



Submission on Exposure Draft:  
Future of Financial Advice  
Amendments

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## About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

To find out more about CHOICE's campaign work visit [www.choice.com.au/campaigns](http://www.choice.com.au/campaigns) and to support our campaigns, sign up at [www.choice.com.au/campaignsupporter](http://www.choice.com.au/campaignsupporter)

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## Introduction:

CHOICE welcomes the opportunity to comment on the Exposure Draft Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 and the Exposure Draft Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014. We do, however, believe that the three-week consultation period is inadequate in light of the significant potential for consumer detriment flowing from the proposed changes.

CHOICE strongly supports the objectives of the Future of Financial Advice (FoFA) reforms, namely to improve the quality of financial advice, build trust and confidence in the financial planning industry and facilitate access through the provision of simple or limited advice. On this basis, we have a number of concerns about the draft bill and regulations, to the extent that they will:

- Dilute the best interests obligation;
- Remove the opt-in requirement;
- Limit the consolidated annual statement of fees to new clients; and
- Water down the ban on commissions.

We note that these changes have followed an aggressive campaign from banks and the financial advice industry. We also note that FoFA was itself a compromise between the interests of consumer protection and industry, and these proposed changes tilt the balance further away from consumers. This submission sets out our concerns with these issues, along with other areas that we believe should be addressed if these reforms are to deliver real and significant consumer benefits consistent with their objectives.

**Recommendation 1:** CHOICE recommends that the Government undertake a comprehensive Regulatory Impact Statement to assess the impact of the proposed changes to FoFA on consumer confidence, consumer engagement and consumer savings.

**Recommendation 2:** CHOICE recommends that the Government release a full exposure draft for all proposed regulatory changes, with adequate opportunity for consultation and comment.

**Recommendation 3:** In the absence of a comprehensive Regulatory Impact Statement demonstrating that the impacts of the proposed FoFA changes in terms of consumer confidence, engagement and savings do not outweigh the benefits, CHOICE recommends that the Government:

- Make no changes to the best interests obligation;
- Make no change to the ban on commissions;
- Make no change to the renewal notice requirement; and
- Make no change to the consolidated statement of ongoing fees to existing clients.

## 1. Regulatory impact analysis and process

CHOICE has spent more than two decades investigating and warning consumers about conflicts of interest in the financial advice industry.<sup>1</sup> We welcomed FoFA as a crucial step towards putting the financial advice industry on a genuinely professional footing, promoting consumer trust and engagement. The reforms were particularly timely given Australia's ageing population, and the significant and growing number of consumers who are becoming first-time investors in their retirement. On this basis, we are deeply concerned that to date, there has been no detailed independent analysis of the impact these proposed changes may have on consumers.

The failings of the financial advice system have been well documented. ASIC has noted "broad systemic problems with the financial advice industry, driven by conflicted remuneration structures and compounded by weaknesses in the regulatory system."<sup>2</sup> Furthermore, studies indicate that a significant proportion of advice is of a low standard. In 2003, an ASIC survey found only 50 per cent of financial advice was at an acceptable level.<sup>3</sup> In 2012, only 58 per cent of retirement advice surveyed was at an acceptable standard.<sup>4</sup> In many cases, this is attributed to the presence of commissions and the failure of an adviser to act in the client's best interest.

The need for widespread reform is highlighted by the catastrophic effects of major financial advice scandals (Opes Prime, Storm Financial, Timbercorp/Great Southern, Bridgecorp, Fincorp, Trio/Astarra, Westpoint and Commonwealth Financial Planning), which have affected over 120,000 Australians,<sup>5</sup> resulting in billions of dollars of lost savings. In this context, **CHOICE believes that a Regulatory Impact Statement should be undertaken to assess the impact of the proposed changes to FoFA on consumer confidence, consumer engagement and consumer savings.**

The focus of the proposed changes has been to reduce the regulatory burden on the financial advice sector. While it is true that consumers ultimately pay for increased compliance costs in relation to financial advice, it is arguable they pay even more for conflicted advice and for services which they no longer value or are even aware of. In such cases, the balance needs to be in favour of protecting consumers and their retirement income, rather than protecting the income of financial advisers. As outlined below, CHOICE is concerned at many of the proposed changes and believes that it would be inappropriate for the legislation to proceed in the absence of a comprehensive consumer impact analysis.

### 1.1. Process concerns

CHOICE is concerned at the prospect of substantial changes being made to FoFA via regulation rather than legislation. These changes will impact millions of Australians and should be subject to the full parliamentary scrutiny afforded by the legislative process. It is particularly

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<sup>1</sup> For example, see <http://www.choice.com.au/reviews-and-tests/money/investing/advice/finding-independent-financial-advice/page/20%20years%20of%20campaigning.aspx>

<sup>2</sup> ASIC (2013) *Main submission to the Senate inquiry into the performance of the Australian Securities and Investments Commission*, October 2013, p 142.

<sup>3</sup> ASIC (2003) *Report 18 Survey on the quality of financial planning advice*, 5-6.

<sup>4</sup> ASIC (2012) *Report 279 Shadow shopping study of retirement advice*, p 8.

<sup>5</sup> For example, see <http://www.choice.com.au/consumer-action/past-campaigns/finance/financial-advice-is-it-in-your-interest/page/choice-submission.aspx>

problematic that the Exposure Draft does not include the draft regulations on the issues which will subsequently be legislated. Therefore **CHOICE** urges the **Government** to release a full exposure draft for all proposed regulatory changes, with adequate opportunity for consultation and comment.

## 2. Substantive concerns

### 2.1 Changes to the best interests obligation

The best interests obligation is a critical component of the FoFA reforms. It provides a statutory assurance for consumers that financial advisers have a legally enforceable obligation to act in their best interests by providing trustworthy, impartial and quality advice. In its current form, the duty promotes professionalism in an industry which has been tainted by its fair share of scandals, resulting in devastating losses for many consumers. We are a strong supporter of the best interests obligation in its current form and believe that the following changes will render it largely ineffective.

#### What is the problem?

##### 2.1.1 Removal of 961B(2)(g)

CHOICE believes that consumers have a right to expect quality financial advice that is in their best interests. By removing 961B(2)(g), which requires advisers to proactively consider a client's best interests, advisers will be able to satisfy the duty without acting in the client's best interest.

While supporters of this change have expressed concerns that the current provision creates legal uncertainty as to how advisers can satisfy the duty, in the absence of 961B(2)(g), 961B(2)(a)-(f) function purely as a 'tick-a-box' check-list for advisers, which can be satisfied without having to provide advice that is actually in the client's best interests.

##### 2.1.2 Removal of 961B(2)(a)

By removing section 961B(2)(a) and replacing it with 961B(2)(ba), the adviser's responsibility for investigating the client's full circumstances is significantly reduced. CHOICE believes that there are fundamental flaws in limiting investigation to disclosure that is provided by the client. For example, this may lead to situations where due to poor language skills or financial illiteracy, clients do not have the capacity to convey all relevant circumstances. It is likely this will impact the most vulnerable groups such as older people.

##### 2.1.3 Scoping of advice

The proposed provision to scope advice may allow advisers to effectively 'contract out' of their duties to consumers. This may result in situations where advisers can abuse their position of power by limiting the scope of advice, resulting in advice that is not in the client's best interest. Consumers are typically ill-equipped to understand what they are agreeing to and what the consequences may be. This is illustrated in the examples below:

*Client X seeks advice from Adviser A for financial advice with regards to her superannuation savings. Adviser A agrees with Client X that the advice will be limited to certain products. Adviser A recommends that Client X should switch superannuation funds into one of these products. Adviser A has no obligation to inform Client X of any detriment that may be caused by this switch, despite the fact that it may not be in her best interests.*

*Client X, a 60-year-old male, seeks advice from Adviser A with regards to investing in the share market. Adviser A agrees with Client X that the advice will be limited to investing in shares. Adviser A has no obligation to inform Client X of any detriment that may be caused by investing in a single asset class, despite the fact that it may not be in his best interests, particularly light of his age and the risk profile of shares.*

In many scandals, the dealer group has followed a “cookie cutter” approach to advice, and this proposal risks legalising this type of activity. This reduced obligation may lead to an increase in sales-driven strategies and the one-size-fits all approach to financial advice that contributed to the collapse of Storm.

#### **2.1.4 Reduced best interests obligation for banks and insurers in certain circumstances**

The proposed law broadens the circumstances where an agent or employee of an Authorised Deposit-taking Institution (ADI) can access a reduced best interests obligation for personal advice provided on a basic banking product, general insurance product or a Consumer Credit Insurance (CCI) product. This is particularly concerning with regards to CCI, where numerous studies have shown persistent and significant mis-selling.<sup>6</sup>

### **What is the solution?**

**CHOICE recommends no change to the best interests obligation.**

## **2.2 Relaxing the ban on commissions**

CHOICE is concerned at the numerous concessions to industry (in both the original and proposed legislation) that have been made with regards to conflicted remuneration. There is a real risk that these changes will impact on the quality of financial advice.<sup>7</sup> Of particular concern are the changes to volume rebates, general advice and client consent.

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<sup>6</sup> See ASIC Report 256 *Consumer credit insurance: A review of sales practices by authorised deposit-taking institutions* (October 2011).

<sup>7</sup> In 2006, ASIC found that superannuation advice was three to six times more likely to be unreasonable in the presence of a commission or the recommendation of an associated product. (ASIC (2006) *Report 69 Shadow shopping survey on superannuation advice*, p 8.)

## What is the problem?

### 2.2.1 Reducing the scope of the ban on volume-based shelf-space fees

The proposed amendment will permit financial adviser and dealer groups to receive payments of volume-based shelf-space fees which can significantly influence the range of products that are recommended to retail clients by financial advisers. This can lead to distorted financial advice by creating an environment where advisers are incentivised to recommend a particular fund manager or platform's product. There is a clear risk that advice under these circumstances is not in the client's best interests.

### 2.2.2 Allowing conflicted remuneration if the client consents

The proposed amendment will enable conflicted payments and commissions from third parties to be paid if the client consents. CHOICE is of the view that this will strongly impact consumers, particularly those who have limited financial literacy, are disengaged and may not be fully capable of understanding what they are consenting to. This amendment enables advisers to contract out of the ban on commissions, and in doing so undermines one of the key premises of the FoFA reforms.

### 2.2.3 Exempting general advice from the ban

This is a very broad exemption that creates a loophole in the conflicted remuneration prohibition. This will mean that financial planners can access commissions and other conflicted remuneration on all products, including those that are high-risk and complex. This is also problematic as consumers may not be clear on the distinction between general and personal advice and may incorrectly believe that the advice provided is appropriate to them.

### 2.2.4 Extending exemptions to conflicted remuneration bans for banks

Under the proposed change, banks will have generous exemptions that will allow commissions of up to 10 per cent of salary to be paid to bank employees - including advisers - based on the volume of product sold. Given that 70% of financial advisers are employed within the banking sector this is likely to result in advice that gives preferential treatment to certain products.

### 2.2.5 Allowing commissions on insurance inside super

By allowing the payment of risk commissions inside super (excluding MySuper), advisers may recommend products based on the availability of commissions. We acknowledge that the risk insurance market is competitive and that risk insurance products are constantly under review, however we believe that there are instances of mis-selling and churning of life risk insurance. Allowing commissions on risk insurance inside super will exacerbate this problem, particularly as it may be the product that is most likely to provide advisers with commission income.

### 2.2.6 Extending Grandfathering Arrangements

The proposed extension of grandfathering arrangements means that advisers will be able to continue to receive grandfathered commissions when they move between licensees.

## What is the solution?

CHOICE recommends no change to the ban on commissions.

### 2.3 Removal of the renewal notice requirement

#### What is the problem?

By removing the renewal requirement, advisers will no longer need to obtain a client's approval at least every two years to continue an ongoing fee arrangement. The renewal notice requirement ensures that clients do not pay fees for little or no service and protects clients who may be disengaged or dissatisfied with their current arrangement. The renewal notice requirement is an important measure as it protects consumers from inappropriate ongoing advice relationships, and gives consumers the opportunity to question whether they require ongoing advice. Removing the requirement ignores a significant issue of consumer harm - millions of dollars of advice fees being charged where no advice is being provided, eroding individual and national savings. CHOICE remains of the view that opt-in is not unreasonably burdensome for providers and its costs are far outweighed by the benefits to consumers. Arguments in favour of removing this requirement emphasise that consumers will benefit from cheaper advice through lower compliance costs.<sup>8</sup> CHOICE contends that the advice would be cheaper still if consumers had the opportunity to stop paying for it.

#### What is the solution?

CHOICE recommends no change to the renewal notice requirement.

### 2.4 Limiting consolidated statement of ongoing fees to new clients

#### What is the problem?

The fee disclosure statement is an important measure for consumer protection as it ensures that clients are aware of the fees they are paying and the services they receive in return for those fees. Until FoFA, financial advisers were not required to provide a consolidated statement of annual fees they received on behalf of clients. By limiting the fee disclosure statement to new clients, existing clients will not have the benefit of a consolidated statement of their fees, and will find it more difficult to transparently assess the value of the service they receive from their adviser.

#### What is the solution?

CHOICE recommends no change to the consolidated statement of ongoing fees to existing clients.

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<sup>8</sup> For example, see 'CBA banks on Abbott's opt-in promise', accessed at <http://www.ifa.com.au/news/12368-cba-banks-on-fofa-opt-in-removal>