ASIC

Australian Securities & Investments Commission

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To

Association of Superannuation Funds of Australia
(ASFA)

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Greg and I are delighted to have the opportunity to present together here at the ASFA conference. Clearly the timing for us is excellent, with the recent introduction of Superannuation Choice, and there is surely no better forum for us to update the superannuation industry about our current program of work focusing on Super Choice.

As Brad mentioned in the introductions, both Greg and I took up our positions in March this year, within a new ASIC structure, so it's probably worthwhile at the outset to explain a little bit about our current structure in ASIC, and therefore to pre-empt some of the different perspectives that Greg and I will bring before you today.

As you all know, the Financial Services Reform Act introduced a new licensing and disclosure regime for providers of financial services. Since the end of the FSR transition period last year, ASIC has taken the opportunity to move away from our previous industry-based structure – which suited our work during the transition phase of FSR – towards a more functional-based structure. We took the view that this would enable us to shift some of our emphasis towards encouraging compliance by those in the regime – as opposed to bringing people within the regime – and would help us to focus our own skills and resources in the most efficient and effective way possible.

In that vein, we created two new Directorates from our previous Financial Services Regulation and Policy and Markets Regulation areas. The first of these is our Regulation Directorate, headed by Malcolm Rodgers, which is responsible for all of our policy and licensing work – setting the framework in which we regulate and bringing people into the regulated population. My Directorate, Compliance, is responsible for what you do once you are within those boundaries. Our Consumer Protection Directorate, headed by Greg, which now has responsibility for complaints as well as its focus on consumer-related issues, including education, financial literacy and some compliance work

including monitoring advertising and looking at financial services from the perspective of consumers, such as the conduct of our work on shadow shopping. We have also maintained our Enforcement Directorate, which handles all criminal, civil or administrative proceedings, and deals with the most serious breaches of corporate law.

The primary focus of our Compliance Directorate is to influence the behaviour of those we regulate, to promote compliance with their obligations and to ensure that consumers can be confident when they purchase financial services or products that they have good information, provided by people they can trust. We want to encourage high ethical standards in business, because the law and prescription can only do so much.

In this context, Superannuation Choice presents a huge challenge for ASIC, as well as for the industry. Both the Compliance and Consumer Protection Directorates have committed a large number of resources to a structured superannuation choice project that aims to both explore industry issues as well as to present ASIC's view on legislative requirements. Ultimately Greg's directorate and mine aim to engage with industry and consumers, where necessary, to influence behaviour, to ensure that the transition to a choice environment is beneficial for all – and to ameliorate the risks we have seen crystallised in other jurisdictions.

We intend in this session to briefly run through a number of the projects we are undertaking this year around superannuation choice. Some of these you will be familiar with already, and others will be less familiar. I'll deal firstly with a number of projects that have particular relevance for trustees, and then Greg and I will move to other aspects of our work in the Choice area which are likely to affect you – and others in your industry.

Promotion of funds

Our team is looking closely at the quality of the disclosure in Product Disclosure Statements and where relevant, related advertising. This work is being integrated with the broader work on super advertising monitoring which Greg will talk about shortly. Our aim is to review a minimum of 100 PDSs in this financial year. So far we have reviewed or are reviewing over 40 PDSs.

Over a third of PDSs we've looked at so far have been identified as having issues that may warrant a stop order. We have provided grounds for concern, a precursor to the issue of any stop order, in a number of cases. Of course we always remain open to resolving these matters where the disclosure is improved, ahead of a hearing or formal stop order and in most cases, this is how matters have turned out. Other issuers have received letters from us where we have indicated our initial concerns or have sought further information.

I think that it will be worthwhile to describe in a general way a real example of where we have taken action to stop a PDS and sought corrective disclosure on these sorts of issues. An issuer was making prominent claims on its website and in its advertising that its superannuation product had "*one low fee*" of '*x*%', when in fact there were additional transaction costs that applied to the product. Our concern with this claim was that consumers might be misled into believing that the "*one low fee*" of '*x*%' was the only cost to the member, when this was not the case on a more detailed reading of the PDS. We have obtained better disclosure in this case and are currently looking at a couple of other issuers who may also be falling foul along the same lines.

We are also focusing on the *disclosure of risks* in PDSs. We have sought and received corrective disclosure in at least one PDS to date in relation to that issuer's disclosure of risk, and another issuer has been

sent an initial warning letter indicating our concerns about how risks were disclosed in their PDS.

We understand that this is a difficult area that probably needs more discussion with industry, but *Prospective financial information* is a further area where we have concerns – Some superannuation PDSs we have seen contain forward-looking statements in the form of objectives or benchmarks that are unsupported by any objective data in the PDS. We are likely to provide those issuers with our grounds for concern shortly.

We strongly encourage trustees to review ASIC's policy statements on these issues. In particular, I draw your attention to Policy Statement 170 and what it has to say about the need for a reasonable basis for any forward-looking statements.

Kickbacks & employer advice

I'd like to talk now about the employer's role in relation to *Kickbacks & Employer Advice*. We have seen a couple of factors in particular that are contributing to the increasing numbers of decisions being made by employers on superannuation. The first is superannuation choice. The other is APRA licensing, as many employers move to wind up their corporate funds.

Advice to employers about superannuation is a relatively small, but lucrative, market space, and in the superannuation choice environment, there are increasing numbers of advisers moving into this area of advice. As we know, an adviser can obtain a trail commission on all employees' benefits by providing advice to the employer only. While this advice is given to the employer, the commission is paid for out of the employees' superannuation benefits. This situation raises a possible area of tension, if there is a divergence between the employer's and the employees' interests!

There are many issues to explore here, but my point is that clearly, there is a risk that advice that is given in this context will we weighted towards employers, rather than towards the needs of employees. In this case, licensees may have a conflict they need to manage. Indeed if we want to build some confidence here it might be seen as a conflict that needs to be *avoided*.

It will be no surprise that ASIC sees corporate superannuation advice as a key consumer protection risk – a challenge for the regulator and for industry. So what's ASIC doing about this? We're looking at the corporate super advice market with an eye on two areas:

- What products and, in particular, what add-ons are being offered by trustees and advisers; and
- How is information about superannuation products being delivered – in other words – *Advice*.

On the first point we're looking closely at what is bundled up in the products that are being offered in corporate superannuation. Our primary focus here is whether trustees are using unlawful kickbacks to provide inappropriate incentives to employers to choose particular funds. On the second point, we are turning our attention to the appropriateness of the advice that employers and trustees are getting about super – including advising arrangements and potential conflicts of interest in the context of corporate super advice. I'll elaborate on these two elements briefly.

The prohibition of *kickbacks* in s68A of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) came into effect on 1 July 2005, and some of the detail in this requirement seems to have slipped under the radar of some trustees. The provision prohibits a trustee or a trustee's associate from making the price or availability of the goods and services that it provides to employers *conditional* upon whether

employees will become members of the trustee's fund. While the kickbacks prohibition is a civil liability provision only, ASIC can take injunctive or administrative action where we think that action is appropriate.

The SIS Regulations (Reg 13.18A) create exemptions from the section 68A prohibitions. The exemptions relate to commercial arms length business loans, clearing houses, advice or administration services that relate to the payment of superannuation contributions and offers that are made available to employees on the same terms.

The prohibition of kickbacks to employers is an important aspect of the Choice of Fund regime because it pushes back against the practice of trustees or their associates using the retirement savings of employees to attract the business of their employer – and, importantly, it reduces the risk of an employer being unduly influenced to select a default fund that is not in the best interests of their employees.

We are encouraging industry to notify us of possible kickback arrangements. In addition, however, we are conducting our own targeted surveillances to detect the frequency of this practice.

We have also had discussions with the ACCC about the overlap between the kickbacks prohibition in the SIS Act and the third line forcing provisions under the Trade Practices Act. The two regulators are coordinating our regulatory responses.

As I mentioned, the second element we are concerned about in this area is *delivery of information* about superannuation products – in particular, the impact of *financial advice* about superannuation to employers and trustees, and how that affects the operation of Superannuation Choice of Fund. It's important to remember in this context that Employers are generally retail clients in relation to advice

about superannuation. No small business, asset value or other size consideration applies in determining whether an employer is a retail client for the purposes of s761G(6). Trustees are also classified as retail unless you have over $10 million in assets (for more on this refer to our FAQ - *QFS 150*). In the retail situation of course, the full licensing and disclosure requirements of the FSR regime apply to any advice given.

ASIC is conducting targeted surveillances to determine how advice is being given about default funds and corporate fund windups. We're looking at remuneration and compliance practices; and at how advisers and employers are handling the types of potential conflicts of interest I have just mentioned in relation to corporate superannuation advising arrangements.

ASIC has requested a number of Australian Financial Services licensees to provide us with information under ASIC's formal notice powers. These licensees include advisers and trustees in the bank groups, consultants and industry funds. We have requested information about the nature of the advice being given to employers in relation to the selection of a default fund and particularly where an employer may be considering winding up their stand alone corporate fund in the face of APRA licensing. We are interested in the nature of the advice, remuneration arrangements and compliance issues. The information that we receive under these notices will also assist us with our work on kickbacks.

We have received many of these documents, and our team is looking at what they reveal about these issues around corporate superannuation arrangements. We look forward to bringing the results of our surveillance into the public domain when we've concluded our analysis.

Advice

One of the critical issues that has attracted recent media attention in the provision of corporate superannuation advice is the at-times difficult distinction between *general* and *personal advice*. When is the provision of the advice deemed to be *personal advice*? When is the adviser considering one or more of the *objectives* of the employer or trustee under S766B of the Act? We are conscious that the planning industry in particular is seeking ASIC guidance on these issues. We are also aware that a view that seems to be gaining traction in industry is that a benchmark *standard* for personal advice is when the advice is aligned with the HR strategy of the employer or the trustee.

We can't give particular comfort on that point, as we must remember that what is *personal* advice – and indeed *good* advice –will always turn on the circumstances – indeed HR strategies may range from treating super as an employee benefit to attract and retain quality staff, to a legal obligation that the employer wants to comply with at a minimum cost. But we will be looking closely at these issues in our work in this area, and we may be able to say more when we have concluded our work on this specific project.

Call centres

While we are on the topic of personal advice – we are receiving at ASIC increasing amounts of anecdotal information that call centres of some industry funds may be straying into this area. Of course we don't necessarily accept all 'noise' we hear at face value. But there is enough of it to suggest to us the prudence of planning to take a close look at call centre operations to test the extent to which call centre staff understand the legal limits of what they are able to tell customers. Where call centre staff give personal advice we want to see that they are properly authorised to do so, and if they are, that they comply with the personal advice disclosure requirements. Systemic training and compliance issues will again be on our radar in this area.

Unlicensed superannuation advice

As I mentioned earlier, the arrival of superannuation choice has opened a new market space and myriad potential commercial opportunities, as well as demand for more information from employees or consumers of superannuation products generally. In this environment, it is critical that ASIC ensure that those who *need* to be licensed, *are* – to provide proper protections for consumers and of course a level playing field for commercial competitors.

We are particularly concerned about the compliance risk posed by the increasing prevalence of face-to-face workplace seminars. Usually they are given by the funds themselves. Trustees should be careful not to encourage employers to give unlicensed advice in the super choice environment.

We are already on the lookout for instances of funds that may be providing information and materials that might stray into the realm of financial product advice. We are currently pursuing at least one matter involving a fund providing information and materials on its website for employers to use to conduct their own workplace seminars.

I should also mention here that we are aware of the practice of Industry funds 'allowing' union representatives to give unlicensed advice to fund members, and we have in the past provided guidance about what *not* to do in this regard. Employers and Unions each have obligations here – there is no exemption from the requirements of the FSR regime for union representatives who are giving financial advice!

I would also like to flag a specific project due to start next year in which we will undertake a broad risk survey in this area.

I would like to stress that we are in no way philosophically opposed to funds giving advice to members as an 'in-fund' service – *with two important caveats*:

- Be very clear when that advice strays in to the realm of personal advice and if it does, the provider must be properly authorised to give it! *and*
- Be aware of and comply with the 'sole purpose test'

In the choice environment it is in our view perfectly reasonable to expect that funds will consider whether there is an 'in-fund' service they can provide to members. I am talking about members seeking advice about how to *use their funds* – for example insurance options, co-contribution, whether the member will meet their retirement target, that sort of thing.

However, as you will be aware, s62 of the SIS Act provides that a super fund must be run for the *sole purpose* of the provision of retirement benefits – this provision is administered by APRA.

APRA take the view – and they have expressed this publicly – that the reduction of a superannuation account balance as a consequence of the provision of advice, that is *beyond* advice about superannuation and retirement planning, may be a breach of the sole purpose test.

What I would say about this is that you should very carefully consider the *structures* that your funds use in providing advice as an in-fund service to members, so that you do not fall foul of the sole purpose test. This may involve the use of an appropriate in-house model, an associated entity model or an external referral model, where members seeking broader financial advice are referred to external providers.

I have more to say in a moment about some of our other key messages about your obligations in giving advice.

Self managed superannuation funds (SMSFs), and early access to super

Our work on self managed super funds has been well publicised, particularly since the release of our joint statement with the ATO in February last year, warning the public against using illegal schemes promising access to their superannuation before retirement.

Consumers will have more opportunities to establish their own SMSF under a choice of fund regime, so naturally ASIC is aware that SMSFs may be seen as a convenient vehicle for illegal early access to superannuation, and is an area ripe for misleading and deceptive advice. In a choice environment, consumers need to be very wary of claims that superannuation can be easily accessed for everyday needs. Arrangements that suggest consumers can use their superannuation funds before retirement are often illegal and are very risky for consumers.

Rest assured that ASIC is all over these issues! ASIC is determined to stamp out these illegal schemes and the marginal behaviours that accompany them, and has formulated a three-pronged approach, involving education, compliance and enforcement action to protect consumers and improve standards in this area.

We have taken over 50 investigatory and enforcement actions on persons involved in illegal early access schemes in superannuation. Invariably many such schemes involve establishing SMSFs or funds that purport to be SMSFs, to receive monies transferred from other super funds.

ASIC has worked with industry, including large superannuation funds and relevant industry associations, to generate consumer warnings about this issue. We are pleased to see this information is being

circulated by superannuation funds with their annual member statement mailouts, and communications with exiting fund members.

We believe that our focus on unlicensed advice and the quality of advice is critical in a SMSF context. We announced in May that we would be looking closely this year at the compliance by *accountants* with the scope and conditions of their exemption, and the appropriateness of advice being given by accountants. We will be conducting surveillances to ensure that accountants and other unlicensed advisers do not provide advice relating to the establishment and operation of SMSFs that may be misleading or deceptive.

In particular ASIC will be looking for instances where an accountant:

- has advised a client to establish an SMSF when their current superannuation savings are insufficient and their circumstances do not otherwise support the advice;
- has failed to advise a client properly about ongoing costs and the time and skill needed to administer an SMSF;
- *without* an AFSL, has failed to advise a client in writing that they are not licensed to provide financial product advice, and that the client should consider taking advice from an AFSL holder before making a decision; or
- has given financial product advice, including about switching to an SMSF or the investment strategy that an SMSF should pursue, without an AFSL.

So that's a project we're about to commence.

Switching superannuation funds – superannuation switching surveillance report

As you will have seen, we released our report on our super switching surveillance in August. This report has had an immediate impact by stimulating discussion in the industry about the quality of advice and the management of conflicts. We think this discussion is a good thing!

We quite clearly spell out in our report that ASIC believes there is more work to be done to lift standards of financial advice to enable consumers to obtain access to complete and appropriate advice about superannuation. Two key themes that emerged from our work were a lack of attention to the existing fund and, secondly, a trend towards overselling life insurance options to people who plainly did not need it, or did not need the level of cover that was sold.

I'll now touch briefly on some of the detail of our findings:

Apart from the need to adequately investigate a client's current, or 'from', fund before recommending that they switch, the findings highlighted the need for advisers to:

- adequately *disclose* any costs, lost benefits or other significant consequences of following switching advice, and
- *manage*, as well as *disclose*, conflicts of interest.

Our report highlighted a number of specific areas that our surveillance identified as requiring particular attention in the superannuation advice area, and I'll touch on each of those briefly:

'Reasonable basis for advice' test – Section 945A

Advisers must only give the advice if they have:

- determined, & made reasonable enquiries about, the client's personal circumstances (and note the s945B warning);

- if they have considered & investigated the subject matter to the extent that it is reasonable in the circumstances; and
- if they have ensured the advice is appropriate to the client

Specific switching disclosure obligation

Section 947D is a disclosure obligation specifically applying to 'switching advice'.

An adviser must disclose:

- The costs of the switch;
- Any loss of benefits as a result of the switch; and
- Other significant consequences to the client of the switch

Conflicts disclosure and management

Our surveillance showed that a significant number of advisers operate within conflicted arrangements. We believe that we have good cause to treat this situation quite seriously; given that *where conflicts existed* we found that 90% of advisers recommended a superannuation fund that was *related to the licensee*. Our strong message to advisers – and we have been making this point quite vocally – is that *disclosure* of and also *management* of conflicts is critical – Our *Policy Statement PS 181* sets out what we expect.

We intend to remain focused on the issue of conflicts of interest in the financial services industry generally, and we will act to ensure that consumers are provided with appropriate disclosures about the implications of switching superannuation funds. We will also be vigilant in monitoring financial services providers, and will take action if they fail to meet their significant obligations under the law.

Well that's been a fairly broad wrap of our current work in dealing with the many compliance challenges that super choice has thrown our way. We'll be saying more about these activities as they develop. We'll obviously be letting industry know where we have found areas that we

think need more work. But we'll also get out there with *good news stories*. It's important that we let industry know when we think that you're getting it *right* – which is, I should say, more often than not!

On this cooperative note, I can't think of a more appropriate moment to hand over to Greg, who will outline some of the critical consumer-focused activities that the Consumer Protection Directorate is knee-deep in this year.