PJC Inquiry into Financial Products and Services in Australia

Submission by the Australian Securities and Investments Commission

August 2009

Contents

A Executive summary

1 The Australian Securities and Investments Commission (ASIC) makes this submission to assist the Parliamentary Joint Committee on Corporations and Financial Services (PJC) with its Inquiry into Financial Products and Services in Australia (the Inquiry).

ASIC's submission

2 This submission sets out:

(a) the policy underpinnings of the Australian financial services regulatory (FSR) regime following the Financial System Inquiry in 1997 (the Wallis Inquiry) and a summary of the key legal provisions (see Section B and Appendix 2);

(b) the key issues raised by the Inquiry's terms of reference and the market context in which they arise (see Sections C to J and Appendix 1);

(c) ASIC's forward program to improve performance of its oversight role (see Sections C to J);

(d) an outline of areas for possible legislative reform to address the issues raised by the Inquiry by moving the policy balance of the FSR regime more in favour of retail investor protection. While ASIC's surveillance, compliance and enforcement activities and forward program will assist in minimising retail investor losses in the future, the PJC may wish to re-examine the regulatory balance between market efficiency and retail investor protection in the FSR regime and consider a number of areas for possible legislative reform (see Sections C to J); and

(e) ASIC's response to criticisms. ASIC has been criticised for not preventing retail investor losses, particularly in relation to Storm Financial Limited (Storm) and Opes Prime Stockbroking Limited (Opes). ASIC rejects those criticisms. Our reasons for rejecting the criticisms are set out in confidential Appendices 5 and 6 which deal specifically with ASIC's actions prior to its formal investigations in relation to Storm and Opes. In Appendix 4 we respond publicly to the criticisms of ASIC in submissions made to the Inquiry.

Financial advice industry

3 The Inquiry is focused on the financial advice industry. The financial advice industry plays an important role in providing advice to retail investors. It is

important to note, however, that access to advice is relatively low with only 22% to 34% of adult Australians accessing financial advice. [1]

4 The financial advice industry is dominated by large dealer groups and financial institutions and approximately 85% of financial advisers are associated with a product manufacturer.[2]

5 ASIC has overall confidence in the advice industry and the current standards of advice are adequate. Nevertheless, the recent collapses and ASIC's surveillance and compliance work have identified areas for improvement which are the subject of more specific comments in Section D of our submission.

6 ASIC is pleased to see that industry associations, such as the Financial Planning Association (FPA) and the Investment and Financial Services Association (IFSA), have embraced the need to improve standards and quality of advice and commenced consultation processes aimed at achieving this end.

Overview of ASIC's position

FSR regime

7 The fundamental policy settings of the FSR regime were developed following the principles set out in the Financial System Inquiry Report 1997 (the Wallis Report). These principles are based on 'efficient markets theory', a belief that markets drive efficiency and that regulatory intervention should be kept to a minimum to allow markets to achieve maximum efficiency. The 'efficient markets theory' has shaped both the FSR regime and ASIC's role and powers.

8 The FSR regime seeks to balance investor protection with market efficiency. As such, the regime regulates markets through conduct and disclosure regulation, that is:

(a) conduct regulation – rules designed to ensure industry participants behave with honesty, fairness, integrity and competence, as well as rules relating to the settlement of disputes between market participants and investors; and

(b) disclosure regulation – rules designed to:

[1] See, for example: Financial Planning Association, Consumer Attitudes to Financial Planning, 2007, [online] <http://www.fpa.asn.au/PrintFriendly.aspx?Doc_id=1051> (22% of Australians aged 16 years and over); ANZ, ANZ Survey of Adult Financial Literacy in Australia, 2008p. 89, [online] <http://www.anz.com/about-us/corporate-responsibility/community/financial-literacy-inclusion/research/> (34% of Australians aged 18 years and over); and Bloch, Jo-
[2] IBISWorld Industry Report, Financial Planning and Investment Advice in Australia (K7515), 22 May 2009, p. 7.

(i) overcome the information asymmetry between industry participants and investors by requiring disclosure of information required to facilitate informed decisions by investors; and

(ii) promote transparency in financial markets.

9 The regime is designed to be largely self-executing and, as such, relies on market participants to comply with the requirements of the law. In this context ASIC's role is to oversee and enforce compliance (i.e. to conduct surveillance, compliance and enforcement).

10 Recent events in the Australian and global financial system have lead to the Inquiry and with that the possible reassessment of the policy settings of the FSR regime and the economic philosophy that supports it.

Recent events

11 Australia has fared better in the global financial crisis than most other countries. This is due, in part, to the strength of Australia's regulatory framework including the FSR regime. Other factors include the economic momentum arising from the resources boom, astute conduct of macroeconomic policies by successive governments and the sound position and performance of Australia's banks.

12 Nevertheless, many Australian investors have seen a significant destruction of their wealth and have suffered considerable pain as a result. This, in turn, has affected investor confidence in Australia's financial markets.

13 Much of the destruction of investor wealth has been caused by the market downturn and its impact on superannuation savings and other investments. For example, from the period November 2007, at the height of the market, to April 2009, the stock market loss was about $617 billion or 52% of GDP.

14 Australian investors have also suffered losses from various collapses and corporate failures including:

(a) Storm and Opes;

(b) failures of agribusiness managed investment scheme operators, Great Southern and Timbercorp;

(c) corporate collapses such as ABC Learning, Allco, and Babcock and Brown; and

(d) insolvency of debenture issuers.

15 The primary causes of these collapses and corporate failures were the market downturn and flawed business models, that is, business models that could only prosper if asset prices continually rose and debt markets remained open and liquid.

16 Some of the particular problems of the Storm and Opes business models included:

(a) extensive use of margin loans with high gearing. In the case of Storm, for example, margin lending was extended to a 'whole balance sheet' (i.e. against all of an investor's assets) with additional leverage against unrealised gains as the market rose;

(b) selling sophisticated and complex investment products designed for institutional investors to retail investors. For example, Opes operated a securities lending business, which, from the clients' perspective, looked like a margin lending business; and

(c) under-capitalisation. For example, Opes was not well capitalised and, as a result, when a number of its clients faced significant losses in the market downturn, it was not able to cover the shortfall.

17 In outlining these causes ASIC is not suggesting that there may not have been any wrongdoing under the *Corporations Act 2001* (Corporations Act). Indeed, ASIC is actively pursuing a number of investigations, including the recovery of money for investors under s50 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

ASIC's oversight activities

18 In performing its role as an oversight body, ASIC exercises a number of powers. ASIC:

(a) administers the Australian financial services (AFS) licensing regime to ensure that applicants meet the minimum entry-level statutory criteria;

(b) registers managed investment schemes that meet the statutory criteria;

(c) monitors compliance with the FSR regime, through monitoring and acting on complaints and breach reports and conducting surveillance and document reviews;

(d) modifies and exempts from the FSR regime where appropriate;

(e) encourages compliance with the law by helping industry understand their obligations;

(f) educates and informs retail investors and consumers; and

(g) enforces the FSR regime where there has been corporate wrongdoing.

19 ASIC has, within the regulatory framework, discharged its responsibilities effectively and efficiently.

20 Prior to the market downturn and collapses, ASIC carried out extensive surveillance, compliance and enforcement (see Appendix 3).

21 ASIC has also sought to recover retail investor losses. For example:

(a) Since November 2007, ASIC has commenced 16 civil actions seeking to recover funds for investors in Westpoint using its power under s50 of the ASIC Act. These are substantial actions seeking to recover some $329 million for investors.

(b) ASIC was successful in obtaining court orders for a global mediation of all Federal Court actions we commenced for compensation arising from the failure of the Westpoint Group.

(c) ASIC, together with the then administrators of Opes (who were subsequently appointed as liquidators), encouraged mediation involving ANZ and Merrill Lynch to resolve claims between the parties. This mediation resulted in a settlement agreement and a creditors scheme of arrangement subsequently approved by the creditors and the Federal Court.

(d) ASIC is continuing its investigations into Storm and is doing everything it can to seek recovery of compensation for investors.

ASIC's forward program

22 While ASIC has fulfilled its role as required in the current FSR regime, ASIC is committed to continually improving its performance. From May 2007 ASIC undertook an extensive strategic review to ensure it is more effective in performing its oversight role and in enforcing the Corporations Act to the limit. The key outcomes of that strategic review were:

(a) expansion and additional skills at the Commission level;

(b) an expanded senior team, much of it recruited from the market;

(c) a restructure to ensure ASIC officers are closer to their stakeholders; and

(d) additional resources for market integrity issues.

23 This has enabled ASIC to respond more effectively and quickly to issues including those arising out of the global financial crisis and to push the existing FSR regime to the limit. ASIC has developed a forward program which will further reduce risks for retail investors. This forward program (which it is actively implementing) is summarised in Table 1

Table 1: ASIC's forward program

Term of Reference	Issue	ASIC Activities
Adequacy of licensing arrangements (TOR 5)	Licensing sets a low barrier to entry and this is not understood by investors Licensing focuses on the entity, not representatives, limiting ASIC's ability to control entry into the financial services industry or ban individuals	ASIC will continue to assess licence applicants using a risk-based approach ASIC will strengthen the financial resource requirements for non-APRA regulated AFS licensees and look at other possible licence conditions to mitigate retail investor risk ASIC will continue to identify and ban problem individuals in the financial services industry
Role of financial advisers (TOR 1)	Access to advice is limited i.e. not all investors can, or do, obtain advice There are some instances of poor quality advice being given	ASIC is assessing how advice can be made more widely available ASIC is developing a generic online advice tool ASIC is looking to benchmark the quality of advice through targeted surveillance activities ASIC will conduct a Shadow Shopping survey to review current training requirements for advisers and the quality of advice ASIC is reviewing whether to raise the training standards for advisers and will consult on proposals for change.
Role of commission arrangements for product sales and advice (TOR 3)	Remuneration structures in the financial advice industry create conflicts of interest which can distort the quality of advice	ASIC will identify the impacts of remuneration structures on conflicts of interest and on the quality of advice

Term of Reference	Issue	ASIC Activities
Appropriateness of information and advice provided to consumers (TOR 6)	Disclosure can be ineffective because of: the length and complexity of some documents; limited consumer engagement and understanding; and the mixed or competing purposes of disclosure	ASIC will continue targeted reviews of disclosure documents to ensure compliance with legal requirements ASIC will continue to work with the FSWG on its project to simplify disclosure ASIC will continue to issue regulatory guidance to improve disclosure e.g. guidance to make it clear that the law requires disclosure of historic yield information in agribusiness managed investment scheme PDSs ASIC will identify and implement ways to improve the effectiveness of disclosure (beyond the scope of the FSWG's project) e.g. by introducing disclosure against benchmarks on an 'if not, why not' basis for specific products, etc
Role of marketing and advertising campaigns (TOR 4)	Advertising campaigns are extremely influential	ASIC will continue to monitor and conduct targeted thematic campaigns on advertising to ensure compliance with ASIC guidance and the law ASIC will publish guidance on the standards of advertising expected
Consumer education and understanding (TOR 7)	Consumers have low levels of financial literacy and understanding	ASIC will continue to promote delivery of financial education ASIC will continue to provide Australians with access to information and tools ASIC will look beyond education for solutions to promote financial well-being e.g. by designing a website to assist retail investors create a financial plan and follow it through ASIC will develop and promote national partnerships to expand delivery of investors and consumer education

Term of Reference	Issue	ASIC Activities
PI Insurance (TOR 8)	PI Insurance has limitations as a compensation mechanism and these limitations are being exacerbated by the current hardening of the insurance market	ASIC will monitor and work with industry to maximise the effectiveness of PI insurance as a compensation mechanism as far as possible ASIC will update RG 126 to clarify guidance on the requirements to hold fraud and product-switching cover
Role of lending institutions (Additional TOR)	There are limited regulatory controls, especially on the provision of credit to retail borrowers to invest There have been failures of corporate governance and risk management leading to higher risk lending and inadequate management of existing loans, particularly where there is a relationship between the lending institution and a financial services intermediary	ASIC will be responsible for the regulation of consumer credit and margin lending under the new margin lending and credit reforms ASIC has set up a dedicated Credit Taskforce to implement the reforms, including engaging in an extensive consultation process on proposed guidance on how we will administer the reforms ASIC will continue to take action within its consumer protection jurisdiction

Note: This table sets out ASIC's forward program to increase investor confidence and better protect retail investors. The projects and activities set out in this table are discussed in Sections C to J of the submission. See also Appendix 3.

24 The key initiatives that ASIC is focusing on in this forward program are:

(a) appropriate financial resource requirements for non-APRA regulated AFS licensees;

Note: Further information about this project is set out in Section C.

(b) improving the quality of advice by increased surveillance and (subject to consultation) raising the training standards for financial advisers;

Note: Further information about this project is set out in Section D.

(c) improving the effectiveness of disclosure e.g. by introducing disclosure against benchmarks for specific products on an 'if not, why not' basis; and

Note: Further information about this project is set out in Section F.

(d) improving financial literacy and retail investor education.

Note: Further information about this project is set out in Section H.

Efficiency versus protection of retail investors – reassessing the balance

25 On the whole the FSR regime has delivered benefits to the Australian economy and retail investors. However, as stated above, recent events have raised the possible need for the PJC to reassess the policy settings of the FSR regime and, in particular, the balance between market efficiency and investor protection.

26 ASIC's forward program (set out in Table 1) will assist in minimising further retail investor losses. Nevertheless, ASIC believes that the Inquiry may need to reassess the balance reached by the Wallis Inquiry between market efficiency and retail investor protection because ASIC and industry action may not, within the current policy settings of the FSR regime, adequately protect retail investors.

27 ASIC believes that changes to the policy settings of the FSR regime are matters for Government. ASIC's role is to assist the Government in providing information, data and advice based on its regulatory experience. In light of our regulatory experience, we have identified a number of possible options for reform (i.e. options that shift the balance more in favour of retail investors). These options are summarised in Table 2 and detailed in subsequent sections of this submission. While increased intervention could impact on market efficiency, the benefits it will deliver, in terms of increased investor protection from loss and increased investor confidence causing retail investors to re-enter the market, may outweigh the costs (using the term in its broadest sense).

Table 2: Options for regulatory change to shift the balance in favour of retail investors

Term of Reference	Issue	Regulatory change options for consideration by Government
Adequacy of licensing arrangements (TOR 5)	Licensing sets a low barrier to entry and this is not understood by investors Licensing focuses on the entity, not representatives, limiting ASIC's ability to control entry or ban individuals	**Financial resource and other requirements** – Depending on the outcome of ASIC's activity to strengthen financial resource requirements and review other possible licence conditions to mitigate retail investor risk, the Government may need to consider changes to policy settings to enable ASIC to set appropriate financial resources requirements for AFS licensees **Minor changes to licensing threshold** – Enable ASIC to refuse or remove a licence where a licensee *may* breach (rather than *will* breach) its obligations **'Negative licensing' of individuals –** Enable ASIC to ban individuals who are not fit and proper and who *may* not comply (rather than *will* not comply) with a financial services law. Clarify that ASIC can ban individuals who are involved in a breach of obligations by another person
Role of financial advisers (TOR 1)	Access to advice is limited i.e. not all investors can, or do, obtain advice There are some instances of poor quality advice being given	**Fiduciary standard –** Clarify the duty owed by financial advisers to clients (i.e. a fiduciary-style duty to act in the best interests of clients and, where there is a conflict between the adviser's interests and the client's interests, prefer the interests of the client) **More prominent disclosure of restrictions on advice** – Require disclosure of restrictions on advice in advertising and marketing material
Role of commission arrangements for product sales and advice (TOR 3)	Remuneration structures in the financial advice industry create conflicts of interest which can distort the quality of advice	**Remuneration structures for advisers** – Prevent remuneration structures that may create conflicts of interest that adversely affect the quality of advice, particularly personal advice

Term of Reference	Issue	Regulatory change options for consideration by Government
Appropriateness of information and advice provided to consumers (TOR 6)	Disclosure can be ineffective because of: length and complexity of some documents; limited consumer engagement and understanding; and the mixed or competing purposes of disclosure	**ASIC's disclosure project** – ASIC's project to improve the effectiveness of disclosure may recommend law reform
Role of marketing and advertising campaigns (TOR 4)	Advertising campaigns are extremely influential	**Mandatory content in advertising** – Enable ASIC to require issuers of certain classes of products to include certain content in their advertising and marketing material **Enhance ASIC's Ch 6D stop order power** – Make ASIC's stop order power under Ch 6D consistent with the stop order power under Pt 7.9
Consumer education and understanding (TOR 7)	Consumers have low levels of financial literacy and understanding	**Government and industry action** – There are no changes to be considered by Government at this stage. However, Government and industry need to fully support financial literacy initiatives
PI insurance (TOR 8)	PI insurance has limitations as a compensation mechanism and these limitations are being exacerbated by the current hardening of the insurance market	**Compensation scheme** – Review PI insurance as a compensation mechanism and consider alternatives such as a statutory compensation scheme
Role of lending institutions (Additional TOR)	There are limited regulatory controls, especially on the provision of credit to retail borrowers to invest There have been failures of corporate governance and risk management leading to higher risk lending and inadequate management of existing loans, particularly where there is a relationship between the lending institution and a financial services intermediary	**Current Government law reform** – The proposed federal credit and margin lending reforms seeks to address these issues

Note: These possible changes to the policy settings of the FSR regime along with some other policy options (e.g. comparative overseas approaches to address similar issues) are discussed in Sections C to J of the submission.

28 In ASIC's view, the following two reforms are likely to have the most significant impact on protecting retail investors:

(a) clarifying the standard of care for advisers by ensuring they act in the best interests of their client (i.e. imposing a statutory fiduciary-style duty to act in the best interests of clients and, where there is a conflict between the interests of the adviser and the client, prefer the interests of the client); and

Note: Further information about this option is set out in Section D.

(b) preventing remuneration structures that may create conflicts of interest that adversely affect the quality of advice.

Note: Further information about this option is set out in Section E.

More far reaching changes

29 In addition, the PJC and the Government may conclude that recent events indicate that the policy settings of the FSR regime should be fundamentally changed and the types of options identified above are insufficient. If this is the case, then the PJC and Government could consider reforms such as:

(a) prudential regulation of a greater range of financial products;

(b) product design prohibitions or limitations;

(c) a duty of suitability for product issuers and intermediaries; and

(d) ‘licensing’ of investors.

30 To assist the PJC and the Government ASIC has set out information about these reforms in Section K.

Criticisms relating to Storm and Opes

31 Criticism has been levelled at ASIC that it should have done more to prevent the collapse of Storm and, possibly, Opes. ASIC rejects those criticisms.

32 In light of the recent collapses and corporate failures, ASIC has reviewed its involvement to determine whether it could have done more to prevent the collapses and corporate failures. This review has confirmed that ASIC has performed its role under the current FSR regime in relation to these events.

33 In Appendix 5, which deals with ASIC’s actions prior to formal investigations relating to Storm, we note the statement ASIC made to the Additional Estimates Hearing of the Senate Standing Committee on Economics on 25 February 2009. In that statement, ASIC said:

> ‘We are in the process of reviewing our contacts with Storm and complaints to ASIC about Storm. What we can say at this stage is that, prior to 2006, there were communications between ASIC, Storm and its officers based on routine ASIC surveillance in Queensland on financial planners. However, issues that arose about disclosure matters raised in those surveillances were resolved at the time.

> During 2006-07, ASIC received four complaints about Storm in relation to its statements of advice and fee levels, but no complaints were received from Storm's clients. These issues which concern disclosure and fees were addressed at the time by Storm. They did not involve the need to look further into their business model.
>
> In November-December 2007, ASIC examined a prospectus lodged by Storm for the purposes of a public offering of its business. That offering did not proceed.
>
> In early 2008, we received a call in our call centre from an unidentified financial advisory firm complaining about Storm, but we were not able to take that further. At the end of October, we did receive complaints from investors of Storm and we followed up those immediately, and as a result ASIC commenced a formal investigation on 12 December 2008.
>
> Neither the earlier surveillance work nor the more recent complaints on the work we have done so far provided ASIC with a smoking gun. Whether with the benefit of hindsight they should have or we should have seen greater signs is a matter that we are still examining. I go back to the point I made earlier: the options that were available to close down that business at the time were very, very limited, if any.'

34 ASIC confirms the conclusion reached in this statement. In summary, ASIC believes it responded appropriately to the concerns raised and surveillances undertaken in relation to Storm. ASIC has considered these concerns and surveillances in the context of market events in 2008 and changes in equity value experienced by the Storm investors. Overall, ASIC confirms its belief that there was no evidence on which ASIC could have and should have taken action to close down Storm.

35 In Appendix 6, which deals with ASIC's actions prior to formal investigations in relation to Opes, we note the statement ASIC made to the Senate Standing Committee on Economics Additional Estimates Hearing on 5 June 2008. In that statement, ASIC said:

> 'The ASX reported to us on 12 and 13 February 2008 that Opes was slightly below its liquidity requirement in relation to, primarily, counterparty risk because it was a market participant and trader on the exchange. We looked at that within a very short time but, in fact, it got its ratio back over what the ASX required for liquidity. Indeed, when it went into voluntary administration it was above that. The liquidity ratio that the ASX asked us to look at was not a solvency test, so you were not able from that to work out that there could be issues of solvency coming up.'

36 In summary, the subsequent review of ASIC's actions in relation to Opes prior to our formal investigation confirms the information provided in this Statement.

37 Appendices 5 and 6 dealing with Storm and Opes are provided to the PJC on a **confidential** basis because disclosure of the information set out in these appendices may prejudice our ongoing investigations in relation to Storm and Opes. When our inquiries and investigations are complete, we will review the appendices to assess the extent to which they can be made public.

38 In addition, in Appendix 4 we respond (on a non-confidential basis) to more specific criticisms concerning Storm, including criticism about ASIC's actions in negotiating an enforceable undertaking (EU) with Storm in December 2008. ASIC commenced the EU negotiations because it was concerned that Storm may have been providing conflicted, incorrect and damaging advice to Storm investors who were in negative equity. By the time ASIC sought to negotiate the EU with Storm in December 2008, the damage to investors had occurred.

39 ASIC at all times has sought to discharge its obligations in the best interests of Storm's clients. As a priority, ASIC is focused on its investigations into Storm and is doing everything it can to seek redress for investors. We are aiming to report back on the status of investigations by around 31 August 2009.

B General regulatory environment for products and services (TOR 2)

Key points

The underlying economic philosophy of the Australian FSR regime is the 'efficient markets theory'.

As a result of this underlying economic philosophy the FSR regime administered by ASIC is designed to promote market integrity and consumer protection through conduct and disclosure regulation.

In the FSR conduct and disclosure regime ASIC is an oversight and enforcement body.

ASIC conducts a number of activities when fulfilling its role as an oversight and enforcement body. ASIC has recently re-structured and undertaken new initiatives to ensure it best fulfils its role.

What is the economic philosophy underlying the regulatory regime?

40 The economic philosophy underlying the Australian FSR regime[3] is that markets drive efficiency and that markets operate most efficiently when there is a minimum of regulatory intervention. This philosophy can be loosely called 'efficient markets theory'.

41 Efficient markets theory has been the foundation of Australian financial services regulatory policy since, at least, the Australian Financial System Inquiry of 1981 (the Campbell Inquiry). Its influence continued through to the Wallis Inquiry in 1997.

42 The basic features of the current FSR regime were developed following the principles set out in the Wallis Report. The Wallis Report, in accordance with efficient markets theory, states that '[i]n designing regulatory arrangements, it is important to ensure minimum distortion of the vital roles of markets themselves in providing competitive, efficient and innovative means of meeting customers' needs'.[4]

[3] 'Australian financial services regulatory regime' or 'Australian FSR regime' refers primarily to Chapter 7 of the Corporations Act. It also includes Chapters 5C and 6D, as well as the financial services provisions of the ASIC Act. Chapter 5C, which deals with the regulation of managed investments schemes, was dealt with in ASIC's submission to the PJC's Inquiry into Agribusiness Managed Investment Schemes.

[4] Wallis Report, p.15.

43 The Wallis Report recognised that, given the complexity of financial products and the adverse consequences of breaching financial promises, there must be some regulatory intervention in the market to ensure that market participants act with integrity and that consumers are protected. That is, the underlying philosophy accepts that regulation is necessary to deal with factors that prevent the market operating efficiently (e.g. fraudulent conduct by market participants, information asymmetries and anti-competitive conduct). However, that regulation should be the minimum necessary to respond to market failures.

How does this economic philosophy shape the regulatory regime?

Conduct and disclosure regulation

44 As a result of this underlying economic philosophy, the FSR regime administered by ASIC seeks to balance investor protection with market efficiency. As such, the regime is designed to promote market integrity and consumer protection through conduct and disclosure regulation, that is:

(a) conduct regulation – rules designed to ensure industry participants behave with honesty, fairness, integrity and competence, as well as rules relating to the settlement of disputes between market participants and investors; and

(b) disclosure regulation – rules designed to:

   (i) overcome the information asymmetry between industry participants and investors by requiring disclosure of information required to facilitate informed decisions by investors; and

   (ii) promote transparency in financial markets.

Efficiency, flexibility and innovation in the financial services industry are promoted by ensuring that these rules are at the bare minimum.

45 Conduct and disclosure regulation does not involve any guarantee that regulated products and institutions will not fail and that promises made to retail investors will be met. Under a conduct and disclosure regime retail investors are still subject to risks.

46 The outcome of this regulatory setting is:

(a) efficient and flexible allocation of risk and resources and a low cost of capital;

(b) promotion of competition, innovation and flexibility; and

(c) retail investors having access to a wide range of products.

47 On the other hand, under this regulatory setting retail investors may suffer loss because:

(a) they have access to all financial products (including high-risk products) offered in the market irrespective of their level of understanding of those products or the suitability of those products;

(b) they can choose the extent of diversification for their investments (including an inappropriately undiversified set of investments); and

(c) the regulation does not aim to prevent failure of financial products. Indeed, failure of certain products because of, for example, high-risk business strategies, is an essential part of an efficient market.

Prudential regulation

48 The Wallis Report accepted that some areas of the financial system require more regulatory intervention than conduct and disclosure regulation. They require financial safety regulation in the form of prudential regulation. Unlike conduct and disclosure regulation, prudential regulation *is* designed to ensure (or increase the likelihood) that financial products and institutions do not fail and that promises by financial service or product providers to investors are met. In this way, prudential regulation may reduce systemic risk (by minimising the risk that key institutions will fail) and promote investor protection (by minimising the risk that promises made to investors are not met).

49 The intensity of that prudential regulation should be greatest where the systemic risks and the intensity of the financial promises, and hence the risk of market failure, are greatest. However, as regulation imposes costs both directly and on the wider economy, this more intense form of regulation should not be extended to all participants in the financial markets or to all financial products.

50 The Wallis Report recommended, and the Government agreed, that Authorised Deposit-taking Institutions and General and Life Insurers and larger superannuation funds should be subject to prudential supervision by the Australian Prudential Regulation Authority (APRA), but not other financial institutions or products. For example, securitisation, which was a significant problem in the recent global financial crisis, was outside prudential regulation. Similarly, market-linked investments (debentures, mortgage trusts and unlisted trusts) were outside prudential regulation.

How does this economic philosophy shape ASIC's role?[5]

51 In the FSR conduct and disclosure regime, ASIC is an oversight and enforcement body. The FSR regime is largely self-executing: AFS licensees and other participants are expected to comply with the conduct and disclosure obligations in the law. ASIC oversees compliance with these obligations and then takes appropriate enforcement action when there is non-compliance. ASIC's power to take action ahead of non-compliance is limited.

52 Consistent with the economic philosophy underlying the FSR regime, ASIC does not take action on the basis of commercially flawed business models. A significant feature of the recent collapses leading to investor losses, is flawed business models, that is, models that could only prosper if asset prices continually rose and debt markets remained open and liquid. Responsibility for flawed business models lies with management and the board.

ASIC's activities

53 The activities ASIC performs when fulfilling its role in the FSR conduct and disclosure regime are summarised in Table 3.

Note: More detail about ASIC's activities relevant to the Inquiry's terms of reference are set out in the relevant sections of this submission and in Appendix 3.

Table 3: Outline of activities ASIC performs in the FSR regime

Role	What ASIC does?
Administer the AFS licensing regime	ASIC assesses applications for an AFS licence and applications to vary an existing licence. ASIC also has power to impose additional conditions on AFS licences, to cancel AFS licences and to ban a person from participating in the financial services industry.
Register managed investment schemes	ASIC registers managed investment schemes that meet the requirements in s601ED of the Corporations Act. Note: ASIC's registration of managed investment schemes is not covered in Appendix 3 as it was dealt with in ASIC's submission to the PJC's Agribusiness Managed Investment Schemes Inquiry.
Monitor compliance with: • the AFS licensing requirements	ASIC monitors and acts on complaints and breach reports. ASIC considers a range of factors when deciding whether to investigate. In addition to monitoring and acting on complaints and breach reports, ASIC

[5] This paper focuses on ASIC's role in the FSR regime. ASIC has responsibilities outside financial products and services regulation. ASIC is the corporate regulator, overseeing approximately 1.7 million Australian companies and their directors and officers. ASIC also regulates the 5,357 auditors and 660 registered liquidators. In the financial industry, ASIC regulates 16 financial markets and 5 clearing and settlement facilities. (Figures current at 31 June 2009.)

Role	What ASIC does?
• the conduct obligations in the Corporations Act • the general consumer protection provisions for financial services and products in the ASIC Act and • disclosure obligations	also directly monitors entities, documents and transactions for compliance with the FSR obligations of its own initiative. ASIC has certain powers that facilitate its monitoring activities.
Take enforcement action against breaches of the law	ASIC's deterrence and enforcement activities consist of: • formal investigations or surveillances of suspected misconduct; and • enforcement actions, that is: – civil proceedings to protect consumers, impose a civil penalty or recover funds for consumers; – criminal proceedings (usually via the Commonwealth Director of Public Prosecutions (CDPP)) to impose a criminal penalty and actively deter misconduct in the market place; – administrative proceedings by ASIC (or via a referral to another decision maker) to remove licence authorisation, disqualify or ban persons; or – set conditions on future conduct by the party (e.g. via an enforceable undertaking). ASIC has a range of compulsory information-gathering, inspection and formal interview powers to facilitate its formal investigations.
Modify and exempt from the law when appropriate	ASIC has powers to exempt individual entities or products or classes of entities or products from aspects of the FSR regime. ASIC can also modify aspects of the FSR regime. ASIC exercises these powers on application and on its own motion. ASIC issues regulatory guidance that explains how and when it will exercise its powers to exempt from or modify the law.
Encourage compliance with the law, by helping the financial services industry understand its compliance obligations	ASIC has developed and issued guidance in relation to how it administers the law to provide clarity to the industry participants about what we expect from them and to help them understand the legislative requirements. ASIC also helps industry understand its obligations through ASIC's compliance activities.
Educate and inform investors	ASIC delivers investor education and information in three ways: • through its consumer websites – ASIC's primary channel for delivering investor education is through the internet. This is because we are able to reach a wide audience this way. ASIC currently has two websites focused on investor education; • through other channels – publications, media, professional learning packages and outreach; and • via stakeholder liaison.

ASIC's structure

54 In 2008 ASIC completed a strategic review of its operations. The aim of the strategic review was to create an ASIC that:

(a) better understands the markets it regulates;

(b) is more forward-looking in examining issues and systemic risks;

(c) is much clearer in outlining to the market why it has chosen to intervene and the behavioural changes it is seeking; and

(d) has a clearer set of priorities.

55 One of the major outcomes of the strategic review was that ASIC restructured to better fulfil its role as a conduct and disclosure regulator. The four directorates (Enforcement, Compliance, Regulation and Consumer Protection) were replaced with outwardly focused stakeholder teams and deterrence teams. There are currently 13 stakeholder teams and 8 deterrence teams.

56 The stakeholder and deterrence teams are located in the Financial Economy part of ASIC's structure. The aim of the Financial Economy teams is to increase confidence and integrity in Australia's capital and financial markets and better protect investors and consumers. The Financial Economy teams are outwardly focused, that is, their work focuses on ASIC's stakeholders. This focus means that ASIC is better placed to drive behavioural change and to better understand the external stakeholders it regulates.

57 Each stakeholder team has around 30 people, operating under a national structure. Each undertakes a variety of activities to influence behaviour of participants in the financial economy and bring about positive changes for consumers and investors, including:

(a) monitoring compliance with the law and promoting behavioural change by conducting surveillances;

(b) intervening in cases where we detect serious non-compliance, particularly where there may be harm to investors or the market integrity of Australia's financial markets;

(c) working with industry and other stakeholders to promote higher standards of business conduct and help them to deliver self-regulatory initiatives;

(d) developing policy and industry guidance;

(e) assisting the financial services industry to understand their legal obligations and the regulator's expectations;

(f) delivering information and education products and services; and

(g) developing consumer protection campaigns and compliance projects.

58 Stakeholder teams will identify specific areas of focus each year and they continuously review their priorities to address new issues and emerging risks.

59 The Financial Economy stakeholder teams most relevant to the Inquiry's terms of reference are:

(a) Financial Advisers;

(b) Consumers and Retail Investors;

(c) Deposit-Takers and Insurance Providers; and

(d) Credit.

There are also three Financial Services deterrence teams which take enforcement action in relation to financial services.

Note: The work of the Investment Managers stakeholder team is relevant to the Committee's Inquiry into Agribusiness Managed Investment Schemes.

C Adequacy of licensing arrangements (TOR 5)

Key points

ASIC's ability to protect investors by restricting entry into, or removing participants from, the financial services industry who might cause or contribute to investor loss is limited under the current FSR regime. This is because the current FSR regime:

- sets the threshold for obtaining an AFS licence relatively low and the threshold for cancelling an AFS licence relatively high; and
- focuses on the entity rather than the directors, employees or other representatives.

ASIC will investigate opportunities to increase the threshold for obtaining an AFS licence by reviewing and strengthening the minimum financial resource requirements expected of a licensee. ASIC will also investigate other ways we can use licence conditions to mitigate retail investor risk.

ASIC also believes the Government should assess whether the following modifications to ASIC's licensing and banning power will enhance ASIC's ability to protect investors:

- minor changes to the licensing threshold so that ASIC can refuse or cancel a licence where a licensee *may* breach (rather than *will* breach) its obligations;
- clarification that ASIC can ban individuals who are involved in a breach of obligations by another person; and
- 'negative licensing' of individuals so that ASIC can ban individuals who are not fit and proper and may not comply with the law.

Key issues

60 The key issues in relation to the AFS licensing regime are:

(a) the FSR regime sets the threshold for obtaining an AFS licence relatively low and the threshold for cancelling an AFS licence relatively high; and

(b) the FSR regime focuses on the entity rather than the directors, employees or other representatives of that entity which means ASIC:

(i) cannot prevent individuals entering the industry; and

(ii) can have difficulty removing individuals.

All of these factors limit ASIC's ability to protect investors by restricting or removing from the industry participants who might cause or contribute to investor loss.

Licensing threshold

61 A key function of licensing is as a 'gate-keeping' mechanism or 'barrier-to-entry'. The AFS licensing process acts as a gate-keeping mechanism to maintain market integrity and protect investors by keeping out participants who may otherwise lack the basic competence, integrity or resources (i.e. adequate financial resources, systems and processes) to provide the relevant financial services.

62 However, the barrier-to-entry set by the AFS licensing regime is relatively low. Consistent with the economic philosophy underlying the FSR regime (see Section B), the legislative framework is designed to let entities enter the market. ASIC must grant a licence if:

(a) the application is made properly;

(b) ASIC has no reason to believe that the applicant will not comply with licensee obligations;

(c) ASIC is satisfied that there is no reason to believe that the applicant or the applicant's responsible officers are not of good fame or character; and

(d) the applicant has provided ASIC with any additional information requested for the purposes of assessing the application.

63 ASIC cannot refuse an application for an AFS licence for reasons beyond the above-specified criteria (e.g. ASIC cannot refuse to grant a licence on the basis of the licensee's proposed business model). At most, the licensing process seeks to ensure that an entity is confined to providing financial services that it is competent to provide and has adequate resources to provide at the time of application. It does not involve an endorsement of business models adopted by the applicant.

64 Once a licence is granted ASIC only has the power to suspend or cancel a licence in limited circumstances.

65 ASIC can only immediately suspend or cancel a licence on application by the licensee or where the licensee is insolvent, ceases to carry on the business, is convicted of serious fraud, or is incapacitated. ASIC can suspend or cancel a licence after a hearing where:

(a) the licensee has not complied with its obligations;

(b) ASIC has reason to believe the licensee will not comply with its obligations in the future;

(c) ASIC is no longer satisfied that the licensee is of good fame or character;

(d) a banning order is made against the licensee or a key representative of the licensee; or

(e) the application was materially false or misleading or omitted a material matter.

66 ASIC's decision to suspend or cancel a licence can be appealed to the Administrative Appeals Tribunal (AAT). In practice ASIC has found it very difficult to establish before the AAT that a licensee will not comply with obligations in the future. This makes it difficult to remove licensees who may potentially cause investor losses in advance of an actual breach.

67 The relatively low threshold for obtaining an AFS licence and the relatively high threshold for removing a licence is not well understood by retail investors. Licensing, therefore, may give retail investors a sense of security which is inconsistent with the settings of the regime. There is a perception amongst some consumers that an AFS licence means that the licensee has been approved by ASIC or that it signifies the high quality of the financial services provided by the licensee. For example, in submissions to the Inquiry, some former Storm clients have stated that 'Storm was approved by ASIC'.

Focus on entity

68 The AFS licensing regime focuses on the entity rather than the directors, employees or other representatives of that entity.

69 Licensing generally occurs at the entity level. Under the Corporations Act, a person or entity that carries on a financial services business in Australia must obtain an AFS licence from ASIC, covering the provision of the relevant financial services, unless an exemption applies. A key exemption is for those who provide services as a representative of a licensee. Essentially, representatives are employees, directors, authorised representatives (including corporate authorised representatives) of the licensee. ASIC does not approve representatives.

70 In addition, conduct and disclosure obligations of the FSR regime are largely imposed on the AFS licensee (i.e. the entity), not the representatives who work for that entity: see Appendix 2 for more detail.

Note: There are some specific conduct and disclosure obligations that are imposed directly on authorised representatives, as well as AFS licensees.

71 This focus on the entity limits ASIC's ability to control the individual participants in the financial services industry.

72 While authorised representatives must be registered with ASIC, ASIC has no information about employee representatives. On the whole, ASIC must rely on licensees to ensure the competence and integrity of their representatives in the financial services industry. ASIC can experience difficulties in

locating (and taking action against) so-called 'bad apples' in the financial services industry.

73 Moreover, ASIC's ability to ban individuals from the industry is also limited. Generally, ASIC may only ban individuals, after a hearing, on the following grounds:

(a) ASIC suspends or cancels an AFS licence held by the person;

(b) the person has not complied with their obligations as an AFS licensee under s912A;

(c) ASIC has reason to believe that the person will not comply with their obligations as an AFS licensee under s912A;

(d) the person has not complied with a financial service law; or

(e) ASIC has reason to believe that the person will not comply with a financial services law.

74 ASIC's ability to ban individuals from the industry under the grounds in paragraph 73 are limited by two factors:

(a) key obligations are imposed on the entity, not its representatives. Often individuals who have behaved inappropriately will not actually have breached the financial services law, because the key obligations are imposed on the authorising licensee; and

(b) it is difficult to establish before the AAT that a person will not comply with its obligations in the future.

ASIC's activities

Licensing process

75 ASIC has a dedicated team that assesses AFS licence applications. ASIC uses a risk-based approach in its assessment of licence applications. This helps ASIC determine the level of scrutiny it gives an application. In general, the factors that ASIC takes into account in its risk assessment are the complexity of the licence authorisations being applied for, as well as ASIC's analysis of the kind of business the applicant is undertaking (e.g. financial planning business or issuing financial products) and the market in which the applicant proposes to operate.

Note: Further details about ASIC's licensing process including what ASIC considers in deciding whether to grant an AFS licence are set out in Appendix 3.

Strengthening the licensing regime – financial resource requirements

76 Investor protection could be improved by increasing the licensing threshold. As indicated above, the relatively low threshold of the AFS licensing regime is consistent with the economic philosophy underpinning the FSR regime and so there are limits to the changes ASIC can make. Nevertheless, ASIC is exploring whether it can increase the threshold within the limits of the existing conduct and disclosure regime. ASIC is exploring whether the financial resource requirements that must be met by AFS licensees can be strengthened, and whether other licence conditions can be imposed to mitigate retail investor risk.

Note: ASIC is also examining strengthening its licence conditions in relation to the minimum training standards that apply to financial advisers: see Section D.

77 ASIC imposes financial requirements by licence conditions on AFS licensees to help ensure that:

(a) a licensee has sufficient financial resources to conduct their business in compliance with the Corporations Act (including carrying out supervisory arrangements);

(b) there is a financial buffer to decrease the risk of a disorderly or non-compliant wind-up if the licensee's business fails; and

(c) there are incentives for the licensee to comply (i.e. through the risk of financial loss).

Note: The financial requirements imposed by ASIC are explained in Regulatory Guide 166 *Licensing: Financial requirements* (RG 166).

78 In general, the type and level of financial requirements will depend on the activities of the licensee e.g. the authorisations being sought and the products that will be covered. The financial requirements do not apply to entities regulated by APRA because these entities are subject to prudential requirements.

79 The financial requirements imposed by ASIC are not the same as the financial requirements imposed by APRA. ASIC is not a prudential regulator and, as such, ASIC's financial requirements are not intended to ensure that a licensee will be able to meet their financial commitments (including commitments to their clients or market counterparties).

Other licence conditions

80 ASIC imposes a number of licence conditions to support the obligations of AFS licensees. These include conditions to ensure that the licensee has adequate risk management systems and other resources such as technological and human resources to provide the financial services covered by the licence and adequately supervise their employees and authorised representatives.

These requirements, like the financial requirements, will vary depending on the activities of the licensee, size of the business, etc.

ASIC's project

81 ASIC is currently reviewing the resource requirements that apply to non-APRA regulated AFS licensees. The project is investigating how an entity's resources (e.g. adequate financial resources, systems and processes) may be bolstered to mitigate:

(a) the risk of failure of, at least some, licensees; and

(b) if failure does occur, the consequences for the licensee's customers and the markets in which it participates.

The project will also look at whether there is scope for ASIC to introduce licence conditions about the delivery of certain high-risk products in order to mitigate retail investor risk. This work is being informed by our experiences, and the experiences of overseas regulators, in the volatile market period of the last year.

82 Strengthening the licensing regime in this manner may enable ASIC to keep some participants out of the industry and enhance investor protection. For example, requiring capital adequacy and liquidity requirements (similar, but not identical, to those required of APRA regulated institutions) for some AFS licensees such as operators of mortgage trusts and unlisted property trusts may improve protection for retail investors in these types of funds.

83 However, it may also:

(a) increase barriers to entry, which will raise costs, reduce competition and stifle innovation;

(b) impede individuals' rights to conduct businesses of their choice;

(c) possibly increase attempts to conduct illegal activity in the unregulated sphere; and

(d) increase regulatory costs.

ASIC will have to balance these factors against enhanced investor and systemic protection.

Focusing on representatives

Bannings

84 ASIC is active in banning individuals in the financial services industry despite the limitations on legal power referred to in paragraph 73 above. For example, from July 2006 to 30 June 2009, ASIC banned 117 individuals

from providing financial services either permanently or for a specified period.

Bad apples project

85 ASIC has worked to deal with the issue of problem representatives (often called 'bad apples') moving from licensee to licensee by working with the financial services industry. In 2007 ASIC published a handbook, developed jointly with industry representatives and Standards Australia, on Reference Checking in the Financial Services Industry, to limit the ability of bad apples to move within the sector. The handbook sought to standardise a reference-checking framework that can be applied to financial services industry participants and encourage sharing of information between licensees.

Changes to the policy settings of the FSR regime

Strengthening the licensing regime

Financial resource and other requirements

86 As stated above, ASIC is currently reviewing the financial resource requirements for non-APRA regulated AFS licensees, with a view to improving investor and systemic protection. However, ASIC is not a prudential regulator and ASIC is not able to set prudential requirements for AFS licensees. This will limit the type and nature of the financial resource requirements we can impose. At this stage of the project, it is too early to tell whether this limitation will prevent ASIC imposing appropriately rigorous resource requirements on some or all AFS licensees. Additionally, ASIC is also investigating whether it can impose other licence conditions to mitigate retail investor risk. ASIC will inform the Government if we conclude that we are unable to impose appropriate conditions to protect retail investors using our current powers and believe that Government should consider law reform.

Enhancing the licensing power

87 ASIC believes the Government should consider the merits of slightly modifying the requirements for granting and removing AFS licences in order to enhance ASIC's ability to protect investors. This could be achieved by replacing the current licensing 'entry' requirement, that ASIC have no reason to believe the licensee 'will not comply' with their obligations under s912A in the future, with the slightly lower standard of 'may not comply' or 'is not likely to comply' with their obligations in the future.

88 This change would overcome the difficulty ASIC currently experiences when trying to assess whether an applicant *will* comply with their obligations and meet their licence conditions before they have commenced business. The slightly lower standard proposed above (i.e. ‘may not comply’ or ‘is not likely to comply’) would enable ASIC to consider a wider range of matters than currently permitted and minimise this difficulty.

89 This requirement (i.e. ‘may’ or ‘is likely’ not to comply with their obligations) could also be introduced as a basis for cancelling or suspending AFS licences after a hearing. As stated above, ASIC has found it very difficult to establish before the AAT that a licensee will not comply with obligations in the future. This limits ASIC’s ability to act prior to a breach.

90 The National Consumer Credit Protection Bill 2009 (the Credit Bill) introduced into Parliament on 25 June 2009, proposes similar licensing requirements to grant and cancel credit licences. The Explanatory Memorandum to the Credit Bill notes that the requirement for ASIC to have a reason to believe that the credit licensee will not comply with the legislation would require ASIC ‘to believe, as a matter of certainty, that the applicant will contravene the obligations in the future’ and notes that ‘[s]uch a standard would be so onerous that it could result, in practice, in ASIC never being able to refuse a credit licence’.[6] ASIC’s experience under the AFS licensing regime has informed this conclusion: see *Saxby Bridge Financial Pty Ltd and Ors and ASIC* [2003] AATA 480.

Focusing on representatives

91 ASIC believes the Government should consider the merits of enhancing ASIC’s power to act against individuals by amending the banning power in s920A as follows:

(a) clarify that ASIC is able to ban an individual (after a hearing) where a person is ‘involved’ in a contravention of a financial services law by another person i.e. its authorising licensee or another person;

(b) enable ASIC to ban an individual (after a hearing) where ASIC has reason to believe that the person is not a ‘fit and proper’ person to engage in financial services; and

(c) replace the existing grounds for banning a person where ASIC has reason to believe that the person ‘will not comply’ with s 912A or a financial services law with the slightly lower standard of ‘may not comply’ or ‘is likely not to comply’.

Note: The Credit Bill contains similar provisions to these proposed amendments.

[6] Explanatory Memorandum to the National Consumer Credit Protection Bill 2009.

92 Together these three changes, if introduced, would enhance ASIC's ability to identify and ban individuals who are likely to cause investor losses. These powers would increase the range of matters ASIC can take into account at the banning stage and make the banning power more like a 'negative licensing' power.

'Involved in'

93 Currently, the banning power does not explicitly permit ASIC to take action against an individual who is involved in a contravention of the financial services law by another person, such as its authorising licensee. For example, the conduct of an employee adviser giving negligent or inappropriate (but not fraudulent) advice to a retail client will result in a breach of s945A of the Corporations Act by the AFS licensee, who is the providing entity of the advice, but not in a breach by the employee. Introducing an explicit power to ban an individual involved in a contravention of a financial services law by another person would clarify that ASIC can make a banning order against the employee in a situation such as this.

'Fit and proper'

94 ASIC cannot currently ban individuals on the basis that they are not 'fit and proper' (i.e. not competent or of good fame or character).

> Note: However, the fact that an individual is not of good fame or character can be taken into account to determine the effect of any banning order established under s920A(1).

95 Introducing a 'fit and proper' grounds for banning individuals from providing financial services would enable ASIC to give consideration to a wider range of conduct than currently possible when determining whether an individual should be removed from the industry to protect retail investors. A fit and proper basis for banning an individual would permit ASIC to consider the conduct of the person in a broad context (i.e. in both a professional and personal capacity) covering the person's judgement, any civil or criminal convictions (i.e. not just convictions for serious fraud) and other factors that may reflect negatively on their character.

96 The Explanatory Memorandum to the Credit Bill notes that the power to ban individuals on the basis that they are not 'fit and proper' would

> 'enable ASIC to take into account conduct such as where:
>
> - ASIC believes the individual has committed a fraud, but the individual has not been prosecuted for this or there is a delay or uncertainty in any prosecution;
> - the individual has engaged in conduct causing serious detriment or financial loss to consumers, so that there is a need to protect the public; or

- the individual has demonstrated a consistent failure to comply with the law, or with directions from any licensee or employer.'[7]

'May not comply'

97 As stated above, ASIC has found it difficult to establish that it has a reasonable belief that the person will not comply with their obligations under financial services law: see *Re Howarth and ASIC* [2008] AATA 278. Specifically, ASIC found it difficult to establish that a broader range of conduct (aside from convictions for fraud) can found a belief that the individual will not comply with their obligations under financial services law. For example, ASIC was unable to establish that the following conduct of a representative should give rise to a banning order under s920A on the grounds that the individual will not comply with the financial services law:

(a) failure to comply with the principal's internal guidelines and procedures;

(b) failure to comply with relevant ASX business rules; or

(c) conduct which may amount to a serious conflict of interest: see *XTWK and ASIC* [2008] AATA 703.

98 Expanding the test to whether an individual 'may not comply', or 'is likely to not comply', with their obligations under financial services law will permit ASIC to take into account a wider range of information relevant to this question. For example, of relevance to financial services representatives, the Explanatory Memorandum to the Credit Bill suggests the following information may be taken into account:

'• the extent of compliance by the applicant with analogous obligations while a registered person (where applicable);

…

- conduct of the applicant that shows deliberation and planning in wilfully disregarding the law; or
- any other conduct of the applicant that may lead ASIC to conclude, on reasonable grounds, that the applicant is not likely to comply (for example, where information from a State or Territory as to the activities of the applicant as a member of an organised criminal group warrants this conclusion).'[8]

Other options

Strengthening the licensing regime

99 Other options to improve investor protection by increasing the licensing threshold include:

[7] Explanatory Memorandum to the National Consumer Credit Protection Bill 2009
[8] Explanatory Memorandum to the National Consumer Credit Protection Bill 2009

(a) placing the onus on applicants to prove that they meet the threshold requirements; or

(b) requiring ASIC to assess the business models of applicants.

100 ASIC considers that increased investor protection created by these options is likely to be outweighed by the costs of these reforms. Increasing the licensing threshold, especially by requiring a review of business models of licence applicants would:

(a) increase barriers to entry, which will raise costs, reduce competition and stifle innovation;

(b) impede individuals' rights to conduct businesses of their choice;

(c) possibly increase attempts to conduct illegal activity in the unregulated sphere; and

(d) increase regulatory costs.

Focusing on representatives

101 In other jurisdictions, there is more focus on the individual during the licensing process, that is, the regulator must approve individuals at the entry stage: see Table 4.

Table 4: Regulation of individuals

Hong Kong	Individuals who carry on regulated activities for a licensed corporation must be licensed and are subject to a 'fit and proper' test.
Singapore	Individuals who perform any of the functions of a financial adviser must be licensed and are subject to a 'fit and proper' test.
United Kingdom	Individuals who perform a 'customer function', including advising on investments, dealing and arranging, must be approved by the Financial Services Authority.

102 However, whilst requiring ASIC to approve individuals involved in the financial services industry might improve ASIC's ability to ensure those who may engage in unacceptable conduct cannot enter the financial services industry, ASIC believes that the costs of such a reform would outweigh this benefit. Such a reform would dilute the key responsibility of the licensee and significantly increase regulatory costs.

Summary

103 Table 5 below summarises the key issues raised by this term of reference, ASIC's forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with the issues.

Table 5: Adequacy of licensing arrangements (TOR 5)

Key issues	ASIC activities	Regulatory change options for consideration by Government
Licensing sets a low barrier to entry and this is not understood by investors Licensing focuses on the entity not representatives, limiting ASIC's ability to control entry or ban individuals	ASIC will continue to assess licence applicants using a risk-based approach ASIC will strengthen the financial resource requirements for non-APRA regulated Australian Financial Services (AFS) licensees and look at other licence conditions to mitigate retail investor risk ASIC will continue to identify and ban problem individuals in the financial service industry	**Financial resource and other requirements** – Depending on the outcome of ASIC's activity to strengthen financial resource requirements and review other possible licence conditions to mitigate retail investor risk, the Government may need to consider changes to policy settings to enable ASIC to set appropriate financial resource requirements for AFS licensees **Minor changes to licensing threshold** – Enable ASIC to refuse or remove a licence where a licensee *may* breach (rather than *will* breach) its obligations **'Negative licensing' of individuals** – Enable ASIC to ban individuals who are not fit and proper and who *may* not comply (rather than *will* not comply) with a financial services law. Clarify that ASIC can ban individuals who are involved in a breach of obligations by another person

D Role of financial advisers (TOR 1)

Key points

The challenge for ASIC, Government and industry is to improve access to advice for retail investors and at the same time improve the quality of advice.

ASIC has several projects underway to address this challenge.

ASIC also believes the Government should assess whether the following changes would improve access to quality advice:

- clarifying the standard of care for advisers by introducing a legislative fiduciary-style duty on advisers (i.e. a duty to act in good faith in the best interests of clients and, where there is a conflict between the interests of the adviser and the client, to prioritise the interests of the client); and
- requiring prominent disclosure of restrictions on the advice that can be provided by an adviser in marketing and promotional material.

Key issues

104 The key issues in relation to the role of financial advisers relate to:

(a) access to financial advice; and

(b) the quality of advice provided by financial advisers.

Access to advice is limited

105 Access to quality advice is crucial because of:

(a) the complexity of financial products and disclosures;

(b) the onus on investors to make financial decisions (about superannuation and other investments) to ensure their financial security; and

(c) low levels of financial literacy.

106 Nevertheless, not all investors can, or do, obtain advice from financial advisers. Available figures indicate that only between 22% and 34% of adult Australians access financial advice.[9] Use of financial advisers appears to

[9] See, for example: Financial Planning Association, Consumer Attitudes to Financial Planning, 2007 (22% of Australians aged 16 years and over); ANZ, Survey of Adult Financial Literacy in Australia, 2008, p 89 (34% of Australians aged 18 years and over) and Bloch, Jo-Anne, 'The Future of Financial Planning', Financial Planning Magazine, 9 December 2008 (32% of adult Australians).

increase with age.[10] According to the Australian Government's Financial Literacy Foundation, most clients seek advice about tax and investments and relatively few clients seek advice about superannuation and 'change in life' type situations. Typically, financial advisers do not provide services to clients with small sums of money to invest. Those who obtain financial advice tend to be older with higher levels of investible assets.[11]

107 The importance of advice is affected by the quality of disclosure, complexity of products and investors' financial literacy. In particular, investors are less likely to require access to financial advice where disclosure is clear, safer and less complex products are readily available (or there are restrictions on investing in more complex, riskier products) and financial literacy is improved.

Quality of advice

108 Overall, ASIC believes that the current standards in the advice industry are adequate. Nevertheless, there are some instances of poor quality advice leading to investor losses.

109 Issues that may affect the quality of advice provided to consumers include:

(a) the structure of the advice industry; and

(b) the standard of care imposed on advisers under the Corporations Act.

Impact of the structure of the advice industry

110 The financial advice industry has developed from the product manufacturing industry (in particular, the life insurance industry) as the means of distribution of products. As a result of these historical roots and other customary practices in the industry a number of factors built into the structure of the advice industry may impact on the quality of advice. These factors include:

(a) the dual role played by a financial adviser in providing advice services to clients and selling products for product manufacturers;

(b) restrictions on the range of products financial advisers may advise on; and

(c) an adviser's links to product issuers and the practice of re-branding aligned financial advisers.

[10] The Survey of Adult Financial Literacy in Australia (2008) conducted by ANZ found that of the 34% of respondents who had consulted a financial planner, 48% were aged 55-69. Respondents aged 18-24 years comprised only 13%. The FPA-commissioned report into Consumer Attitudes to Financial Planning found that 7% of respondents aged 16-24 years had consulted a financial planner, increasing to 21% of those aged 25-34, 23% of those aged 35-49 and 29% of those aged 50 or over.

[11] Financial Literacy Foundation, Financial Literacy: Australians understanding money, 2007, p 32.

111 Today financial advisers usually play a dual role of providing advice services to clients and acting as the sales force for financial product manufacturers. Approximately 85% of financial advisers are associated with a product manufacturer, so that many advisers effectively act as a product pipeline.[12] Of the remainder, the vast majority receive commissions from product manufacturers and so have incentives to sell products: see Section E.[13] This structure creates potential conflicts of interest that may be inconsistent with providing quality advice and these conflicts may not be evident to consumers.

112 The scope of advice provided by an adviser may be restricted. For many reasons licensees restrict the range of products financial advisers can advise on e.g. through an approved product list. This restriction may be to ensure the products recommended meet minimum standards, to ensure the advisers are adequately trained on the products they advise on and to give the professional indemnity insurer comfort about the risks of negligent advice being given. The range of products that an adviser is permitted to advise on can also be influenced by which products are more profitable to the licensee (e.g. where there is a commission from a product manufacturer or a relationship with a product manufacturer). The restricted nature of the advice is often not evident to consumers.

113 Advisers also place a substantial amount of retail investment through platforms.[14] Putting all clients on the same platform creates business management efficiencies for an adviser and it is easier to monitor the portfolio and generally administer a business that uses a single platform. The use of platforms, however, may also restrict the range of products that advisers will recommend to their clients.

114 There is some evidence that the quality of advice is affected by conflicts of interest created by links to product issuers. ASIC’s 2006 Shadow Shopping survey on superannuation advice, which covered 102 AFS licensees (259 individual advisers) suggested that unreasonable advice was more common where the recommended product was associated with the adviser’s licensee.

115 It seems that investors are not often aware of their advisers’ links to product manufacturers and sales distribution role and the conflicts of interests this might create. While conflicts of interest are required to be disclosed to clients, this might not be sufficient to counteract the clients’ own understanding of the role of an adviser.

116 For example, there is a practice of re-branding aligned financial advisers in the industry, which means that consumers might not appreciate that they are

[12] IBISWorld Industry Report, Financial Planning and Investment Advice in Australia: K7515, 22 May 2009, p. 7.
[13] See Investment Trends, Planner Business Model Report, October 2008.
[14] In 2008, approximately 78% of new investments placed by financial planners was through platforms (Investment Trends, 2008 Planner Technology Report).

getting advice from an adviser that is owned by a product manufacturer (even though this is required to be disclosed in the Financial Services Guide (FSG)). In 2008, ASIC conducted a review of branding disclosure of 35 bank or institutionally-owned advisers and found that while advisers disclosed the relationship in their FSG as required by the Corporations Act, the information was often not prominently disclosed.

Obligations on financial advisers

117 The Corporations Act does not require advisers to act in the best interests of their clients.[15] Under the Corporations Act providers of personal advice are required to provide appropriate advice.[16] Additionally, AFS licensees are required to manage their conflicts of interest.

118 It appears that there is a mismatch between the client's expectation that the adviser is providing a 'professional' service (e.g. advice that is in their best interests) and the obligations of the adviser under the Corporations Act (that the adviser provides advice that is appropriate to the client and manages conflicts). Investors may see advisers as similar to lawyers and accountants in terms of duties and professionalism.

Industry initiatives

119 Industry is involved in a number of initiatives to improve the quality of advice and access to advice.

120 The FPA[17] is looking to increase the professionalism of the industry through two initiatives: its code of ethics and its policy on continuing professional development. Both of these initiatives came into force on 1 July 2009. The code of ethics comprises eight principles including, importantly, an obligation on members to put their clients first. The FPA's policy on continuing professional development aims to provide a broader framework for professional development, based on six professional dimensions: inter-dependence, capability, attributes and performance, professional conduct, critical thinking and reflexive practice. The policy deliberately goes further than strict regulatory compliance with ASIC's guidance on training standards in RG 146 *Licensing: Training of financial product advisers* (RG 146).

121 The FPA has also sought to increase access to advice by offering free general advice to all Australians for a limited period of time. The service was delivered online via the FPA's 'Ask an Expert' service. Consumers

[15] However, at common law, if financial advisers put themselves in a relationship of trust with their client, they may be fiduciaries and therefore subject to act in the best interests of their client and avoid conflicts of interest.
[16] There is no appropriate advice obligation on providers of general advice.
[17] Membership of the FPA is not mandatory. There are a number of industry bodies purporting to represent the interests of advisers and these bodies also play other roles such as lobbying on behalf of industry.

could make email inquiries across a range of topics including: superannuation; financial goals and budgeting; saving and investments; and retirement planning. A panel of volunteer financial planners provided general advice in response to each inquiry. The consumer was able to choose who they wished to answer their inquiry based on volunteers' profiles posted on the website. The service was offered from 25 May 2009 to 31 July 2009.

122 The FPA reports that 360 people had made online inquiries to 3 July 2009. A similar program conducted during May 2008 resulted in 354 inquiries.

123 Other industry associations also have internal codes of ethics which govern members' conduct. The Association of Financial Advisers (AFA) obliges members to act in the best interests of clients. IFSA's code of ethics requires that members not allow conflicts of interest to influence members' conduct. More particularly, members must ensure that the client's interests are paramount and come before the member's interests. IFSA also publishes standards on alternative forms of remuneration (soft-dollar payments) and on rebates and related payments. These standards are co-owned with the FPA.

ASIC activities

Improving access to advice

124 ASIC is working with the Government to improve access to advice for super fund members, through the Financial Services Working Group (FSWG): see Regulatory Guide 200 *Advice to super fund members* (RG 200) and Class Order 09/210 *Intra-fund superannuation advice*. The class order provides conditional relief from the requirements of s945A of the Corporations Act (the requirement to have a reasonable basis for advice) where licensed super fund trustees give personal advice to members about their existing interest in a fund on certain limited topics.

> Note: The FSWG, consisting of ASIC, Treasury and the Department of Finance and Deregulation, was established in December 2007. As well as facilitating advice for super fund members, the FSWG is working to simplify point-of-sale product disclosure for particular products.

125 ASIC's Financial Advisers team is conducting a review of the demand for advice by consumers and the nature of the current supply more generally to identify the current gaps in the market. The team will then develop initiatives seeking to address these gaps and improve access to advice.

126 An alternative is to improve access to financial guidance through channels other than financial advisers. ASIC is working to improve access to advice through generic advice information, such as on our FIDO website and online tools: see further Section H.

Improving quality of advice

127 ASIC acts against licensees and individuals who provide substandard financial advice in breach of the Corporations Act. From 1 July 2006 to 30 June 2009, approximately 60% of ASIC's actions to cancel or suspend licences and to ban individuals were against financial advisers.

128 ASIC's Financial Advisers team is also working with industry on the 'Quality of Advice' project to improve the quality of advice to the extent possible within the current regulatory regime.

129 The project will involve:

(a) working with industry to develop a definition of what ASIC considers to be 'quality advice' and a way to measure it;

(b) reviewing how an industry sample measures up to this definition. The team will obtain relevant and comprehensive data to determine where industry currently sits against our definition and use this data to benchmark industry and to look at advice over time; and

Note: see paragraph 131 for more details on how this sample will be obtained.

(c) based on this assessment, identifying factors that lead to both good and poor quality financial advice. The team will then develop initiatives aimed at improving the quality of advice based on these factors.

130 As a sub-set of this project, the team will also look at the impact of the following on the quality of financial advice:

(a) different remuneration structures (see Section E);

(b) training standards; and

(c) other business practices.

These projects are referred to in more detail below.

Targeted surveillance of advisers

131 ASIC's Financial Advisers team will conduct targeted surveillance of 30 AFS licensees (randomly selected to provide a cross-section of the financial planning industry) to assess the quality of advice being provided to the retail investors of those licensees. The results of the project will be released to industry in a report (on a no-names basis) and each licensee will receive an individual assessment from ASIC.

Note: This targeted surveillance will be in addition to the ongoing surveillance work undertaken to address specific regulatory issues. See Appendix 3 for more detail on ASIC's surveillance work.

Shadow shopping

132 ASIC is also planning to carry out a Shadow Shopping survey, which will look at a number of matters including whether the current training requirements for advisers remain appropriate and the quality of advice that retail investors are getting.

Training

133 Fundamental to the provision of quality advice is the expertise of the advisers providing that advice to individual clients. All licensed advisers are obliged under the Corporations Act to ensure that their representatives are adequately trained and competent to give advice. RG 146 sets out ASIC's guidance on how licensees can meet this obligation and sets down minimum training standards for the advice industry. In general, the RG 146 training standards are a set of knowledge and skill requirements that must be satisfied at a certain educational level (e.g. Tier 1 level or Tier 2 level). The Tier 1 education level is broadly equivalent to a Diploma under the Australian Qualifications Framework and the Tier 2 level is broadly equivalent to the Certificate III level.[18]

134 ASIC's Financial Advisers team is reviewing RG 146 with a view to improving training standards and will put forward proposals for change in consultation with industry and other stakeholders. However, some members of the advice industry have argued that raising training standards would lead to increased costs to advisory groups and therefore to consumers. This would ultimately affect access to advice. ASIC will need to take these factors into account when considering changes to the standards in RG 146.

Advice business practices

135 The Financial Advisers team is also looking at all business practices involved in providing personal financial advice to retail clients ranging from the recruitment of the adviser by the licensee through to the preparation of initial and ongoing advice. The aim is to develop research-backed conclusions about how business practices can be improved to increase the quality of advice.

[18] The knowledge and skill requirements and educational levels vary depending on the advice activities being carried out e.g. whether the adviser is giving personal or general advice and what products the adviser is giving advice on. Advisers can meet the training standards by completing one of the training courses listed on the ASIC Training Register relevant to their advisory activities. As an alternative, advisers can demonstrate their competence through individual assessment against the training standards by an authorised assessor.

Changes to the policy settings of the FSR regime

136 ASIC believes that the Government should assess whether the following changes would improve access to quality advice:

(a) clarifying the standard of care for advisers by introducing a legislative, fiduciary-style duty; and

(b) requiring prominent disclosure of restrictions on the advice that can be provided by an adviser in marketing and promotional material.

These changes would help create a professional advice industry delivering quality advice and should increase retail investor confidence in the advice industry, leading more retail investors to seek advice.[19]

Fiduciary-style duty

137 In addition to the current requirement in the Corporations Act that advisers have a reasonable basis for advice, the Corporations Act could be amended to clarify that advisers must act in good faith in the best interests of their clients and, where there is a conflict between their clients' interest and their own interests, to give priority to their clients' interests.[20] Any contract that attempts to exclude the operation of this duty should be deemed void.

138 Currently advisers are required to manage conflicts of interest, and this is usually done by disclosing conflicts to the client. However, disclosure may not be sufficient to ameliorate the impact of conflicts. An additional legislative requirement to put the interests of clients first where there is a conflict would lead to a higher quality of advice and the emergence of a professional advice industry.

139 It would mean that where there is a conflict between the interests of the client and the interests of the adviser, the adviser must give priority to the interests of their client. For example, under the current test, an adviser may have a reasonable basis to recommend a client invest in any of three different products. Of the three products, the adviser could recommend the product that delivers the adviser the greatest fee revenue, provided that this conflict of interest and the amount of the fee is clearly disclosed to the client. However, under the higher standard proposed above, they would be required to recommend the lower fee product because the adviser is required to prioritise the interests of their client (i.e. in paying the lowest fees possible) before their own interest in receiving higher remuneration.

[19] Options to increase access to advice directly are limited. The Government could consider subsidising financial product advice by, for example, providing tax deductions for financial product advice (even if it is paid for on an up-front fee-for-service basis) or direct subsidies to low-income investors.

[20] Similar to the duty imposed on responsible entities of managed investment schemes in s601FC.

140 However, the higher duty would not necessarily mean that the advice given must objectively be the 'best advice', or that the adviser would have to consider every possible option theoretically available to the client. In the example above, the adviser would not have to consider every product available in the market that would offer the same benefits to find the lowest cost option for the client. The adviser could, for example, consider all products on their approved product list that offered this benefit and select the one that provided the best option for the client (e.g. in terms of cost).

141 In relation to conflicts created by administrative efficiencies, an adviser could still consolidate its business on one platform. However, if the result of moving onto this platform was not in the best interests of the client because, for example they incurred costs and taxes that outweighed the benefit of the advice services, the adviser may have to suggest that they cannot take on this client.

142 Further guidance would need to be provided on the meaning of advice that is in the best interests of a client.

Similar approaches in other jurisdictions

143 Some jurisdictions have imposed higher standards than appropriate advice on advisers, such as duties to act in the best interests of clients. For example:

(a) MiFID[21] has a requirement for advisers to act in the best interests of the client, which is higher than suitability requirements in some jurisdictions, including the UK;

(b) in the US 'investment advisers' are considered to have a fiduciary relationship with their clients;[22]

(c) in Canada, 'managers' have fiduciary duties and dealers have to act fairly and honestly;

(d) in France, financial advisers are required to act honestly, fairly and professionally in accordance with the best interests of the client;

(e) in Germany, firms must not make any investment recommendations that are not in the interests of the client or that primarily serve their own interests; and

(f) in Hong Kong, licensees and registered persons have fiduciary-like obligations to act in the best interests of the client and to maintain the 'integrity of the market'.

[21] The MiFID is an EU law, which provides a harmonised regulatory regime for investment services across the 27 member states of the EU plus Iceland, Norway and Liechtenstein.

[22] Under proposed amendments to the Investment Advisers Act of 1940, the Securities Exchange Commission (SEC) would have the power to make rules providing that the standard for all brokers dealers and investment advisers is to act 'solely in the interest of the customer or client without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice'.

More prominent disclosure of restrictions on advice

144 ASIC believes that the current structure of the advice industry reflects a sales culture resulting in conflicts of interest that may be inconsistent with the provision of quality advice. Moreover, these conflicts and their impact on the quality of the advice are not transparent to the consumer. The regulatory changes in relation to remuneration referred to in Section E would go a long way to addressing these conflicts. However, even if the proposals regarding remuneration are adopted, ASIC believes there should be increased clarity for consumers in relation to both the role of the adviser and the nature of the service being provided.

145 In light of this objective, ASIC believes that the Government should assess changes to the regulatory regime that would require advisers to more prominently disclose the restrictions on the advice given to consumers.

146 Currently disclosure about relationships with product issuers tends to be buried in the fine print of a licensee's FSG and there is no legislative requirement for a financial adviser's marketing material (as distinct from FSGs and Statements of Advice (SOAs)) to disclose the association with a product issuer. Many advisers do not disclose this relationship on their website. By the time a potential client receives an FSG or SOA, they may have already gone a long way down the path to making a decision to use the services of the adviser.

147 In order to bring the potential conflict to the attention of the client before they make a purchasing decision about the adviser's services or a particular product, prominent disclosure in marketing material could be required, for example, on advertisements, shopfronts, letterhead, websites etc.

148 Advertising and marketing material could also state that the adviser can advise on a limited range of products and a list of these products is available on the adviser firm's website or on request.

Other options

149 For completeness, we set out below initiatives to address the access to quality of advice in other jurisdictions, principally the United Kingdom.

Separation of sales or restricted advice, and independent advice

150 Extensive work has been undertaken in the UK on the separation of independent and non-independent (or restricted) forms of advice. In a recent consultation paper, the UK Financial Services Authority (FSA) has proposed

that all investment firms must identify their services as comprising either 'independent advice' or 'restricted advice'.[23]

151 Firms providing independent advice must make recommendations based on a comprehensive and fair analysis of the relevant market, and provide unbiased, unrestricted advice. An independent adviser's analysis of the relevant market must comprise all retail investment products that are capable of meeting the investment needs of the consumer.

152 Under this definition, advisers will still be able to offer advice in a specialist market area, for example retirement planning or socially responsible products, provided the whole of that specialist market is considered and the limited field is made clear to the client. Any other advice, for example, advice limited to a particular manufacturer's products, is restricted advice.

153 The proposals do not preclude firms that offer their own products from holding themselves out as providing independent advice. However, such firms will not be able to limit themselves to providing advice solely on their own products.

154 The FSA proposes that, before providing a service, all firms will be required to advise clients in writing whether the advice the firm provides is independent or restricted. An additional verbal disclosure is required in the case of restricted advice.

155 The FSA proposes to mandate the use of the terms 'independent advice' and 'restricted advice' in written disclosure, but does not at this stage propose to mandate a particular form of words to explain the nature of restricted advice. The form of the oral disclosure required in respect of restricted advice will be mandated and must include the name of the firm and the range of products the firm advises on.

156 The proposals put forward by the FSA are broad and place a heavy onus on independent advisers to consider all retail investment products when making a recommendation. The FSA expressly notes that one of the challenges facing advisers will be to ensure they have sufficient knowledge of all the products available that could meet the investment objectives of the client.

157 An alternative approach was taken in Israel, where a strict division between advisers and product providers is legislated by way of a '10% rule'. Investment advisers are prohibited from providing advice on, or executing transactions in, financial assets affiliated with an institutional body that holds 10% of the means of control in the adviser.

158 In 2006 in Australia, a set of initiatives aimed at reducing the regulatory burden on industry, included a proposal to modify the definition of 'financial

[23] Financial Services Authority, Distribution of retail investments: Delivering the RDR, consultation paper 09/18, chapter 2.

product advice' so that sales recommendations were taken out of the scope of financial product advice. This proposal would have removed obligations relating to the provision of advice for the 'sales' part of the industry. Those who opposed this proposal suggested that most investors would use the 'sales' part of the industry (given the high concentration of advice businesses that are tied to product manufacturers) and therefore would receive lower quality 'advice'.

Professional Standards Board for the advice industry

159 In addition to making recommendations on the separation of sales and advice, the UK FSA's consultation paper on distribution of retail investments[24] also proposes to establish a professional standards board charged with setting and implementing new benchmarks in the areas of qualifications, ethics and continuing professional development. The consultation paper recommends that the qualification benchmark be set at the vocational equivalent of the first year of a bachelor's degree.

Summary

160 Table 6 summarises the key issues raised by this term of reference, ASIC's forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with these issues.

Table 6: Role of financial advisers (TOR 1)

Key issues	ASIC activities	Regulatory change options for consideration by Government
Access to advice is limited i.e. not all investors can, or do, obtain advice There are some instances of poor quality advice being given	ASIC is assessing how advice can be made more widely available ASIC is developing a generic online advice tool ASIC is looking to benchmark the quality of advice through targeted surveillance activities ASIC will conduct a Shadow Shopping survey to review current training requirements for advisers and the quality of advice ASIC is reviewing whether to raise the training standards for advisers and will consult on proposals for change	**Fiduciary standard** – Clarify the duty owed by financial advisers to clients (i.e. a fiduciary-style duty to act in the best interests of clients and, where there is a conflict between the adviser's interests and the client's interests, prefer the interests of the client) **More prominent disclosure of restrictions on advice** – require disclosure of restrictions on advice in advertising and marketing material

[24] Financial Services Authority, Distribution of retail investments: Delivering the RDR, consultation paper 09/18.

E Role of commission arrangements for product sales and advice (TOR 3)

Key points

Remuneration structures used in the financial advice industry create real and potential conflicts of interest that can distort the quality of advice.

ASIC and industry are working to address these potential conflicts of interest. In particular, ASIC is reviewing the impact of various remuneration structures upon the quality of advice.

However, ASIC considers that these initiatives may be insufficient to address the potential conflicts of interest.

Therefore, other regulatory options, such as preventing remuneration structures that may create conflicts of interest that adversely affect the quality of advice, could be considered.

Key issues

161 Remuneration of distributors of financial products was historically set by the product manufacturer. It was based on the value of products sold and deducted from the amount paid by the consumer for the product. These remuneration settings encouraged product distributors to sell certain products.

162 As the market for financial advice services has grown, the historic connection with product manufacturers and this remuneration structure has conflicted with investors' needs for quality unbiased advice and their perception that this is what financial advisers provide.

Current remuneration structures

163 There are a variety of ways in which investors pay advisers (directly or indirectly via product manufacturers):

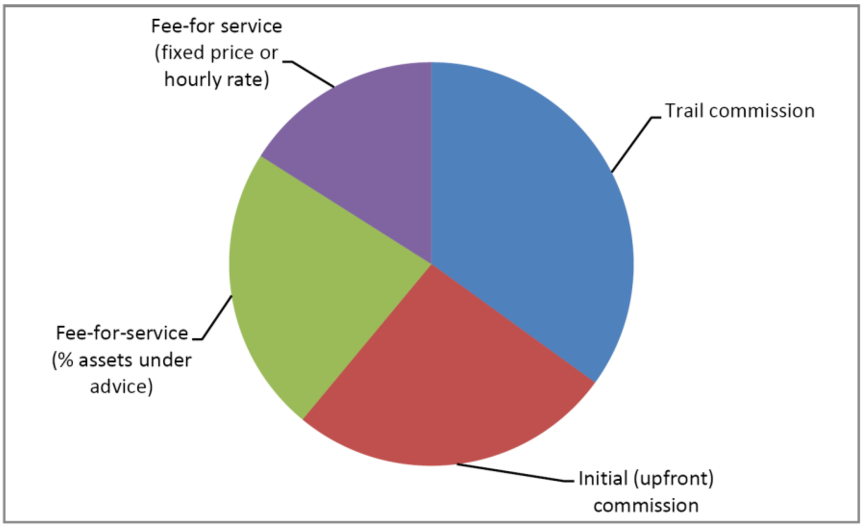
(a) trail commission (% of assets) (estimated at 35% of adviser revenue);

(b) initial (or upfront) commission (% of initial investment) (estimated at 26% of adviser revenue);

(c) fee for service as a % of assets under advice (estimated at 23% of adviser revenue); and

(d) fee for service as a fixed dollar amount or on an hourly rate paid up-front or out of the product (estimated at 16% of adviser revenue).[25]

Figure 1: Diagram of remuneration structures



164 An investor might be paying one, two or three types of remuneration to a single adviser.

Features of commissions

165 The distinguishing feature of commissions is that they are an arrangement between the product manufacturer and the adviser or the adviser's licensee and they are built into the product. After the investor has invested in the product, the investor cannot control the commission.

166 Because the commission is built into the product, it is often difficult to draw a link between the commission and the advice service provided. For example, industry argues that trail commissions are paid for ongoing advice services provided to the client or ongoing administrative costs, for example, the costs of monitoring the client's portfolio. However, trail commissions are often paid regardless of whether there is any ongoing advice or service.

Arguments in favour of commissions

167 Those who support the payment of commissions argue that many clients prefer to pay through commissions rather than upfront payments (possibly for cash flow reasons), even if it ultimately costs them more. This may be particularly the case for superannuation advice, where benefits are preserved. Most clients would prefer to pay the fee from the preserved pool, rather than their own pocket. There is also an argument that commissions increase

[25] Investment Trends October 2008 Planner Business Model Report, 27.

affordability and access to advice. This is possibly because of the perceived lack of up-front payment or because the commission is paid by the product manufacturer and subsidised by all investors who acquire a product (including those who do not access advice).

Conflicts of interest

168 Commission payments can create real and potential conflicts of interest for advisers. They could encourage advisers to sell products rather than give strategic advice (e.g. advice to the client that they should pay off their mortgage), even if this advice is in the best interests of the client and low-risk. Commissions also provide an incentive to recommend products that may be inappropriate but are linked to higher commissions. Higher commissions might be provided for selling higher-risk products, perhaps because other advisers are unwilling to sell these products due to the high risk (e.g. Westpoint).

169 Products that might be in the interests of the client but do not generate a high commission return (such as industry superannuation funds) might not be recommended to clients. Moreover, because many advice businesses are remunerated through product sales, the businesses need to continue to bring in new clients to invest in products. Further, because commissions are paid irrespective of whether or not services are provided there is little incentive to service existing clients.

170 Remuneration based on the amount of funds under advice can also create conflicts of interest. Advisers who are remunerated by reference to funds under advice have an interest in selling investment products to their clients and encouraging their clients to borrow to invest.

171 There is evidence that these conflicts of interest can affect the quality of advice. ASIC’s 2006 Shadow Shopping exercise suggested that unreasonable advice was more common where the adviser stood to get higher remuneration if the recommendation was followed.

172 Storm may be an example of the potential impact on clients of failure to manage conflicts of interest created by commissions and remuneration based on funds under advice. While our investigations are continuing, we understand that Storm advisers may have counted loans as funds under advice and took a percentage of funds under advice as remuneration, creating a possible incentive to recommend clients take out loans or increase the size of existing loans.

Disclosure of remuneration structures

173 The law only requires that fees or remuneration (including commissions) are disclosed clearly to investors. It does not set limits on what can be charged or how it can be charged.

174 The client must be provided with an FSG that contains information about the remuneration (including commission) or other benefits to be received by the providing entity (or a related body corporate or a director or employee of the providing entity or an associate of any of the these parties).[26]

175 The client also receives an SOA, which contains information about the remuneration (including commissions) or other benefits to be received by the providing entity (or any of the before mentioned parties) that might reasonably be expected to influence the advice provided.[27] The PDS is required to include information about the cost of product and information about the cost of commissions or other payments that may impact returns.[28]

176 Disclosure can be an inadequate regulatory tool to manage the conflicts of interest created by commissions because of the strength of the conflict and consumers' difficulty in understanding their impact.

Developments in the industry

177 There is evidence that the industry is moving away from commission-based remuneration. Investment Trends reports that advisers expect revenue from fixed-rate and hourly-rate fee for service to increase over the next few years and revenue from commissions and asset-based fees to decrease.[29] ASIC welcomes these moves and supports the work of industry.

178 The FPA has released a consultation paper on Financial Planner Remuneration that outlines six principles for FPA members to comply with.[30] The principles are mainly focused on disclosure – making sure that consumers understand what the remuneration costs are, and that remuneration costs are comparable, true to label and separate for advice and product. The consultation paper also proposes that consumers must agree to the remuneration and the remuneration must be paid by consumers, not product issuers (i.e. the paper advocates a fee for service, rather than a commission).

179 If adopted by the FPA these proposals would apply from 2012 on a prospective basis (i.e. they would not affect trail commission arrangements

[26] Subsections 942B(2)(e) and 942C(2)(f), Corporations Act.
[27] Subsections 947B(2)(d) and 947C(2)(e), Corporations Act.
[28] Subsection 1013D(1)(d), Corporations Act.
[29] Investment Trends October 2008 Planner Business Model Report, p28
[30] FPA Consultation Paper Financial Planner Remuneration April 2009 at http://riskinfo.com.au/news/files/2009/05/090501-fpa-consultation-paper-financial-planner-remuneration.pdf

entered into before 2012) and they would only apply to FPA members. The FPA does not advocate that commissions be banned, rather it recommends that financial planners transition to a fee-for-service model. The FPA relies on its six principles to better equip clients to make an informed decision where an FPA member retains a commission-based fee structure.

180 In contrast, the AFA has argued that banning commissions is not the answer; commissions are a form of remuneration that can be negotiated and agreed upon with the client. The AFA has suggested that other issues should be considered, such as whether disclosure is the best way to manage conflicts, and that reduction in remuneration choice to clients may reduce access to advice.[31]

181 IFSA has released a draft Super Charter directed at reforming payments made to advisers by super funds, as well as enhancing competition and improving regulation of the super industry. The charter provides for two fee structures. Super fund members who receive personal advice will pay a 'member advice fee'. Super fund members will be asked to agree to the amount and method of payment. There will be an option to turn off the fee if the member ceases to receive advice. Super fund members belonging to a corporate plan established by a financial adviser who do not receive personal advice will pay a 'plan service fee' in respect of ongoing support and administrative services. Annual statements must include the value of the service fee. After an initial period, super fund members will have the option to opt out of receiving the additional services and accordingly from paying the service fee. If the charter is adopted, the policies will come into effect in July 2010, with a transition to full implementation by July 2012. The policies will only apply to new personal super and corporate super plans. In particular, the policies will not apply to new super fund members joining an existing corporate plan.

182 The not-for-profit consumer organisation CHOICE is currently campaigning to end conflicts generated by remuneration structures. CHOICE advocates a fixed fee for service and argues that fees based on a percentage of funds under advice can create the same conflicts as commissions and other soft-dollar payments. In a submission in response to the FPA's consultation paper, CHOICE proposes that all commissions and asset-based fees should be excluded from adviser remuneration, all clients should be given the option to turn off trail commissions in respect of existing investments, soft-dollar payments should cease and all payments from product manufacturers to advisers should be phased out.[32]

[31] Association of Financial Advisers, In defence of fees... and commissions, media release, 9 June 2009, http://www.afa.asn.au/documents/mediacentre/mediareleases/2009/In%20defence%20of%20fees%20and%20commissions.pdf.

[32] CHOICE, Submission: Financial planner remuneration consultation paper, 1 June 2009, http://www.choice. com.au/ files/f135007.pdf.

183 Several financial services providers have announced commitments to no longer charge commissions or to transition from a commissions-based model to a fee-for-service model.[33]

ASIC's activities

184 As part of the Quality of Advice project outlined in Section D, ASIC's Financial Advisers team is looking at the impact of remuneration structures on the quality of advice. The team will then implement strategies based on the findings with the aim of improving the quality of advice.

Note: Depending on the outcomes of the PJC Inquiry, our work on remuneration may change. The scope and terms of this project would necessarily reflect the direction that the Government proposes to take in relation to reviewing remuneration structures.

Changes to the policy settings of the FSR regime

185 While the reforms to clarify the fiduciary-style duty of advisers will have a significant impact on the ability to use commission remuneration, the Government should still assess changing the policy settings of the FSR regime so that advisers cannot be remunerated in a way that has the potential to distort the quality of advice given.

186 This would mean that the following forms of remuneration would not be permitted, particularly in relation to personal advice:

(a) up-front commissions;

(b) trail commissions;

(c) soft-dollar incentives;[34]

(d) volume bonuses;

(e) rewards for achieving sales targets; and

(f) fees based on a percentage of funds under advice.

187 As set out in paragraphs 168–172, commission remuneration can encourage advisers to sell products rather than give strategic advice and to recommend

[33] For example, both NAB's financial planning arm and AMP have recently implemented new fee structures. NAB announced in 2008 that it would transition to a fee-for-service model. All new clients will agree an advice fee with their advisers with trail commissions to be rebated to the client. It is envisaged that existing clients will transition to a fee-for-service model over time. AMP, as a product manufacturer, has announced that it will no longer provide direct commissions to advisers. Adviser fees will be negotiated with the client at the point of sale, based on either a flat fee, a percentage of funds under advice, or an hourly rate. See NAB, NAB financial planning transitions to fee for advice for all new investment clients, media release,23 January 2008, http://www.nab.com.au/wps/wcm/ connect/nab/nab/home/About_Us/8/5/37/3/; Searle, Jane, 'AMP fee revamp upsets advisers', Australian Financial Review,10 July 2009.

[34] For example, subsidised products and services (e.g. discounted loans and margin loans), marketing support and discounted equity or options offered to advisers.

products that may be inappropriate but are linked to higher commissions. Remuneration based on funds under advice also encourages sales and borrowing. Disclosure appears to be an ineffective tool to overcome these conflicts of interests.

188 The exact impact of the proposal is difficult to predict without further regulatory impact analysis. However, at this stage, ASIC considers that it would probably cause some consolidation within the advice industry but that it is unlikely to increase the actual cost of advice (as opposed to the perceived cost of advice).

189 The Government should assess whether this ban should extend beyond providers of personal advice and also apply to providers of general advice or those who provide execution only dealing services. ASIC's preliminary view is that commissions and other similar forms of remuneration could continue to be used by financial services providers who:

(a) provide execution-only services; or

(b) are representatives of a product issuer and do not hold themselves out to be advisers (e.g. they do not use the label 'adviser').

190 The Government may also wish to consider whether:

(a) an adviser should be permitted to rebate remuneration or benefits received from product manufacturers to clients or whether advisers should be banned from receiving any form of remuneration from product manufacturers (regardless of whether it is rebated to clients);[35] and

(b) fees paid to other financial services providers, such as fees paid by product manufacturers to platform providers and research houses, should be reviewed. Shelf fees paid to platform providers have the potential to influence the range of products a client has access to on a platform. Remuneration of research houses is commonly paid by the product issuer, which creates an obvious conflict of interest and has the potential to distort the quality of research reports often used by advisers in making product recommendations to clients. A user-pays model for research house remuneration might help improve the quality of the research used by advisers.

Comparative examples in other jurisdictions

191 The UK FSA proposes to implement a new system of adviser charging. The consultation paper on implementing the Retail Distribution Review proposes that advisers should only be remunerated by way of adviser charges, discussed below, and must not solicit or accept any other commissions,

[35] As proposed by the UK Financial Services Authority draft rules.

remuneration or benefits from a product issuer, in relation to a personal recommendation. [36]

192 The consultation paper proposes that all adviser firms be paid by fees that are agreed to up-front with the client, based on standard charges for each advice service offered. The charges must reflect the services provided, rather than the particular product provider or product. Fees may be paid directly by the client or may be paid by way of deduction from the client's investment. The consultation paper specifically proposes banning commissions, even where commissions will be rebated to a client; advisers will be prohibited from accepting commissions and product issuers will be prohibited from offering commissions.

193 It is proposed that the system of adviser charging also apply to advisers that are tied to product issuers. Further consultation is sought on whether tied advisers should be required to separate product charges from adviser charges, or whether it would be sufficient for tied advisers to disclose which portion of an overall charge is associated with each.

194 The proposed rules are to come into effect at the end of December 2012 and would apply to new business only.

195 The FSA is continuing to consult on the remuneration of individuals within adviser firms. The regulation of charges associated with platforms is reserved for review at a later stage, although preliminary views are currently sought by the FSA.

196 In Israel, advisory services are provided under three separate licences. Investment advisers provide, directly or indirectly, advice on the feasibility of an investment, holding, purchase or sale of securities or of financial assets. Investment marketers provide similar advice, but are affiliated with a particular financial asset. Portfolio managers effect transactions in the investment accounts of others on a discretionary basis. All licensees are prohibited from receiving any benefit, directly or indirectly, in relation to investment advice, investment marketing, or execution or non-execution of a transaction. Remuneration must be by way of fees and reimbursement for costs from a client. A number of important exceptions apply, including:

(a) investment marketers are exempted from the general prohibition in relation to marketing of, and the execution or non-execution of a transaction in, products with which they are affiliated. Investment marketers remain subject to the prohibition in relation to other non-affiliated products;

(b) portfolio managers may receive reimbursement of purchase or sales commissions from a stock exchange member, where the client has given

[36] Financial Services Authority, Distribution of retail investments: Delivering the RDR, consultation paper 09/18.

prior written agreement to receive the reimbursement and has specified the rate; and

(c) distribution commissions may be reimbursed by portfolio managers to persons, other than investment marketers, for executing transactions, where the client has given prior written agreement to receive the reimbursement and has specified the rate.

197 In the US, currently proposed amendments to the Investment Advisers Act of 1940 would give the Securities Exchange Commission (SEC) powers to make rules prohibiting sales practices, conflicts of interest and compensation schemes for intermediaries (including brokers, dealers and investment advisers) that the SEC considers to be contrary to public interest and the interests of investors.

Summary

198 Table 7 summarises the key issues raised by this term of reference, ASIC's forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with the issues.

Table 7: Role of commission arrangements for product sales and advice (TOR 3)

Key issues	ASIC activities	Regulatory change options for consideration by Government
Remuneration structures in the financial advice industry create conflicts of interest which can distort the quality of advice	ASIC will identify the impacts of remuneration structures on conflicts of interest and on the quality of advice	**Remuneration structures for advisers** – Prevent remuneration structures that may create conflicts of interest that adversely affect the quality of advice, particularly personal advice

F Appropriateness of information and advice provided to consumers (TOR 6)

Key points

Disclosure is a key regulatory tool in the FSR regime.

The effectiveness of disclosure as a regulatory tool has been questioned because of the length and complexity of some documents, limited consumer engagement and understanding, and the mixed or competing purposes of disclosure documents.

ASIC has devoted, and continues to devote, considerable resources to improving disclosure to retail investors. In particular, ASIC:

- conducts targeted reviews of disclosure documents to ensure they comply with the legal requirements;
- works with the FSWG to recommend changes to disclosure requirements; and
- issues guidance to improve the standards of disclosure.

To complement the work of the FSWG, ASIC intends to commence a project to explore whether more effective disclosure can be achieved.

ASIC's disclosure project may recommend further changes to the FSR disclosure regime for Government consideration.

199 The appropriateness of advice is dealt with under TOR 1: see Section D. This section focuses on other forms of information provided to investors and, in particular, disclosure documents.

Key Issues

Effectiveness of disclosure

200 Disclosure is a key regulatory tool in the FSR regime. As explained in Section B, according to the economic philosophy underlying the FSR regime, disclosure creates an efficient market by overcoming the information asymmetry between industry participants and investors. It does this by requiring disclosure of information necessary to facilitate informed investment decisions by investors. Therefore, for example, the Corporations Act requires that a Product Disclosure Statement (PDS) contain information

that might reasonably be expected to have a material effect on the decision of a reasonable person to acquire a product.[37]

201 The FSR disclosure regime was intended to be a 'principles based' regime, with flexibility in the legislation to allow for significant differences between products.[38] Therefore, the disclosure requirements in the Corporations Act largely avoid prescribing the content of disclosures. Rather, they set out the type of information that must be disclosed.

202 While few would question that disclosure is a necessary regulatory tool to ensure an informed market and informed investor decision-making, it appears that disclosure may not be a sufficient regulatory tool to overcome information asymmetries. The effectiveness of disclosure as a regulatory tool has been questioned because of:

(a) the mixed or competing purposes of disclosure documents;

(b) the length and complexity of some documents; and

(c) limited consumer engagement and understanding.

203 Disclosure documents generally fulfil multiple and often competing roles. From the investor's perspective, the disclosure document is pre-contractual information about a specific product or service which assists investors in deciding whether to acquire the product or service. From industry's perspective, as well as acting as a consumer education tool, the disclosure document is a mechanism to facilitate the sale of the product or service and to limit providers' liability. The latter role often leads to lengthy and complex disclosure which may mean the document ends up failing to achieve the purpose of informing investors.

204 Lengthy and complex disclosure is also possibly driven by:

(a) the legislation, which sets out high-level content requirements that industry perceives to be complex; and

(b) the complexity of some financial products. The explanation of complex products is inevitably going to result in complex disclosure.

Note: The FSWG commissioned research in 2008 to find out industry's views on why PDSs are long and complex. The findings noted a variety of drivers for PDS length including the ones noted above. Other drivers included operational biases of industry, i.e. its tendency to be risk averse and include more, rather than less, information where there was uncertainty about the information required by the legislation, and the multiplicity of parties involved in the drafting process.

205 There is evidence that some retail investors do not read disclosure documents or if they do read them, do not understand them. For example:

[37] Section 1013E, Corporations Act.

[38] Revised Explanatory Memorandum to the Financial Services Reform Bill 2001, pp9 and 143.

(a) research commissioned by ASIC indicates that a large proportion of the retail investors in Australian Capital Reserve Limited (ACR) identified advertisements as the most influential factor in their investment decisions. The research also found that the riskiness of the investment appears not to have been understood by many of the investors;

(b) the 2006 Adult Literacy and Life Skills Survey (ALLS) of Australians, published by the Australian Bureau of Statistics (ABS) in January 2008, found that 46% of Australians aged 15–74 do not have the level of literacy needed to understand narrative text, such as in newspapers or magazines, to the minimum level required to meet the complex demands of everyday life and work in the emerging knowledge-based economy.[39] This would suggest that many retail investors do not have sufficient literacy to understand financial services disclosure documents; and

(c) research conducted in 2006 by the Hong Kong Securities and Futures Commission found that only 10.7% of investors surveyed[40] received, read and fully understood disclosure documents.[41]

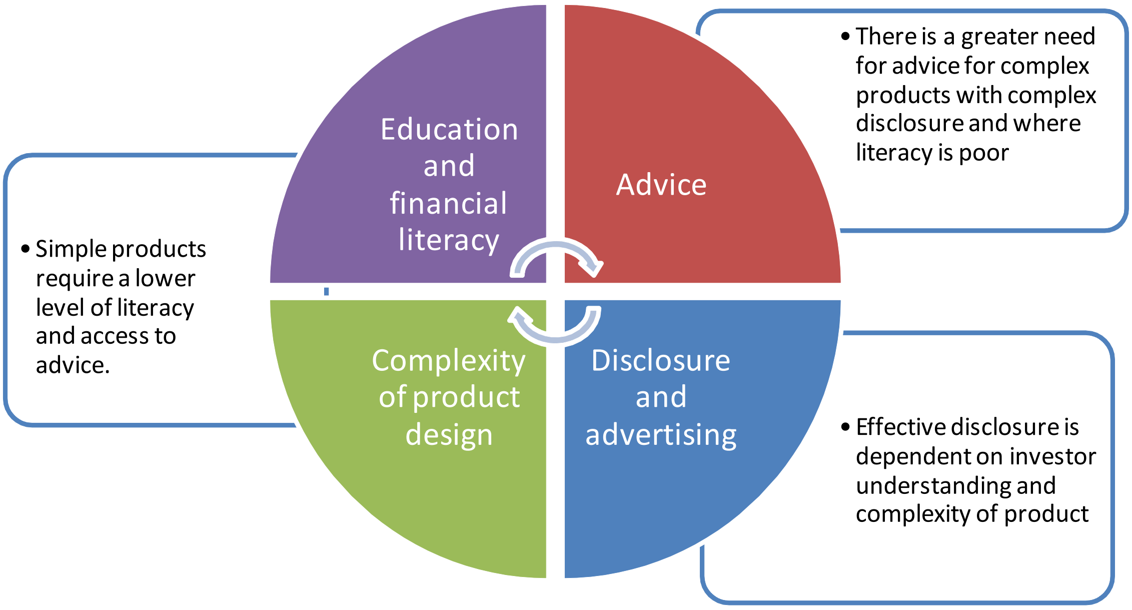
206 Effective disclosure (and ultimately effective decision making by investors) depends on factors such as investor engagement, financial literacy, access to advice and the design of the product. Disclosure is unlikely to be effective if investors are not engaged, do not have sufficient levels of financial literacy or access to advice.

[39] Australian Bureau of Statistics (ABS), Adult Literacy and Life Skills Survey 2006, http://www.abs.gov.au/AUSSTATS/subscriber.nsf/log?openagent&42280_2006 (reissue).pdf&4228.08&Publication&B22A471C221C7BADCA2573C

[40] Investors who had acquired an equity, index or credit-linked structured product in the last two years.

[41] Securities and Futures Commission, Hong Kong, Structured Product Investor Survey, November 2006.

Figure 2: Informing investors and driving good decisions



Inadequate levels of disclosure - Agribusiness managed investment schemes

207 In relation to agribusiness managed investment schemes, there is an issue concerning the level of disclosure of information about the historic yield of the schemes' investments.

208 Historic yield information is a key issue for investors in relation to deciding whether to invest in an agribusiness managed investment scheme. Plantation productivity dictates the volumes that are achieved from harvesting and significantly impacts on the returns ultimately achieved for investors (and managed investment scheme operators). Plantation productivity can be dramatically affected by management of the scheme's crops, rainfall conditions, soil types, diseases and pests.

209 As noted in ASIC's submission to the PJC's Inquiry into Agribusiness Managed Investment Schemes, a number of past projects operated by participants in the agribusiness managed investment scheme industry have failed to achieve their expected returns. This information may be relevant to assist retail investors to decide whether or not they are prepared to invest in an agribusiness scheme. Accordingly, disclosure of historic yield information might reasonably be expected to have a material effect on the decision of a reasonable person to invest in an agribusiness scheme and required under the Corporations Act to be disclosed in PDSs. However, it appears that this information has not been disclosed in some agribusiness managed investment scheme PDSs.

ASIC's activities

210 ASIC has devoted, and continues to devote, considerable resources to improving disclosure to retail investors. In particular, ASIC:

(a) conducts reactive and targeted reviews of disclosure documents to ensure they comply with the legal requirements;

(b) works with the FSWG to recommend changes to disclosure requirements; and

(c) issues guidance to improve the standards of disclosure.

Disclosure document review

211 ASIC's review of disclosure documents typically fall into two categories:

(a) reactive reviews – in response to a specific incident such as a complaint or where ASIC has identified a problem with a disclosure document; and

(b) targeted or campaign reviews – where ASIC has identified areas of concern to further investigate. Targeted or campaign reviews are usually carried out in conjunction with other surveillance activities or a specific project. For example, ASIC's work in relation to disclosure for unlisted and unrated debentures was part of a targeted campaign. A targeted review allows ASIC to pick a sample of disclosure documents based on a set criteria and review each document according to a specific methodology.

212 ASIC takes a strategic approach to its disclosure document reviews. ASIC adopts a risk based methodology to assist with determining which disclosure documents it should review. For example we have previously risk rated disclosure documents according to various indicators and then assessed documents rated as being of medium to very high risk against the disclosure requirements of the Corporations Act and any relevant ASIC guidance. Each ASIC stakeholder team tailors the risk-rating methodology to suit the focus of its activities.

213 ASIC can take remedial action (e.g. issue a stop order) or, in appropriate cases, enforcement action if a disclosure document is identified as defective.

214 An ASIC review may cover any of the disclosure documents or advertising and promotional material issued or made available to prospective retail investors under Ch 6D or Ch 7 of the Corporations Act.

Note: Detail of ASIC's current activities is set out in Appendix 3.

215 ASIC is not required to and does not have the resources to review all disclosure documents. Table 8 shows the number of prospectuses lodged

with ASIC and the number of PDSs and PDS in-use notices lodged with ASIC in the period between 1 July 2006 and 11 June 2009.

Table 8: Number of disclosure documents and in-use notices lodged

Lodgement type	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 11 June 2009	Total – 1 July 2006 to 11 June 2009
PDS in-use notices	9,680	9,540	3,499	22,719
PDSs	76	24	19	119
Prospectuses	1,016	818	546	2,380
Total	***10,772***	***10,380***	***4,051***	***25,218***

Note 1: The numbers of disclosure documents includes supplementary documents lodged with ASIC. The numbers for prospectuses lodged with ASIC are for quoted and unquoted securities. This number also includes information statements for equities lodged with ASIC. The numbers relate to the documents' effective dates (not the dates the documents were received by ASIC).

Note 2: This table does not include other FSR documents that ASIC may review including SOAs, FSGs, periodic statements, significant event notices and financial reports. Nor does it include the documents that ASIC would review in relation to its other regulatory activities e.g. financial reports.

FSWG

216 As a member of the FSWG, ASIC is working towards simple, standard and readable product disclosure for specific financial products, to be used by retail investors as a pre-contractual decision-making tool.

217 The FSWG has already developed the simplified PDS for the First Home Saver Account. The disclosure requirements for this document depart significantly from the principles based approach of the FSR disclosure regime. There are prescriptive form and content requirements and a maximum 4-page page limit. These PDS requirements were implemented through amendments to the Corporations Regulations.

218 The FSWG is now working towards achieving simplified, mandatory disclosure for other products. In particular, it is devising:

(a) short and simplified PDS disclosure requirements for margin loan products, superannuation and 'simple' managed investment scheme products. This simplified form of disclosure will include:

(i) prescribed content requirements;

(ii) a maximum page limit (4 pages for margin loans; 10-12 pages for superannuation and 'simple' managed investment scheme products);

(iii) a new incorporation by reference regime identifying what information, when incorporated by reference, may be considered as part of the PDS; and

(b) sample PDS documents as a guide for industry on the type of content and level of detail that would be expected in a shorter, simpler PDS.

219 ASIC will continue its involvement in the work of the FSWG.

ASIC guidance

220 ASIC has issued a number of Regulatory Guides that provide specific guidance to the financial services industry to improve disclosure.

221 For example, Regulatory Guide 45 *Mortgage schemes–improving disclosure for retail investors* (RG 45), Regulatory Guide 46 *Unlisted property schemes—improving disclosure for retail investors* (RG 46) and Regulatory Guide 69 *Debentures–improving disclosure for retail investors* (RG 69) enhance the disclosure regimes for the unlisted debenture and mortgage and property scheme markets. The enhanced disclosure regimes were designed to increase the level and quality of information being disclosed to retail investors about these products. These products are relatively high-risk but they appeal to ordinary retail investors. The new disclosure regimes include a set of benchmarks to test disclosure about these products. Benchmarks can help retail investors assess the risk and risk-reward prospects of the relevant financial product. The expectation is that the benchmarks are followed (as applicable) and if not, explained on an ‘if not, why not’ basis.

222 Other key disclosure regulatory guides are:

(a) Regulatory Guide 90 *Example Statement of Advice for a limited financial advice scenario for a new client* (RG 90) (the model SOA);

(b) Regulatory Guide 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (RG 168);

(c) Regulatory Guide 170 *Prospective financial information* (RG 170); and

(d) Regulatory Guide 175 *Licensing: Financial product advisers — conduct and disclosure* (RG 175).

Future ASIC work

223 To complement the work of the FSWG, ASIC will commence a project to explore whether more effective disclosure can be achieved by, for example:

(a) applying the FSWG prescriptive form and content requirements to a broader range of products (see paragraphs 216–219 above);

(b) applying benchmark disclosure on an ‘if not, why not’ basis (such as in RG 45, RG 46 and RG 69) to a broader range of products including over-the-counter products, contracts for difference and capital guaranteed products (see paragraph 221 above); or

(c) summaries of disclosure documents (see paragraphs 224–228 below).

Mandatory summaries

224 ASIC will further explore the merits of summary disclosure. A number of key jurisdictions (Canada, United States of America (USA), and the UK) have versions of a mandated summary document prescribed for specific financial products.

225 For example, the Canadian Joint Forum of Financial Market Regulators published a Framework for Point of Sale Disclosure on Mutual Funds and Segregated Funds (Framework) in October 2008.[42] The Framework requires the publication of a two-page 'Fund Facts' document for each series or class of fund. To promote comparability and simplicity, the Framework prescribes the items to be covered on each page, the section headings and certain language.

226 Page one contains basic information on the fund, including:

(a) 'Quick Facts', which include the date of creation, total value, portfolio manager, distributions and minimum investment;

(b) what the fund invests in;

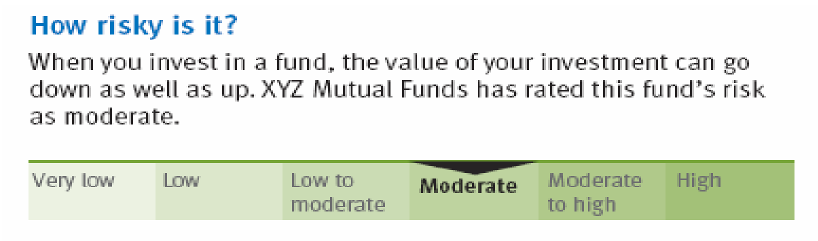
(c) fund performance; and

(d) risks, whether the fund is guaranteed and who it is suited to.

Page two covers costs, including commissions.

227 The prescribed risk section must include a risk scale, shown below in Figure 3. The scale is based on six defined risk categories developed by the Investment Funds Industry of Canada in its Recommendations for Fund Volatility Risk Classification.

Figure 3: Canadian Fund Facts risk scale



228 The IOSCO Standing Committees on Intermediaries and on Investment Management are currently consulting on principles of point-of-sale

[42] Framework 81-406 Point of Sale Disclosure on Mutual Funds and Segregated Funds, www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/rule_20081024_81-406_framework-pos.pdf

disclosure, focusing on 'key information' disclosures to retail investors relating to managed investments and their distribution. [43]

Agribusiness Managed Investment scheme disclosure

229 ASIC will also consider whether it should assist the agribusiness industry by publishing guidance on how agribusiness scheme providers should comply with their PDS disclosure obligations, with particular reference to disclosure of historic yield information. This guidance will address the disclosure issue identified in paragraph 207–209 above.

Changes to the policy settings of the FSR regime

230 ASIC's disclosure project (see paragraph 223) may recommend further changes to the policy settings of the FSR disclosure regime. For example, if we decide mandatory summaries are appropriate, this would require law reform.

Recognising the limits of disclosure

231 It should also be noted that other changes to the FSR regime referred to in this submission (e.g. possible changes to the policy settings to prevent remuneration structures that adversely affect the quality of advice) are also designed to overcome problems with disclosure. This is achieved by reducing reliance on disclosure as a regulatory tool.

232 Disclosure is a necessary regulatory tool; it is important that investors are given information that equips them to make confident and informed decisions. However, for the reasons set out in paragraphs 202–206 above disclosure may never be sufficient to overcome information asymmetries between industry participants and retail investors. If disclosure cannot fulfil its role of overcoming the information asymmetry between industry participants and investors, then it is necessary to consider other changes to the FSR regime to protect investors.

Summary

233 Table 9 below summarises the key issues raised by this term of reference, ASIC's forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with the issues.

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[43] This report has not yet been finalised.

Table 9: Appropriateness of information and advice provided to consumers (TOR 6)

Key issues	ASIC activities	Regulatory change options for consideration by Government
Disclosure can be ineffective because of: the length and complexity of some documents; limited consumer engagement and understanding; and the mixed or competing purposes of disclosure	ASIC will continue targeted reviews of disclosure documents to ensure compliance with legal requirements ASIC will continue to work with the FSWG on its project to simplify disclosure ASIC will continue to issue regulatory guidance to improve disclosure e.g. guidance to make it clear that the law requires disclosure of historic yield information in agribusiness managed investment scheme PDSs ASIC will identify and implement ways to improve the effectiveness of disclosure (beyond the scope of the FSWG's project) e.g. by introducing disclosure against benchmarks for specific products, etc on an 'if not, why not' basis	**ASIC's disclosure project** – ASIC's project to improve the effectiveness of disclosure may recommend law reform

G Role of marketing and advertising campaigns (TOR 4)

Key points

Advertising and related marketing campaigns can be extremely influential in the decision to invest and can facilitate investment without advice.

In light of this ASIC actively monitors advertising and related marketing material and takes action where appropriate.

ASIC intends to publish a new regulatory guide on the standards of advertising it expects and to continue to monitor and enforce those standards through targeted campaigns.

To further protect retail investors, the Government should consider:

- enabling ASIC to require issuers of certain classes of products to include certain content in their advertising and marketing material; and
- other regulatory options such as enhancing ASIC's Ch 6D stop order power.

Key issues

The influence of advertising and marketing campaigns on investment decisions

234 Advertising and related marketing campaigns by financial product providers and services providers can be influential in the decision to invest. Research shows that many investors have made important investment decisions on the basis of information contained in advertising and marketing campaigns, sometimes without referring to disclosure documents or obtaining advice.

235 For example, research commissioned by ASIC in relation to investors in ACR and Fincorp shows that, for the majority of investors, advertising was one of the most influential factors in their investment decision.[44] 53.7% of the investors surveyed who had invested in the products said that they were attracted to and influenced by product advertising. The research indicated that pervasive advertising can have a powerful effect on investors. The brand awareness that results from such pervasive advertising can give consumers a perception that a financial product is a secure investment.

[44] Report 126 *Understanding investors in the unlisted, unrated debenture (UDD) market* (REP 126), April 2008.

Advertising may lead to investing without appropriate advice

236 Advertising provides investors with the opportunity to invest directly through a product issuer. In the context of ACR, for example, many investors contacted ACR directly through its call centre after seeing ACR advertisements. These investors were then invited by the call centre operator to discuss the available investment opportunities in person. The aim of this process was to increase the direct selling of ACR's products.

237 Direct selling can lead to consumers making more risky investments choices because they are investing without seeking appropriate financial advice, which takes into account their personal circumstances and financial needs.

238 The high-risk nature of a product may not be clear to retail investors who invest in products as a result of direct marketing. While the relevant advertising and promotional material may correctly describe a product and its features, the riskiness of a product is not usually conveyed to consumers through advertising.

Limited content and other requirements for advertising of financial products

239 Currently, the Corporations Act only prescribes limited content requirements for advertising. For example:

(a) in relation to fundraising, advertising or publicity is generally prohibited for an offer of securities that needs a disclosure document under Ch 6D. However, an advertisement or publication does not contravene this requirement if, before the disclosure document is lodged with ASIC, an advertisement or publication complies with the content requirements in s734(5) and 734(6). Broadly, an advertisement or publication may need to contain some or all of the following statements:

    (i) the name of the issuer of securities;

    (ii) the name of the seller of the securities (for an offer under s707);

    (iii) a reference to when and where the disclosure document is expected to be made available;

    (iv) that a person should consider a disclosure document in deciding whether to acquire securities; and

    (v) that a person who wants to acquire securities will need to complete an application form;

(b) under s1018A, advertising or other promotional material for a financial product that is made available to retail investors must identify the product issuer and must also refer a person to the issuer's PDS; and

(c) under s949A, if the advertisement or promotional material contains general advice, then a general advice warning must be included e.g. a warning to potential investors that the advertisement does not take into account their personal circumstances and that potential investors should consider whether the product is appropriate for them.

Note: See Appendix 2 for a summary of the legal requirements in relation to advertisements.

240 The Corporations Act does not contain a suitability requirement for advertising for financial products. Advertising and promotional material does not need to contain any messages about the type of investor for whom the advertised financial product would be a suitable investment, or warnings about the particular risks of a financial product. Unless the relevant advertising or promotional material is false, misleading or deceptive, or otherwise breaches the consumer protection provisions in Pt 2 Div 2 of the ASIC Act, ASIC is unable to take regulatory action to protect retail investors.

241 This means that complex and high-risk products can, in compliance with the law, be marketed directly to retail investors through advertisements even if these products may be unsuitable for the likely audience of the advertisements. For example, contracts for difference (CFDs), a very complex financial product, have been advertised through television advertisements targeted at the mainstream audience. This type of mainstream advertising can create the perception that a CFD product is a mainstream investment product.

ASIC's activities

General approach

242 ASIC monitors various forms of advertising for financial products and services, focusing on whether the advertisements:

(a) contain information that may be considered false, misleading or deceptive; and

(b) meet the relevant content requirements.

243 ASIC uses a number of tools to monitor advertising of financial products and services, including:

(a) a service that monitors and identifies advertisements for financial products that appear on television, on radio, in print publications and on internet sites. The service captures major cities and suburbs but not regional or local advertisements;

(b) targeted campaigns. ASIC conducts targeted campaigns looking at advertisements for particular financial products. For example, ASIC has conducted targeted campaigns on advertising in the following areas: credit, equity release products including reverse mortgages, insurance, superannuation, mortgage schemes and debentures: see paragraphs 245–250 for more details about some of these campaigns.

(c) informal monitoring. Particular areas of ASIC will often proactively look at media publications focusing on advertising campaigns relevant to their area and monitor complaints received by ASIC which refers to advertising or promotional material.

244 ASIC has also issued a number of regulatory guides on the standard that ASIC expects product issuers and financial service providers to adopt in relation to advertising and promotional material, including:

(a) Regulatory Guide 45 *Mortgage schemes – improving disclosure for retail investors* (RG 45);

(b) Regulatory Guide 46 *Property schemes – improving disclosure for retail investors* (RG 46);

(c) Regulatory Guide 53 *The use of past performance in promotional material* (RG 53); and

(d) Regulatory Guide 156 *Debenture Advertising* (RG 156).

Overview of past ASIC action on advertising

245 ASIC has achieved a number of successful outcomes for retail investors as a result of its advertisement monitoring activities and targeted campaigns. The following is a summary of some of the more prominent regulatory action ASIC has taken in relation to misleading, deceptive and false advertising in the last few years.

246 In 2009, ASIC raised concerns with Westpac Banking Corporation that some advertising for the Westpac Choice account was misleading, or likely to mislead. Westpac took a number of steps to address ASIC's concerns. For further information, see AD 09-51 *Westpac responds to concerns regarding advertising*, 27 March 2009.

247 Since early 2008, ASIC has engaged with issuers of debentures to discuss content requirements of advertisements in print, radio, television and websites. ASIC has obtained corrective disclosure on a number of advertisements, including ensuring that 'warning statements' have been included in promotional material.

248 In 2007, ASIC conducted a targeted review of advertising for reverse mortgages. As a result of this review, ASIC found five instances of misleading advertisements that contained claims that the reverse mortgage

did not need to be repaid. ASIC raised its concerns with each of the promoters who immediately took steps to withdraw or amend the advertisements. For further information, see AD 07-152 *ASIC works with industry to ensure clear reverse mortgage advertising*, 4 June 2007.

249 In 2007, ASIC obtained injunctions against Etracka Pty Ltd (Etracka) in relation to concerns over a loan calculator licensed to mortgage brokers. The court ordered that Etracka add warnings that advised consumers that if they had not chosen to make additional monthly repayments the calculator would not provide a reliable comparison. For further information, see IR 07-95 *ASIC obtains injunctions against loan calculator operator*, 12 April 2007. Etracka was also ordered by the court to send corrective notices to its members, clients, licensees and users of its calculators.

250 Between July 2006 and August 2007, ASIC conducted a targeted campaign to review advertisements placed in major Australian newspapers and financial periodicals in relation to fundraising activities. This campaign resulted two undertakings to withdraw advertisements and seven corrections to advertisements relating to the offer of securities under a prospectus.

Future activities

Monitoring

251 ASIC continues to follow a thematic approach to monitoring advertising, conducting targeted campaigns on specific areas (e.g. advertising for credit or advertising for debentures). For example:

(a) the Deposit-Takers and Insurance (DTI) stakeholder team has been targeting advertising in relation to credit and reverse mortgage products. DTI is also planning to conduct a targeted surveillance on advertising for retirement income products as part of its 2009/10 business plan;

(b) the Investment Banks (IB) and the Consumers and Retail Investors (CARI) stakeholder teams are currently targeting advertisements for CFDs and other over-the-counter derivatives. As part of this work, ASIC officers will be attending seminars for CFDs. ASIC is reviewing the way CFDs are advertised and sold to retail investors and comparing this information against complaints data;

(c) the Market Participants and Stockbrokers stakeholder team is currently targeting advertising in relation to day trading systems as part of its surveillance activity under s912A and s912E of the Corporations Act; and

(d) the Superannuation Funds stakeholder team has set up a formal monitoring system to monitor advertising and promotional material for superannuation products. Disclosure in superannuation-related advertising has become an increasingly critical and important matter in

> light of the impact the market turmoil has had on superannuation member balances. The team is also working to address illegal early access of superannuation. Advertising is an integral part of these schemes because it is the initial 'hook' to consumers.

Regulatory guide

252 ASIC is also currently developing a regulatory guide for promoters of financial products and services and publishers of advertising material about financial products and services.

253 The guide will set out the standards we will expect promoters and publishers to meet when advertising financial products and services to retail investors. The standards will apply to any advertising designed to inform consumers about or promote financial products or financial advice services, communicated through any medium, including:

(a) magazines and newspapers;

(b) radio and television;

(c) websites;

(d) product brochures and promotional fact sheets;

(e) direct mail (e.g. by post, facsimile or email);

(f) telemarketing activities and audio messages for telephone callers on hold;

(g) presentations to groups of people; and

(h) advertorials.

Changes to the policy settings of the FSR regime

Mandatory content

254 ASIC believes that the Government should consider changing the policy settings of the FSR regime so that ASIC has the power, by legislative instrument, to require product providers to include specific content in their advertising and marketing material.

255 As set out in paragraphs 234–238, advertising is a powerful source of information about financial products; many investors make investment decisions on the basis of information contained in advertisements. In light of this, ASIC should be able, in appropriate situations, to take action to ensure that certain advertisements contain information crucial to investors e.g. information about who a product is suitable for; disclosure against key benchmarks and warnings about key risks.

256 ASIC acknowledges that industry may be concerned about the arbitrary use of such a power. However, we consider that this concern can be allayed by the fact that, under the *Legislative Instruments Act 2003*, ASIC could only exercise this power after appropriate consultation and that the relevant ASIC instrument could be disallowed by Parliament. ASIC also complies with the Government's best practice regulation requirements.

Stop order power

257 ASIC believes the Government should consider enhancing the existing stop order power under Ch 6D of the Corporations Act (s739) by making this power consistent with the stop order power available to ASIC under Pt 7.9 of the Corporations Act (s1020E). Specifically, ASIC suggests that provisions similar to s1020E(8), (9) and (10) be enacted under s739. Subsections 1020E(8), (9) and (10) extend the operation of a stop order power by:

(a) ensuring that a person to whom an order has been served takes reasonable steps to make other persons who engage in conduct the subject of the order, aware of the order;

(b) specifically prohibiting a person to whom an order has been served, or persons who have been made aware of the order, engaging in conduct contrary to the order; and

(c) ensuring that any conduct engaged in contrary to an order would be a contravention of a specified part of Pt 7.9 where the order included a statement to this effect.

Other options

258 One way of addressing concerns about direct selling through advertising would be to introduce limits on the potential for product providers to directly sell their products to investors through advertising. While bans on advertisements of some products may restrict vulnerable investors' access to these products, they may also limit competition in the financial services industry and restrict investors' choice. ASIC considers that at this stage, such bans are not justified.

259 In the UK, the FSA can take action where a product is marketed to an unsuitable audience, through the requirement on product manufacturers to 'treat their customers fairly'. This is part of the broader obligation for product manufacturers to treat customers fairly and ensure that products are sold to suitable persons which is discussed further in Section K below.

Summary

260 Table 10 below summarises the key issues raised by this term of reference, ASIC’s forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with the issues.

Table 10: Role of marketing and advertising campaigns (TOR 4)

Key issues	ASIC activities	Regulatory change options for consideration by Government
Advertising campaigns are extremely influential	ASIC will continue to monitor and conduct targeted thematic campaigns on advertising to ensure compliance with ASIC guidance and the law ASIC will publish guidance on the standards of advertising expected	**Mandatory content in advertisements** – Enable ASIC to require issuers of certain classes of products to include certain content in their advertising and marketing material **Enhance ASIC’s Ch 6D stop order power** – Make ASIC’s stop order power under Ch 6D consistent with the stop order power under Pt 7.9.

H Consumer education and understanding (TOR 7)

Key points

Our judgment is that consumers' and retail investors' understanding about financial products and investing is relatively low.

The costs of this lack of understanding for individuals and the economy are high.

ASIC has, and continues to, pursue a number of initiatives to improve consumer education and understanding. This work includes:

- promoting the delivery of financial literacy education through existing educational pathways;
- providing Australians with access to reliable, independent and free information and tools to help them make better financial decisions;
- looking beyond education to solutions that promote financial well-being; and
- developing and promoting national partnerships to expand the delivery of high quality investor and consumer education in Australia.

In undertaking this work we recognise that:

- improving financial literacy is a long term objective; and
- given the complexity of some financial products and investment decisions we will sometimes need to look beyond education to find the right policy response to achieve good financial outcomes for Australians.

Key issues

Standards of financial literacy and understanding

261 Most Australians are retail investors. Even if they do not think of themselves as investors, they will generally have some investment exposure and exercise some investment choice through the mandatory superannuation system. Many Australians also hold investment products outside the superannuation system.

262 The FSR regime places the onus on investors to take responsibility for their own investment decisions. The onus is on the retail investor to recognise when they need to seek financial advice and to have a sufficient education, understanding and motivation to read and comprehend the disclosure documents they will receive when they receive advice and/or invest in

products (e.g. SOAs, FSGs, and PDSs). This presumes that most Australians will have a reasonable level of financial literacy and understanding.

263 However, a number of research reports show that while Australians seem to be relatively knowledgeable and confident about simple and familiar finance topics such as budgeting, we are less knowledgeable and confident about more complex and unfamiliar topics such as investing and saving for retirement.

264 In addition, as stated in paragraph 205(b) the 2006 ABS Adult Literacy and Life Skills Survey found that 46% of Australians aged 15-74 do not have the level of literacy needed to understand narrative text, such as in newspapers or magazines, to the minimum level required to meet the complex demands of everyday life and work in the emerging knowledge-based economy.[45] This suggests that many people would have difficulty understanding the disclosure documents they would receive when they invest or make other financial decisions.

265 In 2007, ASIC commissioned Roy Morgan Research to conduct a large-scale piece of research about retail investors. The research showed that investors find investment concepts difficult to understand and apply and that some investors do not take an active interest in their investments.[46]

266 A number of other Australian surveys back this finding. They also show that even where we think we understand a concept, we often have difficulty applying it. For example, the 2008 ANZ Survey of Adult Financial Literacy in Australia shows that while 86% of people say they understand higher returns mean higher risks, around 42% would still invest in something offering higher than average returns. Similar results were obtained in the 2002 and 2006 ANZ surveys.[47]

267 The 2008 ANZ survey also sought to assess attitudes to budgeting and money management. 72% of respondents said they save money on a regular basis, with only 24% stating that they have problems setting aside money for major financial outlays. However, these figures were impacted by lower levels of financial literacy with 59% of respondents in the lowest bracket of financial literacy scores saving on a regular basis and 34% agreeing to having problems with setting money aside.

268 In relation to investment and retirement planning, while the 2008 ANZ survey found that there was generally a good understanding of basic rules relating superannuation, 31% of respondents reported that superannuation fund statements were difficult to understand. This figure was down from

[45] Australian Bureau of Statistics (ABS), Adult Literacy and Life Skills Survey 2006, http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/4228.02006%20(Reissue)?OpenDocument
[46] ASIC, *Australian investors: at a glance* (REP 121), April 2008.
[47] ANZ, Survey of Adult Financial Literacy in Australia, 2008, see table 7.3.1a.

36% in 2002. Respondents with lower financial literacy scores were more likely to have difficulty in understanding fund statements. Understanding of superannuation as an investment was found to be moderate, however 42% of respondents did not know what factors would result in a reduction in the final value of the investment. Only 27% of investors had identified a target income for retirement. This figure increased to 34% amongst respondents aged 45-59 years.[48]

269 Overseas jurisdictions have also investigated levels of financial literacy with similar findings: see, for example, the FSA (UK) report on Levels of Financial Capability in the UK: Results of a baseline survey (March 2006).[49]

270 The problems are exacerbated by the fact that for many of us, investing is not a repeat activity where we develop skills over a life-time and can learn from inexpensive mistakes. Often people who have led successful, busy lives, never need to make an investment decision (and learn about investing) until around the time of retirement when they may for the first time have significant funds to invest. The tragedy is that financial mistakes at this time of life are made at a time when it may be impossible to ever fully recover from the consequences.

Costs of poor financial literacy

271 The relatively low level of financial literacy and understanding about financial products poses a number of challenges to successful investing, in turn, exposing the investments of retail investors to vulnerability. The costs of poor financial literacy and uninformed investment decision-making to individuals and for the economy as a whole are high.

272 At the individual level, low financial literacy and understanding can lead to bad investment decisions which may, in turn, lead to a partial or total loss of savings. This is what has happened in the context of Westpoint, ACR and Fincorp where some retail investors had invested all of their savings into products issued by these entities resulting in complete loss of those savings. The risk is intensified where leverage is used for investing and can result in the loss of everything, including the family home.

273 Increasing financial literacy also has significant dividends for the psychological well being of individuals, with flow on benefits to the broader community. Research conducted for the UK FSA estimates that moving a person with a relatively low level of financial literacy to an average level of literacy improves their psychological well-being by around 6% (compared to

[48] ANZ, Survey of Adult Financial Literacy in Australia, 2008, see section 7.
[49] http://www.fsa.gov.uk/pubs/consumer-research/crpr47.pdf

an 8% deterioration in well-being associated with divorce or a 10% deterioration from being unemployed). [50]

274 At a more macro level, research conducted for the Commonwealth Bank Foundation suggests that increasing the level of financial literacy by even a modest amount among the 10% of Australians that are the least financially literate would contribute $6 billion per year to GDP and create over 16,000 new jobs.[51]

Recognising the limits of financial literacy and understanding

275 There are limits to financial literacy and understanding:

(a) improving financial literacy is a long term objective. Consumer education seeks to bring about behavioural change, which can often take a generation or more to achieve and requires significant resources;

(b) as the work of behavioural economists and others have shown, lack of knowledge is frequently not the reason why we do not make sensible financial choices. Knowledge and understanding, while essential, are only two of the many factors that influence all of our choices;[52] and

(c) some financial products and financial decisions are so complex, time consuming or even plain boring that no amount of education will properly equip many of us to make good decisions in relation to them. In these circumstances, alternatives to education need to be considered if we are to help people avoid making disastrous investment choices.

276 Despite the inherent limitations of consumer education, ASIC believes that it is important to continue to better educate people about financial issues and, more particularly, their current and future financial needs. In Australia, individuals are now responsible for planning for their retirement to ensure a comfortable standard of living. In this context, it is important that Australians have a good understanding of investment basics such as diversification and risk. They also need to know when they should ask questions, where to go to find independent reliable information and the importance of shopping around for a suitable and appropriate investment.

277 However, the limitations inherent in financial literacy and consumer education mean that ASIC, Governments and industry need to look beyond these tools to other regulatory responses if we are to have a more immediate, positive impact on retail investor protection.

[50] Taylor, M., Jenkins S., & Sacker, A., *Financial Capability and wellbeing: Evidence from the British Household Panel Survey.* FSA. Institute for Social and Economic Research. University of Essex: Essex.
[51] Cited in Commonwealth Bank of Australia, *Australian Financial Literacy Assessment*, 2006, http://www.commbank.com.au/about-us/download-printed-forms/AFLA-2006-report.pdf
[52] Thaler, R.H., & Sunstein, C.R., *Nudge: Improving decisions about health, wealth and happiness,* Yale University Press, New Haven.

ASIC's activities

278 ASIC is responsible for promoting the confident and informed participation of consumers and investors in the financial system: see s1(2), ASIC Act. In carrying out this responsibility, ASIC's aim is to foster a financially literate community where Australian consumers can make informed decisions about financial products and services, understand their rights and responsibilities, and be in a position to identify and avoid bad investment choices like frauds and scams. From 1 July 2008, ASIC also took over the responsibilities of the former Financial Literacy Foundation and became responsible for leading the Federal Government's financial literacy work.

279 In seeking to foster a more financially literate Australia, ASIC is involved in four streams of work:

(a) delivering financial literacy programs (see paragraphs 280–281);

(b) ensuring access to information and tools (see paragraphs 282–284);

(c) looking beyond education to solutions that promote financial well-being (see paragraph 285); and

(d) developing partnerships with industry and the community (see paragraphs 286–287).

Delivering financial literacy programs

280 ASIC is focussing on delivering financial literacy programs through existing educational pathways, including through:

(a) schools where financial literacy education is now a requirement for all Australian school children from kindergarten to year 10;

(b) the higher education system;

(c) employer and union sponsored programs; and

(d) community based programs run by the community sector.

All of this work is being done in partnership with others.

281 Part of ASIC's work will be ensuring that we maintain and build on the momentum of the financial literacy programs being developed. A new national curriculum is presently being developed and the place of financial literacy within that new curriculum is not yet clear. ASIC and the Australian Government Financial Literacy Board are concerned to ensure that financial literacy has an explicit home in the new curriculum because if it does not the advances of recent years will be lost. We would encourage the PJC to add their voice to those recommending to the Australian Curriculum and Assessment Authority that financial literacy have an explicit home in the new curricula.

Ensuring access to information and tools

282 ASIC is constantly working to ensure that Australians have easy access to the information and tools they need to make good financial choices. We do this through our FIDO website, which receives around 1.5 million visits per year, and the Understanding Money website. Both of these sites contain an enormous array of interactive tools and information to assist consumers and retail investors with their financial needs.

283 We also ensure access to information and tools through a range of other mechanisms such as:

(a) our publications program; and

(b) public seminars such as those conducted for us by Centrelink.

284 We have designed seminars and a booklet (which will be launched soon) on the theme of Investing Between the Flags. This work grew out of the recent collapses where it became apparent that many people did not understand investing basics. We will also have a new investing portal that uses this same well known Australian safety metaphor to help people understand and test their investing knowledge and invest within their safety/risk threshold.

Note: Further information about the information and tools available on FIDO and Understanding Money is contained in Appendix 3.

Promoting financial well being

285 Another stream of our work is looking beyond education for solutions that promote financial well being. ASIC is currently developing a new consumer/investor website. The website is being designed to take people on a journey starting from engagement with their financial circumstances and needs, to knowledge about investing and personal goal setting. The website will also provide personalised guidance and ongoing support to help people follow through on achieving the goals they set themselves. We believe the site will have a very important role to play in meeting, at least, some of the needs of Australians who do not currently use a financial plan.

Developing partnerships

286 ASIC is aiming to develop cross-sectoral partnerships. We consider that this is essential if we are to make a serious impact on the financial literacy levels of Australians. Government is not the only area with an interest and involvement in improving financial literacy. The community, education and financial services sector all put enormous amounts of energy and resources into this common endeavour. As all of the evidence from social marketing tells us, to achieve broad based behavioural change it is essential that we coordinate our efforts and deliver common messages. It is only when people

hear the same message over and over again in all of life's contexts that real change starts to occur.

287 We have formed our first ever national, cross-sectoral community of practice and are using our national videoing facilities to bring together up to 90 people each month, from across Australia and New Zealand and from all of the sectors working in the financial literacy space, to build networks and promote best practice and knowledge sharing about financial literacy.

Changes to the policy settings of the FSR regime

288 Altering policy settings of the FSR regime will not improve financial literacy and consumer education. However, as the discussion above indicates, the task of improving financial literacy will take decades and will need to be well resourced throughout if we are to succeed. It is therefore essential that Government, the regulator and industry work together to achieve this goal.

Summary

289 Table 11 below summarises the key issues raised by this term of reference and ASIC's forward program to deal with these issues.

Table 11: Consumer education and understanding (TOR 7)

Key issues	ASIC activities	Regulatory change options for consideration by Government
Consumers have low levels of financial literacy and understanding	ASIC will continue to promote delivery of financial education ASIC will continue to provide Australians access to information and tools ASIC will look beyond education for solutions to promote financial well-being e.g. by designing a website to assist retail investors create a financial plan and follow it through ASIC will develop and promote national partnerships to expand delivery of investors and consumer education	There are no changes to be considered by Government at this stage. However, Government and industry need to fully support financial literacy initiatives.

I Professional indemnity insurance (TOR 8)

Key points

AFS licensees must have arrangements in the form of professional indemnity (PI) insurance in place to compensate retail investors for losses suffered as a result of a breach of the licensee's obligations.

There are inherent limitations on the effectiveness of PI insurance as a compensation mechanism and these limitations will be exacerbated if the market for PI insurance 'hardens' as currently indicated.

ASIC is working with the industry to ensure that the scope of the current compensation arrangements is maximised within the constraints of the 'hardening' market. The Government may need to review the effectiveness of PI insurance as a compensatory mechanism and consider possible alternatives such as a statutory compensation scheme.

290 Under the Corporations Act, AFS licensees are required to have arrangements in place to compensate retail investors who suffer loss as a result of the licensee breaching the requirements of Chapter 7 of the Corporations Act.[53] Regulations introduced in 2006 prescribe professional indemnity (PI) insurance as the standard way to comply with this obligation.[54]

291 ASIC has provided guidance setting out minimum standards in Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* (RG 126). This guidance, consistent with the legislative scheme, contemplates that most consumer claims will be resolved through external dispute resolution (EDR), and that PI insurance is a potential means to enhance a licensee's ability to meet compensation determinations made by the relevant EDR scheme.

Key issues

292 The key issues in relation to the adequacy of PI insurance arrangements as a compensation mechanism for retail investors are:

(a) the inherent limitations on its effectiveness as a compensation mechanism; and

(b) the 'hardening' of the market for PI insurance affecting the cost, availability and scope of available PI insurance generally.

[53] Section 912B.
[54] Regulation 7.6.02AAA, Corporations Regulations 2001.

Inherent limitations

293 There are significant limitations on the effectiveness of PI insurance as a compensation mechanism for retail investors. PI insurance is not designed to protect consumers directly (i.e. the consumer is not a direct beneficiary of the insurance contract, as explained below) and it does not guarantee that compensation will be paid. PI insurance is a contract between the insurer and the insured (the AFS licensee) under which the insured is protected against the risk of losses arising from poor quality services and misconduct. As a compensation mechanism it is limited by:

(a) what the market is willing to underwrite, expressed in the terms of the insurance contract, for example:

(i) insurance policies do not generally cover fraud by the principal, as such coverage is considered to create a mechanism for the insured to profit through their fraudulent actions;

(ii) PI insurance may be unavailable if the licensee has breached the PI insurance contract e.g. by failing to notify claims;

(iii) PI insurance may be unavailable to the retail investor if the breach by the licensee (upon which the retail client's claim is based) is an identified exclusion under the policy; and

(iv) PI insurance is generally a claims-made insurance contract and generally only covers claims made during the term of the contract. If the AFS licensee does not have a PI insurance policy at the time when the consumer's claim is made (as opposed to when the events giving rise to the claim occurred) because, for example, the AFS licensee has ceased business, then the consumer's claim is not covered by PI insurance; and

Note: the consumer's claim would be covered if the AFS licensee still had run-off cover: see paragraph 299.

(b) what the financial services industry can afford in relation to insurance premiums.

'Hardening' of the market

294 These limitations of PI insurance are currently being magnified by a recent 'hardening' of the PI insurance market, particularly for financial advisers. ASIC's discussions with industry participants indicate:

(a) an increase in premiums for PI insurance for financial advisers;

(b) a reduction in policy limits and exclusions for certain products and types of advice:

(i) new PI policies for financial advisers are unlikely to cover advice about margin lending as a matter of course. Insurers might be prepared to cover margin loans on a case-by-case basis where they are satisfied that there have been sufficient internal controls around advice regarding these products;

(ii) new PI policies for financial advisers might have tighter sub-limits on cover for dishonesty and EDR schemes;

(iii) automatic run-off cover is unlikely to be generally available for advisers; and

(iv) insurers are reviewing approved product lists and specifying products that they will or will not cover; and

(c) some insurers are not writing new cover for advisers or have withdrawn from the financial adviser market.

295 This 'hardening' is most likely a result of the cyclical nature of insurance markets, the effects of the global financial crisis, low interest rates and recent high profile product/adviser failures such as Westpoint and Storm.

296 In spite of this 'hardening', recent inquiries by ASIC indicate that the PI insurance market is still functioning appropriately for AFS licensees. That is, financial advisers, in particular, are able to obtain cover, albeit at an increased premium. However, a number of factors (including the high degree of concentration of supply in a small number of insurers and some degree of specialisation in the segments of the market that particular insurers will cover) could lead to a further tightening of the market in the next one to two years making it harder for some licensees (particularly financial advisers) to obtain PI insurance.

ASIC activities

Maximising the effectiveness of PI insurance arrangements

297 ASIC has created an administrative policy framework in RG 126 designed, as far as possible, to give effect to the objective of reducing the risk that compensation claims to retail clients cannot be met by the relevant licensee due to the lack of available financial resources.

298 RG 126 sought to maximise the effectiveness of PI insurance by dictating a two-stage approach to implementation. The first stage commenced on 1 July 2008 and required licensees to have PI insurance based on what was then commercially available in the market with minimum standards to deliver some practical results for consumers. The second stage is due to commence on 1 January 2010 and requires licensees to have a higher standard of PI insurance with the following key additional features:

(a) run-off cover for as long as practicable, but at least for 12 months after the licensee ceases business;

(b) cover for fraud; and

(c) cover for advice about switching from a product that is not on the licensee's approved product list to a product that is on the licensee's approved product list ('switching cover').

299 Run-off cover is cover for claims made after the insurance policy has ended which have arisen from the acts or omissions of the licensee during the period of insurance cover. In requiring run-off cover for as long as practicable after the licensee ceases business, ASIC seeks to mitigate the consequences where a licensee in financial difficulties either fails to notify claims promptly or fails to maintain its PI insurance, and the period for notifying claims to the insurer passes before the client realises they have suffered a loss as a result of the licensee's breach.

300 However, it appears that there may be some difficulties for licensees in obtaining cover that complies with the additional requirements as of 1 January 2010.

301 ASIC will monitor compliance with RG 126 and PI-related difficulties, and work with the industry to ensure that the scope of the current compensation arrangements are maximised as far as possible within the constraints of the 'hardening' market.

302 ASIC will also clarify its intention behind the fraud and switching cover expected in PI insurance policies to ensure that the industry understands exactly what is expected of it under these requirements.

Changes to the policy settings of the FSR regime

303 In light of the issues referred to above the Government may wish to review PI insurance as a compensation mechanism and assess possible options to overcome the limitations of PI insurance as a compensation mechanism. Options to overcome the limitations of PI insurance as a compensation mechanism include the introduction of a statutory compensation scheme. A statutory scheme could ensure that a source of funds is available for consumers with claims against licensees that cannot be met by PI insurance.

304 The main issues in relation to a statutory compensation scheme are:

(a) the relationship between PI insurance and a statutory scheme; and

(b) funding of a statutory scheme.

305 Other jurisdictions have statutory compensation schemes. For example, the UK Financial Services Compensation Scheme (Compensation Scheme) was set up to assist retail clients who had suffered loss from bad investment advice, misrepresentation, or where a firm has gone out of business and

cannot repay money owed to retail clients. The scheme covers transactions in relation to deposit-taking, investments, insurance and mortgages.

306 The UK FSA or the Compensation Scheme conducts an investigation into a firm and makes a determination about whether it is in ‘default’ (a slightly lower standard than insolvency) and clients are, therefore, eligible to be covered by the Compensation fund.

307 The Compensation Scheme is funded by levies from industry in contribution groups based on their activities (i.e. banks are grouped together and financial advisers are grouped together) to avoid cross-subsidisation across different industries that have different risks of loss for clients. This means that an individual firm in a high-risk industry has to pay a larger contribution.

308 There are also caps on compensation (as a specific monetary amount and as a percentage of the actual loss claimed). The purpose of the cap is to encourage investors to make prudent decisions by not removing their full exposure to the loss resulting from their financial decisions.

Summary

309 Table 12 below summarises the key issues raised by this term of reference, ASIC’s forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with the issues.

Table 12: PI insurance (TOR 8)

Key issues	ASIC activities	Regulatory changes options for consideration by Government
PI insurance has limitations as a compensation mechanism and these limitations are being exacerbated by the current hardening of the insurance market	ASIC will monitor and work with industry to maximise the effectiveness of PI insurance as a compensation mechanism as far as possible ASIC will update RG 126 to clarify guidance on the requirements to hold fraud and product-switching cover	Review PI insurance as a compensation mechanism and consider alternatives such as a statutory compensation scheme

J Role of lending institutions (Additional TOR)

Key points

The key issues in relation to the role of lending institutions are:

- the lack of regulatory controls, especially on the provision of credit to retail investors borrowing to invest; and
- failures of corporate governance and risk management leading to higher risk lending and inadequate management of existing loans, particularly where there is a relationship between the lending institution and a financial services intermediary.

These issues will largely be addressed by the federal credit and margin lending reforms.

ASIC is working to implement the federal credit and margin lending reforms. In addition, ASIC will also continue to use its consumer protection jurisdiction in the ASIC Act.

Key issues

310 This term of reference has been interpreted as a consideration of the role of lending institutions in facilitating the use of borrowing to fund investments (also referred to as 'leverage' and 'gearing').

311 ASIC considers that informed borrowing to invest, when used appropriately, can offer a number of benefits to retail investors. However, as shown by recent large retail investor losses, borrowing to invest can also be a high-risk activity for retail investors as it magnifies losses.

312 ASIC is currently investigating the role of lending institutions in the events leading up to the losses suffered by many former Storm clients. Therefore we cannot comment on the role of lending institutions in relation to Storm at this time to avoid prejudicing our ongoing investigations.

313 The comments we provide below are observations about potential systemic issues that have arisen in relation to the role played by lending institutions in recent retail investor losses, including:

(a) lack of regulatory controls on the provision of credit, particularly the provision of credit to facilitate retail investments, e.g. margin loans; and

(b) failures of corporate governance and risk management procedures that:

(i) encouraged some higher risk lending; and

(ii) resulted in inadequate management of existing loans, particularly where there is a relationship between the lending institution and the financial services intermediary who may have been treated as the 'client' of the lending institution rather than the ultimate retail investor.

Lack of regulatory controls

314 Investment loan agreements and, in particular, margin loan agreements may be complex, with terms that are adverse to the borrower's interest. Therefore, the risks involved in the arrangement, fees and incentive payments may not be apparent to retail investors. This has lead to retail investors misunderstanding the nature of the arrangement they have entered into or failing to appreciate the risks involved in borrowing to invest.

Regulation pre reforms

315 Credit (including margin loans and other investment loans) is not a 'financial product' under the Corporations Act and therefore not regulated by Ch 7 of the Corporations Act. This means that lenders of investment credit such as margin lenders do not have the same obligations in relation to conduct and disclosure under the Corporations Act as AFS licensees, and borrowers do not have the same protections as investors in financial products.

316 ASIC recommended that margin lending should be regulated under Ch 7 of the Corporations Act in its August 2007 submission to the Productivity Commission Inquiry into Australia's Consumer Policy Framework.

317 Credit (including margin loans and other investment loans) is a 'financial product' for the purposes of the ASIC Act and, therefore, ASIC can take action against misleading and deceptive or unconscionable conduct in relation to the provision of credit (including margin loans and other investment loans).

318 The Uniform Consumer Credit Code (UCCC) enacted in each State and Territory regulates consumer credit i.e. credit for personal domestic and household purposes, but not for investment purposes (such as margin loans).

Regulation post reforms

319 The Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 was introduced into Parliament on 25 June 2009. This Bill will amend the Corporations Act so that margin loans are regulated as financial products under the Corporations Act (margin lending reforms).

320 The Council of Australian Governments (COAG) agreed on 3 July 2008 that the Commonwealth would also assume responsibility for the regulation of consumer credit. The Credit Bill was introduced into Parliament on 25 June 2009 (credit reforms). Once passed, it is expected that from 1 Jan 2010 a

person must not engage in a credit activity unless they are registered or hold a licence. Lending for the purposes of investment in residential property will be regulated under this Bill. Other forms of investment lending (i.e. lending other than margin lending (which is covered by the margin lending reforms) or lending for investment in residential property) will not be regulated until Phase II of the credit reforms.

Note: For more information on the regulatory framework, see Appendix 2.

Risk management and corporate governance issues

321 The recent market fall has shown the risk management procedures and corporate governance standards of many financial institutions worldwide to have been inadequate or to have been applied inadequately during the preceding bull market.

322 While Australian lending institutions have not engaged in some high risk lending practices that occurred overseas, recent retail investor losses have shown that in some cases Australian lending institutions may have failed to apply their usual standards in the bull market. This was particularly so where the retail investor dealt with the financial institution indirectly through an intermediary. In some cases this has resulted in higher risk lending to retail investors and inadequate management of existing loans.

Relationships with intermediaries

Treatment of intermediaries as the 'client'

323 Many retail borrowers access lending institutions through other intermediaries, such as financial advisers and stockbrokers.

324 Where a lending institution deals with an intermediary who offers a large volume of business to the lending institution, the lending institution may fail to focus on the retail borrower as the ultimate borrower, that is:

(a) it may place undue reliance on the intermediary to assess the suitability of the loan (sometimes even where the lending institution itself has other dealings with the ultimate borrower and is, therefore, actually aware of the borrower's circumstances);

(b) it may also rely on the intermediary to conduct some of its risk management checks on its behalf, such as checking that the borrower understands the terms of the loan;

(c) it may allow greater amounts to be lent to customers of intermediaries than under its usual rules; and

(d) it may place undue reliance on the intermediary to communicate with the ultimate borrower, monitor the loan or allow unusual arrangements.

For example, where there is an intermediary, such as a financial adviser, there may be a misunderstanding (by the client, adviser or lender) about who is responsible for monitoring a margin lending portfolio.

Links between lending institutions and intermediaries

325 Links between lending institutions and intermediaries raise many of the same issues, such as conflicts of interest, remuneration and consumer understanding, already discussed in the context of financial advisers in Sections D and E. Some intermediaries are given benefits by lending institutions because they are in a position to influence the level of loans taken out by their clients and to bring in business for the lending institution. These may be in the form of trailing commissions or other incentives (such as soft-dollar incentives like overseas trips or discounted loans for themselves) from lenders. The impact of these benefits may not always be clearly disclosed to the investor.

326 Even where there are no benefits provided to the intermediary, competitive forces may lead a lending institution to treat business that comes through an intermediary with a large volume of business differently to its usual procedures.

327 An intermediary can also gain credibility in the mind of the investor from their relationship with the lending institution, even though the lending institution may not be scrutinising the loans as thoroughly as if the customer dealt directly with the lending institution. One example of this has been the re-branding of products manufactured by lending institutions by other financial services providers. Investors may be confused about who is responsible for the product and may give the product greater credibility because of the involvement of the lending institution.

ASIC activities

Prior to the credit and margin lending reforms

328 ASIC has a consumer protection jurisdiction in relation to credit under the ASIC Act, which includes taking action for misleading or deceptive conduct or unconscionable conduct under the ASIC Act.

329 Examples of recent ASIC work in this area include:

(a) ASIC’s reviews of bank default fees and mortgage entry and exit fees;

(b) ASIC’s review of the Electronic Funds Transfer Code of Conduct;

(c) the joint report with Consumer Affairs Victoria examining how lenders and mortgage brokers respond to borrowers experiencing financial difficulties;

(d) ASIC's monitoring and reporting on the reverse mortgage market; and

(e) ASIC's review of lending to indigenous Australians and resulting improvements in lending standards.

Implementing the credit and margin lending reforms

330 Regulation of consumer credit and margin lending under the proposed margin lending and credit reforms will be the responsibility of ASIC.

331 ASIC has set up a dedicated Credit stakeholder team to implement the credit reforms. ASIC is engaging in an extensive consultation process on proposed guidance on how it will administer the credit reforms. ASIC is currently consulting on general conduct obligations, competence and training requirements, compensation requirements and financial resource requirements for credit licensees. ASIC is also consulting on dispute resolution requirements for credit and margin lending. Our final guidance will be published in regulatory guides before the end of the year. ASIC has set up an industry working group for credit comprised of industry representatives and other key stakeholders.

332 As a member of the FSWG, ASIC is working on short and standardised disclosure for margin lending. ASIC is developing policy on training requirements for people who provide advice about margin loans and financial resource requirements for licensees.

Changes to the policy settings of the FSR regime

Will the proposed federal credit reforms address current concerns?

333 The issues raised above will largely be addressed by the proposed margin lending and credit reforms, especially the introduction of responsible lending obligations. The key concept behind responsible lending is that credit licensees and margin loan providers must not provide, suggest or assist with a credit contract or margin loan that is unsuitable for the consumer.

334 The proposed margin lending and credit reforms will also make significant improvements by, for example:

(a) requiring licensing (and imposing general conduct obligations on licensees);

(b) imposing an obligation to notify clients of margin calls;

(c) providing that regulation of remuneration and soft-dollar benefits under the Corporations Act now applies to margin loans; and

(d) requiring credit providers and intermediaries to be members of an EDR scheme.

335 However, it should be noted that:

(a) lending for investment purposes (other than margin lending and lending for residential investment properties) will not be regulated until the proposed Phase II of the reforms; and

(b) margin lenders will be able to rely on the adviser's inquiries of the client (where this information is set out in an SOA) when undertaking the assessment of suitability to comply with their responsible lending obligations.

336 We note that the new margin lending regime is likely to be more liberal than that in some other jurisdictions. Some jurisdictions (including the US, Singapore, Hong Kong and Canada) impose specific restrictions on retail investor margin lending, such as limits on leverage. Other jurisdictions, such as the UK, do not have specific regulation, but general obligations mean that retail investors are not generally offered margin loans. At this stage, ASIC does not believe that these sorts of limitations, which are inconsistent with the fundamental settings of the FSR regime, are necessary in Australia.

337 The changes in policy settings suggested in Section D and E of this submission (e.g. clarifying the duties on financial advisers and restricting remuneration structures that create conflicts of interest that adversely affect the quality of advice) would also address some of the issues raised by the relationship between lending institutions and intermediaries.

Summary

338 Table 13 summarises the key issues raised by this term of reference, ASIC's forward program and possible changes to the policy settings of the FSR regime that the Government should consider to deal with the issues.

Table 13: Role of lending institutions (Additional TOR)

Key issues	ASIC activities	Regulatory change options for consideration by Government
There are limited regulatory controls, especially on the provision of credit to retail borrowers to invest	ASIC will be responsible for the regulation of consumer credit and margin lending under the new margin lending and credit reforms	**Current Government law reform** – The proposed federal credit and margin lending reforms seeks to address these issues
There have been failures of corporate governance and risk management leading to higher risk lending and inadequate management of existing loans, particularly where there is a relationship between the lending institution and a financial services intermediary	ASIC has set up a dedicated Credit Taskforce to implement the reforms, including engaging in an extensive consultation process on proposed guidance on how we will administer the reforms ASIC will continue to take action within its consumer protection jurisdiction	

K Need for legislative and regulatory change (TOR 9)

Key points

Recent events and the issues raised by the Inquiry highlight a possible need to re-examine the balance between market efficiency and investor protection in the FSR regime.

Certain legislative and regulatory changes may be necessary to shift the balance toward greater protection of retail investors.

Some have argued that there is a need to fundamentally review the policy settings and economic philosophy of the FSR regime by considering options such as:

- prudential regulation of a greater range of financial products;
- product design prohibitions or limitations;
- a duty of suitability for product issuers and intermediaries; and
- 'licensing' of investors.

339 The question of whether there is a need for legislative and regulatory change to the FSR regime in light of recent events and the issues raised by the Inquiry is a policy matter for Government. ASIC's role is to assist the Government by providing information, data and advice based on our regulatory experience to the Minister, Treasury and the PJC.

Shifting the balance of the FSR regime

340 In the previous sections of this submission, we have described ASIC's forward program to address the issues raised by the Inquiry. ASIC is pushing the existing FSR regime to the limit to maximise its potential to protect retail investors. ASIC's new market-focused, outward-looking structure has enabled it to both identify and respond to problem areas more effectively and efficiently.

Note: ASIC's forward program is summarised in Table 1.

341 However, ASIC considers that its forward program and industry action may not, within the current settings of the FSR regime, adequately protect retail investors. Therefore, the Inquiry may need to reassess the balance reached by the Wallis Inquiry between market efficiency and retail investor protection and consider options for reform that shift the balance in favour of retail investors. While this increased intervention will impact market efficiency, ASIC believes that the benefits, in terms of increased investor

protection from loss and increased investor confidence causing retail investors to re-enter the market, may outweigh the costs.

342 The options for reform identified by ASIC are summarised in Table 2.

Re-thinking the fundamental settings of the FSR regime

343 ASIC considers that the FSR regime has delivered benefits to the Australian economy. It has led to:

(a) efficient and flexible allocation of risk and resources and a low cost of capital;

(b) promotion of competition, innovation and flexibility in the financial services industry; and

(c) retail investors having access to a wide range of products.

344 ASIC does not consider that recent events and the issues raised by the Inquiry necessarily justify a fundamental review of the policy settings and underlying economic philosophy of the FSR regime.

345 However, some have argued to the contrary. That is, some argue that recent events and the issues raised by the Inquiry demonstrate a need to reject the 'efficient markets theory' underpinnings of the FSR regime and consider more far reaching changes such as:

(a) prudential regulation of a greater range of financial products (see paragraphs 347–352);

(b) product design prohibitions or limitations (see paragraphs 354–361);

(c) a duty of suitability for product issuers and intermediaries (see paragraphs 362–363); or

(d) 'licensing' of investors (see paragraphs 364–365).

346 These options for more far reaching regulatory change are outlined below to assist the PJC. Some of these options could be applied to all products (e.g. duty of suitability). Others (e.g. prudential regulation or product design limitations or prohibitions) would apply only to more complex or high-risk products.

Prudential regulation of a greater range of products

347 A greater range of products could be prudentially regulated. For example, applying the criteria for prudential regulation articulated in the Wallis Report, it is arguable that products such as debentures should be subject to more than conduct and disclosure regulation. The Wallis Report noted that higher levels of regulation may be warranted for products where there is:

(a) inherent difficulty in honouring the promise made by the issuer of the products;

(b) difficulty in assessing the creditworthiness of the issuer of the products; and

(c) potential adversity caused by the failure of the products.

348 Debentures are essentially an undertaking given by a body to repay money lent to it by an investor along with any interest applying to the loan. (The promises made are very similar to fixed rate deposit products offered by banks.) Debentures may be listed, and therefore tradeable on exchanges, or unlisted. They may or may not be rated by ratings agencies.

349 There are inherent difficulties in ensuring that debenture issuers e.g. non-bank deposit takers are able to honour the promise to repay the principal amount of the loan plus interest to the investor without mandatory capital and liquidity requirements. Similarly there are difficulties in assessing the creditworthiness of the issuer of these products and the products themselves where they are unrated. ASIC estimates that, as at December 2008, approximately $9.7 billion out of $16.9 billion of debentures were unrated. These products are not as prevalent in the Australian market as, say, bank deposit products so that their failure has less potential to cause adversity at a systemic level. Nevertheless, as can be seen from the collapse of Westpoint, Fincorp and ACR, the failure of these products has significant potential to cause adversity at an individual level.

350 Interestingly, following the recent spate of investor losses arising from failures of New Zealand finance companies, property funds and mortgage trusts, the NZ Government introduced legislation to require prudential regulation of non-bank deposit takers by the Reserve Bank of New Zealand (RBNZ). This regulation will cover finance companies including debenture issuers. By 2010 all non-bank deposit takers will need to comply with minimum prudential and governance requirements on an ongoing basis. The requirements to be adopted by non-bank deposit takers also include mandatory credit ratings.

351 RBNZ is currently developing regulations to introduce standards for capital and liquidity requirements and standards for lending to associated parties by non-bank deposit takers including finance companies that issue debentures.

352 The prudential standards proposed by NZ for non-deposit takers may be similar to those administered by APRA, but the level of proposed oversight appears to be set at a lower level. While the responsibility for setting the prudential regulations and enforcing them rests with RBNZ, it will be the trustee corporations (or a person approved for this purpose by the NZ Securities Commission) appointed under a trust deed by the non-bank deposit taker who will be responsible for supervising and assessing the

safety and soundness of individual non-bank deposit takers and for intervening where appropriate. The RBNZ will nevertheless require information from trustees of deposit takers to ensure compliance with the minimum prudential and governance requirements it sets.

353 The key issue will be whether these restrictions will lead to a significant reduction in the issue of debentures and similar products. If they do, they may affect the efficiency of the financial markets, as an alternative and higher risk-return form of investment will no longer be available. If there are no substitutes, an important source of capital for the real economy will no longer be available.

Product design prohibitions or limitations

354 The regulatory regime could be amended to prohibit the sale of certain products to retail investors or place limitations on the design of products sold to retail investors, in order to safeguard investors from high-risk or unsuitable products.

Collective investment products

355 In Europe, and some jurisdictions in Asia, the underlying investments of collective investment schemes marketed to retail investors are more tightly controlled.

356 Hong Kong has developed a series of codes setting out core requirements detailing investment limitations and prohibitions for collective investment schemes. For example, the code on unit trusts and mutual funds sets out requirements that include specifications as to:

(a) the spread of investments (e.g. the value of a scheme’s holding of securities issued by any single issuer may not exceed 10% of its total net asset value);

(b) warrants and options;

(c) futures and commodities;

(d) investment in other schemes;

(e) prohibition on real estate investments (and investments in shares and listed real estate investment trusts (REITs) must comply with certain investment limits);

(f) short selling limitations;

(g) limitations on making loans; and

(h) unlimited liability, and limitations on nil-paid/partly-paid securities.

357 For specialised schemes, including leveraged funds, futures and options funds, and hedge funds, the investment and borrowing limitations vary

according to the type of specialised scheme. Limitations may apply to charges, offering document content, name of scheme, filing requirements, limited liability, certification by trustee/custodian, advertisements and reporting, amongst others.

358 In Singapore, the Code on Collective Investments provides for:

(a) limits on the proportion of unlisted assets that the fund can invest in (generally 10%);

(b) the proportion of assets that can be issued by the same issuer;

(c) the proportion of assets that can be lent;

(d) the degree of borrowing; and

(e) the fund's exposure to derivatives.

359 There are additional requirements for specialised schemes. For example, REITs must have a credit rating and there is a leverage limit of 60%.

360 In the UK, retail clients may access UCITS schemes or authorised retail non-UCITS schemes, defined as schemes constituted by an open-ended investment company or an authorised unit trust. Both types of scheme must be authorised under legislation and must adhere to investment rules that include restrictions on:

(a) spread of investments (e.g. not more than 10% of the value of scheme property in transferable securities or money-market instruments issued by any single body; not more than 20% of the value of the scheme property in deposits with a single body);

(b) investments in nil and partly-paid shares; and

(c) investment in derivatives and exposure to underlying assets.

361 Retail clients cannot access qualified investor schemes which are restricted to specified categories of sophisticated investors, including professional clients. Unregulated schemes cannot be marketed to the general public.

Duty of suitability for product issuers and intermediaries

362 Another option for reform is to require product manufacturers and/or distributors to take some responsibility for ensuring products are sold to the right investors. Currently, in the Australian FSR regime, only personal advisers are subject to a duty to ensure that products recommended to retail investors are suitable. Retail investors can acquire any product (including complex and risky products such as derivatives and structured debt products) on an execution-only basis or with general advice only. In these circumstances the intermediary has no obligation to ensure the product is suitable for the retail investor.

363 There are a number of mechanisms to ensure that industry has some role in ensuring investors acquire products that are suitable for them:

(a) in the United Kingdom, product manufacturers are required to 'treat their customers fairly'. The UK FSA has given guidance that requires a product manufacturer to monitor who intermediaries distribute their products to and, if it determines its products are not marketed to the correct market, to address this with the intermediary or consider changing intermediaries:

(b) in Hong Kong, products must generally be sold with advice, including a suitability requirement (i.e. they cannot be sold to retail investors on an execution-only basis) unless they are:

(i) listed; or

(ii) collective investment schemes (and there are significant product design limitations on collective investment schemes: see paragraphs above 356–357).

(c) in Europe, under the Markets in Financial Instruments Directive (MiFID), a firm making a sale must apply an appropriateness test even when it makes no recommendation. This means it must assess whether the client has the knowledge and experience to understand the risks involved in a particular product or service. If the firm considers that the client does not, it must warn the client. If the client does not provide the information needed, the firm is required to warn the client that it does not have sufficient information to determine whether the service or product envisaged is appropriate.

'Licensing' of investors

364 Under the FSR regime retail investors can potentially acquire any product; there are no restrictions on the types of products that can be sold to retail investors. However, it would be possible to categorise investors and provide that only certain products can be sold to certain investors.

365 For example, in the UK more complex, high-risk collective investment schemes are restricted to specified categories of sophisticated investors. Such schemes have a more relaxed set of rules governing their operation, including their investment powers. The categories of sophisticated investors include 'professional clients' which may be either per se (i.e. institutional bodies) or elective. Elective professional clients must meet quantitative and qualitative criteria regarding their capability and experience in financial transactions. In addition, 'qualified investors' are able to participate in offerings of securities not available to the public. Qualified investors must self-certify annually and are placed on a register administered by the FSA. Qualified investors must satisfy two out of three specified criteria, being: size and volume of transactions (at least EUR 1,000 on 10 occasions in one

quarter), size of security portfolio (exceeding EUR 0.5 million) and/or experience working in a professional capacity in the financial services industry.

Appendix 1: Market Context

Introduction

366 To assist the PJC, this appendix provides background information about:

(a) retail participation in the financial market;

(b) the financial planning and advice industry;

(c) stockbrokers; and

(d) retail investment credit.

367 This information supplements the market information contained in the main body of this submission.

Note: Some of the information in this appendix was provided to the PJC on 24 June 2009.

Key retail financial products

What are they?

368 Apart from superannuation products, life insurance and currency and deposits (which are not the focus of the Inquiry), the main investment products typically held by retail investors are:

(a) shares;

(b) debt securities (including debentures); and

(c) managed funds (other than superannuation).

369 The total value of household investment in these investment products is around $350 billion or 5.5% of total household wealth.[55]

Shares

370 Some retail investors hold shares directly. (They also invest in shares indirectly through managed funds and superannuation.) ANZ's 2008 study of financial literacy reported that between 2002 and 2008, the proportion of

[55] Australian Bureau of Statistics, Cat. No. 5204.0, Australian System of National Accounts, 2007-08. Household investment in debt securities at 30 June 2008 was $11.9 billion, or 0.2% of total household assets. The ABS data does not provide information on specific investments in shares and managed funds other than superannuation. However, the total amount of wealth invested in shares and other equity, which include investments in shares and managed funds other than superannuation, at 30 June 2008, was $338.6 billion, or 5.4% of total household assets.

respondents with direct ownership of shares fell from 44% to 38%.[56] ASX's share ownership study has reported that this proportion had fallen from 41% in 2006 to 36% in 2008.[57]

Debt securities (including debentures)

371 Retail investors often invest in debt securities indirectly through managed funds, but they may also acquire them directly.

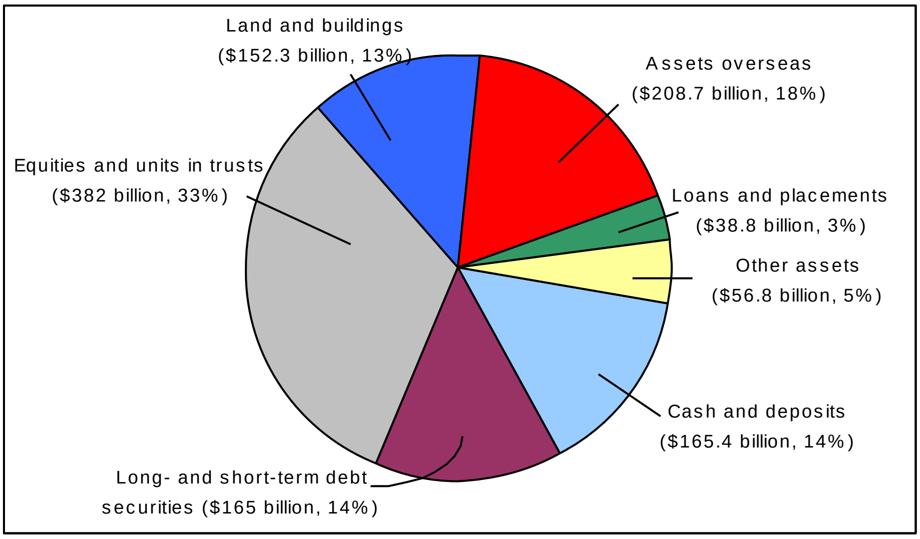
372 Debentures are a debt security that is generally held by retail investors. ASIC estimates that, as at 31 December 2008, there were 109 debenture issuers in Australia who had issued debentures with a total face value of $16.9 billion. The ASIC Investor Research Report 2008, by Roy Morgan Research (Roy Morgan ASIC Investor Research), found that 4.3% of investors surveyed directly owned debentures.

Managed funds (other than superannuation)

373 Typically, managed funds allow investors to 'pool' their money in a fund, which a professional investment manager invests in a particular type of asset or mix of assets with a view to receiving an ongoing return and/or capital gain.

374 At 31 March 2009 managed funds institutions had total consolidated assets of $1,169 billion allocated across a range of assets (see Figure 4).[58] (Note that these figures include assets held by superannuation managed funds.)

Figure 4: Total funds under management – Allocation of assets as at 31 March 2009



[56] ANZ Survey of Adult Financial Literacy in Australia (2008 p.62), (2005, p.77).
[57] ASX share ownership study 2008, p.6.
[58] ABS, March 2009, *Managed Funds, Australia*, Cat No 5655.0.

Source: Australian Bureau of Statistics, Can. No. 5655.0, Managed Funds, Australia, March 2009.

375 It is estimated that direct retail investment (excluding retail investment through superannuation funds) accounts for around $127 billion[59] of managed fund investment. This corresponds to around 11% of the $1,169 billion of total managed fund assets mentioned above.[60] ANZ's 2008 study of financial literacy reported that 20% of adult Australians held managed investments other than superannuation.[61]

376 According to data from Roy Morgan Research, as at March 2006, the types of managed investments most favoured by retail investors were:

(a) cash management trusts (held by 32% of those retail investors who had invested in managed funds);

(b) diversified balanced funds/trusts (16%);

(c) Australian equity funds/trusts (13%); and

(d) life insurance (10%).

377 Other managed investments included diversified growth funds/trusts (9%); listed property funds/trusts (9%); international equity funds/trusts (8%); Australian bond funds/trusts (8%); ethical equity funds/trusts (6%); mortgage funds/trusts (6%); unlisted property funds/trusts (4%); income funds (3%); and international bond funds/trusts, diversified capital stable funds/trusts, friendly society bonds, hedge funds and insurance bonds (all around 1-2.5%).[62]

Who are the product manufacturers?

Shares

378 Retail investors are most likely to hold shares in listed companies as investments. In July 2009 there were 2,054 companies (1,973 domestic and 81 foreign) listed on the ASX. [63] Generally speaking, retail investors tend to invest in the ASX top 200 companies.

Debt securities (including debentures)

379 Debt securities are generally issued by governments, financial institutions and companies. Governments issue debt securities, such as bonds. Debentures are generally issued by non-bank financial institutions or

[59] Roy Morgan Research 2009, *Superannuation and Wealth Management in Australia*, p.6.
[60] The two figures come from different sources and discrepancies in timing, scope and coverage may apply. This comparison should be taken with caution.
[61] ANZ Survey of Adult Financial Literacy in Australia 2008 p.14.
[62] Data from Roy Morgan Research, (survey period April 2005 - March 2006). These data do not include platforms, which, as a matter of law, are managed investment schemes. For more information on platforms see paragraphs 411–424 of this paper.
[63] ASX 2009, *Historical market statistics*, <http://www.asx.com.au/research/market_info/historical_equity_data.htm#No%20of%20Companies>.

companies, such as property development companies, looking to raise money. For example, Victorian Securities Corporations Ltd, a mortgage financing company and a subsidiary of Bendigo Bank, issues debentures.

Managed funds (other than superannuation)

380 While the funds management industry in Australia as a whole is relatively unconcentrated, the retail managed funds industry is substantially concentrated.

381 As of September 2008, Morningstar estimated that total Australian sourced assets under management by Australian fund managers were $952 billion, of which the top 10 managers held $518.8 billion (54%).[64] Retail funds under management were $465.8 billion, of which the top ten managers held $393.4 billion (84%). Retail funds under administration (i.e. on platforms) were $362.2 billion, of which the top ten managers held $332.6 billion (92%). See Table 14 for more information. [65] Note that this data includes money held in retail superannuation funds, but not money held in industry superannuation funds.

Table 14: Australian fund managers: Total funds under management, retail funds under management, and retail funds under administration[66]

Top 10 funds	Total funds under management		Retail funds under management		Retail funds under administration	
		$billion		$billion		$billion
1	Commonwealth–Colonial Group	$108.5	National-MLC Group	$60.1	National-MLC Group	$60.2
2	Macquarie Bank Group	$73.4	AMP Group	$57.3	BT Financial Group	$46.6
3	AMP Group	$64	BT Financial Group	$54.4	AMP Group	$42.6
4	AXA Group	$51.1	Commonwealth-Colonial Group	$51.3	St George Group	$37.1
5	ING-ANZ Group	$50.2	Macquarie Bank Group	$45.3	ING-ANZ Group	$32.9
6	Vanguard Investments Ltd	$49.1	ING-ANZ Group	$44.0	Commonwealth-Colonial Group	$32.5

64 Morningstar 2008, *Market share report*, September Quarter 2008, p.4. This data differs from the ABS data in paragraph 374 because it was compiled on a different basis.
65 Ibid. Retail funds under administration refer to funds invested via platform products, and not actually managed by the financial institutions with which they are placed.
66 We note that since this data was compiled, NAB has announced a purchase of Aviva Australia, which may increase its share of the platform market.

Top 10 funds	Total funds under management		Retail funds under management		Retail funds under administration	
		$billion		$billion		$billion
7	BT-Westpac Group	$37.6	AXA Group	$37.1	AXA Group	$26.7
8	Barclays Global investors Australia	$35.7	Aviva-Navigator	$15.9	Macquarie Bank Group	$24.4
9	Perpetual Ltd	$27.6	Mercer Investment Nominees Ltd	$15.1	Aviva-Navigator	$16.6
10	Russell Investment Management Ltd	$21.6	Australian Wealth Management Ltd	$12.8	Mercer Investment Nominees Ltd	$13.1
Top 10 Total		**$518.8**		**$393.4**		**$332.6**
Industry Total		**$952.0**		**$465.8**		**$362.2**

Source: Morningstar, Market Share Report, September Quarter 2008.

How are financial products distributed and marketed to retail investors?

382 The financial services industry distributes investment products to retail investors in many different ways. In general, the distribution methods for investment products can be simplified into the following three broad categories:

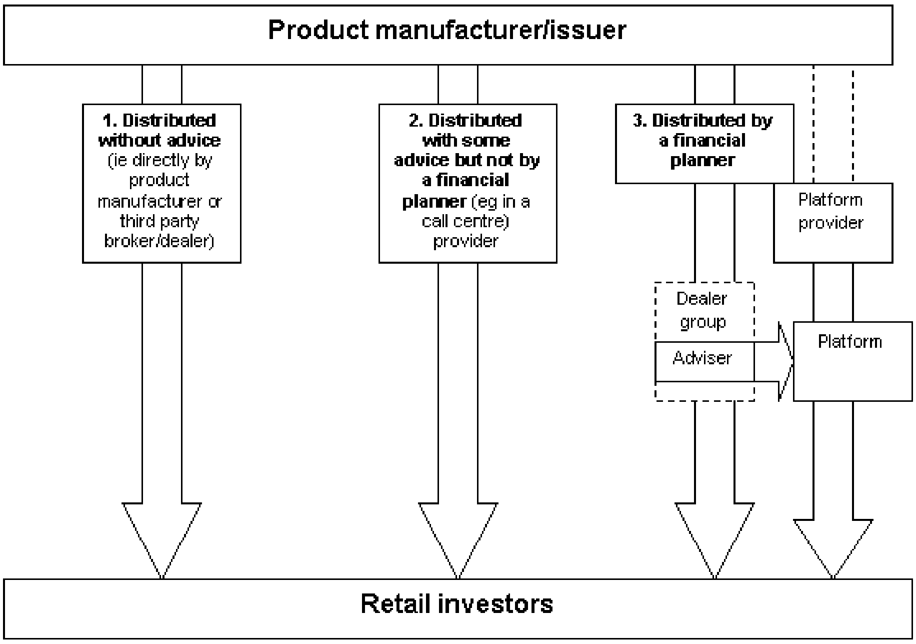
(a) Distributed without advice i.e. distributed directly by the product manufacturer or through a third party broker or dealer;

(b) Distributed with some advice, but not by a financial planner i.e. distributed by a representative of the product manufacturer who provides some general advice about the product (without considering the investor's personal circumstances) or who provides some personal advice but only about the specific product to be sold or issued to the investor; and

(c) Distributed by a financial planner i.e. distributed through a financial planner who provides personal advice to retail clients. The planner may or may not be tied to the product manufacturer, but is likely to receive commissions from the product manufacturer. As set out below in paragraph 418, financial planners generally use platforms to invest in financial products on behalf of their clients.

383 Figure 5 illustrates the main methods of distribution.

Figure 5: Main distribution pipelines



Shares

384 A significant proportion of retail investors acquire their shares passively, that is, through company distributions and employee share ownership schemes. According to the Roy Morgan ASIC Investor Research, around one third of holders of shares obtain their shares without direct applications to purchase. Those retail investors who make an active decision to acquire shares on the secondary market generally do so through a stockbroker, either an online broker or a full service broker. Investors also purchase shares through Initial Public Offerings.

385 Available figures indicate that only around 34%[67] of retail investors who hold shares directly get advice about purchasing shares from financial planners.

Debt securities (including debentures)

386 Most issuers of unlisted, unrated debentures market their products directly at their place of business, on their website, or through direct advertising.

387 Generally speaking, few unlisted, unrated debenture issuers rely on financial planners to market their debentures, although the few that do tend to have relatively more debentures on issue than other issuers (e.g. Westpoint). Listed debentures are more likely to be marketed through financial planners.

[67] ASX, 2008 Australian Share Ownership Study, p.22.

Managed funds (other than superannuation)

388 The majority of funds placed by retail investors in managed funds come from financial planners, via platforms.

389 The channels used to obtain managed funds in September 2008 were:

(a) financial planner/adviser, 54% (tied 34% / not tied 20%);

(b) directly through financial institutions, 20%;

(c) accountants, 8%; and

(d) employers, 3%.[68]

Fees

390 Retail investors pay a variety of fees when they acquire investment products. Using managed funds as an example, this section sets out the different fees that retail investors may pay and how these fees are paid to different financial services providers.

391 In general for managed funds, retail investors tend to pay the same total amount in product fees regardless of whether the product is distributed through a financial planner or directly. Distribution through a platform will involve extra fees for the administration of the platform. Platforms also allow investors to purchase investments at wholesale prices, although this discount in the cost of the product may not be enough to offset the additional fees for administration.

How fees are paid

392 Generally, a retail investor acquiring an interest in a managed fund will make a substantial initial investment in the fund. They may also make subsequent contributions to the investment. Different fees are then deducted from this investment, including entry and contribution fees, administration or account fees, transaction fees and fund management fees (investment and performance fees). Fees are generally set by the product manufacturer and built into the product.

393 Each financial services provider (e.g. product manufacturer, financial planner) involved in the investment then gets a payment from these fees for services they provide to the retail investor. That is:

(a) The product manufacturer (e.g. fund manager) is paid its fund management fees for managing the investment.

(b) Where there is a financial planner, the planner and dealer group are also paid for their advice/sale of the product.

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[68] Roy Morgan Research 2009, *Superannuation and Wealth Management in Australia*, p.15.

(i) The product manufacturer may pay the planner a commission for the sale of a product and it generally pays this commission through the dealer group. All or part of the commission is then passed on to the individual planner. (Some employee planners receive a salary only so they will not directly receive part of the commission for a sale, although the sale may count towards sales targets that may earn the planner a bonus.)

(ii) The planner or dealer group is also generally paid an ongoing commission (trail commission) and this is paid out of the administration fees charged from the retail investor's account.

394 All investors are generally charged the same product fees, but some proportion of these fees may be rebated to the investor depending on the planner remuneration agreed between the planner and the client. Where an adviser charges fee for service, the planner would generally rebate their share of the product fees back to the client. In theory the retail investor and planner can negotiate the remuneration, although we understand that most investors are generally charged the maximum.

395 Platform fees can cost around 2 to 3% annually of the value of funds invested (cost may exceed 4% when planner fees are included).[69] But this varies, and average fees would be much lower.

Financial advice and planning industry

396 The financial advice industry is not a homogenous group and financial advice comes from many different types of sources: financial planners, stockbrokers and accountants.

Note: There is also some misalignment between the common usage of the term 'financial adviser' and the legal concept of 'provider of financial product advice'. As a matter of law, a broad range of persons provide 'financial product advice': see Appendix 2. The industry data in this section relates to the financial advice industry as that term is commonly understood. It does not necessarily capture all persons within the legal definition of 'provider of financial advice' e.g. it does not necessarily cover call-centre staff of a product manufacturer.

Size of the industry

397 Australia currently has 749 adviser groups operating over 8,000 practices and employing around 18,200 people.[70] Since 2003-04, employment in the

[69] Choice March 2008, *Wraps & master trusts: What are the fees?* (online) - http://www.choice.com.au/viewArticle.aspx?id=104561&catId=100268&tid=100008&p=5&title=Wraps+%26+master+trusts

[70] Rainmaker Information, *The Australian Financial Planning Report, Volume 2, No. 1*, January 2009, p.1.

sector has increased at an annual average rate of 5%.[71] Industry revenue for the 2008-09 financial year is expected to be $4.36 billion, an estimated fall of 18.1% compared to 2007-08.[72]

398 The growth of this industry has been fuelled by the Australian superannuation system (and its associated tax advantages) and retail investor wealth accumulation.

Table 15: Size of the industry

Retail funds under advice	Amount: $ 515 billion[73] Annual average growth over five years: 18.2%
No. of advisor groups	749
Number of advisors	18,212
Number of clients	The average financial planner has 380 clients, of whom 40% are advised regularly and on a face-to-face basis.[74]

Sources: Rainmaker; Financial Planning.

Structure of the market

399 The financial planning industry emerged in the 1980s largely from the life insurance industry. Larger dealer groups and banks dominate the market with the top twenty dealer groups holding approximately 50% market share. The largest individual players by number of advisers are Professional Investment Services (1,511 advisers), AMP Financial Planning (1,314 advisers), Count Wealth Accountants (873 advisers) and Commonwealth Financial Planning (730 advisers). The largest adviser groups are ING-ANZ (1,706 advisers), AMP Group (1,620 advisers), Aviva Group (1,574 advisers), AXA Australia (1,315 advisers), NAB (1,281 advisers) and Commonwealth Bank (1,174 advisers).[75] The industry is diverse in its remuneration models, relationship with product issuers and standard of advice provided.

400 The following different business models operate in the industry:

(a) Medium to large sized ‘dealer groups’ that often operate like a franchise where the licensee offers back office support. The advisers operate as

[71] Rainmaker Information, *The Australian Financial Planning Report, Volume 2, No. 1*, January 2009, p.9.
[72] IBIS World Industry Report, Financial Planning & Investment Advice in Australia, May 2009, p.5
[73] Rainmaker Information, *The Australian Financial Planning Report, Volume 2, No. 1*, January 2009, p.3
[74] Jo-Anne Bloch, ‘The future of financial planning’, *Financial Planning*, 9 December 2008 (http://www.financialplanningmagazine.com.au/article/The-Future-of-Financial-Planning/433166.aspx).
[75] Rainmaker Information, *The Australian Financial Planning Report, Volume 2, No. 1*, January 2009, p.11, 15.

authorised representatives who retain a right to take clients with them if they move to another licensee. The licensee is paid a proportion of the remuneration made by the authorised representative. Example: AMP Financial Planning.

(b) Institutional-owned financial adviser firms with employed advisers. Advisers in bank owned financial adviser firms are generally employed by the bank. Advisers are paid a proportion of the commissions earned or salaries or a combination of both. Example: Westpac Financial Planning.

(c) Smaller firms that have their own licence and might outsource compliance functions to specialist dealer services providers such as Paragem Partners or to large dealer groups who provide dealer to dealer compliance services. Example: Securitor.

401 Because of a view that clients' demand for financial advice will increase over the next 12 months[76], experienced advisers are currently in high demand by advisory firms (notwithstanding the market downturn) and, as a result, are highly mobile.

Advisers play a role in product distribution

402 Approximately 85% of financial advisers are associated with a product manufacturer, so that many advisers effectively act as a product pipeline for a product manufacturer.[77] Of the remainder, the vast majority receive commissions from product manufacturers. There is a sales culture in the advice industry. While advisers provide advice services to clients, in most cases they are also the sales force for financial products, on which product providers and investment managers earn fees.

Remuneration models

403 Financial advisers receive a mix of salaries, 'fees for service', bonuses and commissions. The FPA has identified the most common remuneration models to be hourly rate/time-based charging; service-based charging; asset-based charging; commission; and subsidised advice.[78] Different dealer groups work on different models.

404 Because an explicit fee for service would likely be perceived by retail investors as high in relation to the value of advisory services, most financial advisers tend to charge low or zero fees for service, in order to encourage business. They then get remuneration indirectly by receiving commissions from product manufacturers on the funds invested by retail investors.

[76] The Inaugural 2009 Financial Planning Education Trends Survey (April 2009) http://www.kaplanprofessional.edu.au/cms/data/live/resources/marketing/media/200905_EdTrendsSurveyReport.pdf
[77] IBISWorld Industry Report, Financial Planning and Investment Advice in Australia: K7515 (22 May 2009), p. 7.
[78] *Financial Planning Magazine*, 'Proactive response to remuneration paper', June 2009, p 11.

Product manufacturers recover the costs of commissions from the overall charges within the investment products.

405 Trailing commissions (usually 0.6% of account balances) are the main remuneration method for financial planners, with seven in ten planners citing them as a form of remuneration.[79] Other forms of remuneration include initial commission on new investment/contribution (up to 4-5% of contributions), volume bonuses (i.e. additional commission of up to 0.25% of account balances), and fee for service charged to the client (up to 1% of account balance, or a flat fee, perhaps related to the hours involved). These amounts would not all be paid at the maximum level.

406 Trailing commission are more common among aligned independent and aligned planners, while bank-based planners favour up-front commissions.[80]

407 Remuneration models vary across organisations and according to the market segment to which a client belongs. Low to mid-wealth clients tend to pay initial and trail commissions, while 'high net worth' and 'affluent' clients tend to pay a greater proportion of service fees as a percentage of assets invested, or flat dollar adviser fees.[81] This is most likely because wealthy clients are more sophisticated about how much advice is costing, and more able to negotiate fees than less-wealthy clients. (Wealthy clients tend to receive sophisticated treatment and periodic reviews from their advisers, while smaller customers tend to be offered simple strategies, packaged products and one-off sales. Again, this segmentation is likely based on both customers' needs and ability to pay.)

408 Revenue from fixed-rate and hourly-rate fee for service was 16% of total planner revenue in 2008.[82] Independent planners have a higher proportion of fee for service arrangements than bank planners, with around 13% of independent planners deriving over half of their revenue from pure fee for service in 2008, compared to 6% of aligned planners and 1% of bank planners.[83] 48% of bank planners did not derive any revenue from pure 'fee for service' in 2008 (and 9% of all practices).[84]

409 Planners deriving most of their revenue from pure fee for service spend almost half (47%) of their time with clients planning for financial and lifestyle goals, and put less of their client portfolios into managed funds and more into direct equities. Planners deriving no revenue from pure for fee service were more risk-oriented.[85]

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[79] ASX, *Financial Planners Market Research*, July 2006, p.12.
[80] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.28.
[81] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.89.
[82] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.10.
[83] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.11, 12.
[84] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.40.
[85] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.12, 13.

410 Planners expect to derive a greater proportion of practice revenue from pure fee for service within the next three years,[86] with planners expecting revenue from pure fees for service to rise to 25% of all revenue by 2011.[87]

Role of platforms

What are platforms?

411 A platform is an administration facility that simplifies acquisition and management of a portfolio of investments.

412 Platforms allow retail investors to purchase a range of investments through the one facility. In one sense platforms are like a department store where you can choose from different brand names and products in the one place, rather than having to visit a number of specialty stores.[88]

413 Retail investors are generally put into platforms by their financial planner. The main advantage to planners is that the platform consolidates the reporting on each of the client's investments and makes it more efficient for the planner to monitor their client's portfolio.

414 As investors' funds are pooled together in platforms, they are also effectively buying in bulk, enabling them to increase their buying power and gain access to products normally sold to wholesale investors and at prices normally reserved for wholesale buyers. For example, wholesale funds generally require a minimum investment of $500,000, which usually puts them beyond the reach of a retail investor. However, where many retail investors' funds are pooled in a platform, they can access these products at a wholesale price.

415 A platform provider charges fees for providing the platform service to the investor. The investor will also pay the relevant fee for the specific investments they choose on the platform. These fees are deducted from the client's investment.

416 The two most common types of platforms are:

(a) master trusts – a master trust operates as a managed investment scheme. In a master trust the platform operator (or trustee) owns all the assets and the investors hold units in the managed investment scheme; and

(b) wrap accounts – a wrap account allows the investor to set up a portfolio of investments where the investment is made in the name of the wrap account operator (or custodian) but the investor has a specific beneficial

[86] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.19.
[87] Investment Trends, *October 2008 Planner Business Model Report*, April 2009, p.27.
[88] CommSec uses this analogy to explain platforms on its website: <https://funds.comsec.com.au/Public/Platforms/WhatIsAPlatform.aspx>

interest in the assets reflected in the records of the wrap account operator (or custodian). This structure is increasing in popularity. The service 'wraps' or combines investments into a single account to facilitate the management of an investment portfolio.

Note: The use of terminology in this area is not always consistent. The terms 'platforms', 'investor directed portfolio services' (IDPS), 'master trusts' and 'wraps' are often used interchangeably.

Significant proportion of retail investment through platforms

417 A substantial amount of retail investment is made through platforms. Around $55.2 billion of funds are under administration in wrap accounts, around $43.9 billion in investment master trusts, around $191.2 billion in superannuation master trusts and around $70.0 billion in allocated pension master trusts.[89]

418 In 2008, approximately 78% of new investments placed by financial planners was through platforms.[90]

Links between product manufacturers, planners and platform providers

419 There are significant links between product manufacturers, financial planners and platform providers.

420 Most large financial planning firms (i.e. dealer groups) are owned by diversified financial services groups that also include funds management entities (i.e. product manufacturers).

421 It is common practice for financial planning firms in these groups to receive a significant proportion of their revenue in the form of fees and commissions from related product manufacturers. According to ASIC research, some financial planning firms receive over 75% of their revenue from related product manufacturers.

422 There are also links between platform providers and diversified financial institutions (which include dealer groups and product manufacturers): for example see Table 14 which shows that most of the top 10 fund managers are related to the top 10 platform providers.

423 Large diversified financial institutions often own their platforms. Some also have an 'in-house' branded platform that they allow other institutions to use.

424 Platform providers also may charge product manufacturers fees to have their fund on the platform. These are called shelf-space fees. Some platform

[89] Morningstar, *Market Share Report*, September Quarter 2008.
[90] Investment Trends, *Planner Technology Report*, October 2008, p.10.

providers claim that shelf-space fees are charged on a cost-recovery basis only (e.g. to cover the administrative costs of researching the fund before it is placed on the platform).

Who accesses advice?

425 Not all investors can, or do, obtain advice from financial advisers. Available figures indicate that between 22% and 34% of adult Australians access financial advice.[91] Use of financial advisers appears to increase with age.[92] According to the Australian Government's Financial Literacy Foundation, most clients seek advice about tax and investments and relatively few clients seek advice about superannuation and 'change in life' type situations. Typically, financial advisers do not provide services to clients with small sums to invest. Those who obtain financial advice tend to be older with higher levels of investible assets.[93]

Stockbrokers

Quantitative overview

426 The investment banking and stock brokerage industry generated revenue of around $9.34 billion in 2007-08. [94]

427 The industry in 2007-08 comprised around 235 businesses employing around 17,800 people.[95]

428 Retail clients accounted for approximately 17% of cash equity market trades by value in 2008, down from around 25% in 2000.[96] This is largely a result of institutions' increasing use of algorithmic trading.

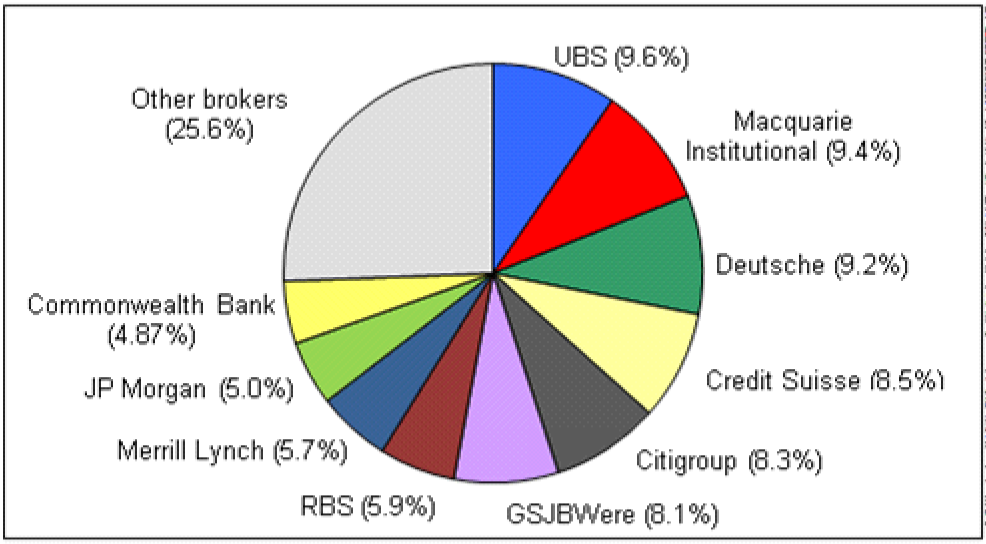
Industry structure and ownership

429 The largest brokerages are arms of large financial services firms. Competition in the industry is quite high; no single brokerage business has

[91] See for example Financial Planning Association, Consumer Attitudes to Financial Planning (2007) (22% of Australians aged 16 and over); ANZ, Survey of Adult Financial Literacy in Australia (2008), p. 89 (34% of Australians aged 18 years and over) and Bloch, Jo-Anne, 'The Future of Financial Planning', *Financial Planning Magazine*, 9 December 2008 (32% of adult Australians).
[92] ANZ, Survey of Adult Financial Literacy in Australia (2008) at p.89 found that of the 34% of respondents who had consulted a financial planner, 48% were aged 55-69. Respondents aged 18-24 years comprised only 13%. The Financial Planning Association's 'Consumer Attitudes to Financial Planning' (2007) found that 7% of respondents aged 16-24 had consulted a financial planner, increasing to 21% of those aged 25-34, 23% of those aged 35-49 and 29% of those aged 50 or over.
[93] Financial Literacy Foundation, 'Financial Literacy, Australians Understanding Money', 2007, p32
[94] IBISWorld, Investment Banking and Securities Brokerage in Australia, 8 April 2009, p.4.
[95] IBISWorld, Investment Banking and Securities Brokerage in Australia, 8 April 2009, p.4.
[96] IRESS

an overall market share greater than 10%. Figure 6 shows the current market shares of the main brokerages, by percentage of total value of shares traded on ASX markets, for the period 1 January 2009 to 30 June 2009.

Figure 6: Industry market share



Source: IRESS; ASIC

430 However, because the services required by institutional (i.e. wholesale) and retail investors are different, brokers generally tend to serve these two broad sets of customers separately.

431 Institutional brokerage is dominated by investment banks, which offer their clients a full range of financial services. The top ten brokerages, by value of shares traded on behalf of institutional clients on ASX markets, for the period 1 January 2009 to 14 April 2009, were: UBS, Macquarie Securities, Credit Suisse, Deutsche Bank, GSJBWere, Citigroup, RBS, Merrill Lynch, JP Morgan, and Morgan Stanley. Together, they account for around 75% of the value of all shares traded on ASX markets.

432 The top retail brokerages are currently: CommSec, E*Trade, Macquarie, Westpac, Bell Potter, Findlay, Patersons and Austock. Many investment banks also operate retail services under the labels 'private client', 'wealth management' or 'private wealth management'.

433 Concentration in the retail stockbroking industry is increasing, as larger firms gain market share through acquisitions. For example, CommSec has purchased IWL and Sanford, while ANZ has purchased E*Trade. CommSec's share of the online trading market has now increased from 9% in 2002 to an estimated 50% in 2008.[97]

[97] IBISWorld, Investment Banking and Securities Brokerage in Australia, 8 April 2009, p.8.

434 Consolidation has likely been driven by the economies of scale made possible by on-line trading, and the need to cut costs during the current economic downturn. Changes to the ASX's liquid capital requirements – requiring brokers to increase their liquid capital reserves from $100,000 to $2 million from January this year – may have encouraged consolidation as well.

435 Continuing pressure on revenues from the economic downturn, and the future need for brokers to set aside liquid capital reserves of at least $10 million, will continue to encourage consolidation in the industry.

Business models and practices in the retail market

436 Online brokers provide retail investors with convenient, advice-free brokerage services at low rates, enabling them to buy shares and derivative instruments directly.

437 Traditionally, competition in the retail client stockbroking market is based on brand name, advisory services, company and industry research, product offerings and exposure to initial public offerings.[98] In order to increase their market share, online brokers are now also offering additional products and services to their clients, including market information (e.g. market depth, charts) and access to managed funds, margin lending facilities and cash management trusts.

438 For a higher charge, full-service brokers offer their clients a range of services in addition to those offered by the online brokers.

Remuneration models

439 Brokerages generally earn commission on the trades that they execute on behalf of their clients. This commission may either be a flat fee per trade, or some percentage of the value of the trade.

440 Commissions paid by retail investors for on-line equities trades range from $15-$30 for trades under $30,000 in value, and 0.10-0.12 percentage points of the value traded for trades greater than $30,000. Full-service retail brokerages' charges are slightly higher, at between $20-$70 for equities trades less than $15,000 in value, and a sliding scale for trades over $15,000 in value.[99]

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[98] IBISWorld, Investment Banking and Securities Brokerage in Australia, 8 April 2009, p.12.
[99] For example: for trades with value $0-$15000 = $69.95; with value $15001-$55000 = 0.40% of the value traded; with value $55001-$1 million = 0.35% of the value traded; with value over $1 million = 0.13% of the value traded.

441 The nature of a retail investor's order will also influence the brokerage's remuneration. Where a trade is ordered through a 'white label'[100] broker, who sends the orders on to a larger broker for execution, remuneration is often a flat fee of $6-$100 per trade, according to the volume and value of trades and the type of transaction.

442 Institutional clients' larger trading volumes and greater bargaining power give them cheaper access to brokerage services. Institutional clients are usually only charged percentage commission. Commissions charged have been estimated to average around 0.01-0.25% of the value traded.[101] Large institutions receive discounts and rebates when they reach threshold levels of trading commissions paid to brokerages.

443 Like most salaries in the financial services industry, stockbrokers' salaries tend to have both a base and a performance component, so that remuneration tends to move in line with revenues and profits, which in turn are strongly influenced by the business cycle.

444 Institutional brokers tend to pay a salary with a year-end bonus being a significant portion of remuneration.

445 Retail brokers vary widely in their approach with some having remuneration structures similar to institutional brokers while at others remuneration is 100% based on brokerage written. Some firms have gone further and employ sales staff effectively as sole traders who receive brokerage direct from the client and then pay the firm for administration and management costs.

446 The smaller the business is, the more likely it is to compensate sales staff on the basis of brokerage written, with 'white label' brokers almost exclusively on this model.

Industry performance

447 The volume of retail investor trading on market is related to the performance of the market and alternative investments, which in turn is related to growth in the economy and financial conditions, such as the level of interest rates. Industry performance is positively related to the volume and value of market turnover, and so will tend to be cyclical.

448 Total industry revenue grew strongly over the three years from 2004-05 to 2006-07, rising from around $5.4 billion to around $9.84 billion – an annual average increase of 35%. Difficult economic and financial conditions,

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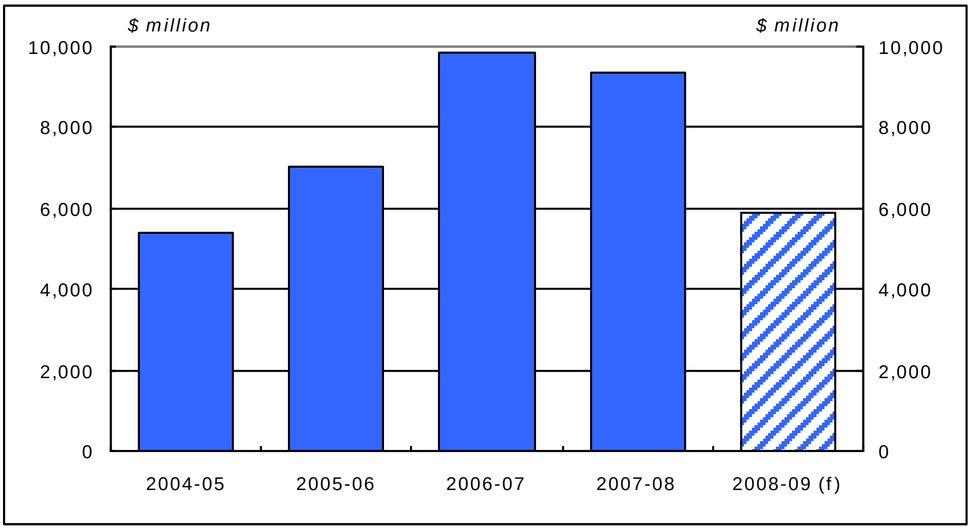
[100] A 'white label' market participant is a holder of an Australian Financial Services licence who has an arrangement for execution and settlement services with an ASX or SFE participant with respect to financial products traded on those exchanges.
[101] The Trade, Issue 19, January – March 2009, p37.

falling household wealth and greater financial uncertainty caused revenue growth to stall in 2007-08, with revenue falling 5% to $9.34 billion (see Figure 7).[102]

Figure 7: Revenue flowing to the stockbroking industry



Source: IBISWorld, *Investment Banking and Securities Brokerage in Australia*, 8 April 2009, p. 4.

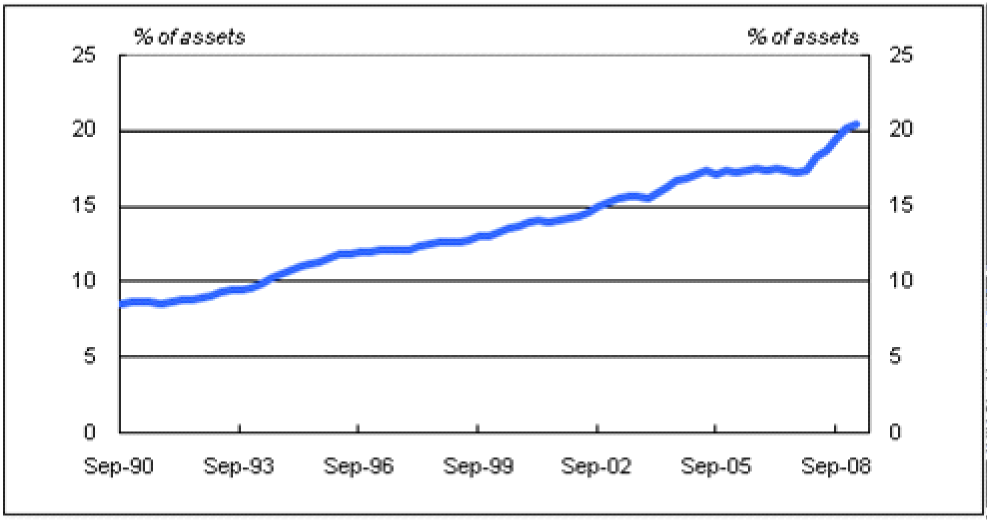
449 IBISWorld expects revenue to fall 37% in 2008-09 to around $5.9 billion, as difficult economic and financial conditions continue. Employment in the stockbroking industry is expected to fall by around 12% in 2008-09 to around 15,700 people.[103]

Retail investment credit

450 Australians have been steadily increasing the amount of debt they hold relative to their assets: see Figure 8.[104] The majority of this debt relates to housing.[105] This has been associated with strong house price inflation driven by a number of factors, including population growth, supply constraints and the tax treatment of residential property investment.

[102] IBISWorld, *Investment Banking and Securities Brokerage in Australia*, 8 April 2009, p.4.
[103] IBISWorld, *Investment Banking and Securities Brokerage in Australia*, 8 April 2009, p.4.
[104] According to the RBA Bulletin Statistical Table B21, the amount of household debt as a percentage of household assets has steadily increased over the period September 1990 until September 2008.
[105] RBA Bulletin Statistical Tables B21, Bulletin Statistical Tables, Data updated to 8 July 2009, http://www.rba.gov.au/Statistics/Bulletin/index.html

Figure 8: Australian household debt as a proportion of assets



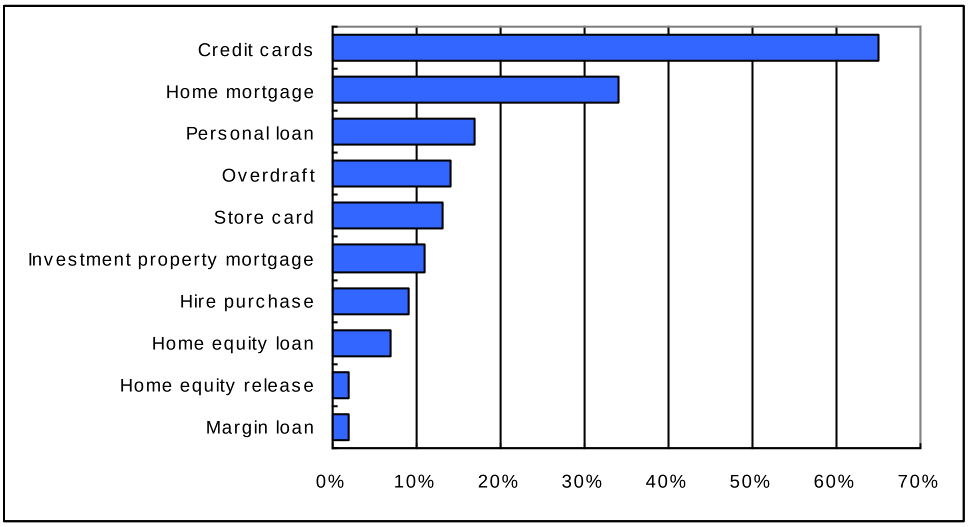
Source: Reserve Bank of Australia, RBA Bulletin, July 2009

451 As at June 2009, Australians had borrowed $1,181 billion for owner-occupied housing, investment properties, and other personal spending.[106]

452 According to ANZ's 2008 study of financial literacy, 55% of respondents said they had not borrowed any money during the previous 12 months.[107] (However, they may have loans taken out more than 12 months ago). The incidence of loan products in ANZ study was: credit card (general) (65%), store card (13%), mortgage on own home (34%), mortgage on investment property (11%), personal loan (17%), line of credit or overdraft (14%), lease or hire purchase agreement (9%), home equity loan (7%), margin loan (2%) and equity release product (2%) (see Figure 9).[108]

[106] Reserve Bank of Australia, *Financial Aggregates,* Table 2.
[107] ANZ Survey of Adult Financial Literacy in Australia (2008), p.43. Note: Respondents were asked 'Which of the following, if any have you personally used to borrow money from in the last 12 months for any purpose?' Of a randomly selected subset in the 2008 ANZ study (n=1162) 55% claimed not to have borrowed from any source (only 24% from a building society, bank or credit union). Whilst of the full sample in the same study (n=3500) 65% claim to hold a credit card. Respondents may not consider holding a credit card borrowing in the last 12 months, hence, the use of lending sources used in the last 12 month may be understated, in particular credit card suppliers.
[108] ANZ Survey of Adult Financial Literacy in Australia (2008 p.41).

Figure 9: Retail investors – sources of borrowing



Source: ANZ Bank, *ANZ Survey of Adult Financial Literacy in Australia*, 2008, p. 43.

453 The lending sources used most often in the last 12 months in ANZ's 2008 study of financial literacy were mainstream financial institutions (24%), family and friends (14%), store loans/retailer finance (10%) and finance companies (7%).[109]

Margin Loans

454 A standard margin loan allows the purchase of leveraged investments in listed securities (for example, shares and managed investments) and unlisted securities (typically interests in managed investment schemes). The 'margin' refers to the margin of equity that lenders require to be maintained by the borrower, being the positive gap between the amount of the loan and the value of the securities.

455 In practice, margin loans are only available to fund purchases of securities 'approved' by the lender (i.e. those that the lender regards as acceptable from a risk and liquidity perspective). Lenders generally apply a different LVR (loan-to-value ratio) or margin depending on the quality of the securities.

456 Storm was distinctive in that it developed a business model to encourage clients to borrow based on their total assets and invest in Storm-badged index funds. Storm recommended that clients use assets including other shares, superannuation (if they were able to access it), equity in their homes and property investments to increase the security for the margin loan and therefore maximise the amount that clients could borrow to invest.

[109] ANZ Survey of Adult Financial Literacy in Australia (2008 p.43).

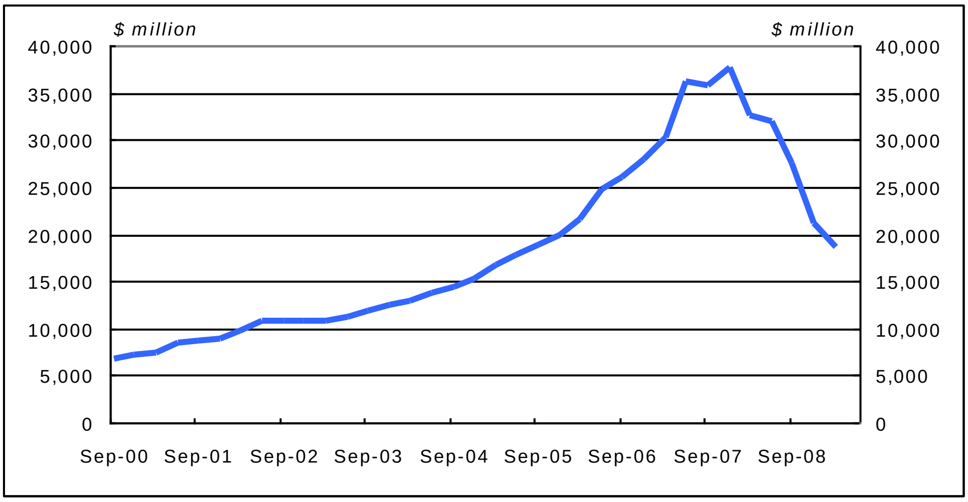
457 The distinctive feature of the Opes business model was that it enabled retail clients to engage in securities lending, an arrangement that is usually only entered into between wholesale parties. From the clients' perspective the securities lending arrangement with Opes had the same commercial effect as a margin loan, that is, the clients accessed cash, using their securities as 'collateral'. However, the legal effect was quite different because title to clients' securities was transferred to Opes, rather than mortgaged in favour of Opes. The use of securities lending, by retail investors, as a means to access cash, using securities as collateral is not common.

Industry Performance

458 As at February 2009, aggregate margin lending constituted around 2% of the total loan portfolio of Australian authorised deposit-taking institutions.[110] Even at its peak the sums involved in margin lending constituted a minor percentage of domestic market equity capitalisation at nearly 2.5%.[111]

459 The value of margin lending increased from $6.7 billion in September 2000 to its peak in December 2007 at $37.8 billion, a rise of 460%, but by March 2009 had fallen by 51% to $18.7 billion. Overall, the value of margin lending increased by 177% from September 2000 to March 2009 (see Figure 10).[112]

Figure 10: Margin lending – value



Source: Reserve Bank, *Reserve Bank Bulletin*, May 2009, Table D10.

Product Providers

460 Different lenders focus on different distribution channels. The main margin lenders providing loans directly to clients are CommSec, St George, ANZ

[110] APRA Opening Statement, John F. Laker, Senate Standing Committee on Economics, Canberra, 4 June 2008.
[111] APRA Opening Statement, John F. Laker, Senate Standing Committee on Economics, Canberra, 4 June 2008.
[112] Reserve Bank, Reserve Bank Bulletin, June 2009, Table D10.

and BT. The main margin lenders used by stockbrokers are Leveraged Equities, Macquarie, St George and ANZ. The main margin lenders that provide loans through financial planners are Colonial Geared Investments, NAB, Macquarie and BT.[113]

461 There are approximately 20 margin lenders and 1250 advisers of margin loans. Most of these are not direct margin lenders but re-brand the loans of a major bank.

Distribution

462 Retail investors can access margin loans directly, or have their access intermediated through an online brokers, a full service broker, or a financial planner.

463 There is no available data on which channel is the most popular. However, a survey of 8,000 investors by Clime Asset Management found that more than 45% consulted a full service broker.[114]

[113] Investment Trends December 2008 Margin Lending Report: Investors, published March 2009, p. 9.
[114] 'Mums and dads might know best after all' The Sydney Morning Herald (print weekend edition) April 12-13 2008.

Appendix 2: Legislative framework

Introduction

464 This appendix sets out the key requirements of the legislative framework in the areas covered by the Inquiry's terms of reference. It covers:

(a) Licensing framework;

(b) Disclosure obligations;

(c) Regulation of financial advice;

(d) Consumer protection provisions;

(e) ASIC's surveillance and investigations powers; and

(f) Credit regulation.

465 This appendix is not a comprehensive description of the regulation of financial services in Australia. There are a number of exceptions that apply in specific circumstances to the general provisions of the Corporations Act set out below. In general, the description below does not refer to those exceptions.

Key concepts in the FSR regime

466 Table 16 summarises key concepts in the FSR regime in Australia. More detail can be found in the Corporations Act and the *Corporations Regulations 2001* (Corporations Regulations).

Table 16: Key concepts in the FSR regime

Concept	Definition	Legislation reference
Financial product	A 'financial product' is a facility that allows a person to make a financial investment, manage a financial risk or make non-cash payments. A financial product includes any of the following: • shares; • debentures; • interests in a managed investment scheme; • derivatives; • general insurance; • life insurance; • superannuation; • basic deposit products; and • retirement savings accounts (RSAs). Credit, including margin loans, is not a financial product for the purposes of the FSR regime in Chapter 7 of the Corporations Act.	Division 3 of Part 7.1, Corporations Act. Regulations 7.1.03A, 7.1.04, 7.1.04A, 7.1.05, 7.1.06, 7.1.06B, 7.1.07, 7.1.07A–7.1.07H, Corporations Regulations.
Financial service	Generally, a person provides a 'financial service' if they: • provide financial product advice; • deal in a financial product; • make a market for a financial product; • operate a registered managed investment scheme; or • provide a custodial or depository service.	Division 4 of Part 7.1, Corporations Act.
Financial product advice	A recommendation or a statement of opinion, or a report of either of those things constitutes 'financial product advice' if it is: • intended to influence a person's decision in relation to financial products; or • could reasonably be regarded as intended to have such an influence.	Section 766B, Corporations Act. Regulation 7.1.08, Corporations Regulations.
Deal in a financial product	The following conduct (or arranging for a person to engage in the following conduct) may constitute 'dealing' in a financial product: • applying for or acquiring, issuing, varying or disposing of a financial product; or • underwriting securities or interests in managed investment schemes.	Section 766C, Corporations Act. Regulations 7.1.34-7.1.35A, Corporations Regulations.

Concept	Definition	Legislation reference
'Wholesale' and 'retail' clients	General insurance, superannuation and RSAs, or services in relation to these products, are provided to an individual as a retail client. Financial products, or financial services relating to products, other than general insurance, superannuation or RSAs, are provided to a person as a retail client unless, the person is: • a person purchasing a financial product, or a financial service related to a financial product, where the value of the product is above the prescribed threshold (currently set by the regulations at $500,000); • a person with certified net assets of at least $2.5 million or a person who had a gross income for each of the last two financial years of $250,000; or • a 'professional investor'. This category includes financial services licensees, listed entities, banks and friendly societies, and other entities that may be presumed to have the expertise or access to professional advice to justify their being treated as wholesale. A person who falls within one of the above categories and to whom a financial product, or financial service relating to a product, other than general insurance, superannuation or an RSA is provided, is generally a wholesale client.	Section 761G, Corporations Act. Regulations 7.1.11–7.1.28, Corporations Regulations.

Note: There are a number of exceptions that apply to the general definitions in this table.

Licensing framework (TOR 5)

Obtaining an Australian financial services licence

467 A person who carries on a financial services business in Australia must obtain from ASIC an AFS licence that covers the provision of the relevant financial services,[115] unless an exemption applies.

468 A key exemption is for those who provide services as a representative of an AFS licensee (i.e. the licensing regime focuses on the licensee rather than the individuals who act on behalf of the licensee). Representatives are employees, directors or authorised representatives (including corporate authorised representatives) of the licensee. ASIC does not approve individual representatives. However, ASIC does maintain a public register of licensees and authorised representatives (but not employees) of licensees.

469 ASIC must grant an AFS licence if:

(a) the application is made properly;

[115] Subsection 911A(1), Corporations Act.

(b) ASIC is satisfied that the applicant or the applicant's responsible managers are of good character;

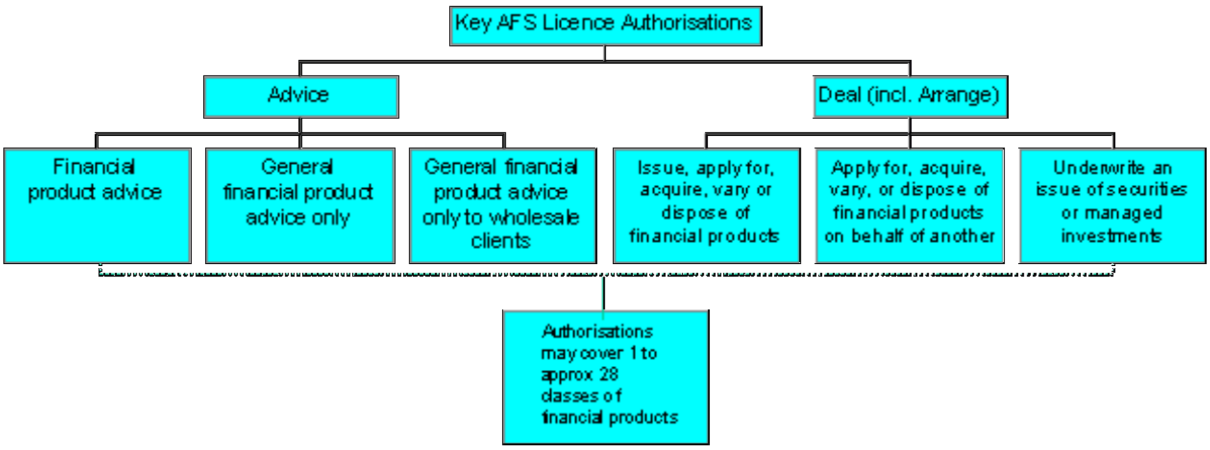
(c) ASIC has no reason to believe that the applicant will not comply with licensee obligations; and

(d) the applicant has provided ASIC with any additional information requested for the purposes of assessing the application.[116]

470 ASIC cannot refuse an application for an AFS licence for reasons beyond the above-specified criteria (e.g. ASIC cannot refuse to grant a licence on the basis of the licensee's proposed business model). ASIC cannot refuse to grant a licence without giving the applicant an opportunity to be heard and a refusal to grant a licence can be appealed to the Administrative Appeals Tribunal (AAT).

471 ASIC may impose conditions on a licence. ASIC imposes conditions on all licences that support the obligations that apply to AFS licensees. A key condition in any licence is the authorisation which sets out the scope of financial services that a licensee is authorised to conduct. The authorisations may permit the licensee to perform one or more financial service and may be further limited by reference to particular financial products. Figure 11 shows the two key licence authorisations. Each authorisation may cover 1 to approximately 28 different classes of financial products, resulting in a multitude of permutations and combinations of financial services offered by licensees.

Figure 11: Key AFS licence authorisations



Conduct obligations

472 Once licensed, AFS licensees are subject to various conduct[117] obligations under the Corporations Act. For example, AFS licensees must:

[116] Subsection 913B(1), Corporations Act.

(a) comply with conditions on their licence and the financial services laws;

(b) provide financial services efficiently, honestly and fairly;

(c) have adequate arrangements to manage conflicts of interest;

(d) ensure representatives (employees, directors and authorised representatives) are adequately trained and competent, and comply with the law;

(e) have adequate resources (including financial, technological and human resources) to provide the financial services covered by their licence and to carry out supervisory arrangements (unless they are regulated by APRA);

(f) maintain the licensee's own competence, skills and experience;

(g) maintain internal and external dispute resolution systems where clients are retail consumers; [118]

(h) maintain adequate risk management systems (unless they are regulated by APRA);

(i) properly handle client money (trust account and audit requirements);

(j) notify ASIC of significant breaches;

(k) have adequate arrangements to compensate retail clients for losses (see paragraphs 473–475); and

(l) provide key disclosure documents (see paragraphs 482–496).

Compensation requirements (TOR 8)

473 AFS licensees are required to have arrangements in place to compensate retail investors who suffer loss as a result of the licensee breaching the requirements of Chapter 7 of the Corporations Act.

474 The Corporations Regulations prescribe PI insurance as the standard way to comply with this obligation.[119] The PI insurance must be adequate having regard to the nature of the licensee's business and its potential liability for compensation claims. ASIC can approve alternative arrangements to PI insurance, taking into account the factors set out in the Corporations Act and the Corporations Regulations.[120]

475 The Corporations Regulations also provide exemptions from the requirement to have compensation arrangements for some licensees that are regulated by APRA or related to an entity regulated by APRA.

[117] Sections 912A and 912B and other various obligations in Parts 7.6, 7.8 and 7.10, Corporations Act.
[118] Unlicensed product issuers and secondary sellers must also maintain internal and external dispute resolution procedures: Section 1017G, Corporations Act.
[119] Regulation 7.6.02AAA, Corporations Regulations.
[120] Subsection 912B(3), Corporations Act and regulation 7.6.02AAA, Corporations Regulations.

ASIC's powers under the licensing regime

Conditions

476 ASIC may impose additional conditions on an AFS licence or vary or revoke conditions on an AFS licence. ASIC may only do this on its own initiative after giving the licensee an opportunity to be heard. ASIC's decision is subject to appeal to the AAT.

Licences

477 ASIC may suspend or cancel AFS licences. ASIC can generally only immediately suspend or cancel a licence where the licensee is insolvent or ceases to carry on the business, or on application from the licensee. ASIC can suspend or cancel a licence after giving the licensee an opportunity to be heard where:

(a) the licensee has not complied with its obligations;

(b) ASIC has reason to believe the licensee will not comply with its obligations in the future;

(c) ASIC is no longer satisfied that the licensee is of good fame or character;

(d) a banning order is made against the licensee or a key representative of a licensee; or

(e) the application was materially false or misleading or omitted a material matter.[121]

Banning

478 ASIC may also ban or disqualify persons from providing financial services (after giving the person an opportunity to be heard) on the following grounds:

(a) ASIC suspends or cancels an AFS licence held by the person;

(b) the person has not complied with their obligations as an AFS licensee under s912A;

(c) ASIC has reason to believe that the person will not comply with their obligations their obligations as an AFS licensee under s912A;

(d) the person becomes an insolvent under administration;

(e) the person is convicted of fraud;

(f) the person has not complied with a financial service law; or

(g) ASIC has reason to believe that the person will not comply with a financial services law.[122]

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[121] Sections 915B and 915C, Corporations Act.

479 ASIC may ban or disqualify persons from providing financial services (without giving the person an opportunity to be heard) where the person's relevant licence has been suspended or cancelled under section 915B or where that person has been convicted of a serious fraud.[123]

480 All these decisions are subject to review by the AAT.

Other powers

481 ASIC also has powers to serve notices on AFS licensees and require production of information and books.[124] AFS licensees and their representatives must also provide such assistance as ASIC reasonably requests for the purpose of surveillance of AFS licensees.

Disclosure obligations (TORs 3, 4, 6 and 7)

Financial services guide

482 All providers of financial services (i.e. AFS licensees or authorised representatives) to retail clients must provide a Financial Services Guide (FSG).[125] The FSG provisions are designed to ensure that the client is given sufficient information to enable them to decide whether to obtain the financial services from the providing entity. An FSG must also include information about:

(a) the kinds of financial services the providing entity is authorised to provide under its AFS licence;

(b) who the providing entity acts for when providing the authorised services;

(c) remuneration (including commission) or other benefits connected to providing the authorised services;

(d) other interests, associations or relationships that might be expected to be or have been capable of influencing the providing entity in providing the authorised services; and

(e) dispute resolution systems.[126]

[122] Section 920A, Corporations Act.
[123] Subsection 920A(3), Corporations Act.
[124] See for example, s912C and 912E of the Corporations Act and s30–31 of the ASIC Act.
[125] Section 912E, Corporations Act.
[126] Subsection 942B(2), Corporations Act.

Product disclosure

Offering financial products – Product Disclosure Statements and prospectuses

483 A person who offers financial products (other than securities) to a retail client in Australia may be obliged to provide point-of-sale disclosure through a Product Disclosure Statement (PDS).[127]

484 A PDS must include information about:

(a) significant benefits of the product;

(b) significant risks of the product;

(c) the costs of the product; and

(d) other significant features of the product.[128]

485 Disclosure is also required of certain other material information.[129] The level of information in the PDS is limited to the amount reasonably required by a retail client who is making a decision whether to acquire that product.[130]

486 The PDS is only required to be lodged with ASIC in certain circumstances.[131] ASIC does not approve or authorise PDSs.

487 Disclosure requirements for offers of securities are specified in Chapter 6D of the Corporations Act. The requirements include the need for a disclosure document (such as a prospectus) to accompany offers of securities[132] unless an exemption applies. Prospectuses must include all information that investors and their professional advisers would reasonably require to make an informed assessment of the issuer and the securities being offered and make specific disclosures.[133]

488 Chapter 6D disclosure documents (such as prospectuses) must be lodged with ASIC but ASIC does not approve or authorise these disclosure documents.

489 PDSs and Chapter 6D disclosure documents must be worded and presented in a clear, concise and effective manner.[134]

490 There have been a number of legislative attempts to deal with lengthy and complex point-of-sale disclosure. For example, short-form PDSs were introduced in 2005 to address complex and lengthy disclosure provided in

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[127] Part 7.9, Corporations Act.
[128] Section 1013D, Corporations Act.
[129] Section 1013E, Corporations Act.
[130] Subsection 1013D(1), Corporations Act
[131] Sections 1013I, 1015B, Corporations Act
[132] Division 2 of Part 6D.2, Corporations Act.
[133] Division 4 of Part 6D.2, Corporations Act.
[134] Section 715A and subsection 1013C(3), Corporations Act.

PDSs. A short-form PDS summarises the key information in a PDS (e.g. information about the issuer, benefits, risks, costs, return, dispute resolution and cooling off). It should comply with Division 3A of Part 7.9 of the Corporations Act, as modified by the Corporations Regulations. A short-form PDS can be given instead of a PDS for all products except for general insurance products (where different requirements apply). Short-form PDSs are now offered in the market but not extensively.

491 The FSWG (consisting of ASIC, Treasury and the Department of Finance and Deregulation) was established in December 2007. It is working to simplify point-of-sale product disclosure by focusing on the key features of particular products. It developed a more prescriptive list of form and content requirements for the First Home Saver Account PDS (introduced in 2008). This is to ensure that these PDSs are kept short and consistent, to aid comparability between accounts offered by different providers. The FSWG is now working on disclosure for margin loans.

Stop orders

492 ASIC has power to issue a stop order, which requires a PDS or Chapter 6D disclosure document (such as a prospectus) to be removed from circulation until the defective disclosure is remedied.[135]

Periodic disclosure

493 In addition to the primary obligation to provide a PDS, there are a number of further disclosure obligations that apply to financial products. These obligations include providing a periodic statement to retail clients in relation to financial products that have an investment component.[136]

494 A periodic statement must be provided for each reporting period during which a holder holds the product. The statement must contain all information the issuer of the financial product reasonably believes the holder needs to understand the investment in the financial product.[137] Among other things, the periodic statement must include:

(a) opening and closing balances for the reporting period;

(b) the termination value of the investment at the end of the reporting period;

(c) any increases in contributions in relation to the financial products by the holder or another person during the reporting period; and

[135] Sections 739 and 1020E, Corporations Act.
[136] Section 1017D, Corporations Act.
[137] Subsection 1017D(4), Corporations Act.

(d) details of any change in circumstances affecting the investment that has not been notified since the previous periodic statement.[138]

Statement of advice

495 If personal advice is given to a retail client, the provider (i.e. AFS licensee or authorised representative) must give the client a statement of advice (SOA).[139] An SOA must set out the advice and the basis on which it was given. It must also contain:

(a) the name and contact details of the provider of the advice;

(b) information about remuneration (including commissions) or other benefits that the provider and related or associated persons or entities may receive (these amounts must be disclosed in dollars unless otherwise permitted by ASIC relief); and

(c) information about other interests, associations or relationships that might be expected to be or have been capable of influencing the advice.[140]

496 If the personal advice is or includes a recommendation that the client replace one financial product with another ('switching advice'), the SOA must also include information about:

(a) any charges the client may incur, or any pecuniary or other benefits the client may lose, as a result of the switch; and

(b) other significant consequences for the client of the switch.

Disclosure of remuneration

Commission arrangements

497 The law only requires that fees or remuneration (including commission) are disclosed clearly to consumers. It does not set limits on what can be charged or how it can be charged.

498 The client must be provided with an FSG that contains information about the remuneration (including commission) or other benefits to be received by the providing entity (or a related body corporate or a director or employee of the providing entity or an associate of any of the these parties).[141] If the client is given personal advice, the client also receives an SOA, which contains information about the remuneration (including commission) or other benefits to be received by the providing entity (or any of the above-mentioned

[138] Subsection 1017D(5), Corporations Act.
[139] Subsection 946A(1), Corporations Act.
[140] Subsection 947B(2), Corporations Act.
[141] Paragraphs 942B(2)(e) and 942C(2)(f), Corporations Act.

associated parties) that might reasonably be expected to influence the advice provided.[142] The PDS is required to include information about the cost of the product and the cost of commissions or other payments that may impact returns.[143]

Specific advertising disclosure

499 Where advertisement or promotional material about a financial product is reasonably likely to induce people to acquire the financial product, the material must identify the issuer of a product and refer potential buyers to the PDS. [144] There are also restrictions under Chapter 6D on advertising offers of securities.[145] The consumer protection provisions of the ASIC Act are also relevant to the regulation of advertisements and promotional material: see paragraphs 511–512.

500 If ASIC believes an advertisement is misleading consumers, we may place an interim stop order on the advertisement, or on the related prospectus or PDS, which is effective immediately and can last for 21 days.[146]

501 ASIC must give any interested party an opportunity to be heard before issuing a final stop order.[147]

Regulation of financial advice (TOR 1)

502 Financial product advice is a broad concept under the FSR regime: see Table 16. The breadth of the definition means that, as a matter of law, providers of financial product advice (advisers) include:

(a) persons who provide general advice about one or more products (e.g. tellers at a bank);

(b) persons who provide personal advice about one or a limited range of products, often products issued by their licensee (e.g. call centre staff of a product issuer or stockbrokers); and

(c) persons who provide financial advice about a broader range of products (e.g. financial planners).

503 There are two types of financial product advice: personal advice and general advice. ‘Personal advice’ is financial product advice given to a person when the provider of advice has considered the objectives, financial situation and

[142] Paragraphs 947B(2)(d) and 947C(2)(e), Corporations Act.
[143] Paragraph 1013D(1)(d), Corporations Act.
[144] Division 4 of Part 7.9, Corporations Act.
[145] Section 734, Corporations Act.
[146] Subsections 739(3) and 1020E(3), Corporations Act.
[147] Subsection 739(2) and section 1020E, Corporations Act.

needs of the person, or when the person might reasonably expect that the provider has considered these matters.[148] All other advice is general advice.

504 Advisers must comply with specific advice conduct and disclosure obligations when dealing with retail investors. These conduct and disclosure obligations vary depending on whether the advice is personal or general.[149]

> Note: Unlike the general licensing conduct obligations, these specific advice conduct and disclosure obligations are imposed directly on authorised representatives, as well as AFS licensees. (The licensee still has an overriding obligation to ensure that the authorised representative complies with its obligations.)

General advice warning

505 If general advice is given to a retail client, no SOA is required. However, at the time of giving the general advice and by the same means as the general advice is given, the provider of the advice must give the general advice warning.[150] That is, the provider must warn the client that:

(a) the advice has been prepared without taking account of the client's objectives, situation and needs; and

(b) the client should therefore consider the appropriateness of the advice to their situation before acting on the advice.

506 If an advertisement contains general advice, it must contain the general advice warning.

Personal advice regime

507 If personal advice is given to a retail client, the adviser must comply with the personal advice regime.[151] Under these provisions the following requirements generally apply:

(a) the advice must comply with the suitability rule (see paragraph 508);

(b) the client must be warned if the advice is based on incomplete or inaccurate information about the client's relevant personal circumstances; and

(c) the client must be given an SOA setting out, among other things, the advice and the basis upon which it is given (see paragraphs 495–496).

508 Under the suitability rule, the adviser must:

[148] Subsection 766B(3), Corporations Act.
[149] Part 7.7, Corporations Act.
[150] Section 949A, Corporations Act.
[151] Division 3 of Part 7.7, Corporations Act

(a) determine the relevant personal circumstances of the client in relation to the advice sought and make reasonable inquiries about those relevant personal circumstances;

(b) reasonably consider and investigate the subject matter of the advice in light of the client's relevant personal circumstances; and

(c) ensure that the personal advice provided is appropriate to the client in light of the client's relevant personal circumstances and investigation about the subject matter of the advice.

509 Advisers are not required under the Corporations Act to act in the best interests of the client. However, a fiduciary relationship, requiring the adviser to act in the best interests of their client, might exist between an adviser and client as a matter of general law.

Training standards

510 Under the Corporations Act, AFS licensees need to ensure that their representatives are adequately trained and competent.[152] ASIC has imposed licence conditions which require AFS licensees to ensure that any person who provides financial product advice to retail clients on behalf of the licensee:

(a) has completed appropriate training courses approved in accordance with Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146);

(b) has been individually assessed as competent by an assessor approved by ASIC; or

(c) in respect of financial product advice on basic deposit products, facilities for making non-cash payments that are related to basic deposit products or First Home Saver Accounts issued by an ADI (i.e. FHSA deposit accounts), has completed training courses that are or have been assessed by the AFS licensee as meeting the appropriate level.

Consumer protection provisions (TORs 4 and 7)

511 The ASIC Act provides for additional consumer protections through the prohibition on unconscionable, misleading or deceptive conduct, false or misleading representations, bait advertising, harassment, coercion and pyramid selling of financial products. There are similar provisions in the Corporations Act in relation to misleading statements and conduct.

[152] Paragraph 912A(1)(f), Corporations Act.

512 Table 17 summarises how some conduct may breach provisions in the ASIC Act and Corporations Act and the penalties and other remedies this may attract.

Table 17: Consumer protection legislative provisions

Description of conduct	Section reference	Penalties and other remedies
Making statements that are materially false or materially misleading and are likely to induce persons to apply for financial products in circumstances where the person does not care whether the statement is true or false, or knows, or ought reasonably to have known, that the statement is false. Contravention of this provision is an offence.	s1041E, Corporations Act	Imprisonment (maximum five years) Fine Compensation (s1041I) Injunction (s1324) Other orders Note: References are to the Corporations Act.
Engaging in conduct, in relation to a financial product or a financial service that is misleading or deceptive or is likely to mislead or deceive. Contravention is not an offence, but may lead to civil liability under s1041I.	s1041H, Corporations Act	Compensation (s1041I) Injunction (s1324) Other orders Note: References are to the Corporations Act.
Making representations about future matters if made without reasonable grounds.	s769C, Corporations Act; s12BB, ASIC Act	Compensation (s12GM, ASIC Act) Injunction (s1324, Corporations Act; s12GD, ASIC Act) Other orders
In trade or commerce, engaging in conduct in relation to financial services that is misleading or deceptive or is likely to mislead or deceive. Contravention of this provision is not an offence.	s12DA, ASIC Act	Injunction (s12GD) Order requiring adverse publicity (s12GLB) Other orders (s12GLA and 12GM) Compensation (12GM) Note: References are to the ASIC Act.
In trade or commerce, making false or misleading representations. Contravention of this provision is an offence.	s12DB, ASIC Act	Fine (s12GB) Injunction (s12GD) Order requiring adverse publicity (s12GLB) Other orders (s12GLA and 12GM) Compensation (s12GM) Note: References are to the ASIC Act.

Description of conduct	Section reference	Penalties and other remedies
In trade or commerce, making false representations or engaging in conduct that is misleading in relation to financial products that involve interests in land. Contravention of this provision is an offence.	s12DC, ASIC Act	Fine (s12GB) Injunction (s12GD) Order requiring adverse publicity (s12GLB) Other orders (s12GLA and 12GM) Compensation (s12GM) Note: References are to the ASIC Act.
Engaging in conduct that is liable to mislead the public as to the nature, the characteristics, the suitability for their purpose or the quantity of any financial services. This provision is a strict liability offence.	s12DF, ASIC Act	Fine (s12GB) Injunction (s12GD) Order requiring adverse publicity (s12GLB) Other orders (s12GLA and 12GM) Compensation (s12GM) Note: References are to the ASIC Act.
In trade and commerce, engaging in any bait advertising. Contravention of this provision is an offence.	s12DG, ASIC Act	Fine (s12GB) Injunction (s12GD) Order requiring adverse publicity (s12GLB) Other orders (s12GLA and 12GM) Compensation (s12GM) Note: References are to the ASIC Act.

Hawking

513 The Corporations Act also prohibits a person from offering financial products for issue or sale in the course of, or because of, an unsolicited meeting or telephone call with a retail client. These hawking prohibitions aim to prevent pressure selling of financial products to retail clients (such as badgering and boiler-room practices). [153]

ASIC's surveillance and investigations powers

514 ASIC can commence a formal investigation on the following three grounds:

(a) suspicion of:

(i) a contravention of the corporations legislation;

[153] Sections 736 and 992A, Corporations Act.

(ii) a contravention of a Commonwealth law involving a body corporate;

(iii) unacceptable circumstances occurring in relation to a takeover;

(iv) liquidator misconduct; or

(v) a breach of Part 2 Div 2 of the ASIC Act;[154]

(b) a direction from the Minister who has responsibility for ASIC;[155] and

(c) a report of a receiver or a liquidator.[156]

515 Besides having the powers to serve notices on AFS licensees and others requiring production of information and books noted above (see paragraph 481), ASIC may also issue a notice requiring a person to give ASIC all reasonable assistance and to appear before ASIC for an examination under oath to answer questions.[157] ASIC also has power to issue notices[158] to produce books:

(a) for the purpose of carrying out ASIC's functions and powers set out in the ASIC Act or Corporations Act;

(b) to ensure compliance with the ASIC Act or Corporations Act; or

(c) in relation to a breach or a suspected breach of the ASIC Act, Corporations Act or any other Commonwealth or State legislation.[159]

516 ASIC has formal powers to conduct surveillance checks of managed investment schemes[160] and of AFS licensees.[161]

Credit regulation (Additional TOR)

Current regulation

Consumer credit

517 Currently the UCCC (as enacted in each state and territory) regulates consumer credit, along with the general consumer protection provisions in the ASIC Act (including the prohibitions on misleading or deceptive conduct and unconscionable conduct). The UCCC regulates credit for personal, domestic and household purposes (but not for investment or business purposes).

[154] Subsections 13(1), (2), (3) and (4), ASIC Act.
[155] Section 14, ASIC Act.
[156] Section 15 ASIC Act.
[157] Section 19, ASIC Act.
[158] Sections 30, 31, 32A and 33, ASIC Act.
[159] Section 28, ASIC Act.
[160] Section 601FF, Corporations Act.
[161] Section 912E, Corporations Act.

ASIC regulation

518 Credit is not a financial product for the purposes of the Corporations Act and, therefore, the licensing framework and other requirements do not apply to credit. However, credit is a financial product for the purposes of the ASIC Act and so ASIC has a consumer protection jurisdiction in relation to credit.

Margin lending

519 Margin loans, as credit facilities, are not financial products for the purposes of the Corporations Act and are, therefore, unregulated by the Corporations Act. They are not regulated by the UCCC because margin lending is borrowing for investment purposes. Margin loans are regulated under the ASIC Act.

Proposed reforms

Consumer credit

520 Under the National Consumer Credit Protection Bill 2009, providers of consumer credit will be regulated by the Commonwealth. The regime will cover consumer credit and real property mortgages for owner-occupied homes and mortgages given for residential investment properties. Lending for investment purposes (other than margin lending and lending secured against residential property) will not be regulated until the proposed Phase II of the reforms. Other areas for further potential regulation under Phase II include predatory or undesirable lending practices, unsolicited credit card limit extension offers, interest rate caps and reverse mortgages.

521 All credit providers will be licensed by ASIC and will have to comply with various conduct requirements and disclosure obligations (including a responsible lending requirement). Credit providers will be required to give borrowers a Credit Guide (similar to a PDS) and a Credit Assessment indicating that they do not consider the loan to be unsuitable for the borrower.

Margin lending

522 The Government has released the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, which will make margin lending products a financial product under Chapter 7 of the Corporations Act. This means anyone dealing in or advising on margin loans will need to apply for an AFS licence or a variation to their existing AFS licence, authorising them with respect to margin loans.

523 The Bill regulates both standard margin loans (where credit is provided to purchase marketable securities) and non-standard margin loans (securities lending arrangements).

524 As margin loans will be a financial product, any parties issuing, recommending or offering margin loans will be required to provide clients with a PDS, and advisers providing personal advice about margin loans will need to give clients an SOA.

525 In addition to the existing general conduct obligations imposed on AFS licensees, the Bill also proposes:

(a) a responsible lending obligation on margin lenders. The responsible lending obligation prohibits the issuer from issuing a margin loan where it is unsuitable for the client. The unsuitability assessment is based on the likelihood of a margin call being made and the client being unable to comply with the terms of the margin loan or unable to comply without substantial hardship. Margin lenders will be able to rely on the adviser's inquiries of the client when undertaking the assessment; and

(b) a new obligation on margin lenders to notify clients of margin calls.

526 The FSWG is also developing a short disclosure document for margin lending which will be implemented in the regulations.

Appendix 3: ASIC's activities

Introduction

527 This appendix sets out ASIC's activities in relation to the Inquiry's terms of reference. It provides further information on the outcomes of ASIC's strategic review and how this will impact on planned future activities. It also sets out ASIC's activities in relation to:

(a) licensing;

(b) compliance;

(c) deterrence;

(d) exemption and modification powers;

(e) encouraging compliance with the law; and

(f) educating and informing investors.

Note: This appendix only covers ASIC's activities as Australia's financial services regulator, with a particular emphasis on the financial products and services that are the focus of the Inquiry. ASIC also devotes considerable resources to its roles as Australia corporate and markets regulator.

ASIC's strategic review

About ASIC's strategic review

528 In 2007, ASIC announced a strategic review covering how ASIC performs all aspects of its regulatory functions and responsibilities. The strategic review was one of six priorities for ASIC outlined by ASIC's Chairman to Senate Estimates on 30 May 2007. The results of the review and the timetable for implementation of the changes flowing from the review were announced publicly by ASIC's Chairman on 8 May 2008: see MR 08-93 *ASIC announces results of its strategic review*, 8 May 2008.

529 The aim of the strategic review was to create an ASIC that:

(a) better understands the markets it regulates;

(b) is more forward looking in examining issues and systemic risks;

(c) is clearer in outlining to the market why it has chosen to intervene and the behavioural changes it is seeking; and

(d) has a clearer set of priorities.

ASIC's operational activities prior to the strategic review

530 Prior to the strategic review, ASIC's operational activities were carried out by four directorates:

(a) the Enforcement directorate was responsible for investigating and taking enforcement action against alleged misconduct, including criminal, civil and administrative actions;

(b) the Compliance directorate was responsible for ensuring that companies, AFS licensees, auditors and liquidators were complying with the law;

(c) the Regulation directorate was responsible for setting ASIC's policy on regulating markets and business and for licensing financial market participants. This directorate comprised a number of separate areas including:

  (i) Licensing, the area responsible for ASIC's licensing and registration activities;

  (ii) Advice and Applications, the area responsible for assessing relief applications in relation to financial services and corporate finance activities and, for ASIC's work in relation to takeovers and fundraising; and

  (iii) Regulatory Policy, the area responsible for setting ASIC policies on how it will administer the laws it is responsible for; and

(d) the Consumer Protection directorate was responsible for dealing with issues that affected consumers through compliance, policy and educational work. It also dealt with international issues.

ASIC's operational activities after the strategic review

531 As a result of the strategic review, ASIC made a number of important changes to its structure and operational processes. Some of the more significant changes include:

(a) abolishing the four directorates and replacing them with twelve (now thirteen with the addition of credit) outwardly focused stakeholder and eight deterrence teams covering the financial economy;

(b) establishing an External Advisory panel to provide high level legal advice to the Commission on market developments and systemic risks; and

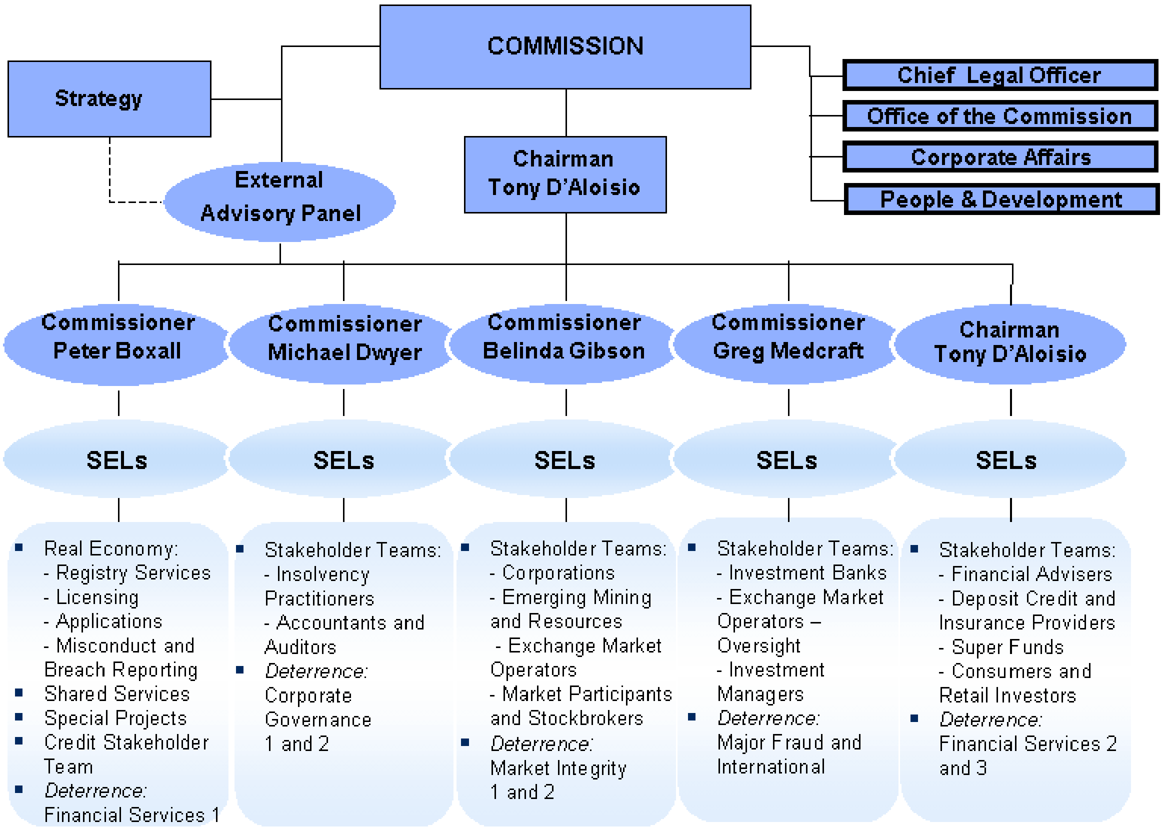
(c) investing more in economic, consumer and industry research.

532 Under the new structure, ASIC has developed a forward program to maintain and build confidence and integrity in Australia's financial markets and financial services industry. Our forward program comprises a number of regulatory, compliance and deterrence activities designed to raise the

standards of the financial services industry and to improve the way ASIC responds to emerging issues.

533 ASIC's new structure commenced on 1 September 2008. Figure 12 is a high level outline of ASIC's new structure.

Figure 12: ASIC's structure



Financial Economy stakeholder teams

534 As stated in paragraph 531(a), one of the major outcomes of the strategic review was removing the four directorates and replacing them with outwardly focused stakeholder and deterrence teams.

535 The stakeholder and deterrence teams are located in the Financial Economy part of ASIC's structure.

536 The Financial Economy teams are outwardly focused, that is, their work focuses on ASIC's stakeholders. This focus means that ASIC is better placed to drive behavioural change and to better understand the external stakeholders it regulates.

537 Each stakeholder team has around 30 people, operating under a national structure. The teams undertake a variety of activities to influence behaviour of participants in the financial economy and bring about positive changes for consumers and retail investors, including:

(a) developing policy and industry guidance;

(b) assisting the financial services industry to understand their legal obligations and the regulator's expectations;

(c) monitoring compliance with the law and promoting behavioural change by conducting surveillances;

(d) intervening in cases where we detect serious non-compliance, particularly where there may be harm to investors or the integrity of Australia's financial markets;

(e) working with industry and other stakeholders to promote higher standards of business conduct and help them to deliver self-regulatory initiatives;

(f) developing consumer protection campaigns and compliance projects; and

(g) delivering information and education products and services.

538 The stakeholder teams will identify specific areas of focus each year and continuously review their priorities to address new and emerging issues and risks.

539 The Financial Economy stakeholder teams most relevant to the Inquiry's terms of reference are:

(a) Financial Advisers;

(b) Consumers and Retail Investors (CARI);

(c) Deposit-Takers and Insurance Providers (DTI); and

(d) Credit.

There are also three financial services deterrence team.

Note: The work of the Investment Managers stakeholder team is relevant to the Committee's Inquiry into Agribusiness Managed Investment Schemes.

Licensing activities (TOR 5)

Assessing licence applications

540 ASIC is responsible for assessing applications for an AFS licence and applications to vary an existing licence (e.g. applications to vary an existing licence authorisation or licence condition). ASIC also has power to impose additional conditions on AFS licences, to cancel AFS licenses and to ban persons from providing financial services.

541 ASIC's licensing activities are performed by the Registry Services and Licensing team, which is located in the Real Economy part of ASIC's structure.

542 The licensing process usually involves three phases. These are:

(a) the pre-lodgement phase: During this stage, an ASIC officer will go through an application prior to it being accepted for lodgement to ensure that the application is properly made in accordance with the Corporations Act and that all the required materials are attached;

(b) the assessment phase: During this phase, an ASIC officer will analyse and assess the application to determine whether to grant an AFS licence, and if so, the appropriate licence authorisations and licence conditions; and

(c) the post assessment phase: During this phase, a Senior Manager will typically review the preliminary decision made by the ASIC officer culminating in a decision in principle being made. If that decision is to grant a licence, the action officer will forward a copy of the draft licence to the applicant. The applicant will then review the draft licence and a final licence will be granted when specified requirements raised by ASIC are satisfied by the applicant. If the application is not approved, an ASIC delegate will inform the applicant and a formal hearing will be scheduled.

Note: ASIC has issued a number of regulatory guides to assist applicants with the licence application process. See: Regulatory Guide 1 *AFS Licensing Kit: Part 1 – Applying for and varying an AFS licence*; Regulatory Guide 2 *AFS Licensing Kit: Part 2 – Preparing your AFS licence or variation application*; and, Regulatory Guide 3 *AFS Licensing Kit Part 3 – Preparing your additional proof*.

543 ASIC uses a risk-based approach in its assessment of licence applications. This helps ASIC determine the level of scrutiny it gives an application. In general, the factors that ASIC takes into account in its risk assessment are the complexity of the licence authorisations being applied for, ASIC's analysis of the kind of business the applicant is undertaking (e.g. financial planning business or issuing financial products) and the market in which the applicant proposes to operate.

544 In deciding whether to grant a licence ASIC considers whether the applicant:

(a) is competent to carry on the kind of financial services business they are applying for;

(b) has sufficient financial resources to carry on the financial services business they are proposing (except where the applicant is an APRA regulated entity); and

(c) can meet the other licensing obligations of an AFS licensee.

> Note: Although licensing focuses on the entity and not the individuals who act on its behalf, ASIC interprets a licensee's statutory obligation to 'maintain competence to provide authorised financial services' by focusing on the people in the business responsible for the quality of the entity's services i.e. by requiring that responsible managers oversee day-to-day decisions about the provision of financial services. ASIC requires responsible managers to demonstrate the appropriate knowledge and skills to engage in the relevant financial services.

545 However, as noted in Appendix 2, ASIC must grant a licence if:

(a) the application has been properly made;

(b) ASIC is satisfied that the person or the applicant's responsible managers are or good fame and character;

(c) ASIC has no reason to believe that the applicant will not comply with the licensee obligations; and

(d) the applicant has provided ASIC with any additional information requested for the purposes of assessing the application.

546 The length of time it takes ASIC to assess an application for a licence varies depending on the quality and nature of the application we receive. The assessment of an application usually involves one or more written or verbal requests for additional information from the applicant, to allow ASIC to make its assessment and so that an applicant is issued a licence with the appropriate authorisations and licence conditions.

547 As a result of this process, we have found that only a small percentage of new licences are granted without modification to the application. For example, for the period 1 July 2007 to 30 June 2008, 88% of applications for new licences granted by ASIC were modified in some way. The changes usually involve different licence authorisations, tailoring the licensing authorisations to the applicants' business, imposing special conditions or requiring the nomination of additional responsible managers to ensure competence.

> Note: Historically, ASIC did not routinely capture data on the number of licences granted by ASIC in a form different to that requested by the applicants and so this information is not reflected in Table 18. The figure in paragraph 547 was manually calculated by ASIC. However, routine capturing of this information was implemented by ASIC in April 2009.

548 Table 18 shows the number of AFS licence applications that ASIC has considered over the past 3 financial years.

Table 18: Licenses granted, refused or cancelled

	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 26 May 2009
Licences granted	369	331	265
Applications refused – see note below	3 (+ 1 refusal overturned by AAT)	0	0
Licences cancelled – initiated by licensee	141	168	199
Licences cancelled – initiated by ASIC	5	20	21

Note: The amount indicated as ‘Applications refused’ does not include the number of applications that were withdrawn. For example, 6% of licence applications received between 1 July 2007 and 18 June 2008 were withdrawn during the licensing process. Applications may have been withdrawn where ASIC indicated that refusal was the most likely outcome.

Imposing licence conditions

549 A number of licence conditions are automatically imposed by the Corporations Act. In addition, the Corporations Act gives ASIC power to impose conditions subject to some requirements being met (e.g. the licensee must be given the opportunity to make submissions before conditions are imposed after the initial grant of the licence).

550 ASIC has issued Pro Forma 209 Australian financial services licence conditions [PF 209], which subject to individual circumstances, sets out the standard licence conditions that will usually be imposed. PF 209 covers a broad range of matters including:

(a) compliance measures;

(b) training requirements for representatives;

(c) financial requirements;

(d) reporting requirements;

(e) compensation requirements; and

(f) dispute resolution.

ASIC policies

551 ASIC has published a number of regulatory guides to help licensees understand and implement the measures necessary to meet the conditions of their licence and their ongoing obligations as a licensee. For the Inquiry’s purpose, the major regulatory licensing guides are:

(a) Regulatory Guide 104 *Licensing: Meeting the general obligations* (RG 104);

(b) Regulatory Guide 105 *Licensing: Organisational competence* (RG 105);

(c) Regulatory Guide 146 *Licensing: Training of financial product advisers* (PS 146);

(d) Regulatory Guide 166 *Licensing: Financial requirements* (RG 166);

(e) Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181); and

(f) Regulatory Guide 165 *Licensing: Internal and external dispute resolution* (RG 165).

Compliance activities (TOR 1, 3, 4, 6, 8 and Additional TOR)

552 ASIC is responsible for overseeing compliance with the FSR regime. ASIC carries out this role in a number of ways, including:

(a) monitoring and acting on complaints;

(b) monitoring and acting on licensee breach reports;

(c) carrying out targeted surveillance activities; and

(d) carrying out targeted disclosure document reviews.

553 The aim of ASIC's compliance activities is to influence the behaviour of financial services providers. We do this as a means to encourage compliance with the law and raise business competence and conduct standards. ASIC's compliance activities may lead to enforcement action (e.g. criminal, civil or administrative action) being undertaken in cases where a breach of the law has been uncovered. This will usually involve a referral of a matter to one of ASIC's FSR deterrence teams.

Complaints and breach reporting

Complaints

554 ASIC receives complaints about financial services providers from a variety of external sources, including:

(a) electronically through ASIC's website (i.e. via e-Complaints and email);

(b) verbally through ASIC's general enquiry line (i.e. Info-line);

(c) in writing, by lodging a complaint form or sending ASIC a formal letter. In some cases, a written complaint may be sent directly to the Chairman; and

(d) in person, by attending one of ASIC's regional offices.

555 All complaints received by ASIC are referred to ASIC's Misconduct and Breach Reporting (M&BR) team. Each complaint is then registered in a database at which time the complaint is assessed in terms of its significance and priority and is then allocated to an action officer for appropriate further action.

556 ASIC assesses every complaint it receives to determine whether there may have been a breach of the law. In cases where a suspected breach is identified, a decision is made as to whether further action is required (e.g. compliance or deterrence activity). The M&BR team will liaise with the appropriate stakeholder teams during this process to ensure that any recommended response is appropriate. Once a decision has been made in relation to a complaint, ASIC contacts the complainant and informs them of this decision. ASIC has procedures in place in cases where a complainant is dissatisfied with ASIC's response.

557 ASIC has a separate procedure for dealing with complaints it receives in relation to reports of market misconduct (e.g. complaints relating to insider trading). This ensures that complaints of this nature are dealt with in an appropriate and timely manner.

558 Approximately 6,150 complaints were registered against financial advisers between 1 July 2006 and 30 June 2009 (which accounts for 17% of total complaints (35,700) received by ASIC in the same period). Table 19 shows the outcomes achieved in relation to the 6,150 complaints.

Table 19: Outcome of complaints against advisers (1July 2006 to 30 June 2009)

Outcome	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 30 June 2009	No of complaints
Referral accepted by another ASIC team i.e. for surveillance, investigation or other action	153	164	207	524
Information referred to assist existing investigation/surveillance			35	35
Complaints consolidated for referrals as a single issue	218	590	1,221	2,029
No Offences/No Breach identified	132	183	225	540
No Jurisdiction	23	37	75	135
Insufficient evidence or action otherwise precluded	321	441	465	1,227
Resolved/Assistance provided	501	380	354	1,235
Unfinalised		1	421	422

Outcome	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 30 June 2009	No of complaints
Total	1,348	1,796	3,003	6,147

Note: Information about complaints referred to assist existing investigations and surveillance has only been captured since February 2009 (when the relevant databases was reconfigured to capture this information)

Breach reporting

559 Under s912D of the Corporations Act, all AFS licensees are required to notify to ASIC in writing of any significant breach or likely significant breach of certain obligations within 10 business days of becoming aware of the breach.

560 ASIC follows a standard procedure for dealing with breach reports. This includes:

(a) acknowledging the breach report;

(b) requesting further information from the licensee where insufficient information has been provided;

(c) deciding whether any further action by ASIC is required (e.g. addressing compliance issues or conducting a formal surveillance);

(d) notifying the licensee of ASIC's decision;

(e) addressing compliance issues (where appropriate); and

(f) formal surveillance (where appropriate).

561 ASIC will consider all of the information in a breach report to decide whether it is necessary or appropriate to take any further action. ASIC does not take further action on all matters that are reported. Whether or not ASIC decides to take any further action will depend on a number of factors. In general however, ASIC will consider:

(a) whether similar breaches have occurred;

(b) whether the breach has been rectified or there is a timeframe for rectification of the breach and updated reporting to ASIC;

(c) whether the licensee has reviewed and amended its compliance procedures following identification of the breach;

(d) whether clients have suffered loss;

(e) whether we should engage an external consultant to review the licensee's compliance systems; and

(f) the seriousness of the misconduct.

Note: if there is serious misconduct, such as fraud or misappropriation of funds, this is reported to the police.

562 If ASIC is not satisfied with the responses it receives from the licensee, then it may require the licensee to take further remedial action, such as changing their procedures, strengthening existing compliance measures, systems and controls, or giving corrective disclosures or compensations to clients. In more serious cases however, ASIC may consider taking enforcement action. Factors underlying our decision to take enforcement action based on a breach report include whether:

(a) the matter involves serious corporate wrongdoing or serious risk or detriment to consumers;

(b) an achievable or appropriate remedy exists; and

(c) the matter satisfies our regulatory and enforcement priorities, including deterrence and public education.

Note: ASIC has published regulatory guidance on the obligations under s912D. See: Regulatory Guide 78 *Breach reporting by AFS licensees* (RG 78).

563 3,010 breach reports were lodged by licensees, auditors and compliance committees between 1 July 2006 and 30 June 2009. The outcomes of the 3,010 breach reports are shown in Table 20.

Table 20: Breach reports from 1 July 2006 to 30 June 2009

Regulatory outcome	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008	1 July 2008 to 30 June 2009	Total	% of total
Activity merged with another activity	54	67	95	216	7%
Change to entity's procedures	101	64	40	205	7%
Corrective communication sent / further disclosure made	29	5	3	37	1%
Monitoring activity	105	112	95	312	10%
Rectified by licensee and noted	367	479	440	1,286	43%
Referred for surveillance, investigations or other regulatory action	112	34	32	178	6%
Resolved	17	10	24	51	2%
Assessed as low risk	351	181	165	697	23%
Unfinalised matters			28	28	1%
Total	1136	952	922	3010	100%

Note: Some licensees advise ASIC of both prospective breaches and of the actual breach when it occurs. This double up of reporting increases the volume of breaches captured by ASIC.

How ASIC deals with complaints and breach reports

564 Prior to ASIC's strategic review, complaints information and breach reports were handled by separate areas of ASIC: complaints were received and dealt with by a Complaints team and breach reports were dealt with by the Compliance directorate.

565 Following the strategic review, ASIC's Misconduct and Breach Reporting (M&BR) team is responsible for the registration and assessment of all reports of misconduct and complaints received from the general public and breach notifications from licensees, responsible entities and auditors. Having a dedicated national team ensures that ASIC is better placed to capture and respond to the intelligence it receives via complaints and breach reports. The M&BR team collects information about trends or systemic issues it has identified as being reported to ASIC and disseminates this information to the Financial Economy stakeholder teams. The key performance indicators of Senior Executive Leaders include how they handle these complaints. In particular, their assessment of whether or not they contain 'smoking guns'.

Surveillance activity

What is surveillance

566 In general, the term 'surveillance' is used to refer to the process of gathering and analysing particular information in relation to a particular entity or class of entities or person or class of persons.

Why we do surveillances

567 ASIC uses surveillance activity to assess and enforce compliance with financial services laws, to produce constructive change in the regulated population, enhance public confidence and ensure the long-term stability and integrity of financial markets.

568 Surveillances allow ASIC to engage with and influence behaviour on an industry-wide, conduct-wide and entity focused basis.

569 Surveillances are particularly useful as they allow us to engage with our regulated population (often on a face-to-face basis) and to actively monitor activities, so that we have a presence in the market. The benefit of this presence is that the regulated population feels watched and is therefore encouraged to comply. This engagement also allows the regulated population to understand ASIC's regulatory focus, and to better understand their own obligations.

Types of surveillances

570 Surveillance activity is taken on either a proactive basis (e.g. targeted projects or campaigns) or on a reactive basis (e.g. following internal or external referrals).

571 A surveillance can take a number of forms, including:

(a) licensee surveillances;

(b) accounts surveillances;

(c) auditor surveillances; and

(d) stock exchange surveillances.

572 Surveillances can be undertaken on companies, partnerships, licensed or unlicensed entities, individuals and disclosure documents.

573 Prior to the strategic review, the Compliance directorate was responsible for carrying out ASIC's compliance and surveillance activity for the financial services industry. In the past, ASIC adopted a risk-based methodology in planning its surveillance activities. In entity under review was rated according to various indicators and on the basis of these indicators was rated as being a low, medium, high or very high risk. In general, ASIC focused its activities on those entities and activities which received a medium to very high risk rating.

574 Following the strategic review, each of the Financial Economy stakeholder teams is responsible for determining how and when it conducts surveillance activities in relation to its area of responsibility. In general, the stakeholders will continue to use a risk-based approach to their surveillance activities. However, each stakeholder team is tailoring the methodology to suit the focus of its activities.

575 The surveillance methodology used by the Financial Advisers team is the most relevant to the Inquiry's purposes. In general, the Financial Advisers has adopted a surveillance methodology which incorporates two types of surveillance campaigns:

(a) a general surveillance, which looks at the whole business of a licensee and assesses its performance against a set of benchmarks. This type of surveillance is typically used in cases where multiple breaches of the law are suspected or where systemic issues have been identified; and

(b) an advice specific surveillance, which looks at issues relating only to the advice being provided by an AFS licensee and its representatives.

Examples of ASIC's surveillance activities

576 ASIC has a number of surveillance activities that it is conducting or planning to conduct in the future. Some of the more significant surveillance activities are:

(a) the Financial Advisers team is currently conducting 12 general surveillance activities and 20 advice specific surveillance activities. As part of its 'Quality of advice' project, the Financial Advisers team is also undertaking an advice specific surveillance program of 30 AFS licensees to set benchmarks;

(b) ASIC is currently conducting a project looking at the sale of complex products to retail investors, including contracts for difference (CFDs), capital guaranteed and capital protected products and unlisted and unrated debentures. It is anticipated that this project will include surveillance activity on issuers and advisers. This project involves a number of ASIC's stakeholder teams, including Corporations, Investment Banks, Consumers and Retail Investors, and Market Participants and Stockbrokers. The aim of this project is to increase retail investor protection in relation to complex products;

(c) the Market Participants and Stockbrokers team is conducting a number of surveillances on licensed entities that provide advice on exchange traded products with access to trading through a market participant (e.g. 'white label brokers'). ASIC is concerned that the compliance structure of these entities is not the same as for licensed market participants and exposes retail investors to risk. To date, this work has resulted in some the licensed entities making significant changes to their compliance and risk management structures;

(d) the Markets Participants and Stockbrokers team is also undertaking a survey of stockbroking clients to assess the quality and nature of the financial services being provided to retail investors; and

(e) the Investment Managers team is conducting surveillance activity of specific managed investment schemes that have been affected or appear to be affected by the downturn in market conditions.

Disclosure document reviews

Why we do reviews

577 ASIC reviews disclosure documents as part of its compliance and surveillance activities. ASIC conducts its reviews to ensure that disclosure documents:

(a) comply with the applicable content requirements;

(b) do not contain false, misleading or deceptive statements; and

(c) are clear, concise and effective.

578 By carrying out disclosure document reviews, ASIC's aim is to improve the standard and level of disclosure made to retail investors. We achieve this objective by, for example:

(a) stopping the issue of defective disclosure documents (e.g. issuing an interim or final stop order). ASIC is able to protect retail investors by removing defective material from the market;

(b) developing disclosure benchmarks and policy guidance for industry sectors. Disclosure document reviews are an invaluable tool for ASIC to determine trends of non-compliance in disclosure. This allows ASIC to direct its guidance to the most critical disclosure issues. For example, ASIC's review of disclosure by mortgage and property schemes assisted ASIC with the development of its regulatory guidance. See, Regulatory Guide 45 *Mortgage schemes – improving disclosure for retail investors* (RG 45) and Regulatory Guide 46 *Property schemes – improving disclosure for retail investors* (RG 46); and

(c) taking enforcement action in appropriate cases.

579 An ASIC review may cover any of the disclosure documents or advertising and promotional material issued or made available to prospective retail investors under Ch 6D and Ch 7. Table 8 in Section F shows the number of prospectuses, PDSs, Supplementary PDSs and PDS in-use notices lodged with ASIC during the previous three financial years. Notably, this table does not include other FSR documents that ASIC may review including SOAs, FSGs, periodic statements, significant event notices and financial reports. Nor does it include the documents that ASIC would review in relation to its other regulatory activities e.g. financial reports.

How we conduct reviews

580 ASIC's document reviews typically fall into two categories:

(a) reactive reviews. This type of review is used in response to a specific incident such as a complaint; or

(b) targeted or campaign reviews. This type of review is used where ASIC has identified areas of concern e.g. disclosure for unlisted and unrated debentures. Given the number of disclosure documents on issue at any given time, it is not possible for ASIC to review all of them. A targeted review allows ASIC to pick a sample of disclosure documents based on a set of criteria and review each document according to a specific methodology.

581 Prior to the strategic review, reviews of FSR disclosure documents were generally carried out by the Compliance directorate and Consumer Protection directorate. They adopted a risk based methodology to assist with

determining which disclosure documents to review. A disclosure document was rated according to various indicators and on the basis of these indicators was rated as a low, medium, high or very high risk rating. In general, ASIC focused its activities on those documents which received a medium to very high risk rating.

582 Following the strategic review, each stakeholder team is responsible for setting its own program for the review of disclosure documents. ASIC will continue to use a risk-rating methodology. However, each stakeholder team is tailoring the methodology to suit the focus of its activities.

Examples of ASIC's document reviews

583 Some of the more significant document reviews include:

(a) a targeted review of the disclosure by unlisted property schemes. This lead the implementation of RG 45, (see MR 08-200 *ASIC releases final guidance to improve disclosure by unlisted mortgage and property schemes*, 2 September 2008);

(b) a targeted review of the disclosure by unlisted mortgage schemes. This lead to the implementation of RG 46, (see MR 08-200);

(c) a targeted review of the implementation of the regulatory measures ASIC introduced for unlisted unrated debentures (see MR 08-82 *ASIC acts to provide retail investors with better disclosure for unlisted unrated debentures*, 23 April 2008 and Report 127 *Debentures – improving disclosure for retail investors*, April 2008);

(d) a targeted review of superannuation PDSs in response to the commencement of choice in superannuation (see IR 06-09 *ASIC puts spotlights on superannuation disclosure*, 29 March 2006 and Report 84 *Monitoring Superannuation fees and costs* (October 2005 to June 2006), November 2006);

(e) a targeted review of the disclosure of transaction fees by banks, building societies and credit unions (see MR 05-266 *ASIC review transaction fee disclosure*, 7 September 2005 and Report 53 *Good transaction fee disclosure*, September 2005); and

(f) a targeted review of the disclosure of soft-dollar benefits (see MR 04-181 *Soft dollar benefits need clear disclosure*, 10 June 2004 and Report 30 *Disclosure of soft dollar benefits*, June 2004).

584 ASIC has a number of disclosure document review projects currently underway. Some of the more significant include:

(a) the Financial Advisers stakeholder team is planning to review the quality of disclosure documents as part of its project on the quality of advice (see Section D);

(b) the complex product project (which involves a number of stakeholder teams) will review disclosure for complex products such as capital protected securities, instalment receipts and debentures;

(c) the Consumers and Retail Investors team is planning to look at disclosure for retirement income stream products;

(d) DTI is planning to review:

(i) disclosure for term deposits and the advertising practices for large ADIs;

(ii) disclosure of mortgage fees;

(iii) disclosure for account switching transactions;

(e) the Superannuation Funds stakeholder team:

(i) currently has a project looking at superannuation risk disclosure. The aim of this project is to look for ways to try and improve risk disclosure in superannuation PDSs as well as other disclosure material. Part of this project included a targeted review of over 60 PDSs in order for ASIC to gain an understanding of current industry practice in risk disclosure; and

(ii) is planning a project looking at member engagement with superannuation from a disclosure perspective. The project will look at the disclosure and promotional material a member receives upon joining a superannuation fund and the ongoing disclosure received as a member of the fund;

(f) the Corporations stakeholder team is planning to Review compliance with the benchmark disclosure framework for debentures in RG 69 *Debentures – improving disclosure for retail investors* (RG 69); and

(g) the Investment Banks stakeholder team is planning to review disclosure for emerging products (e.g. OTC products) with a view to producing regulatory guidance for industry.

Deterrence activities (TOR 1, 3, 4, 5, 6, 8, and Additional TOR)

585 Prior to ASIC's strategic review, ASIC's deterrence activities were carried out by the Enforcement directorate. As a result of the strategic review, ASIC now has 8 deterrence teams, each with a specific area of focus. Three of these teams are dedicated to dealing with financial services matters.

586 In general, each deterrence team is responsible for:

(a) investigating suspected misconduct that may warrant enforcement action;

(b) working with the Commonwealth Director of Public Prosecutions (CDPP) to secure criminal enforcement outcomes;

(c) taking civil action, restraining assets, winding up companies and acting for the protection of consumers and the investing public;

(d) referring briefs to delegates to decide whether officers should be banned from managing corporations or whether financial service providers should be prevented from providing such services (e.g. banning a person or cancelling an AFS licence); and

(e) claiming compensation for investors.

587 Broadly, the remedies available to ASIC can be categorised as follows:

(a) criminal action. A number of criminal offence provisions are contained in the legislation administered by ASIC. In most cases, ASIC must refer criminal actions to the CDPP;

(b) civil action. ASIC has a range of civil remedies available to it. ASIC can take civil action on its own or in addition to criminal action. The types of civil remedies available to ASIC include:

  (i) civil penalties. Civil penalties may be imposed for serious contraventions of specific provisions (e.g. a breach of director's duties);

  (ii) injunctive relief. ASIC may take injunctive proceedings to restrain a person or entity engaging in specific conduct, or to compel compliance with the law to prevent further detriment from occurring;

  (iii) corrective action. ASIC can seek an order for corrective action if we consider that information that is misleading and that it should be corrected; and

  (iv) compensatory action. ASIC can, if it considers it to be in the public interest, commence an action to recover damages or property.

Civil proceedings are expensive and resource intensive and ASIC carefully considers a decision whether or not to undertake civil proceedings. In general, ASIC would consult with the CDPP before commencing a civil action in matters where there is a suggestion that serious misconduct has occurred; and

(c) administrative action. ASIC has a range of administrative remedies available to it, including the power to:

  (i) disqualify or ban a person after a hearing;

  (ii) issue a stop order notice for defective disclosure documents;

  (iii) give a direction to a market to suspend dealing in a financial product if it is necessary or in the public interest; and

  (iv) enter into an enforceable undertaking with a person. An enforceable undertaking is a negotiated outcome with the relevant person. The undertakings provided by the relevant person are enforceable by a court. ASIC does not use enforceable undertakings in cases where there is serious misconduct. In these cases, ASIC would pursue criminal action.

Note: ASIC has published guidance on how and when it will use enforceable undertakings. See, Regulatory Guide 100 *Enforceable undertakings* (RG 100). ASIC has also published guidance on the administrative actions it may take against financial services providers: Regulatory Guide 98 *Licensing: Administrative action against financial services providers* (RG 98).

588 In determining whether ASIC should take enforcement action, and if so, what this action should be, ASIC considers a number of factors including:

(a) the nature of the activity in question (e.g. has there been a serious breach of legislative provisions, or, is the matter something likely to have widespread impact on the industry);

(b) the appropriateness of the remedy in correlation to the conduct in question. For example, ASIC is more likely to take criminal action where there has been serious misconduct; and

(c) the resources available.

Deterrence activities after the strategic review

589 ASIC is adopting a more proactive approach to its enforcement and deterrence activities. ASIC has commenced a number of significant deterrence activities to recover compensation for loss for retail investors and increase confidence and integrity in our financial markets and financial services industry.

590 Examples of our proactive deterrence approach, include:

(a) the launch of Project Mint in March 2008. This project is tackling head on the problem of market manipulation, in particular, the use short-selling on the back of false rumours (e.g. 'rumourtrage'). ASIC established a dedicated webpage and email address to allow market participants to report to ASIC the spreading of false or misleading rumours, and other instances of market misconduct. ASIC has also taken banning action against a number of people who have contravened the law. A number of benefits are flowing from this work including improving the speed with which ASIC responds to ASX referrals and increasing the number of matters ASIC is pursuing with the CDPP. (For further information see MR 08-47 *False or misleading rumours*, 6 March 2008). ASIC's work on this project is continuing;

(b) our work with the liquidators of Opes to encourage mediation discussions between Merrill Lynch (International) Australia Ltd, Merrill Lynch International and ANZ Banking Group Ltd to resolve claims between the parties. On 4 August 2009, the Federal Court approved the creditors schemes of arrangement which give effect to the settlement offer to Opes clients (see AD 09-135 *Opes Prime schemes of arrangement approved*, 4 August 2009); and

(c) the civil penalty proceedings we commenced against James Hardie, including a number of former and current directors and former executives. The civil penalty proceedings relate to disclosures by James Hardie Industries Limited in relation to the adequacy of its funding of the Medical Research and Compensation Foundation. (For further information, see MR 07-35 *ASIC commences proceedings relating to James Hardie*, 15 February 2007 and MR 08-201 *James Hardie Group civil action*, 5 September 2008 and MR 09-69 *James Hardie proceedings*, 23 April 2009); and

(d) the 16 civil actions we commenced under s50 of the ASIC Act seeking compensation for retail investors who suffered loss in relation to the failure of Westpoint (See MR 07-291 *ASIC to pursue compensation for Westpoint investors*, 8 November 2007). ASIC was successful in obtaining court orders for a global mediation of all Federal Court actions we commenced arising from the failure of Westpoint.

Modifying and exempting from the law (TOR 1, 2, 4, 6, 7, and Addition TOR)

Applications for relief

591 ASIC has express powers under the Corporations Act to exempt a person or class of persons or a financial product or class of financial products from compliance with certain aspects of the financial services law. ASIC also has express power to modify how the law operates in relation to a person or class of persons or a financial product or class of financial products. ASIC can exercise its powers on application by an individual person and on its own motion.

Note: An application for relief must be submitted to ASIC in the appropriate form (e.g. with the information necessary to enable ASIC to make a decision) and also be accompanied by the appropriate fee. The fee is set by the Corporations (Fees) Regulations 2001 and is currently set at $270.

592 An exemption or modification applying to a class of persons or financial products will be issued by ASIC as a Class Order instrument. Class orders are legislative instruments and, therefore, subject to the *Legislative Instruments Act 2003*. When issuing a class order, ASIC complies with the Federal Government's Regulatory Impact Assessment requirements, e.g. it publishes a Regulatory Impact Statement where appropriate.

593 ASIC's powers to exempt or modify the law allow ASIC to change the law as it applies to a person or financial product where it may result in atypical

or unforeseen circumstances or unintended consequences. When deciding whether to exercise our powers, ASIC will take into account a number of factors including whether exercising our discretionary powers will:

(a) assist with maintaining and improving confidence in, and the integrity of Australia's capital markets;

(b) assist with facilitating capital flows between Australia and internal markets; and

(c) adversely affect the interests of consumers and investors.

594 ASIC has published a number of regulatory guides explaining when and how ASIC will exercise its various exemption and modification powers. For example:

(a) Regulatory Guide 51 *Applications for relief* (RG 51) gives guidance to applicants on how they can make a relief application to ASIC;

(b) Regulatory Guide 167 *Licensing: Discretionary powers* (RG 167) gives guidance on how ASIC will exercise is licensing exemption and modification powers; and

(c) Regulatory Guide 169 *Disclosure: Discretionary powers* (RG 169) gives guidance on how ASIC will exercise its exemption and modifications powers in relation to Pt 7.9.

595 Each quarter ASIC publishes a report outlining recent decisions on applications for relief from the corporate finance, financial services and managed investment provisions of the Corporations Act. The report usually provides an overview of the applications where ASIC has exercised, or refused to exercise, its exemption and modification powers from the financial reporting, managed investment, takeovers, fundraising, and financial services provisions of the Corporations Act.

Note: The most recent report was issued by ASIC on 3 August 2009. Further information is set out in AD 09-132 *ASIC issues report on relief applications decided between December 2008 and March 2009*.

Applications for no-action letters

596 ASIC may issue a person with a no-action letter. A no-action letter is a letter in which ASIC states to a specific person that it does not intend to take regulatory action over particular conduct or state of affairs. There is no specific legislative power to issue a no-action letter, rather a 'no-action' position is the exercise by ASIC of its inherent power in the administration of the Corporations Act or ASIC Act to decide whether or not to take formal enforcement action.

597 A no-action letter does not provide a guarantee that ASIC will not take action at some stage in the future nor does it affect the rights of other people

to take individual action e.g. to sue for damages. ASIC gives a no-action letter in order to provide some level of comfort or certainty as to whether ASIC will take regulatory action where there has been some inadvertent breach of the Corporations Act or ASIC Act.

Note: ASIC has published guidance on how and when it will issue relief by way of a no-action letter: see Regulatory Guide 108 *No Action letters* (RG 108).

598 ASIC will only give a person a no-action letter where we think that:

(a) it would serve a clear regulatory purpose to provide a no-action letter to an applicant e.g. facilitating business; and

(b) it would not advance the policy of the legislation to take other regulatory action in relation to the conduct in question.

Key data

599 Table 21 shows the total number of relief applications ASIC received during the previous three financial years and the number of applications under Ch 7 of the Act.

Table 21: Total number of relief applications from 1 July 2006 to 30 June 2009

Financial year	Total applications	Total Ch 7 applications	% of total
2006-07	3049	599	19.65%
2007-08	3217	544	16.9%
2008-09	2978	511	17.15

600 Table 22 shows a breakdown of the applications ASIC received under Ch 7 of the Act during the previous 3 financial years.

Table 22: Applications for relief under Ch 7 of the Act from 1 July 2006 to 30 June 2009

Activity	Approved	Refused	Withdrawn	Total
Application for a no action letter	103	25	18	146
Application for an extension to provide a copy of register to members (s173(3))	0	11	0	11
Application for determination under Pt 7.7.11 to 7.7.75 of the Corporations Regulations	0	1	1	2
Application for a declaration that a facility (i.e. a product or service) is not a financial product (s765A(2))	5	11	2	18

Activity	Approved	Refused	Withdrawn	Total
Application for a declaration under Pt 7.6 of the Act	2	2	2	6
Application for an exemption to hold an AFS licence by a person regulated by a foreign regulatory authority (911A(2)(h)(ii))	0	1	0	1
Application for an exemption from the requirement to hold an AFS licence (s911A(2)(l))	281	31	35	347
Application to exempt a person from Pt 7.6 of the Act (s926A(2)(a))	7	7	37	51
Applications to exempt a product from Pt 7.6 of the Act (s926A(2)(b))	19	2	2	23
Application for approval of alternative compensation arrangements (s912B(2)(b))	0	0	1	1
Application to exempt a person or class of persons from Pt 7.7 of the Act (s951B(1)(a))	29	13	21	63
Application to exempt a person or class of persons from Pt 7.7 of the Act (s951B(1)(b))	36	10	4	50
Application for an exemption from Pt 7.8 and reg 7.8.01(2)(a) (s992(1)(a))	65	9	7	81
Application for an exemption from Pt 7.8 (992A(1)(b)	78	18	6	102
Application for an exemption from Pt 7.9 of the Act (1020F(1)(a))	572	60	117	749
Application for an exemption (s1075A(1))	1	2	0	3
Totals	1198	203	253	1654

Encouraging compliance (TOR 1, 3, 4, 6, 8, and Additional TOR)

601 ASIC is responsible for ensuring that people comply with the financial services law. ASIC carries out a number of regulatory activities to designed to assist and encourage participants in the financial services industry to comply with the law and their obligations. Some of the more significant activities that ASIC undertakes to encourage compliance with the law are:

(a) compliance activities that have an educative effect; and

(b) providing guidance to the industry about how ASIC will administer the law and providing clarity to industry participants about their obligations by issuing regulatory guidance.

Publishing regulatory documents

602 ASIC encourages compliance with the law by helping the financial services industry understand it compliance obligations by publishing regulatory documents. ASIC issues four types of regulatory documents:

(a) Consultation Papers: these documents are used to gain stakeholder feedback on matters ASIC is currently considering;

(b) Regulatory Guides: give guidance to industry by:

(i) explaining when and how ASIC will exercise its specific power under the financial services law;

(ii) explaining how ASIC interprets the law;

(iii) describing the principles underling ASIC's approach; and

(iv) giving practical guidance to industry participants, e.g. how a person can make an application for an AFS licence or giving practical examples about how an AFS licensee may meet their licensing obligations;

(c) Reports: these documents describe ASIC compliance or relief activity or the results of a particular research project that ASIC has undertaken; and

(d) Information sheets: these documents provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

603 When issuing a regulatory document, ASIC ensures that it complies with Regulatory Impact Assessment Requirements.

604 For the Inquiry's purpose, Regulatory Guides are the most significant regulatory documents. ASIC has published a large number of Regulatory Guides that provide specific guidance to the financial services industry. Some of the more significant Regulatory Guides relevant to the financial services industry are:

(a) Regulatory Guide 69 *Debentures – improving disclosure for retail investors* (RG 69);

(b) Regulatory Guide 156 *Debenture advertising* (RG 56);

(c) Regulatory Guide 166 *Licensing: Financial requirements* (RG 166);

(d) Regulatory Guide 168 *Disclosure: Product disclosure statements* (*and other disclosure obligations)* (RG 168);

(e) Regulatory Guide 175 *Licensing: Financial product advisers – conduct and disclosure* (RG 175); and

(f) Regulatory Guide 181 *Licensing: managing conflicts of interest* (RG 181).

Educating and informing investors (TOR 7)

605 ASIC is responsible for promoting the confident and informed participation of consumers and investors in the financial system. In carrying out this responsibility, ASIC's aim is to foster a financially literate community where Australian consumers can make informed decisions about financial products and services, understand their rights and responsibilities, and be in a position to identify and avoid bad investment choices like frauds and scams.

606 To achieve its aim, ASIC uses a combination of education campaigns, information alerts and publications, and compliance and enforcement activities designed to promote the integrity of the market place.

607 Following the strategic review, ASIC set up the Consumer and Retail Investors stakeholder team specifically to focus on issues affecting consumers and retail investors. However, it is also expected that the other stakeholder team will also undertake activities that have a consumer and retail investor education component to them.

FIDO

608 ASIC publishes a broad range of information on the FIDO website aimed at educating and informing investors about investing in financial products and using financial services. For example, ASIC publishes information about:

(a) the latest financial scams;

(b) tips on budgeting, savings, money management;

(c) the rights and responsibilities of consumers and retail investors;

(d) financial products and services; and

(e) the risks associated with investing.

609 Table 23 shows some of the consumer information booklets that are currently available on the FIDO website.

Table 23: Consumer publications on FIDO

Document	Explanation
Complex investment products checklist	Provides investors with a checklist to help them better understand risk versus reward.

Document	Explanation
Consumers and money	Provide information on consumer protection laws, e-commerce, insurance, fees and charges, credit cards, superannuation and scams.
Dealing with debt	Provides a guide to dealing with debt, including the rights and responsibilities of consumers, disputing a debt and dealing with debt collectors.
Debt collection guidelines: for collectors and creditors	Provides information to help collectors and creditors better understand how the Commonwealth consumer protection laws apply to them. This document was produced with the ACCC.
Getting Advice	Provides information on getting personal financial product advice.
Investing in...? Investor guides	Independent investor guides about unlisted investments such as mortgage funds, property trusts and debentures.
Term deposits	Provides information on term deposits to enable consumers to make the most of their product.
Thinking of using the equity in your home?	Provides information on reverse mortgages and other equity release programs.
Your money	Provides money tips and covers budgeting, superannuation, credit, superannuation, insurance, investing and retirement planning.
Super decisions	Provides essential facts about superannuation including choosing a fund, choosing an investment strategy, changing funds, complaints, and moving towards retirement.
Thinking about self-managed super?	Sets out 6 steps to help a person decide if a self managed superannuation fund is appropriate for them.

610 The FIDO website also provides a number of interactive tools to help consumers make informed investment decisions, including calculators and budgeting tools. These are shown in Table 24.

Table 24: Interactive consumer tools available on FIDO as at 30 June 2009

Tool	Explanation
Superannuation calculator	Allows investors to see the long term effects of the following factors on their superannuation: • fees and charges • making extra contributions • receiving government co-contributions • reducing contributions as a result of time out of the workforce • switching your investment strategy or changing funds.
Managed funds calculator	Allows investors to see the long term effect on their investment return of fees and charges, contributions, changing funds and choosing an investment option.

Tool	Explanation
Reverse mortgages calculator	Allows investors to see the effect of their decisions: • how much to borrow • whether they should take an initial lump sum or arrange regular income payments or a combination of both • how long to borrow for • interest rates and various fees.
Savings investment calculator	Allows investors to compare the returns offered by savings products e.g. cash, fixed interest, property and shares. It allows investors to see what their money would be worth if: • they re-invest all the interest you earn over a certain period • how much a person would have to invest at a certain interest rate to reach a specific target amount • how long it would take to reach a target amount • what interest rate a person would need to reach a target amount • the effect of investing a single amount or regular amounts.
Risk and return calculator	Allows investors to compare the return offered by a proposed investment with the relevant sector of the overall market.
Credit card calculator	Allows consumers to see how long it will take to pay off their credit card debt depending on the amount of their repayment e.g. whether they pay the minimum amount due or not.
First home saver account calculator	Allows consumers to see the effect on an account balance depending on: • how long a person saves for • how much the person contributes to the account • the type of account chosen and its rates of return • fees and charges.
Multi loan calculator	Helps consumers to choose between the various ways they can pay off their debts. It shows a consumer the savings and costs to them of: • paying off loans faster without refinancing • refinancing • making extra one-off payments or regular payments.
Retirement planner	Allows consumers to see: • how much money they can save in their superannuation until they retire • how much they can draw out of their superannuation • how much of the government age pension they will be eligible to receive.
Account-based pension calculator	Shows the effect of fees and switching on an account based pension.
Term allocated pension calculator	Shows the effect of fees and switching on an allocated pension.
Budget planner	Helps consumers manage their expenses so that they can be sure to spend less than they earn.

Tool	Explanation
Statement of financial position	Allows investors to check their overall financial position and financial capacity.

611 In addition to accessing the information and tools available on FIDO, consumers are also able to subscribe to a regular FIDO newsletter. This newsletter provides consumers with up to date information on a variety of topics e.g. the latest scams or new information available on FIDO.

Understanding Money

612 The Understanding Money website was initially set up by the Financial Literacy Foundation. In July 2008, responsibility for the website was transferred to ASIC.

613 ASIC publishes a broad range of information on Understanding Money designed to assist Australians in better managing their money.

614 Table 25 shows some of the publications that are currently available on the Understanding Money website.

Table 25: Consumer publications on Understanding Money

Document	Explanation
Understanding Money handbook	It has information and tips on budgeting, saving, investing, being in charge of your debt, superannuation, protecting your money, and how to get good advice.
A few simple things	General overview of 3 steps towards better money management. These are • setting financial goals • working out a budget • get into the savings habit.
Budgeting	Provides information on: • how to get started • how to use the budget planner on Understanding Money • putting a budget together • how to stick to a budget • how to managed unexpected expenses • what if the budget is blown.

Document	Explanation
Saving	Provides tips on successful saving, including: • why save • what is compound interest • how to get started • where to save • other investment products • what to look for in a savings account.
Investing	Provides information on investment basics, including: • have a plan e.g. set financial goals • explanation of the different between capital growth or income • how long to invest for • investment risk • diversification (e.g. don't put all your eggs in one basket) • managed funds • fees, taxes and charges.
Controlling your debts	Provides information on how to control debt, including: • debt problems • how to take control of debt • how to deal with multiple debts • what happens if you can't repay a debt • bankruptcy and other legal requirements.
Superannuation	Provides an overview of superannuation, including: • what is superannuation • types of superannuation • employer contributions • personal contributions • when can you get your superannuation? • can you get your superannuation and continue to work? • what will you get when you retire? • keep track of your superannuation • super choices.
Understanding credit	Provides helpful tips on managing credit and avoiding common pitfalls, including: • borrowing money • interest, fees and charges • what type of credit is best for you? • before you use credit • what will your lender do when you apply for credit? • if things go wrong.

Document	Explanation
Insurance	Provides basic information on insurance, including: • how insurance works • what type of insurance is available • how to shop around for a good deal • having enough cover • understanding insurance policies.
Protecting your money	Provides basic tips on protecting money, including: • getting enough insurance • making a will • choosing the right investments • watching out for scams.
Getting information and advice	Provides simple tips on getting financial advice, including: • what help is available • professional financial advice • how to tell if you're getting good advice • how much will you pay for advice • what will you need to tell your adviser.

615 The Understanding Money website also provides a number of interactive tools to help consumers manage their money. These are shown in Table 26.

Table 26: Interactive tools available on Understanding Money

Tool	Explanation
Budget planner	A tool to help consumers budget their money by focusing on the real income and real expenses. It helps consumers see where their money goes and where changes could be made.
Regular savings calculator	Helps consumers work out how much they need to save to reach certain targets (e.g. to buy a home).
Savings period calculator	Helps consumers see how long it will take to reach their target based on their current income.
Savings results calculator	helps consumers see how much money they could save over a certain period of time depending on the amounts they contribute (e.g. how much will be saved in 5 years).
Savings matrix	Helps consumers see at a glance how effective different savings plans will be under a range of interest rates and periods of time.
Borrowing calculator	Helps consumers work out the amount of repayments they can afford to make on a loan.
Loan term calculator	Helps consumers work how long it will take them to pay off a loan.

Tool	Explanation
Personal loan matrix	Shows consumers what their repayments would be if they borrowed a particular amount at different interest rates and over different periods of time.
Mortgage repayment calculator	Helps consumers to work out what their repayments would be for a mortgage.
Mortgage matrix	Shows consumers what their repayments would be if they borrowed a particular amount at different interest rates and over different periods of time.

Consumers and retail investors

616 The Consumer and Retail Investors stakeholder team is working on a range of projects designed to educate, inform and help consumers and retail investors make better investment decisions. Table 27 highlights some of the key projects that ASIC's Consumer and Retail Investors team is or has been involved with.

Table 27: Current CARI projects as at 30 June 2009

Project	Explanation
Investing between the flags	This project is aimed at pre-retirees and retirees. However, its outcomes will also apply more broadly to other consumers and to retail investors. The aim of this project is to increase consumer understanding of the investment basics e.g. understanding the importance of diversification, asset allocation, the risk versus return question and information risk intolerance. ASIC recently completed 10 pilot seminars around Australia that were delivered by Centrelink's Financial Information Service. ASIC is in the process of developing a core education booklet, which will be published on FIDO. ASIC is developing an Investing between the flags e-portal. This site will include much of the information already published but will also include new information.
Financial literacy	A financial literacy program is being developed to integrate ASIC's financial literacy work with the work being done by the Financial Literacy Foundation with the aim of developing a national financial literacy strategy. This currently involves the development of 3 targeted education strategies: • the school education strategy; • the further education strategy; and • the workplace strategy.
Online teaching resource	ASIC recently launched an interactive online teaching resource for secondary school students. It focuses on issues such as how to buy insurance for a first car or receiving superannuation from their first employment position. The tool is available to every secondary school in Australia.

Project	Explanation
Educating retirees about equity release products	ASIC released a new guide to equity release products. The guide informs consumers about: • the risks and costs associated with equity release products; • the alternative ways that consumers can access funding; and • the things that a person should consider before deciding whether or not to take out a reverse mortgage.
Self managed superannuation funds	ASIC has been working with the ATO to give specific messages to anyone considering becoming a SMSF trustee so that they better understand the costs, skills and time involved in running a successful SMSF.
Role of industry	ASIC has also been working with industry, the community sector, educators and governments to set up partnerships to ensure consistent educational messages are being delivered to consumers.

Future activities

617 In response to the impacts of the global financial crisis and ASIC's increased responsibility for regulating credit, the Consumer and Retail Investors stakeholder team is planning to expand the work it is doing in relation to credit. At this stage, the work will focus on Australians of all ages and will consist of targeted campaigns which look at:

(a) the affordability of credit and how to choose the best credit product;

(b) how to manage credit; and

(c) what a person should do if they get into trouble with credit.

These campaigns will also feed into ASIC's financial literacy work.

618 The Consumer and Retail Investors stakeholder team is also planning to focus on helping those consumers most affected by the global financial crisis. This will involve launching a series of modules for surviving the economic crisis and will provide particular assistance to those consumers that have lost their jobs or have had their savings significantly reduced.

619 Over the longer term, the Consumer and Retail Investors stakeholder team is aims to:

(a) firmly embed financial literacy in the school curriculum and ensure its place in the national curriculum;

(b) encourage and promote the acceptance of financial literacy strategies in apprenticeships, other educational institutions e.g. universities and workplaces; and

(c) provide consumers with better access to personalised independent and reliable guidance on financial issues by rationalising and combining the best parts of the FIDO website and the Understanding Money to create a better consumer information website.

Appendix 4: Responses to issues raised in the PJC submissions

620 ASIC provides the following responses to some of the key issues raised by submissions to the Inquiry published on the Inquiry website.[162] In this appendix, we have responded to the issues raised in the submissions that are directly relevant to ASIC's role as regulator.

621 We recognise that other submissions raise issues about the general regulatory regime and we have dealt with these more general issues in the main body of this submission.

622 Many submissions raise issues which relate to ASIC's current investigations, including Storm and Opes. As is ASIC's general practice, to avoid prejudicing ongoing investigations, we have not commented publicly about the subject of these investigations. However, we have addressed the concerns raised in submissions about ASIC's involvement with entities under investigation to the extent we are able to do so without prejudicing our investigations.

ASIC's involvement with Storm

623 As a priority, ASIC is focused on its investigations into Storm and is doing everything it can to seek redress for investors. We are aiming to report back on the status of the investigations by 31 August 2009.

624 Separate to the investigations, ASIC has reviewed its involvement with Storm and we outline below responses to specific issues raised in the submissions. We provide the following in addition to the confidential Appendices 5 and 6, which set out ASIC actions prior to formal investigations in relation to the collapses of Storm and Opes. The appendices dealing with Storm and Opes are provided to the Committee on a confidential basis because disclosure of the information in these appendices may prejudice our ongoing investigations.

Table 28: Responses to issues raised in submissions about ASIC's involvement with Storm

Issue	ASIC's Response
ASIC failed to act on complaints	ASIC assesses every formal complaint it receives. ASIC received four formal complaints about Storm in 2006-2007. These complaints related to Storm's SOAs and seminars, high

[162] http://www.aph.gov.au/senate/committee/corporations_ctte/fps/submissions/sublist.htm.

Issue	ASIC's Response
A number of submissions raise the concern that ASIC received complaints about Storm but did not warn investors and that ASIC failed to investigate complaints.	fees and disclosure in its prospectus. ASIC reviewed a Storm SOA, Storm-badged PDSs and the Storm prospectus during this period, but did not find a breach of the law against which it should take action. ASIC has published warnings about the risks of borrowing to invest in the share market on its website since 1999.
Storm was approved by ASIC Various submissions suggest that because ASIC licensed Storm, it approved Storm and enabled Storm to run its business. Some submissions suggest that clients were told that Storm was being investigated by ASIC and that they found this reassuring, because they believed that if ASIC did not approve of Storm's business model, it would take action against Storm. Other clients were told that ASIC had said Storm was innovative in its field and that other financial planners could learn something from Storm. Some submissions suggest that prospective clients phoned ASIC and were told, for example, that Storm's practices, investment strategies and SOAs were fine and that ASIC did not have any adverse information on Storm.	ASIC does not approve business models. ASIC did not endorse Storm's business model. As outlined in Section C of the submission, AFS licensing is a minimum threshold. An AFS licence does not indicate that ASIC approves the licensee's business model. ASIC granted Storm an AFS licence, as it is required to under law, because Storm met the relevant statutory criteria. ASIC cannot refuse a licence because it does not approve of the applicant's business model. Neither the complaints received about Storm nor ASIC's subsequent surveillance of Storm disclosed misconduct that, under existing law, would have enabled ASIC to cancel Storm's licence. We do not have any record of ASIC officers telling prospective Storm clients that the investment was fine. ASIC does not regulate the merits of investments so does not provide this sort of advice to investors and so instructs its staff.
ASIC gagged Storm at the crucial time Many former clients believe ASIC gagged Storm. A number of submissions claim that the gagging order was confirmed by ASIC.	ASIC did not give instructions to gag Storm. ASIC sought to negotiate an enforceable undertaking (EU) with Storm around 18 December 2008, well after Storm had begun to experience problems. At that point, the damage had occurred in that total investor equity was far less than total margin loans. The purpose of the EU was to address ASIC's concerns that Storm may have been providing conflicted and incorrect advice, to Storm clients who were in negative equity, that they did not need to meet their margin calls and should not deal with the banks. ASIC was concerned that this advice was coloured by the collapse of the Storm model and that clients were better off seeking independent advice about their affairs. The EU was a way to have Storm clients transferred to other advisers without going through a lengthy court process. The EU would need to be executed by Storm to have any effect. However, we did not ultimately execute an EU. Around 19 December 2008, Storm said it would cease contact with all its clients over the Christmas period. This action was not requested by ASIC and was a decision made by Storm. Storm subsequently went into administration on 9 January

Issue	ASIC's Response
	2009. Former Storm clients who contacted ASIC after this time may have been referred to the FPA for assistance in seeking independent advice about their affairs.
'Switch to cash' letter ASIC's response to a letter from Storm in October 2008 to clients seeking authorisation to convert some or all of their investments to cash ('switch to cash' letter).	ASIC was alerted to potential issues with Storm in late October 2008, when it received a copy of a letter Storm sent to clients seeking authorisation to switch their investments to cash. ASIC met with Storm to investigate these compliance issues. Whatever may or may not have been done during this time would not have altered the consequences for Storm's clients. The 'switch to cash' letter was sent at a time when investor equity had been seriously eroded. In the months of October, November and December 2008, the market fell significantly resulting in a significant shortfall between equity and margin loans for Storm clients.
ASIC failed to monitor Storm A number of submissions raise the issue that ASIC appeared to be unaware of Storm's business practices and that ASIC's regulation of Storm was inadequate.	ASIC conducted surveillances of Storm, which provided ASIC with some information about the nature of Storm's business. However, at the time of the surveillance activities, ASIC did not identify any breaches of the law against which it should have taken action.
ASIC failed to respond appropriately to Storm's collapse One submission suggests that ASIC was preoccupied with the $2 million payment to Mr and Mrs Cassimatis.	ASIC commenced formal investigations of Storm on 12 December 2008. ASIC is aiming to report back on the status of the investigations by 31 August 2009. The liquidator is scheduled to commence public examinations from September. ASIC considered it was necessary to take quick action to retrieve the $2 million payment to the Mr and Mrs Cassimatis and to deal with the insolvent status of Storm. The Court granted ASIC's application. ASIC considered these actions were necessary to protect the rights of creditors, including Storm investors.
ASIC failed to monitor the banks Several submissions suggest that margin lending by banks should be monitored by the regulator and that ASIC failed to recognise and address CBA's conduct in relation to lending practices and handling of margin calls.	Currently, the provision of credit for investment purposes is subject to limited regulation. While ASIC can take action for misleading and deceptive conduct under the ASIC Act, the provision of credit for investment purposes (including margin lending) is not regulated under the Corporations Act. ASIC submitted to the Productivity Commission in 2007 that margin lending should be regulated under the Corporations Act. Under the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 margin loans will be regulated as financial products under the Corporations Act. When passed this Bill will give ASIC power to regulate margin lending. The Bill will introduce a responsible lending obligation and a specific obligation for margin lenders to notify clients, or their

Issue	ASIC's Response
	agents, when clients are in margin call. Lenders will also be required to give borrowers a reasonable period of time to meet the margin call. Credit for residential property investment will be regulated under the proposed reforms in the National Consumer Credit Protection Bill 2009. Other forms of investment credit will be regulated in Phase II of the Government's credit reforms.
ASIC should investigate the banks' conduct Several submissions claim that ASIC should investigate: • whether the banks' conduct amounted to misleading and deceptive conduct; and • the failings in the banks' systems, particularly during the margin call period when websites were displaying incorrect data.	ASIC is investigating parties (including the banks) involved in Storm during the period when client accounts were in margin call. As stated above ASIC is aiming to report back on the status of its investigations by around 31 August 2009.
Storm's PI insurance was inadequate Many submissions suggest that clients were advised that Storm had adequate insurance to cover losses in the event of bad advice. Clients now believe this insurance was insufficient or inadequate. Submissions also make reference to insurance cover of $20 million being inadequate.	ASIC is continuing to investigate the availability of Storm's insurance policy for investors. Storm did have PI insurance in place, however, as PI insurance is a contractual arrangement between the insurer and Storm, the insurer can argue that the claim under the PI insurance policy is not valid if the insured did not make the necessary notifications. As ASIC has said for some time, the effectiveness of PI insurance as a compensation method is limited. It is not designed to protect consumers directly and is not a guarantee that compensation will be paid. It is designed to protect the insured against the risk of financial losses, within the limitations of what risks the insurer will agree to take on. In ASIC's guidance about adequate cover (Regulatory Guide 126), ASIC states that, as a minimum, licensees should have cover equal to their revenue, where it is greater than $2 million (up to $20 million). Depending on their business, some licensees will need more than $20 million for their cover to be adequate. For further information on PI insurance, see Section I.
ASIC favours the 'big end of town' Several submissions suggest that ASIC did not prioritise action against CBA and that ASIC should be monitoring lending practices. It has also been suggested that ASIC colluded with	ASIC applies the law without fear or favour. ASIC regularly takes action against larger players in the industry, including the banks. Examples of this include the EUs negotiated with AMP and ANZ and the concerns ASIC raised recently with Westpac about its Westpac Choice account.

Issue	ASIC's Response
CBA.	ASIC will monitor lending practices once the credit jurisdiction is transferred to ASIC under the National Consumer Credit Protection Bill 2009 and the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009.

ASIC's involvement with Opes

Table 29: Responses to issues raised about ASIC's involvement with Opes

Issue	ASIC's Response
ASIC failed to take action A former client states he/she is dismayed by the regulatory response.	On 28 March 2008, ASIC commenced an investigation into the conduct of some directors and officers of Opes and third parties and whether these individuals may have breached various laws. Subsequently ASIC commenced investigations into other possible breaches of the law arising from the collapse of Opes. As part of these investigations ASIC has reviewed hundreds of thousands of documents and examined about 30 persons. Some aspects of ASIC's investigations are substantially completed. On 6 March 2009, ASIC obtained an EU from ANZ in relation to ANZ Custodian Services, the entity that held securities lent by Opes. The purpose of this EU is to remedy deficiencies in the operational procedures across ANZ Custodian Services' business, including its securities lending operations. In early August 2008, ASIC, together with the then administrators of Opes (who were subsequently appointed as liquidators), initiated a mediation process involving ANZ, Merrill Lynch and the receiver of Opes, in relation to separate causes of action available to ASIC and the liquidators against ANZ and Merrill Lynch. ASIC's major objective in encouraging the mediation was to recover compensation for investors without the need for costly litigation and multiple actions. Following the mediation process, the parties agreed to a settlement on 6 March 2009. The settlement agreement proposed that a scheme of arrangement be put to Opes' creditors and the Court. On 23 June 2009, scheme meetings were ordered by the Court. The schemes were approved by the requisite majority of creditors on 24 July 2009 and by the Federal Court on 4 August 2009. Approval of the scheme should increase the return to creditors of Opes, including investors.
ASIC does not enforce adequate disclosure in relation to credit	The FSR regime regulates disclosure in relation to financial products. Margin lending and securities lending under an AMSLA are not defined as financial products and accordingly the disclosure requirements (such as the PDS requirements)

Issue	ASIC's Response
A former client reports that a PDS was not provided on margin lending or AMSLAs (securities lending contracts) by Opes and they cannot understand why this would not have been an ASIC requirement.	do not apply these types of arrangement. Under the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009, margin loans (including securities lending) will be regulated as financial products under the Corporations Act. ASIC welcomes this Bill. When the Bill commences, a PDS will be required for margin loans (including security lending).
ASIC is influenced by ANZ	ASIC applies the law without fear or favour. As stated above, on 6 March 2009 ASIC obtained an EU from ANZ in relation to ANZ Custodian Services. The purpose of this EU is to remedy deficiencies in the operational procedures across ANZ Custodian Services' business, including its securities lending operations. ASIC believes that the EU is the most effective way to improve compliance within ANZ Custodian Services, given the nature and breadth of ASIC's concerns and ANZ's willingness to both acknowledge ASIC's concerns and to cooperate with ASIC in its investigation. ANZ is a party to the mediation, settlement and proposed schemes of arrangements referred to above.

ASIC's involvement with Westpoint

Table 30: Responses to issues raised about ASIC's involvement with Westpoint

Issue	ASIC's Response
ASIC's response to Westpoint Several submissions raised issues in relation to Westpoint. In particular, one submission states that a client invested in promissory notes secured by Kebbel Bank and claims that Kebbel Bank was allowed by ASIC to trade fraudulently as a bank for many years.	This issue has previously been addressed in statements to the PJC and Estimates ASIC is pursuing all available avenues to recover compensation for the benefit of investors and has developed a website to keep investors informed of its progress: https://westpoint.asic.gov.au/. ASIC was successful in obtaining court orders for a global mediation of all Federal Court actions commenced by ASIC for compensation arising from the failure of the Westpoint group. This mediation is on foot at present. ASIC considers that this is in the public interest and is the most efficient way to seek to settle the matters so as to expedite returns to investors and minimise legal costs. The activities of the Kebbel group, which is based in Perth and connected to a director of several companies in the Westpoint group, were investigated by ASIC as part of our broader investigations into Westpoint. Following ASIC's investigations, Neil Austin Burnard was prosecuted and found guilty under the Crimes Act of NSW of obtaining a financial advantage for various Westpoint

Issue	ASIC's Response
	Mezzanine companies by making or publishing a statement which he knew to be false in a material particular. Mr Burnard had made statements that he was a director of 'Kebbel Investment Bank'; this entity did not exist. ASIC also liaised with APRA, as the prudential regulator, about this issue.

Other issues raised by submissions relating to ASIC

Table 31: Responses to other issues raised in the PJC submissions relating to ASIC

Issue	ASIC's Response
ASIC should enhance its licensing process Some submissions suggest that ASIC should take a greater range of factors into account during the licensing process. In particular, it is suggested that ASIC should consider the business model and how an applicant will intend to implement appropriate advice for clients (obligation in s 945A). Other suggestions include consideration of an applicant's resources and level of competency.	ASIC assess all licence applications and uses a risk-based approach. In assessing a licence application, ASIC considers the complexity of the licence authorisations being applied for and utilises internal analysis of the kind of business the applicant is undertaking (e.g. financial planning business or issuing financial products) and the market in which the applicant proposes to operate. ASIC specifically considers whether an applicant is competent to carry on the particular financial service it is seeking authorisation for, as well as whether the applicant has sufficient resources and can meet the other obligations in the Corporations Act. However, under the current regulatory regime, ASIC cannot refuse an application for an AFS licence for reasons beyond the grounds specified in the legislation (e.g. ASIC cannot refuse to grant a licence on the basis of the licensee's proposed business model), and ASIC cannot refuse to grant a licence if it suspects an applicant will not comply in the future with obligations under s912A.
ASIC fails to apply an appropriately risk-weighted approach to surveillance Some submissions suggest that ASIC would more successfully identify failing businesses, or businesses likely to fail, if it adopted a more risk-weighted approach in the exercise of its existing powers. These submissions suggest ASIC should engage in benchmarking industry standards with input from industry. This would enable ASIC to focus on fringe operators who act inconsistently compared to the majority of the advice profession.	ASIC does apply a risk-based approach to its surveillance and compliance activities. Prior to the strategic review, the Compliance directorate utilised an assessment framework that balanced the impact for regulatory action against higher critical risks. Following the strategic review, individual stakeholder teams conduct surveillance of activities undertaken in the team's particular area of responsibility. This analysis will continue to involve risk rating, but will be based on a greater understanding of the market and the key issues for retail investors. For example, the Financial Advisers team is seeking to enhance its approach to surveillance by undertaking a project to develop benchmarks in relation to the quality of advice. For more information see section D and Appendix 3.
ASIC should consider enhancing the PI	ASIC recognises that the PI insurance regime has inherent

Issue	ASIC's Response
insurance regime Some submissions suggest that ASIC should continue to consult on the PI insurance policy, and in particular, should consider the merits of requiring licensees to hold capital to ensure licensees are able to meet any claims for investor loss. Capital requirements may also be considered at the time of licensing,	limitations. In particular, PI insurance is not designed to protect consumers directly (i.e. the consumer is not a direct beneficiary of the insurance contract, as explained below) and it does not guarantee that compensation will be paid. These limitations have been exacerbated by the recent hardening of the PI insurance market. ASIC is continuing to maximise the effectiveness of the PI insurance regime in the context of these limitations. In particular, ASIC is continuing to monitor compliance with RG 126 and is working with the industry to ensure that the scope of the current compensation arrangements are maximised as far as possible within the constraints of the 'hardening' market. See Section I. Beyond this, ASIC is investigating the potential for imposing capital adequacy requirements on licensees. However, as ASIC is not a prudential regulator, there are limitations on our ability to impose capital requirements. Should ASIC conclude appropriate requirements cannot be imposed under our current powers, ASIC will refer the matter to Government for consideration. See Section C.
ASIC fails to enforce legal requirements Several submissions suggest that ASIC is not diligent in enforcing the law, including requirements to disclose conflicts of interest (e.g. disclosure of ultimate ownership of adviser firms, relationships between advisers and product issuers) and does not investigate volume overrides (i.e. volume bonuses paid by product manufacturers).	*Disclosure:* ASIC does not review all disclosure documents. However, ASIC does review many documents, taking a risk-based approach, and takes action where appropriate. ASIC has also released guidance for industry on managing conflicts of interest. *Volume bonuses:* Volume bonuses are paid by platform providers or product manufacturers to advisers based on the volume of the product that the adviser has under advice. This is paid out of the fees charged to the investor (such as the administration fee). Payment of volume bonuses is not a breach of the Corporations Act. However, volume bonuses do have to be appropriately disclosed and any conflicts for licensees arising from the payment have to be appropriately managed. ASIC is working with industry to consider whether these fees are adequately disclosed to investors. See Appendix 3 for information about ASIC's action.
ASIC's licensing regime provides an endorsement of advisers Some submissions discuss the issue that checking whether an entity is licensed is part of researching a financial adviser. Licensing is considered to indicate that advisers have met a particular standard (e.g. in relation to professional conduct and quality of advice).	As outlined in Section C of the submission, AFS licensing is a minimum threshold. An AFS licence does not indicate that ASIC approves the licensee's business model. ASIC must grant an AFS licence where the relevant statutory criteria are met. ASIC cannot refuse a licence because it does not approve of the applicant's business model.

Issue	ASIC's Response
ASIC fails to act on information Several submissions suggest that ASIC does not use industry intelligence or respond to warning signs and that some licensees have given up reporting breaches by other licensees because ASIC does not appear to act on these reports.	ASIC responds to intelligence and complaints about licensees. Such complaints are registered with ASIC's Misconduct and Breach Reporting (M&BR) team The M&BR team refers matters for further action to the various ASIC stakeholder and deterrence teams. Leaders of stakeholder teams, as part of their key performance indicators, are required to make proper assessment of these complaints, including assessment of the potential for wider implications. Following the Strategic Review, ASIC's stakeholder teams have developed a more outward-looking, market-focused approach. This has improved ASIC's internal capacity to identify potential issues and respond efficiently to stakeholder intelligence. ASIC also has a Regional Commissioner in each State and Territory to gain intelligence about issues in each region.
ASIC fails to adequately monitor the market Several submissions suggest that ASIC does not scrutinise corporate activity adequately and that ASIC is not motivated to systematically investigate risks (e.g. disclosure).	ASIC does not review all disclosure documents nor conduct surveillances of all providers on a regular basis. ASIC takes a risk-based approach to the review of documents and surveillance of providers. ASIC also cannot prevent failures of investments. It is not a guarantor of last resort. Following the Strategic Review, we have improved internal capability to better identify 'smoking guns' and respond in the most efficient manner possible. See Appendix 3 for information about ASIC's activities.
ASIC should provide early warnings on dangerous products Several submissions suggest that an early-warning mechanism is needed and ASIC should establish a Consumer Protection Task Force to report on products and practices that endanger consumers. In particular, it is suggested that ASIC should focus on models using gearing. Another submission suggests that ASIC's approach to consumer protection against risky products (i.e. ASIC's focus on compliance arrangements) misplaces the burden of ensuring the appropriateness of products onto the individual adviser.	ASIC provides consumer warnings through its FIDO website and media releases on dangerous products. For example, since 1999 ASIC has published on its website warnings about the risks of borrowing to invest in the share market. However, the basic philosophy of the Australian financial services regime is that any product can be sold to any investor provided the nature of the risks, fees, etc. are disclosed. In this context, ASIC's role is to oversee and enforce compliance with the conduct and disclosure rules enacted in the Corporations Act. The regime relies on market participants to comply with the law and places the onus for assessing risk on the investor.
ASIC should take action against high fees One submission suggests that regulators should move in without delay where high fees are advertised or discovered.	The law does not set limits on what fees can be charged, so ASIC has limited powers to take action to address high fees where the fees are properly disclosed.

Issue	ASIC's Response
ASIC does not provide enough guidance/information A number of submissions suggest that: • ASIC should provide more assistance to consumers; • ASIC's guidance has not been helpful as ASIC refuses to give advice; • ASIC should provide factual material on companies to investors; • the FIDO website should have more information on financial planners, margin loans and liquidation of companies; and • ASIC should develop a database of purely fee-for-service advisers.	ASIC has implemented a range of measures to assist and educate investors. These include: • its consumer websites (www.fido.gov.au and www.understandingmoney.gov.au); • consumer publications (such as on reverse mortgages); • media; • professional learning packages; • outreach activities (including regular participation at expos, conferences and speaking engagements); and • stakeholder liaison. See Section H and Appendix 3 for more information about ASIC's investor protection activities.
ASIC is captive to industry A number of submissions suggest that ASIC is captive to industry as ASIC staff come from industry.	ASIC staff have diverse backgrounds (e.g. financial services, accounting, legal, academic, government and consumer groups). Many ASIC employees have invaluable industry experience. This experience means they understand the practices of and issues facing industry and, therefore, it enhances ASIC's ability to regulate the industry. ASIC's Consumer and Retail Investors stakeholder team, its Consumer Advisory Panel and its public consultation processes ensure that ASIC is extensively exposed to the views and experiences of consumers and retail investors.
ASIC's licensing process is very difficult for small licensees One adviser claims it took 12 months and cost approximately $500,000 to become licensed, but the process still does not identify major risk trends. It is also suggested that the licensing process forces small independent advisers to join large product sellers to achieve economies of scale.	The application fee for a new licence payable to the Commonwealth via ASIC is low, only $270. The application process was designed so as to enable applicants to complete their own applications. However, outsourcing the licensing application process could cost between $7000 and $50,000 depending on the service provider used, and what other services are included. Businesses also incur additional costs such as EDR scheme membership, PI insurance, legal costs and the costs of setting up a business and developing documentation/inputs for provision to ASIC (directly or via an agent). For example, they might need to get staff recruited and trained, appoint representatives, get ASX memberships, etc. ASIC strives to make a decision in principle on 70% of applications within 28 days. That is our Service Charter target. The cost of the licensing process and the length of time it takes vary depending on the nature of the licence application. Higher-risk applications receive greater scrutiny during the licensing process. Additionally, incomplete applications or applications where the criteria for granting a licence are not

Issue	ASIC's Response
	readily satisfied by the applicant take longer to process, as ASIC has to ask the applicant for additional material. These situations could also require additional personnel to be appointed by the applicant, further delaying the process.
Expert reports One submission outlines a proposal made several years ago to ASIC and Department of Treasury outlining a methodology for obtaining expert reports that are independent and professionally sound for use in disclosure documents. The proposed methodology would protect investors. The submission states that no response was received from ASIC.	The compulsory acquisition procedure in Part 6A.4 of the Corporations Act requires an expert's report to be prepared by a person nominated by ASIC. This procedure has not raised any particular problems and could be extended to other mandatory experts reports. However, this would require law reform, which is a matter for Government.
ASIC should improve adviser training A number of submissions suggest that the standard of training required to become a financial planner should be raised.	Regulatory Guide 146 sets down minimum standards for the whole industry. ASIC's Financial Advisers team will review these minimum standards. We note that in the past some sectors of industry have argued that raising these minimum standards would significantly increase the cost of advice and therefore access to advice would be reduced. See discussion in Section D.
ASIC should be made accountable and reviewed Several submissions suggest that a set of performance criteria should be developed for ASIC or performance data should be released, (e.g. on complaints received, investigated, resolved).	ASIC is accountable to Parliament and the PJC. The PJC inquires into and reports to both Houses of Parliament on the activities of ASIC and examines ASIC's annual report and reports to both Houses of Parliament on that report. ASIC reports against a series of benchmarks in its annual report. ASIC has also just conducted a Strategic Review of its performance including a survey of its stakeholders.
ASIC takes a 'tick-a-box' approach to regulation Several submissions suggest that ASIC takes a form-over-substance approach to regulation, for example, it is argued that ASIC should more proactively review PDSs; it should not be a box-ticking exercise.	In certain places the FSR regime does set out processes for licensees to follow and ASIC monitors whether these processes are followed and takes appropriate action where they are not. In general, however, ASIC looks at the substance of licensees' conduct. ASIC's Strategic Review aims to make ASIC more responsive to the market and less focused on merely technical legal issues.
ASIC does not protect consumers/respond to complaints Several submissions suggest that a Consumer Protection Agency or Independent Consumer Watchdog should be established, as ASIC has not adequately responded to complaints.	Following the Strategic Review, ASIC's M&BR team is responsible for the registration and assessment of all reports of misconduct, complaints and relevant information received from the general public, and breach notifications from licensees, responsible entities and auditors. ASIC receives approximately 13,000 complaints per year. ASIC assesses every formal complaint it receives. However, due to resource constraints we cannot pursue all complaints,

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	and in some instances we are restricted from doing so. Issues such as lack of sufficient evidence, lack of jurisdiction, other personal remedies being available, arise in many of the complaints received. Having a dedicated national team ensures that ASIC is better placed to centrally capture and appropriately respond to the intelligence it receives via complaints and breach reports. ASIC's Consumer and Retail Investors stakeholder team is dedicated team looking at consumer and investor protection and education. While section 12A of the ASIC Act includes consumer protection issues within ASIC's functions, any action taken on behalf of consumers must be exercised in the public interest. See Appendix 3 for more information.
Low-doc/no-doc loan arrangements Many submissions refer to losses incurred in low-doc or no-doc loan schemes. Some submissions suggest that ASIC was aware of fraudulent loan schemes but did nothing. Other submissions suggest that ASIC has abrogated its responsibilities in this area. In particular, an investor wrote to ASIC to request that her claims be investigated. ASIC replied that it was a state issue and was being dealt with by the WA fraud squad.	Currently ASIC is not the primary regulator of the provision of credit. The States currently have primary responsibility in this area and where appropriate ASIC refers consumers to the relevant State regulators. ASIC can only take action for misleading or deceptive conduct in relation to credit. ASIC has undertaken work in relation to debt collection and handling of hardship applications by lenders from borrowers in financial stress and worked to establish standards in the industry for mortgage brokers in the absence of a regulatory framework. We have also issued the *Protecting Wealth in the Family Home* report, which looks at inappropriate lending to consumers in financial distress. In 2009 ASIC has intervened in proceedings relating to the enforcement of low-doc loans on public interest grounds to test the legal and regulatory framework that applies to enforcement action taken against borrowers by 'low-doc' lenders. These proceedings concerned the conduct of the Streetwise Group of Companies, which had been subject to investigation by ASIC. ASIC will be responsible for regulating consumer credit following the commencement of the National Consumer Credit Protection Bill 2009 and the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009. ASIC welcomes these reforms.