



ASIC

Australian Securities & Investments Commission

"REGULATING FINANCIAL ADVICE – CURRENT OPPORTUNITIES AND CHALLENGES"

Paper presented by

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to the

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Executive Summary

The key points of this presentation are these:

1. There is considerable evidence that improvements are being made and the retail investor, the consumer, is better protected today than 5 years ago.
2. There are a number of additional regulatory changes just completed or about to be completed which will add further improvements. For example, the compensation and insurance arrangements, EDR and training.
3. There is, however, more to be done and that is why ASIC has set up a retail investor taskforce. The 5 drivers for that taskforce are:
 - imbalance in supply and demand;
 - growth in complex products for the retail sector;
 - concern on accessibility of advice;
 - high proportion of retirees needing special recognition;
 - lessons from the property failures.
4. The taskforce will do two things. First develop a fact base with the industry. This will consist of:
 - in depth study of the retail sector.
 - assessment of who has and has not access to advice and the extent of financial literacy.
 - assessment of different advice models.
5. The second taskforce objective, with this fact base, will be to address 7 specific issues with the industry:
 - disclosure documents – length and complexity.
 - statements of advice – whether 'one size fits all' is working.
 - compensation arrangements for retail investors – are they adequate?
 - lessons from Westpoint.
 - remuneration arrangements and conflicts of interest.
 - whether fiduciary duties apply and, if so, what that means.

The taskforce will take into account international developments (e.g. USA and UK) in examining these issues.

6. In relation to remuneration, in the context of the current legislative framework, ASIC will allow the market to 'vote with its feet' on the models investors prefer. To assist that process, ASIC will be active in applying the existing disclosure regime to its limits (as it has done in the unrated and unlisted area) so that retail investors can make an informed choice and, in effect, can 'vote with their feet'. While ASIC will not seek to pick 'winner models' (as such an approach could distort the competitive dynamics between models) it will be active in applying the existing disclosure regime.
7. Unlike other sectors, the importance of the retail investor is one where ASIC will continue, as part of taskforce's work and otherwise, to maintain an active interest.

Thank you for the opportunity to speak to you this morning and to open the CFP Retreat component of this year's FPA Conference.

As a Certified Financial Planner you have achieved the highest professional certification that can be awarded to a financial planner. Congratulations! ¹ CFP's play a key role in the planning and advice industry.

What I would like to do this morning is:

- First, to tell you a little bit about me and how I have approached the role of Chairman in the past 6½ months.
- Secondly, to update you on the priorities we have set and the one particularly important to you, is our priority on the retail investor sector.
- Thirdly, to then expand on the retail investor sector and raise issues more directly relevant to financial planners and advisers.

(In effect, to provide a basic blueprint on what we intend to do going forward).

After my presentation, there is a question and answer session and we can use that session to cover issues which come out of my presentation and other issues you may wish to raise with me.

What I hope you will get out of the session is:

- A feel for the style and approach at ASIC with what is now a new Commission with a new Chairman and a new Commissioner (Belinda Gibson who joined us on 6 November 2007).
- A better understanding of the issues which ASIC will be pursuing for the retail investor sector.
- The process and the methodology which we will use to handle those issues. Importantly, the consultation process we will use.

What I, as Chairman of ASIC, would like to take out of this session is a feeling from you on whether or not at ASIC, we are focussing on the issues which matter to retail investors and to you as financial planners and advisers and whether we need to make changes in the way we have been approaching issues in this sector.

As financial planners and advisers, you are an important stakeholder group for ASIC and, indeed, for all investors. And together we have a common objective –to ensure that investors, most notably retail investors, are best served when they make investment decisions.

¹ CFPs have met the four "Es", which are:

- **E**ducation and **E**xamination – successful completion of the 5 core financial planning subjects along with an existing university degree;
- **E**xperience – at least 3 years experience in the industry; and
- **E**thics – agreement to adhere to the FPA's principles on ethics.

I recognise that I will be covering matters which are broader than the topic given to me of "Regulating Financial Advice – current Opportunities and Challenges" but, as this the first time I have spoken at a function such as this, I think it is important that I cover the broader issues which I have identified and we have a broader dialogue during the question and answer session.

ASIC Chairman

I took on the role of ASIC Chairman on 13 May this year, some 6½ months ago. This was preceded by a short stint as Commissioner following my departure from ASX.

Now, why did I take the role? It's always interesting to reflect on such a question. Indeed, in order to get to know the inner workings of ASIC, I have met separately with all 54 ASIC teams over the course of a few months (1500 staff in all). At a number of those meetings, I was asked the question, why I took the role on.

And, on at least 2 occasions (which reflects the open culture at ASIC which is good) the question was put rather starkly – given the payout you received from ASX, why on earth would you come to ASIC?

As can often happen the answer to this question was really put well by someone else. In fact, my general physician, during a yearly check up. Quite unsolicited (as he prodded and probed my body in places I leave you to your imagination and I might add, he was impressed that my blood pressure was normal and not affected by the stress of this role) he said you are really well suited for the role. Your background in law and financial markets really sets you up well for ASIC Chairman.

The unsolicited comment resonated with me. I feel that my experience and skills will hopefully enable me to add some value to ASIC's work. And I chose to accept the role for the opportunity to see if I could add value.

Having taken the job of Chairman, I thought there would be a period of settling myself in ... taking time to evaluate. After all Jeffrey Lucy, my predecessor was staying on ensuring a smooth transition. That was not to be.

ASIC had a Senate Estimates appearance (Senate Estimates is a Parliamentary oversight committee) on 30 May and, if a first appearance for a new Chairman did not have enough anxiety, we had in mid May the failure of ACR which had been preceded by the failure of Fincorp and sometime earlier than that Westpoint. Investors stood to lose significant amounts.

You can expect that around that mid May period leading up to Senate Estimates, I was wondering whether, instead of Chairman, I should have chosen the beach and vineyard option!

It is at times like that, however, when you appreciate the strength and quality of people in an organisation such as ASIC. While it has its share of criticism, the way we pulled together as a team to respond was very gratifying for a new Chairman.

We drew together the work ASIC had been doing and were able to go to Senate Estimates with a plan – the "3 Point Plan" as it has been referred in order to deal with the property related failures. We set out a plan over 12 months which had 3 elements – deal with the existing debenture issue, new issues and past problems. Fairly straightforward.

We said, if after 12 months, the plan was not likely to work we would seek legislative assistance. We do not, however, see the need to resort to legislation now (or hopefully at all as legislation inevitably adds to business costs). We felt we needed to test the existing disclosure regime to its limits.

Six months or so into the plan, we have taken all the major steps required:

(a) For existing and new issues of debenture:

- A new disclosure regime against benchmarks on an "if not, why not" basis is in place (RG69).²
- A new draft advertising guide has been circulated.³
- Investor research is going to come up with "investor education" programs for retail investors.

(b) For the past failures, we have investigation teams examining past behaviour. Importantly, for Westpoint investors, we are using now our s50 ASIC Act powers, to see if we can recover compensation for them over and above what they may get out of the liquidations. Those actions involve directors and officers and financial planners where we allege their conduct fell short of what the law expects.

Our team handling the work on unlisted and unrated debenture issues will over the next 4 to 5 months meet with all existing issuers of debentures and work through how the new regime will apply to them. The focus will be on assistance and working through some of the difficult issues.

We will, around May 2008, produce a report of the outcomes of the 3 Point Plan – well within the 12 months we set ourselves.

As we look back at the property related failures, with the benefit of hindsight:

- Disclosure could have been better.
- Investor education in the basics of asset class diversification and understanding pricing of risk could have been better.
- Advertising could have been more forthcoming on risks.

The "3 Point Plan" we are pursuing is addressing these issues.

And, we allege, that in particular cases where advice was sought, the advice could have been better. We are in the process of commencing court proceedings under s50 of the ASIC Act for compensation for the Westpoint investors.

We could stop and say that those issues are now behind us particularly as the unlisted unrated sector is a relatively small part of our financial markets (\$8b against retail investor financial assets of \$2 trillion plus).⁴ My feeling, however, is that there are some wider issues still to assess or lessons to draw out and they are these:

² Regulatory Guide [RG 69] *Debentures – improving disclosure for retail investors*.

³ Consultation Paper [CP 94] *Debenture advertising*

⁴ See Statement on Fincorp by Tony D'Aloisio, Chairman ASIC to the Senate Standing Committee on Economics, 30 May 2007. Available at www.asic.gov.au.

- It seems that significant number of retail investors did not have access to financial planning advice or, if they did, nevertheless chose to invest direct (e.g. respond to direct advertising). What more can we do to improve access to advice?
- The experience of those who did use financial planners or advisers seems to have been mixed. We would like to encourage investors to obtain advice and, for example, to use financial planners and advisers more to assist them with their decisions. We can only do that if investors have trust and confidence in advisers and value the service they provide.
- The alternative dispute resolution methods which investors are pursuing are being tested at present and, in time, we will see how effective they are for these type of failures. Two particular issues of focus are, first, the FICS monetary limit recently increased to \$150,000 with a view of moving to \$280,000 at a later point is in the right direction. However, it should move more quickly to \$280,000 in line with other schemes. Secondly, a complainant who may have a claim in excess of the monetary limit should be able to waive the excess and have their claim met up to the monetary limit rather than not receive any compensation at all.
- The insurance arrangements that financial planners have or do not will also be tested and the initial indications are that they may be inadequate in many cases.
- ASIC's own internal monitoring of prospectuses and disclosures. What did we learn? How can we improve?

When I speak later on the retail investor taskforce, you will see that we will do more work on assessing what we can learn from these collapses and how we propose to work on these broader issues.

And, as ASIC's Chairman, I need to ask an even broader question: are these events confined to property type investments or, could they also be in other forms of investment as the "wall of money" which has been building seeks out more complex investments. Indeed the FPA's CEO, Jo-Anne Bloch raised a similar point in October 2007 Financial Planning when she said in terms of the lessons for Westpoint:

"Noting that the particular ride on the share markets will at some stage head in the other direction, these lessons [out of Westpoint] can be applied to most investments and clients" (p4).

My sense on that is that there is less risk in the listed markets and in the rated markets (provided ratings are understood). The unlisted and unrated areas do not have these secondary market mechanisms and, hence, greater risk. For example, in the Managed Investment Schemes area there are about \$1.3 trillion of investments which may not be subject to listings or ratings.⁵

The Six Priorities

Let me come back and complete the story at Senate Estimates on 30 May. We also outlined 6 priorities ... Notice how things go in 3's. 3 Point Plan and 6 priorities!

ASIC is a complex organisation. It has many functions. But, if we can encapsulate what it does, it plays an important role in both the Real Economy (economy for goods and services) and in the Financial Economy (capital and financial markets).

⁵ Australian Bureau of Statistics, 5655.0 Managed Funds Australia, June 2007.

It would not surprise you that the 6 priorities relate to these two economies. Two priorities in the Real Economy. Three in the Financial Economy. The sixth priority is overlaid on both – a strategic review of ASIC.

Let me give you a brief update on where we are on these.

When we look at the Real Economy, ASIC performs a number of functions around the 'Corporation' and its officers. It also licences a range of people such as financial planners and so on. Central to these functions is efficiency and costs to business.

The 2 priorities we set in the Real Economy are aimed at improving efficiency and reducing costs in a measurable way. We have set ourselves objectives around improving operational effectiveness and service levels and making better use of our technology.

It is useful to focus on some examples to illustrate these benefits:

- We are making it easier for companies to meet their compliance obligations by expanding our electronic document lodgement services. About 60% of all documents received by ASIC are now lodged online.
- We have also developed a web-based software application to further streamline common transactions and implemented our e-charges project, which allows entities to register charges over company assets on-line.

Our vision is to leverage technology in a way which simplifies and improves processes which enhance services to our stakeholders, particularly small to medium businesses.

ASIC's priorities extend to the Financial Economy as well. Here we outlined three priorities.

First, the growth in direct retail investment has increased significantly and we are seeing more sophisticated products aimed at retail investors.

A special team, under the leadership of our Deputy Chairman, Jeremy Cooper (who is well known to you), is examining the risks for the retail investor and respond with projects to help address these risks and to develop a more investment-wise retail sector, with better access to quality advice and better equipped to protect their wealth.

Secondly, for all investors, ASIC will continue to maintain and improve confidence and integrity in Australia's capital markets. While we have had some successes in deterring insider trading and market manipulation, we can to improve.

A special team has been established to determine what additional actions ASIC, in cooperation with ASX, can take in the areas of continuous disclosure, market manipulation and insider trading. This team is headed by ASIC's new commissioner, Belinda Gibson, and will cover both exchange-traded products and the over-the-counter market.

Thirdly, ASIC is looking at ways where it can facilitate the inward and outward flows of capital. ASIC will seek to ensure there are only the necessary minimum roadblocks to investment flows, commensurate with adequate protection.

- Closer international cooperation is in Australia's interest with the increasing globalisation of capital markets.
- In June, the Securities and Exchange Commission in the US indicated it would develop proposals for mutual recognition. Treasury and ASIC have had preliminary discussions with their US counterparts about the SEC's plans. Mutual recognition could permit Australian financial service providers to provide services concerning Australian products to US investors. Similarly US service providers could offer the products into Australia. For example, brokers could invest directly into the US and US brokers could invest directly into Australia.

These priorities (two in the Real Economy and three in the Financial Economy) will be complimented by a sixth, and most important, priority: an overall review of ASIC's strategies to identify areas where we need to improve. Really to look out 3 to 5 years to see where ASIC should be positioned.

The review is being conducted within the existing legislative framework and will look at where ASIC needs to be in three to five years. In other words, looking at where new pressures may come from, as our markets continue to evolve.

A key feature of this strategic review will be an extensive survey of external stakeholders to help us assess what we do well and where we need to do better. A new strategy unit within ASIC has been created with a new head (Malcolm Rodgers) and a Chief Economist (Alex Erskine).

We are well advanced on the 6 priorities. Our objective is to deliver results by May so that we can include changes in our approach into our financial year 2008/09 plan.

It is important to add that these priorities build on the good work of the Commission under the leadership of my predecessor, Jeffrey Lucy. He is an exemplary example of commitment to public service. As I recorded with Senate Estimates on 30 May, 3 achievements stand out:

- diligence in pursuing those companies and individuals who breached the law (e.g. HIH)
- laying the foundations for a more proactive ASIC in compliance (e.g. audit regulation team)
- establishing the foundation for greater international cooperation

Jeffrey's legacy is that he left the organisation in a much better state than the one he found.

The Retail Investor Priority

Quite clearly the 3 Financial Economy priorities – capital markets, retail investors and international capital flows – will have a more direct impact on your business than the 2 priorities in the Real Economy although even those will impact on you in relation to licensing, for example.

Let me now expand on the retail investor priority to outline what it will involve and what it means to you. As I indicated earlier, our Deputy Chairman, Jeremy Cooper will head the taskforce and he and his team will develop proposals on the matters I will cover for the Commission to assess and, as necessary, decide.

When we talk about the retail investor, we talk about the people who own the estimated \$2.2 trillion of financial assets held by households in Australia, either directly or through their superannuation funds – many of which are self-managed. This is obviously a large and diverse group, with varying degrees of understanding of the market and varying levels of engagement with the financial system.

We do not cover in this definition of retail investor professional or institutional investors, or those people who choose to opt-out of the retail regime because they are content (and have sufficient funds) to compete in wholesale financial markets. Of course, they are protected in other ways under the Corporations Act.

Why a taskforce?

It is important at the outset to clarify why a taskforce. It is an important question to ask in the context of what have been a series of positive developments in the regulation of our financial markets for the benefit of retail investors and consumers.

The most important point to make is that the wealth, overall, of retail investors, has been increasing. In 2001, retail investors held \$1.25 trillion invested in a range of financial assets and by the end of 2006 that figure had risen to \$2.139 trillion (or by 70%).⁶ While that is due to economic conditions, a positive role has also been played by Government, industry, consumer associations and by regulators such as ASIC, APRA and ACCC and others.

It is important, I think, to briefly catalogue improvements made by Government and industry and the regulators in the last 5 years. There have been substantial improvements which have translated into benefits of greater investor protection and greater market integrity.

Government

First, the Government (under Treasurer Peter Costello and PST's Ian Campbell, Ross Cameron and Chris Pearce) implemented the FSR regime. A regime providing financial services participants a single gateway to enter Australia's capital markets.

A regime with broad scale consumer and investor protection such disclosure requirements for products and advice and on-going obligations for financial services participants to ensure quality of services to consumers and to promote stability within markets.

The system also catered for dispute resolution processes both internal and, where that does not work, external.

The Howard Government recently conducted a series of improvements to FSR through the Refinements Process 2005 and then the Simpler Regulatory System package of law reform 2007.

ASIC

ASIC, too, has played a role. It has licensed some 5239 financial services professionals.

⁶ See Opening Statement by Tony D'Aloisio, Chairman ASIC to the Senate Standing Committee on Economics, 30 May 2007. Available at www.asic.gov.au.

It has introduced a range of guidance following on from FSR to help licensees and advisers understand their legal obligations in relation to adviser training requirements, on-going licensee obligations, and managing conflicts of interest.

It has developed and reinforced links with industry bodies and industry participants through regular consultation.

It introduced the Better Regulation Program – to improve our transparency and accessibility and to better assist our stakeholders in dealing with us.

It published the Super Switching Questions and Answers: RG 84.⁷

It published Example SOA for a limited advice scenario: RG 90.⁸

It published 'Reference Checking in the Financial Services Industry'. The handbook, developed jointly by ASIC in close consultation with a panel of industry representatives and with Standards Australia, is designed to encourage industry to seek and, when requested, provide reference-checking information to help identify dishonest, incompetent or unethical financial advisers.

ASIC also has put various calculators and related work to assist consumers on, and allocated resources to, its consumer website, FIDO.⁹

Industry

Industry and consumer associations have involved themselves heavily with the policy development process and with ASIC and the Howard Government's regulatory amendments.

In the case of the FPA, it:

- set as a core strategic priority the process of raising levels of professionalism. In doing so, it has:
 - appointed a Conduct Review Committee to provide a strong, streamlined and independent structure to respond to complaints and consumer concerns, and to encourage professional confidence and accountability.
 - increased education standards for practitioners to obtain certification as part of a wider push to improve education levels amongst FPA members. Also recruited an Education Manager (July 2007) and in the FY 2006/2007 had record numbers of enrolments in the CFP program.
- introduced Principles to Manage Conflicts of Interest. The Principles added to the FPA's efforts to improve remuneration practices and clarity of disclosure to consumers. The principles require the separate identification of fees attributable to the advice in the statement of advice.
- implemented a program to improve the clarity and transparency of payment and remuneration practices in financial planning.

There has also been considerable contribution from other associations such as IFSA, ABA, Choice and others.

⁷ Regulatory Guide [RG 84] Super switching advice: Questions and answers.

⁸ Regulatory Guide [RG 90] Example statement of advice for a limited financial advice scenario for a new client.

⁹ www.fido.gov.au

In the case of the FPA (and IFSA) their work has had broad recognition with Money Management (22/11/07) last week congratulating their efforts and saying that there were too many achievements to mention in their lobbying and advocacy work.

Stocktake

There is, therefore, considerable evidence that improvements are being made and the retail investor, the consumer, is better protected today than 5 years ago. That the measures I have outlined are producing outcomes can be evidenced by:

- Overall increase in the level and quality of licensee supervision and an increasing acceptance of compliance as not only a risk management tool but a tool to increase client satisfaction and brand name value;
- Overall upward trend in compliance with conduct and disclosure obligations in relation to financial advice.
- Greater transparency and comparability of fees – This is one of the key successes of FSRA.
- Ongoing and active debate on remuneration practices.
- Developments of different and new models from industry to provide advice to the retail sector.

All evidence that things are going in the right direction for investors and consumers and for the markets.

Matters to Complete

These improvements will be complimented with some additional measures which have just been completed or will be completed shortly. Let me go through these.

First, the Compensation and Insurance Arrangements for AFS licensees.

Yesterday we published a regulatory guide setting out the policy on how we will administer the requirement for financial services licensees to have "adequate compensation arrangements" in place. Essentially, this will be through professional indemnity insurance, which is the current policy setting for increasing protection to retail investors.

Requiring licensees to have PI insurance cover will improve the current level of consumer protection, but will be limited by what insurance is currently available in the insurance market. ASIC has adopted a two-stage approach to administering the new rules to take account of this.

To start with, ASIC will require licensees to have PI insurance based on what is commercially available in the market now, but has set minimum standards to deliver some practical results for consumers. It will be enough for licensees to meet these minimum standards for two years after the requirements commence. Over time, ASIC aims to raise the standard of available PI to make sure it delivers effectively.

At the end of the two-year implementation period, ASIC expects licensees to have a higher standard of PI insurance. It will work with industry to encourage the development of products or solutions that achieve this higher standard during the implementation period.

A staged approach of this kind is the best way to work toward a high standard of PI insurance cover in the industry and in the meantime provide consumers with a minimum standard of insurance protection.

More specifically, for the next 2 years, we will consider adequate PI insurance (provided by an approved insurer), where it meets the criteria:

- (a) There is an appropriate level of insurance coverage based on a sliding scale starting at \$2 million for licensees whose revenue is up to \$2 million, and increasing to a maximum of \$20 million for bigger licensees;
- (b) In terms of scope, the insurance specifically covers breaches of financial services laws, liabilities from EDR determinations and fraud of representatives, employees and agents (but might not cover acts outside the approved product list).
- (c) The insurance contract does not exclude, for example, claims that have been admitted by a licensee to ASIC under the breach notification regime.

This new policy applies from 1 July 2008 for existing licensees and 1 January 2008 for new licensees.

The second area of work we are completing is our review of our policy on external dispute resolution schemes and whether the monetary limits of the EDR schemes are adequate to ensure the desired policy goal of the EDR structure, which is to provide a cheap and efficient forum for dispute settlements. I commented on EDRs when I spoke on the property collapses.

I indicated that the FICS limit should be lifted. And we will work with the industry to see that PI insurance cover lifts to cover the existing and new limits as well.

Let me make the point here that when we speak of EDR we are dealing with investors who have rights. EDR is the alternative to Court proceedings for the financial services provider. The trade off, in my view, for the expense of court proceedings is the monetary limit on claims. If the monetary limit is too low or the EDR process is not effective, it will leave the regulator to examine other options (e.g. s50 of the ASIC Act) and such limitations will further promote more costly class actions. We will, as part of the review of RG139 and RG165¹⁰ on IDR and EDR be consulting further on these important issues.

The third area is IDPS (wraps/platforms/master trusts). ASIC is conducting a review of its policy in this area. We have put out a consultation paper, conducted round table discussions and we will publish our refreshed policy in early 2008.¹¹ The review proposes to scale back and simplify the regulation of operators of IDPS's in a manner consistent with obligations on other financial service licensees. For example, we propose removing prescriptive content requirements in IDPS disclosure documents in favour of principles-based disclosure.

An important aspect of the review is that we have maintained the position of our existing policy that a recommendation to use an IDPS is financial product advice and may be personal advice. This means that advice about an IDPS not only requires an SOA but also means that the adviser must have a reasonable basis for recommending a client switch to a particular IDPS.

¹⁰ Regulatory Guide [RG139] *Approval of external complaints resolution schemes* and Regulatory Guide [RG 165] *Internal and external dispute resolution*

¹¹ Consultation Paper [CP 83] *Review of ASIC policy on investor directed portfolio services*

Finally, we have also recently completed our review of the training requirements for advisers within the review parameters of that set by the Howard Government.¹² ASIC's review focused on "Tier 2" products, which are the simpler financial products such as general insurance and basic deposits. The key outcome of this review was that we decided to relax the training requirements for Tier 2 products so that people advising on a specific product need only be trained on that specific product. This is quite separate approach from the training requirements for the more complicated "Tier 1" products. This approach should provide licensees with a more flexibility to ensure staff are adequately trained.

Summary

These initiatives complete the regulatory framework which has, as I said earlier, been working. They will deliver further improvements in relation to what I said earlier on a system which is delivering results.

So why a taskforce?

Given these improvements, why a taskforce? Let me come back to that question. You may say, why not give time for existing measures to take effect and those few yet completed to be implemented. We did give careful thought to that. However, we think that there are important drivers and issues to be examined in the retail sector and that examination should occur now rather than, for example, at a time when markets may have turned down. (Not that I am suggesting they will turn down!).

What are those drivers and issues? The drivers for setting up the taskforce were these:

- First, we perceive that there is an imbalance between supply and demand in this market. What I mean by that is that there has been a rapid growth in funds looking for investments and a shortage of qualified financial planners and advisers and a shortage of advice. Ordinarily if supply and demand were more balanced, we could leave it more to competition in the market to push for innovation, lift the quality of advice, open up new markets for advice and so on. There are many examples of strong competitive industries where the supply and demand balance fosters innovation and quality improvements.

As a regulator this imbalance in favour of suppliers requires us to take a closer look at this sector and the practices of its participants to ensure investors are adequately protected.

- Secondly, we have, with the growth of retail money looking for investment, seen a growth of more complex products aimed for the retail market. The development of new products really shows innovative capital markets at work. That is not a development we wish to interfere with. Indeed the funds management sector sees the retail investor as a key growth market for the next 10 years. However, the complexity of products raises issues, such as whether there are special or new disclosure methods needed. An example of what I mean by complex products is the retail investor exposure to the sub-prime assets through investment in wrap accounts in Australia, which in turn lead to investments in funds offshore which had CDO exposure and leverage.

¹² Regulatory Guide [RG 146] *Licensing: Training of financial product advisers*

- Thirdly, we have a concern with accessibility of advice for the retail sector. FPA's estimates are that 1 in 5 Australians use an advisor. It seems that funds under advice as at June 2007 was \$425bn. Just what percentage that is of total investment assets of the retail sector is not clear to us. If that sector, as we believe, is over \$2 trillion, then on the face of it, only some 18% of those funds would be subject to advice from advisers. Of course, the retail investor could be getting advice in other ways.

We believe accessibility of advice is important.

Retail investors face some very critical investment and financial decisions at various stages of their life. Some stages are particularly complicated, like retirement, redundancy and other changes in work circumstances. Also, most employees also have the freedom to choose where their superannuation money is invested. The point is that these decisions can be critical, and have major long-term impacts on a person's financial position. It is therefore important that financial advice is available to those who need it.

- Fourthly, the retail sector has a high proportion of retirees who will need their investments for retirement. Ensuring that they are adequately protected is important for a regulator as this group cannot easily re-enter the workforce.
- Fifthly, the experiences with the property related failures have raised (as I said earlier) broader lessons which we feel we should assess further.

For those reasons (or these were the drivers why), we felt that the retail investor should be made a clear priority for ASIC and hence the taskforce.

The Big Issues

What then are likely to be the more important issues for the taskforce? While the taskforce is still formulating its approach, it is likely that its work will involve the following:

- First, an in depth study of the retail investor sector. Who are they? What do they invest in? Where are they likely to invest in the next 3 to 5 years? We have added a Chief Economist and research unit in ASIC to enable us to do this sort of analysis. We need this basic work in order to formulate propositions on how existing advice, disclosure and protection levels work. We will draw on industry studies as well. We need greater clarity around this sector and where it is heading, otherwise, we will not be able to tailor solutions to fit the market segments. For example, the needs of high net worth retail investors will be different from those in the early stages of wealth building. Differing levels of financial literacy will also be relevant to initiatives we may need to take.
- Secondly, we will assess who has access to advice and who uses advice and who does not. We need to be able to identify where advice is available and where it is not (either because the suppliers do not provide the advice or investors do not use it, even if it is available). We also need to see what aspects of the current framework may be inhibiting provision of advice (e.g. the SOA and its length). Our investor research (which we are conducting) into why investors made particular choices, will assist us in this regard.

- Thirdly, we will assess the different advice models which are available to retail investors (e.g. so called "fee for service") versus other models). This will be to assess:
 - what benefits those models deliver
 - impact of future competitive dynamics on those models

These three sets of analyses are very much about understanding the commercial picture and the competitive dynamics. They will build an important fact base. We will through these initiatives get a greater understanding of the needs and wants of the retail sector and the services supplied to them.

We believe that it is timely to do this work, some of which we feel we can easily draw from industry and from industry and consumer associations.

We think that this work will then enable us to focus, with you, on some specific issues. We will be able to do that, unlike in the past, with a factbase which will elucidate who the retail investors are, what the issues are and how best we can serve them. We see the key issues as:

- (a) Disclosure documents for products. Their length and complexity and what changes might needed (e.g. PDS's). We have provided new benchmarks on disclosure for unrated and unlisted debentures. PDS's are used for a range of other investments (e.g. MIS). Are they working? What changes are needed? Should we take the same approach with those as we have done for unrated and unlisted debentures? It is pleasing to see that IFSA is working on these issues as well.
- (b) Statement of Advice. A "one size fits all" approach is generally speaking an efficient and effective form of regulatory policy. There is a question of whether it is correct here. In particular, whether the SOA is part of the reason why some investors are not being targeted by financial planners. It is pleasing to see that the FPA is examining how to improve and shorten the SOA.
- (c) Compensation arrangements. What we are putting in place for what is "adequate" has a target for improvements over 2 years. We need to work with the insurance industry to assist with these targets and what we do if they are not achieved.
- (d) Lessons from Westpoint. I referred to these earlier. They will be picked up as part of the work of the taskforce.

These are the 2 other issues which have currency and which we would like to continue to examine as part of the work of the taskforce: the first is remuneration arrangements in the advice industry and the second, the so called fiduciary duties of advisers and licence holders.

Remuneration

There is a broad spectrum of remuneration arrangements for licensees and their representatives. At one end of the spectrum is full fee for service where clients pay an agreed fee for advice that is given and receives a full rebate of any commissions flowing to the licensee from product manufacturers. This fee may be charged on the basis of the time expended, the complexity of the advice or the value of the assets advised upon or a combination of these factors. At the other end of the spectrum

licensees and indirectly their advisers may be remunerated solely by commissions paid by product providers following a purchase of a product recommended by the adviser.

We have also observed competitive forces driving different means of taking (and rebating) fees up and down the value chain (shelf fees levied by platform providers being one example).

The availability of different models indicates that there is competition between the different models. It is not our desire to inhibit that competitive process. Similarly, the policy behind the FSR regime is reasonably well settled and it is that different remuneration arrangements are acceptable.

Where the "rubber hits the road" for ASIC with the different remuneration arrangements is in the area of management of conflicts of interest. As a general proposition, the greater the reliance on commissions, the greater the conflict which needs to be managed. For ASIC Westpoint will, rightly or wrongly, be used as a case study on how well conflicts were managed where high commissions were paid.

What we want to test with the further analysis (by the taskforce) is whether the different models and levels of disclosure are working for the retail investor. Our objective will be to point out the benefits and risks of each model for the retail investor.

We feel that with adequate disclosure of the benefits and risks, the market will "vote with its feet". It will ultimately choose the models which it will support. And if in that process, some models cannot comply with the law, we will say so.

Fiduciary

There is debate on whether financial planners and advisers are fiduciaries (i.e. owe fiduciary duties to the retail investor). If they are (either as licensee or authorised representative or both), what does that mean? The debate it has been argued, has caused uncertainty for those who provide financial advice; you may well be unsure as to what are the standards expected by the Regulator and the Courts.

At the outset, let me say on this that our compliance focus (e.g. results of the shadow shopping exercise) has been on ensuring compliance with the duties in the Corporations Act and specifically such things as:

- Failure to provide SOA (s.945c(ii))
- Did not make adequate enquiries (s945A(i)(as(ii)))

ASIC has not, in its compliance work, been assessing whether there have been breaches of fiduciary duties.

On the issue of fiduciary, what has developed in the market, as we see it, is this:

- FPA's concern that the duties of advisers (statutory, common law, equity and so on) may include a fiduciary duty.
- a statement from my predecessor at last year's FPA conference that advisers should act in the best interests of their clients, like accountants and lawyers. This has been interpreted saying that fiduciary duties apply.

- the Citigroup decision where ASIC failed to establish a fiduciary obligation between Toll and Citigroup and has raised doubts on when a fiduciary can exist.

Our current position is this:

- The law on whether or not there is a fiduciary duty is unclear.
- Until it is clarified, ASIC's compliance will continue to focus on statutory duties and other established duties (e.g. negligence).

What the taskforce will do on fiduciary duties here is 2 things. First, to form a view on whether a fiduciary duty exists and secondly, what flows from it.

This second issue, if the view is reached that there is a fiduciary duty, is critical. What flows from it? Will it add additional obligations over and above those which exist now? This is not at all clear as the statutory duties are quite wide and cannot be excluded by agreement. If it does add more duties, can they be excluded by agreement on the basis of informed consent?

Summary

You can see from what I have said that the taskforce will work through a number of issues (those which I outlined) that still need analysis and discussion and resolution.

Importantly, however, it will do that:

- with the benefit of an important retail sector fact base;
- and without preconceived ideas of which models of advice are better than others. Ultimately consumer and retail investors should "vote with their feet" on what models they will favour. ASIC's role, with the current legislative settings, is to analyse these models and provide information to the market to ensure retail investors can make choices. ASIC will be active in pushing disclosure to its limits (as it has done in the unlisted and unrated area) so that investors can 'vote with their feet'. While it is not ASIC's role to try and pick winners, ASIC will be active in this sector and the advice provided.

We are looking forward to working with you on the important initiatives which I have outlined.

International Developments

Our focus on the retail sector is not, in case you were wondering, peculiar to Australia. This retail sector focus is also going on overseas.

In the UK, the FSA is conducting a Retail Distribution Review.¹³ It has published a specific proposal to:

- (a) improve the "quality and clarity of services offered to many consumers";
- (b) make advice more accessible; and
- (c) improve consumer understanding.

The proposal suggests that advice be provided in two forms:

¹³ Financial Services Authority UK. See <http://www.fsa.gov.uk/Pages/About/What/rdr/index.shtml>

- (a) Professional financial planning and advisory services – a full range of financial planning and specialist advice administered by a certified and independent advisers for medium-high net worth customers; and
- (b) "Primary Advice" simple straightforward advice using simple products and subject to less rigorous regulatory requirements, with the objective that the costs of the service would be kept to a minimum.

The proposal above is designed to work alongside a project that the UK Treasury is looking into for the provision of Generic Financial Advice – Thoresen Review.¹⁴ The review is designed to lift levels of financial literacy to those who cannot afford traditional advice.

In the US, the SEC is presently conducting a study of the role advisers play in the retail marketplace the results of which are due in December.

The US has both "brokers" registered under the *Securities Exchange Act* who may offer financial advice and charge commissions, and separate "financial planners" registered under the *Investment Advisers Act* who mostly avoid (90%) the use of commissions.¹⁵

This fee-based group (i.e. the financial planners) are subject to fiduciary standards that first, require them to place the interests of the client first and secondly, hold the advisor personally liable for breaches of fiduciary duty. Whereas, the commission-based group (the brokers) are held only to a standard of suitability in their recommendations. Whether or not this group of "brokers" should be required to adhere to the same fiduciary standards as the investment advisers is an issue of hot debate in the US.¹⁶

Some key issues in the US:

- (a) advice remuneration models – there is a strong push towards fee for service models;
- (b) compliance costs are overly burdensome and make providing advice to low-medium wealth clients difficult;
- (c) advisers are looking at using more technology to deliver cheap advice to the broader population, while maintaining the traditional personal model for high net worth clients.

As you can see, therefore, the issues are not just ASIC issues. The taskforce will assess these overseas models as part of its work.

Conclusion

Let me conclude by drawing this together so that we can move to question and answer:

¹⁴ Thoresen Review of Generic Financial Advice, Otto Thoresen, Chair. See http://www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm

¹⁵ Evolution Revolution 2007 – A profile of the investment adviser profession, Investment Adviser Association and National Regulatory Services, Washington DC, USA.

¹⁶ Who's the Fairest of them All? A comparative analysis of Financial Advice, *Journal of Financial Planning (US)* 20 no 5, May 2007.

- First, I hope I have given a feel about me and my style of operation as a new Chairman with, in effect, a new Commission. In particular the forensic and analytical and consultative way that we will approach issues. A good example is how we approached the unlisted and unrated debenture issues.
- Secondly, I hope I have outlined to you our priorities and why, in particular, retail investors will be one of those priorities and why it needs a taskforce and why that work should occur now.
- Thirdly and importantly, I hope I have outlined to you the work of the taskforce and the key issues it will be examining. The outcomes of the taskforce's work will be to set ASIC's agenda in the retail investor area for at least the next 3 years.

As I said at the beginning, we have a common objective – to ensure that investors, most notably retail investors are best served when they make their investment decisions.

Thank you.