

Protection of Retail Investors in Australia: Background Information

Kevin Davis

Professor of Finance, The University of Melbourne

Research Director, Australian Centre for Financial Studies

September 2010

1. The History of Retail Investor Protection

Protection of retail investors over the last decade in Australia has been primarily governed by the provisions of the Corporations Act 2001 and the Financial Services Reform Act 2001, and the regulations made by the Australian Securities and Investments Commission (ASIC). ASIC was allocated responsibility for consumer protection with regards to financial services and products when a restructuring of regulatory agencies occurred in 1998 following the Wallis Report. That restructuring involved the creation of APRA as the prudential regulator of ADIs, insurance and superannuation entities, and transferred from the Australian Competition and Consumer Commission to ASIC consumer protection responsibilities in the finance sector.

ASIC also was given responsibility for promotion of financial literacy in July 2008¹ – which had previously been the responsibility of a Financial Literacy Foundation established by the Government. Also in 2008, a single Financial Services Ombudsman was created out of a number of separate financial sector Ombudsman schemes.

The Corporations Act 2001 introduced definitions of financial products and financial services and required that companies and individuals engaged in creating financial products and providing financial services are required to hold an *Australian Financial Services Licence (AFSL)*. These requirements covered provision of financial investment and planning advice, but did not capture consumer credit and mortgage activities, which were regulated under State Government Laws under the *Uniform Credit Code*.

Obligations of an AFSL include:

“ · providing relevant financial services efficiently, honestly and fairly;

¹ ASIC's consumer website FIDO gives details of activities. <http://www.fido.gov.au/fido/fido.nsf>

- arrangements to manage conflicts of interest;
- complying with licence conditions and relevant financial services laws, including taking reasonable measures to ensure that authorised representatives do this;
- having adequate resources;
- maintaining competence to provide the financial service, including training representatives to maintain their competence;
- adequate risk management systems; and
- a dispute resolution system and compensation arrangements for retail clients.”
Ripoll (2009, p10)

The approach to financial services regulation has been built around a tripartite approach of education, advice and disclosure, backed up by the AFSL requirements. Very few impediments have been placed in the way of retail investors dealing in any financial products or securities, with the main requirement that manufacturers (issuers) of such products (securities) produce appropriate product disclosure statements (PDS) or prospectuses.

ASIC recently described the approach to regulation of financial services (the Financial Services Regime) in the following way

“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.” (ASIC, Submission 378 to Ripoll Inquiry, p. 4).

2. *Recent Developments*

Following significant failures of financial advisers and firms providing financial services and products to retail customers during (and before) the GFC (see chart below)², a Parliamentary Committee undertook an Inquiry (the Ripoll Inquiry) into financial products and services in Australia. It made a number of recommendations including: a requirement for financial advisers to have an explicit fiduciary duty to clients; investigating ways to cease payments from product manufacturers to financial advisers; investigation of a statutory last resort compensation fund for investors. Prior to this, ASIC had introduced its “swimming between the flags” approach to educating financial consumers about risk.

On 26 April 2010, the Minister for Financial Services, Superannuation and Corporate Law announced the Government’s response to the Ripoll Report in the *Future for Financial Advice* statement, including:

- “introduce a statutory ban on commissions being paid from financial product providers to advisers” from 1 July 2012
- “introducing an adviser charging regime... agreed between the client and the adviser upfront [including options such as] either hourly fees or fees as a percentage of funds under management” (but only the non-leveraged part in the latter case).
- A statutory fiduciary duty for financial advisers

In June 2010, the Government provided for the use of short form PDS’s of no more than 8 pages for super and MIS products (4 for margin loans), with prescribed sections, and links to information outside PDS. (The Corporations Act also requires the PDS to “describe, in the form of a summary the risk level of the option”) ASIC has also introduced disclosure requirements for debenture issuers, agribusiness MIS, mortgage trusts on an “if not why not” basis, requiring disclosure of how and why business models

² There were also prior failures of a number of property development/finance companies (Westpoint, ACR, Fincorp) involving losses to debenture holders.

used by these entities differ from a “preferred form” of ASIC. There has also been legislation to allow short form retail bond issues.

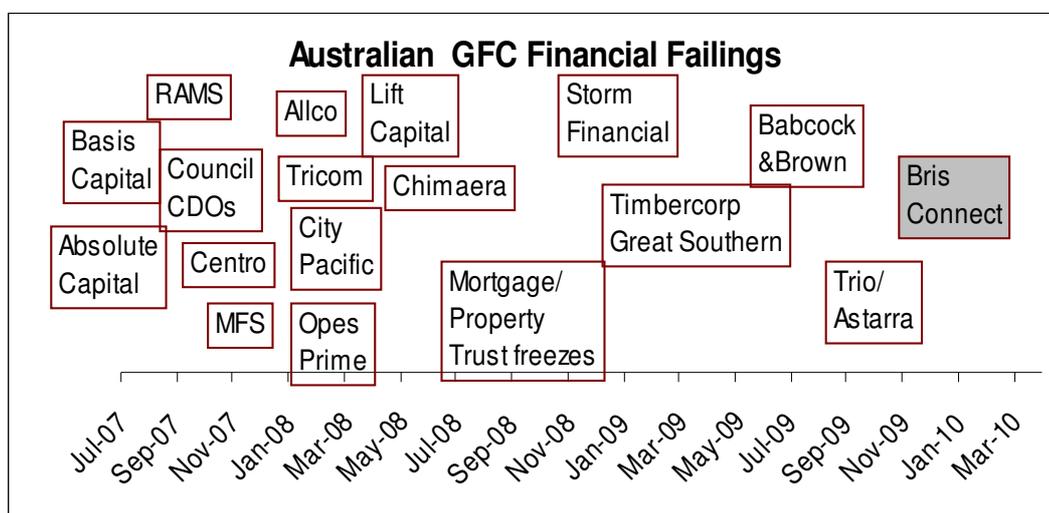
In June 2010, the Government announced the regulations under the National Consumer Credit Code which is replacing the UCCC. Under Phase 1, changes include:

- Responsible lending conduct
- Extended hardship criteria for relief
- Predatory lending and exploitative practice prohibitions
- A single national licensing regime for lenders and brokers.

Under phase 2 of the reforms announced in July 2010 issues to be considered “may include possible further measures to stem predatory lending practices, such as a review of credit card limit extension offers, an examination of state approaches to interest rate caps and other fringe lending issues. The Government will also consider regulatory issues specific to reverse mortgages..” (Bowen 2010)

DRAFT

A GFC roll-call



REFERENCES

Ripoll B (2009) *Inquiry into financial products and services in Australia* Parliamentary Joint Committee on Corporations and Financial Services (Chairman B Ripoll), Commonwealth of Australia November 2009
http://www.aph.gov.au/senate/committee/corporations_ctte/fps/report/report.pdf

Bowen Chris (2010) *Release of Green Paper on Phase Two of the COAG National Credit Reforms* Media Release of 07/07/2010, NO.085 Minister for Financial Services, Superannuation and Corporate Law.
<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/085.htm&pageID=003&min=ceba&Year=&DocType=>