6 June 2007

The Secretary
Parliamentary Joint Committee on
Corporations and Financial Services
Suite SG.64
Parliament House
CANBERRA ACT 2600

Submitted via Email: corporations.joint@aph.gov.au

Dear Mr Sullivan

Re: AIST'S SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Inquiry into the Simpler Regulatory System Legislation – *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007

On behalf of the Board of AIST, it is with pleasure that I attach our submission to the Parliamentary Joint Committee in relation to the above Bill.

AIST has consulted with its Members on the Bill and has incorporated their views into this submission.

If you have any questions in relation to this submission, please contact Peta-Gai McLaughlin, AIST's Legal & Compliance Manager, on (03) 9923 7153 or via email, pgmclaughlin@aist.asn.au.

Yours sincerely

Fiona Reynolds

Fiona Reynolds
Chief Executive Officer

AIST SUBMISSION TO PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Inquiry into the Simpler Regulatory System Legislation

Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007

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A. AIST and its Members

On 2 January 2007, the Australian Institute of Superannuation Trustees, Conference of Major Superannuation Funds and the Industry Fund Services Training Group merged into one new company. The new national company operates under the name of Australian Institute of Superannuation Trustees ('AIST').

The bringing together of these three groups under one umbrella has created an organisation that provides a range of services to the representative superannuation industry, including professional development and training, and major events and conferences, in particular the annual Conference of Major Superannuation Funds ('CMSF'). The new company also engages in public policy relating to superannuation, and liaises with Government, regulators, and other groups involved in the superannuation industry, as well as providing compliance and licensing services.

The Australian Institute of Superannuation Trustees is a membership based professional body. Its members are representative superannuation funds, their Trustee Directors, Executive Management and Fund Staff.

B. Introduction & Executive Summary

As a membership organisation in the superannuation sector, AIST's submissions are focussed on the parts of the Bill which are relevant to AIST's members and relate to superannuation.

Submission Content

For ease of reference for the Joint Committee, AIST's Submission is broken up into five different sections:

PART A Information about AIST

PART B Introduction & Executive Summary

PART C AIST's Recommendations to the Joint Committee

PART D Further explanatory detail about the Recommendations

PART E Contact Details

Introduction

1. AIST understands that the objective of the proposed changes is to facilitate financial advisers providing appropriate advice to investors without diluting the protections provided to them by the current regulatory regime.

2. If anything, the results of ASIC's 'Shadow Shopping' campaigns, the need for the enforceable undertaking imposed on AMP Financial Planning which required the advice given to over 30,000 clients being reviewed, and the failures of Westpoint, Fincorp and ACR (where financial advisers were involved in recommending investor participation) suggest that a tightening of the financial services regime is necessary.

3. AIST also submits that the late inclusion of superannuation in the subject matter of this Bill has not provided the industry with sufficient time in which to thoroughly assess the impact the changes may have on consumer protection provisions and market integrity in general.

4. AIST is attracted to any suggestion which is likely to lead to a closer alignment of the interests of financial advisers and their clients. To that end, AIST supports the proposal that financial advisers be required to always act in the "best interest" of their clients. This would bring their obligation to their clients into line with that of other professionals, notably Superannuation Fund Trustees.

Inclusion of Superannuation in this Bill

5. As indicated in our introductory comments, AIST is concerned that the late inclusion of superannuation in this Bill has not provided sufficient time

for appropriate consultation with participants in the sector, AIST's membership in particular.

6. AIST is concerned that this may inadvertently result in consumer protection provisions being removed or diluted without a full understanding of the impact of such changes.

7. This is particularly true of the proposals to exempt financial advisers from the requirement to provide Statements of Advice in particular circumstances. We explore our concerns in greater depth in Part D of this Submission.

8. Many Australian workers have, as a consequence of job mobility, accumulated benefits in a number of superannuation funds. Prima facie, there is a case for consolidation of these accounts to minimise the impact of administration and other fees.

9. The decision as to which fund is the correct one into which the consolidation should take place is not necessarily a simple one.

   9.1 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.

10. It is complicated matters such as this which AIST believes demands more analysis and understanding than has been possible in the two weeks available to produce this Submission.

11. AIST strongly recommends that the decision to include superannuation as a product included in this Bill be deferred until the matters we have raised are carefully and objectively assessed.

C. AIST's Recommendations to the Joint Committee

12. AIST makes ten recommendations in relation to this Bill, which are based on the arguments raised in Part D of this Submission.

   i. That the inclusion of superannuation products be deferred from this Bill until at least the Regulations have been drafted and appropriate time is given to the superannuation industry to assess the impact of the Regulations and the inclusion of superannuation in this Bill;

ii. That the Regulations which support this Bill be provided to the industry for consultation for an appropriate amount of time (AIST recommends 6 weeks);

iii. The exemption to provide a Statement of Advice ("SOA") should only apply in the situation where the adviser does not receive any remuneration or other benefit in relation to the advice, but only in relation to non-superannuation products;

iv. The SOA exemption should not apply where an adviser does not make a recommendation or provide a statement of opinion in the manner described in the proposed section 946B(7), as the lack of advice in such a situation, or a recommendation to "hold" an existing product or maintain an existing investment strategy, is still considered to be advice which should be documented in an SOA;

v. The word "directly" in proposed section 946B(7)(b) be removed, as it may not include 'soft dollar' remuneration received by advisers as currently drafted;

vi. The $15,000 advice threshold not apply to superannuation as the two objectives of the financial services regulatory framework of consumer protection and market integrity are not furthered by the application of the exemption to superannuation products;

vii. The inclusion of an insurance product "packaged" with a superannuation product be excluded from the SOA exemption as insurance in superannuation funds is unlike stand-alone insurance available in the market, and therefore requires greater protection by the disclosure regime;

viii. In the alternative, that should the Bill be enacted, that the Regulations to support these provisions outline the content requirements of a "Record of Advice" ('ROA'), as it is not appropriate for individual advisers to determine the level, amount, content and specifics of the information to be retained in a ROA, and further, that the specific requirements contained in section 947D of the Corporations Act be included in those content requirements;

ix. In the alternative, that should the Bill be enacted, that the exemption to providing an SOA should be extended to "within product" advice to enable superannuation fund Trustees to provide advice and education to its members; and

x. In the alternative, if the ROA compliance obligation is introduced, that it only be limited to the provision of one type of financial advice, not multiple topics of advice.

D. Further explanatory detail about the Recommendations

INTRODUCTORY COMMENTS

AIST Strongly Objects to These Amendments Applying to Superannuation Products – insufficient consultation time

13. During previous consultation in relation to the changes outlined by this Bill[1], changes of this nature were *not* intended to apply to superannuation products. It is unclear why these changes will now apply to superannuation, and there is very little explanation in the Explanatory Memorandum for this turnaround.

14. AIST believes it is inadvisable to have these legislative changes apply to superannuation products, as outlined in AIST's submission to Treasury on this matter, dated 19 January 2007 (which is provided to the Joint Committee, for its information).

    14.1 Further, AIST submits that these changes should not apply to superannuation products as there has been insufficient time to properly assess their application to superannuation products (given the original proposals were not intended to apply to superannuation), nor has there been an appropriate amount of consultation with industry on these proposed changes.

The Financial Services Regulatory Framework & Purposes of Financial Services Regulation

15. The purpose of the regulation of financial services is to ensure market integrity and consumer protection. This is achieved through a number of measures, with a strong focus on disclosure to consumers to ensure they're armed with the appropriate knowledge to make informed decisions.

16. The financial services regulatory framework is founded on the principle that consumers must take responsibility for their own investment decisions and that, in order to do so, consumers must be given adequate information on which to base their decisions.[2]

    16.1 Whilst the framework's purpose was also to reduce administrative and compliance costs, AIST submits that the more important

[1] Specifically with reference to the *Corporate and Financial Services Review Proposals Paper*, dated November 2006, and the *Streamlining Prudential Regulation: Response to 'Rethinking Regulation' Paper,* dated December 2006.

[2] Paragraph 7.23, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 117

purpose of the framework is to protect consumers and market integrity.

16.2 The industry is reminded on a regular basis why consumers need protection in this environment due to the repeated miss-selling of financial products, the most recent of which was the Australian Capital Reserve ('ACR') collapse. Before ACR's collapse, there was Fincorp's collapse, and before Fincorp, there was the Westpoint scandal.[3]

16.3 Millions of dollars from ordinary Australians have been lost due to the miss-selling of these products by some financial advisers who have the sole aim of maximising the commission income they earn from "mum and dad" investors, the type of advisers who are content to operate in an inherently conflicted financial services environment, act unconscionably and pay scant regard to their client's investment outcome.

16.4 This is particular concern for AIST, as the Honourable Chris Pearce MP, Parliamentary Secretary to the Treasurer, announced that the Simpler Regulatory System Bill *"...will encourage and further enable mum and dad investors to effectively participate in the marketplace."* [4] AIST supports that such "effective participation" is to be encouraged, but without adequate consumer protection, millions of dollars can be lost, which will place a further drain on the Government to provide for these consumers in their retirement. AIST believes that these legislative changes will not provide adequate consumer protection.

16.5 The Financial Planning Association are regularly reported as stating that financial advisers who place their own interests ahead of their clients and act unconscionably are in the minority (which is in all likelihood, true). However, the industry keeps seeing miss-selling of products resulting in tens of thousands of Australians losing millions of dollars in the process, due to these unconscionable and unscrupulous advisers, even if they are in the minority.

16.6 This miss-selling and subsequent loss of hundreds of millions of dollars is occurring in the current regulatory environment.

16.7 AIST is therefore strongly opposed to any further watering down of disclosure in the financial services sector, and specifically with reference to superannuation products, as under the current level of regulation, some financial advisers encourage Australians to part with their retirement savings to invest in flawed financial products and lose their retirement savings. These advisers then reap a financial reward through commissions on those flawed products.

[3] These corporate collapses and the impact of them on consumers will be discussed further in this submission.

[4] The Honourable Chris Pearce, MP, Parliamentary Secretary to the Treasurer Media Release date 24 May 2007.

16.8 A reduction of disclosure obligations in this way will ensure that such miss-selling continues.

17. AIST is concerned that these changes may make it easier for some financial advisers to rort ordinary Australians by reducing the disclosure information which is to be provided to consumers, particularly as AIST believes that these changes will not necessarily reduce the compliance burden on financial advisers and will only increase the loopholes for those unconscionable advisers who take advantage of 'mum and dad' investors.

AIST Reiterates that Consumer Protection Should be Paramount

18. It is for these reasons outlined above, that AIST submits that the reduction of disclosure obligations does nothing for the furtherance of either of ensuring general market integrity and consumer protection.

19. As outlined in previous submissions to this Joint Committee and to Treasury, AIST believes that the overarching issue of consumer protection should be paramount in relation to the changes to the financial services disclosure regime.

EXEMPTION FROM PROVIDING A STATEMENT OF ADVICE – NO PRODUCT RECOMMENDATION & NO REMUNERATION

SOA Exemption should not apply to superannuation products

20. AIST submits that this exemption from providing a Statement of Advice ('SOA') to a client not be extended to superannuation products, as was originally contemplated in the Proposals Paper.

21. AIST believes that superannuation, by its very nature, should be excluded from this SOA exemption, as well from the threshold amount to provide an SOA, which will be discussed later in this submission, as the issues as to why superannuation should be treated differently from other financial products is relevant to both this legislative amendment and the threshold SOA amendment.

The lack of advice, or recommendation to "hold" an existing product or maintain an investment strategy should not be subject to the SOA exemptions

22. Whilst AIST is encouraged to see that advisers cannot rely on this exemption if they are to receive a financial benefit from the advice given, AIST is concerned that there may be a flaw in the logic of this amendment.

23. Presumably, this amendment could be mostly utilised by advisers when conducting an initial meeting with a client. As AIST understands it, in summary, if an adviser decides not to recommend an acquisition or disposal of a product, or provides an opinion in respect of a modification to an investment strategy or contribution level, or will not "directly"

receive any remuneration or benefit from the advice, then that adviser is exempted from the requirement to provide the client with an SOA.

24. Further, in a situation where an adviser recommends that a client continue to "hold" a product, or continues to maintain an investment strategy, this recommendation could still be considered to be advice and should not be exempted from the SOA requirements.

25. AIST believes the possible flaw in the logic of this provision relates to fact that a decision *not* to provide advice could, of itself, be inappropriate advice; or the recommendation to continue to "hold" a product, or maintain a strategy is also advice.

    25.1 If a consumer then does not receive an SOA in relation to the adviser's decision not to provide advice due to the client's particular financial circumstances, or because the adviser's recommendation is to "hold" the product, how can the client determine whether or not that advice is appropriate for them to act upon?

        25.1.1 If that decision not to acquire or dispose of a product, or the lack of an opinion about a client's investment strategy or contribution options, impacts the client adversely, what legal recourse does that client have against the adviser?

        25.1.2 What of the situation where the adviser has acted negligently in not providing that advice? Without any written advice outlining that decision, a client would find it difficult to prove that the advice was negligent, thus diminishing the consumer protection even further.

    25.2 Many clients will seek advice in just one instance, and then will not have another consultation, especially if the costs are a concern for that client. In such a situation, that client would not receive any advice in writing, which could be filed away and referred back to by the client in years to come.

26. For an adviser to determine whether to *not* provide advice, the adviser must still complete a full "fact finding"/"get to know your client" process to properly determine that the client should take no action.

    26.1 This part of providing financial advice can be the most time consuming for an adviser. The adviser must spend time asking questions, gathering information, obtaining copies of the relevant documents from the client etc. This process is still required to be undertaken, regardless of the outcome of the advice – whether the advice is the decision *not* to provide advice, or the decision *to* provide advice to the client.

    26.2 Therefore, on this basis, AIST is unclear as to how this will in fact benefit advisers from a reduction in compliance obligations.

27. Given the issues outlined above, AIST submits that this exemption to provide an SOA **should only apply** in the situation where the adviser does not receive any remuneration or other benefit in relation to the advice, but only in relation to non-superannuation products.

28. AIST further submits that this exemption **should not apply** where an adviser does not recommend the purchase or sale of a product, or modification to an investment strategy or contribution level in a financial product, given the fact that failure to provide advice can still constitute advice of itself.

"Direct" Remuneration or Other Benefits Wording a Concern

29. AIST believes that the use of the word "directly" in the proposed section 946B(7)(b) could arguably not include the "soft dollar" inducements, or the "soft dollar" commissions received by advisers when recommending a product or service.

30. Therefore, for complete transparency, and in line with intent of this amendment, AIST recommends that the word "directly" be removed from the proposed section.

"Record of Advice" Content Requirements

31. In the alternative, if the Joint Committee determines that these amendments should be enacted, AIST submits that the Regulations to support these provisions must outline the content requirements of a "Record of Advice" ('ROA'), as it is not appropriate for individual advisers to determine the level, amount, content and specifics of the information to be retained in a ROA.

32. Another reason why the content requirements for ROAs should be prescribed in the legislation is that the term "ROA" is already in use in the industry, however it appears the new "ROA" definition is different from the existing definition, which could cause confusion.

    32.1 Therefore, the proper definition of the content requirements of an ROA will alleviate the potential for confusion.

33. AIST notes the comments in the Explanatory Memorandum that the ROA sets out the advice given to the client, or brief particulars of the recommendations made, including the basis on which the recommendations were made, as well as the consequences of partially or wholly replacing one financial product with another.[5]

    33.1 Whilst this statement has been made in the Explanatory Memorandum, AIST notes that the content requirements of an ROA outlined above are not currently prescribed under the legislation, or the draft legislation, as opposed to the content requirements of an SOA.

    33.2 AIST submits that the content requirements of the ROA should be prescribed by legislation, just like the content requirements of an SOA. It is not logical to prescribe the content requirements of one disclosure document, but not another, especially when consumer protection is at stake.

[5] Paragraph 7.14, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 123

33.3 Further, such content requirements contained in an ROA should be subject to the usual consultation period outlined above, that is, at least 6 weeks.

Appropriate Time to Consult with Industry Regarding the Regulations

34. Further in the alternative, AIST recommends that the industry be given adequate time to consult with Treasury in relation to all draft Regulations to support these legislative amendments.

34.1 AIST recommends that 6 weeks for consultation would be sufficient in the circumstances, not 2 weeks.

THRESHOLD FOR REQUIRING A STATEMENT OF ADVICE

Research to Support the Presumption that more Consumers will Obtain Financial Advice as Result of Less Disclosure?

35. AIST is not aware of any research which supports the presumption that more consumers will obtain financial advice if they received less disclosure (for example, by obtaining an ROA, rather than an SOA). The Explanatory Memorandum does not provide any information about the basis of this presumption or how it has been established.

36. Further, AIST is also not aware of any research which supports the assertion that more consumers will obtain advice if the cost of the advice is reduced. In the absence of this research, it could appear that the only benefit of a reduction in the work involved in providing financial advice will be the increase of financial adviser profits.

37. Anecdotal evidence from AIST members indicates that members of superannuation funds who want advice will still obtain it, even if they end up with an SOA to document that advice.

38. The Explanatory Memorandum states that "...approximately 5% of [720,000] SOAs are provided for advice in relation to investments of less than $15,000."[6] This statistic has been used to attempt to establish that more clients would seek advice if the cost of the disclosure document was reduced.

38.1 AIST is concerned with that reasoning. Such fundamental change to the consumer protection mechanisms of the Corporations Act appears not to be warranted for such a small number of SOAs issued to clients with account balances under $15,000.

38.2 AIST submits that if this affects so few clients, where is the benefit in introducing such wide-ranging amendments which weaken the integrity of the system?

[6] Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 127

The Details of the Proposed Threshold

39. In relation to a superannuation investment, the proposed legislation introduces a threshold amount of $15,000 before the adviser is required to provide an SOA to a client.

40. It is somewhat unclear due to the drafting of the Bill, (and the amount of detail in the Explanatory Memorandum, which is presumably going to be included in the Regulations supporting the Bill), but it appears that the Explanatory Memorandum contemplates that for superannuation holdings, the SOA exemption can only apply where:

    - The advice is to **consolidate or supplement superannuation into an existing fund** (and then the ROA must contain the section 947D disclosure requirements, relating to the "additional requirements when advice recommends replacement of one product with another"); and
    - Where the advice relates to the **consolidation or supplantation of superannuation in relation to an investment amount of $15,000, the proposal will extend to the consideration of the life risk insurance**, **where it is packaged with the superannuation** interest.

41. Whilst AIST can see the benefit in limiting the SOA exemption in relation to superannuation, due to the fact that superannuation generally involves a significant accumulated investment or potential accumulated investment, and can have a significant impact on consumers' financial situation in retirement, AIST continues to submit that this threshold and SOA exemption should not apply to superannuation at all.

Threshold Argument Aligned With Adviser Profits, not Consumer Protection

42. AIST is concerned that *"[t]he threshold proposed is linked to the point at which it becomes commercially viable for an adviser to provide advice, based on recovering the cost of preparing a Statement of Advice"* [7], as it is an unsound premise from which to base these amendments to the legislation.

    42.1 The purpose of the Corporations Act and regulation of financial services is not to make it more commercially viable for an adviser to provide advice.

    42.2 AIST submits that the policy objective of these amendments should not be about the commercial viability of an adviser providing advice. Instead, it should be based on the objectives of maintaining market integrity and consumer protection.

    42.3 It is for this reason that AIST objects to the $15,000 threshold for a SOA, in that it is arguably an arbitrary figure based on adviser's profit margins and not on an objective, measurable figure relating to consumers' needs in relation to the provision of financial advice.

[7] Ibid, Page 3

43. *"The policy objective is to encourage the provision of financial advice by advisers and facilitate access to advice for consumers, while maintaining important consumer protections, such as ensuring that advice is appropriate and documented and that the documentation is accessible."* [8]

43.1 AIST respectfully disagrees that the only consumer protections involve advice being "appropriate and documented" and that the "documentation is accessible".

43.2 In AIST's opinion, consumer protections also (and more importantly) extend to the provision of a detailed documentation of advice to consumers at the time of providing the advice, or within the statutory deadlines. To enable a consumer to review a detailed Statement of Advice at a later date is a very important consumer protection. It means that the advice they received can be reviewed by them later to determine whether it's still relevant to them, they can refer back to the SOA years later when considering their next investment decisions, and they have more legal protection if it is later considered that the adviser has not given appropriate advice, or has not acted in the client's best interests.

43.3 Not providing a detailed SOA to clients in this situation is not consistent with the financial services regulatory framework's principle that *"...consumers must take responsibility for their own investment decisions and that, in order to do so, consumers must be given adequate information on which to base their decisions."* [9]

44. Further to this point is that if all financial advisers move to an inherently non-conflict based "fee for service" system, then consumers would be better protected, it would reduce adviser's costs, provide a more secure mechanism by which advisers can recover their costs, as well as provide certainty to the industry and restore the faith of cynical investors.

45. In AIST's opinion, the threshold for an SOA argument is flawed and is not geared to greater consumer protection, but to better ensuring advisers' profit margins.

Why This Threshold Amount Should Not Apply to Superannuation Products

46. The $15,000 threshold for Statements of Advice should not apply to superannuation products as superannuation is fundamentally a different product to all other investment related and financial services products. The next eight and a half pages provide arguments in support of why superannuation is different to other investment products and should be excluded from these amendments.

[8] Paragraph 7.9, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 122

[9] Paragraph 7.23, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 117

Superannuation is a Compulsory Investment

47. Firstly, the entitlement to superannuation is a compulsory investment. The payment of the Superannuation Guarantee for employees is mandated. It cannot be compared to a situation within which a person chooses to make a voluntary investment and would seek advice in relation to making that investment

    47.1 Super is potentially the cornerstone of Australia's retirement system, particularly for the low to middle income earners who are unlikely to be able to make additional investments into the share market or property, as examples.

    47.2 Given its compulsory nature, and the billions of dollars involved, the system must ensure that consumers are protected and are not subject to the same market forces which prevail in the voluntary investment environment, especially when one considers the latest round of corporate collapses which have lost ordinary Australians hundreds of millions of dollars from their retirement nest eggs.

    47.3 In a compulsory investment environment, the environment must also provide for consumer confidence and market integrity.

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

Superannuation Fund Members' Apathy and Disengagement from

48. Superannuation fund members are traditionally quite apathetic and disengaged when it comes to their superannuation accounts and superannuation generally. If a trip to a financial adviser results in that adviser verbally recommending a member to invest a certain way or contribute more to super, without detailed advice in writing, it is unlikely that the member will implement that advice.

    48.1 Therefore, the intent of these amendments and making financial advice more accessible would not be met.

49. Superannuation fund members are not as "engaged" with their superannuation as other investors who seeking financial advice about non-superannuation investment products. As such, superannuation fund members are in more of a need to get a detailed written SOA so they can better understand superannuation, have the SOA as a resource document and refer back to it in the future, and make more informed decisions about their superannuation.

Insurance Products Should not be Included in the SOA Exemption

50. As outlined in the Explanatory Memorandum, it appears that advice in relation to general insurance products and insurance risk products will not be able to rely on the SOA exemption, except where the insurance product is *"packaged with the superannuation interest in order to reasonably make recommendations regarding superannuation taking*

into account all the features of the relevant superannuation products." [10]

51. AIST disagrees with this proposal and recommends that when a superannuation product has an insurance product "packaged" with it, that the adviser is ***not*** able to rely upon the SOA exemption.

    51.1 The provision of insurance via a superannuation product is an important component of that superannuation advice and a financial adviser should be required to document their advice in relation to the insurance product regardless of the amount of the investment. There are many reasons for this:

52. Insurance provided via a superannuation fund has many benefits to it which are not available to individuals who purchase a stand-alone insurance policy in the general marketplace.

    52.1 For example, an individual can take advantage of the "group life and total and permanent disablement insurance" which is provided to every member who joins most funds and who is at work on their first day of employment, regardless of any past medical history or claims made. This "group life" cover provides insurers with a large base of low risk policy holders and therefore the group life cover can apply;

    52.2 Further, such individuals can obtain insurance up to an "automatic acceptance level", nominated by the superannuation fund, which means that insurance will be provided up to a certain level without the need for the individual to have a medical assessment or provide detailed medical information;

    52.3 The rates of insurance via an superannuation fund will often be far more competitive than those of a stand-alone policy; and

    52.4 The disclosure required for assessing eligibility for insurance is much reduced, thereby allowing more individuals to obtain appropriate and cost-effective insurance, regardless of their medical histories.

53. Given Australians are, in general, chronically under-insured, the provision of insurance under superannuation funds goes some way in resolving that problem.

54. If an adviser is recommending that a client switches super funds, the adviser *must* give appropriate attention and analysis to the member's insurance arrangements, under both the "to" fund and the "from" fund.

    54.1 For example, the automatic consolidation of multiple superannuation accounts may not be in the member's best interest, as the member may have received a high amount of insurance up to the automatic acceptance level without requiring a medical assessment in one fund, but upon joining a new super fund, would be required to undergo a medical assessment before obtaining the same level of cover.

[10] Paragraph 7.17, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 124

54.2 The member's medical situation may have changed and the member may be disadvantaged if the new super fund would not provide the same level of insurance than the first superannuation fund provided.

55. The above example highlights the importance of requiring a financial adviser to properly assess and outline to the member in a comprehensive Statement of Advice why the adviser is recommending switching super funds and what affect (if any) it would have on the member's insurance arrangements.

56. AIST submits that it is therefore essential that any advice in relation to insurance packaged with a superannuation product should not be able to rely on the SOA exemptions.

The Preponderance of Small Account Balances and Lost Members in Superannuation

57. One in three Australians, or over 5 million Australians, have "lost" superannuation. Superannuation accounts become lost when people move jobs, changes names or addresses, and if they forget to rollover their superannuation when they join a new fund. It is also for these reasons that Australians have multiple small accounts for superannuation purposes.

58. For example, a member may have four superannuation accounts with a combined total of $20,000 – which is a significant accumulated balance. That member may not know they have those four accounts, and instead, are only aware that they have two accounts, which have balances of $5,000 and $7,000, for example.

58.1 If this proposed legislation were to be enacted, such a member may think that they only have $12,000 to invest, and because the financial adviser does not have to write a full Statement of Advice in relation to the advice they are providing the client, the adviser may not know about the multiple accounts, nor conduct the research to determine whether the client has lost super or not.

58.1.1 It is precisely these members who are in need of full and comprehensive advice to consolidate these lost accounts to maximise their investment returns and other benefits.

58.1.2 The above scenario would provide a loophole for a less honest financial adviser to avoid the provision of an SOA, and could arguably roll a client's superannuation into a fund which may not be as appropriate for that member.

59. A threshold amount in relation to the provision of Statements of Advice will segment the advice market.

59.1 It creates inequities in the advice regime, in that those clients with more money to invest will receive better and more comprehensive financial advice. Those who have a small amount to invest and in need of more comprehensive advice, could receive inferior advice.

The Prevalence of Financial Advisers Switching Members Between Superannuation Funds and providing other inappropriate advice

60. ASIC regularly ban and restrain financial advisers and Licensees from providing financial services due to many varied breaches of the Corporations Act, such as the misapplication of client money, non-disclosure related offences, not providing Statements of Advice or not taking into account a client's personal circumstances before providing advice.

61. The compliance and disclosure obligations in relation to the provision of financial advice are there to protect consumers from this type of unscrupulous and unconscionable behaviour.

62. It is the reporting of such cases in the media and by the regulators which provide the basis for AIST's position that disclosure obligations, particularly with reference to Statements of Advice, should not be reduced. This is crucial while Australia operates within a financial services regime which has an inherent conflict of interest due to advisers receiving remuneration or other benefits from financial product originators to recommend certain financial products over others to their clients.

63. Research supports AIST's views that the fundamental conflicts of interest in relation to commissions and incentives for advisers have a negative impact on consumers. AIST was disturbed to read ASIC's Report "Shadow Shopping Survey on Superannuation Advice" released in April 2006 [11] and the previous reports, released in August 2005 [12], as well as the initial ASIC report on these issues, which was a joint undertaking with the Australian Consumers Association, "Survey on the Quality of Financial Planning Advice" released in February 2003 [13]. The 2006 report "*found the financial advice industry still has significant work to do before the quality of advice will be consistently at a level that ASIC and consumers would regard as acceptable.*" [14]

64. In summary, the ASIC Shadow Shopping identified:

- that of 306 participants in the survey, 16% of advice was clearly not reasonable, given the client's needs and that a further 3% was probably not reasonable;
- a third of the advice given to consumers to switch funds lacked credible reasons and risked leaving the consumer worse off;
- unreasonable advice was 3-6 times more common where the adviser had an actual conflict of interest over remuneration (eg receiving commissions from a recommendation for a product) or recommending associated products;

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[11] The ASIC Shadow Shopping Survey on Superannuation Advice report can be downloaded at: http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=shadow_shop_report_2006_pdf

[12] ASIC report, "Superannuation Switching Surveillance" can be downloaded at: http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=Super_switching_report_pdf

[13] The ASIC report can be downloaded at: http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=Advice_Report_pdf

[14] Ibid, Page 2

- consumers were rarely able to detect bad advice;
- in 46% of cases, advisers failed to give a written Statement of Advice where one was required.[15]

65. Of real concern to AIST was ASIC's finding that 85% of consumers felt satisfied with poor advice given to them, including cases where if they followed the advice, they would likely to be left worse off in retirement. This indicates that consumers are not in the position to judge whether advice is flawed, tainted or conflicted or that the adviser would stand to benefit financially if the consumer followed the advice. As ASIC itself stated, "*While some progress has been made, the cultural changes mandated by the Financial Services Reform Act are not happening quickly enough.*"

    65.1 While ever commissions are permitted in general, and specifically in relation to superannuation, consumers are subjected to conflicted and potentially flawed financial advice. This is supported by ASIC's Shadow Shopping Reports.

66. Further in relation to ASIC's report, it found that advice that was non-compliant was about **6 times** more common where the adviser had an actual conflict of interest over remuneration. Where the adviser had a conflict over remuneration, 28% of the advice clearly did not have a reasonable basis for advice. When ASIC used the figures to determine how this would affect a consumer's retirement savings, the calculator projected that consumers would be worse off at retirement based on the advice provided.

The recent corporate collapses of Westpoint, Fincorp and Australian Capital Reserve

67. There have been three major and high profile collapses of property investment companies which highlight the need for further regulation of the financial services industry for both consumer protection and market integrity purposes.

68. The 'Westpoint' Investment scandal has shown the industry the benefit of having financial services regulation. Over 3500 investors lost just under $305 million dollars as a result of the collapse. It's notable that the financial advisers giving the advice to investors received a reported 10-20% commission on any investments made.

    68.1 In general terms, some investors in Westpoint were advised by various financial advisers to borrow money to set up a self-managed superannuation fund ("SMSF"), roll in their current superannuation, as well as any equity they had in their mortgage on their family home, in addition to any personal savings. These SMSFs then invested into the Westpoint structure, and those investors' money was never to be seen again. Due to the nature of SMSFs and the ability to place superannuation and other assets into them, those investors have lost everything – their homes, their superannuation and all their savings.

[15] ASIC Shadow Shopping Survey on Superannuation Advice report, Page 2

68.1.1 Most of the investors were retired couples who averaged investments of around $90,000 each, some of which obtained mortgages on their homes to invest into Westpoint.

68.1.2 This type of miss-selling obviously impacts on consumer protection and confidence in the financial services market and severely impacts on the market's integrity.

68.2 Around February 2006, Westpoint had debts of $312 Million, including $3.5 million in unpaid employee superannuation benefits. It is very disheartening to think that not only did the investors lose their retirement savings, but also the Westpoint employees will also suffer in their retirement, in part due to the unconscionability of a group of advisers within the financial services industry.

68.3 Fallout from the Westpoint collapse has resulted in some major changes in the financial services industry, specifically with reference to the regulations relating to the compensation arrangements of Australian Financial Services Licensees. This has a flow-on affect in relation to professional indemnity insurance and how an industry-imposed standard will now underpin the provision of financial advice to protect consumers and investors. These issues are yet to be resolved.

69. Another example is that of the Fincorp Investments collapse. Over 8,000 investors, most of them retirees and inexperienced, unsophisticated investors (similar to the "mum and dad" demographic often mentioned in the media), invested $200 million dollars into Fincorp, specifically into its "diversified property fund".

69.1 Rather than offering safe, secured and diversified investments for investors, Fincorp was actually operating in an unsecured, high risk end of the mortgage market, which crashed. It is interesting to note that ASIC issued seven stop orders on Fincorp's prospectuses in an attempt to prevent the misleading statements being made to investors.

69.2 Back in September 2005, ASIC stated that, "*It is fair to say that the high-yield debenture market continues to be an area of concern and focus for us. The actions we have taken against Fincorp should covey...that we want this industry to get its act together sooner rather than later. This means sensible advertising and proper disclosure of what is on offer, including what the business really is and what risks are involved.*" [16]

70. Yet a third example of a similar collapse of Australian Capital Reserve further bolsters AIST's point that disclosure requirements should not be diminished, particularly in an environment which does not fully protect ordinary Australians and their retirement savings. AIST believes that consumer protection and market integrity cannot be achieved by reducing disclosure requirements.

[16] ASIC Media Release 05-290.

71. More than 20,000 small investors have lost almost a billion dollars in the Australian Capital Reserve ("ACR") property scheme collapse. There are approximately 8,600 "mum and dad" investors and retirees who are waiting to hear whether any of the $300 million-plus they invested into ACR will be returned to them.

    71.1 ACR is one of 26 companies under the banner of the Estate Property Group. ACR's role was to raise funds from the public that it then lent back to the parent group, Estate Properties, to fund its developments. The directors of the company stated in the media that, "we are internally running quite a stringent compliance regime." [17]

    71.2 Simon Ibbetson, Standard & Poors' Director of Investment Consulting has been quoted in the media as stating, in relation to ACR, *"We see in the press every day adverts for very speculative type of operations that are paying high commissions to financial planners and we just wonder where those schemes are going to end up."* He also believes that more companies of that ilk will collapse in the future. [18]

72. These three examples of miss-selling by financial advisers provide some evidence of the types of unconscionable financial advisers which operate in this financial market. Consumers must be protected from such advisers, and disclosure obligations is one way this is protection is achieved. Clearly the advisers who recommended these products to their clients failed the "know you client know you product rule" or establish a reasonable basis for making those recommendations. Otherwise they could not have recommended a product with such a risk profile to retirees. They did not understand the product or if they did they did indeed act unconscionably.

    72.1 To reduce such disclosure obligations will only provide further loopholes for some financial advisers to exploit at the expense of their clients, resulting in further loss for consumers.

    72.2 If an adviser is legally required to produce a detailed Statement of Advice in relation to the advice they have provided, as opposed to a mere Record of Advice, then the advisers will be required to identify (among other things) the risks and benefits of the investment, details of any remuneration they are to receive as a result of the investment, and all other relevant details.

    72.3 If this information is not provided in a Statement of Advice, then the consumer (and ultimately ASIC) is in a better position to determine whether the financial adviser had acted negligently, or in bad faith.

    72.4 But if the advice is only recorded on a ROA, it is probable that ASIC would have a much more difficult time in establishing that the

[17] In an interview with the Australian Financial Review in 2004.

[18] Reported in Michael Pascoe's "Money Matters" website: http://au.blogs.yahoo.com/michaelpascoe/31/more-property-related-collapses-to-come

adviser provided inappropriate advice. Such a move does nothing to protect consumer and ensure market integrity.

In the alternative, extension of the SOA Exemption should be considered for "within product" superannuation advice

73. In the alternative, if the Bill is enacted as proposed, AIST believes that the one exception to the above arguments in relation to the SOA exemption applying to superannuation is the ability of superannuation fund Trustees to provide "within product" advice to its members.

74. As the proposed section 946B(7) is drafted, it would not permit superannuation fund Trustees to provide their members with advice or provide education to members about their existing superannuation products, including in relation to investment choices or salary sacrificing, details about how to obtain the Government's co-contribution or the benefits of making extra contributions to superannuation.

    74.1 This appears to be an unintentional drafting anomaly and AIST recommends that the proposed subsection 946B(7)(a)(ii) be deleted to enable superannuation fund Trustees the ability to communicate effectively with their members, provide advice and strategic superannuation information, without needing to supply SOAs to each member.

Do these amendments *really* reduce compliance obligations?

75. AIST believes it is questionable that these amendments will in fact reduce the compliance obligations on financial advisers.

76. For example, a financial adviser will still be required to spend the time completing a "fact finding" document about the client to "get to know the client" before any advice can be provided. AIST has been informed that it is the time spent on this fact finding process which is one of the most time consuming for advisers, not in the preparation of the Statement of Advice. The analysis and consideration of various investment options and modelling is also quite time consuming, but not the actual "writing up" of the SOA.

77. Further, AIST cannot see that much time/compliance work will be saved in relation to the preparation of the Statement of Advice. This is because SOAs are prepared utilising a standard form pre-prepared template and either a para-planner or personal assistant can enter the information prepared by a financial adviser, which is then checked by the adviser.

78. Whilst an Record of Advice ("ROA") may save the financial adviser some time, it too will be based on standard form pre-prepared template, similar to the SOA, but presumably shorter and more of a "tick a box" style.

79. AIST submits that the approximate time estimated to complete an ROA in the Explanatory Memorandum, (that is, as being half the time of the

preparation of an SOA [19]) seems understated, given the above information .

80. AIST submits that given the above information, it is likely that the time a financial adviser spends on gathering the information needed to provide advice and the completion of the individualised advice documents (regardless of the investment amount) will not necessarily be reduced.

Evidence to Establish Adviser Liability Reduced

81. AIST has some concerns about the potential for liability issues where an adviser is only preparing a Record of Advice to record the advice given to a client.

    81.1 With limited information on file, how can the adviser, or ASIC, determine whether the adviser had a reasonable basis for their advice if there is no SOA to prove the adviser's rationale and advice to the client?

    81.2 Further, AIST submits that an adviser acting in good faith in accordance with their fiduciary obligations in relation to their client has nothing to hide and therefore should be fulsome in their recording of advice.

82. There is a risk that ASIC may not be able to determine the reasonableness of that advice, with serious consequences for the adviser. Therefore, a prudent adviser may decide to keep more records than is strictly legally required, just to ensure that their own liability is protected.

    82.1 This may also result in the legal fraternity informing financial advisers that whilst the law may have changed to permit shorter disclosure, and less information to be recorded on a ROA, that in fact, from a liability perspective, that the adviser is better protected if they keep detailed records of their advice. This will be unlikely to reduce compliance obligations even further.

An alternative to reducing disclosure requirements in the superannuation environment

83. A statement from the Explanatory Memorandum states that, *"[t]here is evidence that the cost of producing an SOA is not economic for an adviser where a client is seeking a minor piece of advice and/or has a relatively small amount of money to invest. Many advisers are choosing not to provide personal advice to such clients, with the result that in these circumstances small scale consumers may not be able to access advice that may benefit them."* [20]

84. Some of AIST's members have tackled this problem in a different way than reducing disclosure obligations. Superannuation Fund Trustees that

[19] Paragraph 7.2, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 127

[20] Paragraph 7.4, Explanatory Memorandum *Corporations Legislation Amendment (Simpler Regulatory System) Bill* 2007, Page 121

have been granted a "personal advice" AFSL, or utilise the services of a related company to provided personal advice to its members under the related company's own AFSL, are introducing a new layer of advice within the current regime.

84.1 There is an increasing prevalence of superannuation funds introducing a "limited" personal advice service for members of the fund.

84.2 This entails providing a suitably qualified financial adviser (who is commonly employed on a salary basis by the Fund, in this model, they never receive commissions as payment for their advice) providing personal advice based only on the specific fund's own products.

84.3 This advice is often limited to categories which are known to be of particular interest to members, such as investment choice options, contributions types and alternative and insurance arrangements. If a member requires broader advice, then the superannuation fund refers the member onto a suitably qualified financial adviser who is able to address those broader financial issues on a fee-for-service.

84.4 The popularity of these types of service indicates a need for members to receive advice on these areas, regardless of their account balances. A need which is fulfilled without having to reduce the disclosure obligations and therefore reducing consumer protections.

84.5 In fact, the argument can be made that it is the members with small account balances that really need that advice so that they can consolidate their superannuation, make extra contributions and get the benefit of compounding interest, as well as arming them with knowledge to make informed and knowledgeable decisions about their super.

84.6 Further, some superannuation funds have moved to amending their trust deeds to permit the payment of the in-house financial advice out of the member's superannuation fund account (up to certain limits per year, only when the member requests the advice and authorises the payment and subject to other relevant conditions). This model therefore would not require a member to pay for the advice out of their current income, but instead, would pay for it out of their superannuation account.

85. These alternatives are good solutions to the issue of providing advice to clients with low account balances without diminishing the consumer protections in place.

ROAs Should Only Apply to One Area of Advice

86. In the alternative, should this Bill be enacted, AIST submits that a Record of Advice should only be permitted to be provided where the consumer is seeking advice on *one* type of financial product, not a *range* of topics.

86.1 For example, if the client seeks advice on superannuation, insurance and estate planning, (and the total value of their investments is under $15,000), then the adviser should not be permitted to rely on the SOA exemption as the area of advice spans more than one type of financial product advice.

86.2 In such a situation, the adviser should be obliged to provide a full Statement of Advice to the client, weighing up the individual's needs, circumstances and objectives, and providing detailed advice across all of those different types of financial advice.

Further related issues for upcoming separate consultation

87. Rather than reduce disclosure requirements, AIST again submits that the better option would be to revise the definition of "financial product advice" to better allow funds to communicate and educate its members without tripping into "personal advice" territory. This is consistent with AIST's recommendation numbered ix., which would permit a superannuation fund Trustee to more properly educate and communicate with its members.

88. Further, AIST recommends that the "sales recommendation" proposed in the previous round of consultation not be pursued in relation to superannuation products, as superannuation products are not "sales" products per se.

88.1 Superannuation is a necessary and fundamental part of the Government's Retirement Incomes Policy and as superannuation is compulsory for all working Australians (who earn over the threshold to receive superannuation guarantee contributions), there is no element of "choice" of having the product or not. Choice is achieved via some members of superannuation funds choosing which superannuation fund should receive those compulsory contributions, but not in deciding whether to "purchase" a superannuation product.

88.2 Further, if a new term is created, that of a "sales recommendation", there is a risk that consumers will not be able to distinguish between those who are providing independent financial product advice, taking into account a person's needs, objectives and circumstances, and those who are merely "selling" a product and who will derive a financial benefit from selling that product. Given there is a lot of apathy and disengagement with superannuation in general, further complications and creation of new terms which may mean little to the general public, will only hinder that understanding, rather than assist it.

FINANCIAL SERVICES GUIDE EXEMPTION — GENERAL ADVICE TO THE PUBLIC

AIST supportive of the FSG Exemption

89. AIST is supportive of widening the exemption for the provision of a financial services guide to forums, whether or not they are open to the public.

PRODUCT ACTIVITY & DATA COLLECTION

AIST supportive of online reporting

90. AIST is supportive of the online reporting of PDS in-use notices, as it will save time, effort and money for superannuation fund Trustees, and therefore, members of superannuation funds.

E. AIST Contact Information

Should the Committee require further information, AIST would be happy to assist the Committee. The Committee can contact the following persons from AIST:

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