

Association of Financial Advisors

2 November 2005

FSAC Secretariat
Chair
Financial Systems Division
Department of Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Thank you for the opportunity of responding to your letter of 23rd September, on behalf of our Association.

We have circulated 'Attachment B', financial sector regulation feedback form to our membership via email seeking a response, and we have also had a discussion with our Public Affairs Committee when formulating the attached.

We hope the information contained will precipitate some dialogue with your department. We feel there needs to be some discussion to enlarge on many of the issues raised, in order for you to get some feel of the frustration being experienced by our constituency.

Other organizations within the industry seem to be gaining a better hearing than ours, and ours is an adviser organisation, acting totally in the interests of advisers, who are those in direct contact with the consumers. Ours has a real coal-face emphasis, which we believe has been overlooked.

It would be fair to say that we have been encouraged by recent publicity surrounding ASIC's intent to give advice or even samples of Statements of Advice, segmenting the advice being given, but are saddened by no major communication from Jeremy Cooper that went to IFSA and the FPA, but excluded our input. The letter just happened to be forwarded to us by one of our constituents, and understandably, he questioned our very existence.

We hope the attached provides you with some matters for discussion and look forward to being able to make a further contribution to your forum. We have also included, at random, a number of responses.

Yours faithfully

MICHAEL F MURPHY
CHAIRMAN

RESPONSE

FINANCIAL SECTOR REGULATION – FEEDBACK FORM

1. The most significant challenge to Advisers, whether they be authorized representatives or small licensees, is recruitment of suitable staff. Historically, staff were recruited and trained by the manufacturers of product and further training was provided by Associations like ours, which was endorsed by the manufacturers. This endorsement took the form of encouragement by all manufacturers to join our Association, and take advantage of the specific courses available and the community-based education provided by way of workshops, seminars and conferences.

That was normal for advisers and who are our constituents, and numbered at one stage, almost 10,000. The current membership sits at less than 1,000, not due to the fact that we have reduced our services, but more for reason for a change of focus of the educational standard to one of academic qualification, with little skills-based training.

The other problem is the recruitment and training of support staff. There appears to be no pre-education or pre-vocational training for support staff who would like to enter our industry and follow a career path that could take them to being an adviser, para-planner or clerical support staff. This particularly applies in regional Australia, where there has been a void of offices for insurance companies, fund managers in fact, major financial services participants, that provided training for staff in all of the above, and found their way into smaller practices.

The calculation of the cost of training is immeasurable, because it varies with the practice, but a number of practitioners whom we contacted said that it could be up to 50% of the total cost of operation, and without guarantee. The aspect of the loss in production as a result of taking time out to train, puts this at an enormous cost to the individual or small practitioner. We don't think this is a transitional challenge. The efficiency factor is probably minus 50%, based on our discussions.

2. The administrative processes resources required to match the current compliance standards have been nominated to be up to 60% of the costs of administration. This could be reduced by an injection of substantial capital to purchase generic compliance materials and procedures manuals, approximately \$40,000, which then would need to be modified to the individual practice. Admittedly, pre-FSR, there were many practices that were not procedures-based or, in fact, all that compliant, however, they provided good advice and kept adequate files to support that advice. Many of these have found the burden too great and closed shop. That is itself, an expense.

It is really hard to distinguish between procedures, as such, and activities, because one is a function of the other. Our experience with the auditing process of the regulator is, they wish to have written procedures for all functions carried out by a practice, in order to provide accurate record keeping of client's files. Our constituency deals totally with the clients, and therefore, this makes up the total responsibility of running a satisfactory or compliant practice.

3.

- a) The majority of our constituents would only deal with ASIC, and therefore, not subject to a great deal of conflict. However, we have had the odd occurrence when ASIC have maintained that our APRA would be the body we should refer to on particular issues. As an Association, APRA, have not seen us as being all that relevant, and it would be fair to say, that we have not had any assistance from APRA. We have had one communication with the ACCC, and were referred to ASIC as a result of the transfer of responsibilities to ASIC, as a result of FSR.
- b) 'A.' really sums up the frustration of trying to establish which agency has responsibility for some of the issues we have brought forward.
- c) There is an opinion within our Association that the total regulation that applies to industry are out of date. By this we mean that many of the issues that the regulation started out to address had been addressed by the time the legislation was passed and the regulations came into being. The enquiries that led to the eventual legislation commenced some 10 years prior and the mind-set of the draftees seem to have been set and not adjusted to the norm in the industry at the time the regulations came into being.

This particularly applies to the insurance component of the Funds Management Industry or Financial Services Industry. Total regulations seem to be focused on funds management and financial advice with very little focus on life insurance products.

We believe strongly there is a philosophical difference in the process of giving advice to a client on the investment of funds, who has the funds: all he/she needs, is advice on where to invest them. As opposed to the client, which is invariably a young couple, who have all the liabilities, a totally committed budget and the advisers have to find the premium dollars out of that committed budget to limit the liability for the family, in event of death, injury, illness or in fact, disability. We have recommended that life insurance and associated products should be removed from the definition of financial product within the legislation.

- d) We recently raised at one of our regular meetings with the regulator the fact that we didn't think there was sufficient care taken when issuing policy disclosure statements for new product which is slightly counter to the information required in this section. Our concern was specifically related to agricultural products that are given an approved Policy Disclosure Statement, given a tax ruling, and put into the market to be assessed by licensees for distribution. As ASIC and the ATO have endorsed them, they then assess them for inclusion on the recommended list. Once included on the recommend list, the advisers, in good faith, present them to clients as per their Policy Disclosure Statement and we know from our research that the viability of many of these projects is totally and completely questionable.

We see this in mature industries like the timber industry and the viticulture industry and embryonic industries like olives and the like.

We believe there was a little under \$1 Billion invested pre-June into viticulture investment schemes where up to 80% of the projects had not gained contracts for produce (grapes) when the vines finally came into bearing. The figures on projected sale price of the produce were also extremely rubbery. The outcome, in this instance is that the consumers who bought these projects would 'vent their spleen' at the advisers in event of the outcomes as per the PDS, not eventuate, and as we have seen recently reported, that a number of other investment schemes that have had some of ASIC and the ATO would in fact, not be viable without the tax deductions. Not a sound basis for any investment. We believe that contrary to some concerns of others, the regulation is either not strong enough or is being ignored, in some instance regarding product.

4. Ways of improving the on-going operation has probably been touched on above in B, C and D regarding insurance being removed as a financial product, and a far more stringent process being applied to the release of PDS's for some questionable investments.

In addition, there must be further simplification in the issue of Statements of Advice. There have been giant steps taken in this area, but we still see that the small investor has been subjected to enormous expense by having to have detailed strategy and other philosophical discussion about investments, which in many cases, is to justify a fee to recover the expense of advisers having to go through the processes required by the regulators.

There also needs to be some consideration given to the overall legislation as it applies to the supervision of small practices. The legislation is structured for larger organizations who do not have direct contact between management, advisers and support staff and, therefore, there is a need for documented procedures and checks and balances for these procedures that are excessive when applied to a small practice. We have also had instances of inexperienced auditors conducting 'procedure audits' that view the practices from the regulations instead of looking at the practice for what it is and then establishing if the processes in fact meet the requirements of the regulations. The perception of most people involved in this audit process has been that the auditors have no idea of how smaller practices run and don't seem to want to listen.

5. It would be fair to say that all we have received is complaints from all our stakeholders regarding the copious quantities of information and documentation that needs to be supplied on a relatively minor transaction. We are now finding similar reaction from our third-party service providers, as we are demanding, because the regulator requested it, that they enter into performance agreements regarding provision of services.

This may be viewed as an efficiency gain for the industry, but it tends to undermine the long-term relationship the number of our constituents have with their third-party service providers. We can, however, make some positive comments, as an Association we conduct two awards for 'Adviser of the Year' and 'Rising Star or Young Adviser of the Year'.

We have recently been involved in the judging process and the Adviser of the Year Award is now in its third year and we have seen an enormous improvement in the quality of advisers, which is an obvious response to the regulation, and we are seeing with the 'Young or New Advisers' a high standard of compliance or structure at a very early stage of their entry into the industry. This has to be good for all concerned.

6. Our experience with dealing with the regulators has been positive as an Association. ASIC personnel have been very helpful, however, they had the tendency to see it all their way and feel hamstrung on interpretation. There is a complete lack of flexibility, and understandably, because they communicate to us that they are the regulators, not the legislators, and have to work within the confines of the brief they are given.

We have likened it to the job of any infringement officer that is just efficiently and effectively going about their work and issuing the infringement notices when it's the legislator that we need to get to, to implement any change for the regulator to be effective.

We have not had any direct dealings with Treasury, as such, it has always been in a joint forum with ASIC and, therefore, really can't comment. Our submissions has always been to the Parliamentary Committee, which we believe was the step prior to it going to Treasury, and we are not that sure that Treasury is all that flexible. There is evidence that the various Parliamentary Committee's have made a recommendation based on the information they have gathered which has not been acted on by Treasury, which we find a little disappointing when Treasury have not sought dialogue with our Association, prior to drafting the legislation which is contrary to the recommendations being made by the Committee.

We sometimes get the impression that there is a sense of being committed to a certain position and not having the courage to back down when a counter-position is given, which would, in fact, be far more effective. We are quite confident that in spite of all the enquiry and internal investigation, there seems to be a misunderstanding of our industry.

7. We think we have said it all, but sympathise, as the regulator has had to respond to the lowest common denominator management philosophy by the licensees and their compliance departments regarding the supervision of all the life representatives.

We as an adviser organization feel we need greater participation in the dialogue, however, we have expressed that we are a volunteer organization, and therefore, are limited in our contribution because all of our members and officers have a responsibility to themselves and their families to have a profitable business, and this whole period leading up to the regulation and post-regulation has sapped the time and energy of a number of good people, and the obvious result and effect on a downturn in their productivity in their own businesses.