



ASIC

Australian Securities & Investments Commission

Regulatory Futures: Where to on Wealth Management?

An Address by Jeffrey Lucy AM

Chairman

Australian Securities and Investments Commission

IFSA Annual Conference:

Connect 2006

2 August 2006

Gold Coast, Australia

Introduction

- Your conference theme this year, 'Connect', recognises that we all play a role in the wealth management and advice industry.
 - Government, regulators, industry associations, industry players, consumers of financial services and the wider community alike each have an interest in, and responsibility for, pursuing fair, competitive and efficient markets, which, in turn, leads to sustained confidence.

- A large contributor to our financial markets is our managed funds sector.
 - This sector has been gaining volume and momentum over the last couple of decades.
 - Total consolidated funds under management has now surpassed \$1 trillion¹, with superannuation funds accounting for over 70% of this and holding some \$730 billion in assets².
 - IFSA members are responsible for investing over \$920 billion of these funds on behalf of more than nine million Australians. Your significance in this, and your role in it, speaks for itself.

- Overall, we think the industry is sound, but today, as always, we all need to strive for continuous improvement. ASIC is no exception; neither is your industry.

- From the regulatory viewpoint, we have moved to the following position over the last 12 months:
 - real time regulation with a much greater emphasis on surveillance;
 - a strong focus on licensees; and

¹ Australian Bureau of Statistics, 2006, *ABS Catalogue No. 5655.0: Managed Funds Australia – March Quarter 2006*.

² Axiss Australia Data Alert, 20 June 2006, available at www.axiss.gov.au.

- utilising key regulatory outcomes – for example, the enforceable undertaking we have accepted from AMP Financial Planning – as clear guidance from which the industry can move forward.
- Today, I will also address some of the key leadership tasks ahead of us as stakeholders working in the interests of together sustaining market confidence and economic growth.

The current regulatory environment

- The Australian regulatory environment has seen the introduction of a number of important pieces of legislation in the last decade. I will not dwell on these changes that you are all, no doubt, familiar with, but they have included:
 - the managed investments legislation;
 - financial services reforms, including CLERP 9 (which introduced the conflicts management obligation) and the ‘refinements’ that continue to be developed; and, of course,
 - superannuation choice.
- These changes intrinsically altered the way that we all operate and, for our part, ASIC has had to adapt.
- In our view, the changes were necessary stepping-stones given the marked increase in retail participation in our financial markets, financial services and products. This increase in activity is supported by an aging population for whom the vital importance of carefully planned and provided superannuation will underpin their retirements. This, in turn, will directly relate to the cost to the Australian taxpayer of funding retirement benefits for those Australians who have not adequately secured retirement funding for themselves.

- Some 55% of the Australian adult population, or approximately eight million people, now own shares either directly or indirectly (including through managed funds)³.
- There is much greater variety in the investment products that retail consumers can choose from.
 - The products span a broad spectrum, including:
 - prudentially regulated products (e.g. bank accounts);
 - shares (including LICs);
 - managed funds;
 - derivatives;
 - foreign exchange;
 - more complex products (e.g. contracts for difference); and
 - speculative products (e.g. property development schemes).
 - From our perspective, the complex and speculative schemes are more worrying in the *retail* consumer sphere unless accompanied by disclosure that really allows consumers to understand the product and make good decisions in their own interest.
 - I appreciate the need for your industry to be innovative in an extremely competitive and global market. There are many consumers who are able to understand and benefit from investing in complex products. But there are also many who either do not understand adequately, the consequences and risks of such investments or those whose individual profile and circumstances make it likely that these products are inappropriate.
- Evidence suggests that investors are increasingly willing to take on more leverage and purchase a wide range of financial assets⁴.
- This is despite historical evidence that an economic downturn will typically follow times of economic prosperity, such as that which we

³ Australian Stock Exchange Limited, 2005, *Australia's Share Owners: An ASX study of share investors in 2004*, available at www.asx.com.au.

⁴ Reserve Bank of Australia, 2006, *Financial Stability Review: March 2006*, available at www.rba.gov.au.

have experienced over the last 14 years, and amidst growing evidence in increasing interest rates and inflation.

- With such a substantial portion of the managed funds sector accounted for through your wealth management and advice activities, you have the capacity to influence the choices most Australian retail consumers are making.

- In this environment, it is more important than ever before that you provide a leadership role in providing advice to your clients that is appropriate and recognises the economic cycle and that does not exaggerate future expectations.

- Your industry enjoys a strong reputation and most within it have strong, well-known brands. These reputations have been built over the years by providing to Australian consumers a long term and sustainable business model. This business model accepts that consumers are making investment decisions that will rival the purchase of the family home as **the** most significant and financially important decision they will ever take.
 - With this comes responsibility to provide leadership and innovation, but also to take responsibility for the quality of advice and products you offer.

Real time regulation

- As I mentioned at the beginning of this address, ASIC intends to play our role through an increased use of real time regulation in influencing the industry and its approach to its responsibilities through greater use of compliance-based solutions – especially enforceable undertakings – rather than court action. I do not need to remind you that court action always remains a possibility.

- So, when is it appropriate for a regulator, charged with the responsibility to enforce the laws of the Commonwealth, to accept an enforceable undertaking?
 - This is quite complex and our policy is reflected in our Practice Note 69⁵, but in my mind, there are several key ingredients.
 - What is the best outcome for those who have been adversely and directly affected by the problem or issue?
 - Is there a strong willingness by the entity to recognise and accept that the problem or issue requires rectification?
 - Is there a willingness to see the process through in a manner that provides permanent and ongoing rectification, including a role readily built into that process for an independent expert to ensure compliance?
 - Is the agreement legally enforceable?
 - Finally, will the acceptance of the undertaking by ASIC be in a form that is transparent?

- The recent enforceable undertaking that we accepted from AMP Financial Planning is the latest example that highlights the issues around quality advice and disclosure where conflicts of interest are apparent.
 - In my view, the enforceable undertaking provides an extremely important insight for your industry as to what AMP and ASIC consider to be the appropriate way of dealing with important issues affecting the way business should be done.
 - May I remind you that AMP offered, and we accepted, the enforceable undertaking.

- Between October 2005 and April 2006, ASIC reviewed 300 files selected from 30 AMP planners chosen at random.

⁵ Australian Securities and Investments Commission, 1999, *Practice Note 69: Enforceable undertakings [PN 69]*, available at www.asic.gov.au.

- Our analysis revealed, among other things, that on many occasions AMP Financial Planning:
 - financial advisers' files did not disclose a reasonable basis for advice;
 - failed to make proper disclosures about the costs of acquiring the recommended products; and
 - may not have had adequate arrangements in place to manage conflicts of interest, including the commission-based remuneration of its financial advisers.
- Our surveillance also revealed that AMP Financial Planning's approved list contained industry funds, but that they were on 'hold status'. AMP Financial Planning defined 'hold status' as, and I am paraphrasing, the adviser being unable to recommend a client make a new lump sum contribution or increase a regular contribution to an industry fund. Any lump sum or increased contribution had to be directed towards an open product on the current approved list. AMP Financial Planning's advisers were prohibited from recommending that clients establish a new industry fund account.
 - We formed the view that statements on AMP's website and in the Financial Services Guide suggesting that its advisers could advise on industry funds were misleading given that they did not mention the significant limitations on the advice that could be given (which I have just described to you).
 - In the course of negotiating the enforceable undertaking, AMP Financial Planning took industry funds off its approved list. It did this not at the 'say so' of ASIC. It did this because, in the light of ASIC's findings, the only other option open to AMP Financial Planning was to leave them on their approved list, but remove their 'hold status' so that advisers could make recommendations to establish an industry fund account, increase lump sum contributions or increase regular contributions. That is, to treat industry funds in the same way other products on the approved product list were treated.

- In the enforceable undertaking, AMP Financial Planning has committed to:
 - redesigning compliance and training systems;
 - lifting its standards of disclosure;
 - properly managing its conflicts of interest; and
 - being reviewed by an independent expert, who also reports to ASIC and who will determine how successfully it rectifies compliance deficiencies. To the extent that there are further perceived deficiencies identified by the expert, AMP must also rectify these.

Remuneration and association conflicts of interest

- The use of commission-based remuneration models and restrictive approved product lists were common threads in both our surveillance of AMP Financial Planning, as well as our shadow shopping survey on superannuation advice earlier this year.
- I want to reiterate ASIC's previous messages that it is not our role to alter the structure and ownership of the wealth management and advice industry.
- Our focus is on the quality of advice presented to the client and full disclosure of relevant facts, including adviser remuneration.
 - How financial advisers are paid is a matter for individual licensees, not ASIC.
- We do know, though, that there is a clear need for management to adequately manage the advice given to clients where the adviser is remunerated through a commission structure or where the adviser recommends associated products.
 - Our experience suggests that there is a materially higher risk of poor advice being given in these circumstances.

- So, what should the industry do about it?
 - The answer is clear: either manage it properly or change your remuneration model.
 - As I stated to the Parliamentary Joint Committee on Corporations and Financial Services in June, this year, we recognise that 'like oils aren't oils, commissions aren't commissions'.
 - We are concerned about quality and affordable advice being universally available to consumers.

- Perhaps there is no bigger single issue facing your industry than that of remunerating your advisers. There are strong advocates in Parliament and the media, who advocate a total ban on commissions.
 - ASIC cannot dictate this argument. It will either be decided by Parliament or the industry, or perhaps a combination of both.
 - There are already some within your industry that have decided to operate on a fee for service model.
 - If the commission-based remuneration model is to be retained to provide an alternative in a competitive industry, it must not impact on or influence the quality of advice, including the products recommended.

- As many of you would be aware, we issued a discussion paper in April, this year, dealing with conflicts of interest.
 - This paper articulated hypothetical scenarios illustrating real or perceived conflicts of interest across the financial services industry so that we could explain our views on how those conflicts might be managed in such circumstances.
 - We have received over 30 submissions – some supported the approach put; others did not.
 - Having regard to those submissions, we will finalise our guidance. This process will include further consultation.

- Your industry must not see this process of consultation as being an opportunity to assume there is a regulatory vacuum on conflicts management in the meantime. Your responsibilities, as redefined in January 2005, remain.
 - In cases where we consider enforcement action appropriate, we will not hesitate, particularly where an enforceable undertaking is not a viable alternative.

Consumer protection mechanisms

- While the quality of advice and disclosure is cornerstone to achieving fair, efficient markets and confident, informed consumers, it is but one plank in the current regulatory setting.
 - It must be balanced by an equal appreciation of adequate consumer protection mechanisms including dispute resolution and compensation.
- The *Financial Services Reform Act* set out requirements that all Australian financial services licensees have in place adequate internal **dispute resolution procedures** to deal with complaints, and be members of external dispute resolution schemes, such as FICS.
 - Although the role of external dispute resolution schemes is often highlighted, a hallmark of a professional industry will emphasise the role of internal dispute resolution processes.
 - In our view, fair handling of complaints requires licensees to, among other things:
 - ensure dispute resolution processes are readily accessible to complainants and followed by those handling the issue;
 - assess each complaint properly and make clear decisions supported by material that is fair, reasonable and genuine; and
 - communicate to each complainant clearly and fairly.

- It also requires licensees to cooperate fully with any referrals to the external dispute resolution scheme of which the licensee is a member.

- While the transitional arrangements dealing with **compensation** are still in play until 31 December 2006, after this time, Australian financial services licensees will also be required to have in place arrangements to compensate their clients for loss or damage suffered because of breaches of their obligations as licensees.
 - At the moment, licensees need to meet only current minimum compensation requirements (e.g. security deposit for dealers and advisers in investments and certain professional indemnity insurance requirements for some responsible entities of managed investment schemes).
 - That said, we recognise that responsible operators will have voluntarily put in place what they regard as adequate arrangements to ensure they can compensate consumers if the need arises.
 - In a similar vein, I strongly encourage you to support your external dispute resolution schemes, for the benefit of industry reputation and consumer confidence.
 - In that regard, we encourage FICS members to consider consenting to consumer claims over the current \$100,000 monetary limit being dealt with by FICS, as a less costly and more expeditious way of resolving these disputes.

Making the connections

- We all have a leadership role to play in sustaining market confidence.

- For each of us, there is clear recognition that our activities have flow-on effects on the broader financial markets.

Regulatory Futures: Where to on Wealth Management?

- Perhaps too often, we see the approach taken to issues that need to be worked through together, as being adversarial or argued on an ambit basis.

- We do understand that your motive for profit is appropriate. However, we work in a world where:
 - we do see, first hand, the consequences of poor advice and misselling;
 - we do receive daily complaints of poor conduct; and
 - we do see, from time to time, that Australians have had their trust misplaced.

- As part of our Better Regulation initiatives, we have committed to developing and applying a process to analyse the impact of our regulatory decisions.
 - We understand this involves balancing the interests of a range of stakeholders.
 - Adopting this approach will require consultation and constructive dialogue on all of our parts.

- Despite our differences in emphasis, we all have the same broad objectives in view: fair and efficient markets leading to sustained market confidence and economic growth.

- I can assure you that we will play our part in regulating your industry to minimise the potential for any competitive advantage being obtained through non-compliance with the law.