



ASIC

Australian Securities & Investments Commission

ASIC's focus in the financial advice sector

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CHECK AGAINST DELIVERY

Introduction

Good morning and thank you to the Association of Superannuation Funds of Australia (ASFA) for inviting me to speak today.

Today I will be speaking about some current areas of focus for us in 2015 in the financial advice sector. But first, I'd like to make a few comments about restoring trust in our financial system.

As our Chairman, Greg Medcraft, noted in *ASIC's Strategic Outlook* for 2014-15, ensuring that Australians have trust and confidence in our markets is at the heart of everything we do.

Australia's financial system is built on trust – trust in financial institutions and their staff, trust in financial intermediaries, and trust in the regulatory arrangements that underpin them.

Trust of Australian consumers and investors has been eroded in recent years. All of us have an important role to play in restoring that trust. Financial institutions and intermediaries need to foster a culture not just of compliance with the law, but of focus on the long-term best interests of their customers.

Trust and confidence in our markets is dependent on our gatekeepers having a culture that emphasises the best interests of their customers.

At ASIC, we use our regulatory toolkit to further the long-term interests of consumers of financial services, including investors. We are committed to improving our regulatory activities in the interests of promoting a better financial system – because that produces better outcomes for consumers of financial services and, with better outcomes, trust in the financial system will slowly be restored.

Now, I'd also like to make a few comments about the need to lift standards in the financial advice sector.

ASIC has been saying for some time that the financial advice industry is a high-risk sector. We have publicly highlighted our concerns about the poor quality of advice and the problems created by conflicts of interest and poor culture. This is not just a matter of rhetoric. Our surveillance work and shadow shops persistently show poor-quality advice and we have brought this to the public's attention repeatedly through published reports. Parliamentary inquiries in the past, in the present and those that are going to report probably in the future have also highlighted the problems in the financial advice industry.

Given this, lifting the standards of advice in the financial advice sector has been, and is being, comprehensively considered, which is why we have pushed for law reform in this space.

Some of our suggested reforms have been implemented by government, for example:

- The Future of Financial Advice (FoFA) reforms have brought in prohibitions on conflicted remuneration for investment products going forward, the best interest duty for financial advisers and, importantly, enhancements to ASIC's licensing and banning powers.
- The Financial Advisers Register, which was launched on 31 March 2015, is an important reform that will benefit consumers and assist ASIC with our oversight of all advisers.

There are also some reforms which we would like to see in the future that have been recommended by the Financial System Inquiry, such as giving ASIC powers to ban managers and executives from financial advice firms, not just those that actually provide the financial service.

But let's leave aside law reform for now, and get back to the heart of the problem. We understand the impact of conflicts of interest, poor training, compliance cultures and bad apples. We see the harm and damage that poor, conflicted advice has done. We want to see less of it.

We also see the value that good quality advice can deliver. We want to see more of it. We are committed to lifting standards in the financial advice sector because it is through this that we will be able to restore trust and confidence – and it is through this that we will see better long-term outcomes for Australian consumers and investors.

Regulatory and enforcement update

Enforcement outcomes

Since the introduction of the new FoFA provisions, we have continued to be very active with regulatory outcomes. ASIC has had a facilitative compliance approach in place during the first year of the reforms being mandatory, and a further period announced on 19 November 2014, in response to the disallowance of the recent changes to FOFA.

To clarify, our current facilitative compliance approach applies until 1 July 2015, but only in relation to the disallowed FoFA provisions, to assist industry in making system changes to comply with the law as it now stands. It applies where Australian financial services (AFS) licensees have made a good-faith attempt to comply with the law but are unable to do so because of, for example, the need to make systems changes. With respect to the disallowed changes, ASIC will take a practical and measured approach to administering the law.

That said, let me be crystal clear, we are still cracking down on misconduct. For example, ASIC will continue to enforce the laws that were not changed as a result of the disallowance of regulations and enforce other obligations more broadly in the advice space.

We are taking enforcement action where we see deliberate breaches of the new requirements or failure to make reasonable efforts to comply. Where we find deliberate and systemic breaches we are taking stronger regulatory action.

Since 1 July 2013, when the facilitative approach commenced, we have:

- banned 17 people from providing financial advice, nine of them permanently
- removed another five advisers, two of them permanently from the industry through court enforceable undertakings (EUs)
- cancelled 18 AFS licences for failure to comply with the financial services laws
- cancelled another two AFS licences at the AFS licensees' request after action taken by ASIC
- accepted EUs from six AFS licensees requiring them to undertake major improvements to their compliance procedures (among other things);
- entered into public agreements with two AFS licensees requiring them to review and improve their advice provision, and
- issued 24 infringement notices to 14 separate entities for misleading and deceptive advertising in financial services against a range of firms including advice firms. The infringement penalties totalled \$236,400.

This is a non-exhaustive list. We also have a range of matters currently being considered for enforcement that include potential breaches of the new FoFA laws.

Large advice entities

As we recently stated at the Senate Estimates hearing, ASIC is firmly on the record saying that standards in the industry need to be significantly lifted if trust and confidence are to be restored for Australians.

I think the time for action by those who can make a change is clearly here and, in fact, many changes are being made. To that end, in terms of enforcement on our side, we are acting to hold the sector to account.

In response to the problems in the financial advice sector, we have set up a specialist wealth management project to focus on the large advice entities – namely, the four major

banks, Macquarie Group Limited and AMP Limited – we have significant work underway in relation to these entities.

I do not propose to comment further on these particular activities because they are at an early stage. However, what I can say is that we have acted as soon as possible so that we can ensure all allegations and issues raised are investigated.

Adviser competence and professionalism

We have previously said that the competence and training of financial advisers requires improvement. We also take the same view when it comes to the level of professionalism.

While there are many people working in the financial advice industry who are professionals, as a whole, significant changes are required to shift the culture of the industry from a transaction-based sales force to an advice profession.

There appears to be agreement in the industry that competency and professional standards need improving. This was also the conclusion of a number of recent inquiries such as the Ripoll Inquiry, the Senate inquiry into ASIC's performance and the Financial System Inquiry.

However, consensus does not extend to all the details of how this might happen. In 2014, the Government established an industry working group to consider options to improve professional, education and ethical standards of advisers. ASIC was an active participant in this working group. The working group provided a paper containing options for consideration to the Government in November 2014.

The Parliamentary Joint Committee (PJC) inquiry into proposals to lift the professional, education and advice standards (PJC inquiry), reported in December 2014, proposed a package of measures to improve professional, education and training standards which ASIC broadly supports.

Key recommendations included:

- a minimum degree qualification and ongoing professional development
- a registration exam
- the establishment of the Finance Professional Education Council to set the exam, and have input into the specific requirements for the degree-level courses, the professional year programs and professional development, and
- the requirement that advisers hold membership with a professional association that is approved by the Professional Standards Council.

The final report of the Financial System Inquiry also endorsed the need to raise the competence of financial advice providers.

The Government recently released a consultation paper seeking feedback on the proposals put forward by the PJC inquiry. We will continue to work with Government in formulating a model to increase the education and professional standards of the financial advice industry.

Conflicts of interest

The FoFA reforms introduced important new conduct and disclosure requirements, banned a range of conflicted revenue streams, and modified some aspects of ASIC's licensing and banning tests.

ASIC welcomes these reforms and think they are an important step in increasing the quality of advice and moving the financial advice sector towards a professional services industry.

However, many industry participants continue to receive conflicted remuneration due to there being a number of exemptions and grandfathering arrangements in place for the ban on conflicted remuneration. While these remuneration structures are legal, they may have a negative effect on the advice provided to consumers. On our part, ASIC continues to regard conflicted remuneration arrangements as a key risk indicator.

Another area that gets a lot of attention when it comes to the topic of conflicts is vertical integration. We are all aware of the trend towards greater vertical integration in the superannuation and investment management space.

There are benefits to vertical integration, for example, with respect to integrated product solutions for customers. Moreover, the financial capacity of these businesses means they are more readily able to ensure compensation for their clients when there is a decision against the business through the Ombudsman scheme. However, there are inherent conflicts of interests that are created by vertical integration that may not be readily apparent to consumers. The Financial System Inquiry also noted this as a concern, and recommended that advisers be required to disclose ownership structures of the advice firm to consumers. The Financial Advisers Register discloses the entities that control licensees who provide personal advice about investment and life insurance products. This is useful information that has not previously been made available to consumers.

Conflicted remuneration and vertical integration are areas that ASIC is focussing on in 2015. For example:

- ASIC is conducting a surveillance project looking at conflicts of interests in vertically-integrated structures and how those conflicts are managed. This project is expected to operate until mid-2015, with a report of our findings being released shortly thereafter.
- ASIC is currently focussing on the quality of advice, and potential misselling of financial products in large vertically-integrated advice businesses.

Life insurance

Life insurance is a fundamental part of the retirement savings framework in Australia and an area of sustained focus for superannuation trustees, life insurers and APRA over the past few years.

From ASIC's perspective, we have also had a major focus on retail life insurance advice, releasing Report 413 *Review of retail life insurance advice* (REP 413) in October of last year, where we reviewed the quality of retail life insurance advice.

I should note for completeness that group life and direct insurance were excluded from the scope of this project – but our findings do have implications for the superannuation system, which I will turn to in a moment.

For this project, we reviewed more than 200 advice files from large, medium and small AFS licensees. Our review covered a mix of pre and post-FOFA advice.

We found that 37% of the advice we reviewed failed to comply with the laws in force at the time the advice was given, including:

- the appropriate advice obligation
- the best interests duty, and
- the obligation to prioritise the interests of the client where there is a conflict of interest.

Of the advice that we rated as ‘pass’, we found significant room for improvement. We found that the way advisers were paid had a statistically significant bearing on the likelihood of their client receiving advice that did not comply with the law.

Importantly, for this audience, we found that life insurance and superannuation was an area where many advisers fall short in giving their clients appropriate advice. We found that many of the advice files in our surveillance recommended that clients hold their insurance inside superannuation, yet failed to consider important strategic issues such as:

- the merit of making concessional or non-concessional contributions to the client’s superannuation fund to mitigate the effect of insurance premiums on retirement benefits
- relevant taxation issues, and
- the need to make binding or non-binding death benefit nominations, and update those nominations as client circumstances change.

Of particular concern, we found that advisers were recommending policy bundles and a ‘sum insured’ for clients that resulted in an aggregate premium that was unaffordable to the client. All too often, we found the recommended strategy to manage this affordability issue was to pay the insurance premium from the client’s superannuation guarantee contributions.

Our strong view is that appropriate advice that complies with the best interests duty and related obligations should actively consider the long-term effects of insurance costs on clients’ superannuation savings. Too often we found conflicts of interest between advisers earning high upfront commissions that militated against the provision of advice in the best interests of their clients.

The tension between the need to hold life insurance and manage its impact on retirement savings is an ongoing challenge for consumers, superannuation trustees and the advice industry, and one that we will not resolve today.

However, we were encouraged by the fact that insurers and advisers took up the challenge from our findings, particularly in relation to the impact of conflicts of interest and the misalignment of incentives in life insurance distribution channels. Consequently, the Life Insurance and Advice Working Group was formed to address the issues raised in our report.

The working group appointed an independent chair, John Trowbridge, and released its final report at the end of March.¹ The report has been an ambitious project in the context of industry-led reform in Australia, involving consideration of 137 submissions and consultation with individual advisers, AFS licensees, insurers, consumer groups, government and regulators.

We are encouraged by the effort to seriously grapple with what is a longstanding and complex problem for the industry. The report proposes a package of recommendations to achieve structural reform for the life insurance and advice industries, including recommendations that involve ASIC, either directly or indirectly.

We are giving the report careful consideration to understand the response of industry and engage with stakeholders, including the Government, who are also considering some of these issues in the context of their response to the Financial System Inquiry.

In terms of our ongoing work, we continue to see problematic life insurance advice in our surveillance work. It is a live issue. The sooner we deal with the issues, the sooner we can achieve better consumer outcomes and restore trust and confidence in the industry.

In terms of follow up work from REP 413, we have imposed license conditions on the AFS licence of Suncorp-owned Guardian Advice, following a surveillance that uncovered deficiencies in the advice it provided to retail clients, including life insurance advice.

We are continuing our investigations into AFS licensees where we have found significant breaches of the law, inappropriate advice or poor compliance cultures. We may also take administrative action against individual advisers.

Financial Advisers Register

The new Financial Advisers Register was launched on ASIC's MoneySmart website on 31 March 2015, and now lists more than 21,000 advisers across Australia.

The register contains details of individuals employed or authorised – directly or indirectly – by AFS licensees to provide personal financial advice to retail clients on more complex products such investments, superannuation and life insurance.

ASIC has long advocated for a register of financial advisers. We see this as a very important reform. The new register will enable consumers to find out information about their adviser before they receive financial advice. It will give employers greater ability to assess new financial advisers. It will also improve ASIC's ability to identify and track the movements and history of financial advisers.

We anticipate that the new information on the register – such as the control of advice business and appointment history of an adviser – will increase transparency in the industry and build trust.

¹ John Trowbridge, *Review of retail life insurance advice*, final report, 26 March 2015.

Intra-fund advice

Risk-profiled proactive surveillance work is underway in superannuation this year, focusing on the implementation of a range of Stronger Super requirements, as well as other matters.

One area of focus is the new intra-fund advice requirements. As part of our surveillance work, we are asking a range of trustees a number of questions about their intra-fund advice businesses, including:

- basic questions about their advice arrangements, including who provides it and the type of advice given
- what steps trustees take to ensure that the services are not used excessively by some members, to the detriment of others
- how trustees determine how much of the cost is bundled into the administration fee and collectively charged across the membership base, and
- if a trustee provides intra-fund advice, what topics are most commonly covered (e.g. advice about insurance or advice about switching to a different option in the fund) and whether the trustee offers transition to retirement advice under the intra-fund advice framework.

While our visits only concluded in late-March, and results from these visits are still being collated, we do note that intra-fund advice models are being adopted in industry which is positive in terms of a greater number of people potentially having access to advice.

In some of the cases we have seen so far, the advice is provided by a third party rather than by the trustee – under the new intra-fund advice provisions, these arrangements are permitted under the law.

Self-managed superannuation fund advertising and one-stop shops

In 2012, in response to the growth in self-managed superannuation funds (SMSFs), an increase in geared investment strategies and the PJC inquiry into the collapse of Trio, ASIC established an SMSF Taskforce. The Taskforce continues to meet regularly to examine high-risk and emerging SMSF issues such as property spruiking to SMSFs, unlicensed conduct and false and misleading advertising of SMSFs. Recently we have been looking at false and misleading conduct in social media.

SMSFs are also a focus in our enforcement work and will continue to be throughout 2015.

Conclusion

ASIC has been focusing on the problems with the quality of advice in the financial advice sector for some time.

Many companies have learnt the hard way, through ASIC's enforcement work – and media scrutiny – that it is not enough to simply pay lip service to the client's best interests.

Let me be clear. The clients' best interests should be embedded in the culture within an organisation, and should be in the day-to-day of how employees and representatives conduct themselves. This is particularly critical in the context of advice around superannuation, and I know today's audience is keen to see high-quality advice in the superannuation sector.

ASIC looks forward to working with the financial services industry to achieve this vision.