TO: **FOFA STATUTORY COMPENSATION REVIEW COMMITTEE**

FROM: **BRUCE KEENAN**

SUBJECT: **FOFA STATUTORY COMPENSATION REVIEW**

QUALIFICATIONS TO PARTICIPATE:

In brief, I am a former Senior Officer of ASIC with some thirteen years regulatory experience including three years managing the Complaints Division for ASIC in Melbourne.

Over the past eleven years I have been employed by two AFS Licensees as their Compliance Manager involving risk issues, including the complaints management process.

In addition to my professional qualifications, I am also the convenor of the Melbourne Compliance Forum, that acts independently of any other industry association or professional body, which has been meeting for over ten years and is comprised of a list of over 60 professional Compliance Managers employed by Melbourne and metropolitan AFS licensees. Its principal purpose is to enhance the overall compliance standards of its attendees and those of their respective licensees.

BACKGROUND TO THIS ISSUE:

Firstly, I must declare that in principle, I do not see much wrong with the existing compensation system in place via the PI insurance regime other than perhaps the management of the existing process. As well, I am not opposed to a 'statutory compensation scheme' and believe that investors need adequate protection and compensation where necessary. I am however, strongly opposed to the notion that only AFS Licensees who are 'financial planners' would be subject to a compulsory levee over and above their existing PI insurance policy requirements. Any levee for a compensation scheme must be payable by <u>all industry participants</u>, and not just financial planners alone.

In respect to the St John report dealing with the statistics provided by the Financial Ombudsman Service ("FOS") around complaints, it would also be worthy of noting that in at least two of the annual reports for FOS's predecessor, the Financial Industry Complaints Service Limited ("FICS"), showed that in the years 2007 & 2008, 90% and 92% respectively of the financial planning licensees had NO COMPLAINTS against them. This suggests that 10% or less of financial planning licensees are involved in claims for these two years through the recognised EDR scheme. I would also suggest that similar percentage figures would be representative of most other years for this industry.

It is also worthy of noting that from 2002 to 2009, less than 10% (8.7%) of all telephone calls to FOS/FICS related to complaints against 'financial planners'. In terms of those actual 'complaints' progressing to compensation for consumers, it appears from FOS/FICS figures, that less than 22% of those warranted a 'quasi judicial decision/s'.

It is also interesting to note that statistics from ASIC's annual reports for the years 2006, 2007 & 2008 show that only 20% of consumer complaints against financial planners (presumably financial planners and not insurance complaints lumped in with them?) progressed to 'further investigation'. The outcome from this position as to the final disposition is not clear, but, I can say from personal experience whilst managing ASIC's Complaints Division, that about less than 10% of complaints involving financial planners ever warranted serious investigation, and, a smaller number actually moved to finalisation about material misconduct.

All of these statistics above suggest the level of valid claims is not what may be perceived by many, and, the suggestion that the level of compensation should or could be very much higher, is perhaps not truly valid.

I am also somewhat concerned that 'WestPoint' and 'Storm' have been used as 'yardsticks' for this exercise, and, I do not put that in any terms that demeans the report or the work by Richards St John, but rather, I do so from a more historical perspective. WHY? In both cases of 'WestPoint' and 'Storm', regulatory inaction <u>failed to protect investors</u>.

As indicated in the St John report at page 58, it was found that WestPoint was found to have been operating an unregistered managed investment scheme and not held a license. To lay the blame for this regulatory inaction leaving investors 'exposed' at the feet of financial planning community is both legally and morally wrong. Similarly, media reports suggest that ASIC had visited 'Storm' well prior to its demise yet allowed it to continue to operate is again improper for Government to now lay blame for these significant investor losses on the wider financial planning community. This leads to recent report/s from the USA involving the causes of the GFC indicate that two of the four key causation factors involved, (a) *regulatory inaction* and (b) the significant *influence of rating agencies*.

Following on from this, as to the historical perspective mentioned above, most are familiar with the demise of well known entities such as *Babcock and Brown, Pyramid Building Society, Estate Mortgage, Australian Capital Reserve, Fin Corp, Rothwells, Tricontinental, Opus Prime, Lift Capital, Bond Corp, HIH, Ansett, One Tel, Quintex, Basis Capital, Great Southern, Timbercorp* etc, etc. All of these former entities, including 'WestPoint' and 'Storm' have a number of common factors, the principal and secondary being 'the duties of directors' and 'auditors inadequacies'. The current premise by Government and others at influential level is, somehow, that the financial planning community is supposed to be able to determine the significant corporate issues that occur behind 'closed doors', and, then be held entirely liable for it. In fact, the financial planning industry, <u>including consumers</u>, place a significance reliance upon research houses or rating agencies, including, the integrity of ASIC and the ASX to do their jobs efficiently.

While the St John report may look carefully at the financial planning industry itself, the information given above strongly suggests there are other very significant participants who impact heavily upon investor outcomes, and, not just 'financial planners' alone.

Investors loose money simply because 'investment products fail'. In terms of product failure and with the mention of the '*Ripoll Report*' at page 2 of the St John report, it is interesting to note at least one of the Ripoll Committee persons correctly identified the real causes of why investor losses occur.

Ms Owens, said '*products that could not go uphill*'. See Hansard '*Joint Committee on Corporations and Financial Services*' on 4 September 2009. Whilst this concept opens up a new chapter in terms of the St John report, it is essentially the real causation why we currently have an industry External Disputes Resolution scheme to deal with investor losses from product failures. There are some very simple answers to this very vexing problem, but, this is not the place to elaborate upon them within the confines of this paper.

WHAT SHOULD/SHOULD NOT BE THE OUTCOME OF THIS REVIEW:

If Government, after full consultation (which I do not believe has occurred in this instance) and deliberation, is of the view that it will introduce a compulsory compensation scheme, then Government has a legal and moral responsibility to both consumers and the wider industry participants under the law that any such a compensation scheme is both fair and equitable to all parties.

An unintended outcome of a compulsory compensation scheme imposed upon the financial planning industry alone may well cause licensees attempt to offset the new levee costs against existing risk costs, and in particular, compliance costs as they would then have the added comfort that a last resort compensation scheme would pick up any 'product failure' losses leading to investor compensation.

Another unintended consequence of a compulsory scheme would be that the real causation of existing and historic investor losses are still not being addressed by Government. Those identifiable causes are, '*duties of directors*', '*auditors responsibilities*', '*research houses/rating agency inefficiencies*' and '*regulatory deficiencies*'. These four issues are not vastly different to the overall findings in the USA, yet they are not being addressed as part of the entire industry problem.

A new 'last resort scheme' will not change the underlying problem of 'product failure/s' but rather exacerbate it even further. WHY? Because the new industry levee will only be paying to prop up those very badly managed and very risky companies to operate and flourish even further under a 'last resort scheme'.

CONCLUSION:

Government must be mindful of not being seen to be unfair against the financial planning industry alone as the sole causation problem for investor losses.

Government must also consider the consequences of a new 'levee' solely on the financial planning industry as it will cause financial hardship and job losses, and, have other at least three serious unintended consequences, as described above.

If the Government is of a mind to introduce a last resort scheme, then it must consider a '*one in, all in*' approach to a universal guarantee fund that would include all ASX listed companies, all companies that make offerings to the public through a registered Product Disclosure Document, Fund Managers, Research Houses/Rating Agencies and perhaps some others. Such a levee could be by way of proportional contributions. At the same time, it must give a commitment to addressing the unintended consequences referred to above.

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