

Submission to the Financial System
Inquiry

Financial Planning Association of
Australia Limited

September 1996

The Financial Planning Association

Established in January 1992 the Financial Planning Association (FPA) is the national industry body representing professionals in the financial services industry who specialise in financial planning advice.

The FPA now has 6,700 individual members and 350 licensed principal advisory organisations, representing approximately 70% of the financial planning industry. FPA Members serve over 2 million Australians as clients and are responsible for personal investment portfolios of \$76 Billion.

It is actively engaged in the development and enforcement of high standards of professional conduct for its members; professional development and continuing education for the financial planning industry; improving understanding by Australians of the benefits of long term savings; and the promotion of financial planning as an effective way for Australians to make better informed decisions in an uncertain world.

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1 Executive Summary

Enormous growth in the financial services markets in the last decade, coupled with continuing and increasing change, means that weaknesses are becoming evident in the current regulatory process. The present regulatory system suffers from significant ambiguity, duplication, unnecessary cost and inflexibility to cope with the changing environment. Without fundamental changes in the regulatory system, these problems are likely to increase rapidly in the future.

The Financial Planning Association (FPA) proposes a single integrated system of functional regulation of all activities within the financial system, including the important area of financial advice.

Financial planners and advisers play a pivotal role in helping Australians protect and increase savings, through their specialised knowledge and understanding of the structure of markets and investment opportunities, as well as individual investor needs. Financial advice should be recognised as a key function within the financial system and its regulation fully integrated.

The FPA submission explains in detail the reasons for, and benefits of, the recommended approach.

The main recommendations are:

- ◇ Single Integrated Regulator structured on function
- ◇ Universal Advice Regulation
- ◇ Enhanced Industry Role in Regulation
- ◇ Law covering broad principles of Regulation
- ◇ Greater use of Disclosure
- ◇ Adequate Investor Protection

Section 1.3 of this report, “Key Recommendations”, gives a short description for each of these recommendations, and signposts other sections of the Report for further information.

Included in these recommendations are licensing of principal advisory organisations, primary client duty for all advisers, and facilitating the progress of electronic commerce.

1.1 Regulatory Needs

From many perspectives - and particularly from that of a consumer - the traditional roles of institutions such as banks and life companies have become increasingly blurred. Many of the products and services traditional and newer financial institutions provide have also become similar.

In an increasingly complex and confusing financial environment, personal financial advice has emerged as a critical function. Its purpose is to help investors clearly identify choices and to make decisions on how best to access the financial system to fulfil their financial and lifestyle objectives.

Financial advice is the only function in the financial services industry aimed solely at helping Australians make informed decisions about how to best access the financial system, and its myriad of products, to meet their individual financial needs and objectives.

The current system of financial regulation is founded on traditional institutional boundaries which today have little relevance. It suffers from significant ambiguity and duplication. This, combined with increasing costs of regulation, results in an inefficient allocation of resources within the financial system and the economy as a whole.

It is logical that there should be a single Financial Markets Regulator responsible for all financial system regulation - fund raising by all financial institutions, corporate governance, markets, market intermediaries, and financial advice.

Regulation of the financial system should therefore be within a single framework and should be "functionally" not institutionally based. This single regulatory authority for financial system regulation is the key to regulatory harmony and efficiency.

The role of financial advice, and its relationship to other functions within the overall financial system, should be explicitly recognised in the single framework and thus governed by a universal system of regulation.

The key objectives of financial system regulation should be market efficiency (competitive neutrality and cost efficiency), monitoring systemic risk, and adequate investor protection. Disclosure should play a much greater role in financial system regulation to assist Australians to make informed and responsible financial decisions.

The Central Bank should be responsible for monetary policy, oversight of the payments system and systemic risk management and the Australian Competition and Consumer Commission (ACCC) should remain responsible for competition, fair trading and systemic consumer protection issues.

1.2 Universal Advice Regulation

A single regulatory authority would enhance investor protection, overcome the increasing number of weaknesses in the present system, and give more flexibility at reduced cost.

It would eliminate duplication in the regulation of advice on life insurance products and securities, and capture other forms of advice, such as property investment advice, which are presently unregulated.

Under the recommended system all principal advisory organisations would be licensed and have a legal duty to act in the client's interests.

The regulatory authority would set minimum standards of core competence for advisers and more rigorous disclosure obligations. This system will produce a level playing field in the advice industry and a more consistent framework for investor protection. Weaknesses already universally recognised in the current system of regulation would thus be addressed by universal minimum standards of advice regulation.

A process would be established for industry bodies to increase their involvement in regulation, initially through establishment of criteria for formal recognition of industry bodies and, at a later stage, by delegation of certain regulatory functions by the government regulator.

The result will be a regulatory system which is more aware of industry issues and responsive to changes in the financial system and one which has broad acceptance within the industry and among consumer groups. It will also reduce bureaucratic cost, passing such cost to industry bodies and members.

1.3 Key Recommendations Summary

The FPA's submission includes the following key recommendations -

Functional Regulation.

There should be a single integrated system of functional regulation of all activities within the financial system, including financial advice. Refer Section 3 and Appendix 4.

Single Financial Markets Regulator.

A single Financial Markets Regulator should be established to harmonise existing regulatory systems and competing regulatory objectives, and be responsible for the regulation of fund raising institutions (prudential and disclosure), markets, market intermediaries, companies and financial advice. Refer Figure 1 overleaf, Section 5 and Appendix 4.

Universal Advice Regulation.

There should be a comprehensive system for the regulation of all forms of financial advice (across product areas) which licenses principal advisory organisations and imposes minimum standards of competence and conduct on advisers. Refer Section 6 and Appendix 5.

Enhanced Industry Role in Regulation.

There should be an enhanced role for industry in financial system regulation. Initially this will occur through formal consultation with industry bodies on the minimum standards set by government and, in the longer term, through the formal recognition of industry bodies and the delegation of certain regulatory functions under a co-regulatory model. Refer Section 7 and Appendix 5.

Principle Based Regulation.

The law should contain the broad principles of regulation so that it is capable of application in a range of circumstances and to a changing financial system. The law should not prescribe how compliance is to be achieved. Refer Section 6.3 and Appendix 5.

Disclosure.

There should be greater use of disclosure as means of regulating financial system activities - disclosure by financial institutions of their solvency, improved product disclosure and disclosure by advisers about the services they offer and the risks involved in investment. Greater reliance on disclosure will enhance consumer knowledge and understanding and

facilitate more informed decision making. Refer Section 6.4, Section 8 and Appendix 5.

Adequate Investor Protection.

There will be improved levels of investor protection through uniform minimum standards of regulation of financial advice, access to relevant and reliable product information to enable more informed decision making by Australians and access to low cost dispute resolution and redress mechanisms. Refer Section 4.3 and Appendix 4.

TREASURER

SINGLE FINANCIAL MARKETS REGULATOR

ACCC

Competition and Fair Trading

- Regulate **competition and fair trading** generally including-
- restrictive trade practices that lessen competition;
 - prices surveillance and monitoring;
 - systemic consumer protection issues (misleading and deceptive conduct).

Financial Advice Regulation

- Regulation of **financial advisers** including-
- licensing and entry/exit requirements
 - conduct and disclosure obligations
 - dispute resolution
 - sanctions for misconduct

Financial Markets Regulation

- Regulation of the formation and conduct of all **financial markets** (including securities, futures, foreign exchange etc) on and off exchange.
- Regulation of **financial market intermediaries** (eg traders and brokers) that deal on behalf of others -
 - conduct obligations (contract notes etc)
 - client disclosure requirements

Corporate Form & Governance

- Formation and governance of all **companies**
- Internal administration (eg annual meetings)
- External administration (eg insolvency)
- Title to and transfer of rights in securities
- Acquisition of securities (eg takeovers)

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2 The Importance of Advice in the Financial System

Since the early part of the century there have been significant changes in Australia's financial system. There has been enormous growth in the range of financial products and services available to consumers and in the complexity of those products. One of the features of the modern financial system is the blurring of the roles of traditional financial institutions, such as banks and life insurance offices, and the blurring in product distinctions, such as between life and non life investment products, and securities and futures.

With the increasing complexity of the financial system, the wide range of choices available and the role of compulsory savings, advice is playing an ever important role for consumers. Financial advisers provide far more than a product distribution system; advice provides a value added service by making the financial system more accessible to retail consumers and assisting them in making informed decisions about their financial future.

Advice is provided in relation to all activities within the financial system. These include funds intermediation, which is the role of financial institutions (banks, insurance companies, fund managers etc) in directing funds invested by consumers to capital formation by businesses. Advice is also important in relation to risk and liquidity management in the financial system, where financial institutions and investors access the financial markets for trading purposes.

Consumer demand for a more comprehensive and integrated approach to their financial needs and problems has led to the emergence of financial planning. Financial planning extends beyond product distribution, encompassing strategic advice on investment planning, risk management and insurance, salary packaging, superannuation, retirement and estate planning. Advisory services such as these play a key role in the financial system and contribute to its overall efficiency by -

- ◇ helping consumers to understand how the financial system works, the relationship between investment risk and return, and providing strategies for wealth creation and protection;
- ◇ enhancing the information provided by financial institutions on their products and assisting consumers to compare financial products and instruments;
- ◇ redressing the imbalance of information between consumers and financial institutions that offer products;

- ◇ enhancing transparency and competition between financial institutions offering similar products and services;
- ◇ facilitating the allocation of investor funds to more efficient and competitive financial institutions and markets;
- ◇ helping to sustain investor confidence in periods when the financial system is unstable;
- ◇ contributing to increased savings in the economy and in the transition to self funded retirement.

Deregulation has created a large number of investment alternatives and means of accessing them. The opportunities for individuals to improve their living standards by taking advantage of these investments has also been increased greatly. The economy as a whole will be better off if individuals take advantage of these opportunities and if an informed risk taking culture is fostered. Advice is a key part of fostering such a culture.

Without professional advice many consumers tend to rely on outdated notions of risk and security in the financial system and are likely to make less than optimal choices about how to invest their funds. Because of the important role that advice plays in the financial system it is essential that the regulation of financial advice forms an integral part of financial system regulation, and that its regulation is consistent across all forms of advice provided in the financial system.

Refer to Appendix 2, Advice & the Financial System, for further details.

3 Functional Not Institutional Regulation

The current system of financial regulation is founded on traditional institutional boundaries which have little relevance to today's financial system. It has produced varying regulatory requirements for similar functions within the financial system and multiple government regulators, with varying philosophies and cultures. This system encourages the maintenance of artificial institutional and product boundaries, reducing transparency for consumers making choices in the financial system and lessening competition between financial institutions.

This is especially so for the advisory industry where there are separate systems of regulation for advice on securities and life products. With the convergence of many products offered by financial institutions and of the advisory industry, many advisers are now subject to two sets of regulatory obligations and additional compliance costs. Sixty five per cent of financial planners who provide advice on securities also provide advice on life products. The different regulation of securities and life office investments provides the consumer with different standards of disclosure and therefore protection. However, the advice provided is functionally the same in both cases.

The present regulatory system discourages advisers from providing advice on a wider range of financial products, benefits providers of advice in unregulated areas, such as property investment, as well as creating confusion and uncertainty among consumers. This lessens the scope for competition among advisory organisations (and financial institutions on whose products they provide advice) and encourages an inefficient allocation of resources within the financial system and the economy as a whole.

The FPA believes that a new "functional" regulatory framework must be established for the financial system as a whole. The new framework should reflect a clear and consistent policy on financial system regulation and have a clear set of objectives. Regulation should be based on the functions within the financial system not upon the traditional financial institutions that operate in the financial system. The key objectives of financial system regulation should be market efficiency, monitoring systemic risk and adequate investor protection.

Under a functional system of regulation all financial institutions would be subject to minimum standards of prudential regulation according to the nature of the products they offer and consistent disclosure should apply to product offerings. Greater reliance would be placed on disclosure in prudential supervision and other aspects of regulation. The regulatory system would not seek to provide guarantees to consumers, but to assist consumers in making informed and responsible financial decisions.

Disclosure should play a much greater role in financial system regulation under a new regulatory framework in relation to all aspects of financial system regulation. Greater emphasis on disclosure will facilitate more informed decision making by consumers. Disclosure is preferable to other forms of regulation because it does not place operational restrictions on organisations and does not inhibit innovation and change in the financial system.

Refer to Appendix 3 and Appendix 4 for further details.

4 Objectives of Regulation

4.1 Competitive Neutrality

It is especially important that the regulatory system is competitively neutral as between organisations that perform similar functions in the financial system. If regulation creates a competitive advantage for some organisations over others, there will be an inefficient allocation of resources within the financial system.

Competitive neutrality is one of the strongest arguments in support of a system of “functional” regulation. A system of “functional” regulation ensures that the same regulatory requirements apply to similar functions in the financial system, whereas institutional regulation results in different regulatory requirements applying to organisations that carry out the same or similar functions in the market.

4.2 Cost Efficiency

To achieve efficiency in the financial system all regulatory arrangements must be justified in terms of their cost. If the costs of regulation become too great, fewer organisations will seek to participate in the system and consumers will have fewer choices in the financial system. Instead, they will put their funds into areas outside the financial system or invest overseas where the costs of investing are lower.

In assessing the appropriateness of regulatory instruments to be applied to certain financial system activities, there must be an assessment of both the costs and benefits of that regulation. This has not generally been done in the past. Excessive costs of regulation for certain financial products will price them out of the market and hence reduce the range of choices available to consumers.

4.3 Investor Protection

The regulatory system should aim to provide an adequate (but not excessive) level of investor protection. Regulation should not be aimed at protecting individuals from all kinds of losses and risk should be recognised as an integral and necessary part of the financial system. The regulatory system should encourage Australians to better understand the risks that accompany certain financial transactions and their implications, and to make informed decisions in light of their own circumstances. Financial advice plays an important role in more informed decision making.

Under a new regulatory framework improved investor protection will be achieved through

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- ◇ consistent minimum standards applying to financial system functions, with greater emphasis on clear and simple disclosure;
- ◇ increased knowledge by Australians about the financial system and the need to exercise reasonable care in financial decision making;
- ◇ access to effective and low cost dispute resolution and redress mechanisms outside the court system;
- ◇ effective enforcement of regulatory requirements through penalties and sanctions as a disincentive to serious misconduct.

The regulatory system should not seek to over protect investors against taking appropriate and informed risks. Australian investors must be made more aware of the fact that investment outcomes cannot always be guaranteed and that the taking of managed risks combined with asset diversification can greatly enhance investment performance. This education process will occur over time and will require a significant change in attitude and outlook by many Australians.

Regulation that seeks to protect investors from all risks restricts the way in which financial institutions and advisory organisations carry on their business, imposes additional costs of regulation on the financial system and reduces the efficiency of the system as a whole. A regulatory framework that facilitates an active and competitive advisory industry will assist consumers in making informed choices, which will have positive flow-on effects to other functions within the financial system.

Refer Appendix 4, A Framework for Financial System Regulation, for further details.

5 Single Financial Markets Regulator

The FPA proposes that a new Financial Markets Regulator be created with primary responsibility for financial system regulation. Alongside the Financial Markets Regulator, there would be a Central Bank, responsible for monetary policy, oversight of the payments system and systemic risk management. The ACCC as a separate third entity, would remain responsible for competition and fair trading policies, as well as for “systemic” consumer protection issues, but would not be generally involved in the regulation of misconduct in the financial services industry.

Figure 1 contains the FPA’s proposed new regulatory framework and the allocation of responsibilities amongst the regulatory authorities.

The Financial Markets Regulator would embody the new policy of regulation and have specialist expertise to understand the wide range of activities within the financial system. It should be recognised as a new body (not as an extension or adaptation of any existing regulatory authority) and should have a culture of its own. It should have a close working knowledge of the financial system and be located in the major financial centres (Sydney and Melbourne).

It is important that the main regulatory responsibilities are carried out by a single body because -

- ◇ the objectives of financial system regulation (and the costs and benefits of regulation) must be assessed by a single regulatory authority otherwise as different philosophies and cultures of multiple regulators emerge over time, there will be conflict in regulatory objectives and competition for jurisdiction;
- ◇ to make judgements about what is a reasonable level of consumer protection, a regulator must have knowledge about how the financial system works and also the interplay of all financial system functions (not only part of the financial system); and
- ◇ for regulation to be effective a single organisation must have responsibility for all aspects of a particular function within the financial system (eg the ability to achieve regulatory objectives will be diminished if the prudential regulation of fund raising institutions is separate from fund raising disclosure requirements).

Only such fundamental change to regulatory responsibilities will bring about the change necessary to create a competitive and efficient financial system in Australia. Efforts by existing regulators to harmonise or co-ordinate divergent regulatory policies have produced a series of compromises which have not dealt with the fundamental legislative gaps and inconsistencies that exist.

Enhancement of the role of the Council of Financial Supervisors would perpetuate the existing artificial distinctions between institutions and fail to address the fundamental problems that exist in the current system.

The creation of a single Financial Markets Regulator will not mean that expertise in particular areas is lost, nor that all financial products will be regulated in exactly the same way. Product and regulatory specialisations would be retained within the new Financial Markets Regulator, in the same way that existing regulatory bodies have specialist expertise in distinct areas of activity. Regulatory responsibilities will be managed according to the main functions within the financial system.

Refer Appendix 4, A Framework for Financial System Regulation, for further details.

6 A Universal System of Advice Regulation

The current fragmented system of advice regulation creates multiple and overlapping regulation for financial advice on life insurance products and securities, and leaves other forms of financial advice (such as property investment advice) unregulated. This is the result of linking the regulation of advice to specific products in the financial system.

Dual regulation of life insurance intermediaries and securities advisers discourages advisers from providing advice across a wider range products, thereby lessening competition between the major product groups in the financial system, and reduces market transparency. Dual regulation has also created significant and unnecessary cost for advisory organisations. FPA member compliance costs have nearly doubled since 1993, reaching an estimated \$40 million in 1996.

The framework for financial system regulation should explicitly recognise the role of financial advice and its relationship to other functions within the financial system. The broad principles that apply to regulation of the financial system as a whole should also apply to the regulation of financial advice. The adoption of a functional approach to regulation in the financial system necessitates the recognition of advice as a distinct and separate activity from other activities in the financial system.

6.1 Scope

There should be a universal system for the regulation of financial advice. For this purpose advice would include -

Any recommendation made personally to a consumer on which that consumer could reasonably be expected to act in relation to an investment or financial decision, including any recommendations relating to shares, debentures, collective investments, futures or options contracts, life insurance, superannuation, property or other financial instruments, transactions or investments.

Under this universal system of advice regulation, all forms of financial advice would be regulated including financial advice unrelated to products (eg strategic advice, asset allocation advice), as well as financial advice on investment and lending products not presently regulated (eg property investments and loans, bank deposits etc). A universal system of advice regulation will eliminate duplication in the regulation of advice on life insurance products and securities.

Under a universal system of advice regulation, all principal advisory organisations would

be licensed and the regulatory authority would set minimum standards of core competence and conduct after formal consultation with the industry. Such an approach would achieve a level playing field for all financial advisory principals, a more consistent investor protection framework and a more efficient allocation of resources within the financial system.

A critical factor is the recognition of separate requirements for the regulation of fundraising (financial institutions and product disclosure) from the regulation of financial advice. Under the FPA's proposed system, financial institutions that only provide information and explanations of the features of the products they offer will not be subject to additional advice regulation. However, product manufacturers providing consumers with financial advice must be licensed to give advice and must comply with the regulatory requirements that apply to principal advisory organisations, in addition to any obligations they have as financial institutions.

Table 1 provides a summary of the FPA's proposed system of advice regulation and the key requirements.

6.2 Minimum Standards

Under the FPA's model of advice regulation the government regulatory authority would, after formal consultation with the industry and other stakeholders, set minimum standards for all financial advice, including -

- ◇ entry requirements for *licensing* of principal advisory organisations;
- ◇ *core competency standards* for individual advisers and ongoing training requirements;
- ◇ *disclosure* of the nature of advisory services offered by a licensee, risk disclosure and warnings, disclosure of remuneration (costs and charges) and conflicts of interest;
- ◇ conduct obligations such as the obligation to give *appropriate advice*;
- ◇ *supervision* of representatives.

6.3 Principle Based Regulation

The current prescriptive approach adopted under the *Life Code of Practice* and also *ASC Practice Notes* places restricts the ways in which advisers can meet their obligations and imposes a “paper based” approach to compliance. This inhibits innovation in how advice is provided and the choices available to consumers particularly in the context of technological

advances .

One of the key themes in the FPA's approach to financial system regulation is that the law should contain only the broad principles of regulation not prescriptive requirements as to how those principles must be applied in practice. The reason for this approach is that broad legislative requirements are adaptable to market change and innovation, and capable of application to a wide variety of circumstances. A prescriptive approach restricts the market to a fixed set of operational procedures (which inhibits innovation and change); it can also facilitate avoidance of the intent of the law.

Over time regulation that embodies principles, such as the prohibition against misleading and deceptive conduct and the prospectus requirements in the *Corporations Law*, combined with active enforcement programs will be far more effective in achieving compliance.

6.4 Disclosure by Advisers

Under the FPA model of advice regulation greater emphasis will be placed on disclosure to consumers.

6.4.1 New Client Disclosure

All financial advisory organisations should be required to make general disclosures to prospective clients about the advisory services they offer; representatives of financial institutions should be required to make similar disclosures to consumers. Such disclosure would include -

- ◇ an explanation of the services offered and the modus operandi of the licensed advisory organisation;
- ◇ the remuneration for advisory services as well as all costs and charges;
- ◇ any general conflicts of interest of the advisory organisation (eg it is related to a product manufacturer);
- ◇ any limitations on the advice that is offered (ie it is only in a specialised area of financial advice);
- ◇ how client complaints are handled; and
- ◇ the industry body (if any) of which the advisory organisation is a member.

The law will contain only the broad principles of disclosure and should be sufficiently flexible to allow disclosure to prospective clients to be made electronically or in hard copy form; it should not prescribe in detail the form or content of the disclosure document. Minimum disclosure standards will be set by the government regulator in consultation with the industry.

6.4.2 Risk Disclosure and Warnings

Under the FPA's proposed model a new element of disclosure, relating to risk, would be introduced. This would require all advisers to disclose to clients, in simple and clear terms, the major risks associated with a particular recommendation.

This risk disclosure would encompass the investment risk associated with particular types of financial products, as well as the risk of an undiversified portfolio (eg all property) and the risk that a certain investment will not produce a sufficient return to meet the client's particular needs (eg all cash). It would also include warnings about the limitations of

advice provided where a full needs analysis has not been undertaken.

The aim of this new requirement would be to ensure that consumers better understand the role of investment risk in the financial system and the implications of their financial decisions. By providing consumers with a better basis for comparing investment products, it would also enhance competition amongst financial institutions and the products they offer, and improve market transparency.

The FPA believes that the individual and the economy as a whole will be better off by understanding and taking investment risk.

6.5 Licensing of Principal Advisory Organisations

Under the FPA's proposed model all financial advisory businesses should be licensed by the relevant government regulatory authority before entering the market. Carrying on a financial advice business without a licence would be an offence and there will be criminal penalties in the law. Licensing will be subject to an advisory organisation meeting appropriate minimum standards set by the government regulatory authority in consultation with industry, including personal competency standards for individual advisers.

Although retaining a system of licensing will create some barriers to entry, the FPA believes licensing is necessary because of the strong consumer and community expectations that providers of financial advice should be competent in their field. The FPA believes that establishing a universal system of advice regulation and imposing minimum standards through licensing, will produce a competitive and professional financial advice industry.

Licensed advisory organisations will be responsible for the conduct of their advisers (representatives) and will play an important role in implementing many of the minimum standards set under the new regulatory regime.

The FPA does not support the creation of separate categories of advice licence (eg a financial planning licence) because -

- ◇ there are not always clear distinctions between types of advisory services and accurate categories are difficult even for the market to determine;
- ◇ simplified labels (in the form of sub categories) are not always the best way to convey information to consumers about the services they are acquiring;
- ◇ the nature of services available in the market change over time and outdated categories become entrenched in legislation and are difficult to change.

Recognition of the types of advisory services will be achieved through disclosure by

advisers of the nature of advisory services available (refer 6.4.1 above) and also by increased promotion by industry bodies, like the FPA, of the nature and quality of services their members offer.

6.6 Personal Competency Standards for Advisers

All individuals who provide advice must either be licensed or be authorised by a licensed advisory organisations to give advice on behalf of the licensee (representative), similar to the current model under the *Corporations Law*. Licensees will only be able to appoint representatives who are competent to provide financial advisory services of the kind that the licensee provides and licensees must ensure that their representatives are at all times competent to perform the advice giving tasks required of them.

Minimum personal competency standards would be set by the government regulatory authority in consultation with industry bodies and enforceable under the law. There would be penalties for breach of this requirement and a due diligence defence available to advisory organisations that take reasonable steps to ensure their representatives are competent.

The FPA does not support the development of a government mandated, industry run registration board governing all individuals in the advisory industry (as was proposed by the life industry). Such a system would be cumbersome to administer and impose substantial costs on the industry which cannot be justified by the regulatory benefit, particularly when personal competency standards can be achieved by simpler and more effective means.

Under the FPA's model industry bodies will develop guidelines for their members on the procedures for assessment of personal competency standards, for the appointment of representatives and for their ongoing training requirements. The assessment of individual competence should be the responsibility of licensees and should be undertaken in accordance with the minimum standards under the law and the guidelines provided by industry bodies.

6.7 Adviser Client Duty

Under the FPA's universal model of advice regulation all advisory organisations (and the individuals that provide advice on their behalf) would have a legal duty to act in the interests of their client at all times when providing advice. This duty would apply even where product manufacturers and their representatives give advice.

This duty is consistent with the nature of the conduct and disclosure requirements applicable to all advisers and will distinguish advisers from product manufacturers and

salespeople. This approach addresses the potential conflict of interest that advisers face when giving advice as agents of product manufacturers. At present, despite their legal obligations to clients they retain a primary duty to their principal, the product manufacturer.

By imposing a primary duty to the client on financial advisory organisations and their representatives, investors will be better able to distinguish advisory services from other services in the financial market place (product manufacture and distribution) and more able to make informed decisions when facing choices in the financial system.

The complete FPA proposal for Universal Advice Regulation is explained in more detail in Appendix 5.

Table 1 A New Framework for Advice Regulation

STAGES	The Law	Government Regulator	Industry Body(ies)
STAGE 1 THE NEW SYSTEM	<ul style="list-style-type: none"> The law will prohibit organisations from carrying on a financial advice business without a licence. There will be penalties for unlicensed organisations providing advice. Definition of financial advice. Primary duty of advisers to their client. Principles of conduct relating to - <ul style="list-style-type: none"> disclosure (capacity, remuneration, risk, conflicts of interest) suitability of advice (know your client/know your product) Liability of organisations for acts of their representatives. 	<ul style="list-style-type: none"> Licensing of financial advisory principal organisations according to minimum entry standards. Set minimum competency standards for competencies for individuals. Set minimum standards of- <ul style="list-style-type: none"> disclosure; representative training and competency standards; supervision of representatives; dispute resolution procedures. 	<ul style="list-style-type: none"> Contribute through formal consultation in the development of minimum competency standards for the financial advisory industry. Contribute through formal consultation in the development of minimum conduct and disclosure standards for the financial advisory industry.
STAGE 2 RECOGNITION OF INDUSTRY BODIES	<ul style="list-style-type: none"> Penalties for non compliance with certain provisions and civil remedies for breach of legal requirements. Provide for the formal recognition of industry bodies as suitable to assume some regulatory responsibilities. 	<ul style="list-style-type: none"> Surveillance of advisory organisations for compliance with competency standards, conduct and disclosure standards (including supervision, training and other requirements). Enforcement and disciplinary powers including banning licensees and individuals within the industry. 	<ul style="list-style-type: none"> Industry bodies may provide independent dispute resolution for client complaints and grievances. Develop ethical standards, best practice guidelines for members and establish infrastructure necessary to become an approved industry body.
STAGE 3	<ul style="list-style-type: none"> Provide for the delegation of certain regulatory functions 	<ul style="list-style-type: none"> Develop assessment procedures and processes for the 	<ul style="list-style-type: none"> Develop the infrastructure and demonstrate

**DELEGATION OF
REGULATORY
FUNCTIONS**

to approved industry bodies subject to oversight.

delegation of regulatory functions and review the
performance of those functions by industry bodies.

the capability to undertake specific
regulatory functions.

7 Enhanced Industry Role in Regulation

The current regulatory system is largely Government driven with a limited consultative role for industry bodies depending upon the particular government regulator. Regulation that is solely government driven is generally less relevant to an industry context, less aware of the costs of regulation borne by industry and less responsive to industry changes and innovation.

The FPA believes that these are weaknesses in the current system of regulation which should be addressed by industry bodies playing a greater role in regulation and, ultimately, assuming some regulatory responsibilities. The rationale for practitioner based regulation is that it is more responsive to industry change, is able to tailor regulatory requirements to market circumstances and is more cost efficient. It also allows for the costs of regulation to be recovered on a “user pays” basis.

The FPA proposes a staged approach to greater industry involvement in regulation with the government regulator initially taking on primary responsibility for regulatory functions and setting minimum standards through a consultative process with industry. Industry bodies, such as the FPA, would continue to provide services for their members, and play an active role in the consultation process.

The first stage in more formal recognition of the role of industry bodies would be for the government regulator to establish suitability criteria and a process for approval of industry bodies that seek to take on specific regulatory functions. The next stage would be the identification of specific regulatory functions as suitable to delegate to an industry body, which would depend on the capabilities of individual industry bodies and their stage of development. Table 1 shows the stages involved in moving to a co-regulatory model.

Over time there would be a gradual devolution of many of the regulatory functions performed by government, such as assessment of licence applications and surveillance, to suitably qualified industry bodies. It is envisaged that under a co regulatory system, key registration and enforcement activities would always remain with the government regulator, as well as general oversight responsibilities in relation to approved industry bodies.

The FPA recognises that a substantial period of transition will be required to move from the current system to the FPA’s desired model of industry co-regulation and that greater industry involvement will be achieved incrementally rather than by a single process. A staged approach will facilitate the development of a workable regulatory system and one which has broad acceptance within the industry and among consumer groups.

Refer page Appendix 5, section 5 for further details.

8 Improved Product Disclosure

Much of the product disclosure that is currently available to investors is confusing. Many consumers suffer from “information overload” and cannot compare products on the basis of available information. There are differing disclosure standards for comparable products in the financial system and some products are not required to meet any disclosure standards. The regulatory system does not take account of the circumstances in which information is received nor the alternatives to direct product disclosure.

There should be consistent standards of disclosure for product offerings by all financial institutions whether they are deposit taking institutions, life insurance companies or fund managers. The application of consistent standards will ensure a level playing field among financial institutions, increase transparency in the market and improve investor understanding of the choices available in the market. Consistent disclosure standards across the financial system will result in a more efficient allocation of resources.

A general standard of disclosure should be applied to all product offerings based on the standard imposed by the *Corporations Law* and offering institutions should be accountable for the accuracy of this information. Product disclosure should be clear and simple so that investors can better understand and compare the choices that are available, and all product offerings should disclose investment. Institutions should be able to provide information on their products in a short format suitable to retail investors and more comprehensive disclosure according to the general standard should be available on request by investors.

9 Electronic Commerce

The current framework for financial system regulation does not adequately take account of developments in technology and electronic commerce. The legislative framework on which the regulatory system is based assumes a paper based environment and is not easily capable of adaptation to an electronic environment. Increasingly the industry is finding new and more efficient ways to deliver their services and convey information about products, and regulation often restricts or prevents implementation of these new systems.

Under a new regulatory framework there should be recognition of the variety of ways in which compliance can be achieved and legislation should not be tied to a “paper based” environment. This necessitates a “principle based” approach to regulation and means that regulators should not prescribe how compliance is to be achieved. There should also be explicit recognition of the ability of information to be conveyed electronically in a variety of formats, not simply as an electronic version of a written document.

Improvements in technology and electronic commerce have contributed to the globalisation of financial markets. The internet now provides a means of marketing financial services (products and advice) outside the Australian regulatory system. This creates competition between providers of financial services in the domestic market and offshore providers and presents opportunities for Australian consumers in terms of the choices available, but also poses a potential threat to the regulatory system.

It is important that the costs of regulation borne by Australian firms are comparable with international standards if Australian firms are to compete effectively in the international markets. If the costs of regulation in Australia are too high, or innovation by Australian firms is restricted by regulation, Australian firms will be at a competitive disadvantage.

Improvements in electronic commerce highlight the geographic boundaries of our current regulatory system which cannot prevent Australian consumers from accessing (or protect them from) unregulated products originating from other jurisdictions. These limitations should be addressed by increased consumer education of the risks associated with accessing financial services offshore (since they cannot be regulated) and also by continued efforts towards international harmonisation of regulatory requirements.

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