Chapter 3

Issues raised in evidence

3.1 The bills received broad support from submitters, particularly in relation to their objective of reducing the cost of compliance for companies and those involved in the financial services industry. A number of respondents welcomed Treasury's decision to defer further consideration of a new category of advice dealing with sales recommendations. Various submissions also acknowledged the consultation process with government in the development of the legislation.[1] The general exception to this sentiment was in relation to the inclusion of existing superannuation products in the provisions of the bills, a move which caught some stakeholders by surprise.[2]

3.2 However, respondents expressed concern with some aspects of the legislation, particularly provisions dealing with Statements of Advice (SoAs) and Records of Advice (RoAs). This chapter outlines these areas of concern and considers the evidence received in submissions and at the public hearing.

Statements of Advice

3.3 The proposal to exempt advisers from the requirement to provide a SoA in certain circumstances elicited comment from most submitters. Typical of these was the Institute of Chartered Accountants in Australia:

> The Institute supports the intent of this proposal. This is an important step forward for the access of financial advice by consumers and in particular the provision of advice that is of a strategic nature.[3]

3.4 While there was broad support for the measure, some organisations expressed reservations. For example, the Association of Superannuation Funds of Australia (ASFA) offered qualified support for the general intent of the reform. ASFA considered that changing the SoA requirements was potentially hazardous and should be approached with caution, and that the requirement to provide a comprehensive Record of Advice (RoA) in place of an SoA is critical to the system maintaining the necessary consumer safeguards.[4] The Australian Bankers' Association (ABA) criticised the exclusion of certain types of advice from the exemption as a factor limiting the utility of the amendments to financial services providers.[5]

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1 See, for example, Financial Planning Association, *Submission 13*, p.1, CPA Australia, *Submission 1*, p.1.

2 See for example, Australian Institute of Superannuation Trustees, *Submission 3*, p.5.

3 *Submission 12*, p.1.

4 *Submission 6*, p.4.

5 *Submission 4*, p.4.

3.5 In its testimony before the committee, Treasury officials advised that regulations to support the bills would not be available for some time after the bills' consideration by the Senate.[6] This introduces a level of uncertainty into the future operation of a significant number of the bills' provisions.

Records of Advice

3.6 In keeping with its role in achieving simplified disclosure and reduced costs of compliance, the RoA proposal attracted general support, with much of the commentary focusing on the information RoAs ought to contain.

3.7 ASFA emphasised the importance of the client being properly informed, through the RoA, of the costs and other significant consequences of a decision to move funds from one financial product to another.

> ASFA strongly believes that any changes to the Statement of Adice (SoA) requirement must be carefully done. Extending relief too far is hazardous, particularly if it involves a person acquiring a new product or moving monies between funds. The decision of an individual to join a fund, acquire a new product or transfer or rollover significant amounts of money from one fund to another should require investigation of the member's current benefits and costs, and should ordinarily require the provision of an SoA.[7]

3.8 The Australian Institute of Superannuation Trustees (AIST) agreed, noting that the supporting regulations should outline the content requirements of the RoA. It also noted that allowing individual advisers to determine the level, amount, content and specific details of the RoA would be inappropriate. AIST expressed concern that, while the Explanatory Memorandum sets out a list of content requirements for RoAs, these are not described in the legislation.[8]

3.9 There was also concern that advisers are obliged to provide a RoA to clients only at their request, as is reported in the Explanatory Memorandum.[9] Choice argued that:

> To ensure that the RoA accurately reflects the advice the consumer receives, a copy of the RoA must always be presented to the consumer. The consumer needs to be satisfied it is a true reflection of their interaction, especially if the RoA is later required for external dispute resolution purposes.[10]

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6 Ms Ruth Smith, *Committee Hansard*, 13 June 2007, Canberra, p.73.

7 *Submission 6*, p.2.

8 *Submission 3*, p.9. See also Industry Super Network, *Submission 9*, p.3.

9 Explanatory Memorandum, para 1.40.

10 *Submission 8*, p.3.

3.10 However, the committee notes an anomaly in that, at proposed section 946AA(5) of the Bill, the provision of a RoA is mandatory.

Threshold

3.11 Another area of concern relates to the operation of the SoA threshold, and the level at which it should be set. The bill proposes to introduce a threshold amount in relation to the provision of a SoA, which will be required to be prepared and provided to the client if the amount to which the advice relates is $15,000 or more. Where the amount is less than the threshold, the SoA will be substituted with a RoA.

3.12 The evidence revealed a significant level of confusion about the threshold and what should properly be counted in assessing whether a SoA or RoA is required. ASFA was keen to see the definition of the proposed threshold clarified, and in particular, how it applies to future investments. This is particularly germane if the advice relates to superannuation, which is very likely to exceed the threshold over time.[11] ASFA was not alone in expressing confusion about the definition. In their supplementary submission, the ABA put their concerns with the threshold this way:

> It is unclear how future investments will be treated. The Explanatory Memorandum suggests that the threshold will relate to the value that the initial investment and the future amounts anticipated to be reached in the next 12 months. However, [proposed subsections 946AA(1) and (2), read together] seem to restrict subsequent investments made in relation to the advice. [Subsection 1] refers to the total value of all financial investments in relation to which the advice is provided as not exceeding the threshold amount. [Subsection 2] refers to the total value of investments as the 'total acquisition value' and 'total disposal value'. This seems to unduly limit the relief so that in practice it would only apply to one-off small sales or investments. We suggest that the amendment be clarified so that the threshold relates to an acquisition or disposal in a 12 month period.[12]

3.13 Many submitters who expressed an opinion on the threshold considered clarity of its definition to be at least as important as the actual threshold figure itself. Industry Super Network (ISN) argued:

> [W]e agree that the objective of increasing access to advice for small-scale investors is meritorious [but] in order to ensure that the reforms achieve this end without unintended side effects we would urge the Committee to ensure that the $15,000 threshold is well defined so that the *total amount under advice* does not exceed this threshold.[13]

11 *Submission 6*, p.4.

12 *Submission 4A*, p.2

13 *Submission 9*, p.3.

3.14 ISN were in the minority in advocating for a reduction in the proposed threshold, to $10,000, on the basis that the increased limit had been arrived at with insufficient consultation.[14]

3.15 Some stakeholders were dubious about the rationale behind the proposed threshold of $15,000. The ABA, for example, considered that the figure appeared to be arbitrary, and suggested that different thresholds should apply for different classes of product, as each has a different usual minimum investment amount.[15]

3.16 The Financial Planning Association supported the move to grant relief from the need to provide extensive disclosure, and like the ABA, called for the proposed threshold to be raised to $25,000, and for advisers to be able to access the exemption even when being remunerated.[16] IFSA took a similar view, arguing that the calculations undertaken by Treasury as to the 'break even' point for advisers were inaccurate:

> They have actually made an assumption that five per cent of advice provided fell below $15,000. We have had feedback from at least one of our members, who is a major provider of advice in the market, that three per cent of the advice provided falls below $15,000. So, based on that assumption, $25,000 is probably about right.[17]

3.17 While a number of submitters considered the possible utility of anti-avoidance provisions in relation to the threshold, Treasury officials submitted that they could see no clear way for the threshold to be abused without the knowledge and consent of the client.[18]

No product recommendation and no remuneration

3.18 One of the central tenets of the bills is the exclusion for the adviser from a requirement to provide an SoA in circumstances where they receive no remuneration and in which they do not recommend a financial product.

3.19 One issue that was raised by a number of witnesses is the definition of remuneration. To access the exemption, the bill requires that the adviser not receive any direct remuneration or other benefit, other than remuneration already being received for earlier advice, either for, or in relation to, the product.[19]

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14 Mr David Whitely, *Committee Hansard*, 13 June 2007, Canberra, p.30.

15 *Submission 4*, p.4.

16 *Submission 13*, pp.1-2.

17 Mr David O'Reilly, *Committee Hansard*, 13 June 2007, Canberra, p.17.

18 Ms Ruth Smith, *Committee Hansard*, 13 June 2007, Canberra, p.73.

19 Proposed subsection 946B(7)(b).

3.20 The ABA submitted that, in practice, different models of remuneration in the industry made interpretation and compliance with the provision potentially difficult. Elaborating on their concerns, the ABA submitted that:

> Advisers may operate under a number of remuneration structures including on a fee for service basis; under a commission structure linked to a licensed dealer; through salary or wages; or via a plan fee paid directly from a fund/product. Advisers may use more than one of these remuneration structures, depending on their business model and client base … [I]t is unclear how the amendment would impact on an adviser that receives a salary not related to the advice. It is our view that a more definite description of remuneration should be provided.[20]

3.21 AIST were concerned by the use of the word 'directly' in the provision, considering the possibility that 'soft dollar' inducements could be received by advisers while still attracting the exemption.[21] ISN shared this concern, and joined with AIST in recommending that the word 'direct' be deleted, or the words 'and indirect' be added to the provision.[22]

3.22 Another commonly raised issue was the inclusion within the terms of the exemption of advice to 'hold' a product, owing to the requirement that advisers seeking the exemption do not recommend the acquisition or disposal of a product. Choice expressed a common sentiment when they submitted:

> There is no reason why trailing commissions earned on hold advice, which have the potential to generate conflicts of interest for the adviser, should be exempted from the SoA process, particularly as consumers are generally not fully aware of the impact of trailing commissions.[23]

Superannuation

3.23 The inclusion of superannuation in the exemption regime, where no new product is being canvassed by the client and adviser, is another issue that was raised in evidence. The Institute of Chartered Accountants in Australia, ASFA and IFSA supported the inclusion of super in the exemption provisions, with the latter calling for the exemption to be available for all superannuation accounts and advice which fall under the threshold, on the basis that:

> … there does not appear to be any justification for denying low cost and simple retirement planning advice to persons looking at opening a superannuation account … there is little to differentiate advice needed for the choice of the consolidated account, to the opening and consolidation in

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20 *Submission 4*, p.3.

21 *Submission 3*, p.9.

22 *Submission 9*, p.5.

23 *Submission 8*, p.3. See also, for example, ISN, *Submission 9*. p.5; AIST, *Submission 3*, p.8.

> a new account … clients will continue to receive appropriate advice and the provision of a RoA will ensure remuneration [is] disclosed.[24]

3.24 Choice opposed the inclusion of superannuation::

> Compulsory superannuation is deferred earnings designed to fund future retirement. It is a long-term public policy measure and the potential for inappropriate advice or mis-selling is obvious. [25]

3.25 However, it was AIST who argued most strongly against the inclusion of superannuation in the legislation, arguing:

> The decision as to which fund is the correct one into which the consolidation should take place is not necessarily a simple one. Matters like the existence of severe penalties to withdraw from many of the funds provided by financial institutions, the availability and value of life/total and permanent disablement/income continuance insurance arrangements, and the willingness of a current employer to contribute to the selected fund, can all influence a decision that would otherwise be made on the basis of fees or investment returns alone.[26]

3.26 AIST set out its reasons at length. Not least of these was the utility of the provisions as they related to superannuation. To the argument that the provisions would be useful for clients seeking to consolidate accounts, AIST responded:

> Given the average size of lost accounts is in the hundreds of dollars, I cannot imagine that financial planners are going to spend their time trying to consolidate those amounts. It would be only in relation to clients who have got very substantial sums elsewhere that they would get involved in providing advice. I think the whole question of addressing the consolidation of lost accounts of that size has got to be addressed in a totally different fashion.[27]

3.27 More broadly, AIST put forward the compulsory nature of superannuation as a good reason to implement the maximum possible safeguards against uninformed decision making, submitting that:

> Diminishing disclosure requirements and creating loopholes for the minority of financial advisers who are acting unscrupulously, or in bad faith, doers not provide a confident investment environment for consumers to feel that their retirement savings are safe and secure.[28]

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24 ICAA, *Submission 12*, p.2; ASFA, *Submission 6*, p.4; IFSA, *Submission 10*, p.4.

25 *Submission 8*, p.4.

26 *Submission 3*, p.3.

27 *Committee Hansard*, 13 June 2007, Canberra, p.42.

28 *Submission 3*, p.13.

3.28 AIST went on to argue that more analysis and broader understanding is required and that at the very least the inclusion of superannuation be deferred until matters are more deeply assessed. [29]

> Our primary position is that in the time since super appeared on the scene in this bill, there has not been enough time for people to think through—certainly for us to think through—all of the implications of including it. We would like to see its inclusion either not take place or to be deferred until that proper consideration can be given.[30]

3.29 As alluded to by AIST, considerable consternation arose as a result of superannuation's late inclusion in the bill. Several witnesses testified that they were led to believe that it would not appear, and that they were surprised when the bill was made public.[31] The lack of consultation was confirmed by Treasury officials when they appeared before the committee.[32]

Insurance advice

3.30 The evidence revealed some disappointment with the exclusion of certain forms of insurance from being subject to the relief provisions in the bills. The exemption from the requirement to provide a SoA does not apply to a general or life insurance product, except insofar as advice relating to a superannuation product relates to a life risk product.

3.31 The ABA commented:

> It is our view that excluding general insurance products is not scaleable and proportionate to the risk profile of the product and at odds with previous FSR requirements. It is our view that the exclusion should not apply to life risk insurance products … [E]xclusions would create additional complexities for representatives and consumers and sensibly these exclusions should be removed.[33]

3.32 The FPA agreed:

> It is our position that [the exclusion of life risk insurance] would create a bias towards advice on life insurance attached to superannuation, and anecdotal evidence from members suggests that many consumers mistakenly believe that insurance attached to superannuation is adequate.[34]

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29 *Submission 3*, p.3.

30 Mr Graeme Grant, *Committee Hansard*, 13 June 1007, Canberra, p.41.

31 Mr Graeme Grant, *Committee Hansard*, 13 June 1007, Canberra, p.41.

32 Ms Ruth Smith, *Committee Hansard*, 13 June 2007, Canberra, p.74.

33 *Submission 4*, p.5.

34 *Submission 13*, p.2.

'In product' advice

3.33 Some submitters expressed the view that 'in product' advice should be included in the exemption regime. This relates to advice which is given in relation to a product with which the client is already involved. The ISN's argument was typical in this regard:

> If the aim of this reform is to make advice more accessible to consumers, then enabling funds to provide within-product advice would be a more cost effective way of enhancing the coverage of advice without compromising the quality of advice or consumer protection. The advice needs of many consumers, particularly low-income earners, are largely limited to simple issues related to their superannuation – voluntary contributions, salary sacrifice, investment allocation and insurance provided within the product.[35]

3.34 ASFA agreed, observing in relation to 'in product' advice that:

> Appropriately crafted provisions could provide some immediate and meaningful relief to superannuation funds addressing the advice needs of their membership. If these changes are to be about improving cost and access to advice for income earners, then any such changes would be a step in the right direction.[36]

Sophisticated investors

3.35 The amendment provides for an adviser to certify that the client has sufficient experience to be treated as a wholesale investor, enabling expeditious disclosure for the adviser and a larger range of financial products for the client. Existing tests relate to assets and income as the primary indicator of financial sophistication, whereas the new measure will allow certification based on reasonable grounds that sufficient experience is held by the client so as to be treated as a wholesale investor. As is the case currently, general insurance, superannuation and savings account products will not be subject to the provisions, nor any product in connection with a business.

3.36 The ABA's concerns, primarily in respect of the exclusion of small business from the provisions, were serious enough for it to oppose the measure in its current form. The Australian Financial Markets Association (AFMA) also considered this a serious problem.[37] The ABA queried whether the provisions applied to those managing risk, as opposed to investors. They also expressed curiosity as to the longevity of a certification, and whether it applied uniformly across product classes, and suggested that:

> [T]he written statement should be defined to cover a class or sub-class of financial products for which the retail investor shall be treated as wholesale

35 *Submission 9*, p.5.

36 *Submission 6*, p.2.

37 *Submission 11*, p.3.

> for the ongoing provision of financial services for that class or sub-class of financial products by that financial service provider.[38]

3.37 This was said to be particularly relevant where the client is involved in fast-moving foreign exchange markets.[39]

3.38 Other concerns were more general. Choice expressed the view that the proposal:

> … may ultimately blur an important distinction between retail and wholesale investors, and will expose consumers to unacceptable risks of fraud or deceptive conduct. By reclassifying the consumer as a wholesale investor the consumer foregoes a broad range of rights and protections, including their right to
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> - financial service product disclosure;
> - receipt of a financial services guide;
> - the benefit of a suitability analysis by their adviser;
> - the benefit of mechanisms designed to deter pressure selling; and
> - the benefit of compensation arrangements for fraud or negligence.[40]

3.39 Choice went on to observe that advisers are not ideally positioned to make disinterested and independent judgement of their client's sophistication.[41] The ISN questioned whether the new method of judging client sophistication might pose a particular hazard to operators of self-managed superannuation funds (SMSFs), many of whom it considered to be in danger of being mistakenly identified as wholesale investors even though their experience with managing large sums may be limited. [42] Both Choice and the ISN declined to support the measure.[43]

3.40 The ABA and others expressed their confusion at provision 761GA(f)(ii), which proposes to require the client, as a prerequisite to achieving sophisticated investor status, to acknowledge that they have not been provided with a PDS, or 'any other document' that would otherwise be required to be given to the client. The ABA submitted that:

> The amendment excludes financial service providers from giving their clients documents that can be provided to a retail client. This is nonsensical as it discourages financial service providers giving information to their clients. The written acknowledgement ensures that the client is aware of the

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38 *Submission 4A*, p.3.

39 *Submission 4*, p.7

40 *Submission 8*, p.5.

41 *Submission 8*, p.5.

42 *Submission 9*, p.9.

43 Choice, *Submission 8*, p.6; ISN, *Submission 9*, p.9.

> consequences of being treated as wholesale. We suggest the amendment be changed to indicate that a licensee 'does not have an obligation' or 'is not required' to provide the client such information.[44]

3.41 As it stands, the amendment would appear to bar sophisticated clients from receiving information regarding investment products from the adviser, even where they request them. The Committee queries the justification for such a measure.

Other measures

3.42 Much of the remaining commentary was in broad support of other measures contained in the bills. Two areas, company reporting and executive remuneration, elicited the majority of the remaining commentary.

Company Reporting Obligations

3.43 This measure achieved broad support, with ASFA expressing disappointment that it did not extent to the distribution of annual reports of superannuation funds. ASFA observed that:

> ASFA believes that superannuation funds must provide their members with relevant information so that the member is made aware, and remains aware, of their benefits and rights as members. This information needs to be provided in a way that is relevant and useful to members, so that members can make informed decisions. We would support superannuation funds having the option to make their annual reports available electronically with members then having the right to request, at no cost to themselves, a hard copy of the report.[45]

3.44 IFSA went further, calling for the ability to distribute fund information and significant event notices electronically:

> There is no compelling reason why fund information and significant even notices cannot be distributed via the published content of a website … [L]ike annual reports, fund information and significant event notices are by and large generally available. The information is not specific to a particular holder. There are no overarching dissimilarities in consumer protection terms affecting the distribution of either document…[46]

3.45 The ABA and IFSA questioned whether investors who have already opted out of receiving paper reports will be covered by the provision in the bill, or whether permission to send documents electronically will need to be re-sought. They call for transition arrangements to be clarified in this respect.[47]

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44 *Submission 4A*, p.3.

45 *Submission* 6, p.8.

46 *Submission* 10, p.3.

47 *Submission* 4, p.10; *Submission* 10, p.2.

Executive remuneration

3.46 The Australian Shareholders' Association was disappointed that the amendments do not require companies to report the market value of outstanding executive options, but was supportive of the introduction of reporting requirements for hedging of remuneration.[48]

3.47 The ABA considered that the amendments as they are worded place an inappropriate responsibility on auditors to comment on the narrative contained in the remuneration report, and recommended that that provision be clarified to require auditors to comment on the accounting information within the report.[49]

Conclusion

3.48 This package of amendments has as its primary aim the simplification and facilitation of access to affordable financial advice for consumers. Although the committee heard no firm evidence that the price of financial advice would drop as a result of these measures, the committee believes they will succeed in their objective, and that there is no evidence that consumer protections will be adversely affected.

3.49 The committee is mindful that stakeholders took different views on a number of proposed measures and identified specific areas that might need further refinement. One area relates to product disclosure documents. The committee notes that witnesses who appeared before it did not explain how the bills would reduce the size and complexity of disclosure documents that are currently issued. This is why the committee strongly urges the government and industry stakeholders to continue to work to reduce the length and complexity of disclosure documents and make them more readable. However, suggested changes, where they were offered, were relatively minor and do not in any way challenge the substance of the bills. In noting the broad and consistent support for the bills, the committee does not believe that concerns raised are serious enough to warrant delay in their consideration and passage through the Parliament in their current form.

3.50 The committee reminds all stakeholders that the bills, while an important step forward, represent only one part of the government's financial services reform agenda, and that further opportunities to fine-tune the operation of these and other measures will most likely be forthcoming. The committee, therefore, encourages the government to consult further with industry stakeholders over a number of practical and technical issues raised in evidence to this inquiry.

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48 *Submission 2*, p.1.

49 *Submission 4A*, p.4.

Recommendation 1

3.51 The committee recommends that the government and industry stakeholders consult further and devise ways to reduce the length and complexity of Statements of Advice and Product Disclosure Statements, and make them more readable.

Recommendation 2

3.52 The committee recommends that the bills be passed.

Senator Grant Chapman
Chairman