



**Industry
Super
Network**

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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Mr Sullivan

Parliamentary Joint Committee: Inquiry into the *Simpler Regulatory System Bill 2007*

Please find attached the submission to the above Inquiry from the Industry Super Network. Please contact me on 03 9657 4374 if you require further information.

Yours sincerely

A handwritten signature in black ink that reads "David Whiteley".

DAVID WHITELEY
Executive Manager



**INDUSTRY SUPER NETWORK
SUBMISSION**

**PARLIAMENTARY JOINT COMMITTEE
INQUIRY INTO THE *CORPORATIONS
LEGISLATION AMENDMENT (SIMPLER
REGULATORY SYSTEM) BILL 2007***

INDUSTRY SUPER NETWORK SUBMISSION

**TO PARLIAMENTARY JOINT COMMITTEE INQUIRY INTO THE
CORPORATIONS LEGISLATION AMENDMENT
(SIMPLER REGULATORY SYSTEM) BILL 2007**

1. About Industry Super Network

The Industry Super Network (ISN) is a division of Members Equity Bank Pty Limited and has been established to address issues and projects of collective concern to industry super funds including shareholders and clients of Members Equity. Members Equity Bank is owned by 40 large industry super funds.

Industry super funds manage over \$170 billion in funds under management and cover approximately half the workforce.

2. Executive Summary

The purpose of the *Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007* (“the Bill”) is to make financial advice more accessible to consumers by providing regulatory relief to financial advisers without diluting consumer protection.

As we have previously stated, ISN submits that regulatory relief should only be considered in conjunction with a full and thorough review of the financial advice system and consideration of the introduction of a “best interests” test for financial advice. This test would require all advice to be in the best interests of a client and would serve to bring the obligations of advisers to their clients in line with the obligations upon lawyers, doctors and superannuation trustees.

Notwithstanding our concern about the need to undertake a more thorough review of the regulations in the light of professional obligations of financial advisers, ISN makes the following submissions:

2.1 SoA exemption for No Buy or Sell Recommendation, No remuneration

The Bill proposes to exempt advisers from having to provide a SoA where they provide personal advice which does not involve a buy/sell recommendation.

Four key areas must be addressed:

- (a) This exemption should extend to “within product” advice – that is, advice on the features of a product which is already held. As it is currently drafted, the exemption does not permit superannuation trustees to provide their members with advice about their existing superannuation fund including advice on asset allocation and the making of additional contributions (including the government co-contribution).

A minor amendment to this proposed exemption will deliver significant benefits to over five million Australians, who could then receive more

scalable advice from their existing superannuation fund. This is consistent with the principal objective of the Bill, which is to increase access to financial advice.

- (b) The Bill must explicitly require a RoA to be provided to a member/client and clearly set out any conflicts of interests and remuneration (whether direct or indirect) resulting from the advice.
- (c) There is no reason why 'hold' advice should be treated differently from buy and sell advice if the adviser is receiving advice related remuneration. There can be conflicts of interest embedded in hold recommendations especially where the planner is remunerated by way of trail commission.
- (d) The proscription on receiving remuneration must refer to direct *and indirect* sources of remuneration.

2.2 Small Investment Advice – SoA Exemption

The Bill also proposes to exempt a financial adviser from the requirement to provide a statement of advice where the advice relates to a small investment advice (<\$15,000).

There is inadequate explanation as to why the threshold has been increased from \$10,000 to \$15,000.

While we continue to have some concerns about the application of the exemption to superannuation advice on amounts under \$15,000, we agree that the objective of increasing access to advice for small-scale investors is meritorious. In order to ensure that the reforms achieve this end without unintended side effects we would urge the Committee to ensure that the \$15,000 threshold is well defined so that the *total amount under advice* does not exceed this threshold.

To avoid the dilution of consumer protections, it is also critical that the RoA includes a written record of remuneration and conflict of interest disclosure and the consequences of switching information.

2.3 Sophisticated Investors

The Bill also provides a mechanism for advisers to define their clients as sophisticated investors, provided the client exhibits prior experience or expertise. While superannuation has been exempted from the mechanism we are concerned this could be expanded to superannuation at a later time. We also think that it is inappropriate to include the 'sophisticated investor' exemption in the financial product advice and disclosure chapter of the Corporations Law and that the current definition between retail and wholesale investor is adequate.

The 'sophisticated investor' test must continue to be objective (ie asset or income based) and not a subjective test to be made by a financial adviser.

We will now provide more detailed submission on these proposals.

3. Statement of Advice exemption - No recommendation to buy or sell, no remuneration

It is clear from the Explanatory Memorandum (EM) and the Items of the Bill that this proposal, which has evolved from Proposal 1.2 of Treasury's Proposals Paper, is only designed to give relief to financial advisers in a narrow set of circumstances. An adviser would not need to prepare or provide a SoA where:

- they do not recommend or state an opinion in respect of the acquisition or disposal of any specific financial product or products of a specific issuer
- they do not recommend or state an opinion in respect of modifying an investment strategy or a contribution level in relation to a financial product held by the client;
- the adviser, licensee or employing entity do not receive any direct remuneration or other benefit for or in relation to the advice (other than remuneration that is currently being received for an earlier acquisition of a product).

Where the exemption applies, the adviser would not need to provide a SoA to the client but would only need to make a Record of Advice (RoA) provided. The contents of the RoA is not set out in the Bill, but we are advised by Treasury that regulations are being drawn up that would replicate current regulation 7.7.09. Regulation 7.7.09 provides that a record or advice must set out:

- the advice given to the client;
- if information about the consequences of switching products is required to be provided under section 947D(2) or (3)¹, the information or statement or brief particulars of the information provided;
- brief particulars of the recommendations made and the basis on which the recommendations are made.

The Bill also provides that in the same communication used to provide the advice the adviser must give the client information relating to remuneration and conflicts of interest, if this information would have been required to be included in a SoA. The client can request a copy of the RoA under s942B(8) or 942C(8).

The concerns we have about this proposal are as follows:

- It was initially assumed that this proposal would give relief to advisers and superannuation funds in terms of them being able to provide meaningful within-product advice to members, for instance about asset allocation, contribution levels including eligibility for the Government co-contribution, provided there was no remuneration associated with the advice. However, it is now clear that the exemption does not currently cover this situation.
- ISN submits that this provision should be extended to permit personal advice *within a product* where the providing entity does not receive any remuneration related to the advice, directly or indirectly. If the aim of this reform is to make

¹ These subsections relate to advice to dispose of a product and acquire another, and require the adviser to provide information about the charges a client will incur in respect of the disposal or acquisition and any pecuniary or other benefits that the client may lose, or other significant consequences for the client as a result of taking the recommended course of action.

advice more accessible to consumers, then enabling funds to provide within-product advice would be a more cost effective way of enhancing the coverage of advice without compromising the quality of advice or consumer protection. The advice needs of many consumers, particularly low-income earners, are largely limited to simple issues related to their superannuation – voluntary contributions, salary sacrifice, investment allocation and insurance provided within the product. By extending the ‘no buy or sell recommendation, no remuneration’ exemption to within-product advice, Government would ensure that the 5 million members of industry, corporate and public sector superannuation funds also benefit from the cost and access benefits of regulatory relief.

- Additional, incidental or indirect fees or costs of the within-product advice would be included as part of the advice. For instance, if the advice recommends a change in asset allocation which results in a different investment management fee (whether higher or lower), this would be prominently disclosed in the RoA.
- The EM explains that the exemption is framed to apply to ‘a free initial consultation at which general investment options may be discussed but no specific products are recommended.’ However, the exemption also applies to consultations where a client is recommended to hold a particular product, even where the adviser is earning a trail commission on the advice. It is not limited to a situation where an adviser has an initial, general discussion of investment classes.
- There is no reason why ‘hold’ advice should be treated differently from buy and sell advice if the adviser is receiving advice related remuneration. There can be conflicts of interest embedded in hold recommendations especially where the adviser is remunerated by way of trail commission.
- The proscription on receiving remuneration in order to make use of this exemption from having to provide a SoA must refer both to direct *and indirect* remuneration. Regulatory relief should not be provided in situations where advisers receive indirect forms of remuneration.
- A related concern is that the exemption applies to situations where an adviser recommends investment in a particular asset class or classes – for instance, SMSFs, master trusts, unlisted property trusts (for example Westpoint, Fincorp and Australian Capital Reserve). A recommendation to invest in an asset class or classes even if not product specific is essentially about the formulation of long term strategy. Research points to this being critical in determining long-term investment performance. To ensure that consumer protection is not compromised in this situation, it is essential that the RoA contains sufficient detail of the “basis on which the advice was given” and that the adviser must provide the consumer with a copy of the RoA.
- There is no ‘reasonable person’ test in the way that this subsection is drafted – it states “the advice does not recommend or state an opinion ...”. This potentially makes this exemption available to advisers who give recommendations without explicitly expressing them as such. The wording of this section is much looser than the definition of financial product advice in the current section 766B.³ A

³ s766B(1) For the purposes of this Chapter, financial product advice means a recommendation or a statement of opinion, or a report of either of those things, that: (a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products,

reasonable person test provides some additional protection for consumers where the adviser makes recommendations which are not explicitly expressed as such (ie “...if a reasonable person would believe that the adviser was making a recommendation or stating an opinion...”).

- The way that these provisions are currently drafted, remuneration and conflict disclosure is not currently required to be recorded and need only be communicated in the format used to provide the advice; which is likely to be oral in most cases. Remuneration and conflict disclosures should be required to be recorded. We are advised by Treasury that regulations will be drafted to include a requirement to record remuneration and conflict disclosures in the RoA. We set out the minimum contents for all Records of Advice in the table below.
- The adviser should also be required to present the RoA to the client – this would not impose any cost on the adviser (other than the printing costs, which are negligible) but would substantially reinforce consumer protection. It should not be incumbent on the client to ask for a copy of the RoA.

Minimum Contents of A Record of Advice	
The Advice	The advice given to the client by the providing entity; including brief particulars of the recommendations made, the basis on which they were made, and any changes in cost/fees
Information about remuneration	Information about any remuneration (including commission) or other benefits that is received that might reasonably be expected to be or have been capable of influencing the advice given
Information about conflicts of interest	Information about any other conflicts of interest, associations or relationships between the providing entity and any of its associates or product issuers that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice
Information about the consequences of switching	If the advice is or includes a recommendation that the client dispose of or reduce the client’s interest in, all or part of a particular financial product and instead acquire all or part of, or increase the client’s interest in, another financial product, information about the charges a client will incur in respect of the disposal or acquisition and any pecuniary or other benefits that the client may lose, or other significant consequences for the client as a result of taking the recommended course of action.

3.1 Recommendations:

1. The exemption should apply to within-product advice provided that there is no advice-related remuneration earned in relation to the advice. This could be achieved by removing draft section 946B(7)(a)(ii) in Item 118 of the Bill.
2. Remuneration and conflicts of interests should always have to be included in the RoA. It is our understanding that Treasury are drafting regulations which would include this requirement.

or an interest in a particular financial product or class of financial products; or (b) could reasonably be regarded as being intended to have such an influence.

3. The RoA must always be provided to the consumer. This could be achieved by adding a new subsection after draft subsection 946B(9) which is in the same terms as draft subsection 9546AA(5) & (6) in Item 117 of the Bill.
4. Amend draft subsection 946B(7)(a) to include a reasonable person test – i.e. “...if a reasonable person would believe that the adviser was making such a recommendation or stating an opinion”.
5. Remove the words, “(other than remuneration that is currently being received for an earlier acquisition of a product)” and add the words “or indirectly” after “...the following persons do not directly...” from proposed subsection 946B(7)(b).

4. Statement of Advice Exemption for Small Investment Advice

This proposal has grown out of Proposal 1.3 of Treasury’s Proposal Paper and provides that an adviser does not have to issue a SoA to a client where:

- the amount being advised on is less than \$15,000- however it should be noted that this takes into account only the amount being advised on. For instance, if you have \$25,000 in a retail super product (or even \$100,000) and \$14,999 in an industry fund, and the adviser wants to advise on transferring the industry fund account into the retail fund, then the advice would be considered to be ‘small investment advice’.
- the advice does not relate to a derivative, a general insurance product, a life insurance product (except to the extent that super advice relates to a life insurance product) or a super or RSA product, unless the client already has an interest in the product.

The adviser would need to provide a RoA and again, we are advised that regulations are currently being drafted which will provide that the record would need to set out:

- the advice given to the client
- if information about the consequences of switching products is required under section 947D(2) or (3), the information or statement⁴ or brief particulars of the information provided;
- brief particulars of the recommendations made and the basis on which the recommendations are made.

The Bill also provides that the adviser must give the client a copy of the RoA and information relating to remuneration and conflicts of interest, where this information would previously have been required in an SoA. It is not expressly provided that information relating to remuneration and conflicts must be recorded in the RoA. The RoA must be given as soon as practicable after the advice is given and before any further services arising out of the advice are provided to the client.

We have a number of concerns about this proposal:

- No case has been made for the increase in the threshold from \$10,000 to \$15,000.

⁴ See footnote 1

- In principle, it is our view that this exemption should not apply to superannuation. Superannuation is a compulsory form of saving and in order to ensure the highest standard of advice is provided to consumers, we submit that advisers, like superannuation trustees, should be required to act in their client's best interests.
- Superannuation is about long-term accumulation and so the impact of mis-selling can be significant, even if the initial amount invested is under \$15,000. For this reason, it is misconceived to apply a threshold in relation to regulating advice on superannuation products. For example the impact on retirement savings of a recommendation to switch from an industry super fund into a retail super product could be significant. Assuming an average investment market, a 25 year old with a current balance of \$14,999 who is recommended to switch from a major industry super fund into a major retail master trust product would retire with **\$161,147 or 33.7% less superannuation**. See Table 1 for the basis of this case study.
- The policy rationale for creating this exemption was to enable 'small scale' investors to access affordable advice. However, the exemption is cast in far broader terms and is not currently limited to small investors. In our view this type of reform would have benefited from substantial empirical research on consumers' advice needs and on the barriers to accessing that advice, especially for low-income earners.
- If there is no requirement to record disclosure of remuneration and conflicts, surveillance and monitoring by ASIC, dispute resolution before the SCT and legal action on inappropriate advice will be nearly impossible. The regulations must include a requirement to record disclosure of remuneration and conflicts of interest in the RoA, otherwise consumer protections will be substantially reduced by this reform. It is important that if advice is to be made more accessible, then the quality of the advice provided is not compromised.

4.1 Recommendations

Notwithstanding these in-principle objections, however, ISN broadly supports this proposal, provided consumer protections are not diluted, which could be achieved by the following safeguards:

1. The \$15,000 threshold should apply to the total amount under advice, not just the amount being transferred or consolidated.
2. The remuneration, conflict of interest and 's947D' consequences of switching disclosures must be recorded in the RoA.

5. Sophisticated or Wholesale Investors

Chapter 7 of the Corporations Law, which deals with financial product advice and disclosure, currently enables an investor to be treated as a wholesale investor only if they satisfy an objective test, having net assets of more than \$2.5 million or gross income in the last two years of at least \$250,000 a year. This proposal seeks to create a further mechanism for those receiving financial advice (except on superannuation, general insurance and RSAs) to be treated as wholesale investors. Financial services licensees

who are satisfied on reasonable grounds that the client has prior experience with the product or service, is not using the financial product or service in connection with a business and then documents the reasons for concluding the investor is sophisticated can treat the investor as a wholesale client. The investor must also acknowledge the effect of being treated as a wholesale client. The ramifications of being treated as a wholesale rather than retail client are significant- the client foregoes a broad range of rights and consumer protections, including:

- financial service product disclosure;
- receipt of a Financial Services Guide;
- the requirement for advice to be provided by the licensee which has a reasonable basis;
- the provision of a Statement or Record of Advice;
- other protections including compensation arrangements for fraud or negligence.

Both the 'wholesale' (ie high net worth) and 'sophisticated investor' mechanisms exist in Chapter 6A of the Corporations Act; however the activities regulated in that part of the Act (issues of securities) are different in nature to those covered by Chapter 7. In particular, we believe that there are many investors in the SMSF sector who are less experienced investors but who could be wrongly classified as wholesale investors. The remuneration structures and conflicts of interest in the financial advice industry will mean that in some instances, advisers will make subjective, self-interested decisions regarding the level of sophistication of their clients given the significant reduction in regulatory compliance associated with this decision.

5.1 Recommendation

It is our view that given the activities regulated by Division 7 of the Corporation Law, it is not good public policy to create a 'sophisticated investors' exemption in the definition of retail client.

ISN submits that the test remain objective and not a subjective test to be made by a financial adviser.

	Average Market	% Difference	Weak Market	% Difference	Good Market	% Difference
AMP Flexible Lifetime Balanced (70/30)	\$478,303		\$208,830		\$772,695	
AustralianSuper Balanced	\$639,450	33.7%	\$270,416	29.5%	\$1,036,117	34.1%

Calculations:

Starting account balance is \$14,999, initial salary is \$50,000

Inflation rate of 3% and 4.5% wage increased rate

9% Superannuation Guarantee contribution

No additional salary sacrifice or voluntary contributions

15% contribution tax

Income is paid at the end of every year (i.e. compounded annually)

Contributions are made annually at the start of the year

Explicit costs deducted from members' accounts (e.g. member fee) is subject to a 15% tax allowance.

No additional personal contributions

An average tax rate of 6% is assumed for investment earnings

Age		25
Income	\$	50,000
Account	\$	14,999
Personal Cont		0
Retirement Age		65

Fees:

Any contribution fees, entry fees, exit fees, and/or additional adviser fees are excluded from the default position of this model. However, contribution fees can be modeled by operator.

All fees (asset based admin fees, investment fees and member fees) are deducted from the account at the end of each period (year)

Asset based admin fee is also subject to different level of employer asset sizes (i.e. asset size discounts are used on each scenario, if applicable)

AustralianSuper fees are taken from latest available PDS effective 1 April 2007. AMP Flexible Lifetime fees taken from My Super Simulator effective 1 July 2007.

Investment Earnings:

The rates of investment returns applied are as follows:

Investment mix	Investment returns (per annum)		
	Weak market performance	Average market performance	Strong market performance
Balanced	5.00%	9.00%	11.00%

Assumptions taken from AMP - "My Super Simulator"

