Submission to Treasury on the
Exposure Draft - Future of Financial Advice amendments

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Combined Pensioners & Superannuants Association of NSW Inc (CPSA)

Address: Level 9, 28 Foveaux Street, Surry Hills NSW 2010 **ABN**: 11 244 559 772

Phone: (02) 9281 3588 **Country Callers**: 1800 451 488 **Facsimile**: (02) 9281 9716

Email: cpsa@cpsa.org.au **Website**: www.cpsa.org.au **Donations:** 1800 451 488

CPSA is a non-profit, non-party-political membership association founded in 1931 which serves pensioners of all ages, superannuants and low-income retirees. CPSA has 130 branches and affiliated organisations with a combined membership of over 30,000 people living throughout NSW. CPSA's aim is to improve the standard of living and well-being of its members and constituents. CPSA depends for the majority of its funding for core activities as a peak body on a $450,000 grant from NSW Family and Community Services' Office for Ageing. CPSA engages in systemic advocacy on behalf of its constituency. CPSA acknowledges the potential for conflict of interest arising for CPSA and government as a result of this funding arrangement. CPSA is committed to managing any conflict of interest issues in an ethical manner.

CPSA welcomes the opportunity to provide comment on the Exposure Draft of the proposed Future of Financial Advice (FOFA) reforms.

The Australian Government is seeking to amend FOFA to address concerns of the financial services industry that components of FOFA present an unjustifiable cost, which will in turn make financial advice more expensive for consumers.[1]

While Treasury estimates that the amendments will save the industry $90 million in upfront costs and $190 million in annual, ongoing costs,[2] there has been no estimate of the savings for individual consumers. The only mention of consumers in terms of savings is that they will be better off because industry will be saving money. Furthermore, there has been no detailed analysis of the amendments' potential cost to consumers. It would appear that the Australian Government's cost-benefit analysis of the FOFA reforms has contravened its own guidelines on regulatory reform, whereby a cost-benefit analysis:

> "involves a systematic evaluation of the impacts of a regulatory proposal, accounting for all the effects on the community and economy: not just the immediate or direct effects, financial effects or effects on one group."[3]

Although the FOFA amendments are deregulatory, it would appear that the Australian Government's analysis of the benefits of deregulation has focussed on one group – the financial services industry. Meanwhile, the benefit to consumers is surmised in a one-line assumption that whatever the industry saves will be passed on to consumers. FOFA sought to protect consumers from unacceptable risk present in the financial services industry. Therefore, any amendment to FOFA should be assessed in terms of its benefit and cost to consumers.

Research commissioned by the Super Industry Network estimates that the existing FOFA package will boost Australians' savings by $130 billion by 2026.[4] These savings to consumers far outweigh the estimated savings to industry. There has also been no analysis of the potential cost to industry via loss of clientele if FOFA is dismantled. ASIC research shows that there is broad public distrust of the financial advice industry.[5] FOFA attempts to boost consumer confidence in the sector by strengthening consumer protections. However, watering down FOFA may see a loss in potential clients who refrain from seeking financial advice because they lack confidence that their best interests will be served.

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[1] Commonwealth of Australia (2014) 'Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014' Draft Explanatory Memorandum, House of Representatives, p. 33

[2] Ibid.

[3] Department of Finance and Deregulation (2013) 'OBPR Guidance Note – Cost-Benefit Analysis' The Australian Government, p.1

[4] Rice Warner Actuaries (2012) 'The Financial Advice Industry post FoFA' p.8

[5] ASIC (2010) 'Access to financial advice in Australia' Report 224 http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep224.pdf/$file/rep224.pdf, p.60

Best interests duty

CPSA supports the best interests duty, including the so-called 'catch-all' provision 961B(2)(g). This requires advisers to have "taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances."[6]

In CPSA's view, this should be standard practice of financial advisers. A client expects a financial adviser, as a professional, to do everything they can to serve their best interests. Removing the catch-all clause greatly weakens the best interests duty by reducing subsection 961B(2) to a tick-the-box exercise.

Recommendation 1: Subsection 961B(2)(g) and the associated Section 961E should remain, unamended.

Ongoing fee arrangements

CPSA calls for the retention of the opt-in provision in the interests of providing certainty for consumers and increasing transparency and competition in the sector.

ASIC research shows that two-thirds of current financial advice clients are 'inactive'. This suggests that they do not engage with their financial adviser, despite many paying ongoing fees. The opt-in provision would reduce the incidence of consumers paying advisers for years without receiving any service.

FOFA exempts advisers from the opt-in provision if they comply with an approved code of conduct. This provision was supported by the Financial Planners' Association because it claimed that requiring advisers to abide by a code of conduct would augment the 'professionalism' of the industry. However, it would appear that removal of opt-in will also remove this provision.

The debate over opt-in has largely centred on uncertainty over what would happen with a client's money if they do not opt-in (or out) within the specified timeframe. CPSA believes that this problem could be solved by requiring clients at the time of signing up to provide bank details for the transfer of money under management if they fail to respond to the opt-in request. Alternatively, a system similar to that which operates for lost superannuation accounts could be established, so that 'lost clients' could retrieve their money at a later date.

The opt-in provision will save consumers money because it will go some way to tackle the ubiquitous consumer inertia present in the financial services industry. This is in the

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[6] Commonwealth of Australia 'Corporations Act 2001'
http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s961b.html

best interests of the consumer as well as the Australian Government in view of its interest in increasing the retirement savings of Australians.

Recommendation 2: Section 962K should remain, with amendments to specify what happens to client funds where a client fails to advise if they wish to continue receiving the service with the financial adviser.

Fee disclosure statements

Annual fee disclosure statements should be sent to all clients, not just those who became clients after 1 July 2013 as proposed by the amendment.

Annual fee disclosure statements are essential to provide consumers with a clear understanding of the service/s they receive and the cost of that service. In an industry that often employs complex fee structures and/or charges fees as a percentage of accounts, clear fee disclosure should be available to all clients.

In terms of annual fee disclosure statements' cost to business, many advisers would have already made the appropriate changes to their business to comply with the reforms from 1 July 2013 and will not achieve any implementation cost savings. Some advisers may also continue to provide the statements to pre-1 July 2013 clients if this amendment is passed, and therefore derive no cost saving. In terms of ongoing costs to the industry, the saving will not be an ongoing saving as the number of pre-July 2013 clients declines through attrition. New clients will need to be sent annual fee statements. Therefore, the biggest cost saving for industry as a result of this amendment will be witnessed in the first year, with subsequent savings falling over time.

However, there will be a potential cost to many consumers. Contrary to the draft Explanatory Memorandum's claim that the consumer derives 'minimal benefit' from annual fee disclosure statements, the Australian Government's own Regulatory Impact Statement on the FOFA amendments suggests otherwise. With reference to the removal of annual fee disclosure statements, it states that:

> "Consumers who may not have the time or skills to collate and fully understand the fees they are paying may be disadvantaged by this amendment as they will not have the simple source of information the fee disclosure statement provides."[7]

It is unclear why this concern held by the Government as at 13 January 2014 has been whitewashed in the draft Explanatory Memorandum on the amendments. Nonetheless, it is a valid concern to which greater heed should be paid.

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[7]Future of Financial Advice Amendments 'Regulatory Impact Statement', http://ris.finance.gov.au/2014/01/13/future-of-financial-advice-amendments-options-stage-regulation-impact-statement-department-of-the-treasury/ p.2

Recommendation 3: Section 962G should remain, unamended.

General Advice

Section 963A should remain unchanged to protect the interests of consumers. Most consumers seek general advice rather than personal advice. This amendment will result in the majority of consumers subject to advice that could be conflicted. It will also have a distortionary effect by incentivising advisers to provide general advice over personal advice because of the commissions available through general advice. Therefore, rather than assist consumers, this amendment will only benefit the industry.

Recommendation 4: Section 963A should remain, unchanged.

Life risk insurance exemption

The ban on commissions for life risk insurance within superannuation should remain. There is a good reason for the ban to apply to products within superannuation (as opposed to those outside it) as superannuation is a compulsory savings vehicle for the vast majority of Australian workers. Superannuation fund members should therefore be protected from paying for products that may not serve their best interests.

As this amendment does not apply to life risk insurance that has been offered as part of personal advice, it will create another incentive to provide general advice. This will disadvantage consumers in two ways: consumers will likely only receive general advice when personal advice is required and they will subsequently be exposed to conflicted advice (if the full suite of amendments takes effect).

Recommendation 5: Continue ban on conflicted remuneration for life risk insurance in superannuation.

Provision of scaled advice

It is important to point out that FOFA did not ban the provision of scaled advice. ASIC issued guidelines for advisers so that they could meet the best interests duty requirement, while providing scaled advice.

These amendments present a risk to consumers by encouraging limited advice that may be contrary to the consumer's best interest. Although scaled advice is to be 'negotiated' between an adviser and a client, many consumers place their trust in an adviser and such negotiation is likely to be one-sided. At the very least, consumers seeking scaled advice should be protected by an overarching best interests duty so that they are not disadvantaged because other important factors regarding their financial circumstances were not considered by their adviser.

Recommendation 6: Consumers should be protected by an overarching best interests duty so that they can have confidence in scaled advice.

Balanced scorecard remuneration arrangements

This amendment will return conflicted remuneration to the financial advice industry by allowing volume-based bonuses to be paid to advisers. CPSA is strongly opposed to this amendment.

Allowing scorecard remuneration will benefit the big four banks and AMP because of their vertical integration. Advisers will have a considerable economic incentive to work for these institutions, and this amendment could lead to a greater concentration of the industry. This will likely reduce competition in the industry, which is a poor outcome for consumers.

This amendment also completely undermines the goal of FOFA to move the industry away from conflicted financial advice. The proposed regulation states that a benefit is not conflicted remuneration if it "is given in circumstances that is [sic] likely to encourage the giving of personal advice that is in the client's best interests". This statement illustrates how far removed this amendment is from the original intent of FOFA, where conflicted remuneration is allowed *if* it encourages advisers to act in their clients' best interest.

Although the amendment states that the bonus or benefit must be 'low', the amount is not prescribed by the proposed regulations. Regardless of the amount, a volume-based bonus presents a financial incentive for advisers to recommend products that may not be in their clients' best interests and should be banned.

Recommendation 7: Abandon the new regulation 7.7A.12EB that would see a return of conflicted remuneration through performance bonuses.