Wealth management and advice

— the way ahead

by

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Wealth management and advice –the way ahead

How will the Australian financial services industry achieve world's best practice in wealth management and the provision of advice?

This afternoon, I would like to share with you some thoughts about wealth management and advice from the regulator's perspective. I will be talking under three broad headings:

- The environment in which all of us – the regulator, the industry and consumers – are operating;
- The importance of advice for consumers of wealth management products and services and ASIC's role; I will touch on the quality of advice, super choice, super switching and shadow shopping
- The way forward: building strong partnerships to maintain consumer confidence in the quality of services offered by the wealth management industry.

The environment

The wealth management industry has been experiencing a period of phenomenal growth and change. According to the latest Reserve Bank Bulletin, the managed funds industry (broadly defined to include all forms of funds management) has grown by almost 40% in the 3 years from June 2002 to June 2005 and total consolidated funds under management now exceeds $915 billion. Superannuation, of course, has been a major contributor to this. Non-life office superannuation has grown by nearly 69% to around $590 billion dollars. The combined effect of emphasis on retirement savings through the superannuation system, as well as the current buoyant state of the economy, suggests continuing growth of the sector.

This is a large amount of money. It makes the wealth management industry as a whole an extraordinarily important player in Australian capital markets and the economy as a whole and enables it to influence many aspects of the environment we at ASIC have responsibility for. To take just one example, it is in a position to influence corporate governance practices, and it is an important contributor to debates in that area.

Equally importantly, the size of the industry makes it critically important for Australians whose future life plans at all stages are now more than ever dependent on how their savings and investments are managed. The industry has a large responsibility to

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maintain the trust we all place in it. This is what ASIC means when it talks about the continuing need for consumer confidence.

At the same time, of course, the industry itself is continually changing. We all know about the changes in ownership that have occurred over the last ten years; the constant development of new business models, new products and new services.

I will not dwell on these, but I do want to acknowledge the growing concern in the industry about legacy products. I know that IFSA has been taking the lead on developing proposals that will enable funds managers to shift to more modern and reliable systems, and have raised the issue with Government, APRA and ASIC. We have expressed our in principle support for such a move, and indicated a keenness to work with industry on the legislative and policy issues needed to move forward. From ASIC's perspective, the potential of these initiatives to lead to less complexity for consumers is welcome. At the same time, we all need to ensure proper protection for consumers who have often held some of these products in question for many years. I understand a meeting with representatives from IFSA to progress the issue is imminent. We understand that these products can be an administrative nightmare as they were created before the advent of computer software programs and there have been issues where consumers try to ascertain the value of their policies and must wait some months to get an answer.

FSR refinements

Lastly under the heading of the environment, I want to touch on the extent and pace of regulatory change for the wealth management industry. I will not dwell on the changes I know you are all familiar with. The managed investments legislation, financial services reform and now superannuation choice have fundamentally changed the way we all go about our business, including at ASIC.

Let me make one comment about the financial services reforms. The transition to the new regime has been a large exercise, and as you would expect, sometimes a difficult one. It is now time we all work hard to make the regime work effectively in practice for the medium to long term. For industry, most of the costs of change are now behind you; it is time to ensure you start to reap the benefits. The regime's consumer focus is an

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opportunity to build long term relationships with your customers based on trust, and those who have seen this opportunity and built their approach to FSR around it are well placed to enjoy the rewards. We at ASIC look forward to doing our part to bringing the regime to maturity – by making its operation predictable and certain, by continuing to operate as transparently as possible, and by constant communication with stakeholder groups such as IFSA.

The importance of advice

For Australian consumers, quality financial advice is more important than it has ever been. Direct and indirect participation by consumers in markets for financial products and services is at an all time high. And superannuation choice has added a major dimension, with consumers now able to choose how their mandatory savings are managed.

ASIC's job is to promote a financial services industry that is efficient, flexible and innovative in the provision of financial products and services. We must also promote the confident and informed participation of investors and consumers in the financial services industry. ASIC recognises that the needs of both business and consumers must be met, and we work hard to try to balance those needs.

Institutions, in the vast majority of cases, are structurally sound. With the exception of certain problem areas at the fringes, the core of the investment industry is working well. You are generally offering products that meet consumers' needs in an increasingly competitive environment. Of course, there are areas for improvement. Room still remains to increase the participation of investors and consumers in the financial services industry to promote active and confident participants. You may need to look to making products simpler. It is tempting for individual players to compete by differentiating their products with bells and whistles. Financial products are complex enough when one considers tax or social security regimes that can apply. Creating greater complexity in the nature of the product may not be in the consumer's interest. Indeed, sometimes, in differentiating your products by adding bells and whistles, consumers are deterred from acquiring products simply because it is all too complicated and disclosure, of course, has its own limitations. This means you need to look at the challenge carefully because the

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competitive pressure to differentiate sometimes has the potential to undermine the goal of increased participation by investors and consumers.

But it is important that you – as an industry – acknowledge that you must take some responsibility for bearing the burden of building the financial services regulatory regime into a mature, workable and effective regime. We are, after all, talking about having your present and future customers develop and maintain a strong sense of confidence that you are providing a professional reliable service in a fair and efficient manner.

Quality advice

In 2005, given the complexity of the tax and superannuation systems, current standards of financial literacy and human frailties, there is considerable unmet need for quality advice. What does "quality advice" mean in this context?

Quality advice is advice provided by a skilled professional in a disinterested manner in the interests of a client. The Australian Council of Professions defines a profession as "a disciplined group of individuals who adhere to high ethical standards and uphold themselves to, and are accepted by, the public as possessing special knowledge and skills in a widely recognised, organised body of learning derived from education and training at a high level, and who are prepared to exercise this knowledge and these skills in the interests of others".

The Australian Council of Professions goes further to suggest that inherent in its definition of a 'profession' is the "concept that the responsibility for the welfare, health and safety of the community shall take precedence over other considerations".

ASIC is keen to see the advice industry meet these high professional standards and work towards attaining best practice in the provision of advice and in wealth management more generally.

We share the industry's view that giving financial advice should be viewed as a professional activity.

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We have been encouraging the emergence of a fully-fledged profession of financial advice for over a decade from when we overhauled the old securities industries regime in our "Good Advice" Project.

ASIC initiatives

More recently, of course, we have been focussing on the quality of advice in the superannuation context. Let me say a few words about recent and current ASIC initiatives in that area.

Our overall focus has been, as you would expect, compliance with the law. This includes not only the rules about knowing your client and giving advice that is appropriate to the particular client, but also the new, explicit, rules of having adequate arrangements for managing conflicts of interests. This is particularly important to deal with the tension between acting in the best interests of a client while selling in-house financial products and earning commissions and bonuses.

Super Choice

ASIC accepts that, while it is clear that the financial services regulatory regime is bedding down, recent developments, such as superannuation choice, have altered the playing field. I am not going to discuss the ins and outs of this new regime; I am sure you are well versed in them. Indeed, ASIC is confident that the platform for superannuation choice is in place. However, some gaps are evident. I want to reiterate the importance of the advice industry helping retail consumers understand their superannuation so that they can make informed decisions and maximise their savings for retirement. I highlight the role of advisers in this given the range of advice that may interact with superannuation issues.

Returning to key choices regarding superannuation though, ASIC is of the view that the advice industry must assist consumers in making good superannuation choices, including whether they decide to stay in their current superannuation fund or choose a new one. This is not about selling a product because it is in the interests of the adviser or product provider. It is about providing professional advice that is directed at satisfying the needs of the consumer.

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Super switching campaign

It was in recognition of the vulnerability of consumers in the complex area of superannuation that we commenced ASIC's recent superannuation switching campaign. ASIC can make no apology for its findings in this campaign. The methodology was sound. We reviewed around 260 specific pieces of advice from 19 licensees and, put simply, tested whether advisers were complying with the law. Specifically, we were checking that advisers were complying with their conduct and disclosure obligations when advising clients to switch from one superannuation fund to another. This meant that advisers must have a reasonable basis for recommending a switch and had to disclose any disadvantages of switching, such as costs, lost benefits like insurance and other significant consequences of making a switch.

Unfortunately, our findings gave us some cause for concern that there are more instances of failure to meet standards than anyone would consider acceptable – ASIC, consumers or the advice industry itself. So, for example, we found patterns of conduct, as opposed to isolated incidences, of advisers recommending a switch despite having undertaken little or no investigation into the client's current superannuation fund. We also found poor disclosure of the costs of switching to another fund and a tendency for advisers to recommend funds related to the licensee.

Of the 7500 switching recommendations, 4900 were made by advisers connected with a superannuation fund product issuer. 90% of the recommendations made by those advisers were to switch to an in-house fund. There is clearly a risk that advice of this kind may be inappropriate if it is focussed on the products the client ends up with rather than the needs and interest of that client.

To make this concrete for you, let me give you an example. John Smith is a labourer. He received advice to roll over from his existing industry super fund (Fund 1) to Fund 2. Fund 1 provided Death & TPD cover regardless of occupation, while Fund 2 did not provide TPD cover to labourers. The loss of the cover is disclosed in the SOA with the comment *"There is a loss of $55,000 Death and TPD, however the plan compensates for this with a higher cover of $250,000 for Death"*. What the SOA fails to say is that the higher death cover in Fund 2 was at a significantly greater cost. The client was 25 years old, not married, had no dependants, and as a labourer was at much greater risk of requiring TPD than

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someone with an office job. The death cover was far less suited to his situation than TPD cover and arguably of no benefit whatever. John Smith could have kept his TPD cover by remaining in Fund 1, which had lower administration fees and nil establishment and contribution fees. He would also have saved himself the 4.5% entry fee into Fund 2.

Shadow shopping

The work we are currently undertaking in our shadow shopping survey is a continuation of our focus on quality of advice in the superannuation context. It is designed to test superannuation advice given to real consumers to ensure that the advice industry stays **ahead** of stakeholder expectations.

There is a lot of interest about our shadow shopping survey. The survey methodology involves Roy Morgan surveying 300 consumers. These are consumers for whom Superannuation Choice is relevant and who are in the market for superannuation advice in the survey period. Roy Morgan and we know it is relevant for them because of existing Roy Morgan data. Roy Morgan ascertains whether or not they intend to seek advice about superannuation It would be a sad reflection on licensees if they needed ASIC to tell them what their representatives are doing. In some liaison meetings we have even heard some advisers say that they are not going to take on any new clients during that period, in case they were shadow shoppers. Why? What would they do differently? Shadow shopping is just one technique we use to complement the other methods we have for compliance monitoring. We know that a number of firms undertake their own shadow shopping exercises.

Model statement of advice

I should also mention our model Statement of Advice. As you know we issued this as part of our contribution to the Government's FSR refinements project. It illustrates our interpretation of clear, concise and effective communication in a specific financial advice scenario. ASIC considers it a good starting point from which you can work to adapt your style and approach in your own Statements of Advice. However, I stress that it is **only** an example. It is not supposed to reflect a 'perfect' Statement of Advice and is not a template that can be used in all situations.

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The way forward

I would not want you to see our attitude as negative or focussed only on the problems we have seen. As the regulator, we are focussed on our task of making sure the interests of consumers of advice are well served by advisers complying fully with their obligations under the Corporations Act. At the same time, we are keen to see consumers reap the benefits of a fully professional advice industry. This potentially brings benefits beyond legal compliance: a commitment to the highest standards of expertise and ethics, well beyond the minimum standards the law requires.

Against this background, today's focus is to build a constructive dialogue so that we can all work together to resolve the issues. One of these foundations is that you – not only us as regulators – should be concerned about how to get consumers access to quality, affordable advice. We share the goal, as the FPA puts it, of ensuring that consumers 'who use advisers are more likely to reach their financial goals than those who don't'.

For industry, this must be an imperative: you run reputational and customer retention risks if you have inadequate measures in place to recognise and deal effectively with non-compliant conduct.

In light of the debates that followed release of our superannuation switching report, it might help that process if I say something about our overall approach and clear up some misconceptions.

ASIC's overall approach

Let me begin by making clear that, despite recent misplaced press indicating that ASIC is seeking to change the structure and ownership of the advice industry, that is **not** our objective. The structure of the industry is a matter for the industry. But how the advice industry is structured can have an effect on the conduct that takes place within it. And that conduct is a matter for ASIC, because we are the financial services regulator. The fact that product manufacturers own the dominant share of the advice industry is an environmental factor we need to be aware of, because it might influence how people within the industry behave and therefore, whether they comply with their obligations under the law.

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So ASIC – as the financial services regulator carrying out its regulatory duties – and yourselves must be mindful of the influence that this model can have on the delivery of quality advice to consumers. This is an environmental factor that we – and you – cannot ignore.

We also acknowledge that the advice industry in Australia is probably better placed than many other advice industries globally. Australian consumers are also better informed and better protected than ever before. ASIC's commitment to compliance and enforcement action against industry participants who break the law helps to keep this standard high.

More broadly, we see real potential for partnerships between the regulator and industry on key issues facing the wealth management and advice industry. We to bring to the table a clear objective to have increased investor and consumer confidence in the quality of services offered by members of the wealth management industry; an ambition for the industry to thrive and to win and retain the trust of its customers; and a willingness to work closely with industry to achieve these goals.

To my mind, the next stage involves an open and frank dialogue directed to finding common ground in developing high professional standards so as to ensure optimal outcomes for all – ourselves, the industry and, most importantly, consumers (without whom there would be no industry).

Industry's contribution

What can industry contribute? Firstly, let me acknowledge the large contribution already being made.

Since the release of the superannuation switching results, concerted efforts have been made to improve practices in the advice industry.

The main theme of the IFSA conference a couple of months ago was the value of advice. I know too that IFSA has undertaken to engage directly with the specific problems the super switching exercise raised and have asked for details that might be the basis of an industry-wide response.

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The FPA has just launched an advertising campaign on the theme of "the value of advice". I think the campaign is very appropriate, as advisers ***can*** add significant value for their clients. We would like consumers to be confident seeking advice and to be prepared to pay for it.

It is important that you – as an industry – continue to take responsibility for building the financial services regulatory regime into a mature, workable and trusted regime.

To my mind, a critical starting point is for the industry to acknowledge that there are still problems in the overall quality of advice available to consumers. The work that we have done recently shows that departures from legal standards are still too frequent. This is a problem for the industry, as well as ASIC, and it will not be solved by denying it or ignoring it. Let's take those problems on and make a concerted effort to solve them.

ASIC encourages the industry to help build the framework for quality advice. For example, industry could develop other example Statements of Advice in more specific areas like advice on establishing a share portfolio.

We are also keen for industry to recognise the value of strategic advice such as 'make voluntary superannuation contributions' or 'pay off your mortgage'. This is valuable, and quite different from the value of product advice. Given the increased complexity of many products, ASIC would like to see the advice industry aim to provide good quality strategic advice, as well as quality product advice. This includes the provision of strategic advice on existing products that a client holds.

We acknowledge that consumers, too, must play a part, for example, 'by embracing education, particularly in the area of financial literacy [a]nd…by accepting that everything in life carries some degree of risk'.[1] This tripartite solution – as recently enunciated by the Parliamentary Secretary to the Treasurer – will assist in establishing an industry that represents world best practice.

[1] The Political and Regulatory Perspective. Address to the KPMG Global Financial Services Conference presented by the Parliamentary secretary to the Treasurer, the Hon Chris Pearce MP, 22 September 2005

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In our view, the maturing professionalism is reflected in the recognition that soft dollar benefits were undermining confident participation of consumers in the advice market. The reaction – to remove soft dollar benefits – was unanimous. We applaud that. And once the entire advice industry got behind it, none were worse off than others. A similar approach must be adopted to create and sustain high professional standards in the advice industry. And it is possible.

Going forward

My colleague and ASIC's Deputy Chairman, Jeremy Cooper, will be taking the Commission lead on this work with IFSA, the FPA and the rest of the industry. He plans to write to Richard Gilbert and Kerrie Kelly as soon as he returns from overseas, suggesting the need for a close partnership between ASIC and the industry on key issues in the advice area, and the kinds of things that partnership we should begin by working on.

Let me close by mentioning the results of a recent research project commissioned by CPA Australia on the impact of financial services reform. Based on a telephone survey of 820 investors between May and June, this year, it shows that the new regime has created a fence and that consumers are able to trust those inside the fence, confident that certain standards have been met. One in three consumers believe that quality of advice has improved over recent years, most investors understand the information provided by their adviser and many consumers find Statements of Advice useful and relevant (albeit lengthy and complex, although our model Statement of Advice can provide guidance in this area). This is good news.

However, we have to be cautious about drawing definite conclusions where consumers report whether they are satisfied with the advice they receive. Our last shadow shopping exercise revealed that consumers could be happy with their advisers and trust the advice they are getting, even when the quality of that advice was objectively quite poor. Just because consumers are happy and trusting does not necessarily correlate with the provision of quality, affordable advice, which is what we should all aim towards.

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That being said, the survey is a clear signal that we are all dealing with consumers whose understanding of what they expect from the advice industry is developing. Let us make sure we work together closely to deliver on those expectations.

Before I finish, may I repeat:

- ASIC is not "out to get" the advice industry
- ASIC's focus is on your industry's outcomes, not its structure
- The industry deserves credit for its increasing professionalism, however
- There is room for improvement
- We are keen to continue to work with industry to improve standards where necessary.

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