THE FUTURE OF FINANCIAL ADVICE REFORMS: RESTORING PUBLIC TRUST AND CONFIDENCE IN FINANCIAL ADVISERS – AN UNFINISHED PUZZLE

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I INTRODUCTION

In a media release on the Future of Financial Advice (FOFA) reforms, the assistant treasurer and minister for financial services and superannuation, Bill Shorten MP said

> [i]t is a concern that only one in five Australians access financial advice. These reforms will restore trust and confidence in the sector following collapses such as Storm, Westpoint and Trio. They also remove the red tape that has prevented low-cost, good quality advice being delivered to millions of Australians.[1]

In order to 'restore trust and confidence' in the financial services industry, the FOFA draft legislation proposes a 'best interest' obligation that requires financial advisers to give priority to client their interests when giving advice,[2] enhancements to the licensing and banning powers of ASIC,[3] changes to the charging of on-going fees with new disclosure and service renewal provisions,[4] and the banning of specific types of adviser remuneration structures.[5] However, this paper contends that further reforms will need to be implemented to properly restore public faith in the financial advice sector, because issues about adviser competence and professional standards that were raised in the Parliamentary Joint Committee *Inquiry into Financial Products and Services in Australia* (Ripoll Inquiry) have not been addressed in the FOFA bills.[6] Without taking a holistic approach to reforming the industry, which includes

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[1] Bill Shorten the Assistant Treasurer and Minister for Financial Services and Superannuation, 'Future of Financial Advice – Draft Legislation' (Media Release, no. 127, 29 August 2011) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/127.htm&pageID=003&min=brs&Year=&DocType=>.

[2] Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) cl 961C (1).

[3] See, eg, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) sch 1 items 2 – 8; Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) ch 3.

[4] Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) div 3.

[5] See, eg, Corporations Amendment (Further Future of Financial Advice) Bill 2011 (Cth); Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011 (Cth).

[6] The Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, *Inquiry into Financial Products and Services in Australia* (2009).

improving the minimum competency levels of the people who give financial advice, attempts to improve consumer confidence in the financial advisory industry will be significantly hindered.

This paper will provide a brief overview of the Ripoll Inquiry and key issues that were identified in the report. It will then outline the Ripoll Inquiry recommendations that have been implemented in the FOFA reforms, followed by important recommendations that have been omitted from the FOFA draft legislation, in particular, the failure to address issues regarding adviser competency, ethics training and continuing professional development. This issue is closely linked with concerns about the wide range of people who advertise themselves to be financial advisers and yet provide significantly differing services with varying levels of knowledge and skill.[7] This creates confusion about professionalism and the services provided by financial advice industry. It is therefore difficult for consumers to select an appropriate adviser who can provide services that meets their financial needs.[8] Furthermore, the FOFA reforms fail to address calls for the restriction of the use of the term 'financial adviser' and mandatory membership of advisers to a self-regulating body.[9] It will argue that these issues need to be addressed before progress can be made to restore consumer trust and confidence in the financial advice industry. This is because the recommendations outlined in the Ripoll Inquiry are not mutually exclusive and it cannot be reasonably expected that selective implementation of the inquiry recommendations will be effective. Finally it will look at evidence that indicates further industry reform and legislation is likely to be implemented to address the issues that were omitted from the FOFA draft legislation.

II THE JOINT PARLIAMENTARY COMMITTEE INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES

In 2009, the Parliamentary Joint Committee conducted an *Inquiry into Financial Products and Services in Australia* (Ripoll Inquiry) 'on the issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses.'[10] The committee identified 'two broad issues behind the debate on the regulation of financial products and services.'[11] The first is that the collapse of financial product and service providers Storm Financial and Opes Prime highlighted, inter alia, the existence of an advice-sales

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[7] See, eg, Ibid 90 [5.87]; BFPPG, Submission No 251, The Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia*, 2009, 21.
[8] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 90 [5.87]
[9] Financial Planners Association of Australia, *FPA Calls On Minister Shorten to Recognise Financial Planning Profession Under Law* (13 April 2011) Adviser Voice <http://www.adviservoice.com/2011/04/fpa-calls-on-minister-shorten-to-recognise-financial-planning-profession-under-law>.
[10] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 1.
[11] Ibid 69 [5.1].

conflict in the financial advice industry. This conflict can largely be attributed to 'the industry's historical beginnings, particularly the emergence of financial advisers as a sales force for product manufacturers, which is a legacy [that is] potentially inconsistent with contemporary expectations that financial advisers provide a professional service that meets their clients' best interests.'[12] The committee identified arguments[13] that 'the tension between the industry's dual sales and advice functions should be clearly resolved in favour of regulations that mandate a higher level of professionalism and better protect consumers from the negative consequences of conflicted advice.'[14]

This advice-sales conflict is addressed through a combination of several committee recommendations. The primary recommendations that, when implemented concurrently, result in priority being given to the provision of financial advice over any product sales motivations are recommendations one; 'that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own,'[15] and recommendation four; 'that the government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers.'[16]

The other broad issue is

> whether advice about financial products, or the financial products themselves, are responsible for poor investment outcomes. This question is important because the answer dictates whether the focus of regulation needs to be on improving the quality of financial advice, or identifying and restricting the sale of poor financial products.[17]

The committee came to the conclusion that it is the role of the financial advisers to prevent investment losses,[18] therefore, it is poor financial advice that is responsible for poor investment outcomes. The committee focused its recommendations primarily on regulatory issues concerned with the advice given about investment products.[19] A number of regulatory issues were raised,[20] including adviser competency under the current licensing system.[21] The committee found that '[t]he major criticism of the current system is that licensees' minimum training standards for advisers are too low, particularly given the complexity of many financial products.'[22]

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[12] Ibid 69 [5.1].
[13] Ibid 69 – 71 [5.6] – [5.10].
[14] Ibid 71 [5.11].
[15] Ibid 150.
[16] Ibid 150.
[17] Ibid 69 [5.2].
[18] Ibid, 73 [5.18].
[19] Ibid 72 [5.21].
[20] See Ibid [5.22] – [5.103].
[21] Ibid 87 [5.76] – [5.87].
[22] Ibid 87 [5.76].

The Institute of Chartered Accountants of Australia in its submission to the inquiry noted:

> Currently the education requirements introduced through FSR are at a minimum level and the training courses available range from a few days to completion of a post graduate diploma or under graduate degree. All of these course options meet the regulatory requirement of a financial planner becoming compliant with ASIC Regulatory Guide 146. Australians cannot have a professional relationship with an adviser when there is such disparity in the education levels of the advisers in the industry.[23]

A major problem resulting from low levels of competency is the correlation that exists with unethical conduct.[24] Argyle Lawyers asserted that

> ...the minimum competency levels that exist within ASIC Regulatory Guide 146 at the moment are completely inadequate to allow advisers, for example, to position themselves to deal with the complex ethical issues they face when giving advice, and the younger and more inexperienced they are the more likely they are to make the wrong decision and the more likely they are to be influenced by peers and superiors to take the wrong action.[25]

Several other submissions to the inquiry also support the notion that minimum competency requirements are too low,[26] including a claim by AXA that 'it was too easy for prospective licensees to demonstrate that they can meet their obligations, without having the skills or resources to actually do so.'[27]

Another issue associated with the low standards of competency is 'that the licensing system enabled too many people with minimum competency to use the term 'financial planner' in a way that is misleading to consumers.'[28] The Financial Planning Association of Australia suggested 'there are too many people out there holding themselves out to be financial planners when in fact they are not; they are doing a whole range of other things'.[29] This creates difficulties for clients to differentiate between quality financial advice given by properly trained financial planners and advice given by others whom only have knowledge of a specific type or class of product. This confusion results in some members of the public unknowingly obtaining poor advice from inadequately trained advisers, which conversely affects the public perception of the financial advisory profession. As noted by the Boutique Financial Planning Principals Group:

> The public can readily identify other professions: doctors, lawyers etc by their title.

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[23] ICAA, Submission No 363, The Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia*, 2009, 6.
[23] The Parliamentary Joint Committee on Corporations and Financial Services , above n 6, 90 [5.87].
[24] Argyle Lawyers, *Official Committee Hansard*, Melbourne, 26 August 2009, 108.
[25] Ibid.
[26] See The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 87 – 90.
[27] AXA, Submission No 385, The Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia*, 2009, 20.
[28] Ibid 89 [5.84].
[29] FPA, *Official Committee Hansard*, Canberra, 28 August 2009, 34.

> There are, however, thousands of individuals holding themselves out to be financial planners who meet the barest minimum training or ethical requirements. In most cases these people are associated with single product areas of advice or advice that is focussed strongly into one type of asset class or investment type. There are real estate agents who call themselves financial planners so that they can offer advice on the investment of excess funds after the purchase or sale of a property. There are property developers who call themselves financial planners so that they can package the sale of their property development into superannuation funds.[30]

The committee acknowledged

> legitimate concerns about the varying competence of a broad range of people able to operate under the same 'financial adviser' or 'financial planner' banner. The licensing system does not currently provide a distinction between advisers on the basis of their qualifications, which is unhelpful for consumers when choosing a financial adviser.[31]

It took the view that the most effective way to address these issues and to increase professionalism and transparency in the industry is through the use of a professional standards board. As a result, the key recommendation that addresses the aforementioned issues was recommendation nine, which requires

> ASIC [to] immediately begin consultation with the financial services industry on the establishment of an independent, industry-based professional standards board to oversee nomenclature, and competency and conduct standards for financial advisers.[32]

Furthermore, the Financial Planning Association of Australia has made several submissions to define the term 'financial planner' and 'financial adviser' in the *Corporations Act 2001*(Cth).[33] This would attempt to remove the ambiguity associated with whom may advertise themselves as financial advisers and also raise the minimum standards of those who wish to continue to identify themselves with the profession.

Trust and confidence in a professional industry is built upon the belief that the professionals working in that industry have special training and knowledge, high standards of accountability and a belief that advice given is in the best interest of the client seeking expert knowledge. Without adequate training and specialist knowledge, it is difficult to see how any of the previously mentioned factors can be fulfilled, as good advice cannot be given by an adviser whom has not been properly trained and lacks specialist knowledge. In order to restore trust and confidence in the financial advice industry, these issues must be addressed.

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[30] BFPPG, above n 7, 21.
[31] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 90 [5.87].
[32] Ibid 151.
[33] Financial Planners Association of Australia, *FPA Calls On Minister Shorten to Recognise Financial Planning Profession Under Law* (13 April 2011) Adviser Voice <http://www.adviservoice.com/2011/04/fpa-calls-on-minister-shorten-to-recognise-financial-planning-profession-under-law>.

III IMPLEMENTATION OF THE RIPOLL INQUIRY RECOMMENDATIONS

The Joint Parliamentary Committee on Corporations and Financial Services *Inquiry into Financial Products and Services* (Ripoll Inquiry) made eleven recommendations for legislative change and regulatory improvement of the Australian financial advice and services industry. [34] The Government's new Future of Financial Advice (FOFA) reforms stem from these recommendations.[35] The new draft legislation was released in two tranches. The first tranche, released on 28 August 2011, proposes a 'best interest' obligation on financial advisers to give priority of client interests when giving advice,[36] enhancements to the licensing and banning powers of ASIC,[37] and changes to the charging of on-going fees by introducing new disclosure and service renewal provisions.[38]

The 'best interest' obligation is the direct implementation of the first recommendation that states 'the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.'[39] Similarly, enhancements to ASIC's licensing and banning powers are the implementation of recommendation six and eight:

- The committee recommends that section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry;[40] and
- That sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence.[41]

The second tranche, released a month later on 28 September 2011 proposes the banning of specific types of adviser remuneration structures that were raised as issues by the inquiry.[42] The types of adviser remuneration that will be banned if the bill is passed can be generally characterized as 'conflicted remuneration' and also fees that otherwise raise suspicion or questions as to the whether the client's interests have been placed first when the advice was given.

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[34] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6.
[35] Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) 3.
[36] Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) cl 961C (1).
[37] See, eg, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) sch 1 items 2 – 8; Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) ch 3.
[38] Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) div 3.
[39] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 150.
[40] Ibid 151.
[41] Ibid 151.
[42] See committee recommendation four, Ibid 151.

Conflicted remuneration means any monetary or non-monetary benefit given to a licensee or representative that might influence or distort advice, by either influencing the choice of financial product being recommended or by otherwise influencing the financial product advice more generally.[43]

It will ban all commission based remuneration schemes. This is the embodiment of recommendation four which aimed to find a mechanism to 'cease payments from product manufacturers to financial advisers.'[44]

These proposed laws are the legislative implementation of four of the eleven recommendations made in the Ripoll Inquiry. They aim to reduce consumer vulnerability to tainted financial advice and try to build and restore trust and confidence in the financial services industry. [45] However, progress to build trust and confidence in the industry will be significantly hindered without the introduction of legislation and changes to the industry that require an increase in the competence and professional conduct standards of financial advisers. This issue was addressed in recommendation nine, which called for the 'establishment of an independent, industry-based professional standards board to oversee nomenclature, and competency and conduct standards for financial advisers.'[46] The initial response at the time by Chris Bowen MP was that the government did not support this recommendation for reasons that it is the role of the government to establish a Professional Standards Board (PSB) not ASIC.[47] He also raised concerns 'about the costs of a separate PSB, which may be passed to consumers, and for the potential for significant overlap with the role of ASIC in enforcing competency and conduct standards.'[48]

Furthermore, a closely related matter to this issue that is yet to be implemented is the restriction of the use of the term 'financial adviser' and 'financial planner' to people that have membership to the appropriate professional standards board. Until these issues have been addressed, there will remain significant deficiencies in the implementation of the Ripoll Inquiry recommendations which will hinder progress in restoring consumer trust and confidence in the financial advice industry. Despite the unenthusiastic initial response to recommendation 9 and no mention of professional standards in the FOFA draft legislation, it is likely that the Government will implement legislation based on recommendation 9 in the future. Reasons for this conclusion will be discussed in the next part of this paper.

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[43] Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011 (Cth) 8 [1.12].
[44] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 150.
[45] See Ibid 150-151.
[46] Ibid 151.
[47] Chris Bowen Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice' (Media Release, no. 036, 26 April 2010) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=&min=ceba&Year=&DocType=0>.
[48] Ibid.

IV THE REQUIREMENT FOR FURTHER LEGISLATION TO RAISE PROFESSIONAL STANDARDS AND INCREASE CONSUMER CONFIDENCE

The inquiry noted various submissions raised concerns regarding low and inconsistent minimum entry education levels, the relative ease in obtaining an AFS license, and 'the varying competence of a broad range of people able to operate under the same 'financial adviser' or 'financial planner' banner.'[49] It is recommendation 9 that attempts to remedy these issues. A primary objective of the FOFA reforms is to 'restore trust and confidence' in the financial services industry, but without the inclusion of reforms that address recommendation 9, there will continue to be issues concerning the competency and professionalism of financial advisers.

There are indicators that this significant gap will be filled in the future, although the addressing of these issues appear to still be in its preliminary stages and no specific timeline has been given for when any possible reforms may be introduced. On 24 November 2010, the Government announced the formation of the advisory panel on financial advice and professional standards, which would be chaired by Greg Medcraft, the ASIC Commissioner at the time.[50] This was followed up by ASIC's release of consultation paper 153 titled *Licensing: Assessment and professional development framework for financial advisers* in April 2011.[51] This is aimed at addressing the inconsistent and relatively low education standards of entry into the financial advice and planning industry. The paper also raises discussion about ethics and continuing professional development for financial advisers.[52] It proposes a professional development framework for financial advisers that is 'intended to enhance and maintain the competence of financial advisers, [and] lead to improvements in the quality of advice and increase consumer confidence.'[53]

The final indication that further legislation and reforms will be introduced to supplement the FOFA bills is the statement made by the Assistant Treasurer Bill Shorten that:

> Treasury will release a public consultation paper by the end of the year [2011] on restricting the term 'financial planner'. This is consistent with Minister Shorten's announcement in April this year that Treasury will provide the Government with a recommendation as to whether the term 'financial planner/adviser' should be defined in the Corporations Act and its use restricted.[54]

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[49] The Parliamentary Joint Committee on Corporations and Financial Services, above n 6, 90 [5.85]-[5.87].
[50] Bill Shorten, above n 1.
[51] Australian Securities and Investments Commission, 'Licensing: Assessment and professional development framework for financial advisers' (Consultation Paper 153, 6 April 2011) <http://www.asic.gov.au/cp>.
[52] Ibid.
[53] Ibid 1.
[54] Bill Shorten, above n 1.

This is a clear response to a proposal made by the Financial Planning Association on 14 April 2011 to define the term 'financial planner' and 'financial adviser' in legislation.[55]

V CONCLUSION

The introduction of an obligation for advisers to act in the best interest of the client,[56] which requires giving priority to the clients interests in the event of any conflict, bringing changes to the charging of on-going fees,[57] banning conflicted remuneration and remuneration structures that may increase consumer vulnerability to tainted advice,[58] in conjunction with increasing ASIC's powers to prevent the issuing and banning of AFS licensees and individuals will, in part, help to build and restore trust and confidence in the financial services industry.[59]

These new laws are the legislative implementation of some of the recommendations made in the Ripoll Inquiry, however, without introducing reforms to the competence and professional standards of financial advisers, restrictions on the use of the term 'financial adviser' and 'financial planner,' there will remain significant deficiencies in the implementation of the Ripoll Inquiry recommendations. If these deficiencies remain, it will hinder progress in restoring trust and confidence in financial advisers. Therefore it is likely that there will continue to be further implementation of legislation concerned with the financial advice industry. Indicators of government plans to introduce new legislation include statements made in media releases for a discussion paper to be released on the restriction of the use of the term 'financial planner,' the formation of an industry based advisory board on professional standards, and discussion papers such as the ASIC 153 paper regarding the licensing and professional development framework for financial advisers.

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[55] Financial Planners Association of Australia, above n 8.
[56] See Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) cl 961C (1).
[57] See Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) div 3.
[58] See, eg, Corporations Amendment (Further Future of Financial Advice) Bill 2011 (Cth); Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011 (Cth).
[59] See, eg, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) sch 1 items 2 – 8; Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth) ch 3.