Opening statement – Senate Economics Committee – Future of Financial Advice hearings – 22 May 2014 - 4.15pm

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Andrew Bragg

Thank you Chairman for the opportunity to appear before the Senate Economics Committee today. Today we appear as the industry body representing financial adviser licensees, superannuation funds, life insurers and Investment managers. On an enduring basis, the council has strongly supported the principles and objectives of Future of Financial Advice (FOFA) reforms.

For over five years, the FSC and our members have advocated both legislative and cultural change in the delivery of financial advice in Australia.

Fundamentally we believe that financial advice should be accessible and affordable to as many Australians as possible. Equally it is critical that people have confidence and trust that advice is provided free of conflict and in the client's best interest.

A deficit in trust in financial advice has been apparent for some time. Accordingly the industry has sought reform and cultural change.

This started in June 2009 when the FSC announced that through a new Charter of self regulation, the industry would move away from commissions in superannuation and improve the transparency of the wealth management industry.

Within 12 months, the Parliamentary Committee of Corporations and Financial Services had completed a review of the industry in the wake of collapses such as Storm Financial.

This Parliamentary inquiry, which became known as the Ripoll report, was bipartisan. Its 11 recommendations followed an exhaustive 10 month process which involved submissions, discussion and public hearings in capital cities and on the ground in Queensland where the bulk of Storm Financial's clients were located.

The Ripoll report recommended a fiduciary duty, a ban on commissions (ending payments from manufacturers to financial planners/advisers) and increased ASIC powers to name a few.

Each of these three key recommendations were designed to address collapses such as Storm where it was obvious that the law was deficient. Indeed these deficiencies had led to human tragedies such as the loss of retirement savings and family homes because of conflicted or poor financial advice.

The significance of the bipartisan nature of this report cannot be overstated. Both the then Government and Opposition supported the key recommendations that were found to have caused the problems in these collapses and more broadly, the trust deficit.

The bipartisan report was never a given. And the committee members on both sides worked hard to achieve a package that the Parliament could clearly deliver.

The industry therefore expected the Ripoll recommendations to be swiftly implemented.

However, this changed on the day before ANZAC day in 2010 when the policy response to the Ripoll report was announced and the FOFA reforms were born.

The announcement of FOFA went well beyond Ripoll. It significantly overreached. And over the next three years, FOFA got bigger, broader and less targeted. The original objectives which were two fold: to rebuild trust and confidence and to expand the affordability and accessibility of financial advice, they were sadly forgotten as the reforms fundamentally changed.

FOFA ended up including reforms which were neither envisaged nor recommended by Ripoll.

Let me provide some examples

- "Opt-in" and annual fee disclosure statements were added - despite fee disclosure obligations already existing;
- The simple fiduciary duty was turned into an undeliverable quagmire of legalese

- A ban on commissions became "conflicted remuneration" which captured situations that were irrelevant to the stated problem
- A new type of free advice (known as intra fund advice) was created which could only be provided by superannuation funds
- Prospective reform was jettisoned

Let us be clear. The FOFA legislation was fundamentally inconsistent with the principles of wider accessibility and affordability without conflicts and mistrust.

We made these points during the Parliamentary Committee which considered the FOFA legislation.

We then sought amendments to the package to make it workable and in line with these principles.

Chairman we again seek these amendments to do just this.

We believe the government's amendments to the existing laws will largely enhance FOFA and restore appropriate balance between strong consumer protection and affordability of advice.

For example, the amendments in the Bill

- Maintain and strengthen the best interest duty by removing ambiguity
- Permit piece-by-piece or scalable advice as agreed between the client and the adviser
- Abolish the redundant “opt-in” which is unnecessary if advice can only appropriately be sought on a discretionary basis

All of this can be achieved without reducing consumer protection.

In view of the refinements, a survey of advice providers conducted by the FSC has revealed that advice post FoFA has had a cost impact - that is an additional cost increase of 33%.

As an example, the cost of holistic advice is $3040 before FoFA. Post FoFA the cost increases to $3751 - an increase of around 20% if there is no amendment to FoFA law.

If the amendments to FoFA are passed, 1/3rd of the 20% cost increase will be saved - that is $235.

Certainty in the law on the best interest duty and scalable advice will support lower costs, higher growth in scaled and affordable advice for more Australians.

1. **Best interest duty**

The codification of the best interest and related duties are a significant enhancement to consumer protection.

The best interest duty is established in section 961B(1) of the Corporations Act. We note that no amendment is proposed to this obligation in the Bill before Parliament. Nor do we recommend that any be made to section that establishes the best interest duty.

Section 961B(2) sets out a safe harbour for those providers who wish to rely on it, to prove they have provided advice in the clients best interest. Lets be clear, you need not rely on section 961B(2) to comply with the best interest duty set out in section 961B(1). But for those who do wish to rely on the safe harbour, the 7th step of the safe harbour is problematic because of its ambiguity.

What other steps should there be to prove an advice provider has acted in the clients best interest? Retired Judge Margaret Stone summed up the 7th steps in these words - paraphrasing: it's as if the Parliament couldn't think of anything else and is leaving it to the court to determine.

The Bill before the Committee proposes to repeal one of the seven steps an advice provider must prove to demonstrate they are acting in the client's best interest. The removal of this step does not remove the obligation to act in the client's best interest required under s961B(1) of the Corporations Act.

We also note that the Best Interest Duty was never intended to be a backward looking test – the seventh step or section 961B(2)(g) delegates the definition of the Best Interest Duty to the courts and highlights that a judge and the adviser – both reasonable minds exercising professional judgment may differ in their interpretation.

As such our concern has been that the ambiguous test does not provide consumers with certainty, adds costs to the advice and leaves the duty to be tested in courts for decades to come as an outcome and hindsight test.

Chairman, an undefined, unclear and ambiguous best interest duty is a lawyers paradise which will make advice more expensive after the courts will inevitably be forced to define whatever Parliament's intention is with this seventh step.

The removal of this seventh step is paramount. And no, it will not remove the best interest duty. Senior Counsel advice referred to in our submissions makes this very clear.

Beyond the seven steps, there are duties such as the requirement to always give priority to a client over an adviser or licensee's interest.

Despite the protestations of others, the removal of the "catch all" seventh step will improve the clarity of the best interest duty without diminishing the adviser's many new duties to the client.

2. Scalable advice

ASIC 's Report 224 identified in 2010 that consumers are asking for more simple and piece by piece advice[1] which is affordable.

The Best Interest Duty as enacted does not permit a client to get piece by piece advice today.

It is simply unreasonable for a client to have to provide an advice provider with information that is irrelevant to the advice the client is asking for.

We support the amendments to the best interest duty to enable a client to seek and obtain affordable advice on matters they want. That is, we believe a consumer should be able to

[1] ASIC REPORT 224 Access to financial advice in Australia 2010, page 21-22.

determine the subject/scope/scale of the advice they need, want and can afford to pay without being required, by law to pay for holistic advice only. If holistic advice or intra-fund advice provided by a super fund are the only two advice options available for consumers – then we submit that FoFA has failed Australians.

We agree the amendment should not enable an adviser to avoid acting in the client's best interest. Indeed the duty today prohibits an adviser from avoiding the duty at section 960A (no contracting out).

We note that the government's Bill before Parliament has not amended the Best Interest Duty safe harbour steps to clearly enable a client and their adviser to agree on the subject of the advice. However, we are comfortable that the addition of s961B(4A) stating that "To avoid doubt, nothing in this section [the best interest duty section] prevents the provider and a client from agreeing the subject matter of the advice sought by the client" will enable the advice profession to provide Australian consumers with a range of advice solutions and at prices consumers can afford.

We also support the changing of the order of the steps in s961B(2) as the original first step (now step two) of the duty effectively resulted in full fact finds - the extra information sought simply to comply with that step would have added cost to the advice – advice the consumer may not need or want.

3. General advice and conflicted remuneration

FoFA was intended to address poor practices which led to failures such as Storm Financial and change the practices and conduct of financial planners.

It is our view that consumers do not understand the jargon "general" and "personal" advice – and it is a disservice to Australians for the law to reinforce this confusion.

To be clear, general advice involves giving factual and generic information and material (note taking a person's financial situation into account).

General advice is a service consumer's access generally from bank branches and call centres.

It should not be called advice at all. It is simple factual/generic information and should cost the consumer nothing. But providers of this service should be able to be paid salary and performance pay bonuses for providing good and/or exceptional service to consumers.

We understand the consternation raised by some that the general advice exemption included in the Bill enables a reversion to pre-FoFA conflicted remuneration practices. We contend that the need for the exemption is not for that objective.

The FSC has examined the drafting in the Bill and recommends that the committee consider limiting the exemption to ensure that financial planners are not able to earn a commission as a result of the exemption.

4. Intra fund advice

When considering the general advice exemption, it is important to also put it into context with intra fund advice.

Intra fund advice is provided by superannuation funds, it can be personal and general advice. It is changed by superannuation trustees through the administration fee. It is a bundled advice fee that members (including default MySuper members) are unable to opt out of.

Put simply, if you don't seek intra fund advice, you still pay. It is a bundled advice fee which is cross subsidised and hidden from members. It is a commission.

It was never envisaged by Ripoll and it was concocted by some to create a new advice system through blatant regulatory arbitrage.

It is hypocritical to suggest that commissions should be banned under FoFa including for general advice or information when intra fund advice is changed in a non transparent manner for and covers general as well as personal advice.

We strongly suggest the Committee thinks carefully about intra fund advice when it turns its mind to the matter of general advice and conflicted remuneration.

5. Opt-In

FoFA requires financial advisers to issue client who pay **an ongoing fee** an annual fee disclosure statement. The client can stop the service arrangement with the adviser at any time.

The Opt-In requirement is an additional obligation which requires the adviser to obtain confirmation in writing from the client every two years – confirming the client wished to continue to receive services from an adviser.

If the client does not respond in the 30 day window provided in the very detailed law, the adviser would be required to cease servicing the client leaving the client potentially exposed.

It's important to note that not all clients are covered by Opt-in and fee disclosure statements to put these matters into perspective.

For example, if the client pays for the service in full as a fee for service as one might a lawyer or accountant - the law does not require the adviser to issue the client an annual fee statement and therefore the client was not rechaired to Opt in.

Intra-Fund Advice fees legislated in the 3rd Tranche of the Superannuation[2] Law amendments passed in 2012 (which applies to new MySuper fund also) are specifically exempt from Opt-In by FOFA regulations despite the fact they are ongoing fees for advice.

6. Grandfathering

The former government stated that grandfathering of an adviser's book of business would be provided for in FOFA:

[2] **Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012** (AKA 3rd tranche of MySuper Bills) applies equally to MySuper and choice Super

"Finally, while these measures around remuneration are important, they represent a large change to the industry and to individual businesses. It is for this reason that existing trail commission books will be 'grandfathered'. This means that commissions from business entered into prior to the reforms can continue. Of course, commissions on new business and clients after 1 July 2012 will not be allowed. This is a just outcome, and provides an adequate cushion for the industry to transition once the new laws are in place." [3]

Unfortunately, the law does not do this. Current grandfathering regulations enable an adviser to sell their business (to advisers in the industry today) and the 'book' is grandfathered for the new owner. But the regulation does not permit the adviser to move licensee and retain grandfathering.

Prohibiting movement of advisers in the market, effectively locking them into their current Licensee, is anti-competitive and potentially detrimental to consumers and we call on the government to address this issue.

7. Life insurance

Australians are underinsured.

Insurance is sold, not bought and therefore affordable advice solutions are needed to ensure more Australians cover their income and lives.

We seek an amendment to the Bill to exempt insurance inside super (non-MySuper) to be deemed permissible remuneration where a consumer has sought personal advice and proceeded to purchase the cover. This would remove an arbitrary ban on remuneration on insurance cover available via a superannuation fund (usually the more affordable options) which was imposed by FoFA.

Life insurance products play an important role in the community as they protect the insured and their dependents against the financial risks associated with premature death, permanent and temporary disability, as well as various specified critical medical conditions.

[3] Senator the Hon Jacinta Collins – Manager of Government Business – Senate Hansard: http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=BillId_Phrase%3Ar4689%20Title%3A%22second%20reading%22%20Content%3A%22I%20move%22%7C%22and%20move%22%20Content%3A%22be%20now%20read%20a%20second%20time%22%20(Dataset%3Ahansardr%20%7C%20Dataset%3Ahansards);rec=0

According to research undertaken by KPMG for the FSC, 35% of employed people in Australia have no private disability insurance at all and 19% of families do not have any life insurance.

Insurance coverage held through superannuation represents more than half of all life insurances held by Australians. According to KPMG's analysis, approximately 67% of life insurance and approximately 56% of disability insurance in Australia is held through superannuation.

Superannuation has proved to be an important vehicle through which the majority of employed Australians have been able to access life and disability insurance regardless of their personal circumstances. There should not be regulatory distortions which prevent people from accessing affordable life and income protection insurance through superannuation.

The FSC submission notes a few other technical amendments we recommend the Committee consider.

Finally, it is important to note that cultural change to enable trusted advice is also likely to be achieved via higher competency standards. This is an important piece of the jigsaw now covered by the FoFA reforms and the industry is working with Treasury and the regulators to develop a future competency pathway to support the delivery of quality advice.

Thank you.