ASIC
Australian Securities & Investments Commission

REPORT 50

Superannuation switching surveillance

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Executive summary

ASIC started surveillance on superannuation switching advice in December 2004, with our work continuing into the first quarter of 2005. ASIC has used the findings of this surveillance to highlight potential problem areas to the industry and to prepare the ASIC Guide *Superannuation Switching Advice: Questions and Answers* that was released in June.

The surveillance sought to test compliance by licensees and advisers with their obligations under the Corporations Act, including the requirement to have a reasonable basis for the personal advice they give to clients, where there was a recommendation made to move or 'switch' some or all of a client's current superannuation benefits from one superannuation fund to another.

Specifically, in the context of making a recommendation that a client switch, we wanted to test that advisers were complying with their obligations to disclose, in the Statement of Advice (SOA) given to their client, the costs, loss of benefits and other significant consequences of following the advice.

It was not an objective of the surveillance to give a general report card on the quality of financial product advice across the industry. Rather, we wanted to test a range of advice, across a broad spectrum of licensees and representatives, in order to identify problems with compliance obligations where there was a specific recommendation to switch. We did not seek to test other types of advice, eg where an adviser recommended that a client not switch, and even excluded advice that was confined solely to the direction of future contributions.

We reviewed a number of adviser files and considered the compliance arrangements of some licensees. We also got statistical information from licensees about recommendations to switch, which we used to conduct detailed reviews of around 260 specific pieces of advice from 19 licensees.

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 resulted 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.

Further detail on these findings is set out in the following section.

Section 1: Findings

Limited investigation of the ‘from’ fund

Most of the files we reviewed showed that advisers had made limited or no investigation of the ‘from’ fund. Generally, the investigation in the documentation we saw was limited to an explanation of the costs of exiting the fund, although in some cases there appeared to have been no investigation at all about costs.

The files we reviewed showed some correlation between insufficient consideration and investigation of the ‘from’ fund’s characteristics and the giving of inappropriate advice to the client.

In some examples, clients ended up with considerably more expensive insurance arrangements in the ‘to’ fund than were available in the ‘from’ fund. We also saw an instance where a client was recommended to switch funds to get access to a greater range of investment options, even though similar options, at a lower cost, were available in their existing fund. In another case, the basis of the advice set out in the SOA given to the client bore no relation to the goals explained to the adviser and, as a result of accepting the recommendation to switch, the client was liable both for significant immediate expenses and for a higher ongoing cost.

We found that a small number of advisers made inappropriate use of disclaimers or ‘limited advice’ in SOAs. While advice can clearly be tailored to a client's needs, limited advice disclaimers cannot be used in circumstances where they do not reflect the advice actually given. In one SOA, the adviser expressly recommended a switch of funds and then said, “I cannot give advice in relation to [the ‘from’ fund] and I am unable to comment on the quality”. If the adviser is asked by their client to provide switching advice, but is operating under a limitation such as the one in this example, it is likely that the adviser could not give switching advice.

Poor disclosure of the costs, loss of benefits and other significant consequences of following the advice

We found that a number of advisers were making only general statements in SOAs to the effect that there might be costs, lost benefits or other significant consequences as a result of the switch, but the advisers did not know what they were. This type of general statement can only be used if the adviser cannot reasonably find out these things. We found that most SOAs we reviewed did not comply with the specific switching disclosure obligations.

Most advisers did comply with the obligation to disclose in the SOA the termination costs of the 'from' fund and the entry fee of the 'to' fund. However, these costs are only one of three types of information advisers are required to disclose under the switching disclosure obligation. Generally, we found poor compliance with the obligation to disclose the benefits a client would lose as a result of accepting the recommendation to switch. Examples of benefits that would be lost by clients, but that were not disclosed in SOAs, included:

- death, total and permanent disablement (TPD) and/or income protection insurance;
- 'automatic acceptance' in death and TPD insurance where the client has a pre-existing illness. In one file, it was apparent that after acting on the advice and forgoing $50,000 of 'automatic acceptance' life insurance, the client was charged an increased premium by the insurer related to the 'to' fund;
- employer-financed benefits in a defined benefit fund; and
- access to free or subsidised financial advice.

There are a number of other, less commonly considered, benefits that might be relevant to particular clients. If the benefits are relevant to the personal circumstances of particular clients, they should be investigated and considered to ensure that the advice is appropriate to the client.

We also saw SOAs in which switching advice was given, but the adviser failed to disclose a particular consequence of switching that would be significantly adverse to the client. Examples of significant consequences that were not disclosed included:

- a significant increase in ongoing fees. There were a number of instances where this consequence was apparent, but was not disclosed; and
- considerably more expensive insurance in the 'to' fund.

A tendency to recommend a fund related to the licensee.

Our review highlighted a number of apparent conflicts of interest in the giving of switching advice. A number of factors might indicate that a conflict exists and that there is a risk that the adviser will place their interests or their licensee's interests over the interests of the client and therefore, that the advice is more likely to be inappropriate. Indicators of a conflict, include:

- the financial benefit to the adviser will be greater if the client acts on the recommendation to switch; and/or
- the licensee and the trustee of the 'to' fund are related parties.

In reviewing SOAs, we saw examples where disclosure of the basis for the advice was poor and the adviser had recommended a fund related to the adviser or licensee and other examples where the client was recommended to move into a higher cost fund without any additional benefits. These might be indicators of a conflict potentially influencing the advice.

In other cases, where advisers were giving advice about consolidating multiple superannuation funds into a single fund, the advice recommended an entirely new fund and ignored the client's active fund (ie the fund into which the current employer is paying superannuation guarantee payments). In our view, there would need to be a strong basis for consolidating a client's benefits into a new fund. Licensees should carefully consider the conflicts of interest that arise where this occurs and the 'to' fund is related to the licensee.

Based on our statistical review of switching data provided by licensees with a related party conflict, there was a very strong tendency towards switching into a related superannuation fund. Of the 4,900 switching recommendations given by advisers in this circumstance, 90% recommended a switch to the related fund. This does not mean that this advice was necessarily inappropriate, but it does highlight the need for such conflicts to be clearly disclosed and carefully managed.

Section 2: Surveillance outcomes

Since completing our surveillance, we have used the results to discuss with industry groups the problems we have identified. We will provide specific feedback to the targets of our work shortly.

We have also used the findings in developing our new guide for licensees and advisers, *Super switching advice: Questions and Answers* (June 2005). The guide uses plain language and practical examples to help licensees and advisers understand their compliance obligations when giving superannuation switching advice. It is available on our website at **www.asic.gov.au/fsrguides**.

We have already taken some enforcement action as a result of our surveillance, and expect to take further action where the defects identified had more serious consequences, or where the behaviour appeared to be of a more systemic nature.

Section 3: Future action

The results of our switching surveillance identified an unacceptable level of problems at the time it was carried out. Since then, both the industry bodies and ASIC have worked hard to provide further guidance about compliance obligations to licensees and advisers.

Now that the platform for the implementation of super choice is in place, we will continue with our program of surveillance of superannuation switching advice during the 2005/06 year, beginning with our shadow shopping exercise. Our shadow shopping work, which has started, will test the real life experience of consumers in getting advice, and will look at the things consumers are told by their advisers as well as the documentation they receive. We will take action where non-compliance results in a high risk of detriment to consumers.