



ASIC

Australian Securities & Investments Commission

The Financial Advice Industry in Australia: The Regulator's Perspective

An Address by Jeffrey Lucy AM

Chairman

Australian Securities and Investments Commission

Financial Planning Association

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Introductory comments

Good morning and many thanks to the Financial Planning Association for the opportunity to speak to you today.

I think it is a timely opportunity and I welcome the chance to convey to you some of my views of where you, and your industry, are positioned currently.

As the wealth and savings of Australians continue to increase – some suggesting that our investment fund assets pool will more than double over the next ten years or so – it is clear that the need for financial advice will also continue to grow in importance.

We know that the average age of Australians is increasing. Our Government has undertaken deliberate policy initiatives to encourage funding for retirement to achieve less reliance on social welfare. These initiatives include the superannuation guarantee levy and superannuation reform more generally.

Prudent investment for retirement has never been so important.

Against this background, today, I would like to emphasise the value of financial advice and the key role that you play in providing it.

I'd like to give you ASIC's perspective on these issues, which I hope will contribute to your ongoing work in positioning the financial advice industry in Australia and abroad.

The role of the financial advice industry

There is no doubt that a snapshot of the financial advice industry would reveal that the industry as a whole, and the network of financial advisers in it, contributes significantly to Australia's economy.

The size of the industry is reflected, for example, in the membership of the Financial Planning Association, which, on its own, represents some 12,000 of the financial advisers operating in Australia today.

There is also no doubt that financial advisers are responsible for managing the financial affairs of a large number of Australians investing significant proportions of their wealth and future savings for retirement.

Therefore, the significance of your industry cannot be underestimated.

As an industry, you have responsibilities that will impact on providing for the financial future and wellbeing of many Australians.

Individually, you are in a position to influence the wealth management and savings profiles of your clients.

As financial advisers, you are also in a significant position of trust with your clients. You are privy to their circumstances, needs and aspirations. You must utilise that knowledge, coupled with product knowledge, to provide relevant and responsible financial advice.

Public confidence in Australia's capital markets is materially affected by your acceptance of your legal responsibilities, and meeting your clients' reasonable expectations.

Although public confidence remains high, it is challenged by doubt about the quality and value of financial advice. It is my view that the industry is in a good position to provide sound, reliable financial advice. You are also able to promote the value of that advice to your clients.

For the individual adviser dealing with a client, the fundamental question you must ask yourselves as you consider the interests of your clients and your own business needs, is, whose side are you on?

The regulatory framework

I will ask you to ponder that while I reflect for a short while on the historical legislative context.

The reason regulation was introduced across the financial services industry was to recognise the significant impact financial services – including the giving of financial advice – can have on individuals in the Australian community.

This was intended to eradicate the 'sales culture' that was prevalent in the financial advice industry at that time and instead promote the maturing of an industry that was, and *is*, working towards a culture of professionalism and a deserved climate of trust.

The Parliamentary Secretary to the Treasurer, the Honourable Chris Pearce MP, has recently proposed re-emphasising the distinction between sales and advice in his refinements to financial services regulation with the introduction of less onerous requirements for financial product *sales recommendations*.

However, this is appropriately distinguished from the provision of financial product *advice*, the focus of my address today.

In my view, since 2002, you are no longer merely 'distributors' of financial products who are subject to few, if any, legal and professional obligations.

Rather, the professional nature of providing financial advice means that, just like in other professions such as accounting, law and medicine, standards and regulation underpin your activities as a necessary component of ensuring the protection of consumers and investors.

ASIC's expectations

ASIC has responsibility for enforcing the laws of the Commonwealth **and** protecting consumers and investors. We have not chosen this mandate; the Government gave it to us eight years ago in 1998.

The time for debate must be over.

I am of the view that giving financial advice should be viewed as a professional activity, a view that ASIC has advocated for over a decade. Professionals use their special skills, knowledge and experience for the benefit of their clients.

I am extremely encouraged that the Financial Planning Association shares this view. As its members, you must accept the responsibility that accompanies this privilege.

As a regulator, we expect company directors, officers and auditors to meet their legal obligations, as we expect the financial services industry to comply with the law. Realistically, what other choice is there for ASIC if we are to meet our own regulatory responsibilities?

ASIC's minimum expectation, therefore, is that you will comply with requirements of financial services regulation.

Individual practitioners joined together as a *profession* through organisations such as the Financial Planning Association have special responsibilities to protect the reputation of their profession by collectively developing 'best practice' standards beyond the minimum standards set out in the law and ASIC's policy and guidance.

These standards must reflect appropriate disciplinary proceedings when individual advisers fail to adhere to the standards set. As a professional body, you must have the ability, and the will, to discipline your members as and when necessary. This must extend to expelling those persons who

continue to fail to meet your expectations or whose individual activities render them inappropriate for membership.

You must also have sound procedures in place for dealing with things when they go wrong. In my view, this cannot be limited to complaints handling processes.

I suggest it also extends to having adequate compensation arrangements. Treasury's consultation in this area offers a prime opportunity for you, as a professional body, to show leadership and contribute to this debate in helping the Government define the scope of such requirements.

As individual *professionals*, you must see yourselves as part of this profession, being accountable to these high standards (including ethical standards), as set by the profession as a whole.

Above all else, these standards must reflect the fact that each of you, in your capacity as individual advisers, must consider that the interests of your clients, come before all other interests, including your own.

In ASIC's view, these are the responsibilities attached to being a *professional*.

As a profession, therefore, you should not aim to take a minimalist approach, which of course is the easiest to achieve.

A minimalist approach won't lead to improvements in standards. To take an analogy from the world of athletics, world records in any sporting activity are not set by people who aim to just clear the bar, but by those who train hard and strive to easily clear the bar every time they compete.

The financial and human implications of providing inappropriate advice cannot be underestimated.

Indeed, ASIC's research in this area still indicates that the levels of advice being provided, which leaves clients worse off, continues to be too prevalent.

In thinking about whether advice has a reasonable basis, ASIC is not concerned specifically with whether you move a client from a low fee-paying product to a higher fee-paying product. We fully accept that fees are only part of the equation.

The starting point is the client. We acknowledge there will be a range of issues relevant to their needs, and take into account factors like the range of benefits attached to the recommended approach, particularly loss of those benefits, including insurance, that may not be in the clients' interests.

In providing financial advice, therefore, it is my view that the financial advice profession must not only work towards meeting ASIC's expectations in complying with the law; the profession must also ensure that it meets the reasonable expectations of Australian consumers.

The reasonable expectations of consumers

Most financial advisers understand and recognise the extent to which people are relying on and trusting them to provide sound financial advice.

First and foremost in this analysis is the continuum of consumers that you actually provide advice to. Consumers can range from the sophisticated investor and financially astute to the financially illiterate, with a wide range in between.

I am sure everyone in this room is able to compare the robust dialogue that can take place between a professional adviser and an interested and informed client, and compare that to the significant increase in the difficulty you have in engaging with someone who is not interested or engaged, or who simply does not follow what you are saying. In my own

experience, you simply have to work a lot hard in dealing effectively with the second category.

Regardless of where your clients are placed on this continuum, they are entitled to, and expect 'good advice'. They are entitled to advice that is understandable, relevant and suitable for their own situation.

Although ASIC expects you to comply with the law and provide the necessary paperwork that accompanies the provision of financial advice, we are not concerned with fine legal distinctions in interpretation.

Rather, we want your advice to address the reasonable expectations of consumers, which – at an absolute minimum – **must** be understandable *to them*, **must** reflect their needs and **must** make reliable recommendations based on those needs.

And let me observe that your clients' level of satisfaction with your financial services is not, by itself, a reliable indicator of appropriate advice. Our research suggests that in some 85% of cases where financial advice clearly lacked a reasonable basis, consumers were still satisfied with that advice.

In my view, this fact significantly underscores the trust that **is** placed in you. Anecdotal evidence suggests that your clients will make their decisions on the basis of the relationship they have with you. They may not necessarily have the competence or expertise to know of their own accord whether your advice will leave them worse off.

I hasten to add that, of course, it is a good thing that clients have a high degree of satisfaction with their advisers; what I don't want is for that satisfaction to be misplaced.

It is your responsibility as professionals with the knowledge and skills of competent financial advisers to provide them with the advice they need to

make sound investment decisions that are suitable to their circumstances and that they can reliably have confidence in.

To do so, your clients need advice that is relevant to the decision they need to make and, at the very least, provides information about:

- the financial product they are getting advice on;
- the fees that they will need to pay if they invest; and
- anything that might influence your ability to provide unbiased advice.

To do the job, this information needs to be disclosed in a way your client will understand and can make a decision based on it.

Consumers do have choice and you, as their advisers, need to ensure that your clients understand the advice you are providing and can make *informed* choices.

In my view, this means that you need to consider where they fall on the continuum of consumers that I mentioned earlier and consider, for example, their levels of financial literacy and risk tolerance to ensure that the advice you provide is suitable to their circumstances. You also need to be satisfied that they actually understand what you are putting to them.

You are the professional in this relationship, and I believe it reasonable for the regulator charged with the responsibility of protecting consumers, to expect that you will comply with your legal obligations and bring to the table the necessary expertise to provide advice in a manner that your client understands.

ASIC's role

I will turn shortly to our current areas of focus in driving this disclosure, but first, I want to outline what we are **not** directing attention to.

We are **not** seeking the restructuring the financial advice industry, nor do we have the mandate to do so. As we have said on many occasions, the structure of the industry is a matter for you.

The point to note is that the way the financial advice industry is structured can impact on the conduct that occurs within it.

For example, the way you are remunerated might influence your delivery of quality advice to your clients. This, together with a growing demand for both more transparent dollar disclosure of remuneration and choice about how clients pay for their advice, is an environmental factor that you cannot ignore. We at ASIC cannot ignore it either, as our research shows that unreasonable advice given to clients is three to six times more likely if you have a conflict of interest arising from either remuneration or association.

We strongly encourage moves towards managing these environmental factors.

ASIC supports the industry's initiatives to clearly distinguish between the cost of financial products and the cost of advice, and we are heartened to see emerging competitive models giving clients the choice about the way they pay for advice.

We also do **not** propose the banning of commissions.

We are also **not** against approved product lists. To the contrary, we accept that approved product lists are a common, perhaps inevitable, element of the financial advice industry and a useful way for licensees to control the quality of financial advice given by their staff and representatives.

Our concern lies in the fact that approved product lists must be appropriately used. As advisers, you must be aware that your primary obligation is to comply with the law; your obligations to licensees in respect of approved product lists are secondary to this obligation.

What, then, is ASIC's focus at the moment?

To answer this question, I would like to return to the question I posed earlier in relation to yourselves and your clients... Whose side are you on?

In our view, if you seek to be treated as a professional, you must always act in the best interests of your client.

You must put your clients' interests ahead of your own in providing them with appropriate financial advice that meets their requirements, not yours.

As an absolute minimum, you must ensure that they are not, overall, left worse off as a result of following your advice.

From a remuneration viewpoint, the model that you adopt should best align your interests with those of the client so that it is less likely to adversely influence your advice.

Where conflicts of interest arise because of the remuneration you will receive if your client accepts your recommendation or an association between the recommended financial product and your licensee, this must be clearly disclosed or, in certain situations, avoided completely. This ensures that your client can understand how your advice may have been influenced but, of course, does not eliminate the requirement that the advice must be in the clients' best interests. Disclosure does not eliminate the need for the advice to be appropriate.

Concluding comments

In my view, the trends towards professionalism in the financial advice industry are promising.

There are many outstanding examples where your profession is meeting all that is required of them. In varying complementary degrees, some are doing so as a matter of personal pride; others are working to ensure the

sustainability of their business; and some are looking out for the reputation of your profession as a whole.

Your corporate leaders and the Financial Planning Association want a sustainable and valuable environment where you are adding to Australian financial wellbeing and overall confidence in our Australian financial markets.

Those individuals and organisations who do not meet these requirements not only let their clients down; they let us all down.

The cost for unacceptable conduct in this industry is borne by clients and the industry as a whole and I urge you to become impatient with any such behaviour.

We applaud the Financial Planning Association's recent initiatives that explicitly put the value of quality advice on the agenda.

This is an important step, but there is more to be done if you wish to position your profession successfully in the eyes of the community.

Importantly, there is still work to be done in the area of convincing the community that financial advice is valuable and worth paying for.

The Financial Planning Association has a key role to play in providing leadership to the financial advice profession.

The profession as a whole needs to position itself to welcome, rather than resist, initiatives that raise its overall standard and reputation, while weeding out those practices that fail to increase its standing as it moves towards maturity.