Supplementary submission to the

Inquiry into Financial Products and Services in Australia

By

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It has been licensed since 1995 and has never received a complaint from a client.

The Financial Planner Registration Board

A discussion paper – July 2009

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Abstract
This paper expands upon the thoughts put forward in pages 23-25 of APT Strategy's submission to the Parliamentary Joint Committee on Corporations and Financial Services in respect of its "Inquiry into Financial Products and Services in Australia".

The full submission is available at:
http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sublist.htm

In particular, this paper puts forward initial thoughts in respect of the formation of a new entity that would be responsible for:

- setting standards for financial planners;
- registering financial planners; and
- de-registering financial planners.

It explores a range of issues including who might control this entity and how it might operate.

Introduction

It seems evident that the existing AFS licensing system works contrary to the interests of consumers as it has fostered the growth of franchise-like operations in which any AFS Licensee can expand rapidly by recruiting Auth Reps that have minimal training (RG 146) and experience. In theory, this system could work well if all AFS Licensees properly trained and supervised their Auth Reps. However, this does not always occur.

The AFS licensing system also adds unnecessary costs for consumers. This cost is indicated by the profit which is extracted from the industry by aggregators. If the licensing system were different perhaps the economies of scale would be different and the industry/profession would restructure to provide a more cost-efficient service to consumers.

Imagine moving away from the "one size fits all" current licensing system and adding a second the possibility of suitably trained and experienced people to be registered as financial planners. The people would be known as Registered Financial Planners and they would not need to work under an AFS Licence because they would not need to be trained or supervised by an AFS Licensee.

A new entity – The Financial Planner Registration Board

Imagine a new entity called the Financial Planner Registration Board (the Board) which would be responsible for registering financial planners. In order to be registered a person would need to satisfy registration criteria that would be determined by the Board. For example, a person with a Diploma of Financial Planning or CFP + degree + 5 years experience might satisfy the criteria, but a person who had only a year of experience or who merely satisfied RG 146 would not satisfy the criteria.

The immediate outcome of this would be that anyone who was registered would be able to call themselves a Registered Financial Planner. This would enable them to differentiate themselves form all the other people who call themselves financial planners. It would also allow consumers to differentiate between the registered and unregistered financial planners. It would segment the market for advice.

Progressively the two segments would develop a track record. If the track record of the Registered Financial Planners was sufficiently good perhaps legislation would be amended such that Registered Financial Planners did not need to operate under an AFS Licence.

Control of the Financial Planner Registration Board

There are various existing entities that may claim they ought to take on the role of the Board, but they carry baggage.

Imagine a Board consisting of say:

- 5 registered financial planners
- 1 Australian Accounting Standards Board representative
- 2 Government representatives (with the power of veto)
- 2 consumer representatives (with the power of veto)

Such a mix of representatives and veto power would seem to balance the need of all stakeholders.

- Enough financial planners to provide a good depth of knowledge, experience, and range of opinion.
- Enough government representatives and consumer representative to ensure that consumer interests were well represented.

- Power of veto to ensure that while Financial Planners might dominate in numbers they would not be able to dominate the voting. Thus, the professional body could be largely run by financial planners subject to the supervision and agreement of other stakeholders.

Operation of the Financial Planner Registration Board

The Board could operate in either of two ways.

1. It could employ a team of people who would most likely lack the expertise of Registered Financial Planners.
2. It could oversee a system in which its Registered Financial Planners would be judged by their peers.

The first would involve a hierarchy of staff and would be expensive.

The second needs a little imagination.

- Imagine first that a Board has been created and that this Board has set criteria that people must meet before they may be Registered Financial Planners.
- Progressively the Board could create committees to perform various tasks such as recommending standards of conduct, reviewing criteria for Registration, etc. The Board would then have power to accept, reject, or amend any recommendations.
- As the number Registered Financial Planners increases it would probably be valuable to assign Registered Financial Planners to groups of say 250 with each group being able to elect its own committee. The committees of each group of Registered Financial Planners could play a very significant role by communicating with its Registered Financial Planners and by communicating with other committees. The existence of a number of groups would assist in identifying differences of opinion and resolving such differences. The committees could also play a role in the registration process and de-registration process. Perhaps, each group could elect a representative and these representatives would form a Council that would liaise directly with the Board.
- Obviously there would need to be checks and balances, but if systems are designed to be transparent there is little scope for wrongdoing. For example, imagine that in order to be registered a person needs to be recommended by two Registered Financial Planners or two Board members and that no one is permitted to recommend more than five people. Also, imagine the database of Registered Financial Planners is a public document that can be accessed via the web and that this database includes details of qualifications, experience, memberships, and who recommended the person. With a little bit of thought the system could be self-regulating. The integrity of a few could be sufficient to ensure the integrity of the whole.
- Controls would need to be in place to ensure that this board was not influenced unduly by parties which have a poor knowledge of financial planning or which may not have the interest of consumers at heart. Such parties would include product manufacturers who are interested in sales and solicitors and compliance experts who often seem more interested in compliance systems than investment. Controls would need to be in place to ensure the board is not be led away from doing what it can to ensure that good advice is provided fairly to consumers. One such control would be to restrict Board membership to those who are not associated with any product distributor or manufacturer.
- Progressively the issue of standards would need to be discussed. This would probably best be done by focusing on what is bad advice rather than what is good advice. This is for the following reasons. Firstly, it would be very hard to get agreement on what is good advice as there are various schools of thought. Trying to define good advice would most likely lead to disharmony and motherhood statements. Secondly, even if we were able to define good advice we would then have the difficulty of determining how far a person would have to deviate from providing good advice before they would be deregistered or counseled. Thirdly, getting agreement on bad advice would be

relatively easy. For example, there would be widespread agreement that heavy exposure to gearing and certain types of investments is generally bad advice. Such agreement could lead to the evolution of standards. Some of these standards could be quantified. If standards were quantified the standard must be set very carefully. It would need to be suitable for most circumstances, but there must also be provision for special circumstances. To cater for special circumstances I suggest the Registered Financial Planner could breach the standards if they prepared a Breach Report which outlined the circumstances of the breach. This report would be on the database for all to see and the Group Committee would be alerted to the breach as would the Board (or perhaps a subcommittee of the Board). This would allow Registered Financial Planner to continue to use discretion, but would alert their peers to breaches. The standards while originating with Registered Financial Planner would need to be approved by the Board and would be subject to ongoing review and amendment.

- Breaches of standards could lead to many actions including informal counseling by peers, discussion amongst Registered Financial Planners, deregistration of the financial planner by the Board. There are many mechanisms that could evolve for discussion of standards, conduct of Registered Financial Planners, deregistration, etc.

Compensation scheme

A possible role of the Financial Planner Registration Board would be to create a compensation scheme for consumers. For example, imagine that in addition to meeting existing PI insurance requirements each Registered Financial Planner was required to contribute to a compensation scheme in two ways:

- Depositing say $10,000 with the compensation scheme on the understanding that in the event of a consumer being unable to obtain compensation as a result of the bankruptcy of a Registered Financial Planner, inadequate PI cover, or other reason the fund would pay the compensation. Any money not paid to consumers would be returned to the Registered Financial Planner upon their resignation as a Registered Financial Planner.
- Sharing in the cost of an insurance policy to cover all Registered Financial Planners compensation claims that could not be met by either their own PI, their own resources, or by the above mentioned fund.

The existence of such a compensation scheme would not only reassure stakeholders, but it would provide a meaningful incentive for all Registered Financial Planner to keep watch over one another. This incentive could be increased if compensation payments by the fund were taken in the following order: The first $10k would come from the account of the relevant Registered Financial Planner. The next $20k would come from the 2 people who recommended the person. The next money would come from the accounts of everyone in the same group and only if there was insufficient money in the accounts of the group would other groups be called upon to contribute. Localize the pain to increase the incentive.

Limits to the role of the Financial Planner Registration Board

The role of the Board needs to be limited to prevent empire building.

- It should not provide services to Registered Financial Planners as this would lean it towards being a commercial organization with its own conflicts of interests.
- It should not be involved in lobbying.

Benefits of such a Financial Planner Registration Board

A major advantage of forming a Financial Planner Registration Board would be that becoming a registered Financial Planner would be a big deal. Being deregistered would be an even bigger deal. This would provide huge incentive for registered Financial Planners to act responsibly. By contrast, today there are many people who call themselves financial planners who have made minimal investment in their career and who have little to lose.

It would also make it harder for shonky AFS Licensees to exist as the shonks would be unlikely to be able to attract registered Financial Planners to work for them and their representatives would lack the credibility of the representatives of major institutions.

By making it harder for shonky AFS Licensees to exist we could make it hard for shonky products to exist because there would be no one to market them. This would surely cut the number of complaints and PI may be perfectly adequate to meet compensation claims.