Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

31 May – 2 June 2011

Question No: BET 9

Topic: Future of Financial advice reforms

Hansard Page: Written

Senator Cameron asked:

1. What is ASIC's view on the role of commissions and their impact on the provision of financial advice?

ASIC considers that some remuneration structures used in the financial advice industry create real and potential conflicts of interest that can distort the quality of advice. For example, in our 2006 shadow shopping exercise we found 16% of advice was not reasonable, given the client's needs (as required by law) and a further 3% was probably not reasonable. Unreasonable advice was three to six times more common if the adviser had an actual conflict of interest over the advice given to the client.

ASIC's submission to the PJC Inquiry into Financial Services and Products suggested that regulatory options, such as preventing remuneration structures that may create conflicts of interest and adversely affect the quality of advice, should be considered. These views were set out in Section E of ASIC's public submission to the PJC Inquiry into Financial Services and Products. Please refer to submission 378 at:

http://www.aph.gov.au/Senate/committee/corporations_ctte/fps/submissions/sublist.htm

ASIC notes the proposed Future of Financial Advice reforms include a prospective ban on conflicted remuneration structures including commissions. If implemented, it will be a priority for ASIC to identify and address any avoidance mechanisms that have the potential to undermine the positive effects of these reforms.

2. The Government's proposed reforms to the financial advice industry will continue to allow asset based fees for ongoing advice – but subject to 'opt-in requirements' every two years – does ASIC see this as a reasonable safeguard for consumers?

We note the Government is proposing to ban asset based fees where there is leverage involved. The proposed opt-in requirement is a policy matter for Government, and is still under consideration by the Government. Its terms have not yet been finalised or implemented. Accordingly, ASIC cannot comment on the effectiveness of it this stage.

With respect to asset based fees, ASIC noted in its submission to the PJC Inquiry into Financial Products and Services in Australia (mentioned in our answer Q1 above) that:

> "There is evidence that the industry is moving away from commission-based remuneration. Investment Trends reports that advisers expect revenue from fixed-rate and hourly-rate for service to increase over the next few years and revenue from commissions and asset-based fees decrease. ASIC welcomes these moves and supports the work of the industry."[1]

3. If there was no opt-in requirement, could financial advisers and product manufactures structure asset based fees like a trailing commission?

If there is no opt-in requirement, asset based fees on unleveraged products could be ongoing regardless of whether or not advice is ongoing.

While there may be a greater likelihood that investors will realise they are paying ongoing fees because their investment or bank statement will detail the deductions (rather than being absorbed into the product fees as occurs with trail commissions) many people do not read their paperwork and, of those that do, not all understand it. Inertia is also a strong factor in human behaviour. In addition some people may not realise that they have the power to turn off such fees. Where any of these factors occur then asset based fees may resemble trail commissions in effect.

The proposed opt-in is still a matter for Government. In the mean time, ASIC' website Money Smart encourages consumers to pay for advice via a flat dollar fee until the Future of Financial Advice reforms are implemented.

4. Does ASIC believe the proposed opt-in arrangements will be a burden for diligent financial advisers?

The proposed opt-in requirement is still a policy matter for Government. As the precise formulation of the opt-in requirement is still being considered by Government, and will need to be passed by Parliament, ASIC cannot comment on the extent to which it may or may not be a burden on financial advisers.

[1] ASIC submission to the Parliamentary Joint Committee into Financial Products and Services in Australia, August 2009, p51.