



ASIC

Australian Securities & Investments Commission

ASIC's financial adviser work for 2012–13

*A speech by Peter Kell, Commissioner,
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Note: Versions of this speech were delivered at AFA roadshow events in Hobart, Adelaide, Perth, Melbourne and Sydney in July 2012.

Introduction

Thank you for inviting me to speak to you this morning.

I note that the theme for this year's roadshow is 'pathways to excellence'.

We at ASIC are keen to work with the industry, including the Association of Financial Advisers (AFA) and its members, to promote excellence, both in terms of professional standards and in the provision of quality financial advice. As I mentioned when I spoke to the AFA earlier this year, ensuring that financial consumers can access high quality financial advice is a core part of our mandate to facilitate their confident and informed participation in the financial sector. After all, good financial advice can significantly improve the financial wellbeing of consumers.

The examples of good advice and some of the examples of adequate advice which we uncovered in our recent shadow shopping research provide concrete illustrations of the impact that good advice can have.

Interestingly, good advice is not always the advice that a consumer is hoping for or is eager to hear. In fact some of the consumers who received better quality advice in our shadow shop rated that advice less highly than other consumers who had received poor advice. This is because the adviser had more clearly explained to them that some of their goals and objectives were unrealistic, and indicated that, for example, they really needed to get debt under control, save more and keep working for longer, to ensure they could make ends meet in retirement.

These can be challenging messages, but financial advisers have an important role to play in making sure that their clients better understand their financial situation and the decisions required to improve their finances.

Today I would like to outline the key elements of our work for the next year in the area of financial advice.

In particular, I want to highlight three broad streams:

- proactive surveillance and research projects on emerging risks;
- ensuring ASIC and industry are ready for the Future of Financial Advice (FOFA) reforms; and
- reviewing codes of conduct that may be submitted to ASIC for approval.

Proactive surveillance and research

While our work on the implementation of FOFA has been quite intense, ASIC also continues to have an active program of surveillance and research work.

Risk-based industry survey

The industry survey of major licensees is a core project for ASIC and plays an important role in our overall industry surveillance. Phase two of this project has already commenced and we will continue this work through the rest of the 2012–13 year. The objectives of this project are twofold:

- 1 to provide licensees with meaningful and tailored feedback from ASIC on how we think they are travelling in the areas of business processes, and risk and conflict identification and management; and
- 2 to enable ASIC to identify areas and licensees that require greater regulatory attention.

In late 2009 ASIC approached the largest 20 licensed financial advice dealer groups, requesting key information to assist in ASIC's monitoring and improvement of industry standards.

This information proved to be very useful for ASIC and also for the licensees, who received tailored feedback from ASIC on what they were doing well, and also areas where they should consider how to lift their game. Our findings from this exercise were reported in Report 251 *Review of financial advice industry practice* (REP 251), released in September last year.

We are now conducting the second phase of our survey project, using a refined version of the initial questionnaire, sent to the next 30 largest licensees. All the responses have been received and we are now undertaking a preliminary assessment of the key risks and strengths of each licensee. We are also looking for any systemic themes across this market segment.

We expect that some of the results will be different for this group compared to the largest licensees, who participated in phase one of the project. Many medium-sized licensees have quite different business models, and face different risks, to those of their larger counterparts. For this reason we do expect to see different licensee approaches to the management of such matters as risk and conflicts of interest.

Licensees will receive feedback from ASIC on their strengths and areas where they could improve. A letter summarising our review will be sent to each licensee with a meeting to follow, and a revised paper to be provided after the meeting. We also plan to release a public report along the lines of our earlier report later in 2012.

'Bad apples' project

One of the surveillance findings of the first phase of our risk-based survey was that there was significant variation between licensees in their approach to reference checking of new advisers.

This prompted us to discuss reference checking further with some licensees. The licensees we spoke to told us that they *conduct* reference checks; however, most licensees also reported that they did not receive many requests to *provide* reference checks. Clearly, this finding is anomalous. Some licensees did admit that on occasion they have appointed people, even though they were able to obtain only limited or even no reference information.

These inconsistencies in reference checking are a concern for ASIC. While reference checking is a standard employment practice across the economy, there is potentially more at stake in the financial services sector compared to many other industries if inappropriate recruitment occurs. There are risks for consumers, and reputational risks for advisers, if 'bad apples' remain in the industry.

We have commenced work in this area, known within ASIC as the 'bad apples' project. This project is looking at reference checking by both financial services and credit licensees.

The aim of this project is to implement measures to frustrate the ability of 'bad apples' to move from one licensee to another within the advice industry. Obviously, one way we seek to achieve this is by using our licensing and enforcement powers to take action against adviser misconduct. ASIC's new powers under the FOFA package will assist in this regard by allowing us to take into account likely future misconduct.

Reference checking of candidates being considered for employment is an additional, very practical way that 'bad apples' can be identified, and ideally forced to improve their conduct or forced out of the industry.

In 2007, ASIC and Standards Australia co-published a reference checking handbook for the financial services industry. Our discussion with some licensees found that while most were aware of our 2007 handbook, many were not confident to implement all its recommendations within their businesses. One constraint was the concern that providing an unfavourable reference for an adviser exposed the licensee to the risk of defamation claims.

In addition, licensees said it is often difficult to find the right contact person within an organisation to provide a good quality reference check.

We urge all licensees to review their current approach to reference checking, and consider whether their current processes are robust and uniformly applied. If you diligently try to obtain reference information on a candidate and no information is forthcoming, you need to consider whether the lack of information itself may convey something about the candidate you are considering.

Self-managed superannuation funds (SMSFs) and online advice

As well as surveillance and financial advice policy work, ASIC is looking to commence two proactive research projects in 2012–13. One of these projects will look at advice about SMSFs and another will look at online advice services.

SMSFs

Our SMSF project will be focusing on the general suitability of SMSF structures for financial consumers and retail investors.

SMSFs are the fastest growing sector of the superannuation industry and clearly they can offer significant benefits for experienced consumers. However, concerns have been raised about:

- the suitability of SMSFs for many less experienced ‘mum and dad’ investors; and
- the quality of advice these investors are receiving from accountants and financial advisers.

The Parliamentary Joint Committee investigating the collapse of Trio Capital was particularly concerned that some SMSF investors in Trio seemed not only unaware that their investment was unprotected from theft and fraud, but also unaware they had even established a self-managed fund. The committee considered that there is a very real need to improve financial literacy for those considering SMSFs. A large part of this responsibility rests with accountants and financial advisers who offer advice on these products, to better educate their SMSF clients and clearly communicate not only the advantages, but also the risks of investing through SMSFs.

In response to the concerns raised by the committee about investor understanding of SMSFs, ASIC will be making more detailed information available to consumers to help them make a decision as to whether or not to set up an SMSF.

The key message that we want to emphasise is that SMSF structures are not suitable for all investors.

In particular, we want to draw investors’ attention to:

- the time and resource commitments needed to run an SMSF;
- the expertise they need to have or will need to find to operate their fund effectively;
- the roles and responsibilities of SMSF trustees (including the liabilities of trustees in certain situations);
- the need to formulate an appropriate investment strategy;
- insurance considerations;
- lack of access to external dispute resolution (EDR)/compensation schemes in some cases; and
- alternative structures to SMSFs that could provide some investors with the flexibility they require but which do not involve setting up their own fund.

Online advice

ASIC is also planning to undertake a research project looking at current and emerging models of providing financial advice using online tools. Several super funds are already offering simple online advice to their members, providing personal advice with automatically generated Statements of Advice (SOAs). With the implementation of the MySuper reforms, we expect more super funds will consider such offerings. We also expect that other financial advice providers may look at online models, to expand and complement their existing advice services.

Online advice can be very efficient and cost effective, and appears suited to people who have simple queries, are internet savvy and who like to do things at their own convenience. There are however quite obvious limitations to what these services can provide; they are a complement rather than a substitute for traditional face-to-face advice services.

The purpose of our project will be to enable ASIC to get a grasp of the different services on the market, and what directions providers are looking to pursue. We are keen to understand how providers determine the appropriateness of their service for different clients, and what options are presented to clients whose needs, circumstances or objectives demand a different level of service.

With a better understanding of online advice offerings we can ensure our regulatory approach supports the right balance between making advice more accessible while also serving the best interests of the client.

Getting ready for FOFA

I'd now like to turn to the implementation of FOFA, which is a very significant part of our work over the next few years. In the next few months our priority is to ensure that both ASIC and industry are ready for FOFA.

As you are all aware, the FOFA bills passed the Senate on 20 June 2012. The ASIC website now contains a dedicated FOFA page, including the ability to register for email updates. I encourage you to have a look.

Before I discuss our FOFA work any further, I would like to clarify one question which has been raised with us – Will advisers who elect not to adopt the new requirements in advance of 1 July 2013 still be subject to the old s945A (of the *Corporations Act 2001*) reasonable basis of advice provision? The answer is 'yes'.

If you don't want to comply with the FOFA reforms before 1 July 2013, all the pre-FOFA existing obligations will continue to apply. This includes, for example, the requirement to have a reasonable basis for advice. If you want to commence early compliance with the FOFA reforms, before 1 July 2013, you will need to register with ASIC via the approved form (available on our website) and we will add your details to the register.

ASIC has previously announced its intention to publish regulatory guidance on various aspects of the FOFA reforms. Our guidance will cover the following topics:

- scaled advice;
- best interests duty;
- conflicted remuneration;
- ASIC's amended licensing and banning powers; and
- our approach to the approval of codes in the financial advisory sector.

Before issuing final guidance we will issue consultation papers on these topics (except for our guidance on our licensing and banning powers). This consultation process gives you the opportunity to provide feedback on our proposed approach before the guidance is finalised.

The first of these consultation papers will look at the area of scaled or limited advice. Our shadow shopping research, which we released earlier this year, confirmed our view that some industry participants could benefit from further guidance from ASIC about what is and is not appropriate when delivering scaled or limited advice.

The scope of nearly all of the advice we reviewed in the shadow shop was limited in some way. This reflects the reality that limited or scaled advice is not a different 'type' of advice, with its own rules and requirements, but

rather a scaling-up or scaling-down of the same principles, requirements and processes that apply to all advice.

When reviewing advice examples in the shadow shop, we saw several instances where the scope of the advice appeared inappropriate. In several instances, particular topics were excluded from the scope of the advice, to the potential benefit or convenience of the adviser, and to the significant detriment of the client. For example, an adviser might have excluded consideration of a client's debts from their retirement advice. However, if the debts were significant, retirement advice could not have been properly provided without taking this into consideration. Even for very limited advice, there are some topics that cannot reasonably be excluded from the scope.

ASIC's guidance on scaled advice will further assist advice providers to understand how to scale advice in a way that meets their legal obligations, including the best interests duty. Our guidance will cover a range of topics relevant to giving scaled advice, including the fact find and scoping the advice. Our consultation paper will also include draft guidance about giving information and general advice to clients.

Our consultation paper will contain practical guidance and examples about giving scaled personal advice, as well as practical examples about giving factual information and general advice to clients.

The consultation paper will be released in early August. At the same time we will also release our consultation paper on the 'best interests' duty and related obligations. Our guidance on the best interests duty will be in the form of an update to Regulatory Guide 175 *Licensing: Financial product advisers—conduct and disclosure* (RG 175).

Key topics we expect to cover in our best interests guidance are:

- acting in the best interests of the client for the purposes of s961B(1) of the Corporations Act;
- satisfying the best interests duty 'safe harbour' – this will include providing guidance on each element of the safe harbour;
- providing appropriate personal advice; and
- prioritising the interests of the client.

Following the scaled advice and best interests consultation papers, we will then release draft regulatory guidance on conflicted remuneration for consultation in September 2012.

Our conflicted remuneration guidance will cover:

- things we will look at in considering whether remuneration is conflicted, focusing on the substance of the benefit rather than its form;

- when a benefit will be considered conflicted remuneration, including volume-based benefits;
- how the conflicted remuneration provisions apply to performance benefits for employees;
- how we will administer the prohibition on volume-based shelf space fees and when we think the 'fee for service' and 'scale efficiencies' presumptions can be rebutted;
- when the prohibition on charging asset-based fees on borrowed amounts will apply;
- when the anti-avoidance provision may apply; and
- any transitional arrangements that apply, based on the state of the law at publication.

We will generally take a principles-based approach to providing guidance, and will use 'snapshot' examples to illustrate how we envisage our guidance working in practice. Because of the practical focus of the guidance, we strongly encourage you and your members to provide feedback as part of our consultation process.

Codes of conduct

Now to turn to the issue of codes of conduct. As you know, the FOFA legislation in its final form gives ASIC the ability to exempt advisers from the opt-in obligation if we are satisfied that the adviser is signed up to a professional code which 'obviates the need' for opt-in.

As per the other FOFA changes, we will be releasing regulatory guidance on the code approval process. At this stage, we anticipate our consultation paper will cover matters such as:

- appropriate content of a code submitted for approval, including methods to obviate the need for opt-in;
- administration, governance, monitoring and enforcement of codes; and
- ASIC's approval and relief processes, including whether we will grant relief to licensees or individual advisers.

The new FOFA requirements and ASIC's existing code approval powers under s1101A of the Corporations Act make it clear that a code is something that has to be taken seriously. It cannot be entered into lightly, either by industry associations or individual code members. Our code approval process will be careful and rigorous. Any code will take a considerable amount of time to develop and it will take months (at least) rather than weeks for us to assess a code. As well as submitting the terms of the code, applicants will also need to provide us with information about how it was

devised, when and how it will be reviewed and how it will be enforced, as well as any other matters outlined in our guidance.

When developing their codes, we expect applicants to undertake a proper consultation process. ASIC does not want to see codes put forward that have not benefited from appropriate input by interested stakeholders.

As for 'obviating the need' for opt-in, we expect approved codes to contain provisions that will achieve substantially the same outcomes as the opt-in requirement intends to achieve. That is, we expect to see engaged clients who receive agreed services for any ongoing fees that they pay.

For a financial advice industry code to be 'not inconsistent' with the law, as required under s1101A of the Corporations Act, it will need to be consistent with the broader rules included in the FOFA legislation. We will therefore take into account the outcomes of our consultation on regulatory guidance on subjects such as the best interests test and conflicted remuneration in developing our approach to code approval.

Realistically, this means it is likely to be some time before codes that are consistent with the FOFA legislation are out in the marketplace. We strongly encourage industry associations to review ASIC's current regulatory guidance in Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183), and to contribute to the consultation process for our new guidance once the consultation paper is released.

National exam update

Before I conclude, I would like to briefly update you on our adviser assessment project. We received very helpful feedback on this point via responses to our Consultation Paper 153 *Licensing: Training and professional development framework for financial advisers* (CP 153). ASIC will soon hold discussions with industry participants about the potential for setting up a self-regulatory organisation (SRO) which would develop and administer the exam.

ASIC believes a self-regulatory model, when implemented effectively, can be an efficient approach to establishing the exam. Further, it gives industry members the opportunity to jointly take responsibility for shaping their profession. It also demonstrates industry's support and commitment to providing effective accreditation for financial advisers.

ASIC would have a close relationship with the SRO because of its overall responsibility for standards in the retail advice sector, and we would assist by contributing the research we have commissioned on competencies and by providing other support.

Ideally, we would like to see a 2014 start date for the exam with a two-year transition period. We would also like to see the completion of the national exam as a requirement of membership of an industry association, such as the AFA, or a condition of employment for industry participants.

Conclusion

Well, as you can see ASIC has a very busy year ahead.

In the coming months you can expect to see draft guidance from ASIC in relation to the FOFA reforms, and I encourage you to engage in our consultation process, and to consider what our proposed guidance might mean for your businesses. ASIC's website has a FOFA implementation page and I encourage you to regularly check in there to keep abreast of ASIC's work in this area.

We will also be continuing with our ongoing program of research and surveillance, including the completion of phase two of the risk-based licensee survey, continuing to progress work on our 'bad apples' project and commencing two new research projects looking at SMSFs and online advice.

ASIC strongly believes in the value and benefit that good financial advice can provide to consumers, and we look forward to continuing to work with the AFA and other industry associations and their members to continue to raise the bar, in terms of the quality of advice that is provided, consumers' appreciation of the value of that advice, and their ability to access that advice when they need it.