1 May 2007

The Hon Chris Pearce, MP
Parliamentary Secretary to the Treasurer
Room R1.90
House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Parliamentary Secretary

I write to you in relation to one of the changes being considered by Treasury under the Corporate and Financial Services Review process.

CHOICE has been an active participant and supporter of the reform proposals because consumers benefit from better designed regulations and reductions in business compliance costs. We also believe that this can be achieved without compromising consumer protection.

One of the current government proposals that we believe requires further consultation is the proposal (1.3) to exempt the preparation of Statements of Advice (SOAs) on investments of $10,000 or less. We believe this proposal has the potential to harm consumers with less financial capacity to invest. We understand that proposal 1.3 is very likely to be soon drafted as legislation. We have not been able to determine from Treasury as to whether this provision will also to be applied to superannuation, although we understand it has been discussed by some industry groups as an option.

The proposal means that consumers may have little or no documentation on the financial advice they receive for investments on less than $10,000. This will make it very difficult for External Dispute Resolution schemes or ASIC when reviewing the appropriate basis of advice to consumers and will also have implications for any proposed compensation arrangements for financial services licensees. If proposal 1.3 were to be applied to superannuation products then consumers in part-time and casual employment (who are most likely to have low balance accounts) may be effectively denied access to consumer protection on the appropriateness of financial advice where a new superannuation product is recommended. The importance of this is clearly evident in ASIC’s enforceable undertaking against AMP on super switching advice last year.

The proposal has been justified by some industry groups and Treasury on the basis of expanding financial advice to consumers where previously it was uneconomic for an

adviser to provide that advice on such a small investment amount. CHOICE recognises that this is an important issue, and therefore warrants some greater consideration and discussion. Is such an exemption the most efficient or effective way to facilitate advice for consumers with lesser amounts to invest? Are there better ways to encourage such advice without reducing the protection available to consumers against poor or deficient practices?

If there is to be a monetary limit below which product advice would not require an SOA, we believe the proposal to set the limit at $10,000 may be too high. We are not aware of any economic modelling or other research to justify this limit. Further, we are concerned about how the limit would be applied to an accumulation product such as superannuation. If there is to be a monetary limit to a superannuation product involving ongoing contributions then it may be more appropriate to apply this limit to the likely contribution over five or ten years, rather than simply applying to the first payment or current balance.

The proliferation of multiple superannuation accounts is a significant concern which we highlighted in our report earlier this year *The Super Secret: How multiple accounts are costing consumers billions*. However we do not see proposal 1.3 as an appropriate solution to the problem, nor was it a recommendation in our report. Instead, we proposed a package of solutions, including a proposal that relief under FSR could be granted for general advice regarding the benefits of consolidating superannuation accounts (but not advice tied to a switching recommendation).

We commend Treasury on its handling of the proposal 1.1, where further comment was sought in a constructive and successful way. We believe further consideration is also required of 1.3. As yet we have seen no regulatory impact statement accompanying the proposal.

Thank you once again for the opportunity to participate in the Corporate and Financial Services Review process.

Yours sincerely

Peter Kell
Chief Executive Officer

Parliamentary Joint Committee on Corporations and Financial Service

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

June 13, 2007

Supplementary Submission

The primary purpose of our submission to the Committee is to recommend that those parts of the Bill that implement the proposed threshold test for provision of a Statement of Advice be delayed. The first reason is that many of the problems they address will be better addressed through alternative proposals that are currently being considered, and that the Bill does not provide a satisfactory approach to the remaining problem which is the problem of access to financial advice.

If that recommendation is accepted then we would like to provide reasons why the watering down of the current Bill proposed by some industry stakeholders not be considered.

CHOICE approach to FSR and disclosure

1. CHOICE welcomes the continued government work on simplifying the Corporations law including the financial services reform regime. Other than the two matters that we have highlighted the provisions in the bill are in our view positive improvements or unobjectionable.
2. We are however concerned that neither this bill nor any other current work program really gets to grips with the basic problems underlying the approach to consumer protection contained in the current financial service regime.
3. Some elements of the FSR regime are unambiguously successful. These include the licensing, competency and dispute resolution elements. Licensing has contributed to more effective compliance monitoring. The dispute resolution regime has massively increased access to redress for consumers who have suffered loss due to default by financial service licensee. The competency requirements in combination with the requirement to provide a statement of advice have meant that many inappropriate advisers have left the industry.

4. But the same cannot be said for the disclosure regime as it operates in practice. The requirement to provide 'clear, concise and effective disclosure' is more often honoured in the breach than complied with. There are a number of explanations for the fact that the disclosure regime has offered only partial consumer protection and sometimes imposes unnecessary cost on industry. One of these is the risk averse behaviour exhibited by industry players particularly company directors and legal advisers. Another is firms ability to tailor the disclosure documents to suit their needs. Where firms want to communicate they employ communications professionals and succeed. Where they are obliged to disclose things they do not want consumers to know, the get lawyers to insert the bare minimum information. Another is the excessively complex products and payment structures that need to be disclosed. But the fundamental problem is that disclosure is being asked to do what it cannot possibly achieve. Disclosure cannot overcome problems causes by conflicts of interest, overly complex products, systematic behavioural biases or misleading marketing. Until government is prepared to come to grips with the need to increase the range of available 'regulatory tools', disclosure will remain both overly complex and often ineffective in providing consumer protection.
5. Nevertheless, in the absence of effective policy responses to problems such as this, the Statement of Advice remains a key consumer protection tool, as much for the aid it provides for after the fact dispute resolution, compliance monitoring and enforcement as for the degree to which it aids consumers make informed decisions in their best interests.
6. The disclosure regime was a rational regime on a good policy basis but it has been undermined by the factors listed above. Current thinking seems to suggest that we should get rid of the disclosure regime without addressing the problems that have undermined it.
7. Essentially we do not think that a monetary threshold is an effective approach to the set of problems we face. To the extent that the Bill is trying to come up with a 'Statement of Advice' lite – an SOA which is truly 'clear, concise and effective' – it may well be appropriate in a far *wider* range of situations (provide s947D applies) in addition to the other matters covered.

Assumptions about the cost burden on industry

The FSR simplification process has proceeded on a relatively simplistic set of assumptions about costs imposed by the paperwork requirements of FSR. Sometimes broad statements are made about the cost of regulation. Rarely are the corresponding benefits identified at the same time, nor are the precise nature of the particular costs examined. Regulation which imposes requirements for training and documentation plainly imposes direct costs. Regulation which prescribes a standard will generally reduce direct costs. It may also reduce innovation, make innovation possible, or have no effect on innovation. Regulation which prohibits certain harmful behaviours is likely to result in various costs being avoided altogether.

In the case of FSR there are at least three types of cost complained of:

a. the direct costs of producing accurate disclosure documents
b. staff training costs

c. the costs of complexity – designing procedures, working out what to put in the disclosure documents and cover in the training for particular products and fact situations

Proposals 1.1 and 1.2

The Proposals Paper released by the Parliamentary Secretary to the Treasurer in November 2006 contained a number of proposals including a pr.

Proposal 1.1 as there drafted met with little support but we understand discussion is still continuing. It has not yet been settled and is not included in this Bill but we understand that work on a modified form of this proposal continues. It is somewhat bizarre that these closely related proposals are proceeding separately as they will interact.

In particular we understand some industry bodies are promoting a model which would see certain simple well understood products removed from the personal advice regime (maintaining licensing, dispute resolution and some limited training requirements), together with some narrowing of the circumstances in which the personal advice requirements apply.

Some such proposal may have merit, although there would need to be careful consideration of the precise circumstances where the personal advice test was narrowed. *If it was successfully concluded it would in our view would significantly reduce the need for the proposed monetary threshold.*

Given that these proposals inter-relate we do not think that the current proposals should proceed in the absence of a settled response to proposal 1.1.

We strongly recommend that these reforms be excised from the bill allowing the remaining reforms to proceed.

Reducing the Regulatory Burden

The EM claims that the Bill will ‘reduce the regulatory burden on providers of financial services, increase access to financial advice’. Other parts of the Bill will do so – for example the provision enabling corporations to provide annual Reports by email.

It is far from clear that the provisions that we object to will do so. We think they will in fact increase complexity. We note that in some other submissions questions of exactly how they apply have been raised. These are fair questions and suggest that a fundamental rethink of consumer protection in financial services is preferable to the current approach – to tinker with imperfect arrangements.

In particular we note that the EM claims “The amendments are expected to reduce cost burdens for a number of financial services licensees, which are expected to result in cost savings for their clients. An example is the potential cost reduction for licensees of providing advice to clients with relatively small amounts to invest.”

We think that these cost savings will largely be illusory; for example it will not save training costs as all staff will still need to be trained to deal with situations where the

amount involved is greater than the threshold; however they will now have to be trained in knowing when the threshold applies – which as we have seen is not an easy task in all circumstances, and a new risk for business - the risk of wrongly applying the threshold will be created.

In any event, any costs savings through introducing the threshold will certainly be dwarfed by the costs savings that will apply if an effective response to proposal 1.1 can be delivered.

Will it increase access to advice?

We do not believe that the threshold proposal will significantly increase access to advice to those who are currently in need of advice but going without. There is no evidence that many financial advisers are interested in providing advice to clients with small amounts of money to invest. Nor is it likely that advisers will have the right skill set for this client group (eg good knowledge of social security law). The lack of access to financial advice is a real problem; but it is not one that should be addressed in an ad hoc way. The cost saving in preparing a statement of advice – given that to do a competent job the adviser will have had to do the intellectual work required – is not going to be such that it overcomes other barriers to connecting the right advisers to the right clients at the right price.

The downsides to the proposal outweigh any benefits

By removing the requirement for an SOA for amounts below the threshold, the proposal will reduce the ability of ASIC to monitor and enforce compliance with the law and standards of competence and will reduce consumers'' ability to make out their case if they wish to claim compensation.

Does the Regulatory Impact Statement Justify the Change?

The RIS proceeds on the basis that removing the SOA requirement will increase the willingness of advisers to provide advice to people with smaller amounts to invest. This case is not made in the RIS.

The argument in the RIS about costs incurred by planners is flawed. Under the heading *Identification of problems, options, impact analysis, conclusions and recommendations in relation to the Statement of Advice threshold (Proposal 1.3)* the RIS suggests that planners incur costs of $260 in preparing a statement of advice and that at a commission rate of 1% they would need to provide advice on $26000 investment before advice would be viable.

It is not clear that the $260 relates to work that the planner will not have to otherwise do. As noted above the planner will need to do the relevant intellectual work such as considering the problem, researching the options and formulating the advice in any case. It is quite proper that the planner be paid for this work. It is merely the paper work in preparing an SOA which is additional. Much of that is consistent across all clients and can be prepared as standard text/choice from options. Further the alternative to preparing an SOA is not no paperwork at all. In any circumstance the adviser should make a note of the advice given. Under the proposals the adviser must further prepare a record of advice which meets the requirements of the Bill. This is not a zero cost alternative. So the cost saving is grossly exaggerated in the RIS.

But on the other hand, the issue of when advice becomes economical is underplayed. No mention is made of the requirement for the planner to make a living, or the common expectations of the income to be made from each client.

The hypothesis that most competent advisers would not be interested in providing researched and skilled advice to a person who had less than say $500 or $1,000 to pay to them (directly or through commission payments) is not considered. Anecdotal evidence suggests that it may be the case. In other words reducing the cost of advice by $260 or more likely a much lower amount is not likely to generally increase access to advice but will remove consumer protection from those consumers who rightly or wrongly are classified as fitting within the threshold.

The RIS states that the objective may be achieved as follows:

"Appropriate reduction of the costs of providing advice may encourage the provision of small scale advice by advisers and improve access to advice for consumers currently excluded from the advice market."

There is absolutely no evidence that reducing planning costs by even $260 – although we assert that the reduction will be much less – will increase access to advice.

This is not the way to increase access to advice. An entirely different solution is required. Financial planners are not the only potential source of advice for consumers with low amounts to invest and they are certainly not the only potential source of advice for consumers who need to consolidate their super funds.

Small investors need the most protection

Small investors are most likely to be more vulnerable to loss. They are less able to withstand any loss or bad advice. And on average small investors are less likely to be financially sophisticated, in particular less likely to remember oral information about matters they are not familiar with and thus need more than others disclosure which is in fact "clear, concise and effective."

Role of SOA in compensation and enforcement

The RIS appears to have overlooked the role that an SOA plays in protecting consumers through assisting them pursue remedies where advice is inappropriate and in assisting the enforcement agency ensure quality of advice.

Access to Advice can be improved through other means

Rather than create a monetary threshold, it would be possible to create a specific exemption for personal advice in the following circumstances

- no current fund includes a defined benefit,
- no current fund is a corporate fund,
- no specific product recommendation is made.

In these circumstances the adviser would be deemed to be giving general advice. Potential advisers include fee for service advisers, super funds and certain non-profit advice services. The advice would be generally very straight forward, would

encourage consumers to identify exit fees and then choose which of their current funds or other potential fund (eg current employer's default fund).

No product recommendation, no remuneration

We note the Financial Planning Association submission suggesting that remuneration should be allowed. As we understand it, it is not the purpose of this amendment to crate a new class of remunerative business, but to avoid the situations where an adviser (whether a planner or in some other role) cannot have a sensible discussion with a potential client without risk of triggering the personal advice requirements. We do not support the FPA recommendation.

On the other hand the ABA has suggested that the provision would not entitle an adviser to recommend a class of product; for example they could not say "you are obviously near retirement and risk averse so we think you should have a reasonable portion of your investments in low risk products such as term deposits" or as the case may be. We have not formed our own opinion but if this is the case then we would be sympathetic to amendments designed to overcome the problem.

Consolidation Advice

As noted above our preference is that the need for better access to advice be dealt with in other ways, and as a minimum that the threshold provision be deferred pending resolution of Proposal 1.1. If that approach is not adopted we believe it is essential that the record of advice kept on file and provided to the consumer record the reasons that the to fund is preferred to the from fund. What is the point of providing advice if it does not address this question? And if it is addressed then it should be recorded. As we understand it this would require s 947D to apply.

Gordon Renouf
General Manager, Policy and Campaigns

Attachement: Letter to Parliamentary Secretary