offer and member events
- Voice of advice in the media
- Build AFA with licensees
- Build and grow regions
- Build and grow GenXt

Helping Australians secure their financial future

GenXt

bridging the gap...

AFA GenXt Committee

GenXt is an initiative of the Association of Financial Advisers (AFA). The intention is to bridge the gap between the current generation of financial planners and the Next Generation of professionals in financial advice.

GenXt is not an aged based initiative. You are a prospect for GenXt if you have a thirst for knowledge and self improvement, if you want to raise the bar and challenge yourself and fast-track your professional development to become one of the best in your profession.

GenXt is about professional development through the transfer of knowledge, experience, skills and networks:-

- Leading edge workshops, seminars, social forums and conferences - both State based and National
- The transfer of knowledge from an experienced adviser one-to-one through the GenXt SOS Mentoring Program (for members only)
- An education pathway “Fellow Chartered Financial Practitioner” (FChFP)
- Networking with industry peers and experts who are part of the AFA fellowship, as well as centre’s of influence that can enhance your knowledge and profile within the industry
- In joining the AFA you become a member of an association “run by advisers, for advisers”, an association that is the voice of advisers to Government.

It is not a requirement to be a Financial Adviser to join GenXt; associated roles involved in Para-Planning, Compliance, Administration, Underwriting or Management are equally welcome as are people in complimentary services like accounting, law, stock broking and mortgage broking.

AFA National GenXt Committee

AFA
ASSOCIATION OF FINANCIAL ADVISERS LTD

AFA Government & Policy Committee

ADVOCACY IN ACTION...

"The need for common sense and practical responses from advisers to Government and the regulator are now more important than ever."

Jim Taggart
AFA National President

Key Strategic Priorities

- Define and position the role of Financial Adviser
- Increase consumer literacy and education
- Improve education requirements for advisers
- Ensure that disclosure documents meet the "clear, concise and effective mantra" of Financial Services Reform (FSR)
- Address the "under insurance" problem in Australia
- Increase the Superannuation Guarantee (SG) to 15% via a range of strategies
- Ensure that the market place remains robust for all participants in the financial services sector

The Role of Financial Advisers

- to provide appropriate advice
  (that helps clients meet their financial needs and objectives)
- to build sustainable businesses

CLIENT CONSUMER

Build Wealth	+	Manage Wealth	+	Protect Wealth
• Superannuation • Investment • Savings • Financial Literacy		• Financial Literacy • Budgeting & Cashflow • Investment Planning • Retirement & Pre-Retirement		• Risk Management • Comprehensive Insurance Cover • On-going Reviews • Estate Planning

REVIEW & REFINE

ADVISER & PRACTICE

Build Business	+	Manage Business	+	Protect Business
• Business Planning • Staff Recruitment & Development • Systems & Processes • Marketing		• Practice Management • Client Relationship Management • Mapping Processes • Financial Management & Governance		• Compliance Management • PI Cover (RG126) • Business Continuity Planning • Key Person Planning

REVIEW & REFINE

Helping Australians secure their financial future

AFA ASSOCIATION OF FINANCIAL ADVISERS LTD

AFA Education Framework

EDUCATING OUR MEMBERS...

The AFA Education Pathway

The AFA's vision of lifelong learning and education is embodied in its Education Pathway developed to enable members to deliver better advice outcomes to Australian consumers. The aim of the AFA's Education Pathway is to ensure that advisers are competent, compliant and confident in their careers, whilst promoting the professionalism of the insurance and finance community. A map of the pathway is outlined below.

FChFP Pathway

- Professional advisers are committed to ongoing learning and education
- FChFP (Fellow Chartered Financial Practitioner) is the AFA's highest educational designation

Industry Education	Experience	The Pathway		
DFS (Diploma of Financial Services) **ADFS** (Advanced Diploma of Financial Services) **or equivalent**	**5 years as a Practitioner** (currently practicing)	**FChFP 4 Units** • Ethics & Compliance in Practice • Client Engagement & Advice • Understanding, Applying & Implementing Financial Solutions • Managing an Advice Business	**Bachelors / Masters of Financial advice**	**PhD DBA**

Ongoing Professional Development

Philosophy

- The Australian Community expects and needs access to good quality advice and professional service
- The AFA believes that a combination of appropriate education, experience and training leads to good advice outcomes
- The adviser / client relationship is a very powerful relationship that needs hard work by both parties to be successful in the long term

The 4 Pillars of AFA Education

- Formal Education and Qualifications
- Peer to Peer Learning and Mentoring
- Ongoing Professional Development
- Expertise from Real Experience

Good Advice Outcome Formula

Good Education + Good Experience + Good Ongoing Professional Development = **Better Advice**

AFA Awards Program

The AFA awards program reflects the Association's belief that recognising excellent practice is integral to building a strong, professional industry.

Brad Fox 2008 AFA Rising Star of the Year

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The AFA Rising Star Award recognises up-and-coming advisers who provide quality advice, excellence in practice management and are major contributors to the industry and/or community.

The award recognises new advisers who provide quality, holistic advice, demonstrate a commitment to education and contribution to the industry and their community. The award was established in 2005 and ING Australia continues with its sponsorship of this Award for the 4th consecutive year.

The Rising Star Award complements the ongoing AFA GenXt program that is being run around Australia. Together, the AFA offers young advisers the ability to learn, grow and be recognised.

Paul Daily and Adam Smith 2008 AFA Adviser of the Year

ZURICH®

AFA Adviser of The Year, a collaborative venture between the Association of Financial Advisers (AFA) and principle sponsor Zurich Financial Services Australia, is aspirational and aims to promote impressive business practices.

Established in 2003, the AFA Adviser of the Year Award is designed to pay tribute to individuals who not only run highly successful businesses but also go above and beyond in their contribution to the financial services industry and wider community.

In today's corporate environment, where governance and fee/disclosure issues take centre stage, the award provides a valuable opportunity to celebrate the great work performed by advisers in their dual capacity as professionals and good corporate citizens.

Jo Bean 2008 AFA Student of the Year

asteron

AFA Student of the Year sponsored by Asteron, recognises the top-performing student within the advice industry.

The awards are dedicated to supporting and rewarding those who undertake the challenge of acquiring knowledge, and then applying this knowledge to their business, their clients, their industry and their community.

Judges are looking for continuing education, plus application of your knowledge into your practice, your industry and your local community

AFA World of The Brands

AFA ASSOCIATION OF FINANCIAL ADVISERS LTD

AFA ASSOCIATION OF FINANCIAL ADVISERS LTD Foundation changing lives

GenXt bridging the gap...

SOS THE SECRETS OF SUCCESS NETWORK PROGRAM

AFA IDEAS CENTRE For Members Only

AFA ASSOCIATION OF FINANCIAL ADVISERS LTD | AFA Government & Policy Committee | ADVOCACY IN ACTION...

AFA ASSOCIATION OF FINANCIAL ADVISERS LTD | AFA Education Framework | EDUCATING OUR MEMBERS...

AFA ASSOCIATION OF FINANCIAL ADVISERS LTD

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Appendix 2: AFA Media release on Education

Media Release 25th September 2008

AFA Goes Back to School With the Launch of its FChFP Pathway Program

Pilot Program Held Last Weekend With 11 Participants

The AFA today announced that the first course for the FChFP pathway program was held over the past weekend. It was run as an MBA-style executive retreat based on adult learning principles. The inaugural program had 11 participants in the pilot program.

"This is a very momentous time for the AFA " said AFA Chair of Education, Jim Taggart

"The AFA over the past 18 months has worked with members, subject matter experts and the industry at large to develop the learning & content framework for FCHFP. It is been designed by advisers and education specialists and brings a unique blend of practical, useful learning for experienced practitioners. " said Mr Taggart.

"The AFA has a proud history in the field of education/professional standards development and we aim to more than satisfy the expectations of our members, the profession and the end user being their clients," said AFA CEO, Richard Klipin.

"Advisers who enrol in the FChFP pathway program have to get value from learning, the benefits have to drive better outcomes for practices and their clients," said AFA President Dennis Bateman.

"CEO finishing school for advisers" - Dr Dennis Maddern

"The AFA is challenging its members and the profession more broadly to 'go back to school' and discover the passion for learning. We never stop learning in life and the AFA firmly subscribes to this credo." said Mr Bateman.

The AFA's partner in this project is PS 146 Training Australia. PS 146 CEO, Mark Sinclair said," The pilot program on the weekend reaffirmed again how important it is to blend academic rigour with real world experience in attaining the most productive learning outcomes."

"The AFA has a very clear vision for the future of education for advisers and they share our PS146 passion and enthusiasm for education and belief in the strong future for profession advice in Australia," said Mr Sinclair.

Dr Dennis Maddern, a course participant and well known Melbourne adviser stated, "This course is a must for all advisers who see themselves as business owners and CEO's. This program is like a finishing school for CEO's and those advisers who challenge themselves to complete the program will most certainly add value to their businesses, their clients and themselves."

The FChFP Pathway program is now enrolling students for the next intake.

The Fellow Chartered Financial Practitioner (FChFP)

The Fellow Chartered Financial Practitioner (FChFP) is the AFA's highest educational designation, It can be obtained by successfully completing the four 12-week education courses, which prepares you to provide advanced financial advisory services and potentially leads to a rewarding career in the financial services industry.

The FChFP designation will be achieved via an extensive study pathway that brings the real world into the learning experience. Candidates will need to successfully complete the assessment requirements of all 4 courses in the FChFP Program. Assessment for each unit will be by way of a 3 hour examination and a 2,500 word practice-based assignment.