



The Institute of Public Accountants

## **Scrutiny of Financial Advice**

**5 December 2014**



**IPA** INSTITUTE OF PUBLIC  
ACCOUNTANTS

*Partnership beyond numbers*

## Introduction

Committee Secretary  
Senate Economics References Committee  
PO Box 610  
Parliament House  
**CANBERRA ACT 2600**

Email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

The Institute of Public Accountants ('the Institute') welcomes the opportunity to provide input into the Senate Economics References Committee's review of the financial advice 'industry' and looks forward to working with the Government as it establishes appropriate reforms that will shape it into a 'profession' in the near future.

The Institute is one of the three professional accounting bodies in Australia, representing over 26,000 accountants, financial advisers, academics and students throughout Australia and in 57 countries worldwide. The Institute prides itself in not only representing the interests of its accountants and financial advisers but also small business, its owners, employees and their advisers.

Accordingly, this submission has been prepared in the context of the Institute's ongoing advocacy on behalf of the various stakeholders within Australia's small business community and provides direct responses to the range of consultation questions contained within Committee's terms of reference.

Only one in five Australians currently receive financial advice. With a looming storm hovering over the global economy, it is imperative that reforms are put in place to raise the professional, educational and ethical standards of financial advisers to encourage more individuals to participate.

Whilst the Institute has always advocated for financial advice to be accessible and affordable, there must also be an assurance that this advice is professional and of the utmost, highest ethical standard. We applaud the Senate Committee for initiating this review to assist in developing policies which will ensure that consumers and their families are not only protected but will also benefit from the provision of quality advice in the future.

Action to enhance the protection of consumers should be directed at reducing the incidence of licensee misconduct that causes loss or damage to the consumers of financial services. Accordingly, the Institute encourages a 'prevention' approach to any proposed reforms to reduce such misconduct including the raising of current minimum levels of adviser education, a co-regulatory model between professional bodies and regulators as well as stronger sanctions placed on those not licensed and other gatekeepers who may be responsible for the cause of loss. We also encourage the acceleration of financial literacy of consumers. The Institute recommends the strengthening of current compensation requirements and also argues for a more comprehensive statutory compensation scheme of last resort to provide a safety net in circumstances of fraud and insolvency.

We welcome the opportunity to discuss our recommendations in more detail with the Senate Economics References Committee. Please address all further enquires to our General Manager – Technical Policy, Tony Greco [tony.greco@publicaccountants.org.au](mailto:tony.greco@publicaccountants.org.au) or (03) 8665 3134.

Yours faithfully



Andrew Conway FIPA  
Chief Executive Officer, Institute of Public Accountants

### COPYRIGHT

© Institute of Public Accountants (ABN 81 004 130 643) 2014. All rights reserved. Save and except for third party content, all content in these materials is owned or licensed by the Institute of Public Accountants (ABN 81 004 130 643).

## Table of Contents

Introduction .....	2
Table of Contents .....	3
1.0 The current level of consumer protections .....	4
2.0 The role of, and oversight by, regulatory agencies .....	6
3.0 Appropriateness of existing mechanisms.....	7
4.0 Mechanisms assisting with transparency .....	7
5.0 Misconduct responses by financial services participants.....	7
6.0 Other reforms to prevent misconduct.....	8
7.0 Related matters .....	8
Contact .....	9

## 1.0 The current level of consumer protections

It is the view of the Institute that consumers of financial advice currently receive protection and certainty never seen before in this country. The introduction of the Future of Financial Advice (FoFA) reforms have helped consumers more easily understand what advice they are getting, who they are getting it from, how much they will pay and how they will pay for it.<sup>1</sup> In addition to the best interest and the opt-in provisions, banning conflicted remuneration structures has served to build consumer trust and confidence in financial planners, placing the focus on advice, not the product. Accordingly, retail consumers of financial advice in Australia currently receive a comprehensive range of protection measures in a relatively well-developed system of regulation within the financial services industry. These include:

- a. Receiving advice from financial advisers that are required to either hold an Australian Financial Services licence (AFSL) issued by the Australian Securities & Investments Commission (ASIC) or be an authorised representative of an AFSL holder;
- b. An array of enforceable legal obligations and rights placed upon financial advisers;
- c. Relatively well-resourced and empowered regulators in ASIC and the Australian Prudential Regulation Authority (APRA);
- d. Financial advisers who are members of professional bodies are required to comply with their respective codes (or standards) of professional and ethical practice;
- e. The best interests duty and related obligations within Division 2 of Part 7.7A of the *Corporations Act* that were introduced under the FoFA reforms, effective 1 July 2013, such as acting in the best interests of clients (s961B); the provision of appropriate advice (s961G); warnings if advice is based on incomplete or inaccurate information (s961H); and the prioritising of client's interests (s961J and s961L);
- f. AFSL holders need to meet certain financial requirements depending on the financial services and products offered (Regulatory Guide 166);
- g. The opportunity for whistleblowers to report misconduct or dishonest or illegal activity that has occurred within their respective financial service provider to ASIC;
- h. Advisers having adequate compensation and dispute resolution arrangements in place (RG 104);
- i. Advisers holding 'adequate' professional indemnity insurance which covers all the financial services in all the financial products that they provide under their AFSL (RG 126). This cover assists licensees meet claims by clients and reduce the risk that retail compensation claims will not be met due to a lack of financial resources;
- j. Advisers having in place both internal and external dispute resolution (EDR) procedures, including membership of an EDR scheme, such as the Financial Ombudsman Service (FOS), that is approved by ASIC for that purpose and is able to hear complaints relating to the types of financial services provided (RG 165);
- k. In addition to an EDR scheme, consumers who suffer loss or damage by reason of misconduct can pursue claims through the court system; and

---

<sup>1</sup> Subsequent to the announcement of the Inquiry's terms of reference in September, the Institute notes that the proposed changes to the Future of Financial Advice (FoFA) were rejected by the Senate on 19 November 2014. Accordingly, our submission is based on the financial advice reforms which commenced on 1 July 2013.



- I. Various schemes of last resort that are already in place in some areas of the financial sector such as the National Guarantee Fund (NGF), the Financial Claims Scheme (FCS) and Part 23 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

However, the Institute believes that there are certain areas within the financial services industry where consumer protection is considered to be inadequate and could be improved, particularly with respect to the following situations:

- a. Retail clients receiving advice from those who do not hold an AFSL or are not an authorised representative of an AFSL holder. In particular, the Institute is concerned with the various stakeholders within the property industry and their perceived growing influence on individuals establishing self-managed superannuation funds (SMSFs). The Institute recommends greater powers for ASIC to act against such operators;
- b. Retail clients receiving advice from those who do hold an AFSL, but operate beyond the scope of that licence and accordingly have limited or no compensation arrangements in place. Whilst the Institute acknowledges the difficulties in identifying such 'outlaw' activity, we emphasise the importance of a concerted enforcement effort by ASIC to police the boundaries of licensed financial service activities;
- c. The minimum level of education standards required to hold an AFSL or be an authorised representative of an AFSL (RG146). The Institute is of the view that the current Tier 1 requirements, which are broadly equivalent to the AQF 5 Diploma level, are not appropriate for participants in the industry. It is generally this category of advisers who are also not members of any recognised professional body and hence not accountable to any professional or ethical standards. The Institute recommends that in order for the industry to truly be in the position to label itself as a profession then it must raise the current minimum education standards to the AQF 7 Bachelor Degree level, akin to other professions such as law and accounting. The Institute would also encourage specific training of financial advisers on ethical practice as well as membership with an approved professional body, as determined by the Professional Services Council;
- d. Instances where there is a collapse of a financial services provider results in large-scale consumer losses and that consumers who invest directly with the provider in question (that is, they do not have potential recourse via other licensees), may have no access to compensation beyond rights as unsecured creditors in the insolvency of the provider. The Institute recommends that there should be some consideration to protect retail clients with a more comprehensive statutory compensation scheme of last resort to provide a safety net in circumstances where the financial services provider becomes insolvent or is otherwise unable to meet outstanding claims for compensation. Ideally any last resort scheme should be integrated as far as possible with the existing schemes of last resort, namely the NDF, the FCS and Part 23 of the *SIS Act*;
- e. Defence costs coming out of professional indemnity insurance cover. The Institute is concerned where there are instances of professional indemnity insurance policies being substantially drawn down to meet an insured's defence costs, leaving retail clients with no real recourse against the financial services provider. The Institute acknowledges that increase costs may restrict the affordability and accessibility of advice for consumers but, notwithstanding, recommends that consideration should be made for placing the onus on financial planning providers to demonstrate the 'adequacy' of their professional indemnity insurance with ASIC;
- f. Whistleblowers do not appear to have adequate protection in Australia with the perception that they are being left out to dry. The Institute recommends stronger whistleblower protections than are currently available to encourage those individuals within the financial planning industry to report

misconduct or dishonest or illegal activity that has occurred without fear of breaches of confidentiality nor subsequent litigation and victimisation;

- g. Part 23 of the *SIS Act* only enables the trustee/s of APRA-regulated superannuation funds to apply to the Minister for a grant of financial assistance where the fund has suffered loss as a result of fraudulent conduct or theft. As identified in the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the collapse of Trio Capital, this provision does not extend to trustees of SMSFs, the biggest and fastest growing segment of the superannuation industry today. In such circumstances, SMSFs would need to establish that the licensee had engaged in dishonest conduct in breach of s1041G of the *Corporations Act*. The Institute recommends that this provision of the *SIS Act* be extended to SMSFs;
- h. EDR schemes, such as FOS, cannot deal with disputes where the value of the applicant's claim exceeds \$500,000 and can only award compensation up to \$280,000 for investment complaints (increasing to \$313,500 from 1 January 2015) and \$150,000 for insurance complaints. The Institute would encourage that the terms of reference for these EDR schemes be amended to increase these thresholds and reduce the potential gap between claim and monetary award. The Institute believes that such a measure would result in more disputes being referred to the EDR schemes and fewer to the courts given that it is a cheaper and quicker option for retail clients to pursue compensation.
- i. Consumers can be significantly restricted to access to full compensation for loss as the legal obligations and rights placed on product issuers are significantly 'under-weighted' compared to those placed on the licensed financial advice community, who as a result become the only source of compensation. The Institute recommends that the regulations should be reviewed to place greater accountability for the other gatekeepers in the value chain (such as product providers, directors and auditors) who are responsible for the cause of loss.

## 2.0 The role of, and oversight by, regulatory agencies

It is the view of the Institute that the regulatory agencies within the financial services industry take more of a 'reactive' rather than 'preventative' approach with respect to the provision of unethical and misleading financial advice. The current regulatory approach is, at best, 'light-handed' with relatively low thresholds with respect to licensing and a high dependency of self-assessment by licensees. The Institute notes that this approach may be the result of the regulatory agencies having responsibilities beyond the financial services sector with ASIC's main role being to oversee the *Corporations Act* to govern all corporations and auditors (both registered company and SMSF) as well as AFS licensees and their authorised representatives.

The Institute believes that the regulatory agencies should take a stronger, more proactive role to policing the financial services system to improve the prevention of the provision of unethical and misleading financial advice. However, this role should not be their sole domain but rather be shared, in a co-regulatory model capacity, between professional bodies within the industry, such as the IPA.

The Institute recommends that, in addition to satisfying higher educational standards, financial advisers should be required to become members of an approved professional body. In addition to the relevant regulations, these advisers will be subject and accountable to that particular body's professional and ethical standards with appropriate disciplinary action to be taken as required for actual or perceived misdemeanour. The Institute believes that the combination of legal requirements, licence conditions and professional obligations can, as a whole, improve overall consumer protection. This solution could free up regulators and focus their resources on the core consumer protection role of preventing and prosecuting matters in relation to dishonest and fraudulent conduct.

### 3.0 Appropriateness of existing mechanisms

It is the view of the Institute of Public Accountants that the current existing mechanisms are not appropriate for all compensation processes relating to unethical or misleading financial advice. Just like each Statement of Advice needs to be specifically tailored in accordance with the needs of the particular client, there is no 'one size fits all' solution with respect to the appropriateness of existing mechanisms.

As previously outlined in our response in section 1.0, the Institute has noted several instances where existing mechanisms have failed in the compensation process, particularly concerning fraud, insolvency and a statutory compensation scheme of last resort.

### 4.0 Mechanisms assisting with transparency

The Institute would encourage any mechanism that could ensure financial planners who have been found to have breached any law or professional standards in either their employment or in business are transparent, for both the sector and consumers.

The Institute, in particular, is fully supportive of a national, centralised register of AFSL holders and their authorised representatives and envisages that information disclosed would be of a similar nature to that required to be presented in a Financial Services Guide (FSG) including:

- a. the name of the financial adviser;
- b. their registration number;
- c. their contact details, including address;
- d. their status;
- e. their experience;
- f. their qualifications, including year/s of completion/s;
- g. any professional association memberships;
- h. the name and contact details of their licensee, including date of commencement as authorised representative;
- i. details, if any, of ownership of the AFSL;
- j. the name/s of any previous licensees, including periods as authorised representative;
- k. any business name that they may trade under;
- l. the name of the parent and ultimate parent companies (where applicable) of their AFSL;
- m. what product areas that the financial adviser can provide advice on;
- n. what product areas that the financial adviser cannot provide advice on;
- o. any associations or relationships with financial product issuers;
- p. information of external dispute resolution schemes to which the consumer would have access to;
- q. any bans, disqualifications or enforceable undertakings;
- r. any other breaches of relevant laws or professional standards.

The Institute notes that the current 'Banned and Disqualified Adviser' register currently available on the ASIC website should be incorporated within the existing 'Professional Register' to assist with the production of this centralised register.

### 5.0 Misconduct responses by financial services participants

The Institute has been somewhat dismayed and underwhelmed by the timeliness and follow-through of responses to date by the various providers and companies within the financial services industry with respect to misconduct. The recent negative media spotlight shone on the financial services industry has not only highlighted the extreme impact that poor advice has had on meeting the financial/retirement goals and objectives for retail clients, but sadly also the effect on their general well-being, health and

stress on family relationships. Additionally, we note that such negative publicity causes unnecessary reputational damage to those financial advisers who do act professionally and ethically.

Only a prolonged and concerted media effort, together with the actions of whistleblowers, forced the financial services participants to make statements to remedy the situation as well as prodding the regulators to investigate any potential misconduct that occurred more than five years ago.

Whilst the Institute applauded the initial announcements of the major financial planning organisations of their commitment to raise the educational standards to AQF 7 Bachelors Degree and AQF 9 Masters Degree levels, we were equally disappointed when recent refinements to these proposals reduced the self-imposed minimum to an AQF 6 Advanced Diploma level. Not only does this minimum level indicate a lack of academic rigour and volume of body of knowledge in advisers, it also generally precludes satisfying membership entry requirements into a professional body. If the industry participants truly want to be a profession, then it must appear, in every facet, to act professional. Backflips such as these do not assist the participants from restoring or rebuilding the public's trust in financial advice.

The Institute is concerned with that only one in five Australians currently receive financial advice, particularly in light of various bleak assessments of the global economy at present. Whilst the Institute has always advocated for financial advice to be accessible and affordable, there must also be an assurance that this advice is professional and of the utmost, highest ethical standard.

## 6.0 Other reforms to prevent misconduct

The Institute believes that there are a number of other regulatory or legislative reforms that could potentially prevent misconduct in the financial planning industry. Whilst the Institute believes most small businesses are being crippled with regulatory burden and red tape, this does not necessarily extend to the financial services industry given its current parlous state.

It is the view of the Institute that a 'prevention' approach is preferable rather than the 'cure' solutions that EDRs, courts, professional indemnity insurance and last resort schemes provide. Further to our responses earlier in this submission, the Institute would like to reiterate its stance that is a strong advocate for raising the minimum training standards of financial planners from the current requirements under RG146 to an AQF 7 Bachelors Degree level. The Institute would also encourage membership with an approved professional body, as determined by the Professional Services Council, and be subject to their respective professional and ethical codes of conduct, together with any appropriate disciplinary procedures as required for actual or perceived misdemeanours. An added benefit of professional membership is the requirement for financial advisers to satisfy continuing professional development (CPD) benchmarks by the respective bodies so that they maintain and enhance their level of knowledge and education on an ongoing basis.

Although we are cognisant that these reforms would not totally eradicate misconduct, they will undoubtedly have the ability to raise the professional, educational and ethical standards of the financial services industry as a whole. We see this as a by-product which will benefit all retail clients.

The Institute does believe that consumers of financial advice should not be absolved of all responsibility for their financial decisions and would also encourage the acceleration of ongoing efforts to improve the financial literacy of consumers. This will help better equip them to look out for their own interests and understand the risks in making investment decisions as well as utilising financial services.

## 7.0 Related matters

The Institute would like to thank the Senate Economics References Committee for allowing the opportunity to provide input into this Scrutiny of Financial Advice Inquiry. We would like to iterate the importance of this review being viewed in conjunction with the recommendations and outcomes of a number of other concurrent government inquiries and reviews of the industry, such as the Financial Systems Inquiry and the Parliamentary Joint Committee Inquiry into professional and ethical standards.

The Institutes believes that there is a great opportunity for the financial services 'industry' to become a 'profession' but it requires all stakeholders from government and regulatory agencies right through to



professional bodies and the financial advisers themselves to work together to achieve this goal which will ultimately benefit, rather than merely protect, the consumers of such financial advice.

## Contact

### IPA Head Office

**Level 6, 555 Lonsdale Street  
Melbourne Victoria 3000  
Australia**

**Tel:** 61 3 8665 3100

**Fax:** 61 3 8665 3130

**Email:** [headoffice@publicaccountants.org.au](mailto:headoffice@publicaccountants.org.au)

**Website:** [www.publicaccountants.org.au](http://www.publicaccountants.org.au)

IPA Divisional Offices are located in the following cities:

Melbourne  
Sydney  
Brisbane  
Adelaide  
Hobart  
Perth  
Canberra

The IPA has secretariats in:

Kuala Lumpur  
Beijing

For enquiries within Australia call **1800 625 625** or your nearest Divisional Office. International enquiries can be directed in the first instance to IPA Head Office.