Chapter 2

FOFA reforms—objectives

2.1 The original FOFA reforms were welcomed by both consumers and industry as a significant step forward in the financial services sector. CPA Australia and the Institute of Chartered Accountants Australia encapsulated the positive reception that the reforms received:

> The passage of the FoFA reforms was the result of extensive, wide spread consultation over many years. Its introduction marked a milestone opportunity for the sector to take a greater responsibility and refocus its efforts on providing and promoting quality financial advice in the best interests of the client, free from conflict and in a transparent manner.[1]

2.2 FOFA sought to strike a balance by 'introducing further consumer protections while simultaneously requiring financial advisers to meet higher standards of care and skill'.[2]

Australia's financial services industry

2.3 The proposed legislation recognises the importance of the financial services industry in the Australian economy, which currently employs over 400,000 people and, according to the regulation impact statement, is the largest industry in Australia when measured by gross value added. The industry is expected to grow as Australia's population ages and superannuation funds continue to expand.[3]

2.4 In this environment, Australians are looking increasingly to financial advisers for assistance. Financial products, however, are difficult to understand even when they are called basic products and the cost of financial advice is of major consideration for consumers.[4] ASIC observed:

> Today's consumers are being asked to make more financial decisions than ever before and the environment in which they are making those decisions is becoming increasingly complex.[5]

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1 *Submission 14*, covering letter.

2 Governance Institute of Australia, *Submission 11*, p. 2.

3 Regulation Impact Statement, p. 45.

4 See for example, Mr Fox, AFA, *Proof Committee Hansard*, 22 May 2014, p. 3 and Mr Kirkland, CHOICE, *Proof Committee Hansard*, 22 May 2014, p. 11.

5 ASIC, Report 224, *Access to financial advice in Australia*, December 2010, Executive Summary, paragraph 1.

Financial advice

2.5 The Financial Services Council (FSC) commissioned research from KPMG Econtech, which showed:

> …individuals with a financial adviser saved an additional $1,590 each year (after the cost of the initial advice) when compared to a similar individual without a financial adviser. These savings alone equated to an additional $91,000 upon retirement for a 30 year old Australian. The KPMG Econtech research also found that if an additional five per cent of Australians received financial advice, national savings would increase by $4.2 billion (or 0.3 per cent of GDP) by 2016–17.[6]

2.6 Even so, ASIC found that, while many consumers were ill-equipped to make sound financial decisions and would benefit from better access to financial advice, fewer than 40 per cent of the Australian adult population have ever used a financial planner.[7] It highlighted the value of obtaining financial advice:

> Most people could benefit from access to quality personal or general advice and factual information, especially at the time of key life events or transitions (e.g. starting a family, preparing for retirement or managing an unexpected redundancy). Industry studies have shown that consumers who access financial advice benefit financially as a result of the advice, even after the cost of the advice is taken into account. The financial benefits of advice can include increased savings, less interest expense through faster debt reduction or higher investment returns.[8]

2.7 ASIC's review of investment trends research revealed 'a significant disconnect between the amount consumers are willing to pay for financial advice and the typical costs to licensees of providing financial advice'. It found that on average, consumers believed that initial advice should cost $301 and ongoing advice should cost $298 per annum. Twenty-two per cent of consumers believed that the initial advice consultation should be free.[9] The regulation impact statement recorded further that the cost of providing comprehensive financial advice to a client actually ranges between $2,500 and $3,500.[10] Thus cost was a major consideration, as ASIC observed:

> The relatively low amounts consumers are prepared to pay for financial advice, and the sizeable proportion of people who are not willing to pay

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6 *Submission 27*, p. 5.

7 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 4. ASIC cited recent survey results which suggested that 20% to 40% of the Australian adult population use or have used a financial adviser. This means that 60% to 80% of adult Australians have never used a financial adviser.

8 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 8.

9 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 25.

10 Regulation Impact Statement, p. 52.

> anything at all, suggests that many consumers do not fairly value professional financial advice.[11]

2.8 Consistent with the ASIC findings, the Financial Services Council quoted from Roy Morgan research which suggested that Australian consumers perceive the cost of a personalised financial plan to cost less than $1000 (76%). The research found:

> The most frequently reported price expectation was $200–$499 (36%). Only 2% of consumers expected a personal financial plan to cost more than $2000 (even though 20% of consumers have an adviser and 20% have had an adviser in the past). If faced with the need for a comprehensive personalised financial plan, 84% would not pay for the advice. Instead 69% of those surveyed who could not afford the comprehensive personalised financial plan would seek advice from their friends and family, 61% would source advice from the internet and 27% would access financial blogs.[12]

2.9 Importantly, ASIC also made the point that improving access to advice 'is not about providing inferior quality advice to consumers or assisting financial services licensees to simply sell more products to consumers'.[13]

2.10 The main purpose of this bill is to reduce compliance burdens while maintaining consumer protection: to align incentives, improve transparency and improve the basis on which financial advice is provided to consumers.[14] The Explanatory Memorandum states that:

> The proposed amendments to FOFA seek to navigate the fine line between ensuring that unnecessary and burdensome regulations that drive up the cost of business are removed, whilst ensuring that the consumer protections of FOFA are maintained.[15]

2.11 Thus, one of the key challenges for the FOFA reforms is to find the right balance between providing consumer protection and ensuring that consumers have access to affordable and competent financial advice. As Mr Brad Fox, Association of Financial Advisers, noted:

> Every day, Australians face life-defining moments that require financial decision making. Every day, they turn to financial advisers to support them through these challenges.

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11 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 26.

12 *Submission 27*, p. 9.

13 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 11.

14 Explanatory Memorandum, Outline, p. 4 and Meghan Quinn, Treasury, *Proof Committee Hansard*, 22 May 2014, p. 94.

15 Explanatory Memorandum, paragraph 5.60.

2.12 In his view, the FOFA amendments were designed to help people gain access to financial advice and increase the probability that those going through life-defining financial challenges would be able to get affordable, quality financial advice.[16]

2.13 Taken as a whole, submitters agreed that it was imperative to achieve the right balance between acting in the best interests of consumers and reducing regulatory obligations. They appreciated that the original twin objectives of FOFA were to rebuild trust and confidence in the industry and to expand the affordability and accessibility of financial advice. Submitters also recognised the importance for Australians to receive the right financial advice. For example, Mr Paul Drum, CPA Australia, stated that it was:

> …critical to bear in mind the continued low levels of financial literacy within the community and, more generally, the low levels of engagement that consumers have with their finances, including superannuation…not every consumer needs a holistic financial plan or to be recommended a financial product. Many Australians will not have complex financial situations or positions. Rather, all they want is the ability to speak or work with a highly competent professional adviser that they can trust.[17]

2.14 Mr Richard Batten, Minter Ellison Lawyers, reinforced the message that Australians need access to competent professional advice. He acknowledged that:

> …it is important that consumer protection is achieved without imposing an undue burden on industry. Regulation should not unnecessarily increase costs or reduce the availability of services for consumers, because good and timely financial advice is an integral part of future wealth creation. We therefore believe the committee has an important job to do to ensure that the government's FoFA amendment bill enhances the accessibility and availability of good quality financial advice.[18]

2.15 While there was general and keen support for the objectives of the FOFA reforms, submitters differed in their views on whether the proposed reforms would either enhance or detract from these objectives. The Governance Institute of Australia noted the continuing commentary about 'whether or not the right balance has been struck'. It observed that the current round of reforms was 'aimed at redistributing the balance with a view to ensuring that financial advisers are not burdened with unnecessary compliance requirements'.[19]

2.16 Some submitters were of the view that the balance that the bill sought to achieve leant too far in favour of industry and not toward consumer protection. They sought to highlight the enormous gap in knowledge and experience between the

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16 *Proof Committee Hansard*, 22 May 2014, pp 1 and 3.

17 *Proof Committee Hansard*, 22 May 2014, p. 29.

18 *Proof Committee Hansard*, 22 May 2014, p. 36.

19 *Submission 11*, p. 2.

providers of financial services and the retail consumers. For example, National Seniors Australia described the financial services sector as a classic uneven market, where the participants were 'grossly mismatched':

> You have huge corporations, heavily vertically integrated, selling complex products, and financial advisers, who historically have lacked professional standards and education…On the other side, you have consumers, who generally lack understanding or appreciation of the complexity of products and, to a significant extent, lack the financial literacy to deal with them. In such a market, it is proposed to reduce consumer protection, and that is the foundation for our concern.[20]

2.17 In general, those opposing the proposed changes shared the view that the proposed amendments would undermine the consumer protections embedded in the current legislation. Ms Robbie Campo, Industry Super Australia, was concerned that the measures proposed in the bill would significantly dilute key consumer protections in financial advice law and therefore increase the likelihood and impact of future financial advice scandals.[21]

2.18 Similarly, Ms Josephine Root, Council of the Ageing (COTA), feared that the cumulative effect of the changes would seriously weaken the reforms, thereby 'giving less consumer protections and ultimately undermining confidence in the financial advice sector'. She stated that COTA was concerned that people would 'opt out of getting financial advice and, therefore, not get the maximum benefits that they could'.[22] COTA believed that, if implemented, the proposed amendments would wind back the provisions of FOFA significantly, result in considerable consumer detriment, and undermine consumer trust and confidence in the financial advice industry.[23]

2.19 Initially, CHOICE was unhappy with the compromise reached when FOFA was first enacted, which it believed could have been stronger in consumer protection. It regarded the proposed amendments as tilting 'the balance further away from consumers'. In its view, the process to justify the bill had failed to assess thoroughly the cost of proposals to consumers.[24] Mr Alan Kirkland explained that CHOICE did not regard FOFA as 'the gold standard in consumer protection'. Although, it was a significant step forward, CHOICE believed that FOFA could have been even better. Mr Kirkland then observed:

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20 *Proof Committee Hansard*, 22 May 2014, p. 67.

21 *Proof Committee Hansard*, 22 May 2014, p. 55.

22 *Proof Committee Hansard*, 22 May 2014, p. 66.

23 *Submission 10*, p. 5.

24 *Submission 7*, p. 5.

> So to imagine further compromises as a result of some of the current proposals is something that concerns us greatly and is of great concern to the consumers who have contact with us.[25]

2.20 Dr Marina Nehme, Faculty of Law, University of New South Wales, was of the view that the balance between the protection of consumers and the protection of business appeared to have 'shifted toward the interest of businesses'.[26]

2.21 Other submitters had a different interpretation and were concerned that insufficient weight had been given to the costs and practicalities of implementing the FOFA reforms. Those supporting the proposed changes were of the view that readjustments were needed to remove inefficient, unnecessary or ineffective provisions that either would make access to financial advice more expensive through compliance costs or were in practicable ways unworkable. For example, while Minter Ellison Lawyers supported the objectives of the FOFA legislation to promote a professional financial advice sector, they were concerned about certain aspects of the current legislation. In their opinion parts of FOFA were inconsistent with the goal of ensuring 'an efficient, fair and innovative financial sector'. According to Minter Ellison Lawyers:

> Another critical but often overlooked goal of FOFA was 'to provide access to and [expand] affordability of financial advice'.[27]

2.22 They were of the view that the proposed reforms would help ensure that the FOFA legislation realised these goals. The FSC also recognised the need for further reforms to FOFA. It believed that the proposed changes would achieve that right balance by ensuring that consumers would 'be able to access affordable quality financial advice while at the same time maintaining a strong level of consumer protection'.[28]

2.23 The Association of Independent Owned Financial Professionals also supported the original objectives of FOFA to eliminate conflicts of interest and provide greater protection for consumers. It contended, however, that the previous government went too far with some aspects and endorsed changes including: removing the opt-in requirements; removing the annual fee disclosure requirements for pre-1 July 2013 clients; removing the 'catch-all' provision from the best interests duty; explicitly allowing for the provision of scaled advice; exempting general advice from the ban on conflicted remuneration; and broadening the existing grandfathering provisions for the ban on conflicted remuneration.[29] In its view:

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25 *Proof Committee Hansard*, 22 May 2014, p. 11.

26 *Submission 8*, p. 5.

27 *Submission 18*, p. 1.

28 *Submission 27*, p. 21.

29 *Submission 26*, p. 1.

> …these changes will not only simplify the industry for its stakeholders but deliver considerable cost savings to all participants including consumers.

2.24 The Australian Bankers' Association on behalf of the banking industry was 'seeking amendments to make sure the law operates as intended and does not adversely impact on retail banking and to make sure bank customers can continue to conduct their banking in ways they want and expect'.[30]

2.25 It should be noted that the submitters, who tended to support the bill in broad terms, did not necessarily agree with all the changes.

Conclusion

2.26 The committee is cognisant of the need, when considering the proposed changes, to strike the right balance between protecting consumers and relieving the burden imposed on the financial service sector, thereby ensuring the availability, accessibility and affordability of high-quality financial advice.[31] In the following chapters the committee examines the main changes proposed to FOFA in this context of finding the right balance between amending existing provisions and ensuring that the new ones are in the consumers' best interests and deliver positive results for the industry. The committee's focus is not only on the immediate costs and benefits to consumers and providers alike but on the long-terms gains for both. It is particularly concerned with ensuring that the changes result in Australian retail clients having access to good quality information and affordable advice about financial products.

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30 *Submission 25*, p. 1.

31 See in particular, *Submissions 8* and *11*.