

Address to the Financial Planners Association of Australia – Newcastle

Chapter

The Newcastle Club

14 October 2009

Sharon Grierson MP

Ms Grierson: Good evening to everyone and thank you to the Newcastle Chapter of Financial Planners Association Australia for inviting me to speak with you tonight.

I particularly would like to acknowledge Mark Reeson, the FPA Newcastle Chapter Chair, Jo-Anne Bloch, FPA CEO and Mark Folpp, Investors Mutual Limited (IML) National Distribution Manager and IML's sponsorship of this event.

I'd also like to acknowledge the role that the Financial Planning Association of Australia (FPA) plays – I know the Association is recognised as the peak professional organisation representing the financial planning sector in Australia, including almost 300 individuals and business in the Hunter and Central Coast region.

I understand this makes this chapter one of the largest – and oldest – in Australia.

I'd also like to state up front my support for the Financial Planning sector. On any level – be it the individual, business or the wider economic level, good financial planning and advice is important. As observers who have lived through the interesting times of a global financial crisis – its lead up and hopefully soon its aftermath, we have witnessed first-hand the impact of global economic developments on the financial security of every Australian, every Australian business and the Australian economy. And I'm sure there is not one person here this evening who hasn't rethought their beliefs and understandings about sound financial management as a result.

That's a good thing. We come together at a time when old constructs have been challenged and we share a task now to reconstruct systems and confidences about planning, managing and maximizing financial investments and potentials.

There are some things though which haven't changed. Financial advice needs to come from responsible and accurate sources – from financial planners who are informed, risk conscious and responsible.

Planners need to work in a healthy regulatory framework – a framework implemented by the government, and the industry itself, that promotes competition

and profit, but that also provides safety nets and stipulations of responsibility and fairness, and of openness and good governance.

Uncertainty centres around the accountability area more than ever before and that of course is the area government is giving great consideration toward.

In essence, the challenge for us is one of getting the balance right– organising a regulatory structure that provides adequate controls without stifling investment but is fair and even-handed.

That's a challenge the Rudd government is committed to achieving.

I'm here to talk to you tonight wearing 'three hats':

The first is in my role as the Federal Member for Newcastle: the representative in the national parliament of those that deliver financial planning advice and those that are on the receiving end of that advice.

I'm also here in my capacity as a member of the Joint Parliamentary Committee on Corporations and Financial Services, a Committee that through its activities and inquiries advises the Australian government on a number of legislative issues that are of particular importance to the Financial Planning industry.

Finally, I'm here tonight also as Chair of the Joint Parliamentary Committee of Public Accounts and Audit – the most senior and powerful committee of parliament – the committee that in working closely with the Auditor General and the Australian National Audit Office acts as a buffer between corruption and good government.

To begin I would say to you that as the member for Newcastle I have had many contacts from self-funded retirees and baby boomers planning their retirement. Some place the blame for their dwindling retirement income or the unanticipated years they still have to remain in the workforce at the feet of financial planners, others are dissatisfied with lending institutions or superannuation funds and others blame government for failing to provide adequate protections. Overall, there are few happy customers out there that feel confident about their financial security. This is verified in reports last week from the Financial Ombudsman Service that investor complaints about managed investments almost doubled in the year to June and disputes involving margin loans were up close to 420%.

But when it comes to the most unhappy of investors my role in the Joint Parliamentary Committee for Corporations and Financial Services has been perhaps the most illuminating.

The committee was established under the *Australian Securities and Investments Commission Act 2001*. Section 243 sets out the duties of the committee as follows:

- to inquire into, and report to both Houses of Parliament – the Senate and the House of Representatives on:
- activities of the Australian Securities and Investment Commission, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or
- the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and
- to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and
- to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

In the time since the election of the Rudd government, the Committee has undertaken a number of inquiries that I'm sure attracted interest from many here tonight. The first was an inquiry into franchising which exposed some of the inequities between franchisors and franchisees as well as problems around accuracy of financial information, disclosure obligations, conflict resolution processes as well as conflict of interest by lenders.

In the public eye, most interest of late has been the current Inquiry into Financial Products and Services in Australia. This Inquiry is particularly relevant, due to the breadth of the Inquiry's Terms of Reference and its potential impact on the financial services industry.

The Inquiry is looking into the issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses, with particular reference to:

- The role of financial advisers;
- The general regulatory environment for these products and services;
- The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;
- The role played by marketing and advertising campaigns;
- The adequacy of licensing arrangements for those who sold the products and services;
- The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;
- Consumer education and understanding of these financial products and services;
- The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
- The need for any legislative or regulatory change.

The committee is also investigating the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.

I note that the FPA has made a submission to this Inquiry, and commend it for the 18 recommendations it has made around the role of financial advisers, regulatory reform, remuneration and conflict of interests, availability, advertising and promotion of poor products and information education and consumer capability and finally professional indemnity insurance.

The submission overall identifies two key themes to help deliver better outcomes for consumers:

- 1) Better regulation to support the delivery of advice, which includes a host of issues such as licensing, disclosure and product accountability; and
- 2) Better differentiation of professional financial planners from 'financial product advisers' and 'authorised representatives', which is supported by

compulsory membership of an accredited professional association.

I must at this stage also make note of the Value of Advice advertising campaign ran by FPA - an initiative by the FPA to build awareness among Australians about the importance of obtaining professional financial planning advice.

As the inquiry is still underway there are limitations on what I can discuss. However, I can say to you that this inquiry has been a very emotional one for the committee, at times bringing even the most hardened and composed members of parliament to rage and tears. If you have been reading coverage of the federal court case involving Storm Financial I'm sure you'll understand.

In the Financial Products and Services Inquiry we received over 400 written submissions. We have been dealing with many people who have literally lost everything and now face a lifestyle they never envisaged for themselves. Witnessing their despair has not been easy.

Throughout the inquiry it has also been revealing to observe an emerging realization by lending institutions that they are not at arm's length and cannot escape some degree of responsibility for the financial crisis experienced by their customers. Even at this stage of the inquiry the committee is very aware that they have at least been responsible for a more considered and in some cases more compassionate response by banks to customers in serious arrears on mortgages or loans taken to finance investment in Storm and Opes Prime products. But it is my opinion that they have been too slow to come to this realization of corporate responsibility or culpability. At a recent hearing in which David Liddy from the Bank of Queensland presented to us I was quite astounded when he told me that in their internal review of the Storm investments by customers no record of a product analysis was found. It astounds me that a bank will do at minimum a drive-by evaluation of a house before approving a mortgage but in the case of loans for its customers to invest with Storm Financial, the Bank of Queensland did no product analysis or risk analysis whatsoever before approving those loans. I don't wish to single out the bank of Queensland and note that investigations underway by ASIC centre on the CBA. Macquarie bank will present to our committee when we return to parliament in the next fortnight. In their original submission to the inquiry, Macquarie Bank claimed that "all affected clients were made aware of their margin call obligations and were in a position to take action in a timely manner." No doubt Macquarie Bank will be asked about a Business Day survey that found that of 30 margin loan recipients contacted 19 said they had received no margin calls from Macquarie bank and had been sold out at a loan-to-value ratio of 96.7%!

Similarly, as the inquiry has unfolded I also detect a much deeper understanding by ASIC of how they are perceived by the general public. It's evident that before the GFC ordinary investors thought that ASIC was there to protect them and that ASIC as a matter of course would be scrutinizing the market for risky investment products

and businesses. Of course that was never the case. So although the average punter knew enough not to risk all they owned on horse number 6 in race 4 at Randwick, they didn't know that the stock market and some particular financial investment products were also a considerable gamble and that a free market approach meant they were free to risk the lot.

Not all the blame for that mismatch between reality and perception lies with ASIC. Until the last financial year, ASIC never had the legislative powers or resources to be the watch dog many people thought they were. Under the Rudd government ASIC is being strengthened to match those perceptions that ASIC provides consumer protection for investors.

But I'm pleased to say that my observation is that the work of the committee has made ASIC more thoughtful about their role and how they carry that out. I understand that FPA has raised some areas of difference with ASIC's submission to our inquiry and I assume Jo-Anne Bloch will address some of those matters with you.

Another recent report of the Committee that was of particular relevance to the FPA was the Inquiry into Agribusiness Managed Investment Schemes, following the recent collapse of Timbercorp and Great Southern.

This inquiry was a pertinent example of the effectiveness and importance of the Committee – it was a very rapid response to a very real situation.

It is estimated that Great Southern and Timbercorp had 43 per cent of all managed investment scheme business in Australia - and MIS accounted for 100 per cent of their business

The schemes collapsed in April and May of this year, taking with them over \$3 billion from 60,000-plus investors. Many of these investors were from rural Australia – investing in agriculture based investments and in a way backing an industry they believe in.

But it's true to say investors generally were attracted by the offer of an immediate tax deduction on their investment combined with the possibility of a long-term return.

Intervening factors—drought, changes to the economic environment and the natural environment together with the global financial crisis— meant that there were factors of high risk that many people had not considered.

The end result was devastating for those involved.

The Inquiry was held to determine why the collapse happened and how it could be prevented from happening again.

It looked at:

- business models and scheme structures,
- taxation treatments,
- the conflicts of interest for board members and other directors,
- commissions, fees, other remuneration paid to marketers, distributors, related entities and sellers and who they were, including accountants and financial advisors and their roles.

The Committee also looked at the accuracy of promotional and advertising material for MISs, particularly information relating to claim benefits and returns, including carbon offsets, the range of individuals and organisations who were involved with these schemes, including the holders of relevant Australian financial services licences and the level of consumer education and understanding of these schemes.

It looked at the performance of the schemes, the factors underlying the recent scheme collapses, rejected returns and supporting information, including the assumptions that they were based on, product price and demand, the impact of MISs on other related markets and the need for any legislative or regulatory change.

Without going in to too much detail, it was found that investors in these MISs were being encouraged to put their money in to Ponzi-esque schemes. The Ponzi model pays returns to separate investors from their own money or money paid by subsequent investors rather than from any actual profit earned! Just what were they thinking when they came up with that one! Maybe that good times go on forever.

While it would not be accurate to generalise across the entire agribusiness MIS sector, the MIS model can, to quote from the report:

... encourage Responsible Entities to develop business models with a ponzi-like character if external factors such as access to credit and drought intervene, necessitating extra MIS sales to inject working capital into existing schemes— as was the case with Timbercorp and Great Southern.

As the submission by ASIC to the inquiry stated, while there were not literal interpretations of a Ponzi model:

Agribusiness MIS operators have been criticised for adopting business models which rely on receipts from application fees for revenue.

ASIC indicated:

... this business model may be unstable if the flow of new MIS sales is interrupted.

Another recommendation of the report was for an amendment to be made to the Corporations Act, arising from concerns about how liquidators have managed their conflicting obligations to creditors and to investors.

The committee found that ASIC should appoint a responsible entity to manage any registered MIS when it collapses.

Finally, the committee recommended that ASIC disclose the qualifications and accreditation of third parties advising on the schemes.

General concerns about advisers' remuneration and the standard of financial advice provided were also mentioned in the report – however it can be anticipated that these issues will be addressed more comprehensively in the aforementioned Inquiry into Financial Products and Services. And I understand that these are areas of particular interest to this audience.

The inquiry was completed over a very short period of time. It certainly did not go into the depth that some members would have liked but this was because the committee is also involved in the Storm and Opes Prime inquiry.

The committee holds public hearings with ASIC as part of its statutory oversight role. ASIC deserves praise for the way it is now asserting the important role it can play in the financial industry

The Rudd Government has recognised this, and is changing role of ASIC and regulations that bind it – ASIC is stepping up to the plate

This is not to say I support over-regulation – it is important to not stop opportunities for people to invest, and take that certain amount of risk.

But it is also important to manage this risk with the right amount of responsibility

This most recent ASIC Oversight hearing dealt with a number of controversial issues - short selling, market integrity, recent corporate collapses, BrisConnections, mortgage fund and cash management trust redemptions, professional indemnity insurance, ASIC structure and budget, and investor education. Some interesting discussions have been held.

The Corporations and Financial Services committee welcomed ASIC 's decision to lift the ban on covered short-selling sales of financial stocks.

We considered that covered short selling contributes to market liquidity and price discover - it is a valid feature of the Australian market.

But the committee intends to continue monitoring the performance and effective reporting arrangements for covered short sales, particularly when the arrangements to be determined by regulation replace the existing interim arrangements.

We also considered that transparency needs to be a key feature of these arrangements in order to maximise information available to the market and to assist the regulator, ASIC, in identifying false market rumours without the need to resort to future bans.

With regard to market integrity, the committee questioned ASIC about the effectiveness of Project Mint, established to investigate instances of rumourtrage—that is the practice of spreading false or misleading rumours.

ASIC is now also to have a greater role within the Australian Stock Exchange, which I will touch on later.

With regard to BrisConnections, the committee welcomed ASIC's move to ensure that the ASX obtains a signed acknowledgement from investors in partly paid shares.

It is hoped future investors avoid the situation that some BrisConnections shareholders found themselves in—that is, being unable to recover the liabilities of the shares they had purchased.

The committee remained deeply concerned about some of the other governance and disclosure issues allegedly surrounding BrisConnections and urges ASIC to take any relevant action in a timely fashion.

In terms of mortgage fund and cash management trust redemption, the Committee welcomed ASIC 's announcement that it has now expanded relief for hardship withdrawals from frozen funds.

It should also be realised that people have been seriously caught out, often at a time in their lives when they have no other resources and nowhere to turn.

So ASIC has lifted the cap on hardship withdrawals to \$100,000 each calendar year, increased to four the number of hardship withdrawals that can be made each year and extended the list of recognised hardship grounds.

These steps should assist individuals who were affected by the fund freezes.

The Committee also looked at credit-rating agencies, and at ASIC 's structure and budget.

Finally, the Committee looked at investor education – looking at creative ways for ASIC to educate people in responsible investment. As I said earlier, I praise the FPA's current advertising campaign alerting potential investors to the importance of responsible investment.

At our last hearing with ASIC I encouraged them to change their thinking around ways to educate people about financial risk. School based programs which ASIC recommends have their place but you as financial planners will know that there are particular groups of people who are investment sensitive or in the market for financial investment opportunities and advice – those approaching retirement, superannuants looking at lump sum payouts and those who receive lump sum redundancy or insurance pay-outs. It seems to me that at these times particular advice and cautions should automatically be sent to these particular groups. Or when those people are on line looking up their super or looking for financial investment opportunities, a pop up message needs to appear on their computer screen courtesy of ASIC. Perhaps appropriate wording might be "Danger – You could lose the lot!" with the link to ASIC providing appropriate information regarding investment risks.

The Reports from the Joint Committee of Corporations and Financial Services have seen a number of recent changes in legislation relating to financial planning.

The Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, recently introduced the Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009 (Modernisation Bill) into Parliament.

The Bill addresses three key areas of financial services regulation:

- Margin lending

- Trustee companies
- Debentures and promissory notes

According to the Minister, "The new margin loan legislation represents a major improvement in consumer protection in an area which was previously only subject to patchy and inconsistent regulation."

Some important changes were made. A lengthening of the transition period allowed before key provisions in the new legislation begin to apply – particularly the case for the responsible lending requirements, which will introduce a new requirement for margin lenders to assess whether a proposed loan is unsuitable for a consumer.

The Rudd Government also recognises that implementation of this new requirement will require significant efforts on the part of lenders, including the development of new systems and processes, as well as training of staff. Margin lenders will now have 12 months to prepare for the new regime, as compared to 3 months in the exposure draft.

The new regime will make margin loans subject to the investor protection regime in the Corporations Act. It requires margin lenders and advisers to obtain a licence and be subject to supervision and enforcement by ASIC. It will also give borrowers access to free and fast dispute resolution services where they have a dispute with their provider.

Margin loan lenders will be subject to responsible lending requirements which will only allow them to provide a margin loan if they are reasonably sure that the borrower is able to afford the loan without suffering substantial hardship. A new provision is included which clarifies whether lenders or financial advisers are responsible for notifying borrowers of margin calls. Take note Macquarie Bank!

There has also recently been an increase in powers for ASIC on the Australian stock exchange, which I touched on earlier.

Minister Bowen recently announced that ASIC will take over the supervision and surveillance of financial markets in Australia and therefore effectively be the industry watchdog, as well as prosecutor >

As the Minister has said, if there is going to be supervision of market operations – detection of insider trading – it is best that this is undertaken by a government organisation.

It also brings market supervision under the one set of guidelines

A major consideration for me as a member of the Rudd government is the importance of government policy settings in leading investor behaviour. Pertinent examples are a tax setting introduced by the Howard Costello government that encouraged salary sacrificing into superannuation – a policy setting that saw many investors 'de-diversify' or increase their mortgages and loans to place their fortunes in equities alone with the GFC consequence of major financial losses.

Another example of government policy settings that gave false comfort to investors was the tax treatment of MIS that encouraged investment in these particular products.

These are areas that I would like to explore further in my role as Chair of the Joint Parliamentary Committee of Public Audits and Accounts when we hold one of our biennial hearings with the ATO next week.

The purpose of the Joint Committee of Public Accounts and Audit (JCPAA) has remained essentially unchanged since it was first established in 1913: the JCPAA exists to hold Commonwealth agencies to account for the lawfulness, efficiency and effectiveness with which they use public monies.

The JCPAA is committed to good governance. In my role as Chair, I have represented the Australian government on the international stage especially in developing nations – working in countries such as Laos and East Timor to help provide training and advice in frameworks for good governance and accountability

Recently I delivered a paper to a conference of the East Timorese parliament regarding Australia's Financial Management and Accountability Act. The conference was dealing with Timor-Leste's first legislation regarding accountability and financial management, and I was particularly pleased to learn that the proposed legislation was amended to strengthen accountability as a result of my input.

In 2008 I was invited by the World Bank to assist the Laotian National Assembly in developing a comprehensive Strategy and Action Plan for its adoption for institutional development.

Working in these roles - providing frameworks for accountability and good governance in developing nations – is something that is of great importance to me. The challenges they face are different perhaps but the common factor of financial exploitation is always personal or collective and corporate greed.

Whether as the Federal Member for Newcastle, as a voting member on Joint Parliamentary Committee on Corporations and Financial Services or as Chair of the Joint Parliamentary Committee of Public Audits and Accounts, I am a strong proponent of transparency and accountability.

Engagement in the political process at all levels also strengthens good government. So I am pleased to see that the FPA has recently undertaken a greater role, with FPA members meeting local MPs to outline the good work genuine financial planners can do for their clients.

By taking an active role in the formulation of governmental procedure and policy, the FPA are on the right path to creating a legislative framework that is beneficial for all involved – from the individual, to the industry, to the economy at large.

On my own part I very much have appreciated speaking with you this evening. Thank you.