Chapter 7

Remuneration models for financial advice

7.1 This chapter analyses the effect of different remuneration models on the standard of superannuation advice. The committee discusses potential conflicts of interest in commission-based remuneration models. It also notes issues associated with paying ongoing trailing commissions, the use of approved product lists and 'tied' adviser relationships. Remedies to improve the quality of superannuation advice are then examined including suggestions to ban commissions and shelf fees, improve disclosure of conflicts of interest, mandate a higher standard of advice and facilitate the provision of fee-for-service advice. Finally, the committee discusses the important role of education and financial literacy to equip current and future superannuation fund members with the capacity to navigate the new superannuation environment.

Legislative standard for financial advice

7.2 The standard imposed by the *Corporations Act 2001* (Corporations Act) is for there to be a reasonable basis for advice. In meeting this standard, section 945A stipulates that the entity providing advice must comply with the suitability rule, which is comprised of the following three criteria:

(i) knowing the client's personal circumstances;

(ii) knowing the product or subject matter the advice is given on; and

(iii) ensuring that the advice is appropriate to the client.

7.3 ASIC has indicated that 'personal advice does not need to be ideal, perfect or best to comply with the Corporations Act'.[1] Therefore, so long as disclosure requirements are met, it is legally permissible for an adviser to recommend a product privately knowing it is not the best option for the client.

7.4 The standard of advice on superannuation has been most questionable where clients have been advised to transfer their fund balance from one product to another. The introduction of ASIC's policy statement on providing financial product advice states that:

> In the case of advice to replace one product with another product (or to switch between investment options within a financial product), we consider that consideration and investigation of both the new product (or option) and the old product (or option) is generally required under s945A(1)(b).[2]

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1 ASIC, *Policy Statement 175*, 'Licensing: Financial product advisers – conduct and disclosure', November 2005, p. 37.

2 ASIC, *Policy Statement 175*, 'Licensing: Financial product advisers – conduct and disclosure', November 2005, p. 31.

7.5 It indicates that switching advice would not be appropriate if there is no net benefit to the client in doing so:

> In the case of advice to replace one product with another product (or to switch between investment options within a product), we consider that the advice will generally be inappropriate if the providing entity knew (or ought reasonably to have known) that the overall benefits likely to result from the new product (or option) would be lower than under the old product (or option).[3]

7.6 In evidence, ASIC reiterated the importance of enquiries being made into the exit fund:

> The AMP enforceable undertaking deals with that issue. That is one of those examples where I think there is still some industry anxiety about obligation of inquiry. We are sympathetic where it is quite difficult to get details about the possible exit fund, but we have stayed firm that you cannot provide people with good, reliable advice to go from A to B without knowing something about A as well as B.[4]

7.7 The examples of unreasonable advice in a 'switching' scenario were highlighted by the results of ASIC's shadow shopping survey on superannuation advice, released in April 2006. Most significantly, ASIC reported that unreasonable advice was between three and six times more likely where a conflict of interest was present.[5]

Remuneration models

7.8 As referred to in the previous chapter, the majority of fund members do not seek professional advice on the management of their superannuation balance. For those who do seek professional guidance, there are a number of ways in which the adviser can be remunerated for it. These include fee-for-service and commission-based payments, the latter being utilised in the financial advice market with a few different variations.

Fee-for-service

7.9 Fee-for-service remuneration is an up front payment negotiated on the basis of the agreed value of the advice provided, which is normally determined by, and charged at, an hourly rate. This reflects the arrangement clients generally have with other professional advisers such as lawyers. Advisers being paid through this

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3 ASIC, *Policy Statement 175*, 'Licensing: Financial product advisers – conduct and disclosure', November 2005, p. 32.

4 Mr Malcolm Rodgers, Executive Director Regulation, ASIC, *Committee Hansard*, 20 November 2006, Canberra, p. 70.

5 ASIC, *Shadow shopping survey on superannuation advice*, April 2006, p. 2.

arrangement usually rebate back to their clients any commissions paid to them by the funds.

7.10 As referred to in the previous chapter, rigorous disclosure requirements have rendered this an expensive payment option, particularly where it cannot be paid out of a person's superannuation account balance.

7.11 Some superannuation funds have established a mechanism whereby the cost of fee-for-service advice may be deducted from account balances. For instance HostPlus reported that:

> ...from 1 January 2007, members will have the ability to choose an additional method of payment for financial planning advice for superannuation only. Members will be allowed to deduct a set amount from a member's account in order to pay for that advice.[6]

7.12 REST Superannuation outlined its own model for outsourcing the provision of advice:

> REST has engaged the services of Money Solutions Pty Ltd to offer personal advice to our members while operating under its own personal advice licence. This model allows members access to one off coaching for individual issues rather than a full financial plan. We believe that it is appropriate to allow for payments for such advice to be deducted from a member's superannuation account, subject to the sole purpose test rules. Our experience shows that over 92% of our members who receive single issue superannuation advice under this arrangement do not wish to go to a full financial plan and consequently would go unserviced or be poorly serviced by the traditional financial planning industry.[7]

7.13 As REST mentioned, the capacity of funds and members to utilise this payment option is limited by the sole purpose test. Section 62 of the SIS Act stipulates that superannuation fund trustees must maintain the fund for the benefit of members. In the context of deducting fees from members' accounts, the Australian Prudential Regulatory Authority (APRA) has indicated that superannuation fund trustees are 'not permitted to apply members' contributions or fund assets for services provided outside the core and ancillary purposes'.[8]

7.14 Account deductions for advice on superannuation only are permitted on the basis of the connection between that service and the core purpose of the fund. APRA's guidance states:

> 41. It is open to trustees to develop features of their fund which add value to, or differentiate it from, other funds. For example, fund sponsored

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6 HOSTPLUS, *Submission 63*, p. 7.

7 REST Superannuation, *Submission 54*, p. 5.

8 APRA, *Superannuation Circular No. III.A.4*, 'The sole purpose test', February 2001, paragraph 38.

> member awareness, education and financial advice programs, targeted at fund specific issues such as benefit features (including insurance options, the making of binding death benefit nominations etc) or investment choices offered in the fund, may be appropriate. ...
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> ...
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> 43. Financial planning is now a service which many trustees are considering offering to members. As noted in paragraph 41, if the service is aimed only at a member's interest in the fund, such services would generally fall within the sole purpose test. If, however, broader advice is offered, it would be inappropriate for the cost to be borne by the fund.[9]

7.15 A number of organisations expressed uncertainty as to the scope of the sole purpose test with regard to deducting the cost of financial advice from member accounts. This matter is discussed later in the chapter in the context of providing a remedy for the provision of conflicted advice.

Commissions

7.16 Commission-based payments are paid by retail and some industry superannuation funds to financial advisers in exchange for distributing their products in the marketplace. From the funds' perspective, paying commissions is more effective than deploying numerous salespeople to go out and sell their product. Significantly though, commissions are also a useful mechanism for remunerating advisers for the cost of providing advice without their clients needing to find the money from elsewhere, as is generally the case with fee-for-service advice. In this way, paying for advice via commissions is appealing to those who cannot afford costly up-front advice from their discretionary monies.

7.17 In a superannuation context, commission payments are either deducted from a member's account at the beginning, or as a regular payment that may continue for as long as he or she remains in the fund. This latter variety is referred to as a trailing commission. Advisers may be paid a mixture of up-front and trailing commissions.

7.18 ASIC's consumer website outlines the normal range paid in commissions as follows:

> Entry fees for standard investment and superannuation products range from nil to 5% of the amount you invest. About 2% to 3% is common, so you would invest only $98 or $97 of every $100 you pay. Trailing commissions range up to 1% each year, so you would pay $1 every year for every $100 in your account.[10]

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9 APRA, *Superannuation Circular No. III.A.4*, 'The sole purpose test', February 2001, paragraphs 41 and 43.

10 ASIC, *Consumer website*, 'How commissions affect you', http://www.asic.gov.au/fido/fido.nsf/print/how+commissions+affect+you?opendocument, (accessed 19 April 2007).

7.19 Trailing commissions are generally deducted on an annual basis on the premise that a financial adviser, while receiving an ongoing commission payment, will continue to provide his or her client with ongoing financial advice with respect to that fund. Trailing commissions may also result in lower up-front commissions. Some trailing commissions may be able to be switched off or 'dialled down', that is reduced. Many advisers also make arrangements with their clients to rebate trailing commissions earned from the fund back into the member's account.

Sales-based remuneration and the quality of advice

7.20 Commission-based remuneration was the subject of extensive criticism, principally from the industry fund sector, throughout the inquiry. The dual purpose served by commission-based remuneration of funding the cost of advice and serving as a distribution mechanism for the funds raised a number of issues pertaining to conflicts of interest and the quality of advice.

Commission-based conflicts of interest

7.21 A number of organisations expressed the view that remunerating advisers for sales and advice with the same payment mechanism generates a substantial conflict of interest for advisers, often leading to the provision of advice that is not necessarily in the client's best interests. Commissions encourage advisers to recommend, in spite of quality or suitability, superannuation products that pay commissions over those that do not or to favour products that pay high commissions over those paying more standard rates. The committee notes that products offering higher than usual commissions in return for distribution to clients are not generally able to compete on the basis of quality, as the Westpoint collapse demonstrated. However, it is also worth noting that none of the major financial product platforms had Westpoint, Fincorp or ACR on their approved product lists.

7.22 Corporate Superannuation Association offered the view that commission-based conflicts of interest are inevitable:

> You cannot expect a person who has a family to feed to be dispassionate and advise somebody who comes in where there is no product to be sold, because the person is currently perhaps in UniSuper or Rio Tinto, which are very superior funds. If you go into the average planner and get some advice, if they knew their product and they knew your product, they would say, 'Well, you may as well leave now.' But that is not what happens.[11]

7.23 Industry Super Network asserted that 'unsuspecting consumers' were let down by a system of remuneration that is geared towards promoting lucrative sales rather than the best advice:

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11 Mr Mark Cerche, Chairman, Corporate Superannuation Association, *Committee Hansard*, 5 March 2007, Melbourne, p. 33.

> While consumers believe they are paying advisors for professional advice, financial planners are actually paid a sales commission by the financial institution which employs them or which provides the product. Most financial planners do not recommend that consumers consider putting their superannuation in an industry super fund, despite the fact that this would in many cases provide the best retirement outcome for consumers. The structure of commissions ensure that they promote good sales rather than good advice and we submit that recent investigations by ASIC demonstrates that current legislative obligations fail to adequately protect consumers.[12]

7.24 Choice estimated that $772 million in commission was paid on compulsory superannuation investments between March 2005 and March 2006, with an additional $93 million paid in ongoing trailing commissions during that period.[13] Choice commented:

> These remuneration structures can link financial advice about superannuation with how the adviser is remunerated. Fund managers compete with each other based on the commissions and other enticements that they can offer planners to promote their superannuation products. These incentives can distort how advice is framed to consumers and this can lead to inappropriate advice.[14]

7.25 Choice told the committee that the payment of commissions on superannuation products has evolved from the old life insurance model where products needed to be distributed, or sold, using this remuneration mechanism. However, Choice argued that this approach is no longer appropriate in the context of superannuation: 'A compulsory system should not need distribution mechanisms'.[15]

7.26 Superpartners submitted that industry funds were often disregarded by advisers as they do not pay commissions:

> Industry funds do not generally pay commissions to personal advice licensees which results in consumers not being advised about the option of moving to an industry fund. The consequence is that personal superannuation advice is not given on the basis of the product that is most suitable for the client's needs.
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> ASIC has conceded that it "made no secret" that the commission model has meant many advisers did not advise their clients of industry funds. The experience in the United Kingdom with pension fund switching carries a salutary warning of the dangers of commission-driven advice. The potential influence of a commission in advising consumers about switching presents

12 Industry Super Network, *Submission 77*, p. 8.

13 Assuming an average commission of 3% and industry average trail of 0.35%.

14 Choice, *Submission 75*, p. 4.

15 Dr Nick Coates, Senior Policy Officer Superannuation and Financial Services, Choice, *Committee Hansard*, 7 March 2007, Sydney, p. 31.

> industry funds with a structural competitive disadvantage with retail funds.[16]

7.27 Other organisations argued that commissions provide fund members with access to advice that would be otherwise unobtainable. For instance, the Financial Planning Association of Australia (FPA) indicated that commission payments are an effective remuneration method for clients to use when accessing ongoing advice:

> ...from a commission point of view that there is a huge amount of ongoing advice required in some cases. You can often put a set and forget strategy in place, but in some cases—and we can talk through this in quite an amount of detail—you do need to review your strategies, you need to look at your contribution levels, you might like to look at your asset allocation, there might be market movements, or in fact you might simply want advice to say, 'Don't do anything.' So that commission is not only about the initial piece of advice and a product. It is also about providing ongoing advice, being able to ring your adviser whenever you like, being able to ask them questions across a whole range of different issues without necessarily having to sign a cheque.[17]

7.28 This position reflects the view that conflicted advice, properly managed to ensure that appropriate advice is still given, is preferable to no advice on superannuation at all. Or in other words, to prohibit commissions because of a potential for inappropriate or inferior advice would be an overreaction to a manageable problem.

ASIC's shadow shopping survey and related action

7.29 In April 2006 ASIC released the results of its shadow shopping survey on superannuation advice, which surveyed 259 individual advisers and assessed the standard of their advice. Significantly, ASIC reported that advisers are between three and six times more likely to provide unreasonable advice where a conflict of interest is present. It identified as major problems the following practices:

- not examining existing funds before recommending new ones;
- not disclosing the reasons for recommended action; and
- not disclosing the consequences of switching funds.[18]

7.30 Perhaps most worryingly, ASIC concluded that most clients who had received poor advice did not realise it was so.[19]

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16 Superpartners, *Submission 67*, pp. 13-14.

17 Ms Jo-Anne Bloch, CEO, FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 38.

18 Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, August 2006, pp. 9-10.

7.31 Following this exercise, in July 2006 ASIC accepted an enforceable undertaking from AMP Financial Planning Pty Ltd to modify the way in which it provides financial advice to customers. ASIC reported that a significant proportion of AMP planners had been advising clients to shift from rival funds into AMP products without disclosing a reasonable basis for the advice. As a consequence AMP undertook to change a number of its internal procedures and offered to review its clients' advice.[20] Nevertheless, AMP disputes the conclusion that the advice was inappropriate in all of the shadow-shopping cases.

Trailing commissions: paying for ongoing advice

7.32 One form of commission payment attracted particular criticism during the inquiry: trailing commissions. This remuneration model operates on the basis that an annual commission is paid from the fund to the adviser in return for ongoing access to superannuation advice.

7.33 The focus of criticism of trailing commissions related to value for money; the payments could continue indefinitely without a commensurate provision of advice in return. For example, Superpartners told the committee that trailing commissions often cost more than the value of the advice provided:

> What we are concerned about ... is the issue of trailing commissions going on and on, in relation to advice that may have been given many years ago, that the member is not benefiting from it and that the advice has no application to the current circumstances of that member.[21]

7.34 It submitted that such remuneration worked against the interests of the member:

> A fundamental premise of transparency of commission disclosure is that the commission should properly represent a fee for service. ... Commissions that amount to a persistency or volume bonus are incompatible with the purpose of superannuation to provide retirement incomes in trust for the benefit of the members. [22]

7.35 Treasury commented that trailing commissions did not ensure a connection between the value of advice and its cost:

> ...there should be a connection between the value of the advice given and how much you are paying for it through the commission. The real difficulty comes when you have things like trailing commissions, where there does

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19 Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, August 2006, p. 10.

20 Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission*, March 2007, pp. 8-9.

21 Mr Frank Gullone, CEO, Superpartners, *Committee Hansard*, 25 October 2006, Melbourne, p. 4.

22 Superpartners, *Submission 67*, p. 23.

> not seem to be any connection between the value of the advice provided and how much the adviser is being remunerated. That is an issue that the government—as well as this committee and many others in the community—have identified as a significant problem for consumers in the marketplace. The government have said that the industry has to examine this and has to look at how it is going to deal with this particular situation. Within that context, that is why the sales recommendations idea has been developed—it is in order to try to make what is really happening much more transparent to consumers.[23]

7.36 In defence of the practice, CPA Australia told the committee that the majority of planners rebate commission fees to their clients.[24] MLC told the committee that the difference between commissions and fees 'is not that great'.[25] Instead it is mostly a difference in transparency rather than cost:

> The difference between a commission and a fee is that a fee gives a client two fundamental rights. One is to negotiate that fee up-front and agree it and understand it with the adviser. The second is that they can stop paying it if they no longer think they are getting value for it. It could be exactly the same amount of money, the same dollars: two per cent is two per cent, whether it is a fee or a commission. It is simply that the client can see a fee more clearly and they can stop it if they do not like it at a future point in time.[26]

7.37 The Association of Financial Advisers (AFA) described trail commissions as 'another form of remuneration' that enabled ongoing advice:

> Whether the client wishes to pay for it by a monthly debit or whether they wish to pay for it out of their investment, that is their choice. I think if we give clients the choice of how they want to pay for the advice that they receive then that is a lot easier than legislating for it.
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> ...
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> There is an ongoing need for advice. Under the regulations we are supposed to review clients every year. Personally, it is not my favourite thing because I think superannuation particularly is a long-term investment. However, within that environment, as I said, the circumstances will change. There is a need for insurances earlier on and there is a need for, I suppose, a specific investment profile if you look at the requirements of the legislation. But I hold with a view that is really trying to keep the clients focused on their end goal and maintaining a source of information and education all the way through.[27]

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23 Mr David Love, Manager Investment Protection Unit, Corporations and Financial Services Division, Treasury, *Committee Hansard*, 20 November 2006, Canberra, p. 17.

24 CPA Australia, *Committee Hansard*, 25 October 2006, Melbourne, p. 48.

25 Mr Steve Tucker, CEO, MLC, *Committee Hansard*, 7 March 2007, Sydney, p. 81.

26 Mr Steve Tucker, CEO, MLC, *Committee Hansard*, 7 March 2007, Sydney, p. 81.

27 AFA, *Committee Hansard*, 20 November 2006, Canberra, p. 81.

7.38 Fiducian Portfolio Services also argued that the cost was justified by the benefits:

> Superannuation and retirement planning involves far more than simply looking at fees. Professional retirement planning advice to a client will involve consideration of issues such as the client's retirement goals, the breadth and depth of investments based upon their risk profile, salary sacrifice strategies and determining adequate levels of risk insurance.[28]

Approved product lists

7.39 The problem of advisers preferring to recommend superannuation products returning commissions appears to have manifested itself through AFS licensees' approved product lists. Ostensibly, approved product lists function as a risk management tool for licensees, ensuring that their authorised representatives only recommend products into which the licensee has conducted appropriate checks. This level of control avoids the legal risk associated with individual advisers recommending products that his or her licensee would not itself have the confidence to recommend.

7.40 However approved product lists may also be used as a way of sidelining superannuation products that do not pay commissions or shelf fees,[29] or do not benefit the vertical integration strategies of the licensee. Industry funds feel particularly aggrieved that, despite offering competitive returns to members, they are notably absent from the approved product lists from which licensed advisers may recommend specific products. Even if an adviser wishes to, he or she may not recommend an industry fund when it doesn't appear on the list. For example, HostPlus told the committee that 'product lists are a convenient way to lock us out'.[30] At a recent ASIC oversight hearing with the committee, ASIC commented that:

> ...the remuneration model at the moment often means that many financial advisers do not advise about industry funds. We are not making any secret of that.[31]

7.41 Where a large portion of the market is locked out of being distributed through the network of licensed advisers, there are potential implications for the quality of advice. Equipsuper indicated that recommending the best product is not always possible in the context of approved product lists:

> Most if not all financial planners work from an approved product list. In order to get onto the approved product list, the product must meet certain

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28 Fiducian Portfolio Services, *Submission 18*, p. 2.

29 Also referred to as platform fees this is a fee paid by product providers, in addition to commissions, to financial planning licensees to get their products on the approved product list.

30 Mr David Elia, CEO, HOSTPLUS, *Committee Hansard*, 6 March 2007, Melbourne, p. 59.

31 Mr Jeremy Cooper, Deputy Chairman, ASIC, *Committee Hansard*, 13 June 2006, Canberra, p. 13.

> criteria and go through a research process that says, 'Yes, this is an appropriate product for most of the people who will come to us.' Clearly, owning the body that creates the approved product list is a particularly useful way of ensuring that your own products achieve sales targets or are distributed widely. Certainly, you would like to think that financial planners will in all cases recommend the best product, but that may not be immediately apparent from the circumstances or the information that is provided. In most cases, the best that you could hope for is that the consumer will be recommended what appears to be the best product at that time and is appropriate for them. What is the best product is not always going to be entirely clear.[32]

7.42 Approved product lists also generate difficulties for clients seeking advice on choice of fund or consolidation where they hold an account with an industry fund. In accordance with the 'know your product' provision of the Corporations Act, advisers may not recommend a switch from one superannuation product to another without being able to assess the relative merits of both the existing fund and the recommended fund. Consequently, clients with an industry fund account are often told they cannot be advised on choice of fund as their potential 'from' fund is not on the adviser's approved product list.

7.43 Alternatively, if an adviser recommends a switch without knowing the features of the industry fund he or she is recommending a switch from, the act has been contravened. Speaking on the outcomes of its survey into superannuation advice at a recent oversight hearing, ASIC commented:

> Where you are recommending a switch, you need to look at the existing arrangements that the customer has and assess the plusses and minuses of moving out of that product and into a new product. You need to explain those to the client and then include them in the statement of advice. The report that you were referring to, the super switching report, had some rather unhappy outcomes. For example, people had existing funds, where they had quite reasonable insurance, and through lack of care on the part of the adviser it was recommended that they move into another product. They either lost that insurance or ended up having to pay much more for it. We set all that out in that report. That is really a summary of the legal obligation. It makes perfect sense. If you are giving professional advice to someone about whether they should move out of a fund, it is not rocket science to expect that you would have a look at what fund they are already in and see how it stacks up with what you are recommending. It is that simple.[33]

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32 Mr Robin Burns, CEO, Equipsuper, *Committee Hansard*, 25 October 2006, Melbourne, p. 105.

33 Mr Jeremy Cooper, Deputy Chairman, ASIC, *Committee Hansard*, 13 June 2006, Canberra, p. 10.

7.44 Some respondents, though, defended individual advisers working within the parameters of their licensees' risk management structures. For instance, Rainmaker argued that:

> Financial planning provides a really valuable service and, like any service, it has to be delivered properly. We have to get rid of the conflicts of interest. But if planners are only allowed to talk about particular products because that is what they are licensed to talk about, then we cannot crucify them for talking about other products. What we should be doing is thinking about the regulation that is overrestricting them. Shadow shopping is fantastic, but I think to bag planners for doing what the law tells them to do is just silly. [34]

7.45 MLC argued that advisers were not recommending industry funds because they do not offer investment options other than superannuation:

> ...I do not think [advisers] are not choosing to use an industry fund because it does not pay commission; I think they are not choosing an industry fund because it does not offer, in many cases, all of those services they need to implement their advice. That might change over time. Industry funds might start to move into ordinary money and insurance. That might mean that they become more appropriate as a choice.[35]

7.46 Total Portfolio Management suggested that a lack of obtainable information often meant that advisers are not able to offer advice on industry funds:

> When seeking information from Industry Funds quite often the full extent of their fees are not shown. The actual management fees relating to the individual investments are not easily obtainable, and if we don't receive this information no advice can be given. Again the people who are being disadvantaged are those in the most need.[36]

7.47 Industry Funds Forum (IFF) rejected the argument that industry funds did not appear on approved product lists because critical information about them could not be accessed:

> I think that argument might have had some credence 10 years ago, but it has next to no validity now. There might be reasons why certain types of funds are not on a recommended list, but you cannot credibly say it is because we do not have access to information or we do not know where to obtain the information. That is just a nonsense.[37]

7.48 Treasury defended the basis for approved product lists:

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34 Mr Alex Dunnin, Executive Director Editorial and Research, Rainmaker Information, *Committee Hansard*, 24 October 2006, Sydney, p. 80.

35 Mr Steve Tucker, CEO, MLC, *Committee Hansard*, 7 March 2007, Sydney, p. 86.

36 Total Portfolio Management, *Submission 31*, p. 2.

37 Mr Ian Silk, Convenor, IFF, *Committee Hansard*, 25 October 2006, Melbourne, p. 127.

> The authorised product list is driven by the structure of the legal obligations that flow on to the licensee about giving advice. ... [W]e have said that the licensee has to be responsible for the advice given and has to be confident in the products that are being recommended. So there is certainly a very strong and valid argument on the side of industry advisers saying, 'We need to be sure about the products that we are making recommendations for'.[38]

7.49 However, the department did indicate that the situation was being monitored:

> ...we are keeping a close eye on the way these things are done and the impact it is having on the marketplace and whether or not there are any distortions coming about as a result of the way products are being sold in the market.[39]

7.50 The payment of 'shelf fees' (in addition to commissions) to facilitate the placement of particular products on the list also received attention during the inquiry. In its April 2006 discussion paper on managing conflicts of interest in the financial services industry, ASIC indicated that licensees should avoid listing companies that pay shelf fees as it generated a conflict of interest, meaning that 'comparable or better' products that do not pay the fee are more likely to be excluded from the list.[40]

7.51 Choice told the committee of their concern over the apparent requirement to pay shelf fees to have products listed:

> ...we have become concerned about authorised lists becoming attached to platform fees. The product might make the authorised list because it has paid a platform fee. It might not make the list on its own merits but it might make the list because it has paid for the research to be done on the product—the various things that they have to do to change their computer systems to be able to list it. Our concern is that other products that are possibly good value and at lower cost to consumers are not making those lists.[41]

7.52 MLC told the committee that it does not pay shelf fees in order to avoid the perception of a conflict:

> ...whether or not shelf-space fees in reality introduce actual conflict, the perception must be that the reason why you are paying a shelf-space fee is

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38 Mr David Love, Manager Investment Protection Unit, Corporations and Financial Services Division, Treasury, *Committee Hansard*, 20 November 2006, p. 19.

39 Mr David Love, Manager Investment Protection Unit, Corporations and Financial Services Division, Treasury, *Committee Hansard*, 20 November 2006, p. 19.

40 ASIC, *Discussion Paper*, 'Managing conflicts of interest in the financial services industry', April 2006, p. 12.

41 Dr Nick Coates, Senior Policy Officer Superannuation and Financial Services, Choice, *Committee Hansard*, 7 March 2007, Sydney, p. 32.

> to get on the platform, and there must be a question about whether that biases towards that fund the underlying advice that is given.[42]

'Tied' advisers

7.53 The committee also heard concerns in relation to a lack of transparency over the relationship between advisers and superannuation product providers. In instances where advisers are licensed under the financial planning arm of a company that also distributes financial products, the distinction between the financial advice sector and the financial product sales sector can become blurred. Although consumers are aware of the sales motivations of the supplier's representative when visiting a car dealership, in the financial planning sector the incentives may not be as apparent to consumers where a financial services company integrates product supply and sales through its team of financial planners.

7.54 Presently, the nature of these relationships is not reflected in the labels, or nomenclature, attached to purveyors of financial advice. For instance, advisers are not required to describe themselves as an 'agent' or 'franchisee' where their status would be accurately reflected by these generally understood terms. Consequently, when consumers seeking advice on superannuation products try to identify a suitable financial adviser, the broad 'financial adviser' or 'financial planner' labels do not provide them with an instinctive feel for the adviser's motivations. Consumers in this sector are therefore less likely to be able to adequately filter conflicted advice.

7.55 Members Equity Bank highlighted the influence of the major banks in the superannuation product and advice market:

> During the course of the nineties all the major banks, rather than develop their own product offerings around superannuation ... acquired fund managers and superannuation providers. ANZ had a joint venture with ING, Westpac with BT and Rothschild, CBA with Colonial, NAB with MLC. So during the course of the nineties they acquired fund management and superannuation services. They then also acquired a large proportion of the financial planning networks, so they now have vertical integration from the advice through to the transactional banking capability, the banking relationship through to superannuation.[43]

7.56 It warned that many consumers would be unaware of the 'tied' relationship between certain advisers and products.[44]

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42 Mr Steve Tucker, CEO, MLC, *Committee Hansard*, 7 March 2007, Sydney, p. 88.

43 Mr Anthony Beck, Head Workplace Business, Members Equity Bank, *Committee Hansard*, 25 October 2006, Melbourne, p. 29.

44 Members Equity Bank, *Committee Hansard*, 25 October 2006, Melbourne, p. 30.

7.57 The Association of Financial Advisers (AFA) told the committee that disclosure in this regard is inadequate, as the owner of an adviser's licensee does not have to be disclosed.[45]

7.58 The committee notes ASIC's policy statement on managing conflicts of interest, which states that disclosures on the following will 'generally be appropriate':

> a) the extent (if any) to which the licensee (or any associated person) has a legal or beneficial interest in the financial products that are the subject of the financial product advice;
>
> b) the extent (if any) to which the licensee (or any associated person) is related to or associated with the issuer or provider of the financial products that are the subject of the financial product advice; and
>
> c) the extent (if any) to which the licensee (or any associated person) is likely to receive financial or other benefits depending on whether the advice is followed.[46]

7.59 AFA speculated that the tied adviser relationship is a product of the licensing of financial product providers, rather than individual advisers:

> ...part of the function of FSR has been that the majority of advisers are actually receiving remuneration from one source, although that source has a plethora of products. It would have been a better choice had they gone down the original line, which was individual licensing of advisers. We did not get that, so now we have to deal with what we have. I think it is a better situation than it has been previously, but in the AFA's submission back in about 179 we said that the biggest fear we had was that we would go back to a tied adviser relationship, which meant the major distributors virtually corralling the advisers and which was what we went away from during the 170s—and it has happened.[47]

Remedies to improve the quality of advice

7.60 The present legislative arrangements to ensure that consumers receive an appropriate standard of advice are as follows. Firstly, section 945A of the Corporations Act stipulates that advice must be appropriate to the needs of the client having regard to his or her circumstances and knowing the subject matter being advised on. Secondly, advisers must manage conflicts of interest. The committee outlined the Corporations Act disclosure requirements with respect to conflicts of interest in Chapter 6.

7.61 ASIC has indicated that there is no prohibition on conflicts of interest when providing financial services, rather that they should be adequately managed through

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45 AFA, *Committee Hansard*, 20 November 2006, Canberra, p. 98.

46 ASIC, *Policy Statement 181*, 'Licensing: Managing conflicts of interest', August 2004, p. 19.

47 Mr Michael Murphy, Past President, AFA, *Committee Hansard*, 20 November 2006, Canberra, p. 98.

internal controls and disclosure. Where this is not sufficient the conflict must be avoided.[48] On the more specific issue of managing remuneration-based conflicts of interest, ASIC has indicated that while some conflicts can be managed through disclosure others should be avoided altogether:

> In some cases, disclosure to clients is an adequate mechanism for controlling conflicts of interest arising from remuneration practices. Part 7.7 of the Act generally approaches remuneration issues from a disclosure perspective (i.e. remuneration must be fully disclosed). However, licensees should consider whether any particular benefits, compensation or remuneration practices are inconsistent with the requirement to have adequate arrangements in place to manage conflicts of interest or with the requirement for the efficient, honest and fair provision of financial services. For example, those remuneration practices that place the interests of the licensee or its representatives in direct and significant conflict with those of the licensee's clients should be avoided (and not merely disclosed).[49]

7.62 In evidence to the committee ASIC stated:

> ...if a product manufacturer or an advisory network uses commissions as a form of remuneration then they need to be more cautious in managing the potential conflicts caused by those arrangements and in making sure that they do not undermine the integrity of the advice that is given. It is not an argument for or against commissions; it is simply to say that if you choose a particular business model that has in it a risk that is not inherent in another business model, the law obliges you to make a special effort to make sure that that business model does not cause any damage to the integrity of the advice which the law requires you to provide.[50]

7.63 The committee heard evidence, however, that the current mechanisms for managing conflicts of interest were not always sufficient to protect consumers from receiving an inadequate standard of advice. The results of ASIC's shadow shopping exercise lend credence to these concerns. The committee also notes that the introduction of Super Choice has exacerbated the possible deleterious effect of poor quality advice on superannuation. The following section examines possible remedies for addressing perceived deficiencies in the regulatory system to ensure fund members receive a high standard of superannuation advice.

Commissions and shelf fees

7.64 Instead of ensuring that consumers are fully aware of the conflicts of interest associated with commission-based remuneration for advice, some organisations advocated banning commissions on superannuation advice altogether. As justification

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48 ASIC, *Policy Statement 181*, 'Licensing: Managing conflicts of interest', August 2004, p. 11.

49 ASIC, *Policy Statement 181*, 'Licensing: Managing conflicts of interest', August 2004, pp. 14-15.

50 Mr Malcolm Rodgers, Executive Director Regulation, ASIC, *Committee Hansard*, 20 November 2006, Canberra, p. 61.

for ending the practice, the compulsory nature of involvement in the superannuation system was regularly highlighted. For example, Members Equity Bank wrote in its submission:

> There can be no justification for consumers' superannuation guarantee charges being reduced by the imposition of a sales commission as the contribution is mandatory, paid by the employer, and is part of an employee's remuneration.[51]

7.65 The Australian Institute of Superannuation Trustees (AIST) was another organisation advocating the prohibition of commissions on superannuation contributions. It was particularly critical of commissions on compulsory SG payments:

> To allow a financial adviser or financial planner to reap a financial benefit via a trailing or one-off commission on an amount that must, by law, be paid into an employee's superannuation fund is unfair and unreasonable. (An adviser or sales agent does not have to work very hard to obtain funds that are legislated that an employee must receive.) Yet, the adviser or sales agent may be able to obtain a financial benefit from those contributions.[52]

7.66 In evidence to the committee it called for a total ban:

> We should not only go halfway; we should go all the way and get rid of commissions. It is outrageous that, on a nine per cent compulsory contribution, every Australian worker has to pay—that someone can sell someone that product and get a trailing commission on it. They did not have to actively go out and seek this. It is law. [53]

7.67 Industry Super Network also argued that commission-based remuneration should be banned entirely. It submitted:

> ...financial planners remunerated by commission suffer a direct conflict of interest and this has a deleterious effect on the quality of advice consumers receive from commission-remunerated planners.
>
> If commissions dominate the advisory industry, then products not paying commissions will rarely be recommended even if they are superior (indeed such products will not appear on the advisory firm's "approved product list"). Differential percentage commissions will inevitably encourage some advisors to favour high cost products even where they are inferior (the extreme example being Westpoint).[54]

7.68 However, it should be noted that Westpoint was not a superannuation product.

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51 Members Equity Bank, *Submission 64*, p. 4.

52 AIST, *Submission 79*, p. 15.

53 Ms Fiona Reynolds, Director, AIST, *Committee Hansard*, 25 October 2006, Melbourne, p. 91.

54 Industry Super Network, *Submission 77*, p. 6.

7.69 IFF argued that:

> ...customer-focussed financial advice and commission payments are not compatible with each other and the only way to ensure that appropriate financial advice is given, is to remove the temptation of commissions and soft dollar incentives in connection with financial advice.[55]

7.70 While still expressing their opposition to the practice, others adopted a more moderate stand. SuperRatings told the committee that commissions on mandated superannuation contributions should be phased out over a two to three year period.[56] Choice suggested to the committee that trailing commissions should either be banned or, at the very least, be more easily switched off when consumers are not receiving advice.[57]

7.71 Superpartners suggested that trailing commissions should be rebated where unaccompanied by the provision of advice:

> Pending regulatory change, [trailing] commissions so earned should be rebated to the affected members. Rebates should be recommended in ASIC guidance.[58]

7.72 IFF advocated forcing a shift through ensuring the complexity of maintaining commission structures:

> If the element of the mandated superannuation under advice was prohibited from having commissions applied against that, one would think that it would be a very complex model to charge in discretionary pieces for that advice. That would hopefully accelerate a move towards a more transparent fee-for-service across the whole gambit of money under advice. [59]

7.73 While acknowledging the limitations of commissions, MLC told the committee that a voluntary shift to a fee-for-service model is preferable to banning them altogether:

> We would like the industry to voluntarily move towards a fee model over time. We think it is more transparent, we think it is more in the interests of advisers because they will attract more customers and we also think it is better for the customers in terms of understanding how they are paying for the advice they are getting. We do not advocate any bans or changes to the regulations. We think the industry can move on this in a fairly short period of time to avoid the need for that, as any responsible industry should. It does take some time. The industry has been structured around commission

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55 IFF, *Submission 73*, p. 18.

56 SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 2.

57 Choice, *Committee Hansard*, 7 March 2007, Sydney, p. 36.

58 Superpartners, *Submission 67*, p. 23.

59 Mr Paul Watson, Executive Committee Member, IFF, *Committee Hansard*, 25 October 2006, Melbourne, p. 128.

> for many, many years and it is very difficult for people to go home over the weekend and come back and change their business model.[60]

7.74 Contradicting these recommendations was the firmly held view among sections of the financial planning industry that commissions enable those who would not otherwise be able to afford financial advice to access it. The basis for support of commission-based remuneration is that it is preferable for people to have access to affordable yet conflicted advice, properly managed and disclosed, than to no advice at all. For instance, IFSA argued that:

> Commissions allow people to access advice and pay for it over time via their savings. Commissions also tie the interest of the consumer and the financial planner, and give an incentive for the planner to maximise a consumer's savings.
>
> Removing commissions from the remuneration mix will be to the detriment of middle to lower income consumers who cannot afford to pay the fee for service. IFSA believes that commissions are an important means of paying for advice, and any perceived conflicts of interest can be managed by disclosure.[61]

7.75 Similarly, in its submission to the committee FPA wrote that:

> ...if there is advice or some other service provided in relation to that money, it is legitimate for the provider of that service to be paid for that service. Any mandated move toward up front fee-for-service might disenfranchise lower income earners who simply cannot afford to pay for advice through an up front lump sum.[62]

7.76 However, Industry Super Network rejected the argument that eliminating commissions would exclude poorer clients from accessing advice. It raised the following three points:

- Firstly, there is no obligation for ongoing advice or service to be provided in order for the planner to earn the trail commission on an ongoing basis.
- Secondly, we do not accept that most Australians require detailed financial advice on superannuation. The average Australian has an account balance of $25,800. While they may need education and perhaps some limited assistance in relation to matters such as investment choice selection and maintaining appropriate insurance, a full scale financial plan (let alone ongoing advice for their entire working life) is unlikely to be justified. Claims made by the financial planning industry that the absence of ongoing advice will lead Australians to having insufficient superannuation to retire upon

60 Mr Steve Tucker, CEO, MLC, *Committee Hansard*, 7 March 2007, Sydney, pp. 80-81.

61 IFSA, *Submission 60*, p. 17.

62 FPA, *Submission 38*, p. 6.

> is self serving and not backed up by the 'net benefit' evidence already included in this submission.
>
> - Finally, the consumers who are unable to pay upfront commissions would also be unlikely to be able to afford to have their retirement incomes eroded by trail commissions. A fee for service model provides a fair and transparent method of paying for advice which is less likely to erode a consumer's ultimate retirement benefits.[63]

7.77 IFSA rejected any interference from ASIC over the form of remuneration used, provided disclosure requirements are met. They maintained that a competitive financial services market would keep fees at reasonable levels:

> ASIC should ensure that it does not limit the remuneration methods available to both consumers and advisers. It is not for ASIC to determine whether commission or fee-for-service arrangements are the most appropriate form or remuneration. Indeed the current disclosure requirements in the law and the significant investment by both Government and industry in raising the standards and enhancing the regulation of financial advisers should not be undermined by the regulator. Instead, in a highly competitive and transparent market (driven by FSRA disclosure provisions on fees), competition should be the effective regulator on remuneration structures and payment levels.[64]

7.78 A number of contributors also drew on the significance of consumer choice when determining the methods of paying for advice that should be permitted. AXA commented that although FSR had raised the standard of advice, its cost had also increased. Consequently, clients should be entitled to choose how they pay for advice:

> More needs to be done to increase access to financial planning services, and at an earlier stage but undoubtedly one of the barriers to such access is the cost. During the earlier stages in life, when people are purchasing a house and starting a family, they have less disposable income and more competing demands for the money that could be spent on financial advice. Many individuals are reluctant to obtain financial advice because of the up front cost of doing so, and yet decisions made during these earlier stages in life can be critical to a family's future financial wellbeing.
>
> AXA supports the individual's right to choose how they pay for advice.[65]

7.79 The Association of Independent Retirees (AIR) expressed the view that commissions allowed consumers to test the market for advice without incurring great expense:

> We take the view that the marketplace should essentially determine those things. The reason for that is that quite a number of people when they are

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63 Industry Super Network, *Submission 77*, p. 10.

64 IFSA, *Submission 60*, p. 17.

65 AXA Asia Pacific Holdings Ltd, *Submission 45*, p. 7.

> about to retire or are retired want to get advice from a number of people. They do not want to pay a fee to every one of those people to get advice, so if they are going to pay an up-front fee they are almost locked into one person. But if they adopt the commission model, they can go to a number of people at no charge and they can then determine the best approach. So it is a bit of horses for courses. In our view, from the considerable experience of our members, it is better to leave that open because the providers of services will meet the market need. Some will operate on commissions and some will operate on fee for service.[66]

7.80 However, AIR did advocate a legislative prohibition on trailing commissions:

> They cause a lot of credibility problems and a lot of disenchantment, and there is no real rationale for them. [67]

7.81 ABA indicated that consumers should be able to choose in an environment in which fees were transparent:

> Whether a consumer chooses to pay commissions or fee-for-service should be at the discretion of the consumer, depending on what model suits their needs and financial situation. Therefore, it would be useful for there to be greater transparency around fee structures so that consumers can better understand fees and commissions and identify triggers that they may need to consider with respect to a particular investment.[68]

7.82 The committee earlier described the restrictions imposed on advisers by approved product lists, including evidence on the effect shelf fees may have on the likelihood of any given product making the list. One solution is to ban such fees being paid. ASIC has suggested that the conflict of interest generated by the practice should be avoided by platform providers not listing products that pay a shelf fee.[69]

7.83 AFA told the committee that shelf fees should be permitted, but they should be disclosed to clients:

> Our view is simple. It is around transparency, openness and disclosing to clients. In a sense it is a commercial piece of work and as long as people know what is going on and clients are fully informed about it then we are comfortable with that.[70]

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66 Dr James Ritchie, National Chairman Retirees Income Research Group, AIR, *Committee Hansard*, 20 November 2006, Canberra, p. 106.

67 Dr James Ritchie, National Chairman Retirees Income Research Group, AIR, *Committee Hansard*, 20 November 2006, Canberra, p. 106.

68 ABA, *Submission 88*, p. 14.

69 ASIC, *Discussion Paper*, 'Managing conflicts of interest in the financial services industry', April 2006, p. 12.

70 Mr Richard Klipin, CEO, AFA, *Committee Hansard*, 20 November 2006, Canberra, p. 89.

7.84 AFA indicated that presently only the remuneration being paid to the adviser needed to be disclosed, but this should be extended to fees paid by fund managers to licensed product providers.[71]

Committee view

7.85 The committee recognises the problems associated with commission-based remuneration. It generates conflicts of interest for advisers that in many cases lead to inappropriate advice, as demonstrated by ASIC through its shadow shopping survey. Furthermore, trailing commissions potentially lead to significant sums being paid to advisers throughout the life of a financial product without a commensurate return in the form of ongoing superannuation advice.

7.86 The industry funds sector argued most strongly for the prohibition of commissions for superannuation advice/product distribution, a position the committee can understand well. Most industry funds do not pay commissions and their products are generally not recommended by financial planners, for whom commissions form at least a significant proportion of their income. However, some industry funds do pay commissions, examples being Health Super and Statewide Super.

7.87 However, the committee does not recommend the prohibition of commissions on superannuation products. Many consumers cannot afford to pay for up front fee-for-service advice on their superannuation, especially with the unresolved problem of the current disclosure regime causing advice to cost more than its inherent value. The committee also acknowledges that the remuneration environment in which superannuation advice is provided is evolving. Super Choice has not been in existence for long and refinements to the regulatory framework have recently been implemented and more are proposed. According to ASIC, advice is increasingly being paid for through fee-for-service transactions and less through commission-based structures.[72]

7.88 Furthermore, banning commissions will not remove all potential conflicts of interest in the industry. Superannuation funds, including industry funds, have other remuneration practices such as bonuses and incentive plans for sales people which may give rise to conflicts.

7.89 The committee is therefore of the opinion that it would be premature to recommend the prohibition of commissions as recommended by industry funds. The financial planning industry appears to be shifting towards a fee-for-service model and superannuation funds themselves are moving to facilitate the use of member accounts to pay for up front advice. These are welcome trends. Given the weight of regulatory change in this area over the past two to three years it is reasonable for financial planners to be allowed to move away from commission-based remuneration models

71 AFA, *Committee Hansard*, 20 November 2006, Canberra, p. 89.

72 ASIC evidence at the committee's June 2006 oversight hearing, *Committee Hansard*, 13 June 2006, p. 23.

on a voluntary basis. Other strategies such as improving disclosure and education, mentioned later in this chapter, should also be given an opportunity to be implemented before prohibitive measures are taken.

7.90 The committee has more concern regarding shelf fees. Shelf fees can be anti-competitive and may encourage products to be listed and subsequently recommended that may not be in the best interests of the client. Unlike commission-based remuneration, shelf fees cannot be said to facilitate access to advice by making it more immediately affordable to those without discretionary funds to pay up-front fees.

7.91 On the other hand, it is argued that shelf fees result from the fact that the product platform incurs costs in putting a fund manager on an approved list. These include due diligence costs, information technology costs and publishing costs. There is also the risk that having put a particular fund manager on a platform, investors using the platform might not choose to invest in that particular product, so the shelf fee is the only means whereby the platform can recoup those costs.

7.92 There was no evidence before the committee that shelf fees have hindered consumer choice or reduced competition.

7.93 It is noteworthy that none of the major product platforms had Westpoint, Fincorp or ACR on their approved product lists. It therefore appears that the due diligence procedures undertaken in establishing approved product lists is effective.

7.94 Nevertheless, the committee has concerns about shelf fees. As the industry is progressively moving from commission-based to fee-based advice fees, so it should move from shelf fees to a more competitive means of meeting the cost of product listings. The ultimate ideal for the industry would be movement towards fees for advice, payment for funds management and payment for administrative services.

7.95 In the meantime, the Committee is of the view that the key issue is transparency and disclosure.

Recommendation 21

7.96 The Committee recommends that ASIC work with the industry to provide to investors more effective and detailed disclosure of shelf fees.

Better disclosure

7.97 The purpose of requiring commission-based conflicts of interest to be disclosed is to allow the client to reach their own determination as to the significance of the conflict and, in that light, the extent to which they will rely on the advice. However, the committee received evidence that the disclosure of conflicts of interest needs to be more effective to ensure consumers are better able to measure its likely affect on the quality of advice they receive.

7.98 FPA suggested that disclosure of fees and other critical information could be made more prominent for consumers:

> Clearly, we would like all of our advisers to be entirely professional and provide appropriate advice in the interests of the client. But if that is not going to be the case and we cannot completely control that, what are the warning signals from a client's point of view as well, and how do we provide information that sets warning bells going in the client's mind? We are talking, for example, about a five-point summary on top of a statement of advice, 'These are the things you must know.' Statements of advice can be 50 or 60 pages long. Does the client always understand that the commission is high? Do they always understand their particular risk profile and so forth? We are looking at putting some key risk, remuneration and service parameters on top of the statement of advice so that we can set the alarm bells going.[73]

7.99 Superpartners did not support banning trailing commissions or imposing a time frame beyond which they could not be paid. Instead, it also advocated improved disclosure:

> We have proposed a third solution, and that is a more targeted disclosure of the commission to members so that the member is informed that there is a commission payable for persistency rather than being misdescribed as a commission paid for advice.[74]

7.100 Count Financial Ltd highlighted the problem of providing reasonable advice on 'to' and 'from' funds that were differently structured and hard to compare. They suggested:

> To allow a fair and accurate comparison between a client's current super fund and a possible recommended super fund, we ask the Committee to consider recommending that a succinct client-specific comparison disclosure document be required to be produced by all super funds, in a format that allows for comparability.[75]

7.101 Another proposition put to witnesses was for different categories of advisers to be enshrined in legislation. This approach is founded on the view that effective disclosure is dependent on the label attached to financial advisers adequately reflecting their relationship with the products they subsequently recommend. For example, advisers could be licensed either as franchisees, agents or independent advisers utilising well-recognised labels to provide consumers with a more instinctive sense of the motivations behind the advice they receive.[76]

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73 Ms Jo-Anne Bloch, CEO, FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 43.

74 Mr Paul Collins, Manager Legal Services, Superpartners, *Committee Hansard*, 25 October 2006, Melbourne, p. 9.

75 Count Financial Ltd, *Submission 59*, p. 3.

76 See, for example, discussion with Ms Jo-Anne Bloch, Financial Planning Association of Australia, *Committee Hansard*, 24 October 2006, Sydney, p. 53.

7.102 Although advisers whose advice is 'tied' to the products sold by their employer are not currently permitted to describe themselves as 'independent', they do not have to qualify their advertised 'financial adviser' status by using prescribed nomenclature such as 'agent' or 'franchisee'.

7.103 Treasury, though, told the committee that the legislative codification of this approach had not worked in the United Kingdom:

> They basically polarised it into two extremes: you had the pure product sales advice where you could only deal with your own product provider's product line, so you were really like a salesman, and then you had the people who were completely independent and offered a whole range of things.
>
> They found it extraordinarily difficult to make that work in the UK and they have had to move back from it into a situation that is much closer to the idea of authorising product lines that occurs here.[77]

7.104 However the committee notes the apparent inconsistency of this position when held against the government's proposed legislative changes described below.

7.105 ASIC stated that the law already restricts advisers from the labels they may attach to themselves:

> ...the law already provides that a person may not call themselves independent unless that is in fact true. So we do not need to create a new category of independent adviser, because the law already does that. A person is not entitled to call themselves an independent adviser unless that is actually factually true in every respect.[78]

Recent initiatives

7.106 The committee notes two initiatives that reflect an attempt to improve the efficacy of disclosure in this area. From a regulatory perspective, in November 2006 the government released a proposals paper on corporate and financial services regulatory reform. These proposals were to be incorporated into the Corporations Legislation Amendment (Simpler Regulatory System) Bill 2007 that was introduced into the parliament on 24 May 2007.[79]

7.107 One of the proposals was to enable financial product sales recommendations to be made without triggering personal advice disclosure requirements. Referring to the common scenario whereby agents of financial product issuers, solely responsible

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77 Mr David Love, Manager Investment Protection Unit, Corporations and Financial Services Division, Treasury, *Committee Hansard*, 20 November 2006, Canberra, p. 16.

78 Mr Malcolm Rodgers, Executive Director Regulation, ASIC, *Committee Hansard*, 20 November 2006, Canberra, p. 64.

79 Treasury, *Corporate and Financial Services Regulation Review: Proposals Paper*, November 2006.

for selling products, are required to meet the SoA requirements triggered by the provision of personal advice, the proposals paper stated:

> In those situations, it may not be appropriate for that client to be under the impression that they are being given (and possibly charged for) advice. It may also not be appropriate for the agent to be purporting to provide advice or to be regulated as a financial adviser.
>
> The issues that arise in such transactions are whether the role of the service provider and the nature of the service being provided is transparent to, and understood by, the consumer, and whether such salespeople should be presented and/or regulated as though they are providing advice.[80]

7.108 The paper outlined the proposed new category of financial service, separate to financial product advice, as follows:

> It is proposed to provide that, in certain situations, financial product providers and their representatives would be able to recommend financial products based on a client's objectives, financial situation and needs without that recommendation constituting financial advice (either personal or general). Under the proposal, this would be defined as a financial product sales recommendation (sales recommendation).
>
> A sales recommendation may contain elements of personal and/or general advice and would still be a form of financial service, but it would not be captured by the personal and general advice definitions. Persons permitted to provide sales recommendations would only be able to sell financial products for issuers that they act on behalf of. They would not be able to also deal in financial products where they do not act on behalf of the relevant issuer. The sales recommendation definition would be subject to its own regulatory requirements.[81]

7.109 The disclosure requirements associated with this category of financial service would be contained in a 'Sales Recommendation Warning' that could form part of the Financial Services Guide (FSG). This would include information on which entity they are acting for, as well as commission payments and related conflicts of interest.[82] In addition, individuals would not be authorised to provide both licensed financial advice *and* sales recommendations, which Treasury described as 'ring-fenc[ing] a sales recommendation service to ensure that it is separate from the financial advice stream'.[83]

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80 Treasury, *Corporate and Financial Services Regulation Review: Proposals Paper*, November 2006, p. 14.

81 Treasury, *Corporate and Financial Services Regulation Review: Proposals Paper*, November 2006, p. 15.

82 Treasury, *Corporate and Financial Services Regulation Review: Proposals Paper*, November 2006, pp. 17-18.

83 Treasury, *Corporate and Financial Services Regulation Review: Proposals Paper*, November 2006, p. 22.

7.110 Treasury told the committee that the government's intention was to better enable clients to recognise instances where the advice they are receiving is driven by a sales motivation:

> ...the government has come forth with the proposal in regard to sales recommendations, which is aimed at making much more transparent and distinguishing more clearly for consumers the relationship between a provider of a product and those who are giving, let us say, more disinterested client focused advice.
>
> ...
>
> ...we want to make as transparent as possible for consumers the relationship between the seller, or the person holding themselves out to give advice, and the product provider. We feel that this is the real difficulty. For example, if you are buying a car and you walk into a Holden dealer, you know that there is a clear relationship there and you assume that there are commissions being paid, even if you do not know the details. That relationship is very transparent and consumers understand it quite intuitively. At the moment, the way the personal advice model is set up, in many cases it appears to the consumer that they have an adviser who has only their interests at heart. We are saying that we think it is desirable to have a much clearer delineation between those two situations...[84]

7.111 However, the applicability of this proposal to the provision of superannuation advice/product sales was unclear. Despite Treasury's statements to the committee, the proposals paper indicated that the sales recommendation framework would not apply to a superannuation product or retirement savings account.[85] When the bill was introduced into the parliament the proposal had not been included.

7.112 Turning to the realm of industry self-regulation, in January 2005 FPA released a paper providing information to its members on managing conflicts of interest in the financial planning sector. FPA told the committee that its conflict of interest principles are based on disclosing to clients the way commissions operate:

> ...our conflict of interest principles require that the commission be split between advice and product so that you can see which component goes to advice and which bit goes to product, and our conflict of interest principles also require that the remuneration does not bias the advice that is given, and that in fact the advice and necessarily the implementation of advice is in the interests of the client. I think that is a legislative requirement, anyway. It is not that we have come up with some revolution here. We are just demanding of our members that these things are put on the table and the clients absolutely understand what it is they are paying for. [86]

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84 Mr David Love, Manager Investment Protection Unit, Corporations and Financial Services Division, Treasury, *Committee Hansard*, 20 November 2006, Canberra, p. 17.

85 Treasury, *Corporate and Financial Services Regulation Review: Proposals Paper*, November 2006, p. 17.

86 Ms Jo-Anne Bloch, CEO, FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 38.

Potential effect of disclosure

7.113 Despite these initiatives from government and the industry, many contributors to the inquiry strongly maintained that disclosure of commission-based conflicts of interest does not offer sufficient consumer protection from poor advice, particularly given poor financial literacy across the community. Choice was one such organisation to argue this position:

> ...the research that we have seen on declaring commissions shows that it has the perverse effect. How does a consumer discount, for example, a four per cent commission and a three per cent commission? How do they discount the value of the advice on the basis of that commission? It is very difficult for them to do that. When the commission is disclosed, the behavioural finance research is that they trust the adviser more because they feel that they have been told a secret. The other side of it is that the adviser then thinks that their advice is objective because they have disclosed the commission to the consumer, so it can have a perverse effect.[87]

7.114 Industry Super Network also highlighted widespread financial illiteracy when commenting on the inadequacy of disclosure in this context:

> ...in no other professional relationship is such a conflict permitted to exist. The planning industry generally holds up disclosure as an answer to the problem of commissions; however, we think it is a grossly inadequate solution. We do not believe that the average consumer fully appreciates the compounding effect of higher fees and commissions, which significantly erodes retirement savings over a working life.
>
> What should be done? We submit that a legal requirement for financial advisers to act in their clients' best interests is required.[88]

7.115 Superpartners raised concerns over 'certain industry practices where disclosure of commissions may not be adequate'. These were nominated as:

(a) commission paid for procurement of members;

(b) trail commission misdescribed as ongoing service commission; and

(c) commission paid by an interposed entity.[89]

7.116 Fiducian Portfolio Services, however, criticised the focus on disclosing the cost of fees, rather than ensuring clients received the value of advice:

> Even superannuation Product Disclosure Statements are prescribed to display a "Warning" that a lower fee can result in a higher saving. We believe that it is derogatory to have to present fees with a "Warning" sign

87 Dr Nick Coates, Senior Policy Officer Superannuation and Financial Services, Choice, *Committee Hansard*, 7 March 2007, Sydney, p. 32.

88 Mr Gary Weaven, Spokesperson, Industry Super Network, *Committee Hansard*, 6 March 2007, Melbourne, p. 17.

89 Superpartners, *Submission 67*, p. 21.

> akin to a cigarette packet that has connotations of death. As a consequence, investors could probably divert their funds to a product that could be 0.1% or 0.2% cheaper, but not realised that they could have earned 3% to 5% more on their assets through careful financial planning, risk profiling and product Election, They might have saved $10,000 to $15,000 on their fees over a lifetime, but ended up hundreds of thousands of dollars worse off.[90]

7.117 IFSA maintained that disclosure is sufficient and expressed concern that ASIC was targeting businesses that integrated financial product supply and sales:

> The Discussion Paper released by ASIC in April 2006 entitled MANAGING CONFLICTS OF INTEREST IN THE FINANCIAL SERVICES SECTOR gave rise to a significant level of concern amongst industry participants.
>
> ...
>
> The ASIC Discussion Paper appeared to express a bias particularly against conglomerate arrangements and institutional ownership of advisor groups. The fact is that many customers prefer to obtain advice from an adviser who is backed by the financial strength and security of a large financial institution and to invest through a product from the parent institution as long as it is clearly disclosed and they receive choice and appropriate advice regarding their underlying investment and insurance options.[91]

Mandating a higher standard of advice

7.118 The regulatory standard stipulating the quality of financial advice is that it meets the threshold of appropriateness for the client. IFF told the committee that it should be higher:

> We ... believe that financial planners should have a legislative obligation to act in the best interests of their clients. Many planners do that now, but we cannot think of a good reason why there should not be mandatory obligation on all planners to do so.[92]

7.119 However, in the context of approved product lists IFSA stated:

> The regulator has raised the question as to whether the [approved products and services list] APSL may prevent a planner meeting the reasonable basis of advice obligations, particularly when switching advice is given. IFSA believes that the law requires a planner to ensure that any product recommendation that is made must be appropriate for the client. The planner is not required to recommend the best product in the market.
>
> Therefore, as long as the products on the planner's APSL contains products that are appropriate to meet their client's needs (regardless whether they are

90 Fiducian Portfolio Services, *Submission 18*, pp. 2-3.

91 IFSA, *Submission 60*, p. 19.

92 Mr Ian Silk, Convenor, IFF, *Committee Hansard*, 25 October 2006, Melbourne, p. 118.

> in-house products), then a restricted APSL should not prevent a planner meeting their reasonable basis obligations. The law requires planners to recommend appropriate, not best products.[93]

Facilitating affordable fee-for-service advice

7.120 With poor quality advice on superannuation being widely attributed to the conflicts of interest inherent with commission-based remuneration, many contributors to the inquiry focused on the importance of facilitating the provision of fee-for-service advice. There was uncertainty though over the extent to which the sole purpose test under section 62 of the SIS Act constrained the use of superannuation accounts to pay for up-front financial advice.

7.121 RCSA and PASL advocated a clarification of the sole purpose test to facilitate remunerating financial advisers from a member's account:

> At present it appears that the Sole Purpose Test may present a barrier to using money from accounts to pay for advice. We believe this situation should be clarified and argue that this method of payment is preferable to the alternative situation where a fund provides free financial advice to members.[94]

7.122 A number of organisations argued that the scope of the sole purpose test is too narrow in this context, restricting members from using their accounts to pay for advice not specifically related to superannuation that will nonetheless maximise their overall retirement income. For example, IFF noted the limitations on the provision of beneficial financial advice imposed by the sole purpose test:

> Currently there is very limited scope for use of retirement savings to fund financial advice. This is due to the constraints imposed by the sole purpose test under Section 62 of SIS. This limits use of superannuation funds to advice concerning the superannuation product a member has invested in and superannuation advice generally. This prevents members using retirement savings to fund financial advice on their overall financial position, which requires consideration of what other assets they have at their disposal.[95]

7.123 Equipsuper told the committee:

> If a member approaches a financial planner seeking advice on retirement planning, the planner is required to consider both the member's superannuation and non-superannuation assets. However, superannuation funds are currently permitted to deduct from the member's account only the

93 IFSA, *Submission 60*, p. 18.

94 RCSA and PASL, *Submission 56*, p. 7. See also MLC Ltd, *Submission 83*, p. 12.

95 IFF, *Submission 73*, p. 19.

> cost of that part of the advice which relates to superannuation affairs, which clearly complicates the whole process.[96]

7.124 MLC suggested that:

> It will divert money out of the superannuation account in the short term, but it is recognising that somebody's holistic affairs revolve around more than just superannuation. A significant impact to their retirement outcome could be had by dealing with advice around cash flow issues or advice around how they structure their debt—with regard to the amalgamation of debt, with regard to gearing, and with regard to investing in moneys outside superannuation. So we suggest that thinking about protection of superannuation to the extent of 'We will not take fees out of that to help us to pay for advice on the whole lot' might slightly impact on their superannuation outcome but the advice, when taken in its totality, might have a huge impact on them.[97]

7.125 Sunsuper recommended allowing for the provision of broader financial advice funded by superannuation savings, with appropriate limits. It submitted:

> The main barrier to seeking advice for many of these people is access to appropriate and affordable advice.
>
> ...
>
> Allowing members to access a small amount of their superannuation savings to fund appropriate retirement advice can overcome this barrier to some extent. However, the sole purpose test under Section 62 of SIS limits the use of superannuation funds to advice concerning the superannuation product a member has invested in and superannuation advice generally. This prevents members funding advice on their overall financial position from their superannuation account.
>
> We support access to superannuation savings to fund financial advice relating to retirement, however we acknowledge there must be appropriate protections on this to ensure it is not subject to abuse. The types of protection would include:
>
> - An annual cap on the amount withdrawn from the account in the order of a few hundred dollars
> - Adviser remuneration on a true 'fee for service' basis only
> - Advice provided only by advisers approved by the trustee.
>
> We also support improved clarity on the sole purpose test under Section 62 of SIS regarding the use of superannuation savings to fund financial advice.[98]

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96 Mr Robin Burns, CEO, Equipsuper, *Committee Hansard*, 25 October 2006, Melbourne, p. 102.

97 Mr Steve Tucker, CEO, MLC, *Committee Hansard*, 7 March 2007, Sydney, p. 83.

98 Sunsuper, *Submission 74*, pp. 10-11.

7.126 Members Equity Bank offered a broad interpretation of the sole purpose test:

> ...we would take the view that traumatic events that interrupt their employment, their earning capability and their ability to contribute to super are matters that bear more directly than indirectly upon the members' end benefits.[99]

7.127 AIST also stated that a broader interpretation of the sole purpose test would be of net benefit to consumers:

> ...there is quite a strong correlation between employment, superannuation and the benefits of having salary continuance insurance or death and disability insurance. If you cannot work, you then do not get super. That is where the insurance and those sorts of benefits kick in. ... On the proposition that insurance should be excluded from coming out of the superannuation accounts because it reduces the retirement income, we would firmly put the view that the benefits of things like insurance and salary continuance to ordinary Australians, and every Australian that has superannuation, far outweigh the reduction of that retirement benefit.[100]

7.128 IFF offered cautious support for a loosening of the restrictions imposed by the sole purpose test in this area:

> This practice needs to be properly controlled and addressed in the legislation to ensure that use of superannuation savings for this purpose is not subject to abuse. This would include:
>
> - a blanket prohibition on commission being earned from advice funded in this way;
> - a requirement that the advice be in the best interests of the member ; and
> - the type of financial advice that can be given on this basis (i.e. confined to advice on superannuation issues).

7.129 It added:

> The industry needs greater clarity about what superannuation funds are able to do in this area, so there is a consistent approach and so members are aware they can fund access to financial advice in this way.[101]

Altering the effect of trailing commissions

7.130 Other proposals attempted to address the problem of ongoing trailing commissions not matched by the provision of advice, a problem identified earlier in

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99 Mr Anthony Beck, Head Workplace Business, Members Equity Bank, *Committee Hansard*, 25 October 2006, Melbourne, p. 32.

100 Ms Susan Ryan, President, Board of Directors, AIST, *Committee Hansard*, 25 October 2006, Melbourne, p. 95.

101 IFF, *Submission 73*, pp. 18-19.

the chapter. Suggestions focused primarily on enabling consumers to trigger commission payments when they actually receive advice, rather than expecting them to take positive measures to 'turn off' the commission upon realising they are not receiving the benefit of advice.

7.131 SuperRatings suggested that payments for advice should be based on the principle that clients should be able to opt in to the charge, rather than opt out when they realise they are not getting the advice they are paying for. It said: 'the cost of that advice component or services component needs to be stripped out of those fees and then the member applies for advice'.[102]

7.132 IFF cautiously expressed its preference for dial up fees:

> It is certainly a better model to dial up than to dial down. There would need to be a lot of consideration given to the actual operation of that model. Whilst it is theoretically a better model, if it operates de facto as a dial-down situation in the privacy of an adviser-client discussion, then of course that does not progress it very far at all. The notion of the product having a cost or a fee attached to it and then, quite separately, a cost or fee attached to the provision of advice is a good model.[103]

7.133 Choice also suggested that dial up is preferable, but not ideal:

> In an ideal world we would not need to have the remuneration structure attached to product recommendation. But if we were going to talk about a commission, then probably dial up gives the consumer more market power. That having been said, you might only need a relatively small amount of advice and the adviser, to be able to expand their dial-up commission, starts to throw in all the bells and whistles he possibly can to expand the size of that commission.[104]

Committee view

7.134 The disclosure of conflicts of interest caused by commission-based remuneration arrangements is critical. However disclosure must be effective and meaningful, rather than a perfunctory process simply undertaken to comply with legislative requirements. The regulatory framework for disclosure should ensure that consumers comprehend the nature of the material being disclosed. Ideally, clients should be able to interpret the advice they have received in the context of the remunerative motivations of their adviser. In other words, he or she should be in an informed position to answer the question: is this advice conflicted to the extent that an alternative source of advice should be sought?

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102 Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 15.

103 Mr Ian Silk, Convenor, IFF, *Committee Hansard*, 25 October 2006, Melbourne, p. 123.

104 Dr Nick Coates, Senior Policy Officer Superannuation and Financial Services, Choice, *Committee Hansard*, 7 March 2007, Sydney, p. 37.

7.135 As with product disclosure statements, statements of advice should display critical 'warning bell' information prominently. The committee supports FPA's voluntary endeavours to improve industry practice in this regard and urges it to use its authority to ensure that practical improvements are achieved. This is preferable to using the blunt instrument of mandating standard SoAs by regulatory means. The committee also notes that education is relevant to improving the effectiveness of disclosure, an issue discussed later in this section.

7.136 The proposal to raise the threshold of the standard of financial product advice from 'appropriate' to 'best' is not supported by the committee. Although it is preferable that clients are given the best advice possible, the reality of providing financial advice within the constraints imposed by approved product lists render this an unobtainable objective. Advisers on superannuation products cannot offer that which does not appear on the list authorised by their licensee, which in the opinion of the committee is a reasonable risk management tool to use.

7.137 Therefore the committee is of the view that instead of changing the legislative threshold for the standard of advice, the less conflicted fee-for-service remuneration model should be encouraged and consumers should be better equipped to interpret the advice they receive. The committee deals with the latter approach in its comments on disclosure above and education and financial literacy below.

7.138 The committee was told that although some superannuation funds are increasingly implementing the framework to allow payments for up front advice from member accounts, uncertainty as to the legal constraints on such measures was also prevalent. The sole purpose test seems straightforward in this context, clearly stipulating that superannuation account funds may only be used to pay for advice on superannuation. However the breadth of what constitutes advice on superannuation is contestable. For instance, does advice not directly related to superannuation assets but to maximising retirement income more broadly accord with the sole purpose test? Undoubtedly, professional advice on managing non-superannuation assets can affect the amount of money a person is able to contribute to superannuation.

7.139 Given the level of uncertainty over the scope of the sole purpose test in this context, the committee is of the opinion that detailed guidance for the industry on this matter would be beneficial.

7.140 The committee would further support an interpretation that is less restrictive than it appears to be at present. Caution should be exercised in this regard, though. Superannuation funds should not be permitted to be used to pay for all types of financial advice, which would leave the system open to abuse. The purpose of superannuation is to provide an income stream for retirees and the advice that it pays for should be directed to that purpose. Accordingly, the committee is of the view that limitations would need to be applied to any loosening of the constraints currently imposed by the sole purpose test. Limitations that ought to be considered would include applying a cap on the amount that could be withdrawn to pay for advice, prohibiting advisers from earning commissions on advice paid for through this

mechanism and ensuring a connection between the advice and long term financial objectives.

7.141 The committee is therefore of the opinion that, in consultation with the superannuation industry, the government should refine the application of the sole purpose test to allow the payment of up front financial advice from superannuation accounts.

Recommendation 22

7.142 The committee recommends that the government consult with the superannuation industry with a view to reducing, with appropriate limitations, the constraints imposed by the sole purpose test on the payment of up front fees for financial advice from superannuation accounts.

7.143 The committee also notes the suggestion to nullify the effects of trailing commissions by implementing a system whereby clients needed to opt in to paying commissions for superannuation product advice as opposed to having to opt out. This puts the onus on advisers to request that the commission be dialled up, rather than expecting consumers to take positive action to have the commission turned off, or 'dialled down', when the fee is not complemented by the provision of advice. The effect would be to better alert consumers to the nature of the charge and encourage them to consider its merit.

7.144 Unfortunately, it is difficult to contemplate how such an arrangement could be mandated without being manipulated by advisers to enable them to receive the same level of commission anyway. As Choice told the committee, clients could be easily convinced that they require 'bells and whistles' to justify paying commission for services they do not particularly need. While the practice ought to be encouraged on the basis that it could assist in separating the superannuation product sales and advice components of commission payments, the committee believes that the objective for the government and the industry should be to phase out the practice entirely.

7.145 Finally, the committee is concerned about insufficient transparency with regard to the relationship between advisers, their licensees and superannuation product providers. It is apparent clients may not be aware of the integration of superannuation product supply and sales advice and the incentives that stem from such an arrangement. The committee is of the opinion that disclosure will not be effective unless the nomenclature attached to financial advisers accurately conveys to consumers the adviser's relationship with, and interest in, the superannuation products they recommend. Accordingly, the government should investigate the most effective way to prescribe appropriate nomenclature where the product recommendation advice available to consumers is limited by sales imperatives.

Recommendation 23

7.146 The committee recommends that the government investigate the most effective way to develop with the industry appropriate nomenclature where the product recommendation advice available to consumers is limited by sales imperatives.

7.147 The committee is also of the view that financial advisers should be required to disclose to their clients the ownership structure of the licensee under which he or she is operating.

Recommendation 24

7.148 The committee recommends that ASIC should release a policy statement mandating that financial advisers disclose the ownership structure of their licensee when making a superannuation product recommendation.

Education and financial literacy

7.149 A major theme throughout the inquiry was the importance of arming consumers with the skills to interpret the quality and independence of the advice they receive. For instance, Superpartners summed up the vulnerability of consumers when it stated: 'A lot of members do not have the level of financial literacy required to even accept advice'.[105] Members' Equity Bank argued that low levels of financial literacy, combined with a choice of fund regime, had created a 'high risk environment' for consumers.[106]

7.150 AFA espoused education as the long term solution to consumers making informed decisions about advice on superannuation:

> Disclosure is key and critical, but the longer term solution is education. You have seen pretty much all of the mainstream press—television shows, websites and so on—driving education to consumers. The literacy foundation is another key part. If we start education about finances when our kids are in school, we will be better positioned to make informed decisions as we get to our 20s and so on. Obviously, because superannuation for all has only come in in the last 15 to 20 years, we have to grow people through that process. They now face key and important decisions about big amounts of money. There are practice based things and then there are broader industry things that can happen.[107]

7.151 As described in the previous chapter, superannuation funds have complained that FSR has prevented them from providing educational material to members. Some

105 Mr Frank Gullone, CEO, Superpartners, *Committee Hansard*, 25 October 2006, Melbourne, p. 4.

106 Mr Anthony Beck, Head Workplace Business, Members' Equity Bank, *Committee Hansard*, 25 October 2006, Melbourne, p. 27.

107 Mr Richard Klipin, CEO, AFA, *Committee Hansard*, 20 November 2006, p. 97.

funds argued that the FSR restrictions on targeted educational material had fostered a conservative approach to educating members about their options, denying them an important source of information.[108] Criticism was also levelled at the regulation of providing mechanisms to calculate projected benefits, which assist members in determining appropriate contribution levels to meet future retirement income needs.[109]

7.152 However notwithstanding the impediments created by FSR, ASFA explained that education at the fund level is still difficult in the face of widespread apathy:

> Large funds use a variety of communication methods. There are mass mail-outs. They are big customers of Australia Post. Much of that information gets binned. It is just the nature of it. It is a turn-off for some people.[110]

7.153 The financial advice industry also highlighted their educative role, telling the committee that access to professional advice is an important element in assisting consumers to become financially literate. For example, FPA told the committee:

> ...the role of the financial planner is very much to provide an ongoing education process. You cannot teach somebody everything all at once, but as part of an ongoing relationship they develop more and more understanding of risk and return.[111]

7.154 AFA told the committee their role is to educate 'vulnerable' clients:

> I tend to think that most of my clients when they come to see me are financially illiterate. Therefore, it is our role to educate them about what is available, what we expect of them in managing their financial affairs, what their goals and objectives are and what their risk profile is. That is part of our education process; that is what we get paid to do: to help them. I agree with you that they are in a very vulnerable situation.[112]

7.155 IFSA stated that advisers were needed to complement the government's literacy initiatives:

> There needs to be a recognition that the industry in advice in Australia is fundamentally sound and that sustained criticism of the advice industry runs counter to recent government attempts to improve financial literacy and financial understanding.[113]

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108 See for example REST, *Committee Hansard*, 24 October 2006, Sydney, pp. 57 and 64.

109 See for example Corporate Superannuation Association, *Committee Hansard*, 5 March 2007, Melbourne, pp. 30 and 32.

110 Mr Ross Clare, Principal Researcher, ASFA, *Committee Hansard*, 24 October 2006, Sydney, p. 33.

111 Ms Glenese Keavney, Superannuation Committee Member, FPA, *Committee Hansard*, 24 October 2006, Sydney, p. 46.

112 Mr Dennis Bateman, National President, AFA, *Committee Hansard*, 20 November 2006, p. 96.

113 Mr Richard Gilbert, CEO, IFSA, *Committee Hansard*, 24 October 2006, Sydney, p. 90.

7.156 Previous discussions in this report related to the advisers' view that they are an important element in improving financial literacy. In Chapter 6 the committee explored the difficulty of accessing affordable professional financial advice due to onerous disclosure requirements. The remuneration debate outlined above is also relevant, with some contributors arguing that commission-based fees improve the likelihood of consumers affording educative guidance on superannuation from their financial adviser.

7.157 There are two distinct elements to this debate. One, as correctly identified by advisers and funds in the context of their own educative role, relates to understanding the choices available within the system. The other relates to understanding how the system works, allowing consumers to make informed decisions about the quality of the information they are exposed to. While advisers can provide useful guidance on superannuation, the proposition that advisers can bestow consumers with the understanding to better interpret financial advice is problematic. Such a role is best left to government-led initiatives.

7.158 In this respect, the federal government has introduced measures aimed at improving financial literacy standards. On 6 June 2006, the government launched the Financial Literacy Foundation, which includes the following initiatives:

- a media campaign and website titled 'Understanding Money', designed to raise awareness of, and provide information on, financial literacy;
- working with state and territory governments to include financial literacy in the curriculum for Years 3, 5, 7 and 9 from 2008;
- working with employers to improve access to financial literacy information;
- undertaking research to establish a benchmark for national financial literacy and ascertaining the most effective way to deliver information to consumers;
- establishing a web-based catalogue of financial literacy resources.[114]

7.159 With a more specific focus on consumer protection in the financial services market, ASIC has also developed an education-based website, titled FIDO. It provides a broad range of information on the superannuation system, superannuation products and seeking financial advice.[115]

7.160 However SuperRatings told the committee that even more funding for education is needed:

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114 Treasury, *Understanding Money website*, http://www.understandingmoney.gov.au/Content/Consumer/aboutUs.aspx, (accessed 1 May 2007).

115 ASIC, *FIDO website*, http://www.fido.asic.gov.au/fido/fido.nsf, (accessed 1 May 2007).

> There is still a significant level of apathy among Australians with regard to superannuation. Given that it is there to fund Australians' retirement income in the future, the education level needs to be stepped up. Following on from that, the financial literacy board that the government has put in place appears to be underfunded and more should be done with regard to that.[116]

7.161 It also emphasised the importance of improving broad financial literacy before attempting to resolve some of the more technical issues related to choosing appropriate investment or insurance strategies:

> I think those things are thrown up too often before we have even sorted the macro position, which is that Australians do not care about super.[117]

7.162 Superpartners suggested that standard, simple terminology was an important aspect of the education process:

> ...there are plenty of opportunities for us to standardise the way things operate around superannuation funds, thereby acclimatising members to one terminology and the processes that are used to access or get out of a fund. That takes a layer of cost out of it and simplifies the process. It is a bit like a tax return. If we all had different tax return forms, given our circumstances, it would make it a very complex environment. I think there is plenty of opportunity for us to standardise and simplify elements of our superannuation system.[118]

7.163 In addition to the provision of educational information on superannuation, ASFA suggested that facilitating an alternative disciplinary framework for fund members to make decisions in was also important. It advocated a form of 'soft compulsion' utilising a triggering event such as changing employers to automatically increase an employee's post-tax contribution, but allowing that person to opt out should they so desire. ASFA said:

> Education is a very important element. The research has been done overseas and, when we look at international examples, education is just one plank. In fact the idea of having a structure and discipline which people work within is also very important. So one of the very important things is changing people's awareness that nine per cent is not quite enough. At the moment people think nine per cent SG: that is what the government thinks, therefore that must be enough. We need to change the norm more from nine per cent to 12 per cent. The idea of the soft compulsion or having a structure which is not compulsory or obligatory does two things. It says that the norm

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116 Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 3.

117 Mr Jeff Bresnahan, Managing Director, SuperRatings, *Committee Hansard*, 7 March 2007, Sydney, p. 13.

118 Mr Frank Gullone, CEO, Superpartners, *Committee Hansard*, 25 October 2006, Melbourne, p. 10.

should really be 12 per cent and it also provides a structure which provides an easy discipline for people to work within.[119]

Committee view

7.164 The shift from passive superannuation investments in which employers bore investment risk, to today's competitive market in superannuation products where investment risk has transferred to employees, has left consumers more vulnerable to the vagaries of the marketplace than they previously were. This transfer of risk has left superannuation fund members with the responsibility for taking a number of decisions that were previously not required of them. As such, measures need to be taken to enable consumers to adapt to their acquired responsibility.

7.165 The committee firstly recognises that the provision of information from the superannuation industry to its clients has an important educative role. Government initiatives can stimulate people's interest on the subject and provide generic material on the system and interpretive information and advice, but the funds and advisers usually have a more direct input into educating consumers on their own superannuation arrangements. Thus it is important that the government clarify what information provided by superannuation funds represents personal financial advice under the Corporations Act.

7.166 Many of the problems with the provision of superannuation advice identified in this report are a consequence of consumers not having the knowledge to interpret the information they receive and the motivations of those that have provided it. Consequently, education is critical to improving the effectiveness of disclosure. If consumers were more financially literate then conflicted advice thus disclosed could be more meaningfully interpreted and superannuation products paying ongoing trailing commissions could be eschewed. Clients would be more cognisant of the relationship between their adviser and the products they recommend and they would be in a much more secure position from which to exercise their choice of fund options.

7.167 The committee recognises the difficulty of the task. Measurably improving overall financial literacy is not an undertaking that will yield results in the short term. Many Australians with money in superannuation do not take an active interest in superannuation issues, making education campaigns problematic in terms of their effectiveness. The committee believes this challenge can effectively be addressed by improving the accessibility of advice for those already in the system, from funds and licensed financial advisers, as well as ensuring that future superannuation fund members are provided with appropriate guidance during their school years.

7.168 The committee notes with approval the government's Better Super television and radio advertisements designed to inform and educate people about the reforms to superannuation which came into effect on 1 July 2007.[120]

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119 Ms Philippa Smith, CEO, ASFA, *Committee Hansard*, 24 October 2006, Sydney, p. 30.

7.169 The committee also supports the government's Financial Literacy Foundation initiatives. However it is important that the initiatives be actively monitored to ensure that resources are spent wisely. In addition, programs that are designed to bring progress in this area should be provided with additional funding if so needed. Consumers are in an increasingly vulnerable position with respect to their superannuation investment and consequently deserve to be provided with the tools to manage the risks they now shoulder.

Recommendation 25

7.170 The committee recommends that the government conduct a review of its Financial Literacy Foundation initiatives when their effectiveness is able to be measured against clear performance benchmarks.

120 See: http://www.ato.gov.au/bettersuper/