

SEPTEMBER 2022

PROPOSALS PAPER

Submission to The Quality of Advice Review



**financial
counselling
australia**



57 Carrington Road Marrickville NSW 2204

Phone 02 9577 3333 | Fax 02 9577 3377 | Email campaigns@choice.com.au | www.choice.com.au

The Australian Consumers' Association is a not-for-profit company limited by guarantee. ABN 72 000 281 925 ACN 000 281 925

ABOUT US

CHOICE

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

Consumer Action Law Centre

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.

Financial Counselling Australia

Financial Counselling Australia is the peak body for financial counsellors. Financial counsellors work in not-for-profit community organisations. They provide free and confidential advice and support to people experiencing financial stress.

Financial Rights Legal Centre

Financial Rights is a community legal centre that specialises in helping consumers understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the National Debt Helpline, which helps NSW consumers experiencing financial difficulties. We also operate the Mob Strong Debt Help services which assist Aboriginal and Torres Strait Islander Peoples with credit, debt and insurance matters. Finally we operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies.

Contents

Introduction	4
Recommendations	6
The best interests duty is a core consumer protection	7
The Review’s proposal will weaken competition and encourage the rise of vertically integrated businesses	9
There is no evidence that regulation of general advice needs to be dismantled	10
The Review should examine the effectiveness of safe harbour provisions	11
The best interests duty should be codified in primary legislation	12
Reform disclosure in financial advice	14
Ban conflicted remuneration in the advice industry	16
The Review should consider alternatives for Australians on low-to-middle incomes	18

Introduction

Australians who seek financial advice have the right to expect that the advice they receive will be independent, high quality and in their best interests. Poor financial advice has lasting impacts on the financial, emotional and social wellbeing of people across Australia.

The Quality of Financial Advice Review's (**'the Review'**) Proposal Paper recommendations would weaken core consumer protections and fuel the provision of poor quality advice by vertically integrated institutions. They would incentivise major banks, insurance companies and superannuation funds to provide conflicted sales pitches dressed up as advice.

Consumer groups strongly support the retention of a principles-based best interests duty. This is a critical consumer protection that requires financial advisers to act in the best interests of clients, not their own, and to face significant penalties where they fail to do so. The proposed watering down of the best interests duty to an obligation to give 'good advice' will push financial services regulation back decades. The Banking Royal Commission criticised the advice industry saying, "a 'good enough' outcome has been pursued instead of the best interests of the relevant clients or members".¹ The Review is proposing to codify a "good enough" approach - the very approach that the Banking Royal Commission called out for contributing to poor consumer outcomes.

There is a lack of empirical evidence that consumers would benefit by the deregulation of general product recommendations (currently regulated as general advice). There are a number of important consumer protections associated with the general advice model, including the requirement for advisors to be licensed and for consumers to have access to the Australian Financial Complaints Authority. The requirement to be licensed to provide general advice is the most valuable tool currently available to ASIC to rein in the burgeoning 'influencer' sector. It would be a grave error to entirely remove the regulation of general advice without considering the implications for the broader financial system.

It is clear from decades of ASIC reviews into the advice industry that conflicts of interest drive poor consumer outcomes. Conflicted remuneration such as life insurance commissions, asset-based fees and general insurance commissions incentivise the industry to recommend products that have the highest financial payoff for the adviser. Consumer groups strongly support the Review recommending the banning of all remaining forms of conflicted remuneration, to clean up the major conflicts which have marred this industry once and for all.

Consumer groups recognise the limitations of disclosure as a consumer protection. However, disclosure plays an important role in ensuring there is transparency and accountability in the industry. Designed correctly, disclosure documents enable a client to make an informed decision

¹Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, 2018, p.74

about engaging with a financial adviser and whether they are getting value for money. Provision of documentation at key points in an advice relationship creates a paper trail that can be an important source of evidence in the case of a dispute between the consumer and adviser, as well as allowing regulators to assess the quality of advice. We recommend the Review recommend the development of a performance-based disclosure regime that will reduce complexity and increase consumer confidence. This regime would require advisers to prepare less-prescriptive documents that reach a certain measurable threshold of consumer comprehension.

Over 60% of Australians say they would not pay for personal advice.² Many of these people do not have the sort of complex financial needs that the independent financial advice market is intended to address. Policy options should be developed for Australians on low-to-middle incomes for whom due to cost and/or circumstance, personal advice will never be appropriate. CHOICE encourages the Quality of Advice Review to investigate the merits of a model based on the United Kingdom's Money and Pensions Service to address this significant gap.

The Review is presented with an opportunity to recommend solutions that encourage the growth of independent and conflict-free advice. At the moment the proposals tip too far in favour of encouraging large institutions and product manufacturers to sell their own products. Doing so ignores the hard lessons of the Global Financial Crisis and Banking Royal Commission and risks fueling a revival of vertical integration.

²Rice Warner, 2020, Future of Advice, p.11,
<https://www.ricewarner.com/wp-content/uploads/2020/10/RW-Future-of-Advice-Report.pdf>

Recommendations

The Review should:

1. recommend retaining the best interests duty and related obligations as important consumer protections.
2. recommend retaining the requirement that a person providing general product recommendations be licensed.
3. support the Australian Law Reform Commission's proposal to recast the safe harbour provisions as indicative behaviours of compliance.
4. recommend the development of a consumer-tested, performance-based disclosure regime in financial advice.
5. recommend the prohibition of the remaining forms of conflicted remuneration, including a ban on:
 - the life insurance exemption
 - the general insurance exemption
 - the consumer credit insurance exemption
 - the timeshare commission exemption
 - asset-based fees.
6. consider solutions outside the private personal financial advice market that would be accessible for Australians on low to middle incomes. The Review should consider the United Kingdom's Money and Pensions Service as a complementary model.

The best interests duty is a core consumer protection

The best interests duty and related obligations are core protections for consumers in the Australian financial system. Prior to the introduction of the best interests duty, what consumers often received instead was a sales pitch for the product that would provide the greatest financial benefit to their advisor rather than advice about what was best for them.

The best interests duty was introduced as a result of an accumulation of advice scandals. Over 120,000 Australian households lost millions of dollars in the collapses of Opes Prime, Storm Financial, Timbercorp, Bridgecorp, Fincorp, Trio/Astarra and Westpoint. Many other Australians received conflicted advice from other financial planning businesses, including those owned by the major banks, that led to losses. While some of these losses were due to product failures or poor investment performance, the common ingredient was poor advice, which played a critical role in recommending that consumers invest in these entities. That problem was recognised through the many months of parliamentary inquiries that examined the causes of these losses and ultimately recommended the Future of Financial Advice reforms.

The Banking Royal Commission confirmed the merits of a best interests duty. One of Commissioner Hayne's six underlying norms of conduct is, "when acting for another, act in the best interests of that other."³ Commissioner Hayne also recommended that a best interests duty be extended to mortgage brokers and this has since been legislated. It is concerning that the Review is proposing to undermine this fundamental precept of the Banking Royal Commission.. People need to trust that the advisers they turn to will provide them with advice that they can trust.

The recent collapse of Dixon Advisory highlights how vertically integrated models lead to harmful financial advice and devastating economic and social effects. Importantly, ASIC was able to take successful legal action against Dixon Advisory for failing to act in their clients' best interests and failing to provide advice appropriate to their clients' circumstances. Justice McEvoy found:

*'There is no evidence that the (Dixon Advisory) representatives conducted the necessary reasonable investigations into the recommended financial products or any alternative financial products, nor is there evidence that they considered the personal circumstances of the clients.'*⁴

The Review's proposed 'good advice' framework would not require a provider to consider whether there are better products for their customer available in the market. The definition of

³Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, 2018, p.9

⁴Australian Securities and Investments Commission v Dixon Advisory & Superannuation Services Ltd [2022] FCA 1105

'good advice' proposed by the Review is:

advice that would be reasonably likely to benefit the client, having regard to the information that is available to the provider at the time the advice is provided.

In the context of a vertically integrated provider, this will create far too great a conflict to simply be 'managed'. The most likely result will be people being recommended in-house products that may meet a superficial understanding of 'good', but are far from what the best interest duty would deliver if the advice was required to consider broader options in the market. An employee of a superannuation fund providing advice to a consumer in a poorly performing product could likely satisfy the test by simply recommending they move to a product offered by the same fund that is only marginally better.

The best interests duty is an important consumer protection that limits advisers from simply recommending products in which they have an interest and should be retained for all forms of personal advice.

Case study

Barbara was impacted by the poor advice from Dixon Advisory.⁵ When Barbara was first approached by Dixon, she was managing her own investment portfolio and invested in lower-risk, well-established companies on the Australian stock market. However, Dixon advisers recommended Barbara sell her existing shares and invest in Dixon's conflicted in-house property fund. As a result of this advice, Barbara estimates she lost at least \$600,000. This is her experience:

"They groomed me for a couple of years, and then they moved in, sending me recommendations and backing them up with phone calls. They wouldn't hang up until they got a yes.

"I ended up losing all my confidence in my own investment ability and handed it all over to them, because they were the professionals. They just exploited the Daryl Dixon factor. He was held up as the guru of superannuation and wealth management.

"I'd get an information sheet, a recommendation, and then they'd follow up with a phone call. They used every tactic in the book. They wouldn't get off the phone with you. It was like they knew something that you didn't. It was scammer talk when I think about it now, but you don't see it as scammer talk when you're talking to professionals. When I think now how stupid I was. I had all my blue chips, and they trashed them."

⁵CHOICE 2022, Can you trust your financial adviser?

Barbara filed a complaint with AFCA in January 2022 but it's also on hold because Dixon Advisory entered into voluntary administration in January.

The Review's proposal will weaken competition and encourage the rise of vertically integrated businesses

Independent financial advisers play an important role in promoting competition in Australia. If appropriately regulated, an independent adviser can search the market and recommend financial products that meet the needs of clients.

Decades of empirical evidence have shown that conflicted models of financial advice lead to poor quality and harmful advice to consumers. CHOICE has been investigating poor consumer outcomes in the financial advice industry since the 1980s. In April 1987, CHOICE conducted its first shadow shop of financial advisers and raised concerns about vertical integration as we saw a clear preference for advisers to recommend lower quality products of their parent bank.⁶ In this shadow shop for example, a Westpac financial advisor recommended that an individual invest all of their savings in two Westpac branded financial products.

Over 30 years since CHOICE's first shadow shop, the same problems persist, with the 2018 ASIC review into vertically integrated businesses finding that advisers are still overwhelmingly recommending products from their own parent business.⁷ The research found that while in-house products accounted for an average of 21% of products on the licensee's product list, after receiving advice, 68% of funds were invested in in-house products.

We are concerned that the Review's proposal will pave the way for large vertically integrated firms, such as banks and insurers to provide more conflicted financial advice. The rise of vertical integration in the advice industry in the 1990s and 2000s contributed to widespread consumer harm, as observed in the Commonwealth Financial Planning and fees-for-no-service scandals. As the Productivity Commission Review into Competition in Australia's Financial System found:

*"banks saw the growth in wealth management as an opportunity to cross-sell a broader range of financial services to their existing customer base and access the rapidly growing superannuation market."*⁸

The Productivity Commission concluded that:

⁶CHOICE, 1987, 'How to choose an investment adviser', April

⁷ASIC 2018, Report 562, Financial advice: Vertically integrated institutions and conflicts of interest

⁸Productivity Commission, 2018 Competition in the Australian Financial System, p.253

“enforcing the conduct standards required in the financial advice market is pivotal to competition and ensuring the client’s best interests are met.”⁹

A lower “good advice” threshold will mean that bank-affiliated salespeople will be able to recommend financial products manufactured by the bank, irrespective of whether there are better products on the market. This is especially important given the cost of living challenges facing Australian households. There are lasting financial implications for a household if they are recommended a low-quality financial product if there are better-quality products on the market. For example, the difference between a superannuation fund in the bottom quartile of performance versus the top quartile is hundreds of thousands of dollars over a person’s lifetime.

¹⁰

Consumer groups are also concerned that the “relevant provider” proposal will risk creating a loophole where salespeople who do not charge a fee, but provide financial advice, will be exempt from a number of key consumer protections, with serious implications for competition. In essence, advisers employed by product providers would be subject to few compliance requirements other than the vague ‘good advice’ test, while independent advisers would continue to be subject to a range of compliance requirements through the educational standards and Code of Ethics. Big institutions would have strong financial incentives to find ways to cross-subsidise and offer ‘free’ services that escape the regulatory framework and attract new sales. They would also have the advantage of being able to use their superior data to target customers with highly efficient models of advice that meet minimal compliance requirements.

If anything, these proposed reforms are likely to undermine the viability of the independent advice model while fuelling the growth of large institutions.

There is no evidence that regulation of general advice needs to be dismantled

Consumer groups are concerned that removing the general advice model entirely without carefully considering the implications would create unnecessary risks for Australian households and the financial system. Families may be exposed to unregulated product recommendations without any consumer protections.

In essence, the general advice model requires an entity that makes general product recommendations to hold an Australian Financial Services Licence. This in turn provides a range of important protections, including the requirement to have an internal dispute resolution process and be a member of the Australian Financial Complaints Authority. Most importantly, it

⁹Productivity Commission, 2018 Competition in the Australian Financial System, p.264

¹⁰Productivity Commission, 2018, Superannuation: Assessing Efficiency and Competitiveness, p.17

allows ASIC to take a broader range of actions against unlicensed people who seek to spruik products.

We recognise that there are shortcomings to the current regulation of general advice, especially in relation to consumers' understanding of the term.¹¹ It is, however, a crucial safeguard. Deregulation of general advice would see a boom in distribution models such as financial advertisements, property investment seminars, webinars and newsletters. Consumers would have few if any rights if the advice provided through these models was shoddy. They would not be able to complain to the Australian Financial Complaints Authority and would not have access to the proposed Compensation Scheme of Last Resort.

The general advice framework is one of the key tools that ASIC has to regulate and rein in the growth of finfluencers. Finfluencers operate on the margins of the advice framework and the industry's popularity has surged on social media. Inappropriate information provided by finfluencers can have a negative impact on the financial wellbeing of people, particularly younger Australians. ASIC's recent reminders to finfluencers of their duties under the current advice laws has seen a marked improvement in outcomes. ASIC reported that they have "seen finfluencers be much more careful, moderating their language online, and some are pursuing official credentials."¹² It has been reported that since ASIC's crackdown, social media posts about advice have been reduced by up to a third, and bigger finfluencers have applied for an Australian Financial Services Licence.

As consumers face increasing risks through instability in global equities markets and the promotion of cryptocurrencies as alternative investments, it would be imprudent to remove one of the key protections that allows ASIC to control who can make product recommendations.

The Review should examine the effectiveness of safe harbour provisions

Consumer groups are strongly supportive of a principles-based best interests duty.

As a result of intense industry lobbying for prescription, the Federal Government legislated safe harbour provisions as a possible way to satisfy the best interests duty. In 2011, the Financial Services Council argued that without "appropriate clarification" in the best interests duty, advisers would be open to "pernicious lawsuits".¹³ They claimed that without prescriptive steps defined in the law, the cost of professional industry insurance would remain high, "increasing the cost of advice for Australians".

¹¹ASIC, 2019, REP 614 Financial advice: Mind the gap

¹²Alasdair Belling, 2022, 'After the crackdown, these finfluencers are fighting on', The Australian, September 9, <https://www.theaustralian.com.au/business/after-the-crackdown-these-finfluencers-are-fighting-on/news-story/2ccda8378556007e87cfd400cfb85f82>

¹³Financial Services Council, 2011, Submission to Senate Economics Legislation Committee, Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 - Economics Legislation Committee, p.41

The industry now uses the same scare tactics to claim safe harbour provisions increase the cost of advice. The Financial Services Council now estimates that removing the safe harbour provisions would lower the cost of advice from \$5,300 to \$3,500.¹⁴

In its Interim Report into Financial Services Legislation, the Australian Law Reform Commission proposed recasting the safe harbour provisions as ‘indicative behaviours of compliance’. The ALRC considered that this proposal would:

“promote more meaningful — rather than ‘tick a box’ — compliance, and help achieve a more principled and simpler legislative regime.”¹⁵

There is merit to this proposal. We support retaining the principles-based best interests duty and amending the safe harbour provisions to state that they are indicative behaviours of compliance. This approach could help simplify the law to the original intent of Future of Financial advice reforms (**FoFA**) to create a principles-based best interests duty.

The best interests duty should be codified in primary legislation

Consumer groups strongly oppose merely relying on the Code of Ethics (**‘the Code’**) to apply a best interests duty to advisers. The best interests duty is a fundamental consumer protection that should be codified in the *Corporations Act 2001 (Cth)*, with appropriate penalty provisions.

Some in the financial advice industry have relentlessly sought to undermine the Code and continue to actively lobby for it to be dismantled. Despite strong standards enshrined in the Code, there is no conclusive evidence, including in the form of ASIC case file reviews, to allow us to assess whether it has led to any discernible improvement or change in conduct.

Recommendation 1

The Review should recommend retaining the best interests duty and related obligations as important consumer protections.

Recommendation 2

The Review should recommend retaining the general advice framework, unless there is clear empirical evidence the framework needs to be altered.

¹⁴Financial Services Council, 2021, White Paper on Financial Advice, p3.

¹⁵Australian Law Reform Commission, Financial Services Legislation: Interim Report A (ALRC Report 137), p.534

Recommendation 3

The Review should support the Australian Law Reform Commission's proposal to recast the safe harbour provisions as indicative behaviours of compliance.

Reform disclosure in financial advice

Consumer groups recognise the limitations of disclosure in financial advice. However, disclosure does play an important role in ensuring accountability and transparency in the advice industry. Designed correctly, disclosure documents enable a client to make an informed decision about engaging with a financial adviser and whether they are getting value for money. They also provide an important paper trail if anything goes wrong.

The fees-for-no-service scandal shows the incentive that vertically integrated advice firms have in obscuring fees and hiding the true service provided to clients. Without a clear statement that outlines a forward-looking statement of services, some advisers are incentivised to do as little work as possible. The Banking Royal Commission identified the inherent conflict in ongoing service arrangements and found that “the less the adviser does before the fee is paid, the greater the financial advantage.”¹⁶

It is essential that consumers receive advice in writing. We disagree with the Review’s “query whether consumers want written advice at all”.¹⁷ If a consumer receives inappropriate advice, disclosure documents are important pieces of evidence people can take to the Australian Financial Complaints Authority or to the courts. Without these documents, consumers would have little evidence but the file notes of the offending advisers to rely on.

Consumer groups support performance-based disclosure. Prescriptive regulations, such as mandating that an adviser discloses a lack of independence in the Financial Services Guides, give specific instructions about what firms must and must not do. Performance-based regulations, on the other hand, give goals toward which firms must work, but are less prescriptive in how those goals must be met. Prescriptive regulations require only that certain actions be taken, whereas performance-based regulation demands that outcomes, such as consumer comprehension, be achieved.

The principles that should underpin a performance-based disclosure regime in financial advice should include:

- Fees must be transparent, clearly communicated and charged in exchange for a service that is of value.
- Consumers must consent to any fees that are charged on an annual basis.
- Consumers are to receive advice in writing on an opt-out basis.
- Advisers and licensees are to maintain robust and clear record keeping obligations, and records should be kept for at least seven years.
- Performance-based outcomes such as consumer comprehension must be measurable.

¹⁶Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Final Report, 2018, p.9

¹⁷Quality of Advice, Proposals Paper, p.32

The development of a performance-based disclosure regime would be a significant piece of work that is beyond the resources and time available to the Review. Any proposed performance-based disclosure regime would need to be based on significant consumer research, as well as testing by an independent body, such as the Behavioural Economics Team of the Australian Government, to ensure that it achieves its objectives.

Recommendation 4

The Review should recommend the development of a consumer-tested, performance-based disclosure regime in financial advice.

Ban conflicted remuneration in the advice industry

Consumer groups strongly support the prohibition of the remaining forms of conflicted remuneration in the financial advice industry.

The existence of conflicted remuneration continues to lead to poor outcomes and weakens consumer trust and confidence in the financial advice industry. When CHOICE asked members of the community about financial advice, 70% of respondents said they don't trust financial advisers that receive commissions.¹⁸

CHOICE's submission to the Review's Issues Paper identified five examples of conflicted remuneration in the advice industry that need to be prohibited.¹⁹ These include:

- the life insurance exemption
- the general insurance exemption
- the consumer credit insurance exemption
- the timeshare commission exemption
- asset-based fees.

Conflicts of interest are a leading driver of poor outcomes for consumers. They incentivise the industry to recommend products that maximise their revenue. The intent of the FoFA reforms were to prohibit conflicted remuneration, however, the industry successfully lobbied for carve-outs, including for grandfathered commissions and life insurance commissions.

It has been almost ten years since the FoFA reforms first tried to 'manage' some existing conflicts. The industry has had more than enough time to restructure in response to these reforms and develop models for remuneration that do not rely on these conflicts.

We strongly support the Review recommending the banning of all remaining forms of conflicted remuneration

Recommendation 5

The Review should recommend the prohibition of the remaining forms of conflicted remuneration, including a ban on:

- the life insurance exemption
- the general insurance exemption

¹⁸CHOICE & Super Consumers Australia, 2022, "Quality of Advice Review survey", data was collated 4 May – 23 May, 2022, the sample is self-selecting from an online survey asking CHOICE supporters and the general public to share their experiences in seeking financial advice, n=1,221.

¹⁹CHOICE 2022, Submission to the Quality of Advice Issues Paper, <https://www.choice.com.au/consumer-advocacy/policy-submissions/2022/june/submission-to-the-quality-of-advice-review-issues-paper>

- the consumer credit insurance exemption
- the timeshare commission exemption
- asset-based fees.

The Review should consider alternatives for Australians on low-to-middle incomes

Affordability barriers continue to exist for many consumers when accessing professional services such as lawyers or financial advisers.

In CHOICE's submission to the Issues Paper, we recommended the Review consider alternative and independent models for Australians on lower to middle incomes who need financial guidance. Many Australians do not have the financial means to pay for professional financial advice. Over 60% of Australians are unwilling to pay for financial advice and only 10% are willing to pay more than \$500 in fees for financial advice.²⁰ That is not surprising, because many of these people do not have complex financial advice needs.

As a starting point, the Review should consider the United Kingdom's Money and Pensions Service. The Pension Wise service gives people access to free, impartial, specialised guidance about their pension options, delivered face-to-face or over the phone. The service also provides a free online tool to help people choose how to access their pension money, including a product comparison tool. Any such model in Australia should be supplemented by a broader range of independent product comparison tools, to help people to find products that meet their needs after obtaining advice. This proposed model would eliminate the conflicted nature of superannuation funds providing advice to their members.

Consumer groups encourage the Review to consider the effectiveness of the United Kingdom's Money and Pensions Service and recommend areas where this model can be strengthened and adapted to Australia's financial system

Recommendation 6

The Review should consider solutions outside the private personal financial advice market that would be accessible for low to middle income Australians. The Review should consider the United Kingdom's Money and Pensions Service as a complementary model.

²⁰Rice Warner, 2020, Future of Advice, p11.