ACTU Submission to the Senate Economics Legislation Committee Inquiry into the Provisions of the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

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Introduction

The ACTU represents nearly 2 million working Australians and their families. Many more have their pay and conditions of employment shaped by the work of our affiliates.

Unions have a particular interest in improving how financial advice is sold because we campaigned successfully for the introduction of compulsory superannuation contributions in 1992. As a result nearly every worker in Australia now has a superannuation account in relation to which they may seek financial advice on topics such as choice of fund, investment products and their post-retirement options.

Given that legislation mandates nearly every worker have a superannuation account, and enables them to make choices which may have significant implications for their retirement income, it is incumbent on government to ensure that when they seek financial advice such advice is in their best interests and is provided on terms that are transparent and fair.

The Importance of Effective Consumer Protections

Effective protections for those who purchase financial advice play a number of important roles:

- In the context of superannuation they help to minimise the costs associated with paying too much for poor quality and under-utilised advice services, thereby maximising the quantum available for productive investment and increasing eventual retirement balances.

- They help to build public confidence in our retirement income system, encouraging those who may benefit from good quality advice, but who do not obtain it because they do not trust financial advisors, to do so. Research shows that the majority of Australians do not trust advisors because they believe they prioritise their own interests over those of clients.[1]

- They help to compensate for persistently low levels of financial literacy among millions of Australians. Research shows that those who can least afford to pay for poor quality advice (those on low incomes) are those most likely to lack the knowledge and skills to make informed financial decisions.[2]

[1] ASIC (2010) *Access to Financial Advice in Australia Report 224*, Sydney.
[2] ANZ (2011) *Adult Financial Literacy in Australia Report*, Sydney.

- By increasing the professionalism and public standing of financial advisors they will help to increase demand for financial advice.

- They help to secure better quality outcomes for savers and investors, increasing the efficiency and effectiveness of financial decision-making, and so helping to support growth and employment across the Australian economy.

- They minimise the unproductive drain on our national economic resources caused by diverting funds into sub-optimal investment products, overcharging and paying for services that are under-utilised.

In light of these benefits the ACTU has long called for substantive reform of the financial advice industry to better protect the interests of retail investors. Unfortunately, it took a number of scandals, most notably the collapse of Storm Financial in 2009 when 4000 clients suffered $3 billion in losses, for government to act. Other collapses included Great Southern, Opes Prime and Trio. In total, an estimated 120,000 people in Australia suffered losses of around $6 billion.

Many of those responsible for these losses were acting entirely lawfully. It was therefore clear that the law had to change. The Parliamentary Joint Committee on Corporations and Financial Services investigated the collapses. Its report included the following recommendation:

> The committee supports the proposal for the introduction of an explicit legislative fiduciary duty on financial advisers requiring them to place their clients' interests ahead of their own. There is no reason why advisers should not be required to meet this professional standard, nor is there any justification for the current arrangement whereby advisers can provide advice not in their clients' best interests, yet comply with section 945A of the Corporations Act. A legislative fiduciary duty would address this deficiency.[3]

In light of the corporate failures and the Joint Committee's report the ACTU has been a strong supporter of the FOFA reforms that began to operate on 1 July 2013. They introduced a number of important and long overdue changes. In particular the legislation:

- Introduced a duty requiring that financial advice be in the best interests of the client.

[3] Parliamentary Joint Committee on Corporations and Financial Services (2009) *Inquiry into financial products and services in Australia*, Canberra, p. 110.

- Prohibited sales commissions and other forms of conflicted remuneration for new clients.

- Required advisers to seek clients to opt-in to ongoing fee arrangements every two years.

- Prohibited sales commissions on life insurance insider super.

We note that these reforms were implemented after an extensive process of public consultation and parliamentary scrutiny and debate. However, the present government has stated it wishes to proceed on the basis of making regulations to give effect to its desired reforms, pre-empting effective Parliamentary examination.

This approach gives the very strong impression that the government is more concerned to respond to intensive lobbying by the banks than in making good public policy that protects the interests of the large majority of Australians.

In our view the changes contained in the draft bill, and discussed in the associated Explanatory Memorandum, will have the effect of undoing much of the positive change initiated by FOFA. The most important include the following:

a) Removing the so-called 'catch-all' provision

The government proposes to remove section 961B(2)(g) which states that a provider of financial advice must be able to prove that they have 'taken any other step [in addition to the preceding six] that, at the time the advice is provided, would reasonably be regarded as being in the best interest of the client, given the client's relevant circumstances.'

It is argued in the Explanatory Memorandum that there is 'significant legal uncertainty' in relation to how the best interest duty can be satisfied. It is further argued that without subsection 961B(2)(g) the remaining safe harbour provisions set 'a high standard for providers to show they have acted in the best interests of their client.'[4] Both arguments are deeply flawed.

Firstly, the Explanatory Memorandum offers no evidence that 'significant legal uncertainty' exists.

When the new 'catch-all' provision was introduced in 2013 a number of professional associations issued advice to their members about how to meet the new obligation. The advice issued by the

[4] Parliament of the Commonwealth of Australia (2014) *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 Explanatory Memorandum*, p. 11.

Institute of Chartered Accountants of Australia (ICAA), for example, contained clear and concise guidance on the practical steps that should be taken to comply with the new law.[5] It did not warn that it may be difficult to satisfy the new duty. Instead it advised members that to meet their new obligations they should ask themselves two questions in addition to those they were already accustomed to considering:

i) Would a reasonable adviser believe that the client is likely to be in a better position by following my advice?

ii) If this client was my son or daughter being influenced by my advice and trusting me to act in their best interests, is this what I would recommend?

In practice the role of many financial advisers is to act primarily as a sales force for particular banks. Being obliged to consider these or similar questions when providing advice compels advisers to prioritise the interests of their clients over those of institutions whose primary concern is to maximise revenues. Given the information asymmetry that characterises most advisor-client relationships such an obligation is essential.

Secondly, it is misleading for the Explanatory Memorandum to suggest that following the safe harbour provisions prior to subsection 961B(2)(g) is equivalent to acting in the best interests of a client. Parts (a) to (f) of subsection 961B(2) comprise a series of process-related steps that are qualitatively distinct from being required to make the more substantive judgement that assessing a client's best interests demands. The process-related steps that the government intends to retain are little more than a codification of what many financial advisers were doing before 1 July 2013.

Removing 961B(2)(g) would have the effect of eliminating a key safeguard for advice clients, strongly suggesting that the government's stated support for the underlying objective of FOFA is limited to supporting protections the substance of which already existed before FOFA came into effect.

The ACTU strongly supports the retention of subsection 961B(2)(g) and consequential provisions.

[5] Institute of Chartered Accountants of Australia (2013) *Future of Financial Advice: The Best Interests Duty*.

b) Removal of the opt-in requirement

The government is proposing to remove the requirement for licensees to obtain their client's approval at least every two years to continue an ongoing fee arrangement (the so-called 'opt-in' requirement). The government asserts that the current law imposes 'unnecessary costs.'

We note that the Explanatory Memorandum does not offer or refer to any assessment of the costs involved in implementing the opt-in requirement. It is therefore unclear how the government has reached the conclusion that they are 'unnecessary' relative to the benefits of protecting clients from paying ongoing fees for advice services that are under-utilised or not utilised at all.

The introduction of the opt-in requirement under FOFA arose from the fact that in markets for complex financial products and services much consumer behaviour is shaped by low levels of financial literacy and related high levels of inertia. Evidence from behavioural economics clearly shows that when customers are faced with markets characterised by complexity and choice-overload they are very likely to make sub-optimal decisions or make no decisions at all. In short, once they have purchased a financial product or service (which may involve paying an ongoing fee) they are unlikely to switch.[6]

In Australia around 3 million people are paying commissions and ongoing fees for advice they are not receiving.[7]

The government's statements in support of abolishing the opt-in suggest either it is not aware of how real-world markets for retail financial products and services operate, or that it simply doesn't care about the well-being of those who are disadvantaged by them.

Abolishing the opt-in will result in more people paying for advice they do not receive. In the context of superannuation such unnecessary payments will act as a drain on accounts, reducing eventual retirement balances and the ability of retirees to sustain a reasonable standard of living once they stop working.

The argument from the banks and their advisor sales forces that the opt-in imposes unnecessary costs is transparently a self-interested defence of an easy and unproductive source of revenue. It

[6] Springford, J. (ed.) (2011) *A Confidence Crisis? Restoring Trust in Financial Services*, Social Market Foundation, London.
[7] Roy Morgan (2011) *Retirement Planning Report - June*, & estimates by Industry Super Australia.

ignores what they know the real behaviour of many of their clients to be. It is unfortunate that a government charged with representing the public interest appears to be so willing to accept such an argument.

The ACTU strongly supports retaining the opt-in requirement.

c) Fee disclosure for new clients only

The government is proposing to amend FOFA by making the requirement for advisers to provide a fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013.

We note that the Explanatory Memorandum offers no specific argument or evidence in support of this proposal. We have to assume that the government views the statements currently required by FOFA as constituting a 'burden on business' – albeit one that is unquantified and unproven. The possibility that such statements may provide a benefit to pre-1 July 2013 clients that justifies their requirement is simply ignored.

The current FOFA legislation requires such statements because it is clearly in the interests of all retail clients, regardless of when they entered into an advice arrangement, to be able to assess exactly how much they have paid to an advisor. It is a commonplace in all branches of economics that being able to readily access clear and comprehensive price-related information is vital to informed consumer choice and the development of efficient markets. This is particularly important in the context of financial products and services where complex pricing structures and forms of payment are commonplace.

Abolishing the requirement for advisors to provide pre-1 July 2013 clients with a consolidated annual statement of fees will entrench already low levels of price-transparency and deprive many clients of information that may lead them to make better choices about who and how they pay for advice.

The ACTU strongly supports the current requirement that all clients receive a consolidated annual fee disclosure statement.

d) Broadening exemptions from the ban on conflicted remuneration

The government is proposing to broaden the exemption from the ban on conflicted remuneration paid to employees for recommending a licensee's products when providing general advice. The government argues that this change is necessary to reduce 'unnecessary burdens on industry.'[8]

The Explanatory Memorandum offers no quantification of the 'burdens' that have resulted, or can be reasonably expected to result, from the ban on conflicted remuneration in the context of general advice that was introduced as part of FOFA. It is therefore unclear how such burdens can be judged to be 'unnecessary' or unreasonable relative to the benefits of reducing the incidence of commission-driven product selling.

The ban introduced by FOFA formed part of broader set of changes designed to increase the quality of advice and the transparency surrounding how it is sold. It was therefore necessary to curtail the use of conflicted remuneration paid to employees when dealing with non-simple insurance and banking products. There is a clear contradiction between the existence of such remuneration and the recommendation of relatively complex products and services that should be in the best interests of clients.

The government is now proposing to broaden the exemptions already provided for by the FOFA legislation by applying a general advice exemption to all financial products regardless of their complexity and transparency. One result will be to allow conflicted remuneration in the context of selling quite complex products such as superannuation. A high-pressure commission-driven sales environment is clearly not an appropriate context in which relatively complex products and services should be sold to retail clients.

The aim of FOFA is to improve the quality of financial advice. While the government states it supports this broad aim, the proposal to increase the instances in which conflicted remuneration can be paid runs counter to such improvement. In practice it will make it easier for banks and others to sell high-cost and inappropriate products that do not take appropriate account of the circumstances and best interests of clients.

The ACTU strongly opposes the proposal to broaden the exemptions from the ban on conflicted remuneration.

[8] Parliament of the Commonwealth of Australia (2014) *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 Explanatory Memorandum*, p. 25.

ACTU
australian council of trade unions

level 6 365 queen street
melbourne victoria 3000
t 03 9664 7333
f 03 9600 0050
w actu.org.au

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