Future of Financial Advice Bill Tranche 1

NICRI Submission

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EXPOSURE DRAFT - CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011

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NICRI supports underlying objectives

NICRI supports the underlying objective of the reforms set out in the exposure draft 'to improve the quality of financial advice while building trust and confidence in the financial planning industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest' and 'to facilitate access to financial advice'.

However, NICRI has some concerns relating to the provision of limited advice (see later comments).

In essence NICRI supports the intention of the draft Bill to implement:

1. A best interests obligation for financial advisers
2. A requirement for advisers to obtain client agreement to ongoing fees and enhanced disclosure of ongoing fees, and
3. Enhancement of ASIC's licensing and banking powers to improve supervision of the industry

Longer Consultation Period

We would urge the provision of a longer period of consultation for public discussion of measures relating to the ban on conflicted remuneration, including commissions, volume payments and soft-dollar benefits, than the provision of time allowed for comment on this exposure draft.

1. NICRI supports the introduction of Statutory Best Interests Obligation

NICRI fully supports the introduction of a statutory obligation for individuals who provide advice to act in the best interests of the client and to give priority to the interests of the client if a conflict of interest arises. However, there remains a mismatch between the introduction of a 'Best interests' statutory obligation and the remaining focus on the provision of 'appropriate' advice, even though the obligation for the provision of appropriate advice has been shifted from the licensee to the individual giving advice.

NICRI has several concerns in relation to the drafted Best Interests Obligation within the Bill.

In particular NICRI has concerns about Scaled and Limited Advice.

'In situations where limited advice has been requested by the client the adviser is able to tailor the information they obtain about the client solely to what is necessary to provide that form of advice. However, the adviser is required to exercise professional judgement and advise the client if they believe advice on another subject matter could better meet the client's needs and objectives. This reflects the fact that retail clients may not always know what type of advice will meet their needs and objectives.' EM 1.29

NICRI is concerned that under the provisions in relation to scaled or limited advice, some individual advisers, authorised representatives and licensees may use the provision of scalable or limited advice as a means of 'opting out' of their best interest obligations. We feel strongly that the onus must be on the adviser to determine whether a request for scaled advice is reasonable, particularly if it related to the provision of advice about a single or particularly complex class of financial product.

Advisers are increasingly using derivatives, Contracts for Difference, Exchange Traded Funds and synthetic structured products to 'hedge' client portfolios against fluctuations in the more traditional asset classes.

Retail investors are easily influenced by investment trends and fads and attracted to the 'upside' that new or relatively untested products currently deliver. Unless there is a strong obligation on the part of the individual providing advice to use professional judgement when they receive a scalable advice request, such requests for advice could continue to be a way for advisers to bypass some of their best interest obligations. We do not believe that the responsibility for seeking limited advice should rest with the client but believe the individual adviser must be obliged to set out in writing their reasons for scaling or limiting advice and the factors they've considered in determining to provide limited advice.

In addition, NICRI has concerns about the Bill's definition of reasonable investigation in relation to limited advice.

*'However, if the client requests the provider to consider a specified financial product, or financial products of a specified class, a **reasonable investigation** into the financial products that might achieve the objectives and meet the needs of the client includes an investigation into that financial product, or financial products of that class.' ED 961e(2)*

Financial products are increasingly complex and retail clients often become swept up in the latest financial fashion, as dictated by the intensive advertising and marketing undertaken by sectors of the financial planning industry. Again, NICRI's market intelligence and statistics on the inflow of funds to certain product categories over the past 1-3 years, indicates that retail clients are increasingly attracted to Exchange Traded Funds and other such derivatives (CFDs, structured products and forex products).

As stated previously, financial planners are also increasingly using these products to provide clients with a 'hedge' against fluctuations in traditional asset classes such as Australian equities. The current version of the Bill appears to enable providers to confine their 'reasonable investigation' to one product class if that is the request of the retail client.

NICRI believes that if the client's request is for advice about a particularly new or risky asset class, there needs to be an obligation on the provider to suggest alternative asset classes that may not contain the same levels of risk, in which case a 'reasonable investigation' would include 'financial products that might achieve the objectives and meet the needs of the client includes an investigation into that financial product or financial products of that class or other classes that may be more in line with the client's needs and objectives.'

NICRI is concerned that the bill does not improve current practices in relation to conflicts that arise from the use of Approved Product Lists. We urge amendments in this area.

'In relation to the assessment of financial products, there must be a reasonable investigation into the products of which the provider is aware that might achieve the objectives and needs of the client. [Schedule 1, item 13, division 2, paragraph 961C(2)(g)]. This does not require an investigation into every product that is available on the market given that in many cases this would be impractical and costly. [Schedule 1, item 13, division 2, section 961E]. In situations where the range of products that a provider can consider is limited by the imposition of an approved product list, the provider may still be able to comply with the reasonable investigation obligation even though they limit their investigation to the products on the list, but they must not recommend a product on the list if it does not meet the needs and objectives of the client. [Schedule 1, item 13, division] '. EM 1.31

NICRI does not believe that the exposure draft provides any significant improvement on current financial advice industry practice in relation to the use of Approved Product Lists (APL) particularly when one considers that provisions in relation to ongoing advice will only be applied to new clients and not existing clients.

The treatment of APLs in the current Bill is extremely disappointing for retail investors and is at odds with the Government's stated intent in relation to the FoFA reforms.

The Bill places no obligation on individual advisers, authorised representatives or licensees to improve existing practices in relation to approved product lists.

We understand that it is unreasonable to expect any adviser to base product selection on an investigation of all available products. However, the use of APLs as the 'backbone' of the selection process will ensure that conflicted advice continues to be normal practice for some advisers.

The strict requirements placed on advisers by some licensees to adhere to the APL is one reason why 50% of Australia's 11 million employees remain in high-fee, low-return superannuation funds and why many retirees and pre-retirees remain over-exposed to high-growth, high-risk assets.

In many advisory practices, the composition of the APL is directly related to practice ownership, with an over-representation of products owned by the licensee on the APL being the norm.

A typical example:
'Advisory Practice XYZ has been in business since the late 1980s. It started business as an agency for a major life insurance company and 'evolved' into a financial advice business by the mid-1990s.

Its licensee is now a dealer group owned by a 'Big 4' bank that also now owns the life company. All clients of the practice have portfolios constructed of funds, model portfolios and other products (including cash accounts, risk products, brokerage accounts and margin loans) within that Bank/Life Company's Wrap and/or Master Trust.

The adviser says it would be both administratively and financially prohibitive to swap wrap/master trust providers. He also states that he doesn't see the need to review or compare his current wrap provider. Revenue generated by the provider's licensee and parent company in the form of wrap/master trust fees, investment management fees, brokerage and account keeping/transaction fees from the high-net-worth clients of this single advice practice would be substantial. Replicated across the financial planning industry, revenue flowing back to parent and related institutions via APLs is substantial. '

It is common knowledge that the use of parent company wraps and master trusts for product selection and client portfolio management is endemic within the financial planning industry and clearly presents ongoing conflicts for some advisers who are obviously under pressure to recommend their parent company's products.

The provider in this example (and many others) is effectively 'outsourcing' construction of its approved products list to, not only its licensee, but that licensee's wrap/master trust.

Retail clients cannot be expected to understand the significance of the adviser's decision to use one wrap/master trust for all clients, let alone understand the potential for conflicts of interest when that wrap and master trust is owned by the licensee, with a menu of products consisting predominantly of in-house managed funds, cash accounts, brokerage and margin loans.

NICRI believes it is essential that the Corporations Amendment (Future of Financial Advice) Bill should state that individual advisers should not be restricted to only recommending products on the licensee's APL.

In fact, the FoFA laws should provide individual planners with the right to investigate and recommend products outside the APL if doing so enables them to act in the best interests of the client. It is not enough to state that a provider cannot recommend a product if he/she cannot find an appropriate product on the APL.

NICRI believes that retail clients cannot be expected to understand the product selection processes currently used by financial planners. Retail clients need to be overtly informed, within the statement of advice, that products recommended have been drawn from an APL and of any relationship between APL products and the adviser. This is particularly important where the branding of the financial advice practice differs from the branding of the licensee and parent company.

The Bill should be amended to include provision for an obligation on all advisers to inform clients within the Statement of Advice (SoA) that recommended products have been drawn from an APL and that they can request their adviser to investigate and recommend products that are not included on the APL to ensure the recommendation does, in fact, meet the adviser's obligations to act in the client's best interests.

NICRI believes it is impossible for any adviser to meet a best interests test whilst restricted to recommending products on an APL.

The Bill should also enable all retail clients to have access to an adviser's complete APL upon request and this right should also be disclosed in SoAs. Of course, we accept that individual advisers need to be able to justify a decision to recommend a non-APL product in line with the requirement that there must be a reasonable investigation into the product.

2. NICRI supports the concept of compulsory renewal of ongoing fees paid by retail clients but wishes to see the Bill reformed to include a disclosure requirement for existing clients and to include disclosure of commissions and other non-fee forms of remuneration.

However, we wish to express our disappointment that Division 3 (charging of ongoing fees to client) will apply only to new clients. NICRI does not consider it onerous to expect advisers to commence provision of renewal notices for ongoing advice to ALL EXISTING AND NEW retail clients from commencement date.

We are deeply concerned that ongoing advice arrangements already in place prior to commencement date, will be allowed to continue unchanged under the new laws. This essentially means many existing clients will continue to pay fees for ongoing advice when they do not, in effect, receive any such advice.

We strongly urge an amendment to the Bill to ensure Division 3 applies to all retail clients from commencement date. The restriction of Division 3 to new clients only does not sit well with the Government's intent to improve current financial planning practices and will allow remuneration for the non-supply of advisory services to continue well into the future.

At the very least all existing clients on the previous remuneration system should be notified of the change in adviser remuneration requirements to empower them to determine which form of payment is most appropriate.

The current version of the Bill does not require the provision of a disclosure statement in relation to commissions and other forms of remuneration received.

The fee disclosure statement as set out in the exposure draft doesn't include commission disclosure or disclosure of other forms of remuneration not paid by the client.

Even after the proposed ban on conflicted remuneration is implemented, advisers will still receive remuneration in the form of commissions (and other non-fee forms) because the proposed ban does not apply to risk insurance products. These forms of remuneration must still be disclosed to clients as they form part of the ongoing services offered by advisers and may lead to potential conflicts if not disclosed.

NICRI believes the Proposed s962E should include, in addition to information about fees paid directly by the client, disclosure of commissions and other non-fee remuneration received by the provider in relation to services already delivered in the previous 12 months and to be delivered in the subsequent 12 months. The definition of ongoing fee arrangement should include reference to non-fee remuneration received (or to be received) by the provider.

3. Enhancement of ASIC's licensing and banking powers to improve supervision of the industry.

NICRI supports the expansion of ASIC's powers to protect consumers when they, in good faith, look to invest their retirement savings. We acknowledge the process to empower ASIC to deem whether an individual advisor is of good fame and character is quite complex and we would suggest may need to be covered by a separate consultation process.

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