



Financial Planning Association
of Australia Limited
ABN 62 054 174 453

Level 4, 75 Castlereagh Street
Sydney NSW 2000

GPO Box 4285
Sydney NSW 2001

Tel: 02 9220 4500
Fax: 02 9220 4580

Member call: 1300 337 301
Consumer call: 1300 626 393
Fax: 03 9627 5280

fpa@fpa.asn.au
www.fpa.asn.au

4th March 2011

Future of Financial Advice
Department of Treasury
Langton Crescent
Canberra ACT 2600

futureofadvice@treasury.gov.au

Dear Sir / Madam

Wholesale and Retail Clients (Options Paper)

The Financial Planning Association of Australia (FPA)¹ welcomes the opportunity to provide input into the review of the appropriateness of the distinction between wholesale and retail clients in the Corporations Act 2001.

In his announcement, the Minister described the Review as the “line between retail and wholesale clients to properly identify those in need of regulatory protection”. Including this Review within the Future of Financial Advice (FoFA) reforms implies that the Government views this as an advice issue. In addition, the proposals in the Options Paper clearly focus attention on providing regulatory consumer protections by identifying and putting boundaries around the client.

However, the FPA suggests that the evidence indicates a problem which is not in the advice space and which cannot effectively be addressed by regulating the client. A more effective and appropriate solution should be considered by reviewing the regulation of brokerage services and financial products available to Australian consumers.

Many of the examples provided in the Options Paper of clients who had invested in complex financial instruments and who were badly impacted by the GFC, relate to ‘retail client’ access to collateralised debt obligations (CDOs). However, such products were/are predominantly purchased directly from product providers or via a broker, not through a financial planner.

Similarly, the FPA has found little evidence of the misuse of the wholesale threshold tests or of wholesale clients being ill-treated by advisers. Advisers generally treat all clients as ‘retail clients’, affording them the same disclosure and consumer protections (with the exception of access to EDR) even if legally the client is classified as a ‘wholesale client’. FPA members are required to treat **all** clients as ‘retail clients’ under our Code of Professional Practice.

The FPA however, is not dismissing the experience of some ‘retail clients’ who had invested in CDOs and other complex financial instruments, in particular local governments and councils. What we are saying is that the evidence available highlights the fundamental need to improve the regulation of such products.

¹ The Financial Planning Association of Australia (FPA) is the peak professional organisation for the financial planning sector in Australia. With approximately 12,000 members organised across Australia, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than \$630 billion.

The lack of disclosure by brokers and product providers in relation to complex financial product available to Australian consumers, whether retail or wholesale clients, needs to be addressed. As such, the FPA is concerned that expanding the retail client boundaries in an effort to enhance consumer protections by regulating the client would not address the issue and would have negative consequences on consumers:

- Clients, whether classified as 'retail', 'wholesale', 'professional investors', or 'sophisticated investors' would still be at risk of suffering significant losses by investing in unregulated complex financial products sold direct to consumers.
- It would result in misplaced controls on consumers and restrict consumer choice, rather than effectively regulating financial products.
- If product value thresholds were increased, or the wholesale definition removed, External Dispute Resolution thresholds would be required to be increased to accommodate wholesale disputes – high value claims relating to investments in complex and high risk financial products would take EDR scheme' resources away from 'retail clients'.

The FPA has carefully considered the issues raised and options presented in the Options Paper. The FPA is concerned that confining considerations to those proposed in the Paper, will limit the options and opportunity to improve the system.

The FPA believe the following guiding principles should be applied when considering this issue:

1. Consumer protections are appropriate and effective
2. Consumer choice is maintained
3. Proportionate liability of the risks associated with purchasing financial products is employed.

While some components of each of the options in the Paper may assist in improving the current system, the FPA believes there is a need to establish a framework that separates products more effectively based on risk and takes into consideration the different ways consumers uses financial products.

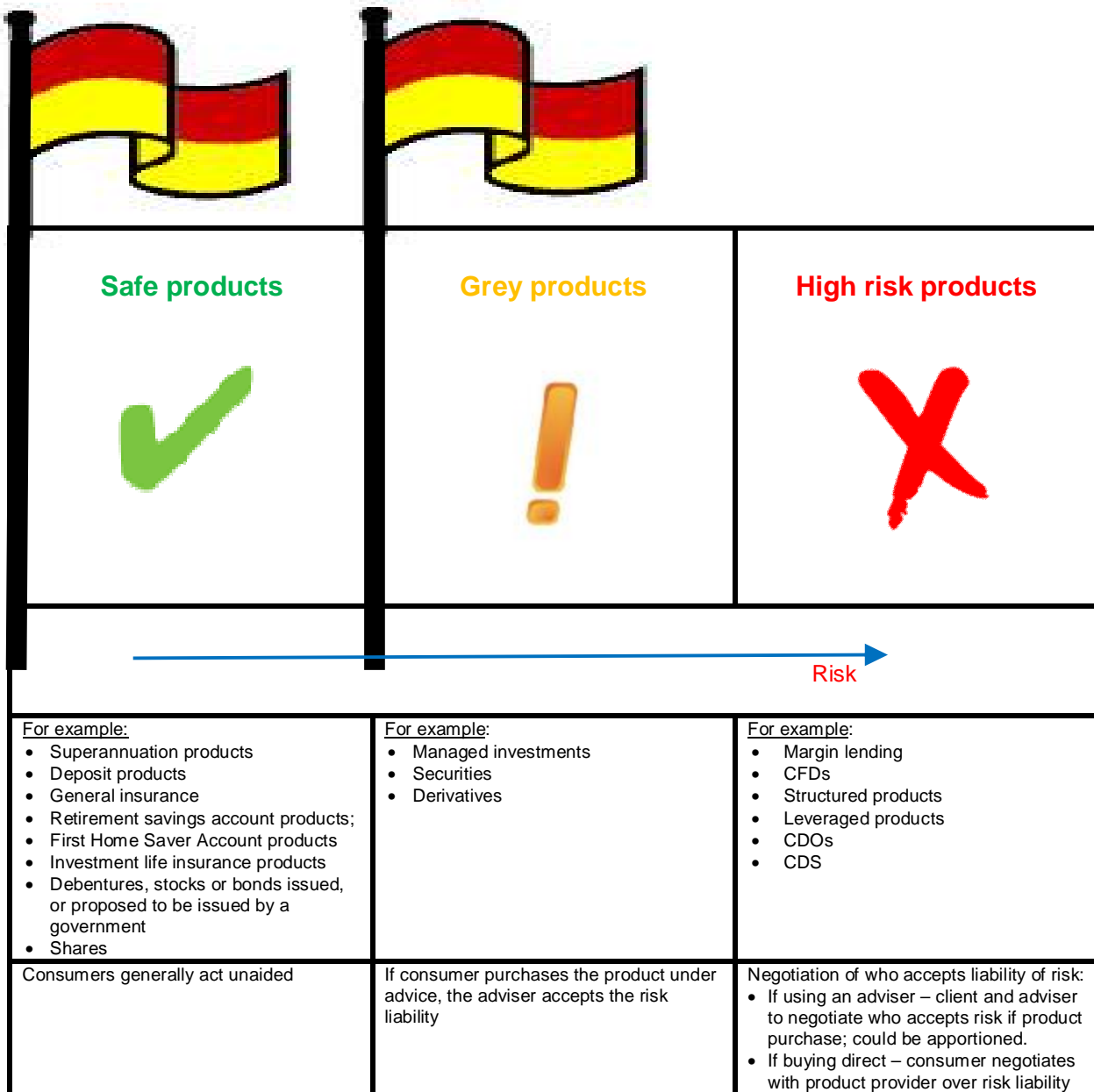
FPA recommendation

The FPA recommends the development of a framework aligned with ASIC's 'Investing between the flags' concept. The framework should provide a model that separates products more effectively based on distinctions in risk in three key areas:

1. Complexity of product
2. Complexity of client needs
3. Complexity of advice

Below is an example framework that categorises products into three categories that could be adopted to support an 'investing between the flags' approach to product regulation:

Investing Between the Flags (example framework model)



The framework should include requirements for appropriate product disclosures and warnings to be provided to consumers when crossing the boundaries of the 'safe', 'grey' and 'high risk' product types. Irrelevant of the product type, the FPA supports the use of appropriate consumer disclosure on all financial products.

While the FPA's preferred option would be the acceptance of the above framework, the Association considers that some of the components of options 1 – 4 in the Options Paper may assist in developing the requirements of the boundaries within this framework. To this end, the FPA has provided responses to some of the questions posed in the Options Paper in Attachment 1. The FPA would like to emphasize that the Association does not support the adoption of any of the options proposed in the Options Paper verbatim, but rather the introduction of the 'Investing between the flags' product regulation framework.

The FPA presents this framework as a concept for consideration. There is of course much detail that would still need to be determined and we would welcome the opportunity to work with Treasury to develop the 'Investing between the flags' framework further.

Should you require further information or wish to discuss the issues raised in this submission, please contact me on (02) 9220 4505 or Dante.Degori@fpa.asn.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Dante De Gori', is written over a light blue rectangular background.

Dante De Gori
General Manager, Policy and Government Relations

Attachment 1: FPA response to Options Paper questions

Please note:

The FPA does not support the adoption of any of the proposals in the Options Paper verbatim, which clearly focus attention on identifying and putting boundaries around the client.

The FPA suggests a review is needed of the regulation of brokerage services and financial products available to Australian consumers.

The FPA recommends the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products. The framework should provide a model that separates products more effectively based on distinctions in risk in three key areas:

1. Complexity of product
2. Complexity of client needs
3. Complexity of advice

The FPA would welcome the opportunity to work with Treasury to develop a product driven 'Investing between the flags' regulatory framework and identify appropriate tests between the 'safe', 'grey' and 'high risk' product boundaries.

Options Paper question	FPA response
Option 1 – Retain and update the current system	
7.4 <u>Update the Product Thresholds</u>	
Is an arbitrary but objective test preferable to a subjective test, which more accurately reflects the individual circumstances of the client?	Should be based around the risk and complexity of the product rather than the wealth thresholds. If the current system remains, both are required. Monetary tests are an ineffective measure of financial literacy. Financial literacy/ knowledge/experience can only be subjective. However such a test should be the responsibility of the client to prove eligibility, with a professional providing verification based on the evidence. See the FPA's recommendation of the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.

<p>Should all 3 thresholds be updated (that is, the product value test and the two tests based on personal wealth in s761G(7)(c)), or just the \$500,000 product value threshold?</p>	<p>The wealth thresholds are complex when applied to clients' financial circumstances.</p> <p>The product value threshold is arbitrary and does not determine the complexity or risks associated with a product.</p> <p>See the FPA's recommendation of the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.</p>
<p>Is \$1,000,000 an appropriate new threshold limit for the product value test?</p>	<p>Product value does not determine to the risk or complexity of the product.</p> <p>The FPA recommends the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.</p> <p>If current system is maintained:</p> <ul style="list-style-type: none"> • There is a risk of reducing consumer investment diversification if product value test increased too high as consumers may pool equity from other assets to meet the test and access high-risk wholesale products. • If introducing an indexation method, commence from the current level of \$500,000.
<p>Is information available on how many investors would meet the proposed new limit for their products?</p>	
<p>Is there any specific reason why regulation 7.1.22 should not be amended to more accurately reflect the investment a client actually makes in a derivative?</p>	<p>The product value threshold is arbitrary and does not determine the complexity or risks associated with a product.</p> <p>See the FPA's recommendation of the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.</p>
<p>7.5 <u>Introduce an indexing mechanism</u></p>	
<p>How could a simple and relevant indexing mechanism be introduced?</p>	

Will three different threshold limits and constant indexing be too difficult or confusing to implement?	There is a concern that this would be the case. However a standard approach of reviewing every three years and rounded up to whole numbers could help in reducing such confusion.
What value should be used as the basis for indexing?	We believe that should you adopt an indexation approach that the Consumer Price Index (CPI) be used.
How often should the 3 limits be indexed?	They should be reviewed every 3 years
7.6 <u>Exclude Illiquid Assets</u>	
Are there any reasons why a primary residence should/should not be included in the net assets test?	Primary residence should be excluded from the net assets test. Many primary residences have very high values and would therefore allow many consumers to meet the net assets test very easily even if they do not have many other assets. This would put the primary residence at risk should the wholesale investment fail.
Are there any specific reasons why superannuation should/should not be included in the net assets test?	Superannuation is a financial product with investment growth objectives and therefore should be included in the asset test.
Would excluding some assets cause too much difficulty or confusion for industry? Which assets?	Any exclusions in law cause confusion. Primary residence should be excluded. Other assets should be included.
Would this work prohibitively to exclude clients who should be classified as wholesale?	The proposed expansion of the 'retail client' boundaries serves to regulate the client and therefore could restrict consumer choice. The focus should be on product regulation not client regulation. The FPA recommends the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.

7.7 Amend the Deeming Process	
Would an explicit opt-in make investors sufficiently aware of what protections they are afforded?	<p>An opt-in is supported and should come with clear mandatory warnings of the risks associated with wholesale products and the consumer protections that will not apply (such as disclosure requirements and EDR).</p> <p>By opting-in consumers accept liability of risk associated with purchasing the product.</p> <p>Disclosures about the product and its risks should be required (not as onerous as retail client disclosures).</p> <p>We note the reference how this has been implemented in Italy as provided in the options paper and would support such a process.</p>
Would an explicit opt-in be prohibitively inefficient for industry?	<p>The FPA suggests this would need to be tested further.</p> <p>A client opt-in requirement should not only apply to advisers, but also brokers and product providers who sell financial products directly to clients.</p>
What would be a more appropriate test for investor opt-in?	<p>The FPA would welcome the opportunity to work with Treasury to identify appropriate tests between the 'safe', 'grey' and 'high risk' boundaries of its recommended 'Investing between the flags' framework for separating products more effectively, which is based on risk and the different ways consumers use financial products.</p>
Would the true policy objective and message be easy to avoid via standard forms?	<p>It would depend on the changes adopted by Government.</p> <p>It could be achievable between the 'safe', 'grey' and 'high risk' boundaries of the FPA's recommended 'Investing between the flags' framework proposed in its submission.</p>
Should investors be able to elect to be treated as a retail client even when they meet the wholesale wealth threshold tests?	<p>Should be based around the risk and complexity of the product and client needs, rather than the wealth thresholds of the consumer.</p> <p>If the product is high risk, the client should be required to negotiate the acceptance of risk with either an adviser or the product provider or broker.</p> <p>If maintaining the current system, it should depend on the product they purchase.</p>

7.8 <u>Two out of Three Requirements</u>	
Are there any specific reasons why meeting 1 out of 3 requirements is better than meeting 2 out of the 3 (or vice versa)?	A 2 out of 3 approach provides a greater level of scrutiny and if used in conjunction with a client opt-in and better product regulations, could provide a higher level of consumer protection.
Is meeting 2 of the 3 requirements likely to be a better proxy for financial literacy than the current test?	The real answer is no, however as mentioned above the more hurdles that need to be jumped the greater likelihood of improved protections for the consumer.
Would this requirement be prohibitive for investors who wish to be classed as wholesale?	If the test is used alongside an opt-in requirement by the consumer then this should not be prohibitive for investors.
7.9 <u>Introduce extra requirements for certain complex products</u>	
What are the complex products that the higher threshold should apply to?	Refer to the FPA's 'Invest between the flags' framework
What is the higher threshold that should apply to these products?	Refer to the FPA's 'Invest between the flags' framework
7.10 <u>Repeal the 'Sophisticated Investor' Test</u>	
Should investors with less wealth but high financial literacy have some way of accessing wholesale products?	<p>The concept of a client opt-in could be used in this scenario to allow a client who believes they are a wholesale investor to purchase wholesale products, even if they are unable to meet any of the objective tests and even their adviser does not consider them to be wholesale.</p> <p>If the product is high risk, the client should be required to negotiate the acceptance of risk with either an adviser or the product provider or broker.</p>
If yes, how might this be operationalised in an objective manner?	<p>This would be very difficult to operationalise in an objective manner without a client opt-in within the current regulatory framework, which is based around the client.</p> <p>It could be achievable between the 'safe', 'grey' and 'high risk' boundaries of the FPA's recommended 'Investing between the flags' framework proposed in its submission.</p> <p>If the product was high risk, the client should negotiate the acceptance of risk with either an adviser or the product provider or broker.</p>

<p>Given that industry favours objective tests over subjective tests, is this a strong enough reason to repeal the section entirely?</p>	<p>No, however placing an opt-in requirement would assist in this process.</p> <p>A product driven regulatory framework would resolve these issues.</p> <p>The FPA recommends an ‘Investing between the flags’ framework for separating products more effectively, which is based on risk and the different ways consumers use financial products, and would welcome the opportunity to work with Treasury to identify appropriate tests between the ‘safe’, ‘grey’ and ‘high risk’ boundaries.</p>
<p>Should the section be retained even if it is scarcely used?</p>	<p>The client opt-in process could include a financial literacy component, however such a test should be the responsibility of the client to prove eligibility, with a professional providing verification based on the evidence. This could negate the need for the sophisticated investor test.</p> <p>The system should be based around the risk and complexity of the product. However, if the current system is maintained, both financial thresholds and financial literacy tests may be needed as monetary tests are an ineffective measure of financial literacy. Financial literacy/ knowledge/experience can only be subjective. However such a test should be the responsibility of the client as noted above.</p> <p>The FPA’s recommends the establishment of a framework aligned with ASIC’s ‘Investing between the flags’ concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.</p>
<p>Option 2 – Remove the distinction between wholesale and retail clients</p>	
<p>Would the financial advice industry be willing to undertake a suitability and best interest verification for each retail client that personal advice is provided to under the retail client definition proposed in this option?</p>	<p>The FPA is unclear as to what “verification” means and how a “suitability and best interest verification” would differ from the requirements of 945A (for suitability) and the proposed best interest obligations.</p> <p>The FPA seeks clarification on this proposal before providing a direct response to this question.</p> <p>FPA members already meet ‘client first’ obligations and are required to treat all clients as ‘retail clients’ under our Code of Professional Practice.</p>
<p>Is the loss in efficiency offset by greater investor protection?</p>	<p>Consumer protections must always come first. We believe our framework of ‘Investing between the flags’ could reduce inefficiencies and improve consumer protections.</p>

<p>Is it appropriate to remove the distinction from the entire Act?</p>	<p>The FPA would welcome the opportunity to work with Treasury to identify appropriate tests between the 'safe', 'grey' and 'high risk' boundaries within an 'Investing between the flags' framework.</p> <p>This would include reviewing the need for the retail wholesale distinction in the Corporations Act, under the FPA's recommended framework.</p>
<p>Option 3 – Introduce a 'sophisticated investor' test as the sole way to distinguish between wholesale and retail clients</p>	
<p>Is the test under section 761GA a true indication of financial literacy?</p>	<p>Financial planners form an ongoing relationship with clients and are fairly well placed to form a reasonable view as to someone's capacity to comprehend risk and understanding of financial products.</p> <p>However, not all consumers use financial planners and many financial products, including high risk complex products such as CDOs, are sold direct to consumers by product providers and brokers.</p> <p>The FPA would welcome the opportunity to work with Treasury to identify appropriate tests between the 'safe', 'grey' and 'high risk' boundaries within an 'Investing between the flags' framework, including identifiers of appropriate levels of financial literacy.</p>
<p>Is there any way that section 761GA can be amended to allay fears of licensees being exposed to legal liability while maintaining investor protection?</p>	<p>A consumer opt-in could help with section 761GA</p> <p>A client opt-in process could include a financial literacy component. Such a test should be the responsibility of the client to prove eligibility, with a professional providing verification based on the evidence. This could assist in reducing licensee fears of legal liability..</p>
<p>Is it possible for a subjective test to be easy to administer and ensure that intermediaries are not unduly cautious?</p>	<p>The subjective test should be used in conjunction with the objective test and a client opt-in. The objective test could serve to support the sophisticated investor test with an opt-in to provide final cover.</p> <p>The subjective financial literacy test should be the responsibility of the client to prove eligibility, with a professional providing verification based on the evidence. This could assist in reducing licensee fears of legal liability..</p>

Option 4 – Do Nothing	
Is there any reason why the current tests should be retained in the face of problems experienced during the GFC?	<p>The FPA's recommends the establishment of a framework aligned with ASIC's 'Investing between the flags' concept, that separates products more effectively based on risk and takes into consideration the different ways consumers use financial products.</p> <p>The FPA would welcome the opportunity to work with Treasury to identify appropriate tests between the 'safe', 'grey' and 'high risk' boundaries within an 'Investing between the flags' framework, taking into account the problems experienced during the GFC and other issues impacting Australian consumers.</p> <p>This would include reviewing the need for the retail wholesale distinction in the Corporations Act, and the related tests, under the FPA's recommended framework.</p>
Are the monetary threshold limits still relevant?	<p>Should be based around the risk and complexity of the product and client needs, rather than product value and the wealth thresholds of the consumer. Product value does not determine to the risk or complexity of the product.</p> <p>The FPA would welcome the opportunity to work with Treasury to identify appropriate tests between the 'safe', 'grey' and 'high risk' boundaries within an 'Investing between the flags' framework, taking into account the problems experienced during the GFC and other issues impacting Australian consumers.</p> <p>This would include reviewing the need for the retail wholesale distinction in the Corporations Act, and the related tests, under the FPA's recommended framework.</p>
Should they be increased? If so, by how much?	
8. FURTHER CONSIDERATIONS	
Is the professional investor definition still valid?	<p>If the current system is maintained, the FPA strongly recommends that local governments, councils and other small community organisations should be reviewed separately and have provided to them a unique set of criteria and protections.</p> <p>However, the FPA suggests an 'Investing between the flags' framework based on product complexity and risk and consumer needs, would provide appropriate and effective protections for 'professional investors' such as those identified.</p>

<p>Do any classes of investor need to be added or removed from the list of professional investors?</p>	<p>The FPA suggests an ‘Investing between the flags’ framework based on product complexity and risk and consumer needs, would provide appropriate and effective protections for ‘professional investors’.</p>
<p>Should professional investors continue to be subject to the same protections and disclosures that they currently receive?</p>	<p>The FPA supports the establishment of a product driven regulatory framework, rather than a regime based on client type.</p> <p>Irrelevant of the product type, the FPA supports the use of appropriate consumer disclosure on all financial products.</p>
<p>8.2 A final question for consideration is whether clarification is needed regarding the interpretation of s761G. There is currently some confusion regarding whether “in relation to a superannuation product” in s761G applies to financial services and product made available to the trustee of a superannuation fund (other than superannuation products).</p>	