Industry Super Australia

Melbourne
Casselden Place
Level 39, 2 Lonsdale St,
Melbourne, VIC 3000
P: (03) 9657 4321

Canberra
Dialogue
GF, 4 National Circuit
Barton, ACT 2600
P: (02) 6269 5710

20 April 2020

Fee consents and independence
Australian Securities and Investments Commission

Email: feeconsentsandindependence@asic.gov.au

Dear Sir or Madam

Consultation Paper 329 Implementing the Royal Commission recommendations: Advice fee consents and independence disclosure

Industry Super Australia (ISA) undertakes policy research and advocacy on behalf of over five million members of industry superannuation funds, to ensure that the policy settings for superannuation are consistent with the objective of maximising their retirement incomes.

ISA appreciates the opportunity to provide feedback on Consultation Paper 329 *Advice fee consents and independence disclosure* (CP 329) *Product design and distribution* which contains ASIC's proposed approach to implementing aspects of the law reform arising from Royal Commission recommendations 2.1, 2.2 and 3.3.

Summary of ISA's position

Implementation of Royal Commission recommendation 2.1 – consent to deductions – ongoing fee arrangements

While ASIC's proposed consent requirements are comprehensive, as detailed in our submission to Treasury on the Exposure draft legislation to implement the same recommendations[1], ISA considers that ongoing fee arrangements should be banned and advisers should be required to charge for specific services, when those services are provided.

Implementation of Royal Commission recommendation 3.3 – consent to pass on costs of providing advice – non-ongoing fee arrangements

ISA supports the proposed consent requirements which are comprehensive however we make the following suggestions:

- Instead of requiring the consent to contain a warning about possible loss of benefits flowing from deduction of advice fees, ASIC could make it clear that before asking a member to sign the consent, the financial adviser should assess whether deducting the advice fee will result

[1] https://www.industrysuper.com/media/financial-services-royal-commission-exposure-draft-legislation-recommendation/

in the loss of benefits and if so, the adviser should ensure that the member understands this is likely. The adviser could ask the member to sign an acknowledgement or make a statement via email that they understand.
- ASIC should publish its observations arising from the survey it conducted in 2019 on deduction of advice fees by super funds so that all trustees have the benefit of ASIC's views on current practices.

Implementation of Royal Commission recommendation 2.2 – disclosure of lack of independence

ISA accepts that Royal Commission recommendation 2.2 is aimed at enhancing consumer understanding of conflicts of interest that arise largely from vertical integration– not at removing them.

However, as explained in our submission to Treasury on the Exposure draft legislation, ISA is concerned that relying on disclosure (which ASIC acknowledges is often insufficient to drive good consumer outcomes) in a document of questionable utility – a Financial Services Guide - is unlikely to achieve the desired outcome of protecting consumers from conflicts of interest. Nevertheless, for those who may find it useful it is important that the measure is implemented in an effective way.

Against this background, ASIC's proposed draft instrument which prescribes the format of the required disclosure is insufficient. While industry does not need prescription, some guidance on ASIC's expectations is needed. To rely on a 'clear, concise and effective' requirement that ASIC will struggle to enforce implies a disinclination by ASIC to effectively implement the recommendation.

Testing consumer outcomes

The consultation paper expressly acknowledges the limits of disclosure but simultaneously encourages trustees to assess consumer outcomes in light of the proposed disclosures: see paragraph 51 and 78. The language used to encourage firms and trustees to monitor consumer outcomes is so vague and permissive that it is unhelpful as guidance (para 51). In the case of the lack of independence disclosure (para 78), it seems illogical to simultaneously acknowledge the ineffectiveness of disclosure while urging entities 'to develop a statement that suits the needs of their clients.' ASIC should abandon this expectation.

Detailed position

Proposal B1: Implementation of Royal Commission recommendation 2.1 – consent to deductions – ongoing fee arrangements

ISA acknowledges that the content prescribed in the draft legislative instrument is comprehensive however we do not support the proposal.

As explained in our submission to Treasury, ISA considers that ongoing fee arrangements should be banned and advisers required to charge for specific services when those services are provided. Ongoing asset-based fees clearly create a conflict of interest as they incentivise advisers to recommend investments that will increase the fee. The ongoing fee regime which ASIC's proposed instrument seeks to enhance is arguably a risk management device for licensees to charge ongoing fees that are disproportionately more than the value of financial advice being provided. Further, it is almost impossible for consumers, or ASIC to assess whether an ongoing asset-based fee is an appropriate amount for the services to be provided: see Recommendation 2.1 in the attached submission for ISA's detailed position.

Proposal B2: Implementation of Royal Commission recommendation 3.3 – consent to pass on costs of providing advice – non-ongoing fee arrangements

ISA supports the proposed consent requirements which are comprehensive however we make the following suggestions.

ASIC research highlights the limitations of the effectiveness of warnings, noting that they can be ignored, overlooked, misunderstood or misremembered, can have no impact on behaviour, or even backfire .[2] We therefore question the effectiveness of the proposed warning about loss of benefits flowing from deduction of advice fees in paragraph 5(h) of both fee instruments.

Instead of requiring the consent to contain a warning about possible loss of benefits flowing from deduction of advice fees, ASIC could make it clear that before asking a member to sign the consent, the financial adviser should assess whether deducting the advice fee will result in the loss of benefits and if so, the adviser should ensure that the member understands this is likely. The adviser could ask the member to sign an acknowledgement, or make a statement via email, that they understand.

In 2019 ASIC conducted a survey on deduction of advice fees by super funds. ASIC states that the proposed draft instrument is informed by this survey. It would be helpful for funds if ASIC could publish its observations arising from the survey so that all trustees have the benefit of ASIC's views on current practices.

Proposal B3: Implementation of Royal Commission recommendation 2.2 – disclosure of lack of independence

In the Final Report of Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Commissioner Hayne considered the conflicts that arise from the associations or relationships between a financial adviser and the issuer of financial products but did not recommend structural separation between product and advice because he did not consider that the benefits would outweigh the costs. Royal Commission recommendation 2.2 is aimed at enhancing consumer understanding of the conflicts of interest that arise largely from vertical integration. It is not aimed at removing those conflicts.

While we appreciate that ASIC is tasked with implementing a specific aspect of this recommendation, we are concerned that relying on disclosure (which ASIC acknowledges is often insufficient to drive good consumer outcomes) in a document of questionable utility – a Financial Services Guide - is unlikely to achieve the desired outcome of protecting consumers from conflicts of interest. Also, as we noted on our submission to Treasury, research shows disclosure, rather than management of conflicts of interest, can entrench market failure associated with conflicts of interest.[3] This approach is therefore unlikely to be effective in addressing the conflicts inherent in vertically integrated structures. Nevertheless, for those who may find it useful it is important that the measure is implemented in an effective way.

Against this background ASIC's proposed draft instrument is insufficient and without any guidance risks providing entities making disclosures that are legalistic or complex. The instrument prescribes format but no content and 'focuses only on the requirement relating to

[2] ASIC Report 632 *Disclosure: Why it shouldn't be the default,* p.45

[3] Daylian M. Cain, George Loewenstein and Don A. Moore 1 (January 2005) "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest", The Journal of Legal Studies, Vol. 34, No., pp. 1-25

the prominence of the statement'[4] (a box on the front page of an FSG headed Not Independent). While industry does not need prescription, some guidance on ASIC's expectations is needed. ASIC could consider each of the scenarios in s923A of the Corporations Act and offer examples of what a compliant statement may look like. To rely on a 'clear, concise and effective' requirement that ASIC will struggle to enforce implies a disinclination by ASIC to effectively implement the recommendation.

ASIC could also consider requiring advisers to place the same disclosure in Statements of Advice. These documents are more likely to be read by consumers and discussed with their advisers so there is a more realistic chance that a consumer will understand the disclosure.

Finally, given ASIC's own work on disclosure[5] and the findings of the Royal Commission, ASIC's current guidance on managing conflicts of interest in Regulatory Guide 181 *Licensing: Managing conflicts of interest* which was published in 2004 highlights an inconsistent approach within ASIC to managing conflicts of interest and should be updated or withdrawn.

Testing consumer outcomes

The consultation paper expressly acknowledges the limitations of disclosure while simultaneously encouraging firms and trustees to assess consumer outcomes in light of the proposed disclosures: see paragraph 49 and 50. The propositions are mutually inconsistent.

Further, the language used to encourage firms and trustees to monitor consumer outcomes in paragraph 51 is so vague and permissive that it is meaningless. It is unclear what data could sensibly be collected or indeed what 'metrics about fees, renewals and accounts' actually means.

In the case of the lack of independence disclosure, ASIC is simultaneously acknowledging the ineffectiveness of disclosure while urging entities 'to develop a statement that suits the needs of their clients.' To then suggest that firms 'collect and analyse a range of relevant and reliable consumer and transaction data to monitor consumer outcomes in light of this new disclosure' is illogical.

ASIC should abandon its expectation that firms and trustees assess consumer outcomes in light of the proposed disclosures. If ASIC considers that prescribed disclosures should be consumer tested, then ASIC should undertake this testing before prescribing the disclosures.

If you wish to discuss this submission, please contact Ella Cebon on [redacted]

Kind regards

[redacted]

Ella Cebon
Senior Policy Adviser.

[4] Consultation Paper 329 *Implementing the Royal Commission recommendations: advice fee consents and independence disclosure*, paragraph 75
[5] ASIC Report 632 *Disclosure: Why it shouldn't be the default*