AMP's response to the Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Financial Products and Services

August 09

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Executive Summary / Recommendations

The Australian Financial System is generally a well-regulated, highly regarded world-class system, which has withstood the recent Global Financial Crisis.

AMP recognises however, that there is room for improvement and makes the following recommendations.

1. Sound financial advice is a valuable service in today's society and delivers tangible and intangible benefits for consumers. In order to maximise the benefits of financial advice, AMP recommends that:

   any change to the advice framework continues to ensure that advice is accessible and affordable for middle income Australians.

2. It is acknowledged that the overall level of financial literacy of many Australians is inadequate. Financial advisers play a significant role in educating their clients, increasing their overall level of financial literacy. AMP supports:

   Government efforts to improve financial literacy and encourages ASIC to work closely with the financial services industry to further develop financial literacy programs

3. In order to ensure consumers receive good quality, sound financial advice, it is imperative that financial advisers are appropriately and adequately qualified. Recognising that existing minimum qualification and experience standards are inadequate, AMP recommends that:

   ASIC works with the financial advice industry to raise professional standards by strengthening the minimum experience and qualification standards for financial advisers.

4. As an integrated organisation AMP is better able to ensure consumer protection through higher standards of training, monitoring and supervision than the minimum standards prescribe. AMP also is vigilant in protecting its brand and reputation in the event of a failure in process. AMP therefore recommends that:

   the PJC recognises the benefits that an integrated structure provides within the financial services industry, particularly in relation to consumer protection.

5. In recognition of the limitations of Professional Indemnity insurance, AMP considers the best form of protection for consumers rests through requiring a minimum level of balance sheet strength of Australian Financial Services Licence holders. Accordingly, AMP recommends that:

   minimum Net Tangible Asset requirements be examined for all Australian Financial Services Licence holders.

6. Conflicts of interest have been a consistent theme across a number of the recent corporate collapses. However, AMP does believe that the vast majority of licensees have adequate arrangements in place; the challenge comes in identifying those that do not. AMP agrees with ASIC that:

   an appropriately resourced ASIC adopt a risk based approach to monitoring and supervision to more effectively monitor and assess management of conflicts by Licensees.

7. Due to the inevitable increase in costs associated with higher levels of regulation and the prospect of unintended consequences from such regulation, AMP recommends that:

   any proposed changes to regulation be approached cautiously, specifically recognising the possibility of unintended consequences and additional costs to the industry, and ultimately, to consumers.

8. That said, there are clear deficiencies in the existing AFS licensing regime that result in inappropriately resourced and insufficiently competent operators to obtain an AFS licence. AMP recommends that:

   ASIC works with the industry to strengthen the requirements to obtain an AFSL and that Licensees are appropriately resourced and competent to provide financial services and products.

1. Introduction

AMP welcomes the opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the collapse of Storm, Opes Prime and other similar failures.

AMP is one of the largest financial services organisations in Australia and has assisted Australians in protecting and growing their wealth, generation after generation.

We have vast experience in providing both products and financial advice to consumers for over 160 years. With an advice distribution network of over 1600 financial advisers nationally and products to suit superannuation, insurance, investment and banking needs, AMP is well placed to make observations in relation to some of the operating deficiencies within the existing financial services industry regulatory framework.

This submission does not seek to address all the Terms of Reference of the Inquiry as many of these issues are covered adequately in other submissions such as those made by Investment and Financial Services Association (IFSA) and the Financial Planning Association of Australia (FPA).

Rather, AMP would like to focus our submission on three areas AMP considers vital from a consumer perspective:

1. the value of financial advice;
2. the benefits of integrated organisations; and
3. issues associated with regulation.

AMP considers that the key question the Committee needs to consider in relation to the recent failures is:

> *"do the recent corporate collapses indicate a fundamental flaw with the design and regulation of the industry, or rather, was this an inevitable flushing out of unscrupulous players in the market, assisted by the Global Financial Crisis in exposing their activities?"*

AMP's view is firmly towards the latter case.

In the wake of the current global financial crisis, those organisations with sound risk management practices and balanced business models have demonstrated that they have been able to withstand the crisis.

Those with less sound practices have been revealed. As ASIC presented in their submission to the Inquiry, "a flawed business model has been characteristic of a lot of the business failures recently"

It is also significant that the failures at the centre of the Inquiry were independent, boutique financial services organisations, not backed by large institutions such as AMP.

AMP recognises there is room for improvement in certain areas of the regulatory framework governing the Australian financial services industry. However, it is not possible to regulate against inappropriate management behaviour.

AMP is of the view that these corporate failures were as a result of inappropriate management behaviour and unsound business models, rather than a fundamental flaw in the design of the regulatory system.

2. The Value of Financial Advice

Financial advice is a valuable service, especially when looked at over a working life.

2.1 The role of financial advisers

The simple fact is individuals are better off when they act on advice received from a properly qualified, professional financial adviser.

Whilst there are perceptions that advice is only for the wealthy, AMP believes that advice is critical to all Australians, particularly middle income Australians. Good financial advice boils down to three simple things:

- helping people own their own homes sooner;
- making sure they protect themselves and their families in the event of misfortune; and
- ensuring they can retire comfortably.

Most people know they should pay off their mortgages earlier, stop revolving credit card debt, have adequate insurance and save more for their retirement; however, most don't get around to doing it or doing it well.

The value of advice comes through the ongoing relationship a client forms with their financial adviser. A good financial adviser will help a client to define their financial goals and then develop strategies that will achieve those goals.

Good advice provides peace of mind for clients. Recent research shows that consumers with a structured stable financial plan feel they have more control of their finances and look forward to the prospect of a more comfortable retirement[1]. Further, this research showed that more broadly, the benefits to Australia of people obtaining advice include:-

- Reduced debt which increases disposable income
- Insurance protection reduces reliance on welfare
- Higher levels of savings reduce calls on government benefits during and after retirement.

Clients with a tailored financial plan in place are able to demonstrate financial discipline over the long-term. Clients with an ongoing, or even intermittent, adviser relationship are more likely to have a higher level of retirement savings and a greater level of risk cover then someone without[2].

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[1] Research conducted by Rice Warner Actuaries, titled "Value of Advice". Commissioned by the Financial Planning Association of Australia, February 2008.
[2] Taken from the "Financial Planning Affection" Survey (May 2009) prepared by brandmanagement.

2.2 Advice and Financial Literacy

AMP recognises that improving consumer's financial literacy and capability is critical to increasing consumer confidence with their financial decisions and ensuring greater consumer protection.

AMP believes that financial advisers play an important role in increasing consumer financial literacy. Through an active, ongoing relationship with a financial adviser, consumers develop an enhanced understanding of the financial services markets in which they engage.

A financial adviser assists their client to understand the consequences of financial action or inaction and guides them in making decisions that ultimately support the client's financial goals.

An adviser educates their client to understand the need for diversification and asset allocation and the risks associated with one financial strategy over another – for example, the difference between an aggressive strategy and a conservative strategy, and how both may be relevant at different times of a client's life.

Consumers who have received advice are also more likely to pass on some of their financial knowledge to family members and friends thus improving the level of financial literacy in the community over the longer term.

2.3 Industry qualification standards

AMP believes that the minimum entry levels for financial advisers are too low and this is a significant contributing factor to advisers providing advice on products that they do not fully understand. It is now the time to act decisively and raise the professional adviser qualification standards.

Regulatory Guide 146 (RG 146) issued by ASIC, sets out the minimum education standards for financial advisers, however, no minimum experience or ongoing education standards are mandated by this guide.

Membership of an industry association is voluntary rather than mandatory and whilst available, no professional qualification program is required to be completed in order to become a member of that industry association.

Each Licensee is left to set its own benchmark (at or above the prescribed minimum standard) for assessing adviser capability. Whilst some Licensees prescribe rigorous training standards, supplemented with "on-the-job" supervision, there is inconsistency across the industry.

AMP's adviser qualification standards are far in excess of the prescribed minimum standards. To achieve this, AMP has established its own dedicated training academy for developing highly competent financial advisers.

In addition to RG146, AMP advisers are required to complete additional accreditation programs and meet rigorously applied continuing education standards. New planners are closely monitored and mentored and all their advice is vetted until they can demonstrate competency. Their competencies are regularly reviewed and audited.

In addition, AMP has over 600 Certified Financial Planner (CFP) qualified advisers, more than twice the number of any other licensee in the industry and represents 40% of total AMP advisers. The CFP qualification is an internationally recognised professional qualification which now requires an undergraduate degree as entry to the programme and typically takes a further 2-3 years to complete.

Recommendation # 1

AMP recommends that any change to the advice framework continues to ensure that advice is accessible and affordable for middle income Australians

Recommendation # 2

AMP supports Governments efforts to improve financial literacy and encourages ASIC to work closely with the financial services industry to further develop financial literacy programs.

Recommendation # 3

AMP recommends that ASIC works with the financial advice industry to raise professional standards by strengthening the minimum experience and qualification standards for financial advisers.

3 Benefits of integrated organisations

It is important for the PJC to recognise that the company failures at the centre of this Inquiry were independent players in their respective parts of the financial services products and advice markets. Furthermore, advisers aligned to the large institutions have largely avoided the financial failures of the last 18 months.

AMP, like many others in the industry operates under an integrated structure, whereby the company owns the product manufacturer and also operates a distribution network.

AMP recognises that each business model, whether independent or integrated, presents its own advantages and disadvantages.

However, AMP believes that only an integrated structure provides consumers with a higher level of protection. This is because AMP stands behind its products and the advice provided by its advisers.

AMP considers that amongst the choices of business structure, an integrated model provides a higher level of security for consumers. This security primarily comes from:

a) Importance of brand and reputation
b) Scalability and consistency in procedures
c) Balance sheet strength
d) Adequacy of Professional Indemnity insurance

3.1 Importance of brand and reputation

AMP is the leading brand with Australian households with more than 160 years in the Australian life insurance and superannuation industry.

AMP has worked hard to build its reputation and protection of our brand is fundamental to the ongoing success of our business.

AMP believes that consumers want their relationship with their financial adviser to be backed by a company with a solid reputation that they can trust and rely on. They want to know that the company provides strong support to the adviser and that the company will stand by their advice.

AMP stands behind the products it builds and the advice delivered by its advisers.

In the event there are problems in the distribution of AMP products or advice through the AMP distribution network, the company has the financial strength and the will to move quickly to rectify the position.

3.2 Scalability and consistency in procedures

An integrated model provides significant advantages in relation to scalability and consistency in procedures.

Due to the scale of activity, a licensee in an integrated model needs to ensure it has robust and consistent procedures in place to maximise its effectiveness and efficiency, all the while ensuring compliance with licence obligations. Consistency in procedures, backed by strong monitoring and supervision practices, allows greater visibility of instances of non-compliance.

In order to achieve consistent outcomes for consumers, AMP has implemented a framework of standards and a code of conduct exists to ensure the delivery of quality advice. Advisers are bound to adhere to the supervisory framework set by the licensee.

In an integrated model, the robustness of this framework must be sufficient to protect not just consumers, but the reputation and brand of the organisation as a whole. As a result, the framework discourages advisers from acting inappropriately, in the knowledge that they will be found out by the licensee.

3.3 Balance Sheet Strength

Entities holding an Australian Financial Services Licence are required to meet mandated financial requirements, as well as have in place appropriate professional indemnity insurance cover. The financial requirements applicable for each type of entity are set out in Regulatory Guide 166 (RG 166), issued by ASIC. The requirements may include the need to maintain a defined level of:

- Net Tangible Assets or
- Surplus Liquid Funds or
- Adjusted Surplus Liquid Funds or
- Tier One Capital (as defined by APRA) or
- Lodge a security bond with ASIC.

However, for many licensees, their financial requirements merely translate into the requirement to maintain positive net assets and a liquidity measure of sufficient cash projections to cover 3 months of activities. There is no amount or percentage set by which assets must be in excess of liabilities. Security bonds required to be lodged with the regulator are generally minimal in value and do not reflect the extent of a licensees activities.

Whilst many licensees within an integrated organisation may not have heightened financial requirements, the organisation as a whole will generally demonstrate financial strength in excess of the minimum requirements.

AMP believes the existing financial requirements for Licensees should be increased to provide a greater level of consistency and thus certainty for both licensees and consumers.

If all licensed entities were required to maintain a minimum level of Net Tangible Assets, a greater level of security could be achieved for all consumers. Those licence holders that are authorised to conduct "higher risk" activities, such as Custodians, Market or Clearing participants, foreign exchange dealers or those transacting with clients as principal would still be subject to a higher level of financial requirement, as currently required by RG 166.

3.4 Adequacy of Professional Indemnity insurance

AFS Licensees are required to maintain an adequate level of Professional Indemnity (PI) insurance having regard to the nature of the licensee's business and its potential liability for compensation claims[3]. However, ASIC also recognises that having PI cover does not necessarily mean that compensation will be paid if a claim is made[4].

ASIC acknowledged at the time of releasing RG 126 (March 2008) that the PI insurance market in Australia was not fully mature, and hence the products available would not meet their ultimate goal of providing a "high standard of protection". The Insurance Council of Australia confirms that the level of coverage currently available from individual insurers can vary. Further, a "hardening insurance market, exacerbated by the global financial crisis, has negatively impacted the ability of insurers to underwrite higher risk activities"[5].

In some of the recent collapses, PI cover has shown to be inadequate in providing sufficient levels of compensation for affected clients. Unscrupulous licensees can avoid their responsibilities and the existing compensation model tends to punish those that comply with the regulations while also failing the consumer.

PI premiums have increased significantly over the last 12 months and restrictions tend to be increasing, rather than improving. If this trend continues smaller licensees may be forced to exit the industry. Whilst larger, vertically integrated organisations are more easily able to absorb increases or adverse changes in cover; this can lead to a need to reduce their offers, which ultimately will affect the choice for consumers.

In the event there were problems in the distribution of AMP products or advice through the AMP distribution network, the company has the financial strength and the will to move quickly to rectify the position.

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[3] ASIC Regulatory Guide 126 – Compensation and insurance arrangements for AFS Licensees, RG126.2
[4] ASIC Regulatory Guide 126 – Compensation and insurance arrangements for AFS Licensees, page 4,
[5] Information taken from the Insurance Council of Australia submission to the Parliamentary Joint Committee inquiry in Financial Products and Services in Australia, dated 6 July 2009.

3.5 Conflicts of interest

Conflicts of interest exist in any business model – the challenge is how these conflicts are identified and managed.

Systematic identification and careful management of conflicts of interest helps to ensure good outcomes for consumers. Strong management behaviour and a sound business model provide an enhanced level of protection for the consumer.

AMP believes that the vast majority of licensees have adequate arrangements in place to manage conflicts of interest. In AMP, for example, there are clearly communicated guidelines set out for Authorised Representatives in our Professional Standards Manual and adherence is regularly and closely monitored by dedicated personnel.

We do not believe that there is a systemic problem within the industry. However, some licensees have not met their obligations under the Corporations Act and this has been a major factor in many of the recent collapses. This is particularly the case for those business models where poor arrangements were in place to manage the inherent conflicts.

In essence, AMP believes that there should be an increase in targeted monitoring and supervision rather than more regulation.

Recommendation # 4

AMP recommends that the PJC recognises the benefits that an integrated structure provides within the financial services industry, particularly in relation to consumer protection.

Recommendation # 5

AMP recommends that minimum Net Tangible Asset requirements be examined for all Australian Financial Services Licence holders.

Recommendation # 6

AMP recommends that an appropriately resourced ASIC adopt a risk based approach to monitoring and supervision to more effectively monitor and assess management of conflicts by Licensees.

4 Regulation

Over the past decade the financial services industry has been subject to many and varied new regulations. Many of these stemmed from the Financial Services Reform ('FSR') Act, and were aimed at improved consumer protection.

Unfortunately increased regulation has not protected those clients/investors who have lost their life savings.

It follows, then, that more regulation is not necessarily the answer to the question "How should regulation be reformed such that disasters like Storm Financial are not repeated?"

4.1 Consequences of more regulation

More regulation, though well intentioned, does not always achieve its desired results. Rather, it is more productive to think in terms of how the existing regulation could be more stringently applied and appropriately supported (through risk-based monitoring and supervision by regulators) to provide better outcomes for consumers.

We must also question to what extent regulation can overcome poor management behaviour? In legislating for the minority, regulators and governments run the risk of condemning the broader industry, along with any value to end consumers.

There are several predictable consequences of more regulation including an increase in costs for those who comply.

A key example is the disclosure obligations imposed on financial advisers flowing from FSR. The legislation resulted in a large increase in the volume of paperwork provided to consumers, with its associated costs, which are necessarily passed on to the consumer.

In light of the recent collapses it is reasonable of the Inquiry to question the effectiveness of the additional disclosure requirements. However, the PJC needs to critically evaluate whether additional or new regulation can deliver a better outcome or prevent future consumers from being 'sold' inappropriate investment strategies.

There is also the problem of unintended (and unforseen) consequences that often arise from higher levels of regulation. By its nature it is not always possible to exhaustively consider all outcomes that will arise when regulation is changed, which again should counsel the need for a cautious approach in advocating new regulation.

Accordingly, AMP would caution the Committee to carefully consider potential unintended consequences of any recommendations it makes.

4.2 Licensing Standards

In light of the recent corporate collapses, AMP believes the licensing standards need to be strengthened.

In their submission to this inquiry in June, ASIC acknowledged that licensing only ensures that applicants meet the minimum standards required by the Corporations Act.

AMP believes that the licensing application process should enable the regulator to remove unscrupulous operators (with appropriate rights of appeal) and ensure that licensees are and remain appropriately resourced and competent to provide the products and services they are seeking a licence for.

Recommendation # 7

AMP recommends that any proposed changes to regulation be approached cautiously, specifically recognising the possibility of unintended consequences and additional costs to the industry, and ultimately, to consumers.

Recommendation #8

AMP recommends that ASIC works with the industry to strengthen the requirements to obtain an AFSL and that licensees are appropriately resourced and competent to provide financial services and products.