



**ASIC**

Australian Securities & Investments Commission

# FOFA and the new reality

*A speech by Peter Kell, Commissioner,  
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*Money Management and Financial Services Council (FSC) Breakfast  
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## Introduction

Good morning. Thank you to the FSC and Money Management for the invitation to speak about the upcoming Future of Financial Advice (FOFA) reforms.

As you know, ASIC has communicated extensively with the industry about FOFA. We recently released our final regulatory guides on approving codes and on conflicted remuneration. That completes the five regulatory guides we have produced on FOFA, being:

- best interests duty
- scaled advice
- fee disclosure statements (FDSs)
- codes
- conflicted remuneration.<sup>1</sup>

On Monday 4 March the Government released further draft regulations for consultation on grandfathering.

This means we are all on the home straight as we get ready for mandatory compliance on 1 July 2013.

Today I am going to focus on the broad aims of FOFA, rather than technical details. Sometimes these aims get lost in the consultation processes, trips to Canberra and the meetings with the lawyers.

I want to cover:

- Why do we need FOFA?
- How can we ensure successful FOFA implementation?
- Life insurance in a FOFA world.
- Finally, what will this mean for advisers and consumers in the future?

## Why do we need FOFA?

In a nutshell, we all need these reforms because we want to improve the quality and accessibility of financial advice. We all want to better *align* the interests of advisers and consumers. This is the new reality.

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<sup>1</sup> See Regulatory Guide 175 *Licensing: Financial product advisers—conduct and disclosure* (RG 175), Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183), Regulatory Guide 244 *Giving information, general advice and scaled advice* (RG 244), Regulatory Guide 245 *Fee disclosure statements* (RG 245) and Regulatory Guide 246 *Conflicted remuneration* (RG 246).

- 1 The advice industry must increase the level of professionalism. It needs to move from a sales-based culture.
- 2 Advice quality should be supported by business models, rather than compromised by practices that place product distribution ahead of the quality of advice.
- 3 We want consumers to trust advisers, to fully appreciate the value of advice, and to understand and value any ongoing services they receive.

The advice industry will struggle to move to the level of professionalism we all want unless the regulatory settings and framework encourage better alignment with consumers. Too often we've seen the wrong incentives dominating the way advice is provided and the products being recommended, rather than being client focused and driven. Too often we've seen structurally embedded conflicts of interest determine the way that clients are dealt with.

FOFA helps address these issues. Now, I'm not suggesting that FOFA alone is the solution, and there are other regulatory and industry initiatives that will help lift the quality of financial services. But the FOFA reforms, by including a duty to act in the interests of the client and by switching off forms of conflicted remuneration, help to provide a structural basis for professionalism.

The track record on the quality of financial advice since ASIC became the regulator for this area is mixed at best. We've seen, to name a few, problematic advice issues related to Westpoint, Trio, Opes Prime, Storm, and now Banksia. These collapses were personally tragic for those many people who lost their retirement savings. We would have missed an opportunity if we had simply thought about these collapses as a series of isolated incidents in the past and failed to look for necessary *systemic* changes.

ASIC gets to see a lot of financial advice provided to clients. Some of it is excellent, and for these advisers the FOFA reforms are more business as usual. Some of the advice is adequate, but could be better. Unfortunately, we also see a lot of advice that is poor. We see this through our surveillance and compliance work, through our shadow shops, through complaints brought to us both by consumers and by other industry participants.

Importantly, the FOFA reforms should not just reduce the incidence of poor advice, but also help lift 'adequate' advice into the 'good' and 'excellent' categories.

ASIC's work also regularly identifies significant issues in Australian financial services licensees, related to the quality of their oversight and weaknesses in meeting the general obligations under the *Corporations Act 2001* (Corporations Act). Often licensees get into these situations because of business model considerations, particularly related to remuneration.

Given all of these factors, it is understandable that public confidence and trust in the financial advice industry could see significant improvement. Currently, only one in five consumers receive financial advice. Further, when asked how much they are willing to pay for advice, most people quote figures that are far less than good advice costs to provide.

These trust and affordability problems are linked. On the affordability side, this is partly a result of the old commission model, which is banned under FOFA going forward. Consumers thought advice was free because commissions were inside the product costs. In my experience, the commission-dominated models made advisers lazy when it came to explaining how advice added value.

ASIC's objective is to ensure that consumers better understand the benefits of receiving financial advice, including ongoing advice. On this point, can I suggest it's about time that the discussion around the FOFA codes turns to a positive agenda around engagement with clients, rather than simply the issue of avoiding 'opt-in'? There's an opportunity here to tell a positive story about the industry's approach to client communication and ongoing services.

On the issue of affordability, the FOFA reforms aim to encourage access to advice, through facilitation of scaled advice models. ASIC has provided guidance to clarify the previously murky waters of giving scaled advice, to expand the availability of lower-cost advice with the aim of increasing access and affordability of advice for consumers. ASIC is strongly committed to facilitating scaled advice in this sector.

FOFA helps address the above issues collectively as an industry. It provides a regulatory basis for better aligning the interests of client and adviser, which your industry can build on through your own practices and professional efforts. It helps focus all of us, including the regulator, on the quality of the advice being provided and the benefits of that advice for consumers. It's time to collectively embrace the new reality of financial services.

## Implementing FOFA

We understand that there are considerable changes that have been made and that are being made to enable firms to be FOFA ready by 1 July 2013.

- *Changing IT systems* – financial planning software is being updated, new platform controls are being put in place, there are new client interfaces, new disclosure requirements to be met through IT builds, and new advice models being developed (e.g. online advice).
- *Developing compliance frameworks* – for new duties on advisers, making sure conflicted remuneration is turned off, scaled advice is done appropriately, etc.
- *Licensees have to develop new oversight mechanisms*– for example, tracking which advisers are potentially members of a code or which are subject to opt-in.
- And, of course, there is a lot of work to be done *training advisers* on their new and modified obligations.

This flurry of activity, though, is not limited to industry. ASIC, of course, has been busy developing our FOFA regulatory guidance. We have also been working to facilitate FOFA implementation through our response to transitional challenges. For example, our three no-action positions on the FDS requirements will help advisers implement the FDS requirements.

The success of FOFA relies on the financial advice industry accepting and meeting their legal responsibilities, and applying professional judgement during the implementation phase and beyond. Particularly in the first 12 months, you will need to apply judgement and common sense to smooth out any wrinkles and implement the reforms in a consistent and workable manner. You have seen in ASIC's guidance that we have taken a common sense and principles-based approach to allow industry space and flexibility to implement FOFA into their business model, noting of course that there will be changes to business models.

Our focus in the first 12 months of FOFA is on facilitating compliance with the new regime. We expect all licensees and representatives to be actively taking steps to adapt to the changes resulting from FOFA. Having said this, let me be clear that our facilitative approach is not a 12 month delay in the commencement of FOFA!

Our Financial Advisers team will work cooperatively with licensees and representatives to assist implementation and compliance, and to

build understanding of the regime. Go to the ASIC website's special FOFA page,<sup>2</sup> or talk to us if you have questions.

Where we see breaches we take a tiered approach. If breaches are inadvertent and/or there are systems changes underway, we will be taking a measured approach that involves consulting with you to ensure any problems are addressed.

In considering whether a breach is inadvertent, we may consider matters such as the steps taken to embed the organisation's compliance with FOFA and implement the necessary changes (policies, procedures and training). We will give consideration to whether, taking into account the size of the business, sufficient and adequate resources were allocated to implement the changes.

We expect breaches to be reported to ASIC in the usual way, as required by the legislation. On this point, it's preferable to have a breach that has been self-reported than one which is reported to us by a third party or client.

If breaches are deliberate, are significantly damaging to consumers, and occur in situations where firms are making little or no effort to comply, we will take a tougher approach. And of course, we will continue to take strong action against breaches that would also have been considered unlawful conduct under the pre-FOFA legislation.

## **Life insurance in a FOFA world**

I now want to touch on the issue of industry self-regulation and life insurance sales.

Last year ASIC was supportive of industry initiatives to deal with 'churning', the excessive switching of life insurance policies by financial advisers and brokers. We were pleased to see industry taking steps to address this issue under the leadership of the FSC.

If you don't think financial advice on life insurance is a problem area for ASIC and for industry, please think again. A number of our major surveillances resulting in licensing conditions, enforceable undertakings and, most seriously, licence revocations, involved evidence of significant amounts of inappropriate advice on life insurance.

The issues we found can be summarised into four types of problematic advice:

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<sup>2</sup> See [www.asic.gov.au/fofa](http://www.asic.gov.au/fofa).

- 1 Replacing a client's life policy regularly with little or no demonstration (under s947D) of why the new policies are an improvement on the old policy.
- 2 Replacing client life policies with more expensive life policies with little or no additional coverage.
- 3 Evidence that the client's personal circumstances were not taken into account when new policies were recommended. For example, providing additional cover at greater cost where the client's circumstances clearly did not require that additional cover.
- 4 Alarming, we also see examples where advisers have falsified client information when assisting them to change policies. For example, a client became uninsurable after an adviser failed to disclose the client's pre-existing medical conditions.

Why does this behaviour occur? Commission-based incentives in remuneration, combined with inadequate compliance, do not align the interests of the adviser with the client.

ASIC supports effective self-regulation. ASIC Chairman Greg Medcraft has publicly stated our support for industry to take a lead on addressing collective market problems, where possible, through self-regulatory or co-regulatory frameworks. It has been disappointing, then, to see these developments stall in the life insurance area. It's a demonstration of the difficulties in achieving a common industry position even if it should ultimately benefit consumers.

People have observed that such a framework would, from a legal perspective, be anti-competitive. Yes, that's the point! There are problems or market failures in any industry that can only be addressed by collective responses. Australia's competition law allows for the formal approval of such arrangements if they are in the public interest, and there are many examples right across the economy. In financial services it's why we have successful examples of cross-industry arrangements, such as the Banking Code, General Insurance Code, ePayments Code, etc.

You all understand that the decision to carve out life insurance from the FOFA conflicted remuneration provisions envisaged a self-regulatory initiative to address the issue of churning and 'claw back'. Let me be clear – ASIC is not the owner, designer or driver of any such initiative. But, given our experience, we would welcome an effective self-regulatory framework.

In the absence of an industry-led initiative, and given our experience with poor advice on life insurance, ASIC considers life insurance sales to be a risk area for non-compliance where high levels of switching

are apparent. In particular we have a concern to ensure that life insurance switching is compliant with the best interests duty in the FOFA era. Life insurance switching will therefore be an area of focus for us, especially if potentially poor practices are not addressed through self-regulatory mechanisms.

## **What will this mean for advisers and consumers in the future?**

The aim of all of us – regulator and industry – is to improve the standards of advice. FOFA provides an opportunity to take a positive step towards improving consumer confidence and trust following the turbulence in the market during the previous decade.

We want to encourage more people to seek financial advice, because we can see how much better off people can be from receiving good advice.

The FOFA reforms address current issues for consumers such as trust, access and affordability, and we expect that this will result in a greater uptake of advice. Promoting the interests of clients through a best interests duty will drive advice that is better focused on the actual needs of the client. The removal of a range of conflicted forms of remuneration will help ensure that the interests of the client are given priority. These reforms will also improve communication, engagement and transparency between advisers and clients, as well as providing a greater focus on strategic financial advice.

I recognise that there is a lot of work and resources involved in implementing the reforms. It is widely acknowledged that the reforms will drive structural changes in the financial services industry. It will change the way in which advice is provided and, in doing so, lead to the emergence of new business models and channels for the provision of advice. The FOFA reforms provide a structured framework through which the financial advice industry can evolve and achieve professionalism.

ASIC is focused on working with industry to achieve excellence and raising professionalism. We look forward to continuing to work with you, both in the lead up to 1 July 2013 and beyond.