



FINANCIAL SYSTEM INQUIRY - PHASE TWO

CHAPTER TWO

CONSUMER OUTCOMES

2. FINANCIAL ADVICE

The FSC has long supported a financial advice regime where consumers can access high quality, affordable, conflict-free financial advice from skilled professionals.

We strongly agree with the following observation from the interim report:

Affordable, quality financial advice can bring significant benefits for consumers. Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.

The recent reforms have delivered a mechanism to achieve many of

⁸ Australian Human Rights Commission Annual Report 2012-13

these objectives - however there is more work to be done on:

- ❖ Clarifying the different segments of financial advice;
- ❖ Adviser competence and professionalism;
- ❖ Governance and disclosure; and
- ❖ Increased powers for ASIC;

We are supportive of new clearly defined advice segments (between personal advice, general information, factual information and intrafund advice), to better explain the different ways in which advice is provided.

This will provide consumers with a better understanding of whether the information they are receiving is factual information or general information (which does not take into account a client's personal circumstances) or personal advice (which does).

To help support and distinguish the advice segments, we believe that a national competency framework should be associated with each segment. Establishing a national comprehensive competency framework will uniformly enhance the professional standards of financial advisers and may ultimately culminate in defining the term "financial adviser / planner" in law.

We also believe that it is important that clients are able to access information on the governance ownership and structure of the licensee. The enhanced public register of advisers which is currently being developed will assist with this and should contain disclosure of the owner of the licensee and the ultimate parent.

Future of financial advice

The Future of Financial Advice (FOFA) reforms provide the framework for meeting the many objectives contained with the interim report's observation.

FOFA establishes a:

- ❖ Best interest duty;
- ❖ Requirement to always place the client's interest first;
- ❖ Prohibition on commissions for personal or general advice (ex risk insurance);
- ❖ Prohibition on conflicted remuneration payments for personal advice;
- ❖ Permitting scaled advice with legal certainty;
- ❖ New disclosure obligation for advisers;
- ❖ Suite of new powers for ASIC.

These are transformational reforms that have substantially changed the structure and operation of the financial advice industry.

The cost of the transition to FOFA alone has cost the financial services industry an estimated \$700 million. This cost has now been reduced as a result of refinements made to the FOFA laws in July 2014. There is a flow on cost of advice to consumers of raising standards - which is justifiable.

However the pace and cost of regulatory change in recent years has led to the near collapse of the independent financial advice sector.

There has been significant consolidation in the financial advice industry over the last three years. This has seen the consolidation of over ten takeovers by major players which has included;

- ❖ AMP acquiring AXA Asia Pacific;
- ❖ CBA acquiring Count;
- ❖ Shadforth Financial Group merged with Snowball;
- ❖ IOOF acquiring DKN Financial Group;
- ❖ Financial Index Wealth Accountants (Findex) acquiring Centric Wealth;
- ❖ Infocus Wealth Management merged with Patron Financial Advice.

This is likely to continue with further takeovers expected this year;

- ❖ IOOF looks set to acquire Shadforth Financial Group (if approved);
- ❖ Australian Unity looks set to acquire Premium Wealth Management (if approved);

The rapid consolidation has reduced the number of independent financial advice participants.

A revised advice model

FOFA reforms have placed consumer interest at the forefront of advice and have served to strengthen the financial industry. As many of the reforms however have only recently been implemented it will take time to see the benefits of these reforms. There is more work which needs to be done to raise professional standards in the financial advice sector.

The interim report has raised questions on independence and whether consumers are confused about the nature of advice they are receiving. We believe that FOFA needs to be complemented with clearer advice

segment labelling, clearly distinguishing between what is advice and what is information as well as enhanced adviser professional competency for each respective advice segment.

To ensure that consumers receive appropriate advice from advice providers with appropriate competency and skills, it is essential that any 'new model for financial advice' also takes into account intra-fund advice. This is of particular importance from a consumer perspective as intra-fund advice can be provided for both personal and general purposes. Consumers should be able to expect the same degree of professional competency and have trust that the advice provider is acting in their best interests regardless of whether the personal advice is provided in the context of intra-fund advice or not.

RECOMMENDATION

Adopt a new financial advice model which establishes

- a. Clear segments of
 - (i) personal advice
 - (ii) general information
 - (iii) factual information
 - (iv) intrafund advice

A link between advice / information and professionalism and competency.

A revised model

ADVICE MODEL				
SEGMENTS	PERSONAL ADVICE	GENERAL INFORMATION -(INCLUDING PRODUCT)	FACTUAL INFORMATION	INTRAFUND ADVICE (INCLUDES PERSONAL)
PROVIDED BY	LICENSEE OR ADVISER ⁹	- LICENSEE - ADVISER - EMPLOYEE	- LICENSEE - ADVISER - EMPLOYEE	SUPER TRUSTEE or THIRD PARTY (RELATED OR OTHERWISE) THE TRUSTEE ENGAGES
DUTIES	- BEST INTEREST - APPROPRIATE ADVICE - PRIORITY RULE - PROFESSIONAL FRAMEWORK - CONDUCT & DISCLOSURE -CONFLICTED REMUNERATION	CONDUCT & DISCLOSURE CONFLICTED REMUNERATION	CONDUCT & DISCLOSURE	- BEST INTEREST - APPROPRIATE ADVICE - PRIORITY RULE - PROFESSIONAL FRAMEWORK - CONDUCT & DISCLOSURE
COMPETENCY	NEW FRAMEWORK APPLIES	NEW FRAMEWORK APPLIES		NEW FRAMEWORK APPLIES

The benefit of the revised model is that it clearly distinguishes between what is personal financial advice and what is information. The new model seeks to limit the use of the term 'advice' to the category of personal

⁹ Adviser would defined in law as "adviser" - this would come with restrictions for usage

advice so that it is easier for consumers to understand that they are receiving advice which is tailored to their personal circumstances.

It also proposes clearly defined segments of general information and factual information. Under this model general advice is redefined to general information as it does not and has never take into account the client's personal circumstances. We believe this model will be easier and clearer for consumers to understand.

Competency framework

The FSC supports the creation of a comprehensive adviser competency framework including:

- ❖ Education requirements (including ethics training;
- ❖ And/ or a National exam;
- ❖ Enhanced comprehensive register of advisers;

The model

- ❖ A new Advice Competency Standards Board (ACSB) be established.
- ❖ The Board should include the following representatives:
 - ASIC;
 - Tax Practitioners Board;
 - A representative nominee from each of the applicable advice associations (eg: FSC, FPA, AFA, SPAA, CPA, ICAA) - the suggestion is that this person need not be the CEO but a duly qualified person;
 - Academics;
- ❖ The Board establish an Advice Competency model applicable for three of the advice segments (personal advice, general information and intrafund advice) within the new advice model (see principles);
- ❖ The Board should set minimum competency requirements and any "advanced competency" to enable specialisations. Ongoing education requirements should also be set by the Board;
- ❖ The Board can establish competency setting sub-committees - these sub-committees can be made up of advice training professionals, licensee representatives, academics and other training experts to help establish the competency standards for each advice type;
- ❖ This process could culminate in defining "financial adviser / planner" in law;

Principles

- ❖ The profession develops and administers the competency standards required for financial planners/advisers;
- ❖ There should be three levels of minimum competency standard set for three of the four different “advice segments” within the new advice model (note: a new competency framework is not proposed for factual information);
- ❖ Personal Advice - Financial planners/advisers who provide personal financial advice;
- ❖ General information (including product information providers);
- ❖ Factual information providers; and
- ❖ Intrafund advice providers;
- ❖ The regulators should supervise, monitor that registration/licensing requirements are met (i.e. competency met), and undertake enforcement;
- ❖ Competency levels need to be raised for personal advice providers;
- ❖ Competency standards need to ensure that existing practitioners have sufficient transitional pathways and that new entrants also have a means to enter the evolving profession;
- ❖ Ethics training needs to be included in future competency;
- ❖ Both advice regulators (ASIC and TPB) are satisfied with the standards;
- ❖ Advice competency should be readily accessible for consumers to understand (eg pass an exam, hold a degree or certificate etc);
- ❖ A national enhanced public register of personal advice providers could be leveraged to record competency achieved (this does not need to be detailed, it could say “Competency - met” or “exam - passed”);
- ❖ Timeframe - critical the framework should be finalised imminently so that course developments and transitions can commence;

National Exam

A national exam is one way of allowing minimum competency to be demonstrated to consumers.

The ACSB should determine the means of achieving enhanced competency including if a single national exam or minimum education/experience is to be set for the future advice competency frameworks. This may also include consideration of a flexible mechanism for meeting competency, which could for example include completion of either a national exam or minimum education/experience. The legal profession similarly also offers a flexible approach for admission as a solicitor which commonly includes completion of either an article of

clerkship or Practical Legal Training¹⁰ following the completion of legal education.

Enhanced Public Register for Financial Advisers

We support the proposal the Commonwealth is currently pursuing in developing an enhanced public register for financial advisers. We also support the inclusion of employee representatives, providing personal advice on Tier 1 products, on the register. The FSC is a participant in the consultation.

RECOMMENDATION

Establish a comprehensive adviser competency framework linked to the revised model segments which is to be developed by a new Advice Competency Standards Board (ACSB).

Increased ASIC powers

ASIC has a range of powers which includes banning someone from providing financial services. It does not however have the power to remove or prevent an individual from managing a financial services business.¹¹ There may be circumstances where there are strong reasons for ASIC to have such powers.

We support the ability for ASIC to have the power to prevent a person from managing a financial services business provided judicial review is available for such a decision.

3. DISCLOSURE

As canvassed in the interim report, disclosure does not appear to be working as the Wallis inquiry had predicted. We agree with the observation in the interim report that “the current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding of financial products and services, and impose significant costs on industry participants.”

FSC’s members manufacture and or distribute financial products and services across the wealth management industry. Widely used products include managed investments, superannuation and life insurance.

Following both Wallis and the Financial Services Reform Acts (FSRA) which led to lengthy disclosure documents, the FSC has been

¹⁰ Admission requirements vary on a state by state basis, for example following completion of a legal degree, a Practical Legal Training (PLT) course is completed or a 1 year traineeship for admission in Qld and a PLT course or 12 months article clerkship in Western Australia.

¹¹ Page 24; Financial System Inquiry; Submission by the Australian Securities and Investment Commission Page 24 ASIC submission to Financial Services Inquiry.

supportive of initiatives to enhance both the relevance and readability of disclosure information designed for consumers.

Industry and the government have undertaken initiatives such as:

- ❖ The Standard Risk Measure (SRM) for superannuation products - a backward looking investment risk descriptor created by the FSC and ASFA and endorsed by ASIC and APRA;
- ❖ Shorter PDS regime - an eight page document for simple managed investments, superannuation and standard margin lending facilities;
- ❖ The MySuper dashboard - a snapshot of key product features such as investment return target, past performance, fees and costs and the SRM rating;

Each of these measures endeavoured to limit or standardise the disclosure regime. Two of the three of these measures above were specifically targeted at superannuation products. We would agree that there is a strong case to consider disclosure in superannuation differently to discretionary products such as managed investments. The compulsory nature of superannuation has led to initiatives such as the dashboard which are designed to lower disengagement in superannuation.

Product Intervention powers

Product issuers are required to provide complete and accurate disclosure which is clear, concise and effective. If product intervention powers are made available to ASIC, there is a risk of some level of moral hazard in the sense that it may appear that if ASIC has not intervened, the product is not inappropriate.

If such powers are required, they should only be provided by the court on application from ASIC.. We consider the intervention on the issue of a product (absence compliance with disclosure and licensee laws) should be a power only vested in the courts (on application by ASIC).

If a licensee (including a licenced product issuer) breaches any licence or other regulatory requirements, ASIC has power to intervene (such as take action against the provider) even without product intervention powers.

Product Suitability Obligations

There have been some calls for some form of additional obligation on product issuers in the form of a product suitability obligation. Currently

licenced product issuers are subject to obligations under section 912A of the Corporations Act including to act efficiently, honestly and fairly. Issuers should also comply with disclosure obligations.

It is not practical for a product issuer to understand the personal circumstances of a prospective investor and therefore it is not appropriate that a product issuer be required to assess whether a product is suitable for a prospective investor or a particular class of investor type.

Product issuers are not financial advisers and only the prospective investor (or their advisor) is in a position to assess if the product is suitable given the personal circumstances of the investor.

We consider there may be some risks in requiring product issuers to suggest which type of investor a product may be suited to (or not suited to) - because it may not always be the case that a product is suited to that investor type given the personal circumstances of the investor.

Expanded use of Electronic Media for Disclosure

We strongly encourage increased and better use of internet and other media for the purposes of providing relevant disclosure that both informs and educates. Whilst there is a place for traditional disclosures such as PDS, these should be complimented and supported by meaningful related electronic disclosures at the outset and on an ongoing basis.

Recent additional disclosures relating to superannuation under the Stronger Super reforms (primarily those required by s.29QB of the SIS Act) have significantly increased the volume of disclosure to members.

The policy intent of this extended disclosure has been generalised as “system transparency”. Whilst many of these disclosures may be of value to support the integrity of the superannuation system, their usefulness as disclosures to members is questionable particularly where that disclosure is irrelevant to some or many.

Enhanced disclosure should not leave a member asking the question “what do I do with this information?”.

Further, the expanded disclosure obligations impose an additional compliance burden and cost which must be appropriately balanced with the benefit derived.

These recent additional disclosures have been promoted as enhancing competition and providing better outcomes for members to drive costs down. We support the view that greater disclosure can enhance competition, however we caution that driving down fees and costs can also produce detrimental outcomes for members, through forced abandonment of valued services that can no longer be sustained under the product cost structures - a "race to the bottom" with no winner.

GfK research

To better understand how effective consumers find the current disclosure regime, the FSC engaged GfK to undertake consumer testing on the matters raised in the interim report.

- ❖ The key aim of the research is to understand what consumers need in terms of financial product information in order to make purchase decisions:
 - Current financial product disclosure experience;
 - Relative importance of different aspects of 'disclosure' from consumer perspective;
 - Appeal of enhancement mechanisms as outlined in the Interim FSI report;

Current experience of financial product information appears to be challenging for consumers

- ❖ Most (94%) adult Australians have experience with financial product information, and three in four (74%) have interacted with financial product information in the last 12 months;
 - One in two (51%) have read a product disclosure statement (PDS) in the last 12 months, increasing to two thirds of those who have a managed investment, self-managed investment or online share trading account (62%, 69% and 67% read a PDS in the last 12 months, respectively);
 - No real demographic differences in product information exposure apart from a slight younger age related skew (fewer people over 65 are reading financial product information compared to other age groups);
- ❖ Evaluation of the current way in which financial product information is provided is not favourable;
 - A third of consumers who have read financial product information in the last 12 months believe there is too much information to read (72%) and that legal or technical information makes it difficult to understand (64%);

- Whilst a third of consumers agree that the information is easy to understand and informs all aspects of products, making comparisons easy, more consumers disagree with these statements;
- ❖ Therefore, current financial product disclosure does not necessarily make product choice easy;
 - At least three in four who have read a PDS in the last 12 months say that it contained product features and benefits, charges, inclusions and exclusions and how the product works;
 - However, a third state that the PDS did not include information to help choose the right product (including risks, past performance and different product options available);
- ❖ Information sought to inform product choice focuses on product costs versus benefits;
- ❖ Fees/charges are by far the most sought after product information when choosing a new product, with over a quarter of consumers (28%) choosing this as the most important information and over two thirds (71%) choosing it in their top three;
- ❖ Product details (features, benefits, inclusions and exclusions and risks) are the next most sought after information, selected by around a third of consumers;
- ❖ How a product works and how to choose the best product to meet needs are the other product choice information sought by at least one in five consumers;
- ❖ All other product information, such as company information, commissions, complaint avenues, cooling off periods, application information and technical definitions are sought after by few;
- ❖ There are no real demographic differences in information sought, nor does it differ by financial product ownership or involvement with a financial adviser;

Current product disclosure is not optimal - consumers want standardised information so they can make informed product choices

- ❖ When presented with the range of possible mechanisms for financial product disclosure current practice was ranked last in preference

- Most preferred: A standardised format used across all product disclosure documents to allow easy comparison of key information such as risk (Risk profile disclosure);
 - Second: Product disclosure documents to be reformatted into short, clear documents with plain English and graphics (Better information presentation);
 - Third: Financial product information is disclosed in a series of steps (Layered disclosure);
 - Fourth: All information provided in product disclosure statements be available in online product comparison sites (Online comparators and choice engines);
 - Last: current product disclosure format (current PDSs);
- ❖ Standardised risk profile disclosure and better information presentation are clear favourites in terms of product disclosure, accounting for two thirds of first preference (38% and 30% respectively);
 - ❖ Only half of consumers are open to assistance in financial product literacy - one in two (43%) do not want product suitability decided or advised for them
 - One in three (32%) are comfortable with someone else determining the best product for their needs, with an even split across the government regulator, product issuer or a financial adviser;
 - One in two (45%) are open to financial advice though one in three (30%) want product recommendations only rather than for an adviser to decide what is best;

This information shows us that:

1. The existing disclosure regime is not meeting consumer needs or expectations;
2. Consumers value:
 - a. comparable, standardised information;
 - b. plain English;
 - c. less voluminous materials;
3. Consumers are not open to products being chosen or suggested by a government regulator.

This research does not necessarily present information which comes as a revelation to industry or regulators, which is why the range of initiatives listed above have been previously supported.

However, the research does highlight that there is more work to do on improving disclosure of which are supportive. Further it shows that more work needs to be done on making disclosure work rather than discarding disclosure as a regulatory tool.

RECOMMENDATION

1. Consumer testing should be a mandatory element of Regulatory Impact Statements where new disclosure reforms are being considered
2. Existing disclosure documents should be reviewed against these key consumer factors of plain English, comparable templates and less volume
3. All disclosure documents should be deliverable by digital means
4. Imposing product suitability obligations on product issuers risks a consumer inappropriately using or relying on statements as to suitability.
5. The disclosure should be relevant, targeted and facilitate member action. Disclosure of too much information does not equate to usefulness.

4. COMPENSATION SCHEMES

Multiple reviews, including the Wallis Inquiry and Richard St John Report, have confirmed there is no compelling reason for introducing a statutory consumer compensation scheme.

The most comprehensive examination of compensation arrangements, by Richard St John in 2012, concluded that such a scheme would be “inappropriate and possibly counter-productive”. In particular, St John highlighted the risk of regulatory moral hazard, and the inappropriateness of having more responsible, financially secure licensees, underwriting others.

It should not be forgotten that consumers already have legislatively mandated, free access to external dispute resolution systems, such as the Financial Ombudsman Service (FOS), which are binding on financial service providers (FSPs).

Ongoing reform of the Financial Ombudsman Service - currently on foot - will only improve the dispute resolution system, producing a more timely, more efficient and less costly service.

Notwithstanding such mechanisms, the courts provide an additional, time-honoured avenue for consumer redress. As highlighted most recently in the FSI interim report, statutory compensation schemes merely lead to better participants in the industry subsidising less scrupulous entities.

RECOMMENDATION

That the introduction of a statutory compensation scheme for consumers would be counter productive, involve regulatory moral hazard and lead to the most responsible providers underwriting others.

