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Super standards must be met

ASIC is not picking on financial planners but just doing its job, writes **Jeremy Cooper**.

FINANCIAL planners are wrong to think that the Australian Securities and Investments Commission is picking on them. True, we were far from happy with what we found in our super switching advice surveillance late last year and early this year.

But by early last month, when we released our report on the surveillance, we were more confident that advisers were clear on their obligations and we said so. A lot of work had been done in the interim by the industry associations and ASIC.

In our surveillance, ASIC looked at 260 examples of written recommendations by advisers to switch from one super fund to another. The advice came from advisers working for 19 different Australian financial services licensees (not just Financial Planning Association members) from an initial list of 7500 examples of switching advice. The methodology was sound and the results real.

What did ASIC find?

Much of the advice was substandard. Advisers often did not look at their client's existing super fund, failed to check their insurance cover and did not look at the costs and potential loss of benefits before recommending a switch to a new fund. There were also some examples of outright mis-selling of life insurance to people who didn't need it, couldn't afford it or both. The issues were not about fine legal distinctions, new rules or a lack of guidance from ASIC.

Of the 19 licensees involved in the surveillance, ASIC is taking enforcement action, or requiring remedial compliance measures, in relation to 17 of them.

Of the 7500 switching recommendations, 4900 were made by advisers who were connected with a super fund product issuer (the remainder were recommendations by independently owned advisers). Ninety per cent of the recommendations made by those advisers were to switch to a super fund connected to the adviser (that is, an in-house fund). Our broad observation was that switching advice was more likely to be inappropriate when it recommended a switch to an in-house fund.

In response, the industry said that a consumer visiting a Ford dealer knows they are going to be sold a Ford and so it is OK for an adviser who works for XYZ to recommend only XYZ funds.

What does this mean for the 70 per cent of advisers who work in an organisation owned by a product issuer? The law says that they, like all financial advisers, have to give advice that has a reasonable basis and is appropriate for their clients.

There is no lower standard because your clients are supposed to know that you are owned by a product issuer.

In practice there might even be a higher standard.

A higher standard? Advisers in a financial services conglomerate have several conflicts where they largely advise about in-house products. There is a tension between acting in the best interests of the client versus selling in-house product and earning commissions and bonuses. Most institutionally owned planner groups are also governed by an approved product list that increases the conflict. Some of them can't recommend other products even if they wanted to. That said, ASIC recognises the risk management and quality control benefits of product lists.

> **'There was outright mis-selling of life insurance to people who didn't need it, couldn't afford it or both.'**

Where an in-house product is being recommended, mere disclosure of a conflict is not enough. Since January 1, all licensees must have a system for adequately "managing" their conflicts. The institutionally owned planning groups need to be sure that their in-house products are at least on par with other products in areas such as fees, performance, and functionality, before a switch to an in-house product is recommended. Also, licensees will not be not managing their structural conflict if they recommend in-house products that are not at least as good as their client's current products. Disclosure of a conflict does not allow the giving of inappropriate advice.

What about trailing commissions? There are three types of trailing commission: first, a payment of an agreed amount over time for a product or service provided up-front; second, an ongoing fee for services provided on a periodic basis (typically, advice); and third a trail that lasts for the life of the product, but bears only a loose relation to any benefit provided to the client. It is the third type of trail that is so often a rip-off. This type of trail represents an ongoing cost to the consumer and cannot be justified in cases where they do not match the value provided to the client. Trailing commissions can

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be a valid method of remuneration or amortising up-front costs, but not where no corresponding value to the consumer can be identified.

Where to from here? ASIC's charter is to promote an efficient financial services industry and the confident participation of consumers and investors. ASIC will continue to take enforcement action against licensees and advisers who break the law. We will continue to work with the industry to increase the co-operation that has resulted in much progress to date.

The important point is that ASIC will speak up about weaknesses in the financial services industry.

Under scrutiny: ASIC's study finds that much advice given by financial planners was sub-standard.