



PETER BOBBIN

LEGAL BRIEF

ASICzophrenia threatens

The Australian Securities and Investments Commission's conflicts of interest paper is out of touch with an industry it failed to consult during the paper's compilation.

In my job I often deal with the Australian Securities and Investments Commission. Sometimes they are aware of my representation on behalf of a particular Australian financial services licensee, but mostly it is behind the scenes. Nevertheless, my work presents a broad exposure to our financial services regulator. I have recently noticed a marked improvement in ASIC's attitude. The government body has been making an effort to bring a balanced approach to its regulation activity.

In the past it has been hard to be patient with ASIC's front-line staff who are often not long out of university and who present unreal expectations or misguided understandings of the profession and how it works for the investing public. Their lack of experience is understandable. ASIC has tremendous staff turnover, partly because some see it as a training ground from which to enter the compliance sector of financial services. I cope with my frustration because of the good people at more senior levels who are genuinely committed to a robust and internationally envied Australian financial services industry. They seek to bring balance to each issue that confronts them.

But a new threat is emerging that I have named "ASICzophrenia", best described by reference to its root word, schizophrenia. People with schizophrenia often suffer terrifying symptoms, such as hearing internal voices or believing that other people are plotting to harm them. These symptoms may leave them fearful and withdrawn. Their speech and behaviour can be so disorganised that they may be incomprehensible or frightening to others.

I thought these symptoms, within our regulator, were limited. However, a fully developed, I-don't-trust-them, ASICzophrenia leaps from the pages of the April 2006 ASIC discussion paper, *Managing conflicts of interest in the financial services industry*.

This paper should be withdrawn.

Read it and then re-read my description of schizophrenia – you will see striking similarities. And you will understand my new word, ASICzophrenia.

It is in ASIC's interest to claim true schizophrenia as its reason for issuing this vacuous piece. At least there would be some hope of a cure. To suggest any other reason for the paper's issue would confirm my belief that ASIC is out of touch. If ASIC would seek to defend itself against my accusation, the organisation would only be left with the admission that it is now seeking to write law, not administer it.

Not all within ASIC agree with the conflicts paper. Thankfully, some regard it as overstepping or missing the mark in many ways, but they are the silent ones. We should rejoice in this observation; it means that ASICzophrenia is not too contagious.

The conflicts of interest paper affords us an interesting insight into

the thinking of some within the regulator of one of Australia's largest industries. Earlier ASIC papers, such as its *Super switching advice* in 2005, reflected the benefit of broad industry consultation. Many of us in the financial services profession were able to contribute to ASIC's thinking. More importantly, ASIC listened and accepted some suggestions. It is my understanding that ASIC did not undertake any consultation on its conflicts of interest paper and as such, it represents an unvarnished insight into the thinking of those at ASIC. This is scary.

If I had no knowledge of the industry, after reading the paper I would have to conclude that it is self-centred, unethical, greedy, uncaring and so full of conflict it should be abandoned.

I would also form the view that commissions are bad and fees are good – a common theme throughout the paper. But what types of fees are good? If I charge an asset under advice a fee of 0.6 per cent,



ANDREW TAYLOR

Despite the implications of the ASIC report, the great majority of financial advisers are not cheetahs or hyenas

how is this any different to a platform commission of 0.6 per cent?

Parliamentary Secretary to the Treasurer, Chris Pearce, puts a different gloss on the fees-versus-commission debate. In a June address to the Investment and Financial Services Association, he highlighted the fact that the real issue is value to the client, not how they pay for their financial planning services or advice.

Peter Kell of the Australian Consumers' Association (ACA) expresses a similar view. While he remains cautious on commissions, he recognises that the real issue lies with the financial services profession being able to identify the value they bring to consumers and doing so in a manner the consumer understands. He also expects that the value charged should reflect the value given and received.

Kell has some good thoughts on fees versus commissions and these are not as radical as some might otherwise believe. ASIC should have a chat with him.

Additionally, Kell recognises the claim that commission can be more tax effective for the consumer than a fee-based approach. He says the ACA would certainly welcome an examination of the tax basis of commission. Perhaps this issue of taxation should be pressed upon ASIC. It could save the body from the embarrassment of appearing to encourage consumers to seek the less tax-efficient means of paying fees for financial services and product advice.

Or maybe ASIC should back out of the debate and encourage the government to revisit the July 2003 Senate Select Committee on Superannuation recommendation that "the government re-examine the deductibility rules for financial planners' fees to remove the inducement to pay for financial planners' services through trailing commissions".

Want proof that some within ASIC view the financial services profession with absolute disdain? Look no further than the conflicts of interest paper. Its fictitious names are full of contempt. What was the author thinking of when he, she or they penned the names Hyena Financial Management Ltd, Cheetah Fund and Bigfee Growth Fund. I am certain someone had a giggle but it is no laughing matter.

ASICzophrenia means we should fear some within ASIC who simply believe that we are hyenas (scavengers with relatively short hind limbs and coarse hair), cheetahs (or is that cheaters?) and collectors of big fees.

One of the most interesting things about the paper is how the ASICzophrenic author examines the conflicts within particular examples but misses the fact that some of the scenarios presented are breaches of the law. These provide no guidance at all, other than supporting the belief that some within ASIC – and I believe not too many – are so conflict-focused that they miss the real issues. This is serious; we need a regulator that is properly focused on its job.

"The CLERP 9 legislation," Pamela McAlister, ASIC's deputy executive director of financial services regulation, says, "imposes, for the first time, a direct and specific obligation on licensees to have adequate arrangements to manage their conflicts of interest." When did she say this? On August 30, 2004. Was it true? Was it really the first time for a direct and specific obligation?

I emphasise that the nature of financial services in Australia is such that most licensees and representatives have fiduciary responsibilities to clients. In 2001, in *Pilmer v the Duke Group*, the High Court of Australia said with respect to the rules of professional ethics relevant to a decision that largely turned on a conflict of interest issue: "Such rules would obviously be pertinent to the consideration representing the 'essence' of the fiduciary principle ... A similar use of professional rules in the context of fiduciary obligations has been

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adopted in Canada and New Zealand in judicial opinions that have otherwise been cited in this Court with apparent approval."

So CLERP 9 did not impose, for the first time, a direct and specific obligation on licensees to have adequate arrangements to manage their conflicts of interest. This has gone hand-in-hand with the financial services profession since its creation. New section 912A(1)(aa) of the Corporations Act and ASIC's Policy Statement 181 did not introduce something new. And neither are the revelations in the conflicts of interest paper really revealing.

Just who wrote this paper and what was the intention behind releasing it without industry consultation?

On March 2, 2006, the deputy chairman of ASIC, Jeremy Cooper, welcomed the development of a set of principles by the Financial Planning Association to assist its members in managing conflicts of interest. Seven weeks later, as part of the paper's release he said: "It is essential that the financial services industry recognises conflicts and manages them adequately." Perhaps Cooper also meant to say that we don't trust the effectiveness of the FPA's principles so here is our guide instead.

Managing conflicts of interest is essentially an issue of ethics. This cannot be regulated or promulgated. And this is why ASIC needs to withdraw the paper, say it was mistaken – or ASICzophrenic at the time – and continue to encourage the financial services profession to embrace and further develop (and there is plenty of proof that it is doing so) professional ethics.

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