



Submission to Parliamentary Joint Committee on Corporations and Financial Services re Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007

Summary

CHOICE supports much of the bill and the intention behind it. CHOICE is however concerned that three provisions dramatically reduce consumer protection without any direct or indirect corresponding benefit for consumers.

IN particular CHOICE is extremely concerned at the proposal to include superannuation in the provision imposing a threshold on the requirement to provide a statement of advice.

Introduction

CHOICE has been active participant in the Corporate and Financial Services Review of Regulatory Burden process. We have supported the regulatory reform process on the basis that that reduced business compliance costs are eventually passed onto consumers. At times though it has also been necessary to oppose or amend some reforms on the basis that they may reduce essential consumer protection, which could ultimately cost consumers far more in the form of market failure.

In this submission we comment on the following terms of reference of the Inquiry into the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007:

- Exemption from providing a Statement of Advice where there is no product recommendation or remuneration;
- The threshold for requiring a Statement of Advice; and
- Sophisticated investors.

About CHOICE

CHOICE is a not-for-profit, non-government, non-party-political organisation established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the

information to make confident choices and campaign for change when markets or regulation fails consumers.

CHOICE is fiercely independent: we do not receive ongoing funding or advertising revenue from any commercial, government or other organisation. With over 200,000 subscribers to our information products, we are the largest consumer organisation in Australia. We earn the money to buy all the products we test and support our campaigns through the sale of our own products and services.

Our policy voice is widely recognised. We campaign without fear or favour on key consumer issues based on research into consumers' experiences and opinions and the benefit or detriment they face. Our current campaigns cover food, health, financial services, product safety, communications and consumer protection law.

CHOICE conducts research, publishes policy reports and online information, gives presentations and keeps the media informed of our policy views. We provide representatives for many industry and government committees and independent bodies considering matters of concern to consumers.

Exemption from providing a Statement of Advice where there is no product recommendation or remuneration

The Proposed Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 will mean that an entity providing advice does not need to prepare an Statement of Advice (SoA) to a consumer provided that:

- The advice does not recommend the acquisition or disposal of a specific product and that the entity does not receive any remuneration directly; and
- Where a SoA is not required the entity must provide a Record of Advice (RoA) that includes information about remuneration or other benefits, interests, and associations.

The purpose of this regulatory reform is to provide advisers relief from the requirements of a SoA for introductory meetings with clients "where general investment options may be discussed but no specific products are recommended". However, there is nothing in the Bill limiting this to the first or initial discussion between the consumer and adviser. This sets up a situation where in subsequent meetings, for example, 'hold' advice on an existing product can be given. The adviser could, for example, recommend a consumer stays in a particular product and continue to earn a trailing commission on that product, but not have to issue a SoA to the consumer.

There is also the possibility that an adviser could present recommendations or opinions about products implicitly rather than directly to try to avoid their obligations under a SoA.

At this stage it is also unclear what consumer protection disclosures the RoA will contain. Presumably, disclosure will involve a description of the nature of the advice, and an outline recommendations made, and basis for those recommendations. The RoA will also contain information relating to remuneration and conflicts of interest. However, the adviser is NOT required to present a copy of the RoA to the consumer. Instead, the consumer can request a copy if they wish.

CHOICE is concerned about the potential for the RoA to be used for on-going advice and the lack of detail on what information will form the basis of the disclosure on the RoA. For this reason we believe it is crucial that this proposal contain a number of additional forms of consumer protection. These include:

- **Recommendation 1:** The RoA should disclose the nature of the advice and the basis of that advice, remuneration and any conflicts of interest.
- **Recommendation 2:** 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. Failure to do otherwise would leave the RoA process open to abuse.
- **Recommendation 3:** Anti-avoidance measures should be developed for situations where advisers might try to present recommendations or opinions as initial information only requiring only a RoA.
- **Recommendation 4:** The 'no remuneration' test for relief from providing a SoA should be amended back to the original test in the proposal paper. 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.

Threshold for requiring a Statement of Advice

Originally proposal 1.3 in the proposals paper sought to provide relief for advisers on a SoA where advice was below \$10,000, Further superannuation advice was expressly excluded. The proposed Bill lifts the monetary limit from \$10,000 to \$15,000 and superannuation has now been included. However, superannuation is only included where it relates to existing superannuation products. For example, it would apply to consolidation advice on existing multiple superannuation accounts, but not apply to the sale of a new superannuation product.

While there is clearly a need to find ways of assisting consumers to consolidate their superannuation, we are not sure lightening the consumer protection requirements on a SoA is the best way to do this (or will in fact have much impact in the market). Our paper last year on *Multiple Superannuation Accounts* instead argued for a range of measures with some relief around general advice, an automatic real time account transfer system, and the more widespread use of tax file numbers as a unique identifier. We still believe these measures are better placed to engage the multiple accounts problem than the proposed monetary limit on SoAs. The problem of multiple superannuation accounts is far broader than simply whether consumers can access financial advisory services. Equally it is unclear that the relied proposed will see financial advisers making their services available to a typical consumer with a multiple account problem.

CHOICE has in previous submissions expressed a concern about how a monetary limit would apply to an accumulation product, such as 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. It is therefore very unfortunate that Treasury has given little thought to how this monetary limit will operate in practice. We also note that the empirical evidence about the affordability of advice and its relationship to the proposed \$15,000 limit is flimsy at best. We do not believe this limit has been rigorously tested. Our view in previous submissions was that if a threshold was proposed at all, it should apply to potential future amounts rather than the starting amount. The limit should also apply to the total amount under advice and not just the amount being consolidated or transferred.

We also have concerns about how the threshold will operate in non-superannuation areas prone to mis-selling and inferior product design. There is the potential for agricultural investment schemes and for property related investment schemes to be sold in \$14,999 units.

Accordingly CHOICE makes the following recommendations in regards to the threshold proposal:

- **Recommendation 5:** Superannuation should not be included in the products which do not require Statements of Advice where the amount in question is below the threshold.
- **Recommendation 6:** Anti-avoidance measures should be developed for situations where products are designed to be sold in multiple amounts of less than \$15,000 or where advisers might try to recommend additional units of an investment at a later time in amounts of less than \$15,000. The \$15,000 limit should apply to the total amount under advice and not just the amount that the adviser recommends be consolidated.

- **Recommendation 7:** If the threshold is to remain on superannuation then at the very least the Ro should be required to include: reason for the advice, advice given, disclosure of remuneration and conflicts of interest and crucially should also contain information about the “from fund”. There is no mention of “from fund” information in the Bill and this is necessary so that ASIC, the Courts, or an industry dispute resolution process can test the appropriate basis of the advice.

Sophisticated or Wholesale Investors

The proposal extends a wholesale investor test applying to securities investors into the realm of retail financial advice (except on superannuation, general insurance and RSAs). In effect, financial services licensees could “opt-up” clients from retail to wholesale investors provided the adviser can establish that the consumer has prior experience with the product or asset class and then documents the reasons for concluding the investor is sophisticated. The investor must also acknowledge the effect of being treated as a wholesale client.

The proposal will create a new mechanism in addition to the existing wholesale test where the consumer was classified a wholesale investor if they had net assets of more than \$2.5 million, or gross income in each of the last two years of at least \$250,000.

CHOICE is concerned that this 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:

- 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.

Advisers, in particular, are not ideally positioned to make a disinterested and independent judgment of their client's sophistication. Commissions and other forms of remuneration may provide an incentive to conclude that their client is sufficiently sophisticated to be classified as wholesale investors. There is a real danger that inexperienced investors, particularly those in self-managed superannuation funds, could be sold high risk investment products as sophisticated investors. They would have no access to the disclosure, appropriate advice tests, and compensation arrangements should the investment company go into receivership. The evidence from the Westpoint, Fincorp and Australian Capital Reserve collapses is that most of the investors losing money were far from sophisticated. Many were attracted to the products because advertising implied they would earn guaranteed returns. Very few of the investors understood the level of risk

exposure on these investments and in the case of Westpoint, many were recommended the product because the adviser could earn up to 12 per cent commission.

But these consumer risks will also create significant risks for wholesale markets and financial service licensees which could well offset any compliance benefits that may be gained by exempting a range of consumers from retail consumer protection provisions. Large numbers of consumers unable to absorb significant losses would create pressure for Government to intervene. Such a situation is likely to create a regulatory environment that will expand the regulatory burden at a later time rather than reduce it. Furthermore, the damage of even just one or two advisers using the sophisticated investor test to engage in fraud or misleading conduct is something that the reputation of the financial advise industry would not recover from.

Recommendation 6: The existing wholesale investor test of more than \$2.5 million or gross income in the last two years of at least \$250,000 a year income remains an appropriate test. CHOICE opposes any change to the existing sophisticated investor test.