



FUTURE OF FINANCIAL ADVICE

CONSULTATION RESPONSE – 19/2/2014

Prepared by AIOFP CONSULTATIVE COMMITTEE [ACC]



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1. **EXECUTIVE SUMMARY:-** The following is the AIOFP and its member's response to the FOFA amendments proposed by Minister Sinodinos.

The AIOFP supports the original objectives of FOFA to eliminate conflicts of interest and provide greater protection for consumers. We however contend that the previous Government went too far with its amendments and support the following changes:-

- removing the opt-in requirements;
- removing the annual fee disclosure requirements for pre-1 July 2013 clients;
- removing the 'catch-all' provision from the best interests duty;
- explicitly allowing for the provision of scaled advice;
- exempting general advice from the ban on conflicted remuneration; and
- broadening the existing grandfathering provisions for the ban on conflicted remuneration.

We believe these changes will not only simplify the industry for its stakeholders but deliver considerable cost savings to all participants including consumers.

We believe opt in and pre July 2013 fee disclosure are an unnecessary burden with little benefit to consumers. Removing the "catch all" provision from best interest is a practical approach to a difficult conundrum. Broadening the existing grandfathering provision on conflicted remuneration is a sensible and practical solution to an unintended consequence and allowing a controlled environment or investment payments is welcomed. We believe any incentives are a necessary component of remuneration structure as long as it is in a controlled environment.

We of course would like to suggest some further amendments that will level the playing field for the entire advisory industry and assist consumers.

2. **GLOSSARY OF TERMS:-** Please note that any reference to the term 'institutions' means we are referring to Industry Funds, Banks, Life Assurance Companies and 'administration services' refers to any superannuation administration function including SMSF services, Industry Funds, Retail/wholesale platforms. 'Independent advisers' are considered those who operate their own AFSL and are not owned or aligned to an institution.
3. **CONFLICTED REMUNERATION ANOMALIES:-** We agree that financial product commissions are a conflict and should be banned. We however contend that the

banning of administration revenue sharing with independent advisers is fundamentally flawed, discriminatory and will lead to unintended consequences that may not be in the best interests of consumers and the industry in general.

4. **THE CURRENT POSITION:-** Over 90% of the advice industry is financially cross - subsidised by administration revenue where institutions achieve it via vertically integrated models and SMSF advisers via SMSF structures.

1 - Institutions and Industry Funds [have not ever and] cannot make their advice practices profitable without cross subsidising operational expenses with revenue profits from their administration/manufacturing division. The ratio is generally 10:1, for every \$1m of losses occurred in the advice practice the manufacturing division makes \$10m profit from administration sales.

2 - SMSF promoters direct clients' monies away from the retail platforms and charge clients directly for establishing their own SMSF structure. This is tantamount to taking 100% of the client administration fee and using it to cross subsidise their advice practices.

5. **DISCRIMINATION:-** With the banning of platform administration revenue sharing with independent advisers, FOFA is turning a 'blind eye' to the Institutions vertically integrated models cross subsidisation activities and disregarding SMSF internal administration dealings. Both activities are fundamentally conflicted as they are blatantly recommending their own internal administration services and disregarding all other options, surely the BEST INTERESTS regulations must come into play here. Advisers who chose not to work under an Institutional business model or do not chose to offer SMSF structures to consumers are faced with trying to compete with a grossly cross subsidised market under a 'pure' business model of charging clients directly to cover their practice infrastructure costs and trying to survive. This is all in a 150 year old consumer culture of so called 'free' services being offered by the institutions and a consumer reluctance to pay a fair price for advice.

6. **POTENTIAL RAMIFICATIONS:-** There is now a significant trend of Independent advisers adjusting their business models to only offering SMSF structures to clients instead of retail administration platforms operated by the institutions. Besides for the superior flexibilities of SMSF structures, the major incentives are being able to receive 100% of the administration fees and only offering their in house service without being accused of being conflicted. In what can only be described as 'genuinely bizarre', if an adviser chooses to only offer retail administration services [ie retail platforms with a major institution] to clients, any share of the administration service revenue is considered

conflicted and they are potentially subjected to Best Interest scrutiny if they do not select the best option.

How can SMSF promoters and institutions take 100% of the administration fee to support their practice infrastructure without consequence and if an independent adviser takes even \$1 they are considered conflicted?

The seismic emergence of the SMSF preference by advisers and consumers is well documented and is showing no signs of abating. The Government needs to consider whether they want a significant amount of our national superannuation savings being managed by a myriad of small business owners in an environment of minimal APRA/ASIC jurisdiction and the propensity to buy direct property. If future Governments are considering superannuation savings for infrastructure project funding, accessing savings in SMSF areas will be a more difficult task. As Paul Keating once said, 'Nations don't advance by consumers selling each other residential property'.....

7. **A POSSIBLE SOLUTION:-** The competitive advantage of retail platforms has been significantly eroded under FOFA. Despite Institutions thinking they have a 'captive client base' to manipulate, we feel the trend will continue unabated to the SMSF market particularly with an ever increasing educated consumer market and the other trend of institutional advisers now moving back into the independent space. It is highly likely these advisers will be offering SMSF options to clients. If the Government [and institutions] want consumer monies either staying or moving back into the APRA/ASIC regulated retail platform area, this blatant discrimination needs to be removed. The easiest way to achieve this is to classify platforms as 'administration services', not the current erroneously classification of 'financial products'.

8. **PROFESSIONAL INDEMNITY INSURANCE AND EXTERNAL DISPUTE RESOLUTION SERVICE:-** Also in line with the FOFA objectives to reduce consumer costs and provide greater protection for consumers, consideration needs to be given to the impact of the FOFA legislation on PI Insurance and EDR schemes.

Currently, the number of Insurers willing to provide PI Insurance to financial planners has diminished and the costs of the premiums has increased significantly. The main reason for the reduction of Insurers is that the risks have increased for Insurers and the potential for an adverse determination against the insured has increased. With the reduction of numbers, competition has decreased and with an increase in risk, the costs of premiums have risen. Ultimately, these increased costs are either passed on to consumers or financial planners leave the industry and the objective of increased availability of financial advice to consumers is actually decreased.

A primary reason for the increased costs and risks is the manner in which the EDR system currently operates. Determinations by the EDR service providers have been inconsistent and even when a complaint is dismissed; the financial service provider is liable to pay for the costs of the determination which generally is in the region of \$10,000. The EDR service providers are now seeking an increase in the compensation cap from \$280,000 to \$500,000 and this will have an immense impact upon the PI environment.

ASIC have stated that the PI Insurance was never designed to be a compensation scheme; however the EDR services have effectively made it the sole compensation scheme.

In light of the various difficulties with the current EDR structure and the ultimate adverse impact upon consumers, the current EDR system needs to be reviewed by the Government to ensure that consumers are adequately protected and the goals of reduced costs and access to financial advice is made more readily available.

9. **SUMMARY:-** The AIOFP supports the original objectives of FOFA to eliminate conflicts of interests, make advisers more accountable to their clients and create a better outcome for consumers. Unfortunately these objectives have been compromised and distorted by the previous Government's apparent political agenda to disadvantage the independent adviser sector. The AIOFP agrees with the 6 FOFA amendments and believes it will create a better working environment for the market which will translate into to meaningful benefits for consumers.

We are however seeking some other FOFA considerations to create a level playing field for advice delivery and ensuring the perpetuation of choice for consumers.

How can it be fair to allow the Institutions to operate loss leading advice practices that heavily rely upon selling their own in house administration products to consumers to fund their business model, and this is not considered to be conflicted? Considering institutionally aligned/owned advisers represent over 80% of the market it is a significant distortion. How can it be fair that SMSF promoters who take 100% of the administration fee they charge their clients to fund their business model [and only offer their own in house service], are not be considered conflicted? Whilst all this is going on, an independent adviser who decides to select 1-3 different administration services to offer clients, negotiates a price reduction on the administration fees that is either given back to the client or used to help fund their business model is considered to be conflicted.

The AIOFP whole heartedly agrees with the elimination of financial product commissions, they definitely presented an inducement to use one product over another, but to selectively include administration fee sharing as a conflict for independents but not apply the same principle to institutional and SMSF promoter advisers is blatant discrimination. If the Government wants healthy market competition a level playing field needs to be established.

The current operating environment of the EDR schemes is threatening to destroy the PI market. Something needs to be done to adjust their business model to create a fairer working environment for all stakeholders. We are willing to provide some suggestions at the appropriate time.