



ASIC

Australian Securities & Investments Commission

Views on disclosure, advice and more

Paper presented by

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1. Introduction

There are six issues I would like to talk about this morning:

- disclosure and its challenges;
- some recent developments in the area of advice;
- super switching;
- the PJC report into super;
- conflicts in super; and
- a plug for ASIC's 2008 Summer School!

2. Disclosure and its challenges

General comments

There is no doubt Australian investors are becoming increasingly sophisticated. If you look at participation on the Australian Securities Exchange (ASX) as an indicator, 44% of the adult population own shares (directly or indirectly), the average investor has about \$190,000 invested (excluding super) and 19% of those that hold direct equity investments have a direct investment in overseas equities.¹

But while investors are becoming more sophisticated, so too are the products they are being offered. The innovation of products has generally translated into longer and more complicated disclosures. This has prompted a number of questions over how well disclosure is working.

Earlier this year, a Parliamentary Joint Committee (PJC) investigating the structure and operation of the super industry² commented on the readability of product disclosure statements (PDS). According to the PJC's report in August 2007:

The readability of disclosure material is vital for consumers to be able to readily access information and advice on superannuation. Unfortunately, this is seldom the case as most PDS are too long and complex and unsuitable for general consumption.³

On the whole, industry agreed that consumers would benefit from shorter, more comprehensible and comparable PDSs, but there were mixed views about how this could be achieved.

¹ ASX 2006 Share Ownership Study

² See generally *Inquiry into the structure and operation of the superannuation industry*. The report was published on 7 August 2007 and is available electronically from: http://www.aph.gov.au/senate/committee/corporations_ctte/superannuation/report/index.htm
See the Executive Summary of the *Inquiry into the structure and operation of the superannuation industry*, xviii, p3

The PJC recommended that the Australian Government conduct market research on the readability of superannuation PDSs with the goal of introducing simple, standard, readable documentation.⁴

Separately, in September this year, the Investment and Financial Services Association (IFSA) and Investment Trends published a report *Super Decisions: Communicating with Customers and Effective Disclosure*.⁵ The report, which followed qualitative and quantitative research of people that have made a super decision in the previous two years, provides insight into how customers make decisions and use disclosure documents.

The report contained a number of interesting observations that I don't have time to go into now. But the flavour of the report is contained in the following quote from IFSA's CEO, Richard Gilbert:

The high levels of satisfaction and comfort recorded in our research show that many companies are supporting the decision making process well, however we can't ignore the fact that customers are still calling for shorter documents that are presented well and are written in plain English.⁶

ASIC agrees with the PJC, IFSA and other industry participants that disclosure can be simplified. But unfortunately there is no magic cure. To improve disclosure to the next level, we will all need to make some significant changes in the way we approach disclosure. Here are some challenges I see:

- There is not enough 'back to the drawing board' or ground-up preparation of documents.
- Product issuers often see disclosure as, at least partly, a liability minimisation exercise.
- Some products are just too complicated to explain in a simple way, or too many options are offered.
- In the super space, boilerplate material about key super issues, and not the product itself, are included in the PDS, rather than being incorporated by reference.⁷

To drive real improvements, ASIC and industry need to work much more closely together.

To this end, ASIC has just set up a Retail Investor Group, which I am heading up. We will be conducting a scoping survey with an external consulting group for the next few months working out what our priorities should be in the current environment. Following the review, I imagine that the group will look at ways of improving disclosure, advice and financial literacy among other things.

⁴ *Inquiry into the structure and operation of the superannuation industry*, Recommendation 20

⁵ The report is available at www.ifsa.com.au

⁶ IFSA Media Release, *Supporting Super decisions requires industry wide effort says IFSA*, 29 September 2007

⁷ Information can now be incorporated by reference into a PDS: see reg 7.9.15DA of the Corporations Regulations 2001

I envisage ASIC partnering with industry to develop things like an example disclosure package. This will quite deliberately not be a template or ‘just add water’ solution to disclosure, but will be aimed at provoking more experimentation by industry by providing illustrations, ideas and general approaches to disclosure; rather than prescription.

I am very keen to hear ideas from industry and consumer groups on improving disclosure. I passionately believe we can make disclosure work better for everyone!

Specific super disclosure projects ASIC has been working on

ASIC has just conducted some very specific work on how super funds are complying with some of their disclosure requirements. We looked at disclosure:

- when transferring members’ benefits to other super funds without the members’ written consent; and
- for periodic statements issued to super fund members at the end of the reporting period⁸ (i.e. the member benefits statement).

I will briefly discuss our findings.

Transfer of benefits without consent

Because of amendments to the ‘portability’ rules, super fund members can now transfer and rollover their benefits to a super fund of their choice. However, there are three circumstances where members might be transferred out of their current fund to another fund without their written consent:

- Where a member’s fund is wound-up, the member might be moved without consent to a successor fund.
- Where set criteria are met (e.g. a member has left employment of a sponsoring employer or becomes lost), the member might be transferred to an eligible rollover fund (ERF).
- A member may leave a particular employer and be moved from the employer’s sub-plan within the super fund to the fund’s personal division.

ASIC looked at the disclosures made in these circumstances to assess whether the information provided to members was effective and readily understandable.

We looked at 116 disclosure documents⁹ from 37 funds.¹⁰ Of these disclosure documents, we thought that there was room for improvement both in the content of the disclosures made and, in some more limited instances, in the timing of the provision of the information to the member.

⁸ As required by s1017D of the *Corporations Act 2001* (Cth) (Corporations Act)

⁹ The disclosure documents we examined included PDSs, annual reports, significant event disclosure and exit statements

¹⁰ Funds reviewed included industry, corporate and retail/public offer funds

We noticed that, in some cases, the disclosure of circumstances in which a member will be transferred to an ERF differed between the PDS and the annual report. We referred four PDSs to delegates with these types of inconsistencies and poor disclosure about transfer circumstances (i.e. to determine whether a stop order should be issued).

We also found that, in some cases, members were being transferred to ERFs with significantly higher fees. Where fees are going to increase, ASIC considers it particularly critical that members receive timely and accurate transfer information from their superannuation fund.

Periodic statements (member benefit statements)

We also recently reviewed 99 periodic statements from 51 super funds to check compliance with the disclosure requirements and the enhanced fee disclosure regulations.

We chose to look at periodic statements because they are probably the most important bit of disclosure for ongoing members of a super fund. Research shows that more people read member benefit statements than any other disclosure document.¹¹

From the 99 periodic statements we reviewed, some of the most common problems we saw included:

- little or no disclosure on how members can access information about benefits;
- little or no disclosure about other investment strategies, contribution levels and insurance coverage available to the holder and where to get this information;¹² and
- a lack of disclosure to members that withdrawal benefits might have changed since the date of the periodic statements.

We think that the type of information outlined here is information that members need in order to make informed choices about their superannuation funds and the options available to them within those funds.

We will release more detailed findings on these two projects shortly.

Electronic delivery of financial services disclosures

Another project we have underway that deals with disclosure is electronic delivery of financial services disclosures. A consultation paper on this topic will be circulated shortly.

The extent to which the Corporations Act permits the electronic delivery of financial services disclosures, and the practicalities of doing so, is a little unclear

¹¹ See IFSA's research, *Super Decisions: Communicating with Customers and Effective Disclosure*
¹² See reg 7.9.30(1)(a)

in some areas. We are keen to address this uncertainty and facilitate the use of electronic financial services disclosures, to the maximum extent possible, but in keeping with the level of Internet access enjoyed by the average Australian.¹³

We think that electronic delivery of financial services disclosures has a number of important benefits for industry and for consumers, including more interactive, innovative and user-friendly documents, cost savings and environmental benefits.

For example, we are proposing to give relief to allow trustees of super entities to use a website as the default method of delivering annual super information to members (much like the regime now in place for company financial statements). Members will still be able to elect to receive a hard copy of the disclosure.

Superannuation disclosure is different from disclosure in the non-super sector because it is directed to the entire adult workforce and beyond, rather than a narrower sector who might be expected to be more likely to look for investment information online. Notwithstanding this, ASIC wants Australian superannuation disclosure to be at the cusp of world's best practice, allowing low cost and effective disclosure while providing information for consumers in a way that most suits their needs.

This will definitely not be the last word on the electronic delivery of financial services disclosures.

3. Advice

As always, there is a lot currently happening in the advice space.

New statement of advice rules

The changes coming out of the Australian Government's Corporate and Financial Services Regulation Review¹⁴ should already be having an impact in terms of making financial advice cheaper and more accessible to consumers.

The changes include:

- not requiring a statement of advice for investment amounts under \$15,000;
- not requiring a statement of advice when personal advice is provided that does not involve the recommendation of a product and no remuneration is received for, or in relation to, the advice (so-called 'strategic advice exemption'); and
- avoiding the need to repeat disclosure where the client already has the information.

ASIC views the changes as being a positive development.

¹³ A report by the Australian Bureau of Statistics, *Household Use of Information Technology, Australia, 2005–06*, Cat no. 8146.0, 15 December 2006, says that in 2005–06 about 60% of Australian households had home Internet access and 66% of people had Internet access ie work, school etc. A copy of the ABS report is available at www.abs.gov.au

¹⁴ Resulting in the *Corporations Legislation (Simpler Regulatory System) Act 2007*, No. 101, 2007

Bad apples

ASIC and Standards Australia recently launched a new handbook *Reference Checking in the Financial Services Industry*¹⁵ which provides employers with a reference-checking framework that can be applied to financial advisers.

The handbook, developed by ASIC and a panel of industry representatives with assistance from Standards Australia, is designed to encourage industry to seek and, when requested, provide reference-checking information to help identify dishonest, incompetent or unethical financial advisers.

The ‘Bad Apples’ project, as it has become known, aims to disrupt the movement within the industry of financial advisers with dubious employment records who, in some instances, have been able to resign from one position and move to a similar position in another firm that is unaware of their history.

ASIC’s website has recently been updated to include a new page on ‘reference checking’ with links to professional industry associations, Standards Australia and other relevant websites.

Compensation and insurance arrangements for AFS licensees

The compensation requirements under the Corporations Act start for new Australian financial services (AFS) licensees from 1 January 2008 and for existing licensees from 1 July 2008. The primary method of compliance will be to get professional indemnity insurance cover.¹⁶

Certain categories of licensees are exempt from the requirements, including general insurance companies, life insurance companies and authorised deposit taking institutions regulated by the Australian Prudential Regulation Authority (APRA). The explanatory memorandum says that these categories of exempt licensees ‘have been selected because of the capital adequacy requirements, rather than because they are regulated by APRA’. The Australian Government decided not to include superannuation trustees in this list.

ASIC published a consultation paper in July on how we proposed to administer these requirements. In the consultation paper, ASIC acknowledged that some superannuation trustees are obliged to hold professional indemnity (PI) insurance under APRA’s Registrable Superannuation Entity licence regime. However, we proposed that because their existing cover was obtained under a different regime with different objectives, such licensees would still need to consider whether their existing cover was adequate for the purposes of the new compensation requirements.

During the consultation process, ASIC met with ASFA to discuss issues in administering the compensation requirements that affect super trustees. ASIC is currently reviewing feedback received in the consultation period and plans to publish a regulatory guide before the end of the year. ASIC will also publish a feedback summary of the main issues raised in the consultation process and ASIC’s responses to them.

¹⁵ For a copy of the handbook, go to www.asic.gov.au/referencechecking

¹⁶ See reg 7.6.02AA

Overseas developments

The issue of advice is getting a lot of attention in the United Kingdom (UK) at the moment with two important reviews under way:

- a review on generic financial advice (GFA) by Otto Thoresen; and
- a review of retail distribution by the Financial Services Authority (FSA).

Thoresen review

In January 2007, the then Economic Secretary to the Treasury, Ed Balls MP, asked Otto Thoresen¹⁷ to prepare a report on delivering a national approach to GFA.

The terms of reference of this review were to determine a range of models for achieving greater access to GFA, taking into account future developments in financial services markets and, in particular, personal accounts.¹⁸

One of the drivers behind the timing of the review is the planned introduction in 2012 of auto-enrolment for most employees into an occupational pension scheme. Auto-enrolment is seen as being a significant trigger of demand for advice on retirement planning.

To date, the review has surveyed the financial services landscape and has just delivered its interim findings. The interim report concludes that GFA, delivered nationally, is an essential element in the overall strategy to improve levels of financial capability. According to Thoresen:

The evidence gathered to date shows that, beyond altruism, there are benefits to the financial services industry of having consumers who are more capable, confident and more willing to transact in the market-place. Such individuals are likely to be more persistent savers and more reliable borrowers. Over time, the Government could also benefit from reduced spending on income-related benefits.¹⁹

The interim report found that while high quality GFA-type information is currently being delivered as part of debt management advice and in relation to pensions, key gaps exist in the areas of forward planning, taking action, budgeting and preventing individuals who manage to resolve a crisis from becoming caught up in it again.

At this stage, the review considers that funding for GFA should be shared between government and industry. A compulsory levy is considered the most secure and equitable funding mechanism for the industry contribution.

The next stage of the review is to conduct consumer pilots of GFA.

¹⁷ Chief Executive of Aegon UK, a financial services organisation wholly-owned by Aegon N.V. The AEGON Group is one of the world's largest listed insurers and has assets under management of £245 billion.

¹⁸ See *Thoresen Review of Generic Financial Advice: Interim Report*, October 2007, available at hm-treasury.gov.uk

¹⁹ See p12 of the *Thoresen Review of Generic Financial Advice: Interim Report*

The consumer pilots will:

- test GFA across three channels (i.e. the telephone, the Internet and face-to-face);
- aim to reach more than 5,000 consumers, providing guidance or information, not regulated advice, on a range of areas from jargon busting, to budgeting, tax and benefits, saving and planning for retirement.

The pilots have been designed to be:

- ‘on my side’ (i.e. impartial from government and the industry);
- supportive and informative (i.e. not criticising, but persuasive of the need to act);
- preventative (i.e. helping people take charge of their affairs before serious problems develop);
- delivered in an environment which is clearly not linked to a product sale;
- able to give guidance, to empower individuals in making decisions, but stopping short of recommending a product with a specific provider.

The pilots will run for three months to mid-December 2007 with consumers encouraged to take part through local marketing and communications campaigns. The pilots will be independently evaluated and the results will be published in a final report in early 2008.

FSA retail distribution review

While the UK Treasury is considering GFA, the FSA is also looking at how to improve access to retail advice.

In June 2007, the FSA released a discussion paper entitled *Review of Retail Distribution*.²⁰ The discussion paper considers the efficiency of the retail distribution marketplace and market proposals to improve it.

The ideas set out in the discussion paper seek to improve the current standard of professionalism, find more cost effective ways of making advice available to a wider range of consumers and to improve consumer understanding of what they are getting for their money. The discussion paper follows selective consultation with senior market and consumer representatives.

The key proposal in the discussion paper is to split regulated investment advice into two distinct categories:

- professional financial planning; and
- primary advice.

The thinking behind the two categories of advice is that professional financial planning and advisory services would be offered to more affluent consumers by

²⁰ The discussion paper is available on the FSA’s website at www.fsa.gov.uk

highly qualified advisers and would cover a full range of financial services. In contrast, primary advice (i.e. simple, straight forward advice) would be offered by advisers who are only required to have the skills appropriate to the advice they are providing.

The expectation is that the primary advice model will allow firms to offer low cost advice to a much greater number of consumers. It is envisaged that the following types of firms will be interested in offering primary advice:

- banks, building societies and insurers (which might choose to offer primary advice through their branches, by telephone or over the Internet);
- existing advisory firms that are interested in reducing their costs and servicing more clients;
- employers (known as ‘worksite marketing’); and
- mortgage or general insurance brokers.

The two-tiered advice model being suggested in the discussion paper is designed to work in tandem with GFA.

The consultation period on the discussion paper ends on 31 December 2007. The FSA expects to issue a feedback statement in the second half of 2008.

4. Super switching

Super switching remains a tension point for industry.

In June 2005, ASIC released Regulatory Guide 84 *Super switching advice: questions and answers* (RG 84). The guide was designed for advisers and provides answers to some common questions around providing advice on super switching.

We have received feedback from industry that, notwithstanding our earlier guidance, advisers are finding providing advice on super switching to retail clients too onerous and time consuming. In preliminary discussions, it has become clear that there is a rhetoric/reality gap between what advisers think ASIC wants them to do and what they actually need to do. Some advisers think they need to make long-term comparisons between the expected performance of funds as part of the switching advice process.

Perhaps the best way of explaining where ASIC is coming from with super switching is to quote from what I said during a Parliamentary hearing²¹ on the subject:

Where you are recommending a switch, you need to look at the existing arrangements that the customer has and assess the plusses and minuses of moving out of that product and into a new product. You need to explain those to the client and then include them in the statement of advice. It makes perfect sense. If you are giving professional advice to someone about whether they should move out of a fund, it is not rocket science to expect that you would

²¹ Parliamentary Joint Committee on Corporations and Financial Services Hansard, 13 June 2006, Canberra, p 10

have a look at what fund they are already in and see how it stacks up with what you are recommending. It is that simple.

To help advisers, ASIC has put together a small working group of industry participants to develop more guidance on super switching to supplement the guide we issued in mid-2005. The guidance will take the form of a number of short super switching case studies and will demonstrate what steps advisers need to take when advising on a potential super switch.

We expect to release the updated guidance in the first half of next year.

5. Parliamentary Joint Committee inquiry into super

I mentioned earlier the PJC inquiry into the structure and operation of the superannuation industry that reported in August this year.

This inquiry was particularly concerned with the operation of the *Superannuation Industry (Supervision) Act 1993* (Cth) and the superannuation industry to ensure that it provides an efficient, effective and safe regulatory structure for the management of super funds.

A common thread running through evidence from peak industry associations and other stakeholders to the PJC was that the laws and regulations governing superannuation have become too complex, onerous and conflicting in some instances and have not kept pace with industry developments.

The PJC agreed and one of its key recommendations was that Treasury conduct a review of the laws and regulations governing super to identify how they may be rationalised and simplified. The PJC also recommended that Treasury examine and report to government on the issue of overlapping, inconsistent and conflicting requirements of super funds from a number of different regulators.

While the PJC dealt with a wide range of issues, it made a number of recommendations directed specifically at ASIC. These included that ASIC:

- provide guidance to super funds on the provision of targeted communication to separate categories of fund members, so called 'limited advice', without triggering the need for a statement of advice;
- consult further with super funds on the provision of online calculators;
- provide accountants with relief from holding an AFS licence in circumstances where they advise clients to alter their superannuation contribution levels or consolidate their superannuation investments into an existing fund;
- work with industry to provide investors with more effective and detailed disclosure of shelf fees; and
- release a policy statement mandating that financial advisers disclose the ownership structure of their licensee when making a super product recommendation.

ASIC is considering the recommendations.

6. Conflicts in super

Conflicts of interest in super remain a problem in some key areas.

Supermarket shelf fees

The effect of different remuneration models on the standard of super advice was a major issue raised during the PJC inquiry on super.

As part of its inquiry, the PJC looked at potential conflicts of interest in commission-based remuneration models, payment of ongoing trailing commissions and use of approved product lists and ‘tied’ adviser relationships. While the PJC considered recommending banning commissions to improve the quality of super advice, it ultimately decided against this on the basis that it accepted that many consumers cannot afford to pay for up-front fee-for-service advice on their super.

The PJC did, however, make some negative comments about supermarket shelf fees. According to the PJC:

Unlike commission-based remuneration, shelf fees cannot be said to facilitate access to advice by making it more immediately affordable to those without discretionary funds to pay up-front fees. As the industry is moving from commission-based to fee-based advice fees, so it should move from shelf fees to a more competitive means of meeting the cost of product listings. The Committee recommends that ASIC work with the industry to provide investors more effective and detailed disclosure of shelf fees.²²

ASIC agrees that supermarket shelf fees do create potential conflict problems and need careful management and disclosure. Where an issuer/fund manager pays to have its products on the menu in a master trust, it might mean that comparable or better products, whose issuers are not prepared to pay the fee demanded, do not get on the menu. This would be a bad outcome for fund members and the industry as a whole. It almost goes without saying that choosing a product to go in a master trust menu should always be about quality and suitability and never about whether a fee is being paid.

On the disclosure front, we will, as the PJC recommended, work with industry on the effective disclosure of shelf fees to members and potential members. Shelf fees must be disclosed appropriately in the master trust PDS and, potentially, in any statements of advice about investing in the master trust. There is no doubt that the complexity of some arrangements, combined with the rebating of fees to dealer groups, increases the difficulty of effective disclosure to consumers.

Pre-tax returns versus post-tax returns

Another conflict I am concerned about in the super space is pre-tax versus post-tax returns.

Let’s imagine that a super fund manager’s pre-tax returns for its growth fund over the last five years is in the top quartile of peer funds. However, on an after-

²² See *Inquiry into the structure and operation of the superannuation industry*, p xix

tax basis, the fund's performance is less impressive (i.e. only in the second quartile of peer funds). The fund manager still earns its fees for managing the fund based on its pre-tax returns.

The potential conflict here is between the fund manager's interest in maximising its fees based on pre-tax returns and fund members' interest in post-tax returns (being what ultimately makes up their retirement savings). The conflict might result in the fund manager trading securities more frequently than desirable from a post-tax return perspective, or not taking advantage of things like off-market share buy-backs because they affect pre-tax performance.

This conflict could potentially be managed by internal controls ensuring that all investment decisions give priority to the best interests of fund members in maximising post-tax returns, rather than the fund manager's interest in pre-tax returns: One way to help achieve this is by having experienced supervisors review and monitor investment decisions. Another is by ensuring that the incentive structure for the remuneration of the manager's staff (as opposed to the manager itself) focuses on broader issues than just pre-tax returns (e.g. post-tax returns, compliance, customer satisfaction, capital growth and unit price volatility).

A more complete solution would be for the trustee of the super fund to require that fund management fees be based on, or at least take into account, after-tax returns. Short of this full solution, the trustee should disclose to members that the fund manager's fees are calculated on a pre-tax returns basis meaning that the fund manager's interests might not be fully aligned with the members' interest in post-tax returns.

Superannuation is where the industry needs to move to post-tax returns for the benefit of all superannuants. After all, unlike a non-super managed investment, a super fund is not in the dark about the impact of its actions on the tax position of its members and so should be able to make tax-related decisions much more effectively than outside the superannuation environment.

7. A plug for ASIC's 2008 Summer School

Just to prove there's no such thing as a free speech, I thought I'd end my presentation by giving a plug for ASIC's upcoming Summer School.

The 2008 Summer School will be held in Melbourne from Monday, 18 February to Wednesday, 20 February.

It will focus on retail investors, capital markets integrity, international investment issues and the importance of corporate governance. It will offer perspectives on global capital flows and cross-border financial regulation, as well as looking at ways of lifting business integrity.

More information on ASIC's 2008 Summer School is available on our website at www.asic.gov.au/summerschool.

And now there's time for some questions.