

SUBMISSION TO FINANCIAL SYSTEM INQUIRY

I am a chartered accountant, a financial educator and a former licensed financial adviser of some thirty years' experience. My submission does not attempt to cover all of the Inquiry's Terms of Reference. However, I have noted the following statement in the preamble to the Inquiry's website: **"Recommendations will be made that foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, public confidence and capacity to meet the needs of users"**.

My principal proposition in this submission is that for a significant number of users the system is inefficient, uncompetitive and inflexible. Furthermore, the system does not meet their needs due to its highly conflicted structure. This leads to low public confidence and a lack of trust. My submission includes a recommendation to overcome this shortcoming in the system.

In making my submission and recommendation, I am concentrating on the vast majority of the Australian population who are generally referred to as 'retail' users of the system, rather than larger 'wholesale' users who (generally speaking) are capable of looking after their own financial affairs.

A key conclusion from an analysis of the global financial crisis is that the financial services system was (and still is) substantially driven by conflicts of interest which have embedded a strong culture of product sales. This is inconsistent with the expectations and needs of most users who are seeking advice, not a product. As a result, retail users of the system do not trust it and have little confidence in its ability to meet their needs and best interests.

A number of attempts have been made over the decades to address the problem of trust and confidence through inquiries and subsequent legislation. In recent years, an inquiry was held which resulted in parliament passing legislation in 2012 (Future of Financial Advice/FoFA) which was designed to curtail the excesses of licensed financial planners/advisers, particularly in the area of conflicted remuneration. This law is now subject to proposed amendments which have caused considerable and unprecedented public controversy. Regrettably, this publicity has led to a further lowering of trust and confidence in the financial services system, especially amongst its retail users.

Much of the recent discussion has been about the importance of creating a system which offers access to **affordable** advice. This is a commendable objective. There is no doubt that much cost is created by a system which is burdened with a great deal of complex and ineffective box-ticking regulation, although it must be recognised that much of this regulation has been self-inflicted by the industry's poor behaviour over recent decades. Nevertheless, anything that can sensibly be done to remove red tape and reduce the cost of advice should be supported.

However, users of the system must also be able to access advice that can be **trusted**. This is where existing legislation falls short because governments have never been willing to do what needs to be done to create an **affordable** and **trusted** financial system.

The **affordable** part is easy. There will always be enthusiastic support for that. The hard part is creating a **trusted** system. That's where the financial services industry always pushes back, usually claiming the need for 'balance' with respect to consumer protection. In this context, 'balance' is often code language for not doing anything that would substantially disturb the continuity of conflicted remuneration and the product distribution networks that are sustained by those forms of remuneration. For example, it's important from the industry's point of view that the FoFA definition of 'conflicted remuneration' is **not** comprehensive, so that one form of conflicted remuneration can simply be replaced by another.

As a result of this lack of legislative rigour, the consumer protection measures in the financial services laws are so compromised that the industry can (and does) easily avoid the laws' intentions. This game has been played for decades, resulting in a financial system that is heavily, **but ineffectively**, regulated and in which users have little confidence or trust that their needs will be met.

So the threshold questions in examining the financial system are:

- 1) Are we serious about creating an **affordable** and **trusted** system? or
- 2) Do we just want the problem to go away to be dealt with by future generations?

If the answer to question 1) is "yes", I recommend a solution in which government offers to remove all (not just some) of the complex regulatory red tape in return for the industry adopting a comprehensive self-regulatory code of ethics and conduct in which all forms of conflicted remuneration would be removed (not just some of them). All participants in the financial system would be bound by this code.

Consumers would support this outcome because it would create both an **affordable** and **trusted** system. The regulator should support it because it could then concentrate on the 'rogues' with the assurance that the industry would no longer be structurally flawed.

But would the financial services industry participants support it? They should do so because a comprehensive self-regulation code would remove much of the costly and complex regulation about which the industry complains so loudly. However, many in the industry are likely to oppose a comprehensive self-regulatory code because it would work.

Sadly, much of the industry would prefer a complex, costly and ineffective legislative regime which can be avoided, rather than a cheaper, simpler and effective self-regulatory code; but, of course, they would not admit that publicly for obvious reasons.

Consequently, if the idea of a comprehensive self-regulatory code were to be raised, the industry's reaction is likely to be that it is 'impractical' and 'unworkable'. And if government insisted on such a course of action, the industry would spend much time trying to water down the code before it was adopted, in much the same way that they have lobbied political parties to water-down the FoFA consumer protection legislation in the name of reducing red tape, complexity and cost (when, in truth that's not the genuine reason behind the lobbying).

I have watched the course of regulatory reform in financial services throughout my career and must sadly conclude that behaviour in the financial system has not substantially improved. There's been a lot of talk, a lot of complex legislation, but very little meaningful action. Successive governments have never had the courage to act comprehensively; such is the power and influence of the industry to resist change through lobbying and access to financial resources way beyond those of people who hold a contrary opinion.

I submit that unless we act comprehensively (preferably by self-regulation) nothing will change. Parliaments of the future will be faced with the same problem that generation after generation of politicians have failed to address and the lack of trust and public confidence in the Australian Financial system will continue.

Robert M.C. Brown AM BEc FCA

30th March 2014