



Boutique Financial Planning Principals Group Inc.

Submission to the  
Financial System Inquiry

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# The Boutique Financial Planning Principals Group

The BFP is a national, non profit association of like-minded, small Australian Financial Services Licensees (AFSLs) which are independently owned and non-aligned to financial institutions. The BFP was incorporated on 26th April 2002, formalising a monthly study meeting of boutique financial planners going back to 1996. The BFP now has around 80 members, with members in every state.

Members of the BFP must:

- Have their own AFSL to provide financial advice;
- Be providing ethical and professional financial planning advice which puts the client's interests first;
- Be independent and independently-owned, as defined in the BFP Constitution;
- Be practitioner members of the Financial Planning Association of Australia (FPA); and
- Have 20 or less Authorised Representatives.

The Mission of the BFPPG is to use our collective strength to improve financial planning for clients and financial planners by:

1. Sharing ideas and information between members — helping members in all areas of financial planning with emphasis on the particular vulnerabilities of small businesses in an industry where the majority are large businesses.
2. Fostering friendship between members and providing support to financial planning representatives seeking their own AFSL.
3. Communicating with the FPA — providing a united and strong boutique voice to the FPA and working with the FPA to promote the specific interests of boutique financial planners.
4. Communicating with regulators and government — providing a united and strong voice to regulators and government about matters that are consistent with the provision of client- focused as distinct from product-focused financial planning advice to the Australian public.
5. Promoting awareness and recognition — promoting the significant differences between boutique financial planners and institutionally aligned financial planners and the differences between “advice businesses” and “product sales businesses” to regulators, politicians and to the public.



# Summary

## **CONSUMER OUTCOMES** (FSI Interim report 3-49)

### **Personal Advice** (FSI Interim report 3-67)

BFP members are working with the FPA on the matters raised in the Interim Report and therefore have not commented on them separately in this submission.

### **Accessibility** (FSI Interim report 3-69)

Technology is undoubtedly improving the efficiency of practice management and the delivery of financial advice.

The existing financial services framework is simultaneously prescriptive and proscriptive in nature. It is complex and the cost of compliance is high. In addition it is overlaid with other regulatory requirements, (AML/CTF and Privacy laws are two examples). This results in barriers to providing the advice consumers seek and high costs which are passed on to consumers.

To enhance opportunities for consumers to access low cost, effective advice you need to identify and remove the regulatory barriers to providing that advice. We acknowledge a need to balance this with adequate consumer protection.

Quality of advice can be regulated through education standards, which could include compulsory professional association membership to assist in co-regulating the provision of advice to an “industry standard”.

### **Independence** (FSI Interim Report 3-72)

Some consumers prefer to receive advice from a well known institutional “brand” whereas others prefer advisers who are independent of product providers, so a clearer distinction is required to enable consumers to make informed choices.

There is clear evidence that consumers are often unaware that their adviser is licensed through an AFSL wholly or partially owned by a product manufacturer. A simple fix is to require such disclosure in all public documents and marketing material, including advertising.

BFP members are all successful non-aligned businesses with their own AFSLs, indicating clients are prepared to pay for advice from independently owned advisers, despite an appearance of that price being higher. BFP members are not able to subsidise the cost of providing advice from the profits of a wholly owned product manufacturing business.



### **General Advice (FSI Interim report 3-73)**

Given low levels of financial literacy, consumers are unlikely to be able to distinguish between information and advice, and between general advice and personal advice, as defined by the Corporations Act.

The current “disclosure” based approach has proven to be ineffective in informing consumer investment decisions.

A clear distinction needs to be made between employees and agents of product issuers providing information about those products, and advisers making independent product recommendations.

The BFP supports removing the term “general advice” and replacing it with Product Information, together with mandatory warnings that personal advice is not being provided and that the “best interests” obligations do not apply.

### **Adequacy of Framework (FSI Interim report 3-84)**

Many of the “product failures” were not just managed investment schemes (they were promissory notes, debentures, and unsecured deposits, usually related to property financing) or were listed companies (in the case of most “tax effective” scheme operators).

The BFP would support more effective regulation of all product issuers (not just managed investment scheme operators) and notes the Interim Report’s observations about the need for simpler and more effective product disclosure requirements.

### **Compensation Arrangements (FSI Interim report 3-85)**

Consumers should not be compensated for their own poor decisions.

Product issuers have to be more accountable for both the mis-selling of their products by associated “advisers” and for product failures.

Consumers have used free dispute resolution schemes to make financial advisers and their insurers responsible for product failures under the guise of “inappropriate advice”.

The current arrangements should be re-worked to align them with other arrangements;

- Consumers take product disputes to a product dispute ombudsman
- Consumers take advice disputes to the advisers’ professional associations’

### **Other (FSI Interim Report 3-87)**

Consumer losses from the activities of property investment sales persons have been severe. Drawing property investment into the financial services regulatory framework would improve consumer outcomes.



## **Regulatory Architecture** (FSI Interim report 3-89)

## **Regulatory Burden** (FSI Interim report 3-91)

BFP members, as AFSL holders, are required to comply with the applicable provisions of eight Chapters of the Corporations Act, Division 2 of the ASIC Act, and a dozen other Federal and State laws relating to financial services.

ASIC provides over 1000 pages of regulatory guidance in relation to Chapter 7 of the Corporations Act, while the Tax Practitioners Board, the Information Commissioner and AUSTRAC also issue “guidance” as to how a financial advice business should comply with its obligations.

None of this regulation has resulted in consumers being provided with cost effective financial advice or being protected from receiving inappropriate advice.

In comparison, the Tax Practitioners Board, working in a co-regulatory environment with the accounting professional bodies, has resulted in consumers receiving high quality independent tax advice at a reasonable cost from a large number of competing, relatively small, businesses.

The BFP believes a similar regime can be applied to the provision of more clearly defined “financial advice” and “product information”.



## Consumer Outcomes (FSI Interim Report 3-49)

### Personal advice (FSI Interim report 3-67)

*The Inquiry would value views on the costs, benefits and trade-offs of the following policy options or other alternatives:*

- No change to current arrangements.
- Raise minimum education and competency standards for personal advice (including particular standards for more complex products or structures, such as SMSFs) and introduce a national examination for financial advisers providing personal advice.
- Introduce an enhanced public register of financial advisers (including employee advisers) which includes a record of each adviser's credentials and current status in the industry, managed either by Government or industry.
- Enhance ASIC's power to include banning individuals from managing a financial services business.

The BFP is working with the FPA in its submissions to the PJC inquiry and ASIC working group that are now dealing with the issues raised above so we make no separate comment herein.

THE BFP supports FPA moves to improve minimum adviser education and competency standards and having a "representative" ASIC register which includes employee adviser representatives.



## Accessibility (FSI Interim Report 3-69)

*The Inquiry seeks further information on the following areas:*

- What opportunities exist for enhancing consumer access to low-cost, effective advice?
- What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?
- What are the potential costs or risks of this form of financial advice, and what measures could be taken to mitigate any risks?

Technology is undoubtedly improving the efficiency of practice management and the delivery of financial advice.

The existing financial services framework is simultaneously prescriptive and proscriptive in nature. It is complex and the cost of compliance is high. In addition it is overlaid with other regulatory requirements, (AML/CTF and Privacy laws are two examples). This results in barriers to providing the advice consumers seek and high costs which are passed on to consumers.

Prescriptive legislative requirements as to the form in which advice is provided via a Statement of Advice impinges on the flexibility of providing advice. The fact that a legislative instrument was required to empower an adviser to provide scaled or limited personal advice without fear of contravening the law is indicative of a flawed regulatory framework imposing unnecessary disclosure requirements which serve no constructive purpose.

Co-mingling legislative requirements relevant to product providers with advice providers is another example of this flawed approach. While arguably it may make some sense to legislatively provide that a product issuer must have sufficient financial, human, technological and other resources before being licensed to issue a financial product, applying the same approach to an individual wishing to provide advice is unnecessary regulatory overkill.

As an example, the following table provides a simple comparison between being registered as a tax agent and being licensed to provide financial advice.



Requirement	Registered Tax Agent	Licensed Financial Adviser
Fit & Proper Person	Good fame, integrity & character Bankruptcy Check Criminal History check	Good fame, integrity & character Bankruptcy Check Criminal History check
Education Requirement	Diploma or Tertiary level Tax & Commercial Law, Accountancy Principles	Diploma or relevant University Degree and relevant short industry course
Experience Requirement	Depends on Education – ranges from 12 months full time in preceding 5 years to 8 years full time in preceding 10 years.	3 years relevant experience in the last 5 years
Professional Indemnity Insurance	Minimum prescribed levels	Minimum prescribed levels
A5 Proof Business Description	Not Required	Business Description Organisational Chart
B2 Proof Development Program for Responsible Manager and Compliance with Industry	Not Required	Development Program for Responsible Manager 3 <sup>rd</sup> Party Assessment of compliance with Industry Standards
B3 Proof	Not Required	Compliance Arrangements Conflicts of Interest Management Arrangements Outsourcing Statement
B4 Proof	Not Required	Program for Monitoring, Supervision & Training of advisers
B5 Proof Financial Statement & Financial Resources	Not Required	Balance Sheet, Profit & Loss Statement, Cash Flow Projection
B5 Proof Human Resources & information Technology Capacity Statements	Not Required	A description of your processes for ensuring that you have adequate human and information technology resources, including succession plan and disaster recovery plan
B6 Dispute Resolution Statement	Not Required	Have an IDR that complies with AS ISO 10002-2006 and membership of ASIC approved EDR
B7 Proof	Not Required	Risk Management System

The BFP has no issues with the first four requirements relating to character, education, experience and insurance but submits that the balance of the requirements are an unwarranted regulatory intrusion which has no impact on the quality of financial advice and restricts the availability of affordable and accessible advice.



This difference in regulatory approach results in:

- a significant barrier to individual financial advisers obtaining their own licence and becoming independent of product owned or associated licensees
- a significant increase in the cost of establishing and maintaining a licensed financial advice business.

It should be noted that there are additional compliance requirements on licensed financial advisers regarding the retention of records, auditing of financial statements, and other matters. (See Regulatory Burden section below).

To enhance opportunities for consumers to access low cost, effective advice you need to identify and remove the regulatory barriers to providing that advice. Those barriers include barriers to entry as described above and barriers to providing advice such as those prescribing complex disclosure requirements (eg Statements of Advice).

Technology can assist consumers to identify their advice needs, provide simple answers to simple questions, and direct consumers to seek advice for more complex needs. That advice may not necessarily involve specific investment recommendations, so much of the existing disclosure and consumer protection regulatory requirements become irrelevant and un-necessary.

Risks involved in providing advice in this way would mainly involve the “dressing up” of product information to suggest a particular product was a suitable solution while hiding behind the “general advice” disclaimers to avoid responsibility. Removing the term “general advice” and replacing it with “product information” would assist in reducing this risk. In addition we note the Interim Report’s comments regarding “Suitability of Financial Products”, pg 3-61, and would support making product issuers “subject to more positive obligations with respect to the suitability of their products for retail clients.”

Quality of advice can be regulated through education standards, which could include compulsory professional association membership to assist in co-regulating the provision of advice to an “industry standard”. The existing FSR regime has done little (if anything) to improve the quality of advice, although we acknowledge and support the likely positive effect of mandating a “best interests duty” and removing conflicted remuneration.



## Independence (FS Interim Report 3-72)

*The Inquiry seeks further information on the following areas:*

- Is there a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?
- Would consumers be likely to understand the difference between aligned and independent advisers and, if so, to what extent would this be likely to factor into a consumer's decision to take the advice?
- Would consumers be likely to be sensitive to differences in the price of independent or aligned advice?

Some consumers prefer to receive advice from a well known institutional “brand” whereas others may prefer advisers who are independent of product providers, so a clearer distinction is required to enable consumers to make informed choices.

Any move to more clearly identify “independent” and “restricted” advice along the lines of the UK model, which deals with the issue in terms of what in Australia is referred to as the “Approved Product List”, will not work in Australia without changing the existing legislative description of what “independent” means.

While the FOFA reforms defined and banned conflicted remuneration, the definition of non-conflicted remuneration is at odds with the definition relating to using the term independent in describing a financial advice business – in simple terms policy makers have determined that commission is not conflicted remuneration in relation to certain financial products, yet the receipt of any commission bars the recipient from calling itself independent.

This ban extends further, so that a representative of a licensee that receives or retains no commissions, cannot call him or herself independent if the licensee itself receives and retains commission. Given historical practices and “grandfathering” it can be very difficult for a licensee to completely free itself of receiving commissions and at the same time retain access to client information held by a product issuer.

At the BFP we adopted the following definition of “independent” in our Association's Constitution, drafted in 2002:

“

- (c) For BFPPG Ordinary membership purposes, the term **independent** shall have the meaning as conferred by the commonly understood meaning of the term, as defined in the Oxford and Collins English dictionaries:
- (i) free from outside control or influence (Oxford)
  - (ii) not connected with another; separate (Oxford)
  - (iii) free from control in action, judgment, etc; autonomous (Collins)



*The implications are that to be **independent** means that the member:*

- (iv) is not subject to influence with respect to their Approved Product List (or equivalent) from any investment product provider, or other external source*
  - (v) has unfettered freedom of choice with respect to their ability to choose from the full spectrum of investment products, securities and services, which is allowed under their Licence*
  - (vi) is not subject to Conflicts of Interest which would prejudice the Member's ability to provide advice which is in the best interest of the client.*
- (d) For BFPPG Ordinary membership purposes, **independently-owned** means that the Licensee business is 'non-aligned' and is majority owned by financial planning practitioners, employees of the business or their associated entities ie the business is not majority owned or otherwise controlled by any bank, life office or fund manager. Where there is part ownership by any external entity or person, the member must be able to comply with the provisions of 2B(c)(iv) (v) and (vi) in the above definition of 'independent'. "*

The BFP accepts that more consultation may be required to ascertain a generally well understood and accepted definition of "independent" that meets current community standards.

There is clear evidence that consumers are often unaware that their adviser is licensed through an AFSL wholly or partially owned by a product issuer. A simple legislative fix is to require such disclosure in all public documents and marketing material, including advertising, something the BFP has been advocating for over the last decade.

Another simple fix would be to ban product issuers from owning advice businesses operating under a different brand.

Research indicates that many consumers are not prepared to pay a price for advice ("independent" or otherwise) which covers the cost of providing that advice under the current regulatory regime.

This has resulted in vertically integrated business models which cross-subsidise loss making "advice" activities with the higher margins from product issuing, putting advice businesses owned by product issuers at a competitive advantage to advice businesses which only provide advice, and hiding the true cost of advice.

We have also seen examples of platform operators differentiating the price of administration where the investment product being invested in via the platform is associated with the platform operator. As a result the total cost to the client is cheaper when using the aligned product & platform than if using that platform to invest in a non-aligned (but otherwise cheaper) product. These distortions are unlikely to be apparent or communicated to the client of an aligned adviser.



BFP members are all successful non-aligned businesses with their own AFSLs, indicating that once clients are educated as to the value of professional advice they are prepared to pay for advice from independently owned licensees. Whilst the cost of “advice” may appear to be higher, because our members are able to access most products and platforms, the total cost to the client of advice, investment management and portfolio administration can in fact be less than that provided by aligned advisers, and certainly the costs to the client are more transparent.

We have commented in other areas of our submission regarding how overly complex regulation has driven up the cost of providing advice without providing any commensurate consumer benefits. In the absence of any reduction in regulatory burden we would ask that the cross-subsidisation of advice businesses owned or aligned with product issuers be banned.



## General advice (FSI Interim Report 3-73)

*The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:*

- No change to current arrangements
- Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice.

Given low levels of financial literacy, consumers are unlikely to be able to distinguish between information and advice, and between general advice and personal advice, as defined by the Corporations Act.

The current "disclosure" based approach has proven to be ineffective in informing consumer investment decisions.

The last 20 years has seen growth in demand for financial advice (as distinct from investment advice) due to increased complexity in the interaction of the tax, social security and superannuation systems.

Product Issuers, in response to the growth in demand for advice, either provided that advice themselves or through intermediaries for "free", recovering the cost from product fees. The focus of the financial services industry remained product sales.

With product issuers controlling 70% - 80% of those licensed to provide advice it is no surprise that product sales remained the focus, with commissions and volume based bonuses conflicting the "advice", and ultimately resulting in the mis-selling of products. The recent FOFA reforms are intended to remove or reduce those conflicts.

A clear distinction needs to be made between employees and agents of product issuers providing information about those products, and advisers providing personal financial advice and/or making product recommendations.

The BFP supports removing the term "general advice" and replacing it with Product Information, together with mandatory warnings that personal advice is not being provided and that the "best interests" obligations do not apply.

Once again we also note the Interim Report's comments regarding "Suitability of Financial Products", pg 3-61, referred to earlier.



## Adequacy of framework (FSI Interim Report 3-84)

Given recent financial collapses, submissions question the adequacy of the regulatory framework for managed investment schemes to protect the interests of their investors.

*The Inquiry would value views on the costs, benefits and trade-offs of the following policy options:*

- No change to current arrangements.
- Amend the existing regulatory framework for managed investment schemes.

Many of the “product failures” were not managed investment schemes (they were promissory notes, debentures, and unsecured deposits, usually related to property financing) or were listed companies (in the case of most “tax effective” scheme operators). Some, but not all, involved product issuers paying high commissions to intermediaries. Now that investment product commissions have been banned, mis-selling may be less of a problem in the future.

However, the policy, legislative and regulatory response to product failures has seen little or no changes to requirements related to product issuers – the response has been to further regulate financial advisers. Yet statistics indicate only 20% of the investing population have an ongoing advice relationship and less than half have ever sought advice, so making it more expensive and difficult for consumers to access advice is counterproductive to reducing consumer losses from product failures.

The BFP would support more effective regulation of all product issuers (not just managed investment scheme operators) and notes the Interim Report’s questions regarding product design and intervention and observations about the need for simpler and more effective product disclosure requirements.



## Compensation arrangements (FSI Interim Report 3-85)

*The Inquiry seeks further information on the following area:*

Given the limitations of professional indemnity insurance, what options, if any, exist for addressing the issue of consumer loss?

Consumers should not be compensated for their own poor decisions or for movements in asset prices.

Product issuers have to be more accountable for both the mis-selling of their products by associated “advisers” and for product failures.

Consumers have used free dispute resolution schemes to make financial advisers and their insurers responsible for product failures under the guise of “inappropriate advice”.

The recent removal of conflicted remuneration for many financial products will reduce incentives that have caused mis-selling in the past. Current discussions about lifting the quality of advice may also reduce the incidence of consumer loss in the future.

Any options which seek to impose additional requirements on advisers will be self-defeating given the low proportion of consumers seeking advice.

The current arrangements should be re-worked to align them with other arrangements;

- Consumers take product disputes to a product dispute ombudsman.
- Consumers take advice disputes to the advisers’ professional associations.

## Other (FSI Interim report 3-87)

*The Inquiry seeks further information on the following areas:*

- Are there elements of the consumer framework not covered in this chapter that require consideration?
- In addition to the current regulatory framework, what role can industry self-regulation play in improving consumer outcomes generally?

The practical enforcement of State based regulation regarding the activities of investment property sales persons is, in the view of the BFP and others, seriously deficient. Consumer losses from these activities have been severe, yet this issue has yet to be addressed. Drawing property investment into the financial services regulatory framework would improve consumer outcomes.



## Regulatory Architecture (FSI Interim report 3-89)

## Regulatory Burden (FSI Interim report 3-91)

### Policy options for consultation

The Inquiry has commissioned further work on the costs and benefits of financial system regulation in Australia and welcomes empirical evidence on this point.

*The Inquiry seeks further information on the following areas:*

- Is there evidence to support conclusions that the regulatory burden is relatively high in Australia when considered against comparable jurisdictions?
- Are there examples where it can be demonstrated that the costs of regulation affecting the financial system are outweighing the benefits?
- Are there examples where a more tailored approach could be taken to regulation; for example, for smaller ADIs?
- Are there regulatory outcomes that could be improved, without adding to the complexity or volume of existing rules?
- Could data collection processes be streamlined?
- If new data is required, is there existing data reporting that could be dropped?
- Instead of collecting new data, could more be made of existing data, including making more of it publicly available?

BFP members, as AFSL holders, are required to comply with all financial service laws (Corporations Act s.912A(1)(c)).

“Financial services law” means any provision of:

- Chapter 7 (as enacted by the *Financial Services Reform Act 2001*) or of Chapter 5C, 6, 6A, 6B, 6C or 6D of the Act;
- Chapter 9 of the Act as it applies in relation to a provision referred to above;
- Division 2 of Part 2 of the ASIC Act 2001; or
- Other Commonwealth, State or Territory legislation that covers conduct relating to the provision of financial services, such as;
  - Life Insurance Act 1995 and Insurance Contracts 1995;



- Superannuation Industry (Supervision) Act 1993 and Superannuation (Resolution of Complaints) Act 1993 ;
- Competition and Consumer Act 2010
- Income Tax Assess Act (as amended) and Tax Agent Services Act 2009;
- Privacy Act 1988 & Privacy (Private Sector) Amendment Act 2000;
- Anti-money Laundering & Counter-Terrorism Financing Act 2006
- National Consumer Credit Protection Act 2009;

ASIC provides over 1000 pages of regulatory guidance in relation to Chapter 7, while the Tax Practitioners Board, the Information Commissioner and AUSTRAC also issue “guidance” as to how a financial advice business should comply with its obligations.

None of this regulation has resulted in consumers being provided with cost effective financial advice or being protected from receiving inappropriate advice.

We have noted above in the section “Adequacy of Framework” that advisers have been subjected to additional regulation in response to product failures, which given the majority of consumers don’t seek financial advice, is likely to be counter-productive.

In relation to the AML-CTF requirements AFSLs providing advice are reporting entities requiring registration with Austrac and the application of a complaint AML-CTF policy, even where the AFSL does not receive or hold cash from clients for investment. Any client moving funds from a bank account (where the client has already been identified) to another investment, needs to be identified to each separate investment product provider, involving significant duplication of record keeping requirements, form filling and time – the cost of which is passed on to consumers.

The requirements of the Privacy Act generally apply to organisations with annual turnover in excess of \$3 million. However small businesses which are reporting entities under the Anti-Money Laundering and Counter Terrorism Financing Act are included - capturing all AFSLs providing financial advice (which will soon extend to all public accountants providing SMSF advice). As a result small AFSLs providing advice are required to have a compliant Privacy Policy, imposing additional compliance costs which are passed on to consumers.

The regulatory burden on financial advisers (which we distinguish from product information providers) is extreme and mitigates against providing affordable advice.



## The Author

This submission was prepared by the Executive of the BFP with input from, and on behalf of, the members and represents the collective view of the BFP.

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