

ISN SUBMISSION

INQUIRY INTO THE COLLAPSE OF TRIO CAPITAL

ISN SUBMISSION TO THE
PARLIAMENTARY JOINT
COMMITTEE ON CORPORATIONS
AND FINANCIAL SERVICES

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Industry
Super
Network

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About Industry Super Network

Industry Super Network (ISN) is an umbrella organisation for the industry super movement. ISN manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of five million industry super members. Please direct questions and comments to:

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EXECUTIVE SUMMARY

Industry Super Network (ISN) welcomes the opportunity to make a submission to the Parliamentary Joint Committee on Corporations and Financial Services into the collapse of Trio Capital and any other related matters.

This case represents yet another appalling and tragic example of unwitting investors being advised to adopt strategies and products by licensed financial planners which result in them losing all or substantial amounts of their life savings. This case provides further proof that the reforms proposed for the financial advice industry are critical and must address the systemic conflicts of interest which directly cause bad financial advice and sour public confidence in all financial advice and superannuation. This case also gives rise to questions regarding other regulatory failure, in relation to the regulation of default funds in workplaces to cater for the majority of workers who have failed to exercise choice of fund and the role played by research and ratings agencies in providing 'independent' approval of investment products. ISN will also make submissions regarding the regulatory regime governing SMSFs and the compensation scheme available to APRA regulated funds in cases of fraud.

ISN's submission will set out a number of pieces of research which support the case for regulatory change in the area of financial advice.

Will those organisations whose self interest causes them to advocate against the Future of Financial Advice reforms be willing to take responsibility for the next collapse which will inevitably occur if the moderate reforms proposed by Government are not passed in their entirety?

ISN will make submissions on the following Terms of Reference set by the Committee.

Term of Reference 1 - The type of investment vehicles, funds and other products involved in Trio Capital, and the relevant regulatory regime

The primary type of investment relevant to the Trio case was superannuation and retirement savings. The Trio products were distributed through retail financial planners recommending Trio super and retirement income products to clients, through the Trio super product being made the default product at workplaces and because SMSF and other investors were advised to invest in the Astarra and Trio investment funds. In particular, in some cases financial planning businesses badged (or white labelled) the Trio products as their in-house product.

It is critical to contextualise this collapse and the implications for the regulatory environment, due to the fact that it was primarily superannuation monies involved, as follows:

- Superannuation is a compulsory investment. It is heavily subsidised by the taxpayer through the tax concessions provided to encourage superannuation savings. The regulation of super must ensure that both private savings and public contributions are protected through appropriately stringent regulation, which minimises future instances of collapse and fraud such as Trio.
- The majority of consumers are passive and disengaged from their superannuation, which is typically the only investable asset they hold. While the average retirement balance for Australian

workers is still reasonably modest, balances will increase as our superannuation system approaches maturity (in around 2031), leaving consumers with even more to lose.

- Financial disengagement and low levels of financial literacy in Australia are well documented. This means that where consumers seek financial advice they are nearly always utterly reliant on their adviser and so the regulatory framework for advice must ensure that financial advisers provide impartial and high quality financial advice. It is accepted that the existing regulatory framework which is premised on disclosure of conflicts of interest has been inadequate to protect consumers. The proposed Future of Financial Advice (FOFA) reforms resulted from the recommendations made by this Committee in its Inquiry into the Storm collapse and are intended to increase the professional obligations of providers of financial advice.
- A majority of workers do not choose their own super fund and members excessively discount their future needs. Since the introduction of Super Choice in 2005, the proportion of super fund members who exercise choice of fund has declined from 4.6% in 2006 to 2.4% in 2010 and the majority of these switch only because they change jobsⁱ. This means that it is critical to ensure that only the most competitive (in terms of cost and net performance) and well governed super funds are allowed to be default funds.
- The SMSF sector is now the largest in the superannuation market. While many are attracted to using SMSFs for their retirement savings because the notion of control and self governance appeals to them, it is clear from the over-representation of SMSF investors in each of the major financial collapses that there are a number of SMSF investors who lack the financial sophistication to be making key investment decisions. The absence of APRA regulatory oversight leaves these investors less protected in the event of fraud.

The Trio collapse will hopefully prove to be the worst instance of regulatory failure in superannuation. Furthermore, it must be acknowledged that regulation will only go so far – no law can be totally effective to prevent individuals who are prepared to engage in criminal and fraudulent activity as they were in this case. However, notwithstanding the existence of criminal fraud, the Trio case adds to the significant body of evidence pointing to the need for urgent reform in the regulation of superannuation and financial advice. ISN's submission will focus on:

- The regulation of provision of financial advice, in terms of how the existing provisions failed to protect consumers in this case and will also look at the measures in the proposed FOFA reforms and how they would have better protected consumers.
- The regulation of default funds, particularly in terms of how proposed reform around nomination of default funds would better protect the vast majority workers who rely on the default fund at their workplace.
- The regulation of superannuation and in particular the distinction between APRA regulated superannuation funds and ATO regulated SMSFs.

Term of Reference 2 - The points of failure in relation to products or advice

There were numerous points of failure in relation to product and advice in this case, as follows:

1.1 The role of financial planners in recommending Trio products to retail investors

Financial planners were paid very generous commissions and other financial incentives to recommend the Trio products to their clients.

Time and again, it has been shown that payment of financial incentives by product providers to financial advisers leads to biased and poor quality advice. The following table summarises the major financial collapses in Australia over the past five years:

1.1.1 Table 1: Financial Collapses in Australia between 2006-2011

Company	Scheme	Commissions and Fees	Clients Affected	Total Losses
Storm Financial	Margin lending/ financial planning	6-7% upfront commission with two trail commissions of between 0.22 – 0.385% and 0.33% pa. ⁱⁱ	14,000 ⁱⁱⁱ	\$4.7 billion ^{iv}
Timbercorp / Great Southern	managed investment schemes (MIS)	10% up front commission, ongoing fixed based fee, and 27.5% performance fee ^v	18,000 ^{vi} (Timbercorp) 47,000 (GS) ^{vii}	\$3 billion+ ^{viii}
Opes Prime	non-standard margin loan, or 'equity finance scheme'	trail commissions of up to 0.75% to referring brokers ^{ix}	1,200 ^x	\$600 million ^{xi}
Bridgecorp	Property investment	Unknown	14,500 ^{xii}	\$459 million ^{xiii}
Westpoint	Margin lending	10% up front commission ^{xiv}	3,524 ^{xv}	\$310 million ^{xvi}
Fincorp	Property investment	\$3 million in fees ^{xvii}	8,100 ^{xviii}	\$200 million ^{xix}
Trio/Astarra	Corporate and Retail Super	4% up front commission ^{xx} and 1.1% trail commission ^{xxi} Additional volume rebates also paid to advisers ^{xxii}	5000+ ^{xxiii}	\$185 million ^{xxiv}

All data is taken from publically available sources which are provided in the end notes.

Any payment by a product provider to a financial adviser will ‘corrupt’ the advice and create a serious misalignment of interest between the adviser and client. The facts of the Trio case are a stark example of this misalignment.

Astarra used multiple incentives, including the payment of commissions, to influence financial advisers to sell Astarra backed products. Media reporting of the arrangements between Astarra/Trio and ‘independent’ financial advisers has included:

- Up-front commissions (entry fees) of 4% for placing client monies in a Trio/Astarra product^{xxv}
- Trail commissions of up to 1.1%^{xxvi}
- Substantial financial benefits for financial planning firms to ‘white-label’ Astarra super products – for instance it is reported that a regional-NSW planning firm who created a white labelled Astarra product charged ongoing management fees of 2.65% which it split 50/50 with Astarra, in addition to earning trail commission and additional equity generated from business of running the badged products (the Seagrims Personal Retirement Plan)^{xxvii}. Other advice groups, including NSW-based Tarrants, received substantial ‘marketing allowances’ of 3.3 % of all client monies which on advice were placed in the Astarra Strategic Fund.^{xxviii}
- The Association of Independently Owned financial Planners’ (AOIFP) acted as a “consolidated distribution network” for Astarra products. It is reported that AOIFP members received volume rebates from Astarra and an AOIFP conference was ‘gold sponsored’ by Astarra.^{xxix}

This case demonstrates yet again how the payment of commissions and other financial incentives from product providers results in sales rather than professional impartial advice. Many of the advisers caught up in this case held themselves out as part of the ‘independent’ financial planning sector – their clients would undoubtedly have had an expectation that the advice was being given in their best interests. The product information provided should have raised a healthy scepticism among any experienced financial services professional in terms of promising unrealistically stable returns for growth style investments. ISN has seen a Statement of Advice from one investor who was advised to invest in the Alpha Strategic Fund, later renamed the Astarra Strategic Fund. The material included a graphic and table which shows performance targets of returns higher than the S&P 500 Index and volatility lower than the SSB Govt Bond Index. It is reasonable to conclude that the financial advisers involved were heavily influenced by the generous commissions and incentives paid on this product.

However, even putting aside the existence of criminal fraud and unrealistic marketing claims, the products involved in the Trio case were very expensive products which eroded the savings of the clients involved through very high ongoing fees. Approved product lists and product recommendations were constructed based on conflicted arrangements and relationships between the dealer groups and product manufacturers. One of the key issues which the reform process must address is the best interests test which will require advisers and dealer groups to recommend products based on the client’s financial interests rather than their own. **In a regulatory regime which requires an adviser to meet a best interests obligation, financial products (and particularly related party products) should only be recommended if they stack up in terms of cost, expected return, performance history and are appropriate to the client’s risk tolerance.**

Until advisers’ income is agnostic to product and strategy, the financial planning industry will always be prone to conflicted advice and scandal. Furthermore while any commissions or conflicted payments can be

drawn from the superannuation environment it will be impossible to protect consumers from advice which is driven by sales rather than by what is in the client's interests.

The evidence on the public record would suggest that the advisers involved in this case complied with the current disclosure requirements and shows yet again that disclosure on its own is an insufficient solution to dealing with conflicts of interest.

While there were certainly other points of failure in relation to the product provider and ratings agency who also provided 'independent' ratings which facilitated the distribution of these products, clients seek the services of a financial planner because they believe that they will act as a 'gatekeeper' who will provide impartial, well-founded and informed advice in the client's best interests. Clearly the imposition of a higher professional standard on financial advisers by way of a legislative 'best interests' obligation is critical to adequately deal with conflicts of interest and ensure the regulatory regime demands that the client's interests are paramount when they are being given personal financial advice.

It is financial advisers in whom clients place their trust to professionally manage their life savings. Once planners are subject to a higher legal professional obligation, this higher obligation will be reflected in their contractual relationships with other outsourced providers such as research houses.

The following table summarises the gaps in the regulatory regime and the measures proposed in the FOFA reforms which seek to address these gaps.

Regulatory gap	Proposed FOFA measure
Commissions, volume rebates, and other financial payments paid by product providers to financial planners which incentivise sales and lead to biased and poor quality advice	Ban on conflicted remuneration including commissions on investment and super products
Ongoing asset based fees replicate the effects of commissions by providing an ongoing stream of income to an adviser irrespective of provision of ongoing advice – so biases advice in favour of the retail products which offer this payment mechanism	Requirement for advisers to seek client renewal of ongoing fees at least every 2 years
Approved product lists and product recommendations are based on relationships between product providers and dealer groups rather than in finding the highest quality, best value products	Introduction of a best interests obligation for providers of financial advice which requires the client's interests to be prioritised. Critical to this duty will be around selecting products which serve the client's interests rather than because of relationships between the dealer group and product provider
Advisers allow their own interests or the interests of the dealer group to take priority over those of their client	Introduction of a best interests obligation for providers of financial advice
Soft dollar benefits including conference sponsorship, holidays and other non financial benefits are paid based on volume of product sales	Regulation of soft dollar benefits to prohibit payments above \$300 unless for legitimate PD purposes or IT hard/software not commercially available

There is now a significant body of evidence which supports reforming the regulation of financial advice, which ISN has summarised and attached as Appendix 1 to this submission.

1.2 Trio and Default Superannuation Fund Arrangements

The collapse of Trio saw a not inconsiderable number of workers lose their accumulated superannuation savings. In many instances the employees did not actively choose Trio as an investment vehicle to safeguard their retirement savings. The scheme was chosen by their employers as the default fund to invest the employees' compulsory 9% superannuation contributions as required by the *Superannuation Guarantee Act 1992*, (the SG Act).

The SG Act requires 9% of an employee's ordinary time earnings be paid into a complying superannuation fund. The *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005* provided most employees with the option of choosing the fund that their employer would place their SG payments into.

Where employees fail to exercise choice, the employer is obliged to place superannuation payments into a default fund. The default fund is either chosen by an employer, by agreement with employees at the workplace via an Enterprise Agreement or determined by the relevant Award.

The choice of fund initiative did not result in the anticipated high levels of member engagement leading to employees exercising choice of superannuation fund. As a result the selection of an appropriate default fund to safeguard and grow an employee's retirement savings is even more important.

ISN has long advocated that good public policy dictates there should be minimum criteria that should be applied to superannuation funds before they can qualify to receive SG payments and that the qualification bar should be set higher when default funds are involved.

The Super System Review Panel (the Cooper Review) recognised the higher duty of care that applies when choice is not exercised. The Review Panel recommended that default superannuation funds must have certain characteristics to protect a non-engaged fund member in receipt of compulsory superannuation payments. This should ensure that poor performing funds are not named as default funds within industrial instruments.

ISN strongly supports the establishment of a set of objective criteria (a combination of soft principle based duties to be imposed on trustees and hard regulatory requirements), which all funds must meet to be entitled to be named as a default fund by an employer, within Awards or Enterprise Agreements.

ISN has argued that the objective criteria to be applied to default funds should be constructed in such a way as to impose a higher degree of fund member protection and the removal of unnecessary costs whilst allowing sufficient diversity to ensure a fund has characteristics appropriate to its membership.

ISN believes that the selection of an appropriate and complying default fund within awards and enterprise agreements is a matter for the industrial parties under the auspices of Fair Work Australia. The selection of a workplace default fund carries with it a legal, moral and industrial risk. This burden should not be borne alone by an individual employer.

Astarra Management actively targeted workplaces with a view to convincing employers and employees to choose Astarra/Trio superannuation products as their default superannuation funds. (See Attachment 1)

Those employers that chose Trio or Astarra related plans as the default funds for their employees' superannuation contributions in hindsight no doubt regret the choice. Had a set of reasonable objective criteria been applied at the time, both employees and employers would have been spared much angst.

Employees of Tabcorp at the NSW TAB provide an example of the impact on disengaged employees. While half of the 500 casual employees of Tabcorp chose to have their contributions paid into an industry super fund, the 250 casual employees who did not exercise choice and were placed in the Astarra fund by their employer.

1.3 MySuper would have protected workers

The Stronger Super announcement by the Federal Government in December 2010 accepted many of the Cooper Review Panel's recommendations, including the establishment of new arrangements that would apply to MySuper default funds.

Under the proposed MySuper legislation, as of 1 July 2013 all new default funds will be required to qualify as default funds. These new funds will have certain minimum criteria and protections for employees. Importantly for a fund's trustees to gain a licence to offer a MySuper default fund, amongst other things, the fund must not pay commissions to financial advisers; the fund must have low and limited fees; be operated in the financial best interests of the fund's members and have a single, diversified investment strategy.

The MySuper legislation is yet to pass Parliament. If the proposed MySuper protections had been in place the Astarra Superannuation Plan, the Astarra Personal Pension Plan, the My Retirement Plan and the Employers Federation of NSW Superannuation Plan, would not have qualified to receive superannuation guarantee default fund payments.

The system which requires compulsory savings must ensure that all employees, particularly those most vulnerable, receive the protection of a superannuation system that ensures minimum standards and appropriate regulation.

The Trio collapse highlights the importance of the continued regulation of default funds to ensure they meet minimum objective criteria. The introduction of MySuper default fund arrangements will go a long way to adding to these protections, unfortunately too late for those directly and indirectly affected by the Trio collapse.

Term of Reference 3 - The relationship between the SMSF arrangements and regulatory coverage

In the Trio case, as in all the major collapses which have occurred over the past few years, there has been significant representation of SMSF investors. Part of the regulatory response to this collapse should be to ensure that consumers are not advised to establish an SMSF if they lack the resources or skills to run their own super fund in the less regulated SMSF environment.

Together with the other disclosures required by s947D of the Corporations Act (the switching provisions), clear disclosure of the consequences of leaving the regulated environment should be part of any recommendation to establish an SMSF. Importantly, a best interests obligation would require the provider of advice to establish that it is in the best interests of the client to assume responsibility for managing their own superannuation fund. A key protection against fraud and loss is to ensure that consumers who lack the financial sophistication to run their own fund are not advised to open an SMSF.

ISN makes some further submissions regarding the regulation of SMSFs later in this submission.

Terms of reference 4 & 5 - the role of ASIC in monitoring Trio Capital and any subsequent pursuit of directors, advisors and fund managers; and the APRA regulatory relationship to Trio Capital and the use of SMSF

ISN does not wish to make any extensive submissions on ASIC and APRA regulation except to note that both regulators addressed this scandal as soon as they were aware of it.. As noted above, no regulatory regime can completely protect against such instances of gross and criminal fraud. Once concerns were raised regarding the Trio/Astarra arrangements, the regulators acted swiftly to close down the schemes and to seek to protect the funds which had been 'invested' in them. While many consumers and advisers seek to apportion significant blame on regulators in instances such as this, in our view it is more constructive to look at the regulatory gaps which facilitated the distribution of the Trio products.

Term of Reference 8 - Whether there are adequate protections against fraud for those who invest through self-managed superannuation funds as opposed to other investment vehicles.

It is estimated that approximately 285 SMSFs were directly affected by the Trio collapse. While compensation is available via a levy on APRA regulated funds, this compensation does not extend to the trustee members of self-managed funds who are not regulated by APRA.

One of the important considerations for those establishing a self-managed super fund is the unique arrangements applying to self-managed funds. The regulatory architecture surrounding SMSFs recognises that the member trustees are responsible for the decisions relating to the fund and directly receive the benefits of those decisions; including investment decisions.

It is recognised that many investors are encouraged to establish self-managed funds. For small self-managed funds there is often little direct control of the fund by the trustees who are relying on advice and professional assistance. These funds often have a higher risk profile as the scale of the investments do not readily lend themselves to a diverse investment portfolio.

Holding 33% of assets, the ever expanding self-managed super sector is now the largest single component of the superannuation industry. It is therefore important that the policy and regulatory architecture surrounding SMSFs is sound.

If SMSFs are to be treated as genuine self-managed funds that do not require the oversight of APRA, and enjoy the advantages of reduced regulatory oversight, then the trustees of self-managed funds must take responsibility for their own decisions.

It would not be appropriate for the members of APRA regulated funds to compensate the trustees of self-managed funds for the investment decisions made by the trustee members.

In the event that it is the view of the Committee that some form of compensation to the trustee members of self-managed funds affected by the Trio/Astarra collapse would be appropriate, consideration should be given to the establishment of a scheme that is funded wholly by the self-managed superannuation sector. One option would be a levy via the ATO.

Term of Reference 10 - The role of ratings agencies and research organisations in product promotion and confidence.

The Trio and Astarra products received independent validation from a number of high profile ratings agencies and research houses. These independent ratings are relied on by consumers to gain confidence in relation to a product they are considering investing in or retaining. Submissions made by victims of the Trio collapse would confirm the importance of these ratings.

The Committee should consider whether the legal obligations currently imposed on ratings agencies and research houses are sufficient given the reliance placed on them by retail consumers.

Appendix One

1.4 The evidence base for reforming the financial advice industry

This appendix outlines the evidence base for reform in the financial advice industry. Financial advice in relation to superannuation is given particular attention because 1) superannuation in Australia is compulsory, 2) of all wealth management assets superannuation assets have the widest coverage in the Australian population (almost 70% of Australians have a superannuation account), and 3) superannuation assets in total represent twice the value of owner occupied home loans¹.

1.5 Commissions and ongoing asset-based fees are expensive

Conflicted remuneration structures including commissions and volume rebates, and ongoing asset based fees are expensive, substantially decrease the value of advice for consumers, and create a systemic bias in advice provision which is at odds with acting upon the best interests of their clients.

In 2010, commissions paid by super fund members and consumers totalled \$2.4 billion². This comprised of 1.9 billion from superannuation - \$700 million from compulsory SG contributions, and \$500 million from life insurance products.

In five common advice scenarios modelled by Rice Warner Actuaries, advice paid for through commissions and ongoing asset based fees were more expensive than advice paid for by a set or hourly fee in all scenarios. The difference in cost ranged from two to 17 times more expensive³. Not only does advice cost less when paid for by set or hourly fees, but in each scenario where advice was provided on a fee for service basis the value of advice was also greater due to the lower costs of products recommended.

1.6 Commissions and ongoing asset-based fees bias the advice provided

Financial planning has a high level of vertical integration with financial institutions, with 85%⁴ of the financial planning industry and 73%⁵ of planner groups (counted by planner numbers) being owned by, or affiliated with, a financial product provider. According to Roy Morgan research over the past four years, financial planning groups associated with the 'Big 6' fund managers (ANZ, AMP, AXA, CAB, NAB, and Westpac) have allocated over 70% of their sales to their own super products⁶.

¹ Roy Morgan (2011) *Superannuation and Wealth Management in Australia: An analysis of consumer behaviour, advice and fund performance*, Report 13, July, 2011.

² Rainmaker Consulting (2011) *Commissions Revenue Report*, prepared for Industry Super Network, August 2011,

³ Rice Warner Actuaries (2011) *Value of IFFP Advice*, prepared for Industry Super Network, May 2011.

⁴ Bridger, Trevor. 2010. "Getting your not-for-profit's financial house in order." *Third Sector*. Retrieved August 18, 2011 (http://thirdsectormagazine.com.au/news/getting_your_not-for-profits_financial_house_in_order/009082/).

⁵ Rainmaker Information (2009) *Financial Planning Report*, Vol 2 No 1, January 2009.

⁶ Roy Morgan (2011) *Superannuation and Wealth Management in Australia: An analysis of consumer behaviour, advice and fund performance*, Report 13, July, 2011.

The 2006 ASIC Shadow Shopping Survey on Financial Advice found that in 48% of the cases of licensed financial advice surveyed there was an actual conflict of interest around adviser remuneration, and in 38% of licensed cases there was a conflict of interest around a fund associated with the licensee⁷. In situations in which there was a conflict of interest, non-compliance (in relation to taking into account a client's circumstances and the provision and disclosure of information) was six times more common than situations in which there was no conflict of interest⁸.

Commissions and ongoing fees are by far the most common form of remuneration in the retail financial advice sector. Roy Morgan Research points to the fact that for many advisers in this sector commissions and ongoing fees are a source of passive income, with 52% of retail super fund members reporting that they have never communicated with an adviser. A further 20% only communicate with an adviser every few years or less⁹.

In addition to providing poor value for clients, correlating strongly to higher levels of non-compliance, and providing passive income streams for many advisers, conflicted remuneration is also contributing to a loss in national savings of tens of billions of dollars. Over the past 10 years, industry super funds on average have out-performed retail super funds over rolling one, three, five, seven and 10 year periods (see Table A1). The most significant time frame, the 10 year rolling average, shows an average outperformance of 2.04%. Using current APRA data, ISN analysis estimates that this outperformance amounts to a total loss of \$83 billion in the super savings of Australians over the last decade.

Table A1

Product Type	FYTD	Rolling 1 Year	Rolling 3 Year	Rolling 5 Year	Rolling 7 Year	Rolling 10 Year
SR50 Balanced (60-76) Index	9.26%	8.05%	0.13%	2.79%	6.00%	5.09%
Industry Fund Median	9.45%	8.30%	0.20%	3.17%	6.52%	5.54%
Master Trust Median	8.50%	6.83%	-0.55%	1.27%	4.62%	3.50%
Industry Fund Outperformance	0.95%	1.47%	0.75%	1.90%	1.89%	2.04%

Source: SuperRatings (2011) *Fund Crediting Rate Survey*, May 2011.

1.7 Current business model does not suit most consumer need

The predominant business model for the financial advice industry revolves around delivering high margin holistic advice services which are at odds with the needs of most consumers. Research by Forethought has found that the two main deterrents for people seeking advice are type of advice service offered (i.e. holistic

⁷ Australian Securities and Investments Commission (2006) *Shadow Shopping Survey on Superannuation Advice*, April 2006.

⁸ Australian Securities and Investments Commission (2006) *Shadow Shopping Survey on Superannuation Advice*, April 2006.

⁹ Roy Morgan (2011) 'Retirement Planning Report' June 2011 (RMR special request data).

or limited) and cost¹⁰. The benefits to reducing the cost of advice through banning commissions have been addressed above. With regard to type of advice, Forethought found that less than half of those seeking advice sought ongoing comprehensive advice. This was even more pronounced when the sample was broken down by income with only 20% of workers earning under \$100,000 seeking complex financial advice in the two years to November 2009¹¹. A meta-study of consumer attitudes and behaviour undertaken by the Baker Group found similar results¹².

The Baker Group found that consumer demand for advice was dominated by a demand for transactional and modular advice, and an expectation of receiving advice from super funds. A recent Report by ASIC has also found 'piece-by-piece' advice to be the most commonly sought after level of advice¹³. Although adviser groups do offer piece-by-piece advice in all the areas of interest to consumers, most notably superannuation, ASIC found that only 27% of advisers groups promote piece-by-piece advice. Both the Baker Group and ASIC conclude that the current mismatch between the demand for advice and advice provision is not in relation to areas of advice (superannuation, retirement, mortgage) but between the dominant business model which promotes holistic advice, and consumer demand, which is for limited or single issue transactional advice.

Compounding this discrepancy is the severely skewed distribution in wealth management assets and current use of financial advice. Roy Morgan research since 2009 has found that 70% of wealth management assets in Australia are held by 20% of the population. This 20% also benefit from 50% of all financial advice provided. In contrast, the 60% of the population who hold only 12% of wealth management assets receive only 26% of advice provided.¹⁴

The proposed Future of Financial Advice reforms are timely for a number of reasons, and have the potential to make a significant and lasting impact on the integrity of the sector. The reforms will have the biggest impact in relation to superannuation. Roy Morgan research on consumer behaviour and attitudes has found that while 70% of Australians are either "Very" or "Fairly" interested in their superannuation, 73% of Australians with superannuation state that they are either "Not Very" or "Not At All Involved" with the management of their superannuation.¹⁵ This discrepancy between high interest and low engagement demonstrates a significant opportunity for the superannuation sector to increase the involvement of members in the planning of their retirement.

1.8 Public support for reforms and increased transparency

In addition to these extrinsic reasons for the low level of advice take up, the Baker Group research found three intrinsic reasons contributing to low up take of financial advice. These are perceptions of personal

¹⁰ Forethought Research (2010) *ISN Seeking Advice Research Executive Report*, prepared for Industry Super Network, March 2010.

¹¹ Forethought Research (2010) *ISN Seeking Advice Research Executive Report*, prepared for Industry Super Network, March 2010.

¹² Baker, A. (2010) *Consumer Attitudes to Financial Advice: Research Insights* Presentation to Treasury, Baker Group, November 2010.

¹³ Australian Investments and Securities Commission (2010) *REPORT 224: Access to financial advice in Australia*, December 2010.

¹⁴ Roy Morgan *Superannuation and Wealth Management in Australia: An analysis of consumer behaviour, advice and fund performance*, Reports 11, 12 & 13. Date?

¹⁵ Roy Morgan (2011) 'Retirement Planning Report' June 2011.

finances ('not enough money') or lifestage ('not relevant now'), attitudes towards taking personal responsibility ('should do it myself'), and concern about the ability to find a 'trusted' adviser. Research on consumer attitudes undertaken by Newspoll supports these findings, with 85% of respondents who use a financial adviser preferring set fee or hourly rate to commissions¹⁶ and almost 90% of respondents (if they knew the adviser was receiving a commission) saying they would be concerned that an adviser might recommend products that were in the adviser's own interests rather than the client's¹⁷.

In response to the issue of trust, research over the last few years has evidenced growing support for a 'best interests' obligation to be imposed on financial advisers¹⁸. As recently as February 2011, the same tracking has found that almost 9 in 10 respondents (89%) believed there should be a law requiring financial planners to act in the best interests of their clients¹⁹.

The opt-in measure proposed as part of the FOFA reforms will also go some way to increase the transparency of financial advice and its remuneration, and the trust consumers will develop for the industry. Newspoll found that 75% respondents are in favour of a yearly opt-in requirement for ongoing fees rather than an opt-out model²⁰. Although financial planners have expressed concern that the opt-in requirement would prove expensive and thus increase the cost of advice to consumers, modelling done by Rice Warner Actuaries has found that an annual opt-in requirement would ensure that advisers only charged for advice that was actually provided and would prevent fees creeping up in line with market performance (superannuation for example is growing by about 6% p.a. in real terms)²¹.

Although there is strong public support for reform, Roy Morgan has also found that Australian consumers are unable to accurately discern the independence of financial planning practices. Over the past five years, an average of one in five Australians receiving advice from planners associated with the Big 6 companies believes their adviser to be independent even when the service is branded, and nearly half of those receiving advice from a planner or planner group branded differently to the associated company (AMP's Hillcross brand for example) believe their adviser to be independent²².

1.9 FOFA reforms will have a positive effect on provision of advice

Despite much recent speculation and doomsday predictions, there are only two research reports which look at the impact of the FOFA reforms. The Association of Financial Advisers (AFA) White Paper 'Tides of Change', which surveyed financial planners about the impact of the reforms, found that of the 1,343

¹⁶ Newspoll (2011) 'Financial Advice Study', prepared for Industry Super Network, February 2011.

¹⁷ Newspoll (2010) 'Financial Advice Study', prepared for Industry Super Network, January 2010.

¹⁸ Newspoll (2007) 'Financial Advice Study', prepared for Industry Super Network, March 2007; Newspoll (2009) 'Financial Advice Study', prepared for Industry Super Network, March 2009.

¹⁹ Newspoll (2011) 'Financial Advice Study', prepared for Industry Super Network, February 2011.

²⁰ Newspoll (2011) 'Financial Advice Study', prepared for Industry Super Network, February 2011.

²¹ Rice Warner (2011) *Value of IFFP Advice*, prepared for Industry Super Network, May 2011.

²² Roy Morgan (2011) *Superannuation & Wealth Management in Australia: an analysis of consumer behaviour and fund performance*, July 2011; Roy Morgan (2007) *Superannuation Choice: A Tracking Study into Consumer Behaviour and Fund Performance in Australia*, July 2007.

respondents almost 80% were likely or very likely to grow their businesses in the next two years, with less than 10% being very likely to sell their business or leave the industry in the next two years²³.

A much more comprehensive study is the Rice Warner report 'Transformation of the Financial Advice Industry'²⁴.

The Rice Warner report predicts that the financial advice industry will grow over the next fifteen years with assets expected to increase by 9.6%. The provision of advice will also increase substantially over the next fifteen years. By 2024, there will be 900,000 additional pieces of advice being provided (a 17 fold increase) if the reforms are implemented, compared to an additional 80,000 pieces of additional advice if no regulatory change occurs (an increase of only 1.2 times). The proportion of the population receiving advice will increase from 24% to 35% by 2024. The main change will be the proportion of small scale advice to full advice, which will be 10:14 (simple:full) with the reforms and 1:10 without.

²³ CoreData/brandmanagement (2011) *AFA White Paper 'The Tides of Change'*, sponsored by National Australia Bank, January 2011.

²⁴ Rice Warner Actuaries (2010) *Transformation of the Financial Advice Industry*, prepared for Industry Super Network, March 2010.

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