



Response to Treasury Exposure Draft:  
FOIA amendments

February 2014

AIST Submission

## AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose mission is to promote and protect the interests of Australia's \$600 billion not-for-profit superannuation sector. AIST's membership includes the trustee directors and staff of industry, corporate and public-sector funds, who manage the superannuation accounts of nearly two-thirds of the Australian workforce.

As the principal advocate and peak representative body for the not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training, consulting services and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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## 1 Executive summary

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The package of amendments proposed in this exposure draft and accompanying draft regulations have received significant media exposure. AIST has made a series of amendments designed to satisfy our aim of ensuring that members of superannuation funds can get the answers that they require, when discussing the financial situation with a financial adviser.

In keeping with this aim, AIST have taken the approach of looking at these proposed changes from the perspective of a superannuation fund member. With this in mind, we make the following recommendations:

- We oppose the removal of the catch-all provision of the adviser best interest duty, and note that it should no longer be considered to be a 'duty'.
- AIST does not support a scope of investigation that is reduced by legislation that are not explicitly relevant to the scope of advice being provided.
- We believe that allowing clients and advisers to 'agree' on the scope of advice to be provided could be subject to manipulation, and recommend its removal.
- AIST believes that the exemptions provided where advice is provided on basic banking products, general insurance, consumer credit insurance or a combination of these effectively legalises bad advice and recommends its removal.
- AIST cannot support the removal of the opt-in provisions, or the reduced requirements with regards to fee disclosure statements. Clients have a right to know what they are being charged and when, and should be provided with the decision to continue on an opt-in basis.
- We support the note that brings intrafund advice into line with the definition contained at section 99F of the Superannuation Industry (Administration) Act 1993 and support efforts to make advice available to all members of superannuation funds.
- AIST does not support any further carve-outs to the conflicted remuneration provisions, although we view the proposed changes to the education and training exemption as sensible.
- Whilst we cautiously welcome the definition of volume-based shelf-space fees, we point out that scale based efficiencies should be made available to customers in all instances with no exceptions.
- Finally, we do not support changes to grandfathering where a client moves between licensees, or into the pension phase. We consider that even with a 'balanced scorecard', any tainting of the advice process with conflicted remuneration is unacceptable.

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## 2 Introduction

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AIST supports measures that ensure that members of superannuation funds are able to rely on competent, diligent and safe financial product advice. AIST also supports measures to ensure the availability of such advice, noting that such an environment helps members save for retirement, which will reduce future reliance on the Age Pension. Unfortunately, we feel that most of these measures proposed in this package do not meet this test.

AIST supports measures that provide members of superannuation funds with the answers that they are after, whether this is from fund representatives or separately employed financial planners; and whether the answers sought are regarded as factual information or financial product advice, general or personal. And we support this, whether the advice relates to members' superannuation fund accounts, or whether it relates to the other financial products that they buy, hold, sell or make changes to.

We have long been aware of the difference that exists in law between the different types of information and advice that financial services representatives can provide. Whilst the exposure drafts of the Bill (the "Draft Bill", "Exposure Draft", ED) and the accompanying draft regulations focus primarily on the provision of personal financial product advice, we note that the difference is routinely confused by consumers. Consumers will often consider financial product advice as gospel truth, or request "could you please advise me of my account balance" from a contact centre operator.

Even commentators who have followed the financial advice debate closely confuse these concepts: A well-regarded journalist in one of the national newspapers recently conflated general advice with both factual information and personal advice in the same sentence in an article that related to this very package of amendments<sup>1</sup>.

AIST maintains that, given this level of confusion, the idea that some of this information going out to mum and dad investors might be allowed to be conflicted, is to be resisted. We support efforts to provide certainty and to reduce red tape, but not at the expense of consumers.

Finally, AIST is on record as supporting the efforts undertaken by financial advisers to establish financial planning as a viable and respected profession. We believe that watering down these provisions can only hurt these objectives.

Our recommendations are presented in the order that they appear in the Explanatory Memorandum to the Draft Bill. Where our recommendations refer to sections or regulations specifically, references will refer to the *Corporations Act 2001* or *Corporations Regulations 2001* unless otherwise indicated.

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<sup>1</sup> Boyd, T. 2014. 'Chanticleer: FoFA scare tactics don't stand scrutiny'. *Australian Financial Review*, 18 February 2014, p. 56.

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## 3 Recommendations

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### 3.1 Best interests obligation

#### 3.1.1 Removal of the 'catch-all' provision

In the case of *Commonwealth Financial Planning Ltd v Couper*<sup>2</sup>, at paragraph 109, it was concluded that

*The unfortunate facts of this appeal tend to bear out the first recommendation of the conclusions of the Report of the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia (November 2009): hat the Act be amended to:*

*"explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own."*

AIST believes that key principles of a well-governed system (including advice) in every component of the superannuation system must be followed, conflicts managed and that there is transparency and accountability, that advisers are well skilled, and that the best interests of members are being looked after. We question what message is being sent to the Australian population in removing the catch-all provision?

The removal of subsection 961B(2)(g) reduces the adviser's best interests duty to a checklist, by not requiring advisers to take all other reasonable steps. Further to this, the proposed changes remove what would be 'reasonably' in the best interests of clients by removing the 'what would a reasonable adviser do' test at 961E.

AIST supports the implementation of a best interest duty for financial advisers, and has supported this, since the Ripoll Report recommended that such a duty be mandated. However, as we wrote in our submission to the Senate Economics Legislation Committee in 2012<sup>3</sup> whilst the FOFA bills were proceeding through Parliament:

*AIST supports the creation of the best interests duty and agrees that the proposed section 961B is a vital step in the right direction. However, although we agree and support the intent of the proposed section 961B, we would have preferred that this duty was worded less prescriptively and that a principles-based approach was taken. Section 52(2)(c) of the Superannuation Industry (Supervision) Act 1993 – the obligation for superannuation trustees to act in the best interests of super fund members – illustrates that such an approach is not only possible, but successful.*

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<sup>2</sup> *Commonwealth Financial Planning Ltd v Couper* [2013] NSWCA 444.

<sup>3</sup> AIST. 2012. *Response to Inquiry: Future of Financial Advice (FOFA) Bills 2011*. [pdf] Melbourne: Australian Institute of Superannuation Trustees. <http://tinyurl.com/mxzyjg> [Accessed: 18 Feb 2014]

The removal of 961B(2)(g) has the effect of removing this principles-based approach, with only a checklist of steps remaining. As such, we cannot support its removal. Further, we point out that it is wrong, both in and out of law, to continue to refer to this as a ‘duty’.

The current provisions – which include the best interests test – reflect various international reports where a ‘best interests’ test is viewed as highly desirable wherever managing potential conflicts needs to be managed. For example, in its Green Paper, *Corporate Governance in Financial Institutions and Remuneration Policies*, the European Commission<sup>4</sup> said (in considering financial institutions post the GFC) that a duty of care should be imposed on boards to help better balance potential conflicts between shareholders and depositors. We see no reason why the same duty should not apply between advisers and their clients.

### 3.1.2 Reduce the scope of investigation

The amendments to 961B(2)(a) would remove the advisers’ requirement to ask any questions outside those that are explicitly relevant to the scope of the advice. We consider that such an approach to an adviser’s investigation can only lead to an increase in poor advice, and provide the following example to demonstrate how this may work under the changes proposed in this package.

#### Case study

Archie has recently changed jobs and will be earning significantly more than what he previously earned. He makes an appointment to see Bianca to get advice on salary sacrificing into superannuation.

Bianca and Archie agree that, on this occasion, Archie will only require advice on salary sacrificing into superannuation, and Bianca limits her investigation accordingly, before recommending that Archie sacrifice an additional \$300 per fortnight into his super fund.

However, Bianca’s investigation did not and was not required to inquire about Archie’s mortgage: Archie bought a house about three years ago, and still has about \$300,000 left to pay off. Had Bianca included this in her scope of investigation, she might have potentially considered that the additional contributions to superannuation may not have been in Archie’s best interests.

AIST recommends that no changes be made to accommodate a reduced scope of investigation of a client’s circumstances.

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<sup>4</sup> European Commission. 2010. *Corporate governance in financial institutions and remuneration policies*. Green paper. [report] Brussels.

### 3.1.3 Permission for advisers and clients to ‘agree’ on scope of any scaled advice to be provided.

As indicated in the case study above, the proposed ED outlines an arrangement whereby the client and their adviser can ‘agree’ on the scope of the advice.

AIST believes that such arrangements are potentially subject to a variety of manipulation. We wish to draw attention to the findings of the Parliamentary Joint Committee on Corporations and Financial Services.

During hearings in 2009 into the collapse of Storm Financial, the Parliamentary Joint Committee on Corporations and Financial Services found that the process in place involved providing the one type of advice to clients<sup>5</sup>. Potential clients, whom this advice was not deemed appropriate for, were weeded out and the organisation and its advisers proceeded no further.

The Report further indicates that the ‘education’ process used at Storm was, in effect grooming clients towards the singular type of advice that might ordinarily only be appropriate for certain clients<sup>6</sup>. Although the Committee stopped short of making such an explicit recommendation, the Committee received recommendations (including from the Institute of Actuaries of Australia and Peter Worcester and Paul Resnik) around stress-testing a client to ensure that commitments such as personal debt can be serviced.

We point out that in the event that advisers and clients ‘agree’ on the scope of scaled advice, commitments such as debt servicing may not even be discussed. As such, AIST cannot support this measure.

### 3.1.4 Extend exemption of employees of ADIs providing personal advice to consumer credit insurance, or a combination of different product types

AIST does not believe that a case has been made as to why any financial products should be exempt from the steps contained in section 961B(2)(d) to (f).

This measure exempts advisers who are providing personal financial product advice on these products from the following:

- Assessing whether the provider has the expertise required to advise given the subject matter (and declining, if not);
- Conducting a reasonable investigation into the financial products (the “know your product rule”);
- Assessing the information gathered in the investigation; and

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<sup>5</sup> Ripoll, B., Mason, B., Boyce, S., Farrell, D., Mclucas, J., Williams, J., Grierson, S., Owens, J., Pearce, C. and Robert, S. 2014. *Inquiry into financial products and services in Australia*. Parliamentary Joint Committee on Corporations and Financial Services. [report] Canberra: Commonwealth of Australia, p. 22, at para. 3.15.

<sup>6</sup> Ripoll, B., et al. 2014. *Inquiry into financial products and services in Australia*. Parliamentary Joint Committee on Corporations and Financial Services. [report] Canberra: Commonwealth of Australia, p. 22, at para. 3.16.

- Basing all judgement on the client's relevant circumstances.

AIST did not support the original exemption for these originally, when it extended to basic banking or general insurance products on their own. As such, we cannot support the addition of consumer credit insurance, or allowing a combination of these to be advised on with this exemption.

We believe that this continues to legalise bad advice with respect to these products and cannot support this measure. Furthermore, we believe that to legislate this measure can only act to reduce the reputation of financial advisers.

## 3.2 Ongoing fee arrangements

### 3.2.1 Removal of opt-in

AIST opposes the removal of the 'opt-in' requirement. The opt-in measure ensured that asset-based ongoing fees could only continue to be charged with clients' express consent. At the time that this measure was enacted, this was part of a package of measures to ensure that money didn't continue to be bled from member accounts unnecessarily.

'Trail' commissions paid to advisers or their dealer groups were in the process of being grandfathered, however there was no prohibition on asset-based ongoing fees, such as adviser service fees. We noted at the time this measure was enacted that asset-based ongoing fees could easily continue the role that trail commissions had filled and recommended that these payments stop completely.

Without the opt-in requirements, these fees can continue to be charged to clients' accounts indefinitely.

The requirement that clients get express consent from clients to opt-in every two years was, effectively, a compromise. We note that industry opposition to this measure had largely proposed maintaining the *status quo*, however we continued to support an environment where investors know what they are paying and what they are getting in return. Removal of the opt-out requirements conceals this vital information.

In 2010, AIST released our research report into investment management fees, conducted with RiceWarner Actuaries<sup>7</sup>. In our report, we concluded that returns, after fees and taxes, need an approach where they are maximised, in order to produce better retirement outcomes. The imposition of unnecessary fees compromises such an approach and therefore produces sub-optimal retirement outcomes.

Finally, we are aware that the issues around investors being charged ongoing fees and getting no obvious service benefits or communication at all are well documented. Whilst we have chosen to address the issue of fee disclosure statements separately in this submission, the notion that ongoing fees should continue

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<sup>7</sup> AIST and RiceWarner Actuaries. 2010. *Investment Management Fee Research*. [pdf] Melbourne: Australian Institute of Superannuation Trustees. <http://tinyurl.com/mrn7rt5> [Accessed: 18 Feb 2014]

indefinitely for no ostensible benefit, in an environment where there is no transparency around how much is being charged and for what is clearly not in a client's best interest.

We cannot support a situation where clients continue to be charged ongoing fees without evidence of any services being provided. Although we are aware of arrangements such as these outside of financial services, we point to celebrated examples, such as the notorious difficulty with terminating gym memberships, as supporting our argument that requiring members to opt-out is not good policy. Furthermore, we re-iterate our opposition to any measure that has the net effect of further reducing member returns after fees.

### **3.2.2 Fee disclosure only for new clients (removal of fee disclosure statement requirements)**

AIST does not support this measure, whereby only investors who entered into their ongoing fee arrangement after 1 July 2013 are required to be provided with ongoing fee disclosure statements.

This measure will remove transparency for older clients of advisers where it existed after the FOFA bills were passed. The result is that clients who entered into these arrangements prior to 1 July 2013 will not know how much they are being charged.

Furthermore, we believe that this measure, combined with the removal of the opt-in requirements will create a perception that these charges are product related, and therefore unable to be opted-out of easily. This is untenable.

### **3.2.3 Note clarifying intrafund advice.**

AIST supports all efforts to ensure that members of superannuation funds are able to receive the answers that they require, concerning their investment, when they require it and with minimal cost. We believe that the intrafund advice arrangements established under FOFA and Stronger Super provide the most efficient avenue to enable this for superannuation fund members.

We are aware that the difference between factual information and financial product advice is only a legal one. AIST strongly supported the Stronger Super reforms that aimed to provide members with single issue advice that relates to their account, which serviced a need that is not met by either the provision of factual information, or general financial product advice.

In addition, we note that where members are unable to get intrafund advice, they will not get personal financial product advice at all. We note that, in the days prior to the bans on conflicted remuneration coming into effect, the incentives to a financial planner to provide advice to members with small account balances was compromised by the amount of a commission which might arise from this figure being relatively small.

We provide the following example of how intrafund advice can assist members with their superannuation queries.

## Case study

Erin is a member of another superannuation fund, and is also looking to get advice on the most appropriate investment option for her. She calls the fund and speaks to Francis, who, after providing a general financial product advice warning, explains that he cannot provide advice that is relevant to Erin's financial situation.

However, he can explain about the different investment options the fund offers, and what kind of investor the investment options are generally designed for.

Francis closes by asking if Erin would like to speak to one of the fund's financial advisers. Erin says not today, thanks Francis, and hangs up.

Half an hour later, Erin has digested the information that Francis has provided her with, and does not know if she falls into any of the typical investor types that Francis discussed with her. Erin decides to call the fund back.

Erin asks to speak to Francis and, once she has been put through to Francis, asks to speak to a financial adviser.

Francis directs Erin to Gustav, a financial adviser for the fund, who explains that he can make a recommendation as to what might be most appropriate for her. Gustav tells Erin that this is a service that they are allowed to offer free of charge to the fund's members.

After explaining the process, Erin agrees to go through the process and, after a series of questions regarding her circumstances, Gustav explains to Erin that, based upon the information she had provided, he would be recommending the fund's 'Conservative' option.

Gustav also forwards Erin a Statement of Advice, which also contains instructions about how to change investment options.

Erin thanks Gustav for his time, and hangs up.

We believe that a considerable number of members are like the caller above, for whom factual information and general financial product advice are not necessarily enough.

AIST welcomes the addition of the proposed note at the end of section 960 that synchronises the notion of intrafund advice with section 99F of the *Superannuation Industry (Supervision) Act 1993* and believes that this underscores the important role that this advice plays.

## 3.3 Conflicted remuneration and other banned remuneration

### 3.3.1 Carve out of conflicted remuneration on general advice

This exemption would apply to general financial product advice provided to retail clients. We further note that this would apply to all financial products, whether they are relatively simple, such as basic banking products, or considerably complex, such as structured investment products, or derivatives.

AIST considers that superannuation products are not necessarily simple financial products. We are unwilling to support any measure that could lead to high pressure sales environments where general financial product advice is provided solely to secure sales, and warn against this measure on this basis.

Furthermore, we re-iterate that the re-introduction of commissions for general advice will further erode retirement savings and create additional future pressure on the age pension.

### 3.3.2 Carve out of conflicted remuneration on all risk insurance other than MySuper or where no personal advice has been provided

AIST supported the recommendation contained in the Ripoll Report<sup>8</sup>, where, at recommendation 4:

*The committee recommends that the government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers.*

We further note the recommendations from the Cooper Review<sup>9</sup>, where recommendation 5.12 stated:

*Up-front and trailing commissions and similar payments should be prohibited in respect of any insurance offered to any superannuation entity, including to SMSFs, regardless of rules on commissions that might apply outside superannuation.*

The exemptions currently provided to risk insurance are concessions that were negotiated in the aftermath of these two reviews. However should this measure proceed, we will see the situation where, not only will commissions continue to be paid from product manufacturers to advisers, but will also be paid from inside of superannuation.

This measure reduces the ban on commissions down to MySuper, or where no personal advice has been provided. We do not support this.

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<sup>8</sup> Ripoll, B., et al. 2014. *Inquiry into financial products and services in Australia*. Parliamentary Joint Committee on Corporations and Financial Services. [report] Canberra: Commonwealth of Australia.

<sup>9</sup> Cooper, J., Casey, K., Evans, G., Grant, A., Gruen, D., Heffron, M., Martin, I. and Wilson, B. 2010. *Super System Review Final Report Super System Review*. [report] Canberra: Commonwealth of Australia.

### **3.3.3 Carve out of conflicted remuneration on execution only services where general advice has been provided**

This measure brings execution-only transactions into line with the proposed exemption on conflicted remuneration on general advice.

The previous exemption required no financial product advice to be provided within the previous 12 months, however, this waters this down to requiring no personal financial product advice to have been provided during that period. Further to this, the wording appears to open the door to the possibility of personal advice having been provided by a different representative of the same AFS licensee, within the same 12 month period.

We are unable to support a measure which may potentially reward staff for transactions executed on behalf of customers where advice, albeit general, actually has been provided to customers recommending the transaction.

### **3.3.4 Carve out of conflicted remuneration the education and training exemption where it is relevant to the “operation of a financial services business”**

AIST is a Registered Training Provider (RTO) who also provides a variety of education-based activities which support the needs of financial services professionals both within and outside of Australia.

AIST supports the relief granted here, acknowledging that where the activities provided are of an educational nature relevant to financial advice, this would appear to be sensible. We also acknowledge that the role of operating a financial services business is relevant to a financial adviser and agree that this should ordinarily form part of a well-rounded program of continuing professional education.

### **3.3.5 Definition of volume-based shelf-space fee to be provided**

AIST welcomes the proposed definition at subsection 964A(2) of a volume-based shelf-space fee. However, we welcome this definition with some caution.

We note that exemptions are provided with regards to scale-based efficiencies, where these can be reasonably attributed as the reason for such payments.

It is AIST’s opinion that where discount or rebate for scale-based efficiencies are genuine, such discounts or rebates must be passed on to customers in all instances. To do otherwise can only raise additional questions about the nature and transparency of such arrangements.

We also consider that the criterion of ‘reasonably attributed to economies of scale’ as described in the proposed subsection 964A(3)(b) is vaguely defined and open to abuse and that this term must be tightly defined in this Bill, or in the Regulations, including reference to examples about the number or value of the funds manager’s financial products.

### 3.3.6 Other exemptions.

AIST opposes the proposal to allow grandfathering of commissions to continue where a client moves between licensees as proposed in items 19 to 23 of the draft regulations. Advice that is provided to a customer is the joint responsibility of the adviser who provided it, and the licensee. It would not be in clients' best interests for deals to be struck that they had no say in. AIST strongly recommends that any attempt to interpose a new AFS licensee should be interpreted as an entirely new relationship.

We also have concerns regarding the notion of a 'balanced scorecard remuneration arrangement'. AIST supports a model where advice is the product, and where financial products are merely tools to facilitate the advice. We cannot support any kind of benchmarking where an employee's remuneration is even linked partially to a measure that could skew the quality of advice.

Lastly, we cannot support an exemption for clients who switch from the accumulation phase to the growth phase. Products offered by superannuation funds are different financial products, and any new product purchased should be treated as a new product regardless of whether the product is offered by the same, or a different provider. The notion that grandfathered arrangements should continue through such a change in products is not justified.