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Australian Securities and Investments Commission
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Dear Xenia,

**SUBMISSION RE: CONSULTATION PAPER 247:
Client review and remediation programs and update to record-keeping requirements**

Thank you for the opportunity to comment on ASIC's Client review and remediation programs and update to record-keeping requirements set out in CP 247.

Introduction

Industry Super Australia manages collective projects on behalf of Industry SuperFunds with the objective of maximising the retirement savings of five million industry super members. These projects include research, policy development, government relations and advocacy as well as the well-known Industry SuperFunds Joint Marketing Campaign. All fifteen Industry SuperFunds are run in the best interest of members with a common goal of providing the best possible retirement outcome for members.

In 2015, Industry Super Australia and the Australian Institute of Superannuation Trustees surveyed 19 not-for-profit funds to obtain detailed, up to date information about the full spectrum of member engagement and advice services provided by each fund to members during the 2013/2014 financial year.¹ The survey covered 12 Industry SuperFunds. At the time of conducting this survey, these funds held \$314 billion in assets and had 10 million members.

The survey found:

- Over 130,000 members receive personally delivered financial advice.
- Not-for-profit super funds offer a comprehensive spectrum of advice services. For 18 of the funds that participated in the survey, this included intra-fund advice.
- Advice is delivered using a wide range of channels including face to face, web-based, telephone advice and online advice tools.
- Advice services have grown strongly since 2009 and this is predicted to continue.

¹ ISA and AIST, *Meeting Member Advice Needs* (2015).

Not-for-profit super funds do not offer advice services as a way of selling products to new clients. Rather, they are committed to meeting the advice needs of their existing membership. The objective of their advice services is to improve retirement outcomes for their existing members, not to profit from them.

Role of review and remediation programs

ISA acknowledges the importance of review and remediation programs in achieving redress for consumers who have experienced poor quality personal advice. Many consumers are not in a position to identify poor quality advice and complain about this. Review and remediation programs overcome this because they do not rely on client complaints to identify problematic advice.

These programs are also more cost effective than legal action for consumers, particularly those with claims that exceed EDR scheme monetary limits.

ISA strongly supports ASIC's decision to produce detailed regulatory guidance on the establishment, scope, design and implementation of review and remediation programs.

While valuable, these programs are not however a substitute for regulatory action against licensees or individual advisers. Regulatory action leading to sanctions at the adviser and/or licensee level is an important tool in raising advice standards by removing problem advisers from the financial advice industry and achieving cultural change at an organisational level.

Proposal B1 and B2 Scope of proposed guidance

The proposed guidance is intended to apply to advice licensees conducting a program to address systemic issues that are a result of the decisions and behaviour of the licensee or its representatives in relation to personal advice.

The draft guidance acknowledges that not all review and remediation programs are conducted in relation to personal advice programs, they are also conducted to remediate retail clients for losses suffered in areas such as superannuation or credit, or programs are conducted by advice licensees not relating to personal advice.

While ASIC encourages licensees to apply the principles in the proposed guidance to other review and remediation programs, the draft guidance states that the implementation of these principles may differ.

Many retail clients suffer loss as a result of poor quality personal advice that is about their superannuation.

ISA's view is that ASIC's guidance on review and remediation programs should apply to all instances of poor quality personal advice about superannuation. ISA recommends that this be clarified in the final guidance.

Proposal B2 Definition of systemic issue

ASIC proposes to define a review and remediation program as a project set up to review personal advice where a systemic issue in relation to the advice has been identified, and then to remediate clients who have suffered loss.

The proposed definition of systemic issue is an issue with implications beyond rights of clients, or that may affect more than one client.

It is widely recognised that conflicted remuneration is a longstanding driver of poor quality personal advice. While the Future of Financial Advice reforms banned certain forms of conflicted remuneration, extensive carve-outs and grandfathering arrangements mean that commissions and other forms of conflicted remuneration for personal advice continue to be permitted under the law.

For example, ASIC Report 407, *Review of the financial advice industry's implementation of the FOFA reforms* found:

'Some licensees continued to receive the majority of their revenue from commissions, including investment commissions from arrangements that existed before July 2013, and insurance commissions that were not subject to the conflicted remuneration ban. For example, while commissions were worth 25% of licensees' revenue on average, the average for nine large licensees in the sample was approximately 40%, and for some the figure exceeded 50%.' (ASIC REP 407.92(a))

ISA recommends that the final regulatory guide include guidance that conflicted remuneration continues to be a key driver of systemic issues in the provision of personal advice, despite the Future of Financial Advice reforms.

Proposal C3 Interaction with AFS licensing obligations

Breach reporting

The draft guidance provides that in many cases, a systemic issue that triggers establishment of a review and remediation program will also be a significant breach for the purposes of the Corporations Act breach reporting obligations. However, licensees need to make this assessment on a case-by-case basis.

ISA does not support this approach. An issue that is sufficiently serious to warrant the establishment of a review and remediation program should always be assessed as a significant breach and a breach report lodged with ASIC. ISA recommends that the final regulatory guide include guidance to this effect.

Compensation arrangements

The draft guidance states that when remediating clients in a single instance of client loss or as part of a broader client remediation program, advice licensees will often consider how their compensation arrangements can assist in providing remediation to clients.

ISA's view is that licensees should be required to consider how their compensation arrangements can assist in remediating clients who have suffered loss as a result of poor quality advice as a result of the overarching obligation on licensees to operate their financial services business efficiently, honestly and fairly under s 912A(a)(a) of the Corporations Act. ISA recommends that ASIC's guidance on the interaction of the obligation to establish review and remediation programs and the obligation under s 912B to have arrangements for compensating retail clients for losses they suffer as a result of a breach of Chapter should state that licensees must consider whether their compensation arrangements are adequate to provide remediation to clients.

Proposal C4 ASIC's role

The draft guidance notes that there may be times when ASIC will encourage an advice licensee to establish a review and remediation program, or may require this as part of its enforcement activities. In these instances, and when a licensee voluntarily commences a program that ASIC is aware of, it may be involved in reviewing the design and implementation of the program.

As noted above in response to proposal C3, ISA's view is that at a minimum, ASIC should be aware of the establishment of all review and remediation programs. This is necessary to ensure that ASIC has the opportunity to decide whether to become involved in the design and implementation of a program, which is necessary for ASIC to fulfil its role of promoting the confident and informed participation of investors and consumers in the financial system under s 1 of the ASIC Act.

The draft guidance lists five factors that will determine the extent of ASIC's involvement in reviewing the design and implementation of a review and remediation program. These factors do not explicitly include the impact of the misconduct on consumers. ISA's view is that the impact of poor quality advice on consumers this should be central to ASIC's decision as to whether to become involved in the design and implementation of a program, and if so, to what extent. ISA recommends that the first factor that will determine the extent of ASIC's involvement should be the impact of the systemic issue that triggered the establishment of a review and remediation program on consumers.

Proposal D1 Identifying the scope of a program

As noted above, it is widely recognised, including by ASIC, that conflicted remuneration has long been a key driver of poor quality advice and that despite the Future of Financial Advice reforms, commissions and other forms of conflicted remuneration are still permitted in a range of situations.

The draft guidance states that the type of misconduct and the relevant advisers could be identified, for example, by examining any trends in the advice given to clients that may indicate advisers have given non-compliant advice (e.g. advice that generated higher than average commissions).

In addition to this situation, advisers may also be faced with a range of other conflicts. These include:

- (a) A conflict between advice that generates a commission (e.g. advice to acquire a retail life insurance product) versus advice that does not generate a commission.
- (b) A conflict between advice that would preserve existing commissions (e.g. advice to continue to hold a legacy product) versus advice that does not generate a commission and results in the cessation of existing conflicted remuneration (e.g. advice to switch to a better performing contemporary product).

ISA recommends that the final guidance should expand on the scope to identify poor quality advice by analysing trends in conflicted remuneration by including these situations together with examples.

Proposal E2 Developing the processes for a program

ASIC's draft guidance provides that all review and remediation programs should have some level of independent oversight in developing and operating the program. The guidance defines independent oversight as oversight provided by an independent expert or a person internal to the licensee who is sufficiently senior and independent of the operation of the program (e.g. a licensee's internal audit team).

ISA agrees that all review and remediation programs should include independent oversight of the design and implementation of the program. However, ISA does not support including oversight by

internal personnel in the definition of independent oversight. Effective independent oversight must be provided by a genuinely independent expert. In particular, internal audit teams are not sufficiently at arms' length to provide this function. Arguably, the fact that a systemic issue requiring a review and remediation program has occurred within a licensee suggests that there has been a failure of internal audit.

ISA recommends that the final guidance state that independent oversight must be provided and define independent oversight as oversight by an independent expert.

Proposal E7 Reporting publicly

The draft guidance states that licensees should consider whether to report publicly on the program and its progress, applying a public interest test. ASIC's guidance is designed to encourage public reporting, especially for larger review and remediation programs or programs that follow public reports of client losses or alleged misconduct.

ISA does not support this guidance which gives licensees discretion about whether to report publicly using a bar that is set too high. It is likely that many licensees would choose not to publicly report programs to avoid or contain reputational damage. There is little value in linking the value of public reporting to situations where the public is already aware of a systemic issue with poor quality advice, except to the licensee seeking to manage damage to its brand.

ISA recommends that public reporting of the establishment, progress and outcomes of all review and remediation programs should be required in all cases. This is necessary to ensure that the licensee is accountable to affected consumers for the design and implementation of the program, especially if ASIC proceeds with its proposal to not require licensees to report the establishment of every program to it.

The financial advice industry is undergoing fundamental change. A long-running series of high profile scandals involving poor quality advice have cost consumers billions of dollars and destroyed public confidence and trust in the industry.

The Final Report of the Financial System Inquiry (FSI) released in November 2014 found that:

Previous collapses involving poor advice, information imbalances and exploitation of consumer behavioural biases have affected more than 80,000 consumers, with losses totalling more than \$5 billion, or \$ 4 billion after compensation and liquidator recoveries.²

These collapses, which include the collapses of Storm Financial, Opes Prime, Westpoint, Great Southern, Timbercorp and Banksia Securities have damaged consumer confidence and trust in the financial advice industry.

The FSI's estimate of losses resulting from poor quality advice does not include advice scandals at Macquarie Bank, Commonwealth Financial Planning, NAB and ANZ involving poor quality advice and a failure to provide advice services which clients paid for.

² FSI, Final Report at 28.

Public reporting of all systemic issues and how licensees remediate affected consumers is an important step in the ongoing process of rebuilding public confidence and trust in the financial advice industry.

Proposal G2 Settlement deeds

ASIC's draft guidance proposes that settlement deeds should not restrict a client's ability to speak to ASIC, other Government agencies, an EDR scheme, an adviser's professional association or legal representation about the operation of a review and remediation program or the way in which their matter has been reviewed.

ISA supports this guidance. History has shown that whistleblowers have also played an important role in uncovering systemic issues in the financial advice industry, and the failure of licensees to resolve these issues efficiently, honestly and fairly.

ASIC has acknowledged this, reissuing Information Sheet 52 *Guidance for Whistleblowers* in 2015.

ISA recommends that the final guidance state that settlement deeds must not restrict a client's ability to speak publicly about their experience or poor quality advice or of the review and remediation process. Confidentiality clauses of any scope are inconsistent with the principle of transparency which, as discussed above, is fundamental to holding licensees accountable for systemic issues involving poor quality advice and restoring public confidence in the financial advice industry.

Please contact Ailsa Goodwin on (03) 9923 7172 if you have any questions about this submission.

Kind Regards,



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