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20th December 2011

Hon B Ripoll
Chair - Parliamentary Joint Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Submission to the Parliamentary Joint Committee on Corporations and Financial Services concerning the Effect of the Proposed Future of Financial Advice (FOFA) legislation

KEY POINT: The biggest effect of the proposed new FOFA legislation will be to progressively make financial planning advice unavailable to small value investors across the country. This is because financial advisers governed by the proposed new legislation will not want to deal with them.

The Victorian bushfires took a terrible toll of life and property in February 2009. In total 173 people were killed and 414 people were injured in the fires. General insurance companies paid out a total of $846 million for loss of houses, cars, businesses, farm buildings, agricultural equipment and so on.

How much did life insurance companies pay out for death, permanent disablement and trauma insurance? Less than $50 million. One large insurer, Comminsure, formerly Colonial Mutual, paid out less than $2 million.

Why is this relevant to the proposed FOFA legislation? Bear with me a couple of minutes and I will explain.

From the above we can conclude that few Australians today have life or disability insurance. Life insurance coverage thirty years ago was much higher. AMP, National Mutual, MLC and Colonial Mutual each had an office in most suburbs and country towns. Each office housed a team of 6 to 20 insurance salesmen who sold large volumes of insurance. Those offices and the salesmen and women in them no longer exist. That is why Australians generally have very little life insurance.

Why don't those offices exist anymore? They don't exist because of legislation. Due to a few cases of mis-selling and dishonest and deceptive conduct by a small number of rogue insurance salespeople, rafts of legislation were introduced. There were new training and licensing requirements, new ongoing education requirements, new statements of advice had to be prepared, new fee disclosures, new cooling off periods, bans on same day sales. Then came rules tightly governing telephone canvassing and door to door sales. More recently we have had strict privacy laws and do-not-call registers.

The life insurance salesmen and women gave up. They decided it was all too hard. They retired or changed careers. At least 75% of all life insurance sales people who were operating in the early 1980's quit the business within a decade and no-one replaced them. Now the Australian population mostly have very little life insurance and the Government pays when disaster strikes, by way of much higher medical and social security outlays.

The proposed new FOFA laws will have a similar effect. They will eliminate those financial planners who service small value investors and insurance clients. Those advisers will be forced by the new rules to change their business models and activities.

Not all financial planning businesses are the same

Some "exclusive" financial advisers service small numbers of high value investors who have high net worth and/or high incomes. These financial planners collect large fees from their clients for providing very high levels of service. These businesses will be largely unaffected by the new rules.

Other financial planning businesses service large numbers of small and medium value investors and life insurance clients. These "inclusive" financial planners provide comprehensive initial advice to get clients on track but then, because they have lower incomes and smaller investment amounts, the advisers charge lower fees and provide a lower level of ongoing service.

1. The Opt-In Proposal

These inclusive financial advisers must have large numbers of clients for their businesses to be viable. Getting all those clients, perhaps 500 to 1,000 of them, to sign regular Opt-In forms will be impossible. This is because many will be away, or busy, or preoccupied with more important issues, or sick, or inefficient at doing paperwork, or it was lost in the post, or the dog ate it.

People who have large amounts of money invested usually watch it very closely and attend to required paperwork promptly. People who have only small amounts invested have many other more important things going on in their lives.

2. Annual Fee and Service Disclosure Notices

The proposed requirement to send each client yet another fee disclosure notice every year will also be counter-productive. Clients already receive a Statement of Advice setting out the fees they will need to pay. They then receive a statement from each investment fund or administration service at least annually, and in many cases more frequently, telling them how much has been paid to their adviser.

The proposal that financial planners be required to send clients another fee disclosure notice including details of the services they used and didn't use during the year is overkill and entirely unnecessary. The constant emphasis on fund and adviser fees will only encourage clients who have less frequent personal contact with their financial planner to dispense with their adviser's services to save a small amount in fees. These people with smaller investment values and insurance amounts are the very people who need advice and guidance the most.

3. Ban on Percentage Based Fees on Borrowed Money

The proposal to ban percentage based fees on borrowed money is yet another policy that will be counter-productive. Many small investors who have a little surplus income currently borrow $50,000 to $100,000 to invest in managed funds and shares as a long term savings plan. Other young people with no available savings as a deposit use instalment gearing plans where a small amount is invested automatically by bank debit each month and an equal amount is borrowed to go with it.

Usually financial planners who service these smaller value clients charge their fees as a percentage of funds under management. Initially these fees are small and do not cover the cost of the initial advice. However the advisor is gradually paid over time based on the ongoing percentage fee received, 0.5% per annum for example. Banning percentage fees on borrowed money will mean these clients will need to be charged large initial fees to set up their savings plans. This will make such strategies unattractive and discourage saving in this way.

The proposed ban on percentage based fees on borrowed money is a reaction to the Storm Financial disaster. However that should be seen for exactly what it was – a complete failure by ASIC to do its job. ASIC was well aware of Storm's activities several years before its collapse and did nothing about it. ASIC claims it did not have the power to close Storm down. That is completely incorrect. The advice being given by Storm advisers was totally inappropriate for the clients' needs and circumstances.

It is a fundamental requirement of all advice provided by financial planners that it must be appropriate to clients' needs and circumstances.

It appears highly likely that ASIC under its new Commissioner Mr Greg Medcraft would now be much more active if another Storm were to arise.

The Effect of These Proposals

Inclusive financial planners who service small investors and insurance clients will abandon those clients because they cannot be relied on to return Opt-In forms and continue the relationship, and they only provide low levels of fee income. Financial planners will move to increase the level and frequency of their services to their high value clients who pay the most fees to ensure they sign their Opt-In forms. This will be essential for the financial planning businesses to be able to pay their staff salaries and running costs and continue to operate.

I urge the Committee to recommend that:

- The Opt-In proposal be abandoned
- The requirement that an additional fee and service disclosure notice be sent to clients annually be abandoned
- The proposed ban on percentage based fees on investments made with borrowed money be abandoned.

I would be most happy to meet the Committee and explain my concerns in more detail if the opportunity arose.

Yours faithfully

Russell Tym
Certified Financial Planner
Managing Director