



**ASIC**

Australian Securities & Investments Commission

**REPORT 51**

**Report to the Parliamentary  
Joint Committee on late 2004  
(and early 2005)  
superannuation switching  
advice surveillance**

November 2005



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# **Report to the Parliamentary Joint Committee on late 2004 (and early 2005) superannuation switching advice surveillance**

## **INTRODUCTION**

In late 2004 and early 2005, ASIC undertook a surveillance looking at whether advisers were complying with their obligations to disclose, in the Statement of Advice (SOA) given to clients, the costs, possible loss of benefits and other significant consequences of following advice to switch super funds.

During this surveillance, ASIC uncovered some cases where the interests of clients were harmed by poor advice.

## **PURPOSE OF THIS REPORT**

The purpose of this report is twofold:

- to explain the methodology behind the surveillance; and
- to illustrate the results of the surveillance in simple language.

## **PROJECT METHODOLOGY**

ASIC started surveillance on superannuation switching advice in December 2004 to assess how financial advisers were, at that time, complying with new legal obligations relating to advice to switch superannuation products.

ASIC's surveillance sample included 19 AFS licensees and 93 representatives of those licensees. Initially, ASIC reviewed 101 client files in which personal advice was given to switch superannuation funds in the second half of 2004. In the process of making further inquiries, ASIC reviewed the compliance procedures of some licensees and over 160 further advice files (ie a total of 261 files from 93 people representing 19 licensees).

Licensees were selected from the retail, industry fund, corporate and government sectors. Some advice was from independently-owned advisers. ASIC also reviewed advice given in relation to self-managed superannuation funds (SMSFs).

ASIC required all licensees the subject of the surveillance to provide information about the switching advice they had provided during a 3 month period. ASIC received information on around 7,500 pieces of switching advice. 4,900 of those were from advisers whose licensee was a related entity to the trustee of the superannuation fund they recommended (see table below for break-up of conflicted advice per licensee).

ASIC used a number of tools to determine whether the licensee was a related entity to the trustee of the super fund recommended. This included review of the Financial Services Guide provided by the adviser, and also use of ASIC's ASCOT database to ascertain related entity status.

ASIC required each licensee to produce on average 5 client files for full review (totalling approximately 100 files). Typical selection for a retail adviser included one consolidation advice, one switch recommendation from an industry fund to a retail fund, one retail fund to another retail fund, one corporate fund to a retail fund, and one public sector to a retail fund. These files were taken from a selection of switching advice given over a specified three-month period for each licensee. For one very large licensee, however, ASIC reduced the scope of the notice to only include information about switching advice provided by representatives with surnames (or company names) beginning with A-D over a one month period.

Further files were also requested from advisers and licensees where concerns were detected after review of the first batch of client files – an additional 160 files in this category, totalling 261 files overall.

## SUMMARY OF FINDINGS

There were three main findings:

- **Limited investigation of the 'from' fund.** Most advisers recommending a switch had made limited or no investigation of the fund that they advised the client to switch from (ie the 'from' fund).
- **Poor disclosure of the costs, loss of benefits and other significant consequences if the advice is followed.** As a result of limited or no investigation of the 'from' fund, most advisers in our surveillance did not comply with the specific obligations to disclose the costs, loss of benefits and other significant consequences of the recommended switch. In the SOAs we reviewed, disclosure about the basis for the recommendation to switch was generally poor.
- **A tendency to recommend a fund related to the licensee.** Based on the statistics provided by licensees, there is a strong tendency among advisers to recommend switching to a fund related to the licensee. In these cases, there is a conflict of interest that must be carefully managed in order to avoid the perception that advice is inappropriate or is not given on a reasonable basis, or that the interests of the licensee are placed above those of the client.
- **A tendency to oversell life insurance.** There were a number of examples where advisers seemed to recommend life insurance to clients where there did not seem to be a reasonable basis for doing so.

## ASIC ACTION

ASIC has taken, and proposes to take, a wide range of actions in relation to the findings of the surveillance.

At the extreme end was the case of Superannuation Retrieval Services (see ASIC media release [MR 05-205]) which involved an unlicensed adviser giving misleading advice to consumers about rolling over their superannuation entitlements into self-managed superannuation funds (SMSFs). One victim with only \$8,000 in super savings was sold an SMSF and charged \$1,500 in fees. In that case, ASIC obtained orders in the Federal Court restraining the relevant parties and compelling them to repay all client money. This matter is ongoing.

ASIC has also issued a direction to national financial planning and stockbroking firm, Bridges Financial Services Pty Ltd, requiring it to provide an audited opinion that it has changed its procedures and is complying with its switching advice obligations (see ASIC media release [MR 05-318]). ASIC had discovered that Bridges had failed to provide clients with information in statements of advice about charges incurred and benefits lost as a result of super switching recommendations.

ASIC has also initiated a detailed and more wide-ranging surveillance of one of the major financial planning groups involved. This could result in a range of outcomes; ranging from a 'clean bill of health' to enforcement action. It is too early to make any comment at this stage.

Other action includes a number of enforcement referrals in relation to the behaviour of individual advisers summarised in the examples set out later in this report, together with proposed Federal Court action in relation to the conduct described in Example 7. Compliance action<sup>1</sup>, along the lines of the Bridges matter is also proposed for a number of licensees.

ASIC believes that the disclosure, at this time, of more details of proposed enforcement and compliance action, by identifying particular conduct and the proposed response, would have the potential to compromise our work in this area. It has the potential to be misused by participants in the industry to argue that certain types of conduct result in a certain level of response from ASIC. It also has the potential to be misleading in that ASIC might decide not to take enforcement action based on certain information and then take a different decision based on subsequent information. It must also be remembered that all of these matters are ongoing, even where compliance action has already been undertaken, under investigation or the subject of preparation for enforcement action (either judicial or administrative). For all of those reasons, ASIC is not in a position to provide further information at this stage.

## TABLE OF DATA

Below is a table indicating the level of conflicted advice per licensee based on the statistical review of switching information provided by licensees under notice. It also summarises the compliance findings across all licensees.

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<sup>1</sup> 'Compliance action' is a tool used by ASIC, particularly in the financial services industry, to improve the standard of compliance with the law. It has the benefit of being more wide ranging, timely and less costly (for ASIC and the licensee) than traditional enforcement action. In this case, it includes formal directions requiring licensees to take steps to address the compliance findings set out in the 6<sup>th</sup> column of this table. Licensees who receive such directions are required to provide an audited report to ASIC in early December 2005 detailing the steps taken and changes made. Where monitoring of specific advisers is required, the licensee must review, train and supervise that adviser over the course of one year.

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
1	Yes (Retail)	98% of 709 recommendations	12	55 (15 then a further 40)	<p>1. Advice - failure to investigate the client's existing fund</p> <p>2. Disclosure - inadequate switching disclosure.</p> <p>3. No advisers nominated for specific monitoring due to enforcement referral.</p>	
2	Yes (Retail)	69% of 78 recommendations	5	5	<p>1. Advice - failure to investigate the client's existing fund.</p> <p>2. Disclosure - inadequate switching disclosure</p> <p>3. Monitoring required – 3 advisers</p>	1. Some instances of pre-FSR language being used.
3	Yes (Retail)	75% of 257 recommendations	8	28 (9 then a further 19)	No findings letter will be issued because the AFSLee is with Enforcement. Their compliance manuals mislead advisers as to their obligations.	

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
4	Yes (Retail)	75% of 360 recommendations	10	20 (11 then a further 9)	<ol style="list-style-type: none"> <li>1. Advice - failure to make adequate investigation of the client's existing fund.</li> <li>2. Advice - setting scope of advice (insurance)</li> <li>3. Risk management - licensee liability for representatives acting outside authority</li> <li>4. Disclosure - inadequate switching disclosure (insurance)</li> <li>5. Monitoring required - 3 advisers.</li> </ol>	<ol style="list-style-type: none"> <li>1. Presentation of SOA - some advice not CC&amp;E.</li> <li>2. Advice on SMSF - SOA should outline ongoing obligations &amp; costs.</li> </ol>
5	Yes (Retail)	99% of 1,320 recommendations	9	10	<ol style="list-style-type: none"> <li>1. Advice - failure to investigate the client's existing fund (insurance)</li> <li>2. Advice - setting scope of advice (insurance &amp; fund comparison)</li> <li>3. Advice - licensee business structure may preclude compliant switching advice.</li> <li>4. Disclosure - general switching disclosure inappropriate</li> <li>5. Monitoring required - 3 advisers</li> </ol>	<ol style="list-style-type: none"> <li>1. Advice - use of templates may lead to misleading representations about comparative benefits.</li> </ol>

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
6	Yes (Public Sector)	100% of 3 recommendations	1	1	1. Advice - failure to investigate the client's existing fund leading to misleading advice. 2. Disclosure - inadequate switching disclosure	
7	No	(Note a strong leaning to XX products - likely conflict based on remuneration structures OR narrow product list.	6	8	1. Advice - failure to investigate the client's existing fund leading to misleading advice. 2. Disclosure - inadequate switching disclosure 3. Not supervising risk of accountant / representatives giving SMSF advice under acc. Exemption but ostensibly as representative.	
8	Yes (Retail)	55% of 58 recommendations	6	8	1. Advice - failure to adequately investigate the client's existing fund. 2. Disclosure - inadequate switching disclosure. 3. Monitoring required - 1 adviser	

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
9	Yes (Industry funds)	89% of 766 recommendations	9	33	<p>1. Advice - failure to adequately investigate the client's existing fund. - if there is investigation beyond costs and insurance, a recommendation to switch cannot be made under s945A.</p> <p>2. Disclosure - inadequate switching disclosure - general statement that there may be other lost benefits not available to XXX adviser because more information cannot be reasonably found out.</p>	



Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
10	Yes (Retail)	61% of 343 recommendations	6	35 (7 + a further 28)	<ol style="list-style-type: none"> <li>1. Advice - failure to make adequate investigation of the client's existing fund.</li> <li>2. Advice - inappropriate scope of advice (insurance)</li> <li>3. Disclosure - inadequate switching disclosure</li> <li>4. Disclosure - inappropriate use of general switching disclosure</li> <li>5. Disclosure - templated statements about benefits of a recommended fund may be misleading.</li> <li>6. Disclosure - SOAs must be given before other financial services are provided.</li> <li>7. Monitoring required – 3 advisers</li> </ol>	<ol style="list-style-type: none"> <li>1. Some terminology needs to be updated to reflect Australian financial services license regime (white)</li> <li>2. Comparison of funds should include ongoing costs.</li> <li>3. Recommendations of consolidation into an entirely new fund should clearly disclose the basis of this advice.</li> <li>4. Presentation - inclusion of lengthy research reports and lack of structure makes SOAs less clear, concise &amp; effective.</li> </ol>

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
11	Yes (Retail)	86% of 129 recommendations	5	14 (5 + a further 9 files)	<ol style="list-style-type: none"> <li>1. Advice - failure to make adequate investigation of the client's existing fund.</li> <li>2. Disclosure - inadequate switching disclosure.</li> <li>3. Monitoring required – 2 advisers</li> </ol>	<ol style="list-style-type: none"> <li>1. Disclosure - non-compliant disclosure of interests by link to website</li> </ol>
12	Yes (Retail)	85% of 330 recommendations	6	14 (7 + a further 7)		<ol style="list-style-type: none"> <li>1. Disclosure - isolated instance of late SOA.</li> <li>2. Disclosure - inadequate switching disclosure (ongoing costs of corporate / public sector funds)</li> </ol>
13	Yes (Retail)	100% of 123 recommendations	5	5	<ol style="list-style-type: none"> <li>1. Advice - failure to make adequate investigation of the client's existing fund.</li> <li>2. Disclosure - inadequate switching disclosure.</li> <li>3. Monitoring required – 3 advisers</li> </ol>	<ol style="list-style-type: none"> <li>1. Disclosure - strategies raised by an adviser but presented as a client direction may be misleading.</li> </ol>

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
14	Yes (Public Sector)	100% of 151 recommendations	2	4	<p>1. Advice - failure to make adequate investigation of the client's existing fund.</p> <p>2. Advice - inappropriate scoping of switching advice.</p> <p>3. Monitoring required – 1 adviser</p>	<p>1. Advice - strategies raised by an adviser but presented as a client direction may be misleading.</p> <p>2. Advisers tied to specific superannuation funds must have strong conflicts management processes.</p>
15	Yes (Public Sector)	100% of 14 recommendations	1	1	<p>1. Disclosure - failure to disclose conflicts of interest (relationship with product provider)</p>	<p>1. Review templates for pre-FSR language</p>

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
17	No	(This adviser was the only one selected from complaints data)	1	1	<p>1. Advice - failure to make adequate investigation of the client's existing fund.</p> <p>2. Advice - failure to make adequate enquiries about the client.</p> <p>3. Disclosure - inadequate switching disclosure.</p> <p>4. Disclosure - holding out. (Further surveillance on other AFSL related compliance issues)</p>	
18	Yes (Corporate / Public sector)	100% of 40 recommendations	3	5	<p>1. Advice - failure to make adequate investigation of the client's existing fund (even name)</p> <p>2. Disclosure - inadequate switching disclosure.</p>	<p>1. Disclosure - templated comparisons on fees may be misleading in particular circumstances.</p>

Licensee	Equity Conflict?	% of recommendations to related party fund	Number of advisers whose files were reviewed	Number of files reviewed	Compliance Findings	Other Concerns
19	Yes (Retail)	98% of 178 recommendations	5	5	<p>1. Advice - recommendations of insurance may not be appropriate</p> <p>2. Disclosure - inadequate switching disclosure (espec. Comparative costs)</p> <p>3. Monitoring - use of 'product replacement statement' in template.</p> <p>4. Report - misleading advice on co-contributions 1 adviser</p> <p>5. Monitoring required – 2 advisers</p>	<p>1. Consolidation advice - reasonable basis for consolidating into a new fund where one of the existing funds suits the client's needs.</p>
20	Yes (Public Sector)	100% 93 recommendations	5	35 (5 + a further 30 files)	<p>1. Advice - failure to investigate the from fund.</p> <p>2. Disclosure - failure to make switching disclosure</p> <p>3. Disclosure - general switching disclosure used improperly</p>	

## **EXAMPLES OF POOR ADVICE**

The following scenarios are taken from some of the 261 files actually retrieved during the surveillance. The names of the clients and other parties involved have been changed, but the factual information is unaltered.

### **Example 1: Jane Adams<sup>2</sup>**

Jane Adams had existing super with \$92k worth of death & TPD cover in Fund 1. She earns approximately \$10k per annum and her husband has an income of \$36k per annum. They have no dependants. She is not in good health and would like to give up work because of this.

She was given advice to roll over her balance into Fund 2. Fund 2 required her to pass health checks in order to get equivalent cover. She was rejected for TPD (total & permanent disablement) cover and now only has death cover. The wording in the SOA relating to the loss of benefits from the switch are as follows "*There will be a \$91,905 Death and TPD benefit replaced with the rollover of (Fund 1) to (Fund 2). However, the increased cover under (Fund 2) is more appropriate to your situation.*" The adviser did not disclose that health checks would be necessary to get TPD cover in Fund 2 or that she could potentially lose her TPD.

**ASIC's conclusion so far – We doubt whether there is a reasonable basis for this advice. There is clearly client detriment suffered if there is a loss of TPD cover. There is a breach of disclosure obligations in respect of the potential loss of benefits, due to the health check required.**

### **Example 2: John Smith**

John Smith was a labourer. He received advice to roll over from his existing industry super fund (Fund 1) to Fund 2. Fund 1 provided Death & TPD cover regardless of occupation, while Fund 2 did not provide TPD cover to labourers. The loss of the cover is disclosed in the SOA with the comment "*There is a loss of \$55,000 Death and TPD, however the FLS plan compensates for this with a higher cover of \$250,000 for Death.*" What the SOA fails to say is that the higher death cover in Fund 2 was at a significantly greater cost. The client was 25 years old, not married, had no dependents, and as a labourer was at much greater risk of requiring TPD than someone with an office job. The death cover was far less suited to his situation than TPD cover and arguably of no benefit. He was separately advised to get trauma cover that was considerably more expensive than the TPD available in Fund 1 and less suitable as it is not as connected to his capacity to work.

John Smith could have kept his TPD cover by remaining in Fund 1, which had lower administration fees and nil establishment and contribution fees. He would also have saved himself the 4.5% entry fee into Fund 2.

**ASIC's conclusion so far - \$250k is very large life cover for a 25-year old labourer with no family – it is questionable whether this person needed this death cover at all and certainly not at the cost of losing TPD cover. There is a marked increase in**

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<sup>2</sup> All names have been changed to protect the identity of the parties

**fees payable which will have a significant impact on the client's end retirement payout. We doubt whether there is a reasonable basis for this advice.**

### **Example 3: Anne and Michael Stevens**

Anne and Michael Stevens are a married couple. Anne was recommended to roll the \$6,110 she had in Fund 1 into Fund 2. The termination cost was \$882.37 and the entry fee for Fund 2 was \$274.95, so the total cost of the rollover was \$1,157.32 or 19% of the value of her fund. These entry/exit fees were disclosed.

The rationale for the switch was stated in the SOA as "*[Fund 2] performs better and gives more flexibility as far as insurance benefits and ongoing premiums are concerned. Any new funds going into this policy over and above the contracted level incur excessive fees and so it has remained frozen for some time.*"

This statement was misleading because it indicates the client should leave Fund 1 due to excessive fees on her contributions. However, in reality Fund 1 charged 5% on all contributions *in excess* of her agreed premium, whereas in Fund 2 she would pay 4.5% on the *entirety* of all contributions.

As it turns out, Fund 1 had no less flexibility than Fund 2 in relation to insurance options available.

Michael was recommended to rollover funds from Fund 1 to Fund 2. However, important details about Fund 1 were not ascertained by the adviser who instead *referred the client to Fund 1 to find these details out for himself.*

Anne and Michael were also advised to buy insurance totalling \$5,719 in annual premiums. This was excessive given their combined gross annual income was \$45,000.

**ASIC's conclusion so far – This advice is incorrect on cost issues that adversely affect the financial circumstances of the client. There is a significant cost associated with switching between these products and the financial benefits of such a switch are not apparent. We doubt whether there is a reasonable basis for this advice.**

### **Example 4: Jim Barlow**

Jim Barlow was in a so-called 'old' employer Fund 1 plan. He was recommended to switch to a 'new' employer Fund 1 plan, but was given no details about the difference between the old and the new. The client was to be charged a 3% entry fee for going into the 'new' fund. ASIC spoke with the product manager of Fund 1 who said that there is no such thing as an 'old' and a 'new' plan. She could not think of any instance where a new entry fee could be charged unless one account was closed and a new one opened up some time later.

**ASIC's conclusion so far – this advice may have been given solely to secure the transfer of trail commissions from a previous adviser.**

### **Example 5: Ruth Taylor**

Ruth Taylor had \$26,000 super with an industry fund (Fund 1). The SOA recommended that the client switch to Fund 2 and get extra death cover.

A review of the file discloses that the adviser did not get any details of the client's income. There is inadequate information about the client's circumstances and financial objectives. The client was charged \$782 to switch her funds. The client is a 45-year-old divorcee with no dependants, and as such the need for additional death cover is not apparent. She is on a low income, working 12 hours per week as a shop assistant. The additional costs have had a significant impact on her financial position.

**ASIC's conclusion so far – There is a marked increase in fees payable which will have a significant impact on the client's end retirement payout. We doubt whether there is a reasonable basis for this advice.**

## **Example 6: Douglas Kant**

Douglas Kant earns \$38,000 per year and owes \$46,500 in personal debts. He visited an adviser to get advice on how to restructure his finances to pay off his debts. He was not seeking advice about super and had \$22,533 worth of super with a low cost fund (Fund 1).

The adviser recommended in the SOA that he switch into Fund 2. Fund 2 has an entry fee of \$977 and an ongoing fee of 0.4%.

The adviser did not do any research about Fund 1, nor discuss the advantages or disadvantages of the switch in the SOA. There appears to be no reasonable basis for the advice given in the SOA. The reason for the switch is said in the SOA to be "ability to choose different fund managers and to fit those fund managers within your investment profile."

**In considering the reason given for the switch, it is hard to see how "the ability to choose different fund managers" is relevant to a person who owes more than their annual salary in personal debts.**

**Further, there is a concern as to whether the adviser should have given any advice at all in these circumstances, given they have not researched the fund of which this client is a member, before providing advice which adversely affects the client's financial situation. We doubt whether there is a reasonable basis for this advice.**

## **Example 7: Adviser 1**

Adviser 1 recommended six of his clients move from industry superannuation funds (Funds1) to Fund 2. The clients were all low-to-middle income earners and were significantly worse off as a result of Adviser 1's advice to switch. The fees and charges associated with Fund 2 were significantly higher.

Using the ASIC super calculator, we estimate the clients' retirement payouts will be reduced by between 22% and 44% as a result of the advice to switch. There is some evidence that Adviser 1 deliberately lied by saying that Fund 2 was cheaper. In one instance, the SOA does not disclose important costs in Fund 2.

In addition, Adviser 1 recommended three clients (all single with no dependants and little debt) take out life insurance of \$250-\$300,000, which was far more than they were likely to need.



The SOAs also failed to disclose that clients will generally lose their insurance as a result of the switch and that Fund 2's insurance premiums were generally more expensive than Funds 1.

In each case, Adviser 1 distorted the client's financial circumstances to justify his advice to switch funds. In several cases, the summary of the client's circumstances in the SOA was directly contradicted by the client's evidence about their instructions to Adviser 1.

Adviser 1 also failed to investigate Funds 1 and had no knowledge of the exit fees or cap on insurance offered by Funds 1. Adviser 1 even failed to investigate Fund 2 as evidenced by the fact that he was ignorant of the fact that it was possible to get TPD insurance without getting an equivalent amount of life cover.

The incentive for Adviser 1 to advise clients to switch is that he would be entitled to a commission equal to:

- 104% of the insurance premiums paid in the first year (plus 11% every year thereafter);
- 4.5% of all funds paid into Fund 2; and
- an annual ongoing fee (ie 'trail') of 1% of the value of his clients' share of the assets in Fund 2.

In light of the conduct of Adviser 1, ASIC intends to take enforcement action against this adviser in the Federal Court.

**Australian Securities and Investments Commission  
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