Chan & Naylor: Second Submission to the Financial System Inquiry

2014

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Introduction

Recognising that this as a once in a generation chance to "establish a direction for the future of Australia's financial system", Chan & Naylor welcomes the opportunity to provide further input into the Governments Financial System Inquiry (FSI).

Following the publication of the FSI's Interim Report in July this year, Chan & Naylor would like to respond to the following observations:

1. If allowed to continue, growth in direct leverage by superannuation funds, although embryonic, may create vulnerabilities for the superannuation and financial systems.
2. Affordable, quality financial advice can bring significant benefits for consumers. Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.
3. Australia generally has strong, well-regarded regulators, but some areas of possible improvement have been identified to increase independence and accountability.

As Australia's fastest growing accounting firm Chan & Naylor is a holistic provider of financial advice and accounting services for individuals, small business and property investors. With a national presence in metropolitan, suburban and regional Australia Chan & Naylor has a clear understanding of the financial pressure points and short falls that adversely impact many ordinary Australians.

Chan & Naylor Response to FSI Observations

4: Superannuation – Leverage

Inquiry observation: If allowed to continue, growth in direct leverage by superannuation funds, although embryonic, may create vulnerabilities for the superannuation and financial systems.

Chan & Naylor response to the following policy option or other alternatives:

- Restore the general prohibition on direct leverage of superannuation funds on a prospective basis.

As more Australians turn away from industry and retail super funds in favour of an independent approach, the opportunity presented by superannuation in helping more Australians achieve financial independence during retirement has never been more auspicious. At the same time the staggering size of Australia's future retirement cost is the elephant in the room that no longer be ignored.

With the welfare safety net already under severe strain, more Australians must to be encouraged to prepare for an independent retirement, and being able to purchase and retain an asset that grows in value over the next 30 years within super is an excellent way of achieving this outcome.

The popularity of SMSFs continues to grow as more Australians look for greater control of their financial destinies through reduced fees, greater liquidity and the opportunity to invest in a wider variety of long term asset classes, including property. According to research firm CoreData there were 528,700 SMSFs with 1 million members as of June this year (compared to 271,000 funds ten years ago) representing almost 32% of Australia's total $1.6 trillion super pool.

However, scrutinising and potentially taking away the opportunity to borrow within a self-managed super fund (SMSF) structure, as potentially suggested in the Interim Report, will limit the opportunity for more Australians to purchase an asset that will grow in value over the long term and help pay for a comfortable and independent retirement. Property is a long term asset with a relatively small proportion owned as investments (unlike shares) and as such has a less volatile market. The ability to borrow within prudent levels can be a significant boost to retirement income and therefore beneficial over the long term. In effect, superannuation balances may need to last 30 years, so leveraged property can be a very defensive asset.

Currently most super property investment is within the commercial sector and between only 1% and 3% of SMSFs hold residential property debt. Nonetheless, thanks to the laws of compound interest the fund holders that have chosen to borrow within their super can still benefit over the long term. For this reason Australian SMSF holders should continue to be allowed to leverage assets as part of a prudent long-term investment strategy.

6: Consumer outcomes – Assessing the regulatory framework

Inquiry observation: Affordable, quality financial advice can bring significant benefits for consumers. Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.

Chan & Naylor response to the following policy option or other alternatives:

- No change to current arrangements. Change is required – please refer to further notes below on restoring the fiduciary relationship.
- 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. The framework currently in place for specialist financial advice education is adequate and Chan & Naylor does not believe that a national examination is required. What is however lacking is a framework for educating investors. There is also a need to advance the notion that investors must take part of the responsibility within a regulated advisor industry. Consumers must also respect a person's right to income and as such there is no free advice and a fee for service model should not be shied away from.
- 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. Chan & Naylor is in favour of a public register which would greatly enhance industry transparency.
- Enhance ASIC's power to include banning individuals from managing a financial services business. Chan & Naylor is in favour of this enhancement.
- Rename general advice as 'sales' or 'product information' and mandate that the term 'advice' can only be used in relation to personal advice. Chan & Naylor agrees with this change which would better account for someone's personal circumstances being factored into the advice provided.

Regrettably when it comes to providing excellence in client advice both the financial services and accounting industries have, in Chan & Naylor's opinion, 'missed the boat'. The former industry has been closely scrutinised and even penalised over the years, whilst the latter has simply failed to step up to the plate, which is troubling given that accountants enjoy one of the closest and most trusted of client relationships of any profession.

And whilst the financial services industry has arguably been too forward looking, the accounting industry has been too backwards looking. Meanwhile the insurance sector has been allowed to morph itself into the financial advice profession as the Australian financial system itself has been blind-sided by hidden agendas, conflicted interests and ineffectual financial literacy standards.

Until these discrepancies are resolved it is the consumer who will bear the brunt of an industry short fall. Put simply, the financial sector has dropped its duty of care to Australian consumers.

The intent of any reform is to never lose sight of who this service is for, and in the case of the FSI Chan & Naylor believes that we now have an opportunity to restore the fiduciary client relationship.

Whilst the Government's proposed Future of Financial Advice (FoFA) regulations will be retained following the recent failure of a disallowance motion in the Senate, Chan & Naylor is calling on all parties with influence to consult with the wider industry ahead of further near term changes in order to fix the broken regulation before long term harm is done to both the financial advisory industry and consumers.

If FoFA passes to law in its current iteration this will lead to a number of perturbing outcomes including increased red tape, further consumer confusion and, as the cost of providing financial advice gets inevitably more expensive; the provision of quality advice will become further removed from ordinary Australians who need it most. This will mask the real issues and leave people vulnerable in believing their best interests are being taken care of.

7: Regulatory architecture – Independence and accountability

Inquiry observation: Australia generally has strong, well-regarded regulators, but some areas of possible improvement have been identified to increase independence and accountability.

Chan & Naylor response to the following policy option or other alternatives:

- Move ASIC and APRA to a more autonomous budget and funding process. Chan & Naylor would agree with this approach.
- Conduct periodic, legislated independent reviews of the performance and capability of regulators. Continual review and assessment of the regulators will help ensure that they are up to date in the processes that govern this industry.
- Improve the oversight processes of regulators. Chan & Naylor believes that there is always room for improvement for the oversight processes of regulators.

7: Regulatory architecture – Execution of mandate

Inquiry observation: Regulators' mandates and powers are generally well defined and clear; however, more could be done to emphasise competition matters. In addition, ASIC has a broad mandate, and the civil and administrative penalties available to it are comparatively low in relation to comparable peers internationally.

Chan & Naylor response to the following policy options or other alternatives:

- Refine the scope and breadth of ASIC's mandate. Chan & Naylor believes that the scope and breadth of ASIC's mandate requires urgent review.

Chan & Naylor response to the following areas:

- Are changes needed to strengthen and/or refocus ASIC? Chan & Naylor believes that changes are required to strengthen and focus ASIC.
- Is the current enforcement regime adequate? Does ASIC have adequate powers?

Australia requires a cross industry level playing field ruled by a common standard of corporate governance, education (both for industry and consumer) and ultimately one regulatory authority overseeing the collective investment industry.

By example there is no recourse on the real estate industry should a $1m off the plan property investment sours or the market does not move as expected. This is not the case for financial planners or dealer groups. Whereas ASIC controls dealer groups, planners and manufacturers, who is controlling the real estate agents regarding the appropriateness of their advice?

Chan & Naylor recommends that ASIC should be at the forefront in upholding a widely recognised standard and code of conduct that provides clear and consistent compliance guidelines for all areas of investment and related advice.

Having a single set of industry rules with one common outcome will enable the industry to act in the best interests of its clients and achieve the best outcome on their behalf.

If a common standard is not achieved then the financial services sector risks becoming an even more disjointed environment, allowing the unscrupulous to fly under the radar and prey on vulnerable consumers. This will necessarily require ASIC's reactive response to put out spot fires and rule with an iron fist rather than educational agenda.

The question is, how many Storm Financial or Westpoint collapses does Australia need before we realise that self-regulation is not working for the common good?

About Chan & Naylor

Chan & Naylor is Australia's leading national property business tax accounting and wealth advisory group. Chan & Naylor's key point of difference is a personalised team-centric accounting service complemented by business advisors, wealth planners and finance strategists that are part of the national Chan & Naylor Group.

Established in 1990 by Edward Chan and David Naylor, the Group has 24 offices in 15 locations nationwide and offers its clients a complete suite of property accounting, asset protection and wealth creation strategies and services.

BRW ranked Chan & Naylor as Australia's fastest growing accounting firm in 2007, 2008 and 2013 and is now proudly ranked 39th largest accounting firm in Australia. The top 50 firm's revenue lifted 42.8 per cent to $18.6 million with 15 per cent organic growth and 85 per cent through joint venture acquisitions of smaller firms.

Renowned as property investment experts and innovative leaders for accounting services and products, Chan & Naylor is the first and only accountancy firm to have successfully obtained a Product Ruling from the ATO (PR2011/15) for interest deductibility on borrowed monies to invest in a Trust.

Chan & Naylor is addressing industry consolidation and the growth of fewer, bigger sovereign players through its Joint Venture Partner program. The program, which is backed by the centralised research and systems of the National Group, provides clients in major metropolitan and regional centres with a consistent and holistic one-stop accounting and financial advice service.

Chan & Naylor's partnership program offers multiple benefits including: centralised marketing support, a proven operations system, outsourced IT, HR, regulatory support; access to CN Academy, expert financial planning and mortgage brokerage capabilities within the Group.

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